

# FREE TRADE AGREEMENT BETWEEN THE EU AND VIETNAM

## DIFFICULT PARTNERSHIP

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### THE POLITICAL SITUATION IN VIETNAM

In Vietnam, progress and stagnation lie closer together than ever before. While the country's leadership is willing to allow the population some economic freedoms, political reforms are not up for discussion. The political leadership comprises the Secretary General of the Communist Party of Vietnam (CPV) Nguyen Phu Trong, Prime Minister Nguyen Tan Dung and President Truong Tan Sang. The fundamental Marxist-Leninist principles and the ideology of Ho Chi Minh continue to determine the activities of the Vietnamese government. The Party persists in its fundamental rejection of political pluralism, let alone a multi-party system. Even though the state and party systems are separate on the face of it, the policy guidelines approved by the National Party Congress which takes place every five years determine the objectives for government policy, which are then implemented by the legislative and the executive. All the key positions in politics, the administration and the judiciary are held by party members. The constitutional amendments adopted by the National Assembly, the Vietnamese parliament, on 28 November 2013 did not have any great impact on the CPV's monopoly on power. The amendments were to bring about stronger protection of human rights, a greater emphasis on democratic participation and a clear separation of state powers. While the National Assembly was assigned further competences in the area of budgetary supervision, hopes that the reforms would create a body responsible for monitoring constitutional standards have remained unfulfilled. This deficiency greatly undermines the effectiveness of the constitutional



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changes, with the result that the CPV and the government remain free to continue using their monopoly on power without constraint.

## EU-VIETNAM RELATIONS

Despite the political differences, Vietnam is already among the EU's closest partners in Asia. Next year, they will look back on 25 years of diplomatic relations. Initially, the EU's goals in Vietnam were limited to development cooperation and sustainable economic growth. After some time, however, political cooperation developed rapidly. The first cooperation agreement between Brussels and Hanoi was adopted in 1995. A more comprehensive Partnership and Cooperation Agreement (PCA) was signed in June 2012. It envisages strong cooperation in the areas of trade, science, technology, energy and the environment as well as in the fight against corruption. The agreement is also intended to strengthen collaboration in efforts to meet regional and global challenges such as the fight against terrorism and climate change.

**The EU represents Vietnam's largest overseas market with exports totalling 24.4 billion U.S. dollars and is – after China – Vietnam's second largest trading partner.**

In spite of the fact that political relations have recently intensified, it is the economic cooperation between the two parties that is of particular significance. The EU represents

Vietnam's largest overseas market with exports totalling 24.4 billion U.S. dollars. This corresponds to 19 per cent of the country's global exports in 2013 and means that – after China – the EU is Vietnam's second largest trading partner. The EU exports mainly high-tech products, vehicles, machinery, aircraft and pharmaceutical products. Imports from Vietnam to the EU, on the other hand, consist of electronic products, shoes, coffee, textiles, rice, seafood and furniture.<sup>1</sup> Bilateral trade has increased five-fold over the last decade, rising from 6.5 billion to 33.6 billion U.S. dollars. In that regard, Vietnam has always benefited from a high trade surplus (9.2 billion U.S. dollars in 2013).<sup>2</sup> This

1 | Cf. European Commission, "Countries and regions. Vietnam", <http://ec.europa.eu/trade/policy/countries-and-regions/countries/vietnam> (accessed 15 May 2014).

2 | Cf. Jean-Jacques Bouffet, "Overview on VN-EU Trade and investment relation, prospective and orientation for development", Vietnam-EU Business Forum 2014, 2.

strong growth in trade reflects the economic development of the Southeast Asian country over the last two decades.



A differing range of products: The EU exports mainly high-tech products like vehicles or machinery. Compared to that, furniture and handicrafts enter the European market. | Source: Xiaojun Deng, flickr ©.

