Hogan Lovells SEA View

Vietnam and the U.S.-China Trade War

It matters how you start, but it *really* matters how you finish

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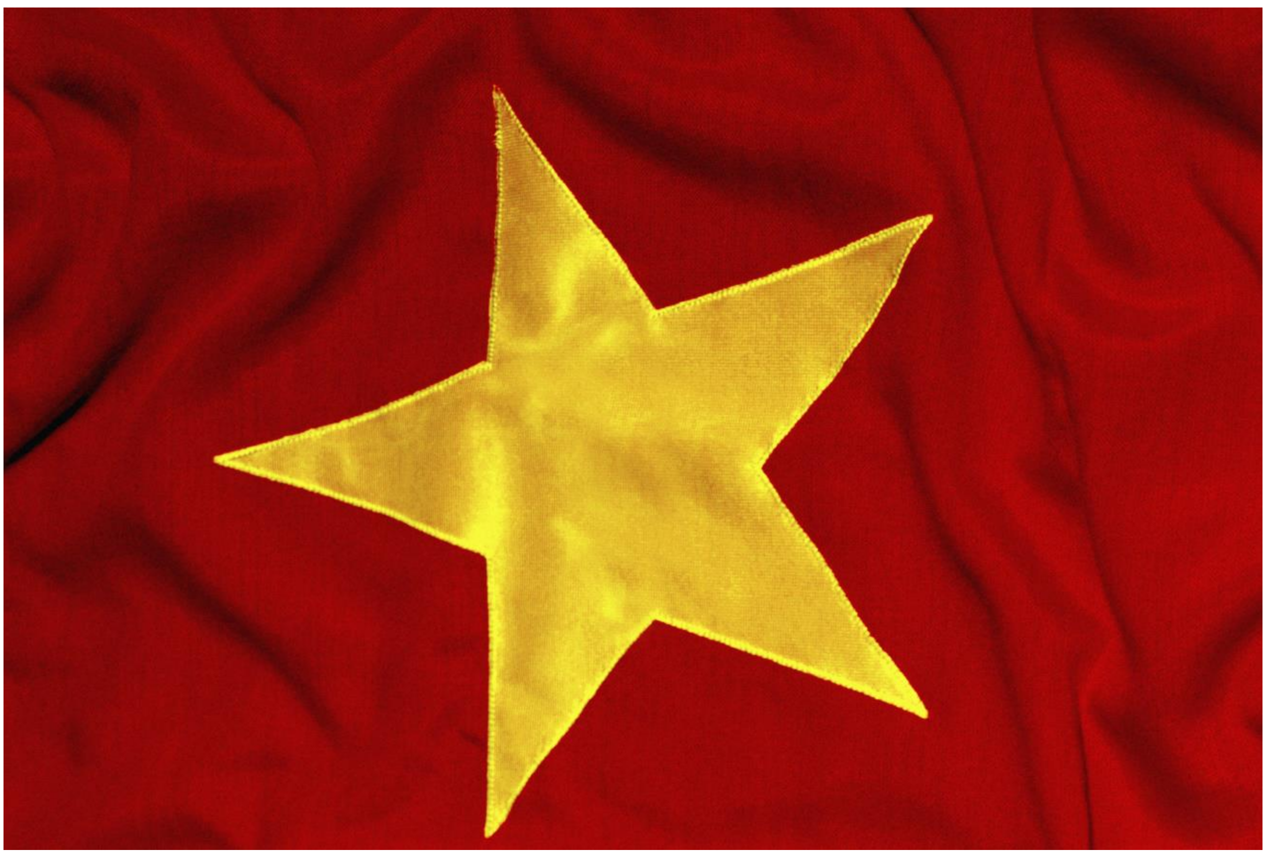
The U.S.-China trade war's rhetoric and ramifications have affected its economies but also nations worldwide. The effects on Vietnam though, shine out. Rather than negatively impacting Vietnam, the Southeast Asian nation has flourished.

