



# TPP and the Benefits of Freer Trade for Vietnam: Some Lessons from U.S. Free Trade Agreements

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## TPP as a Win-Win

Countries trade because trade delivers mutual benefits.<sup>1</sup> New market-opening trade agreements like the Trans Pacific Partnership (TPP) can enhance the shared benefits of trade by eliminating barriers to expanded international commerce and deepening economic cooperation between partners. It's not surprising, therefore, that a detailed economic simulation of freer commerce under the TPP finds that each of the 12 TPP countries would see aggregate income gains and increased exports under a comprehensive TPP.<sup>2</sup> A strong TPP agreement, in short, could be a win—times 12.

But governments and their leaders don't simply operate in the aggregate. Despite trade's undeniable overall benefits, not everyone benefits from trade—and beneficial agreements that increase trade and open markets can require sometimes-difficult economic adjustments.

For the United States, for example, the TPP could support more good-paying jobs for U.S. workers who produce and sell American goods and services to growing Pacific Rim economies that should see even stronger growth under TPP.<sup>3</sup> At the same time, however, growing trade can lead to lost jobs and lower wages for some American workers, and will require a renewed U.S. focus on comprehensive solutions, including assistance and better training for lower-skilled workers.

Other countries will need to adjust as well. Japan, for instance, will require reforms to its farm sector, while Canada will need to upgrade its intellectual property rules to comply with global standards.

## Benefits and Adjustments for Vietnam

While all member countries stand to benefit from TPP, Vietnam is poised to be TPP's biggest winner. In a 2012 study, the Peterson Institute estimated that—compared to a baseline with no TPP—Vietnam's income gains in 2025 with a comprehensive TPP would be over 13 percent higher, while its exports in 2025 would be over 37 percent greater.<sup>4</sup> Much of these gains would come—especially

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initially—from Vietnam’s growing production and export of apparel and footwear,<sup>5</sup> resulting from the phase out of high duties in TPP partner countries, especially the United States.<sup>6</sup>

But a high-standard TPP—along with Vietnam’s new trade agreement with the European Union—will also require Vietnam to make—and adhere to—major structural adjustments. These will include important steps to enhance transparency and the rule of law, implement new labor and environmental standards, foster digital commerce, and revise the competitive landscape for state-owned enterprises, among other significant changes.

For over two decades, U.S. trade agreement partners—and the United States itself—have also had to implement substantial reforms under high-standard free trade agreements (FTAs). Making these changes can be challenging. But participating countries have also found that the benefits of implementing comprehensive FTAs are significant—and go well beyond the obvious advantages of eliminating duties on a country’s primary exports. The adjustments required by high-standard FTAs can also promote foreign investment, technological advancement, innovation, broader participation in trade, and other key developments that— together with additional reforms—can drive stronger and more broadly shared economic development.

As Vietnam transitions towards a network of new, higher-standard trade agreements, it has an obvious interest in the track record of current comprehensive FTAs. We highlight below five vital contributions that high-standard FTAs can potentially make in advancing country’s economic development. And we briefly review some important lessons that America and its partners have learned about FTAs along the way.

## Key Contributions from FTAs

### 1. Attracting Investment

High-standard FTAs can play a vital role in attracting foreign direct investment (FDI). In choosing where to invest, foreign investors seek countries with stable investment environments and strong rules to assure transparency, freer trade, and open financial markets—elements that are among the most important commitments in modern FTAs.

Comprehensive FTAs have helped countries like Peru and Mexico “lock in” these and other structural changes that are important for investors. At the same time, FTAs can also provide a powerful signal of a country’s long-term political commitment to maintaining a favorable environment for investment.<sup>7</sup> Panama’s Ambassador to the United States has noted, for example, that entering into an FTA with the United States is like a “seal of certification” that demonstrates to investors worldwide that a country is a first-class destination for foreign investment.<sup>8</sup>

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Although FTAs are, of course, not the only key factor in attracting and maintaining foreign investment, they are often linked to strong FDI growth. Since Mexico’s entry into the North American Free Trade Agreement (NAFTA) in 1994, Mexico’s FDI stock has surged from \$52 billion (7 percent of GDP) in 1993 to \$315 billion (27 percent of GDP) in 2012.<sup>9</sup> Experts in Singapore note that, by raising Singapore’s intellectual property rules to world-class levels, the U.S.-Singapore FTA has made Singapore a major investment hub.<sup>10</sup> As a result, Singapore’s FDI stock surged from \$277 billion in 2004 to \$853 billion in 2013, and the United States became Singapore’s largest single country source of FDI.<sup>11</sup>

Vietnam is seeing increased levels of FDI in anticipation of the TPP. History suggests that the new agreement—together with an ongoing commitment by Vietnam to a favorable investment environment—could help assure that this vital investment continues and grows.