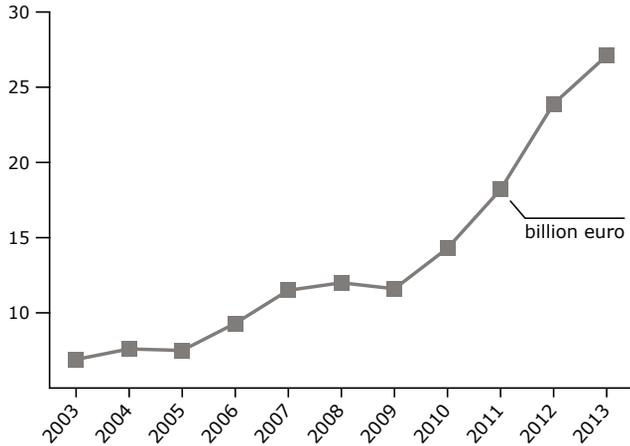
Vietnam's economic boom has its roots in the comprehensive *Doi Moi* reforms (English: "renovation") of the 1980s. These reforms supported the shift from a centralised planned economy towards a market economy, which Vietnam officially labels "socialist-oriented".<sup>3</sup> Within just two decades, an average annual growth rate of 7.3 per cent has transformed one of the poorest countries of the world into a lower-middle income country. The rapid economic growth went hand in hand with an influx of foreign investment, an increase in trading volumes and a remarkable reduction in poverty. Vietnam's admission to the World Trade Organization (WTO) in 2007 furthered trade liberalisation, increased foreign direct investments (FDI), stabilised the export sector and improved the quality of products and services. Vietnam is pursuing the ambitious goal of achieving a per capita income of 3,000 U.S. dollars by 2020, prioritising the stabilisation of economic growth, the construction of first-class infrastructure, access to

3 | Cf. Nadine Mensel, *Der Entwicklungsprozess der Sozialistischen Republik Vietnam. Erfolge und Herausforderungen durch staatlich gelenkte Entwicklung*, Wiesbaden, Springer VS, 2013, 158-183.

professional and vocational training and the strengthening of the institutions of the market economy.<sup>4</sup>

Fig. 1

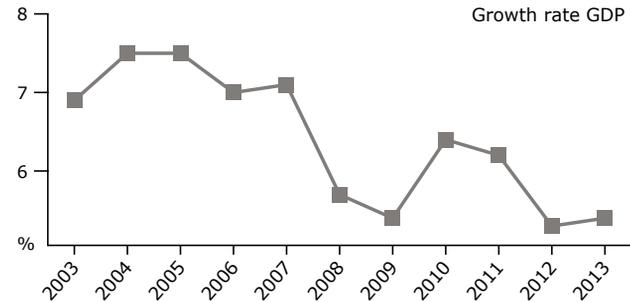
**Trade balance in goods between Vietnam and the EU, 2003 to 2013**



Source: European Commission, "European Union, Trade in goods with Vietnam", 16 Apr 2014, <http://trade.ec.europa.eu/doclib/html/113463.htm> (accessed 3 Sep 2014).

Fig. 2

**Economic Growth in Vietnam, 2003 to 2013**



Source: The World Bank, "GDP growth", <http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG> (accessed 3 Sep 2014).

4 | Cf. Deepak Mishra, "Vietnam development report 2012: market economy for a middle-income Vietnam", 6 Dec 2011, <http://documents.worldbank.org/curated/en/2011/12/15546780/vietnam-development-report-2012-market-economy-middle-income-vietnam> (accessed 3 Sep 2014).

