Media title: Textile sector must be tailored for FTA rewards
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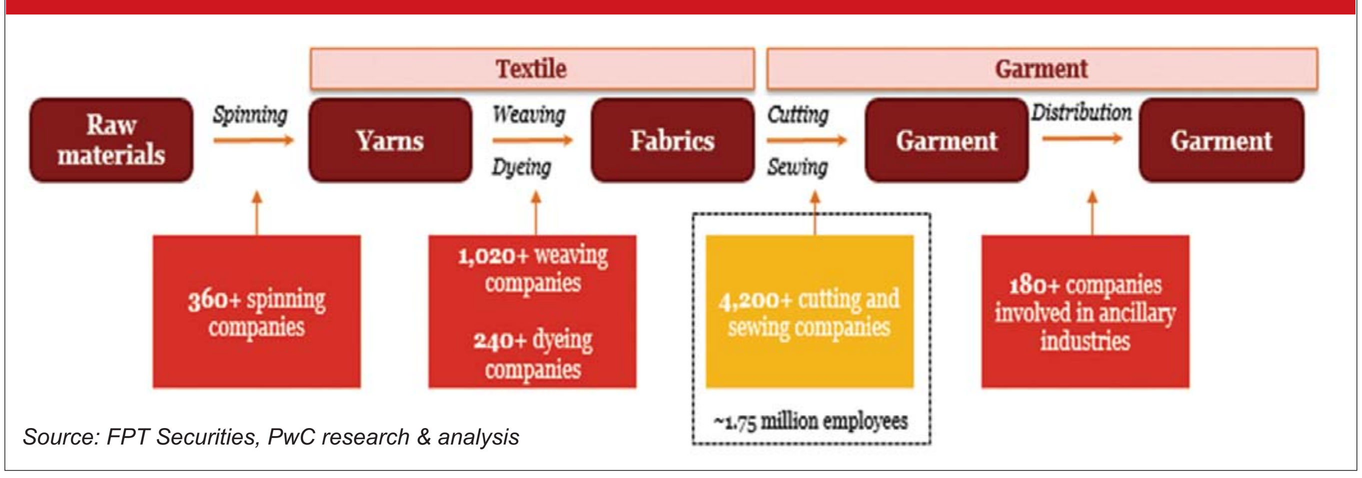
Textile sector must be tailored for FTA rewards

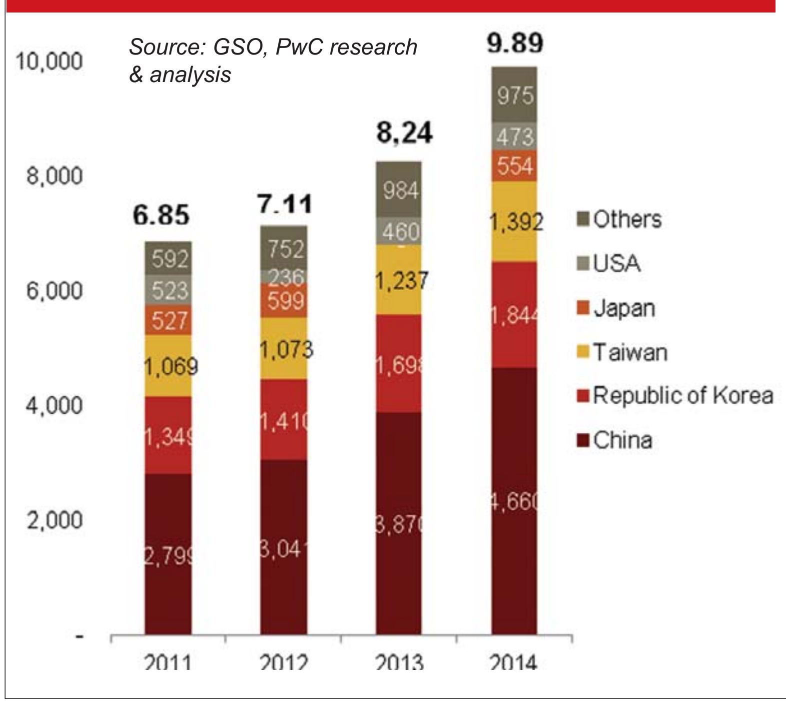
By Stephen Gaskill and Nguyen Luong Hien*