## 2. Moving Up the Value Chain

FTAs can also play an important role in helping countries “move up the value chain,” enabling them to compete in more advanced economic sectors and supporting higher quality jobs.

Since entering into NAFTA, for example, Mexico’s regionally integrated auto sector has seen extraordinary growth. Between 1993 and 2013, the value (in constant dollars) of Mexico’s auto exports surged from \$7 billion to \$70 billion. At the same time, Mexican auto employment has grown from 122,000 to 552,000 workers, and workers have gained higher skills.<sup>12</sup> Autos accounted for a quarter of Mexico’s exports in 2012,<sup>13</sup> and Mexico is now the world’s seventh largest producer and fourth largest exporter of cars.<sup>14</sup>

Trade ties—including strong links with U.S. and Canadian manufactures and suppliers—have also been an important factor in driving the recent, significant growth of Mexico’s aerospace sector. Between 2006 and 2011, Mexico’s base of aerospace suppliers grew from 109 to 249 firms, and aerospace employment grew from 10,000 to 31,000 workers. Mexico was reportedly the largest recipient of aerospace FDI between 2009-11, with over \$1 billion in FDI annually.<sup>15</sup>

Vietnam is already a significant player in advanced economic sectors like electronics.<sup>16</sup> Further increasing the sophistication of production in Vietnam will, of course, require additional investment, growing skills, and an array of other commitments. But, as Mexico’s experience shows, strong trade ties can provide a solid launching pad for an upward trajectory.

## 3. Enabling SME Trade

Small and Medium-Sized Enterprises (SMEs) are key drivers of growth and good jobs in countries worldwide. But in many countries—including the United States—only a small percentage of SMEs export. A key reason for this is that foreign barriers to trade—including high duties, complex regulations, and en-

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trenched bureaucracy—often pose much larger challenges for smaller firms with limited resources and experience.<sup>17</sup>

Surveys by the U.S. International Trade Commission show that FTAs can boost small business exports by reducing trade costs, lowering risks, and opening new markets for SMEs. NAFTA, for example, has played a significant role in helping small U.S. manufacturers of industrial valves sell to Canada and Mexico, while U.S. FTAs with Chile and Singapore enabled U.S. SMEs to sell remanufactured goods in those markets.<sup>18</sup> Modern FTAs also focus on e-commerce and the digital economy, which can be critical tools in helping small entrepreneurs with innovative products to sell directly to the world.<sup>19</sup>

Overall, an impressive 40 percent of exports by U.S. SMEs go to America’s FTA partners, while SME exports account for over 47 percent of total U.S. exports to FTA partners El Salvador, Jordan, Morocco, and Nicaragua.<sup>20</sup>

As a nation with a vibrant entrepreneurial culture and growing numbers of SMEs,<sup>21</sup> Vietnam and its many small firms can benefit significantly from the TPP, which is being negotiated with an unprecedented focus on promoting trade by SMEs.<sup>22</sup> And, because e-commerce is a powerful tool for innovative SMEs,<sup>23</sup> TPP provisions that foster digitally enabled trade could provide key support for Vietnam’s ambitious goal to boost direct exports by SMEs to a quarter of Vietnam’s total exports.<sup>24</sup>

#### **4. Negotiating More FTAs**

The “heavy lifting” of concluding comprehensive trade agreements with the United States and its FTA partners also makes it easier for countries to negotiate—and benefit from—additional higher-standard FTAs with new trade partners.

Peru’s trade officials have noted, for example, that Peru’s FTA with the United States (signed in 2006, entered into force in 2009) helped Peru significantly in building a strong network of additional agreements, which now includes high-standard agreements with U.S. FTA partners like Canada, Chile, Mexico, and South Korea, as well as trade deals with China, the EU, and Japan.<sup>25</sup> Similarly, Chile now has an extraordinary network of 24 FTAs covering 63 economies, with 94 percent of its trade is covered by FTA preferences.<sup>26</sup>

These growing networks of trade agreements can help countries create a “virtuous cycle” which makes them increasingly attractive candidates for additional trade and investment. Mexico’s ten FTAs—which encompass 45 countries and provide duty-free access to 60 percent of the world economy—has, for example, been a key factor in attracting billions of dollars in recent, new investment by world automakers in the Mexican economy.<sup>27</sup>

Vietnam’s growing roster of high-standard trade agreements—especially TPP and Vietnam’s new agreement with the EU—could similarly enhance Vietnam’s al-

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ready strong position as a globally competitive hub for trade, production, and investment.

## 5. Helping the Broader Economy

Finally, high standard FTAs can provide economy-wide benefits that go well beyond trade or FDI.