In line with the PCA, the European Union and Vietnam are now taking the next step towards a more stable partnership, which logically entails negotiations about a Free Trade Agreement (FTA). Vietnam is the third ASEAN country to enter into such negotiations after Singapore (March 2010) and Malaysia (October 2010).<sup>5</sup> The seventh round of negotiations was already held in March this year in Hanoi. The two parties hope to be able to conclude the talks successfully by the end of the year, in the expectation that the Free Trade Agreement will reduce customs duties and curtail restrictive trade barriers. It further deals with pressing issues such as legal certainty, investments, public procurement, the trade in goods and services, and patent legislation.<sup>6</sup>

### **ECONOMIC EVALUATION OF A FREE TRADE AGREEMENT**

If you apply David Ricardo's theory of comparative cost advantage to the trade relations between the EU and Vietnam, the latter has a comparative cost advantage where labour and resource-intensive products are concerned. And Vietnam does, in fact, export mainly products from the low-wage sector. The EU, on the other hand, exports high-tech products from the capital and technology-intensive sector. According to the theory, the FTA would be highly beneficial to both sides. In line with this thinking, studies on EU-ASEAN relations conclude that a Free Trade Agreement could provide a 20 per cent boost to Vietnam's export activities.<sup>7</sup> Eliminating import duties on shoes, for example, has increased exports in this segment from seven to an estimated 21 per cent,<sup>8</sup> which represents an enormous

5 | Cf. European Commission, "EU and Vietnam launch negotiations for a comprehensive Free Trade Agreement", 26 Jun 2012, <http://trade.ec.europa.eu/doclib/press/index.cfm?id=811> (accessed 3 Sep 2014).

6 | Cf. European Institute for Asian Studies, "The EU Seeks to Strengthen Trade Relations with ASEAN Countries", 21 Mar 2014, <http://eias.org/asian-news-outlook/eu-seeks-strengthen-trade-relations-asean-countries> (accessed 3 Sep 2014).

7 | Cf. Gauri Khandekar, Mapping EU-ASEAN Relations, FRIDE, Brussels, 2014, 57.

8 | Cf. Claudio Dordi and Federico Lupo Pasini, "The impact of Vietnam-EU FTA on some selected exporting sectors of Vietnam", WTO-Center, Vietnam Chamber Of Commerce And Industry, 9 Jun 2011, <http://wtocenter.vn/content/impact-vietnam---eu-fta-some-selected-exporting-sectors-vietnam> (accessed 3 Sep 2014).

benefit to Vietnam in view of the stagnating economy. According to its own studies, the European Parliament assumes that Vietnam's gross domestic product (GDP) would increase by as much as 15 per cent in the long run.<sup>9</sup> Such increases in prosperity have a positive effect on consumer behaviour. The Deutsche Bank is already forecasting a 5.5 per cent rise in private consumption in Vietnam for 2014.<sup>10</sup> With the conclusion of the FTA, this trend would be set to continue. The crucial advantage to the EU would be that wholesalers and retailers would obtain better market access for their much sought-after high-tech goods.

The Free Trade Agreement is linked to hopes for a more liberal economic policy in Vietnam. In the past, the socialist-style economic structures have attracted direct investments predominantly from Asia, particularly from Japan, Taiwan, South Korea and Singapore.<sup>11</sup> The Agreement would result in conditions for companies from the EU improving considerably. They could establish subsidiaries in Vietnam in order to supply not only the Vietnamese market but also the ASEAN and other Asian countries such as Japan, China and India. From the EU's perspective, Vietnam represents an important gateway for gaining access to a dynamic market of the future. A Free Trade Agreement would stimulate the negotiations between the EU and the group of Southeast Asian states, seeing that a joint trade agreement with all ten ASEAN member states is the EU's ultimate goal.<sup>12</sup> Vietnam, on the other hand, would benefit from the influx of funds and the transfer of know-how which would be of particular advantage to small businesses and their international sales.

**From the EU's perspective, Vietnam represents an important gateway for gaining access to a dynamic market of the future. A Free Trade Agreement would stimulate the negotiations between the EU and ASEAN.**

9 | Cf. Marika Armanovica, "Policy Briefing. EU-Vietnam economic and trade relations", Sep 2012, Europäisches Parlament, Generaldirektion Externe Politikbereiche, [http://europarl.europa.eu/RegData/etudes/briefing\\_note/join/2012/491454/EXPO-INTA\\_SP\(2012\)491454\\_EN.pdf](http://europarl.europa.eu/RegData/etudes/briefing_note/join/2012/491454/EXPO-INTA_SP(2012)491454_EN.pdf) (accessed 3 Sep 2014).