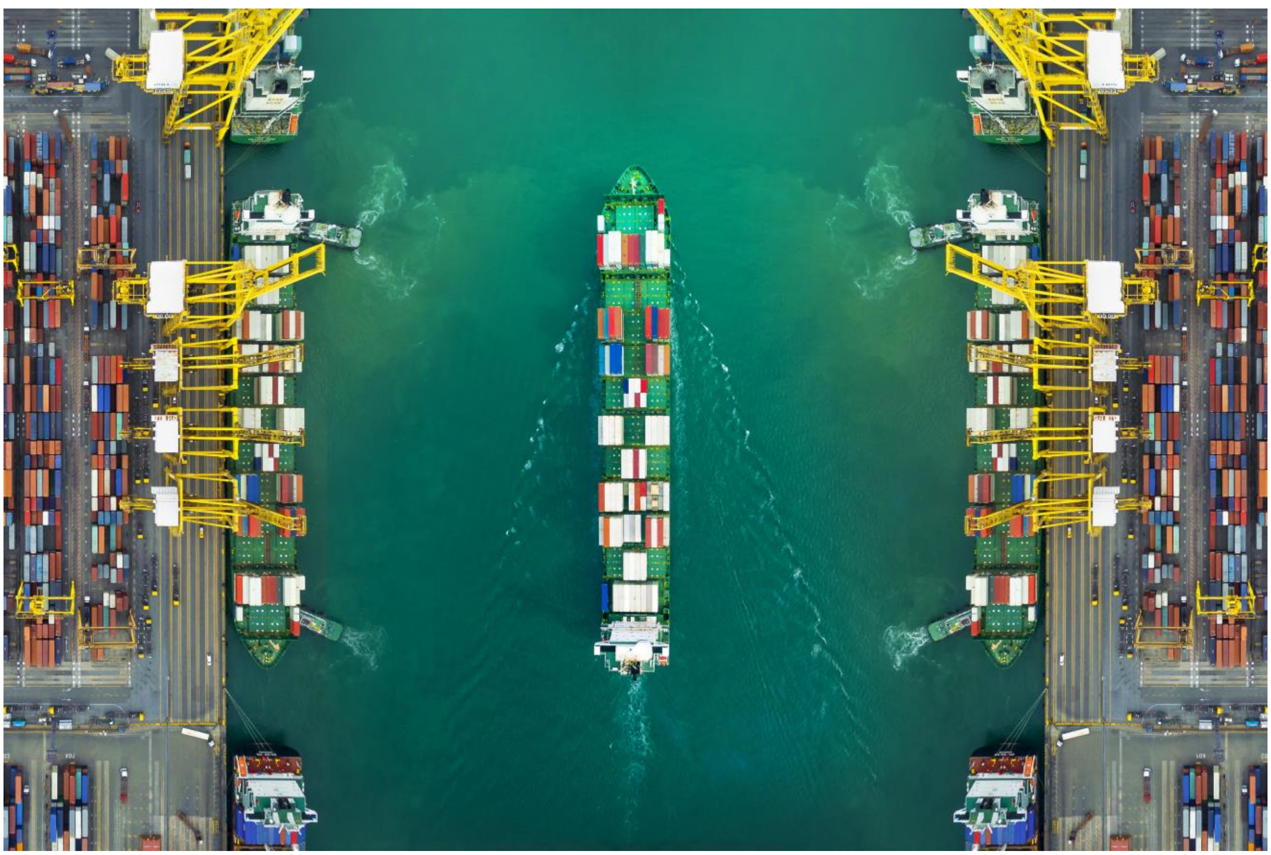


Vietnam has an early lead – the Southeast Asian nation declared as "the biggest winner" in the ongoing tussle between Washington, D.C. and Beijing. Benefiting from tariffs on China, with operations, and supply chains shifting to Vietnam, our fifth SEA View article considers how long this success will last.

Our Hogan Lovells' authors, with jurisdictional, regulatory, and industry perspectives stemming from all over the globe debate if the U.S. tariffs that created the growth in Vietnam could also snatch it away.

Since the U.S.-China trade conflict started in earnest in the middle of 2018, trade experts on both sides of the Pacific declared Vietnam as the "biggest winner" of the Sino-American trade war. Many companies are moving (or have moved) their operations or shifted their supply chain to Vietnam in response to the tariffs on China. The swing in supply chains has created measurable economic gains in Vietnam, both in terms of employment and Gross Domestic Product (GDP) growth.[1] The latest round of 10 percent tariffs announced on 1 August 2019 on Chinese goods, combined with the subsequent retaliation by China, positions Vietnam to continue to benefit from the ongoing trade war in the near term.

Unfortunately, evidence of trade fraud in the form of "rebranded" or "transshipped" goods of Chinese origin entering the United States through Vietnam to avoid the Chinese tariffs has led the Trump Administration to start slapping tariffs on products from Vietnam. The Trump Administration could implement additional tariffs if Vietnam does not crack down on these practices. These tariffs could threaten the growth of Vietnam's export-led economy. Companies that are thinking about shifting their supply chain to Vietnam or making other investments based on the short-term effects of the trade war should keep in mind that the U.S. tariffs that created the growth in Vietnam could also take it away.



[1] Vietnam GDP Grows on Trade War Gains, Financial Times, June 28, 2019, available here

Vietnam emerging as the "biggest winner"

Many trade observers dubbed Vietnam as the "biggest winner" in the first year of the U.S.-China trade war. A study by investment bank Nomura found that in the first quarter of 2019, the value of orders diverted from China to Vietnam to avoid tariffs was equal to 7.9 percent of Vietnam's GDP. Taiwan was a distant second, with gains equivalent to 2.1 percent of its GDP, though Taiwan's economy is larger, so the absolute gains were closer in comparison. According to a May 2019 DBS *Economics and Strategy report*[2], large multinational companies have moved production and sourcing out of China to Vietnam.