Studies of NAFTA, for example, have shown that the agreement helped Mexico move closer to levels of economic development in Canada and the United States, helped boost the productivity of Mexican manufacturing plants, aided Mexican manufacturers in adopting U.S. technological innovation more quickly, and had a positive effect on the number and quality of Mexican jobs.<sup>28</sup>

Other FTA partners note that FTAs can boost national productivity and promote higher GDP growth by providing domestic manufacturers with access to lower-cost imported inputs and better technologies.<sup>29</sup> FTAs can also drive beneficial domestic reforms. South Korean officials have noted, for example, that service sector reforms brought about by the U.S.-South Korea FTA would enable Koreans to benefit from a more globally competitive service economy

## Important Lessons

Experience with high-standard FTAs has also taught the United States and its FTA partners some important lessons. We highlight three key lessons below.

### 1. FTAs are Only Part of the Picture

High-standard FTAs are only one element of a comprehensive approach to economic growth.

Mexico’s experience highlights this. In the mid-1990s, the opening of trade and investment under NAFTA did little—at least initially—to overcome the much larger economic forces triggered by earlier policies that led to Mexico’s peso crisis, which caused investors to flee Mexico and severely disrupted trade. Studies also show that regions (and sectors) in Mexico that have benefitted the most from NAFTA are—not surprisingly—those with higher skills, better infrastructure, and stronger institutions. And experts in Mexico and elsewhere note that Mexico would likely have seen stronger—and more broadly shared—growth from NAFTA if it had not waited to enact recent significant reforms in areas including education, energy, and fiscal policy.<sup>30</sup>

The U.S.-Israel FTA provides an unexpected—and especially compelling—illustration of how factors beyond FTAs are vital in driving economic development. The 20-page agreement with Israel—America’s very first FTA—was focused almost entirely on eliminating industrial tariffs and is hardly a high-standard FTA by modern measures.<sup>31</sup> Nevertheless, America and Israel have built an extraordinary shared ecosystem for high-tech innovation by combining the entrepreneurial and educated members of Israel’s “Start Up Nation,” the vast experience and re-

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sources of leading U.S. tech firms, pioneering joint programs to fund commercial R&D, and a generally pro-innovation approach to government regulation.<sup>32</sup>

## 2. Information is Vital

Even the most advanced FTA is of little use if a country's traders don't take advantage of the agreement.

Surveys in a number of countries show that many eligible firms don't utilize FTA benefits—either because they don't understand how FTAs work or because they have limited access to needed information. Boosting FTA participation requires aggressive government outreach, streamlined procedures, and better and more user-friendly information, especially for SMEs.<sup>33</sup> With recent surveys showing that fewer than 30 percent of Vietnam's firms have some knowledge of the emerging TPP, these efforts would appear to be a high priority for Vietnam.<sup>34</sup>

## 3. The Broader, the Deeper, the Better

A recent APEC study confirms that FTAs have a “compelling impact” on trade, resulting in “significantly higher” exports five years after they enter into force. But not all FTAs are equal. APEC found that the most successful FTAs are larger (i.e., with more parties) and of higher quality (i.e., with deeper commitments).<sup>35</sup>

Many of the benefits of broader, deeper FTAs are clear, including the significant efficiencies gained when multiple countries adopt common rules of origin and shared approaches to product standards.<sup>36</sup>

But broad, high-standard FTAs can also lead to more fundamental transformations. Under NAFTA, for example, Canada, Mexico, and the United States increasingly “make things together,” investing and combining their particular skills with less regard to borders.<sup>37</sup> By working together, the three countries are more globally competitive and share significantly in each other's success. When Canada's Bombardier sells North American-made business aircraft to the world, for instance, it's directly employing some 1,800 skilled workers in Mexico and creating export opportunities for over 2,000 U.S. suppliers of aviation systems and components.<sup>38</sup>

## Building for the Future

As it seeks to advance its economic development, Vietnam has placed considerable emphasis on expanding international trade. Growing trade can be a powerful tool for economic development, as Vietnam's regional neighbors—including Japan, South Korea, and China—have demonstrated repeatedly over the last seven decades.<sup>39</sup>

Vietnam has taken a major step by joining in trade negotiations with some of the world's largest and most advanced economies, and is playing an important and constructive role in the effort to conclude a high-standard TPP. A comprehensive TPP would benefit all TPP partners, and would provide Vietnam with significant

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new access to major markets in Japan and the United States for its major exports, including apparel. Perhaps even more importantly, however, Vietnam's ongoing commitment to key structural adjustments under TPP can lead to growing investment and innovation, technological advancement, broader participation in trade, and other transformational changes that could promote stronger, deeper, and lasting economic growth.

As Vietnam continues on its path toward advancing economic development, it can learn much from the experience of its partners under earlier comprehensive FTAs. And, as it grows and deepens its engagement under TPP, Vietnam can also offer valuable lessons to its partners, as it shares in their success.

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