BREAKDOWN OF VIETNAM'S CURRENT POSITION ON THE GARMENT INDUSTRY VALUE CHAIN

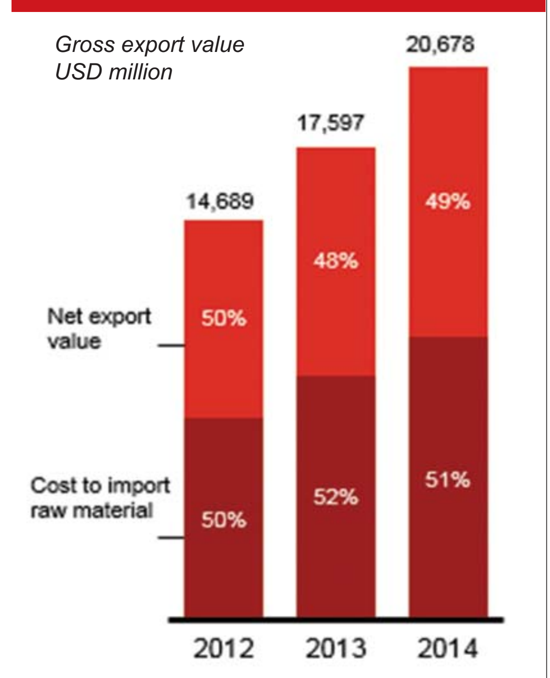


Source: FPT Securities, PwC research & analysis

VIETNAM'S FABRIC + YARN IMPORTS FROM TOP 5 COUNTRIES USDmn



PERFORMANCE OF TEXTILE SECTOR - IMPORTS VS EXPORTS % BREAKDOWN



In 2015, Vietnam concluded negotiations on the Trans-Pacific Partnership (TPP) and the Europe - Vietnam Free Trade Agreement (EVFTA) – two major free trade agreements that will likely transform Vietnam's economic landscape.

Jose Manuel Barraso, president of the European Commission aptly noted that "Vietnam has one of the highest export-to-GDP ratios of any country in Southeast Asia" during a presentation to EuroCham members for the 2015 White Book debut. He went on to note that "free trade with developed countries via the TPP and the EVFTA are major steps forward for Vietnam's emerging economy." Indeed, much has been said about the effect of FTAs and plenty of predictions have been made about their potential impact on the Vietnamese economy, with many analysts pinpointing Vietnam as the biggest beneficiary of the partnership. Researchers from *Bloomberg Business* have projected a boost of 28 per cent in the export sector within a decade of implementation.

Along with the agriculture sector, the textile industry has been one of the key contributors to Vietnam's emergence as an export-led economy. As of 2014, the industry output amounts to more than 12 per cent of the country's GDP. Textile products are perhaps the most visible ambassador of the Vietnamese economy with "Made in Vietnam" garments now widely available in markets such as the US, Europe, and other Asian countries like Japan and South Korea.

Vietnam already exports nearly $10 billion worth of garments and textiles to the US alone, which comprises nearly 50 per cent of the industry's total export value, while Germany and Spain together account for another $1 billion in garment and textile exports. These figures are likely to increase, as tariffs with the US will come down from 16-17 per cent to 0 per cent after full implementation of the TPP, and tariffs with EU countries will fall from 12 per cent to 0 per cent within seven years of the EVFTA. On paper, Vietnam's exporters stand to gain a great deal from these FTAs, but the question is how they will actually benefit from the opportunities offered by the deals.

