Effects of EVFTA on Vietnam's apparel exports:
An application of WITS-SMART simulation model

VO THANH THU [a], LE QUYNH HOA [b], HOANG THU HANG [c]

[a,c] *University of Economics Ho Chi Minh City*

[b] *Thu Dau Mot University*

A R T I C L E I N F O	A B S T R A C T
	The textile and apparel industries play an important role in Vietnam's economy in general and the manufacturing sector in particular. As a matter of fact, Vietnam ranks as one of the leading suppliers of textile and apparel for major economies in the world, including the European Union. This paper attempts to examine the potential impacts of the European Union - Vietnam Free Trade Agreement on the export of Vietnam's apparel at three levels: 2, 4, 6–digit HS respectively, assuming full liberalization from Vietnam to European Union by 2026. An analysis is undertaken using WITS-SMART model to identify the variation of Vietnam's apparel export as well as to predict some most affected products if European Union - Vietnam Free Trade Agreement is in full application. As a result, Vietnam's apparel exporting to European Union will increase significantly by 42% compared to the base year (2016) and is expected to reach US\$4.220 billion in the next 8 years. Due to trade diversion dominates over trade creation effect, Vietnam's apparels will get more gains than non - European Union - Vietnam Free Trade Agreement members; however, this result is not because of an effective allocation of resources. Therefore, policy makers should implement some remedies to improve the competitive of Vietnam's apparels, to reduce the production price to bring advantages for both Vietnam and Europe.

[a] vothanhthu@ueh.edu.vn, * Corresponding author.

[b] hoalq@tdmu.edu.vn

[c] hanght@ueh.edu.vn

1. Introduction

The liberalization of international trade has contributed in a major way to the rapid economic growth of the international economy and altered the competitive dynamics of nations, firms, and industries. In the case of the textile and apparel (T&A) industries, apparel is one of the oldest and largest export industries in the world. Globally, Vietnam was the world's third largest apparel exporter in 2015, after China and Bangladesh (WTO, 2016). In 2015, Vietnam's textile and clothing exports totaled $28 billion (84% were clothing), which represented 16% of Vietnam's total merchandise exports. EU is the second largest market for textile and apparel of Vietnam with a share of 16 per cent in 2015. Specifically, Vietnam and EU have engaged in a free trade agreement (FTA) which will change the prices of imports from partners due to reduction or phasing of tariffs starting from 2018. This FTA will inevitably involve some "trade creation" effects by allowing cheaper products from other member states to substitute for more expensive domestic production or "trade diversion" effects by substituting intra-bloc imports for imports from outside the group that were cheaper when both faced equal tariffs (Schiff & Winters, 2003).

In view of EU-Vietnam free trade agreement (EVFTA) full engagement, this paper attempts to examine potential impacts of EVFTA on Vietnam's apparel exporting to the EU and to compare various hypothetical tariff liberalization scenarios on certain key variables, such as prices, imports, exports and revenue using SMART models. All export and import trade data used in this study was sourced primarily from credible online SMART database and Trade Map data flow, the Office of Textiles and Apparel, International Trade Administration... and so on. Thus, this study will add to the existing literature on this issue.

Since the introduction of the paper has been given, the next section gives a brief overview impact of FTAs, apparel industry of the world and Vietnam and EVFTA, followed by the third section presenting the analytical framework, including WITS-SMART model, data and robustness test. Section 4 offers the results and discussion. Lastly, section 5 summarizes the findings of the paper and policy implications.

2. Background

2.1. Impacts of FTAs on trade

Since the Doha development round of the WTO, the merits of free-trade agreements (FTAs) have had a controversial topic of many economists. Some argue that the tremendous number of FTAs have been hampered the domestic production and non-FTA members by eliminating tariff between partners (Levy, 1997), while others view FTAs as a positive vehicle to move nations toward free multilateral trade (Freund, 2000).

By creating a more integrated trading area, FTAs eliminate trade barriers on goods between member nations. Thus, the agreement increases trade volume among the member

countries through trade creation and diversion effects. The earliest work on the theory of trade creation and trade diversion was presented by Viner (1950).

Trade creation occurs when FTAs reduce the import prices from partners and change the patterns of domestic demand. This is achieved through facilitation of consumer choices and increasing competition between foreign manufacturers and local producers. In this case, the price of the imported goods after the tariff change become lower, which results in an increasing level of domestic demand for imports from a specific trading partner. Indeed, the benefits of tariff changes would be passed on to consumers. This brings about a better allocation of resources (Laird & Yeats, 1986).