10 | Cf. Thomas Hundt, *Wirtschaftstrends Jahreswechsel 2013/14 Vietnam*, Germany Trade and Invest, Hanoi, 2013, 4.

11 | Cf. *ibid.*, 3.

12 | Cf. European Commission, "Association of South East Asian Nations (ASEAN)", <http://ec.europa.eu/trade/policy/countries-and-regions/regions/asean> (accessed 3 Sep 2014).

One further advantage to both sides would be the simplification of rules, standards and regulations. Although Vietnam is currently still benefiting from the Generalised Scheme of Preferences (GSP), it will drop out of the group of preferred countries by 2017 at the latest. The GSP allows exporters from developing countries to pay either no or minimal duties when they trade with the EU. Since January 2014, the GSP has been predominantly supporting the least-developed countries,<sup>13</sup> a group Vietnam no longer qualifies for. An FTA would enable Vietnam to compensate for the forecasted loss of GSP benefits. At the same time, it would help the EU to counter the protectionist measures and incongruent import restrictions imposed by Vietnam. Currently, virtually every import into Vietnam from the EU is subject to taxes. Although hardly any taxes are payable for machinery, tool components, technical equipment, raw materials and capital goods for the manufacturing industry, which are not available locally, consumer and luxury goods (such as cars) are subject to high taxes.<sup>14</sup> Alcoholic beverages, cosmetics, vehicles and mobile phones (non-essential goods) can only be imported through the ports of Ho Chi Minh City, Da Nang and Hai Phong, for instance. In addition, imports require certain permits. Consequently, conducting business deals without local middlemen and networks are either not feasible or extremely costly.

**Due to certain permits, conducting business deals without local middlemen and networks are either not feasible or extremely costly until today.**

A further urgent objective pursued by the FTA is an improvement of the conditions under which European businesses are allowed to operate in Vietnam. At present, work permits for foreigners are valid for a maximum of 24 months (formerly 36).<sup>15</sup> Also, any proposed new business must pass the Economic Needs Test (ENT). The purpose of this test is to establish whether the investment by the

13 | Cf. European Commission, "Generalised Scheme of Preferences (GSP)", <http://ec.europa.eu/trade/policy/countries-and-regions/development/generalised-scheme-of-preferences> (accessed 3 Sep 2014).

14 | Cf. Vietnam Trade Promotion Agency, "Taxation", [http://www.vietrade.gov.vn/en/index.php?option=com\\_content&id=783&Itemid=179](http://www.vietrade.gov.vn/en/index.php?option=com_content&id=783&Itemid=179) (accessed 3 Sep 2014).

15 | Cf. Foreign Trade Association, "FTA Position Paper. EU-Vietnam Trade Negotiations", 20 Nov 2012, <http://fta-eu.org/doc/unp/opinion/en/FTA-Position-Paper-EU-Vietnam-trade-relations.pdf> (accessed 3 Sep 2014).

foreign company in a particular province would benefit the local economy. The ENT is not only applied when businesses are founded, but also when businesses already established in Vietnam are to be expanded. It is a typical instrument of the socialist planned economy and is used strategically by the government to control the distribution of international capital in Vietnam. Although the government wishes to avoid the impression that this represents an impediment to direct investments, in practice, this test does mean exactly that for foreign businesses. According to Csaba Budnik, Executive Managing Director of the European Chamber of Commerce in Vietnam (EuroCham), the rules of the lengthy and laborious ENT process are so opaque that each provincial government interprets them differently.<sup>16</sup> This results in inconsistent application of the rules and makes it more difficult for foreign businesses to gain a foothold in the Vietnamese market. The trade liberalisation the FTA entails would therefore generate a positive impact on Vietnamese exporters and European businesses.