Although the number of enterprises and people that are actively involved in the Vietnamese textile industry is high (at more than 6,000 and 2.5 million respectively), approximately 70 per cent of these resources are employed to perform labour intensive and low value-added work such as the "cut-make-trim" services to transform fabrics into garments to be exported. Under this operating model, the inputs such as cotton, yarn, and raw textile materials are imported from other countries such as China, South Korea, India, and Taiwan. Currently, Vietnam is importing over 65 per cent of its raw materials for textile manufacturing. The labour intensive nature of the "cutting and sewing" stage worked to Vietnam's advantage in the past, as the country was able to leverage its large pool of workers and low labour cost to transform itself into the textile factory of more developed countries.

Vice president of the Vietnam Textile and Apparel Association Dang Phuong Dung noted the need for Vietnam to diversify/expand in order to progress: "The added value of textiles and garments in Vietnam is very low. Vietnam's role in the global supply chain does not occupy an important position – the only advantage Vietnam has over others is our affordable source of labour." This may be true for the time being, but other countries in the ASEAN region such as Bangladesh and Myanmar are attracting foreign investment because of their low labour costs.

Since Vietnam currently has minimal capabilities in terms of raw material processing, they are losing out on this part of the value chain as the industry is heavily reliant on imports. At the very beginning of the value chain, where significant value is added to the garment manufacturing process, the designs for garments are largely not coming from Vietnam, but from international players. Vietnamese textile companies will need to address these gaps if they are to seize the opportunities offered by the TPP and also to make the move into more significant and lucrative stages within the garment manufacturing process.

TPP, EVFTA, and other FTAs – Opportunities and challenges

The ending of tariffs for Vietnamese products (from 16-17 per cent to 0 per cent in the TPP and 12 per cent to 0 per cent in the EVFTA) is likely to trigger more demand for Vietnamese products. Foreign investors are taking note, and have been increasingly willing to invest in Vietnam's textile manufacturing space in order to break into untapped parts of the value chain, such as raw material processing. Investments in these areas help to increase Vietnam's ability to meet growing demand for its products, as well as expand its current capabilities. Indeed, over the last few months Vietnam has seen a significant portion of new FDI flowing into the textile and garment sector, with a number of large scale textile and garment projects from Taiwanese, South Korean, and Indian investors. Through these investments, valuable partnerships are formed, whereby Vietnamese companies benefit from the expertise of foreign experts. Furthermore, these partnerships increase the ability of Vietnamese companies to hire and train more people to expand their capabilities across the value chain. Right now, it's easier for domestic companies to continue to employ cutting/sewing workers because they command salaries much lower than dyeing technicians, for example, who require significantly more in pay/training to employ. When partnerships are formed between Vietnamese companies and both foreign/local investors, domestic companies can then afford to expand their service offering.

Other remaining hurdles

Much lower tariffs on Vietnam's textile products will help boost exports to TPP members, in which USA and Japan are currently top export markets for Vietnam. The elimination of import taxes on input materials such as cotton will also help Vietnam to reduce its production costs. Nevertheless, to receive duty-free access to TPP member markets, Vietnam is required to use raw materials, such as yarn, produced by a TPP member (the "Yarn Forward Agreement"). Currently, Vietnam imports 40 per cent of its yarn from non-TPP signee China, and reducing this level of reliance will be a practical and political challenge for the industry. Foreign countries such as India (which is also not a TPP signee) are taking advantage of this challenge by pouring money into Vietnam's textile sector, hoping to increase Vietnam's ability to play by this rule and also benefit from the surge in exports that the country will likely experience. Industry players will also be required to operate under market principles, creating an impetus for state-controlled enterprises such as Vinatex, Dong Xuan, and others to improve their efficiency. With requirements on equal competition, the private sector will have more growth opportunities in textile industry.

Vietnamese companies must take action

Vietnam's textile sector is at a crossroads. The market conditions and the business climate are both forcing and enabling the industry to change itself, and there are huge benefits to be won by those who make the right moves at the right time. Both foreign and local companies should take this interim period before the FTAs are implemented to step back and assess their options moving forward.

For local companies, this means addressing their ability to meet demand as well as expanding capabilities to achieve sustained growth. For foreign investors, this means developing a deep understanding of the market and its current opportunities/challenges in order to determine the best way to get involved. With all of these ongoing developments in the industry, both foreign and domestic companies will require substantial transformation.■

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