The trade diversion effect can be explained by the fact that imports of goods from a member are going to further increase due to the substitution away from imports of goods from other countries that becomes relatively more expensive. It means the trade flow is diverted from a truly cost-efficient partner to less efficient one, because when a country joins in a member of economic union, which makes its goods cheaper within a union, but higher compared to the rest of the world. This leads to ineffective allocation of resources (Laird & Yeats, 1986; Othieno & Shinyekwa, 2011).

According to current literature research, the impacts of FTAs on textile and apparel's trade creation and trade diversion vary and depend on the organizational structure of the association (Krueger, 1999). For example, Tsang and Au (2008) assessed and divulged the impacts of North American Free Trade Agreement (NAFTA) on textile and clothing exports from selected South and Southeast Asian developing countries. The study found that textile and apparel exports from the South and Southeast Asian developing countries to the US market were hampered by the enforcement of NAFTA in the 1990s due to the trade diversion effect. By contrast, Datta and Kouliavtsev (2009) examined the impact of US textile imports before and after the creation of NAFTA. They claimed that there was little evidence of trade diversion in textiles frequently attributed to NAFTA, while trade creation was clearly present.

Gurler et al. (2006) investigated the effects of FTA on intra-industrial trade with a case study of textile sector in Turkey. The results showed that agreements had a positive effect on textile import of Turkey. By the rise of intra-industrial trade, while taking advantage of various markets in textile sector, Turkey will be able to offer a wide variety of products to customer, and will be able to reap economies of scale.

As for Vietnam, there is a very limited number of papers evaluating how particular FTAs would have affected Vietnamese textile and apparel exports. Knowingly, the study of Sayres (2002) with the focus on Vietnam's textile and apparel indicated that the export of textile products was expected to be increasing remarkably after the United States and Vietnam signed Bilateral Trade Agreement (BTA). In addition, Baker et al. (2014) estimated the impact of EVFTA on Vietnamese economy and forecasted that textile and apparel trade would be one of the most beneficial sectors as EVFTA comes into force.

2.2. Apparel industry overview

Known to date, textile and apparel manufacturing process begins with fiber, and passes through four main stages of processing: yarn, fabric, finishing and fabrication (Platzer, 2012). This paper focuses on the last process of fabrication and final products which are articles of apparel and clothing accessories, knitted or crocheted; and not knitted or crocheted, which belong to HS groups of Chapter 61 and 62 (Appendix A). These groups of products usually cover nearly 50% and 80% of all T&A exports of the world and Vietnam respectively.

Vietnam does have a growing textile industry, but currently the majority of its yarns and fabrics are sourced regionally, from China and other Asian suppliers such as South Korea and Taiwan. Only about 12%–13% of fabrics and other input materials are sourced from local textile manufacturers (GSO, 2016). A majority of big textile and garment manufacturers in Vietnam are based in Japan, Hong Kong, South Korea, Taiwan, Austria, and Australia, all these counries also consider expanding their current production in Vietnam.

Table 1 below shows the market share (%) of apparel by nations from 2007 to 2015. As can be seen from this table, because of high consumers' purchasing power (often measured by GDP per capita) and size of the population, the EU nations, the United States and Japan became the top three importers of world apparel. Altogether, they accounted for over two-thirds of world imports, but this number decreases from 77 percent in 2007 to 69 percent in 2015. This downward trend indicates that import demand from other economies, especially some emerging markets (Hongkong, Canada, South Korea), have been growing faster over the past decade.

Table 1.

Top World Apparel Importers by share

Main Buyers	2007	2008	2009	2010	2011	2012	2013	2014	2015
EU	45.80%	47.20%	47.90%	45.50%	45.50%	41.80%	42.10%	43.70%	40.80%
USA	24.10%	21.80%	21.20%	22.10%	20.70%	21.60%	21.30%	20.70%	21.90%
Japan	6.90%	6.90%	7.60%	7.40%	7.90%	8.60%	8.10%	7.10%	6.60%
Hong Kong	5.50%	5.00%	4.70%	4.60%	4.10%	4.10%	3.90%	3.60%	3.40%
Canada	2.10%	2.10%	2.20%	2.20%	2.20%	2.30%	2.30%	2.20%	2.20%
Korea	1.20%	1.10%	1.00%	1.20%	1.50%	1.60%	1.80%	1.90%	2.00%

Source: Author's calculation from ITC (2016), Apparel represented by HS 61, 62.