However, the biggest benefit Vietnam can derive from the FTA is greater integration into global trade. The aspects of particular importance in this context are stable economic growth and the modernisation of the Vietnamese economy. It would give Vietnam the opportunity to reform its economic structures. This includes above all greater support for small and medium enterprises (SME). In the past, economic development in Vietnam has been greatly hampered by the poor performance of state-owned enterprises (SOE). Despite some privatisation efforts in the last few years, the state continues to play a dominant role in the economy, even though SOEs generally perform worse than private companies and have generated considerable amounts of defaulted debt. This is costing Vietnam some eight per cent of its GDP, denying the private sector growth opportunities, deterring investment and weakening the banking sector and thereby the country's economic performance.<sup>17</sup>

**Despite some privatisation efforts in the last few years, the state continues to play a dominant role in the economy.**

16 | Cf. My Chau, "ENTs be consistently implemented", VCCINEWS, 4 Apr 2014.

17 | Cf. Armanovica, n. 9.

Comprehensive competition legislation could benefit the private sector. While the government has set up a Competition Commission, this has not been allocated any financial or HR resources.<sup>18</sup> Hardly surprising, seeing that effective competition legislation which would strengthen private enterprise would simultaneously weaken the role of the state. State-owned enterprises enjoy special conditions, particularly with respect to the awarding of loans. This gives them an advantage over private enterprises where the raising of capital is concerned. Vietnam is still far from fair competition between state-owned and private enterprises. Removing these disparities would make funding private enterprises a great deal easier; it would allow them to plan better for the future and take advantage of the benefits of the global market. The proportion of competitive private enterprises in Vietnam would increase as a result. However, one has to assume that the political leadership would consider such a development as unwelcome competition for the SOEs.



Structural change: Experts expect a higher unemployment rate after the FTA will enter into force. In particular Vietnam's agricultural sector is likely to experience negative impacts. | Source: M M, flickr ©©©.

18 | Cf. ECORYS Nederland BV, "Commission Services' Position Paper on the Trade Sustainability Impact Assessment of the Free Trade Agreement between the EU and ASEAN", 2013, [http://trade.ec.europa.eu/doclib/docs/2013/may/tradoc\\_151230.pdf](http://trade.ec.europa.eu/doclib/docs/2013/may/tradoc_151230.pdf) (accessed 3 Sep 2014).

## Negative Aspects of the Free Trade Agreement

Although the Free Trade Agreement between the EU and Vietnam is being declared a “win-win situation”, it does involve a number of challenges. Vietnam could be caught in a so-called low-wage trap. The country has a competitive advantage where the manufacture of low-value goods is concerned, which depends on advantageous wages and resources. The EU, for its part, has a competitive advantage regarding the manufacture of high-value goods, which involves sophisticated technology and innovation. If market entry were to be made easier for European companies, this might entail the risk that Vietnamese companies could not meet the competition from Europe. This would adversely affect Vietnam’s economic development, as its manufacture would continue to be limited to goods of lower value. It may even be that the agreement could even result in economic development stagnating at some point, precisely at a time when Vietnam would be on the verge of becoming an industrialised country.

**While the shoe, textile and clothing industries would probably grow, the agricultural sector could be expected to suffer losses of up to 27 per cent.**

Experts foresee unemployment to rise in some sectors if the FTA is implemented. While the shoe, textile and clothing industries would probably grow, the agricultural sector could suffer losses of up to 27 per cent.<sup>19</sup> The causes of this would include a likely reduction in production volumes as well as increasing unemployment in the grain sector. In the area of industrially processed foods, European traders have a clear comparative advantage over their Vietnamese counterparts. When European traders enter the Vietnamese food market, the domestic food industry as a whole will shrink due to the competitive disadvantage. The predictable unemployment will predominantly affect the agricultural workforce. There will be a transfer of human resources to more profitable sectors such as the leather industry. The automotive and component industries as well as the electronics and machinery sectors, which were developed relatively late in Vietnam compared to other Asian countries, will experience a downturn in production because Vietnamese suppliers will find it hard to hold their own against stronger competitors from Europe.<sup>20</sup>

19 | Cf. Armanovica, n. 9.