The DBS report posits that Vietnam is well-placed to continue to benefit from the ongoing U.S.-China trade disputes due to its strategic position in the regional supply chain, extensive network of free trade agreements, and increasingly pro-market government. Vietnam is also investing heavily in infrastructure and maintains low taxes and labor costs. As a result, Vietnam is moving up the value chain quickly and manufactures more-and-more sophisticated products across more industries.

Increasing evidence of trade fraud

Recent evidence of trade fraud being perpetrated in response to the tariffs exposes Vietnam to significant risks. According to a *Wall Street Journal report* from June 2019[3], billions of dollars worth of Chinese goods subject to the Trump tariffs have been dodging the levies by entering the U.S. through countries like Vietnam. Through a practice known as "transshipment," goods of Chinese origin are minimally processed or altered in Vietnam then relabeled as "made in Vietnam" to dodge the tariffs. This practice is not unique to Vietnam, but the scope of the

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[2] Understanding Vietnam: The Rising Star, May 28, 2019, available here

[3] American Tariffs on China Are Being Blunted by Trade Cheats, June 26, 2019, available here

transshipment problems threatens Vietnam's gains. Vietnam's imports from China have dramatically increased in a way that correlates to Vietnam's exports to the United States.

The good news is that the Vietnamese government appears to have begun taking steps to crack down on these shipments. Anecdotal evidence suggests that Vietnam is already making concrete changes to rule-of-origin labeling as a result of the recent criticism. The Vietnamese government has also urged local manufacturers to use domestic materials or those manufactured in countries without U.S. tariffs.

Horizon spotting and practical implications

Whether Vietnam will be able to do enough to avoid retaliation from the U.S. government remains to be seen. However, after President Trump said, "Vietnam takes advantage of us worse than China," in response to a question about imposing tariffs on the country, the U.S. government fired its first salvo against Vietnam in early July 2019, placing duties of over 400 percent on certain steel imports from Vietnam. In its rulings on Vietnamese steel, the U.S. Department of Commerce said certain products produced in South Korea and Taiwan were shipped to Vietnam for minor processing before being exported to the U.S. as corrosion-resistant steel products and cold-rolled steel.

In recent weeks, the U.S. Customs and Border Patrol (CBP) are also generally ramping up investigations into companies. As a result, even companies that are not transshipping should review their customs classification and rule-of-origin labeling to avoid scrutiny and to protect their brands from fraudulent goods. When filling out U.S. import documents, companies should include complete product descriptions, accurate country of origin labels, and correct values in accordance with CBP rules. These requirements fall under the importer's legal responsibility to exercise "reasonable care." Early attention to detail on the customs forms will decrease the risk of delays of the release of goods, a CBP audit, and civil penalties.

Companies looking for alternatives to China should ensure a secure supply chain that prevents diversion to sanctioned countries, entities, and persons, especially in light of the increased focus by the U.S. Department of Justice and Office of Foreign Assets Control on Southeast Asian countries for trades with restricted countries such as North Korea.

Fortunately, the Vietnamese government appears to be taking a proactive approach to resolving these concerns. Officials from Vietnam and the United States continue to talk, and there are rumors that the Vietnamese government may be interested in purchasing U.S. military products as a way to reduce the trade deficit. Such a deal would allow the U.S. to claim a trade victory and strengthen its political relationship with Vietnam. If these talks are successful, companies that have recently set up manufacturing in Vietnam may avoid a full-scale trade-dust up with the United States. Vietnam may emerge as the ultimate "winner".

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SEA View

Since April 2019 our monthly periodical has featured investigation, compliance, and regulatory developments in Southeast Asia (SEA). For a 12-month period, one monthly article will showcase our insights on particular developments in the region, liaising with our extensive global network. We draw on the firm's market-leading practices, including our assembled Global Regulatory team, to lead clients' businesses through challenges encountered in and out of SEA.

SEA View is horizon spotting in practice.

This month's analysis explores the effects of the U.S.-China trade war on Vietnam but queries if such success stemming from Sino-U.S. tensions is sustainable and what practices companies can implement to avoid the risk of U.S. regulatory purview. Having showcased our know-how on navigating sanctions for financial institutions and the key regulatory developments for the mining industry in Australia, as well as an analysis of corruption and money laundering in Indonesia and the AML inadequacies in Hong Kong that may have prompted the protests, next month we approach how to communicate a crisis with a piece from Mark Irion, Head of our firm's Strategic Communications team.