In terms of global suppliers (see Table 2), most of apparel manufacturers are located in developing countries such as China, India, Bangladesh, and Vietnam. With rich natural resources and labor costs significantly lower than other competitors in developed nations, these top three producers accounted for over a half of world textile and apparel with 52.4%

in 2015. Specifically, China was the leading supplier by far in the global apparel export share during the past 8 years with the average share of 40%, kept far ahead of the following ones such as Bangladesh, India and Vietnam.

Table 2.

Top global apparel suppliers by share

Suppliers	2008	2009	2010	2011	2012	2013	2014	2015
China	38.70%	38.70%	41.40%	40.80%	41.50%	41.50%	40.80%	40.30%
Bangladesh	3.30%	3.90%	4.30%	4.70%	5.70%	6.00%	6.20%	6.80%
Vietnam	2.40%	2.60%	2.90%	3.10%	3.40%	3.70%	4.20%	5.30%
India	2.80%	3.60%	3.00%	3.40%	3.20%	3.50%	3.50%	3.80%
Turkey	3.60%	3.60%	3.60%	3.30%	3.40%	3.30%	3.40%	3.30%
Indonesia	1.70%	1.80%	1.90%	1.90%	1.80%	1.70%	1.60%	1.60%
Cambodia	0.80%	0.80%	0.90%	1.00%	1.00%	1.10%	1.10%	1.30%
Mexico	1.30%	1.30%	1.20%	1.10%	1.10%	1.00%	0.90%	1.00%
Sri Lanka	0.90%	1.00%	1.00%	1.00%	0.90%	1.00%	1.00%	1.00%
Pakistan	0.90%	0.90%	1.00%	1.00%	0.90%	0.90%	0.90%	1.00%
Total	56%	57%	57%	58%	61%	61%	63%	64%

Source: Author's calculation from ITC (2016), Apparel represented by HS 61, 62

2.3. Overview of Vietnam's apparel export

In Vietnam, textile and apparel manufacturing is one of the largest economic sectors, consisting 4,000 enterprises with a turnover of US$20 billion a year, accounting for 15% of GDP (VITAS, 2016). In 2015, Vietnamese apparel products are exported to over 180 countries and territories in the world with total exports of US$21.4 billion.

Beside the US market, Europe is a promising market for Vietnamese apparel with export turnover reaching US$3.4 billion in 2015, accounting for 16% of Vietnamese apparel export (Figure 1). The textile exporting to EU has been witnessing a steady growth over the recent years and pushing Vietnam to become one of the top T&A exporters to EU.
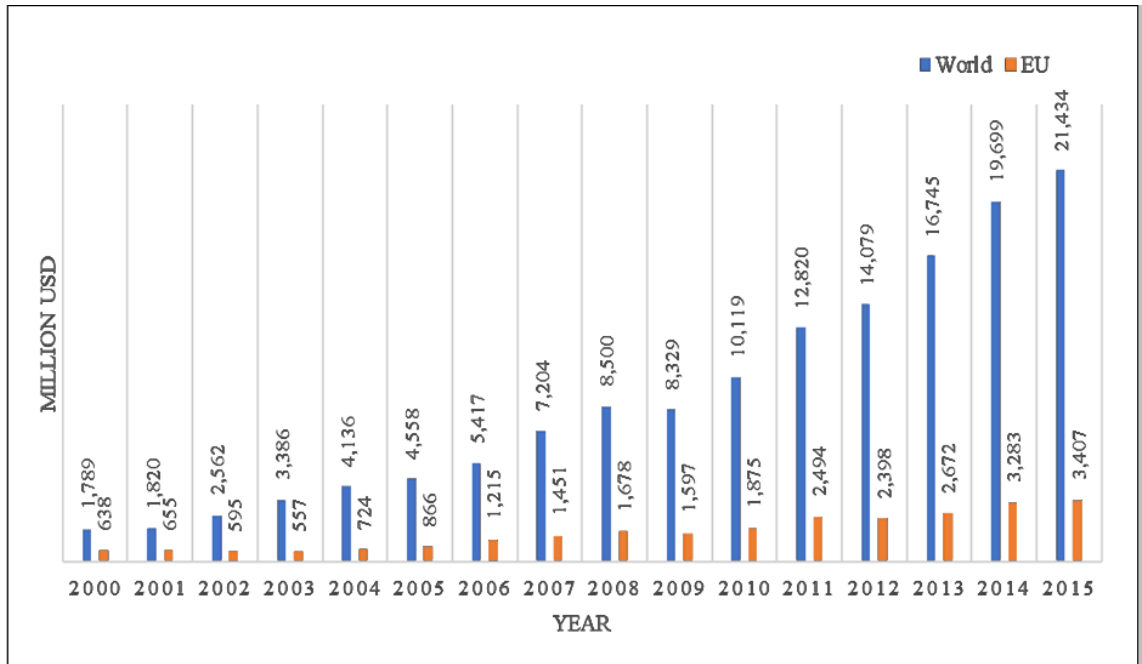
Figure 1. Vietnam's apparel exports to the World and EU (US$ Million)

Source: Author's calculation from UN Comtrade, Apparel represented by HS 61, 62

More interestingly, EU and Vietnam have started the negotiation for FTA since June 2012. At that time, EU, covering a big market with 28 partners, has been granting Vietnam with the Generalized Scheme of Preferences (GSP).