20 | Cf. n. 18.

Although it is likely that general prosperity will increase in Vietnam, the growth in GDP will be distributed unevenly between industry sectors and regions as well as between the social strata. The shift from agriculture towards manufacturing will result in a decline in the real income of people living in rural areas. This will involve a short-term rise in poverty for part of the population, which will in turn spur migration to the cities.<sup>21</sup> Economists assume that people formerly working in agriculture will have no difficulty in finding jobs in other sectors, which means that the Free Trade Agreement should foster poverty reduction in the long run.<sup>22</sup>



Competition from Europe: Due to the import of industrially processed foods the Vietnamese food industry will contract. Rice farmers must expect drops in sales, while consumers could enjoy lower prices. | Source: Julien Boulin, flickr ©©©.

Vietnam's developmental progress will result in a reduction in official development assistance (ODA) in the medium term. In 2012, Vietnam received over four billion U.S. dollars in bi-lateral and multi-lateral ODA.<sup>23</sup> In future, the country will have to deal with a reduction in foreign capital as well as taking measures to ensure macroeconomic stability. The repercussions of the FTA also include environmental problems. Increasing exports of fishery and

21 | Cf. *ibid.*

22 | Cf. Armanovica, n. 9.

23 | Cf. World Bank, "Net official development assistance and official aid received", <http://data.worldbank.org/indicator/DT.ODA.ALLD.CD> (accessed 3 Sep 2014).

seafood products, for instance, will exacerbate overfishing, which is already widespread. The heavy use of aquacultures is also impacting land-use and biodiversity.<sup>24</sup>

### **POLITICAL AND LEGAL CHALLENGES FOR VIETNAM**

The strict EU quality standards represent a challenge to Vietnam. This involves primarily the Technical Barriers to Trade (TBT) and the Sanitary and Phytosanitary (SPS) Measures. Both tools are aimed at protecting people's health and safety, biodiversity as well as natural resources. Compliance with these standards is a prerequisite to successful trading with the EU. As for almost all developing countries, this is no easy task for Vietnam.

For Vietnam, the proposed Free Trade Agreement is in a different league compared to the existing agreements, such as those with Japan and South Korea. Ever since the *Doi Moi* reforms, the government has been consistently pursuing a policy of economic opening-up, intended to make the country attractive to foreign investors without giving up any political power and control. Foreign direct investments are considered to play a central role in promoting economic growth. The large number of free trade agreements that have come into force over recent years act as important tools for achieving this goal. Particularly after the country joined the WTO in 2007, the Vietnamese leadership increased its efforts to conclude further FTAs in order to accelerate the process of trade liberalisation and Vietnam's global integration.

However, the FTA with the EU is of a far more complex nature than existing agreements. It does not only involve tax reductions and more advantageous business conditions, but most importantly also includes qualitative components. The EU thus attaches great importance to accurate details about product origins, observance of patent rights and competition legislation, as well as consideration of the sustainability principle and environmental standards. All this requires extensive legal reforms, not restricted solely to legislation. In many instances, the legal framework lacks effective mechanisms for monitoring and evaluating the implementation of the laws. That is why the Vietnamese

24 | Cf. Armanovica, n. 9.

legal system is not yet capable of coping with this plethora of changes. Before the full potential of the Free Trade Agreement can unfold, the Vietnamese legal system will have to undergo fundamental reform. Otherwise, Vietnam will be unable to satisfy the EU's exacting requirements. To allow the consequences of the FTA to be evaluated, a monitoring and evaluation system should begin to operate as soon as the Agreement has become effective. This is one of the main concerns of the European Commission, as the EU is looking to safeguard both the principles of sustainable development and essential labour standards.<sup>25</sup>

Will the Free Trade Agreement encourage not only economic reform but political change as well? Considering the above-described consequences, the concept of the state will inevitably need to be revised, because the role played by the government in the sphere of economic activities will undergo considerable change in the course of the FTA's implementation. The effective introduction of the modified competition legislation as well as the EU demand for the different legal treatment of state-owned and private enterprises to be abandoned would mean a loss of power for the government. In the event that the Free Trade Agreement is concluded, the Communist Party of Vietnam will have to be prepared to rethink its original role of planning and shaping the economy. But as the CPV, in fact, has been strengthened by the new constitution (in force since 1 January 2014), it is unlikely that there will be any change to the Party's supremacy. Should the FTA be signed, however, the Vietnamese government would have to commit itself to some political reforms.

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The EU Member States, in particular, as well as the European Parliament continue to draw attention to the disregard for fundamental freedoms and civil rights in Vietnam. They press for freedom of expression, freedom of the press and religious freedom as well as equitable treatment of political dissidents. A "Motion for Resolution" by the European Parliament called for the observance of human rights by the Vietnamese government to be included in the Trade Agreement. Accordingly, there should be an option to terminate the FTA with immediate effect in the event of

25 | Cf. n. 18.

human rights violations.<sup>26</sup> If the European Parliament were to uphold its demand and only allow the Agreement to go ahead on these conditions, this could provide for a boost to the improvement of the human rights situation in Vietnam. Under these circumstances, it would, however, also be conceivable that the Vietnamese government would refuse the signature in the foreseeable future.

Vietnamese academics are, in fact, ascribing the FTA some influence on the situation regarding the lack of freedom of expression and freedom of the press, albeit anonymously. To guarantee fair competition and improved conditions for businesses, the state must permit transparency in all areas. The academics view the press – to date a state-controlled tool for agitation and PR – as the crucial medium. They are keeping their own expectations low at the same time, as freedom of the press has hitherto been unthinkable in Vietnam. Nor is any improvement to be expected in the area of religious freedom in the foreseeable future. Since the beginning of 2013, religious communities have been required to undergo a stricter registration process (Decree 92/2012/ND-CP). Furthermore, religious groups

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see themselves confronted with the confiscation of church property and land. Vietnam lacks a clear legal framework in the area of expropriation, and the issue of the illegality of expropriations is set to remain unclear in the future as well. One can generally assume

that the human rights situation in Vietnam will not improve in the medium term. The Vietnamese government and the CPV will continue to take tough measures against dissidents, reformist activists as well as journalists who are critical of the government. For these reasons, academics do not consider Vietnam ready for the Agreement. The country is not capable of exploiting the advantages of the FTA in full due to the lack of political will to commit to serious change.

26 | Cf. Gerald Häfner, Barbara Lochbihler, Rui Tavares, Nicole Kiil-Nielsen and Raül Romeva i Rueda, "Motion for a Resolution with request for inclusion in the agenda for a debate on cases of breaches of human rights, democracy and the rule of law pursuant to Rule 122 of the Rules of Procedure on Vietnam", 2013/2599(RSP), 16 Apr 2013, <http://europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+MOTION+B7-2013-0166+0+DOC+PDF+V0//EN> (accessed 3 Sep 2014).

The lack of willingness to commit to political change on the Vietnamese side and the EU's insistence on qualitative conditions for the FTA and on human rights illustrate the political divide in the parties' negotiating positions. There is disagreement on crucial points between Brussels and Hanoi. The political relations between the two sides are not sufficiently substantive to allow for a speedy rapprochement and for constructive solutions to be devised. Perception of the EU as a unit is not widespread either in Vietnamese society or among those active in the political arena. Although there is no doubt about the economic benefits for both sides, the EU's lack of political weight in the eyes of Vietnam represents a major obstacle on the path towards a rapprochement in the negotiations.

### **Territorial Dispute Opens up New Prospects**

Until several months ago, it did indeed look like the negotiations would fail. The stalled efforts to make progress on the FTA experienced an unexpected momentum on 2 May 2014. A drilling rig that China had moved into Vietnam's exclusive economic zone in the South China Sea destabilised the power landscape underpinning Vietnam's foreign policy. A difficult friend had turned into an uncontrollable foe overnight. The South China Sea has been an international trouble spot for decades, with several Southeast Asian countries and China making territorial claims in the region.



Intensified negotiations: Here, the former President of European Commission, Manuel José Barroso meets Vietnamese Prime Minister Nguyen Tan Dung for political talks in Vietnam, August 2014. | Source: © European Union Delegation to Vietnam.

**Over the last few months, Vietnam has had to realise that its economic dependence on China is placing severe restrictions on the scope of its own foreign policy activities in the region.**

The People's Republic of China and the Socialist Republic of Vietnam are not merely bound by close links ideologically due to their communist societies, they also have intensive trade relations. The economic interdependencies between the two countries are having a continued influence on Vietnam's foreign policy. And this has placed the country in a dilemma. As its economy is in the process of stabilising, an economic downturn caused by foreign policy tensions would be disruptive. Over the last few months, Vietnam has had to realise that its economic dependence on China is placing severe restrictions on the scope of its own external affairs in the region. The country therefore needs a new overall political strategy. In that regard, the envisaged FTA with the EU could become the most important element. More intensive economic relations between the EU and Vietnam can provide a counterweight to China, reduce undesirable dependencies and create some much-needed scope for diplomatic action.

#### **FROM SCEPTICISM TO HOPE: A LOOK AHEAD**

Up until the end of April, EU representatives and Vietnam's political cadres as well as entrepreneurs from both sides were still pessimistic about the conclusion of the Free Trade Agreement. The ideas of the two sides were too divergent. Hopes for the agreement to be signed by the end of 2014 were receding. It was not until the dispute with China, that Hanoi felt compelled to re-evaluate and revitalise its partnerships. This included a re-evaluation of the topics under discussion in connection with the FTA as well as a re-assessment of the Vietnamese positions. Conciliatory messages are now emanating from the ministries and from the Central Committee, suggesting the gap between the ideas and demands of the two sides is narrow. In fact, according to Dr Claudio Dordi, a leading expert in this area, Vietnam has no alternative to the Trade Agreement with the EU.<sup>27</sup> The disadvantages of the FTA, which are to be expected, form part of the development process that Vietnam inevitably has to go through. In Dordi's opinion, a

27 | Dr Claudio Dordi is the Technical Director of EU project "European Trade Policy and Investment Support Project (MUTRAP)" in Vietnam and a professor at the Università Bocconi in Milan.

postponement or even failure of the agreement would be fatal for Vietnam's economic development. In terms of competition, Vietnam would be at a distinct disadvantage in the trade with the EU compared to other ASEAN states, which either already have a joint trade agreement in place or which are in negotiations for one (Thailand, Malaysia).

Without the crisis in the South China Sea and the re-orientation of Vietnamese foreign policy this triggered, Vietnam would take a more critical stance towards concluding the Agreement. During his visit on 25 and 26 August, Jose Manuel Barroso held talks with Vietnam's highest political leadership regarding the relations between the two sides. Particularly the suggestion by Vietnam's President Truong Tan San that the EU-VN FTA should be signed as soon as possible was a strong indication that Vietnam has the political will to intensify its relations with the EU immediately. Current developments are having a positive effect where the EU's significance for Vietnam is concerned. The FTA offers Vietnam the opportunity to engage in urgently needed reforms and could provide new impetus to its stagnating economy. For Asia and Europe, this Free Trade Agreement would ensure a new dynamic in the currently unsatisfactory foreign relations between the two sides as well as greater mutual understanding.