The EU-Vietnam free trade agreement is expected to substantially expand Vietnam's textile and apparel exports to the EU market. In other words, EU's import duties on textile and apparel from Vietnam will be eliminated through an eight-year phase-out period once the agreement comes into force.

EVFTA has planned the elimination of roughly 99% of all tariff lines. Vietnam will liberalize tariffs over a 10-year period and the EU over an 8-year period. EU duties on textile apparel have periods from five to eight years for the more sensitive items and three years and entry into force for less sensitive goods. The agreement also covers non-tariff barriers to trade and other trade related aspects such as public procurement, regulatory issues, competition, services, investment, intellectual property rights, and sustainable development (MOIT, 2016).

According to Vietnam's tariff schedule, apparel reductions are categorized into four groups: A, B3, B5, B7 with the basic tariff rate of the negotiated year 2012. Accordingly, 43% of apparel tariff lines are under Schedule A, where tariff rates shall be eliminated immediately on the date the EVFTA officially applies (see Figure 2).
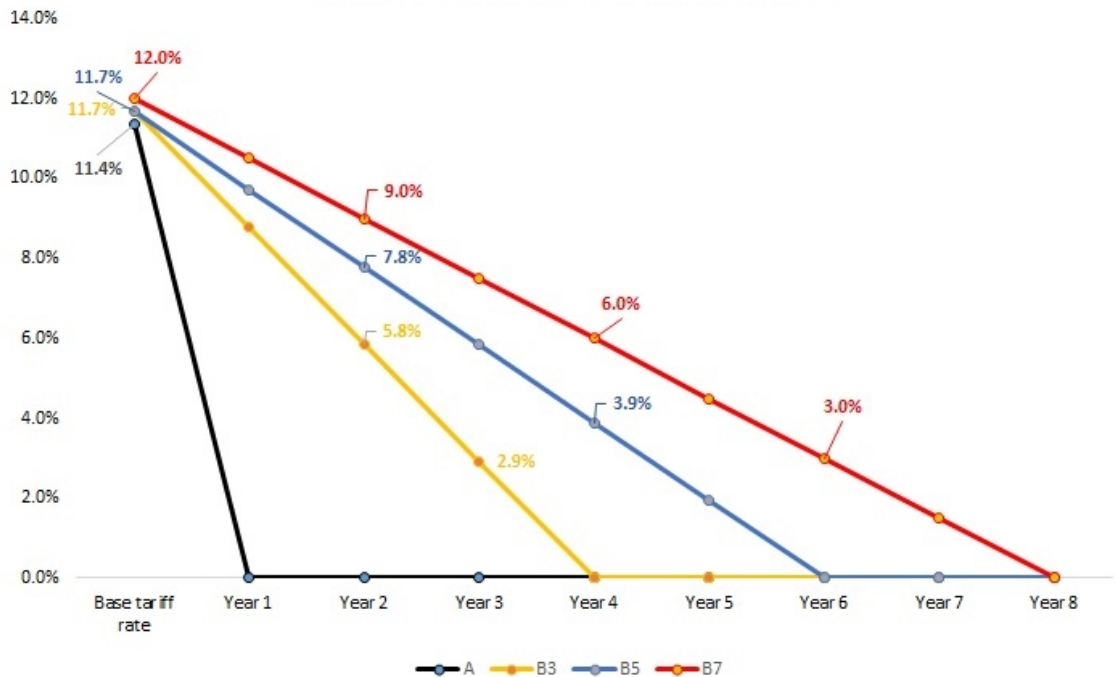
Figure 2. Tariff Phase-out Details for Vietnam's apparel to EU market by EVFTA

Category	Tariff Phaseout Details
A	be free of any customs duty on the date the Agreement comes into force (EIF), expected in 2018
B3	removed in four equal annual stages since effective date, expected in 2022
B5	removed in six equal annual stages since effective date, expected in 2024
B7	removed in eight equal annual stages since effective date, expected in 2026

Source: Vietnamese WTO Center. (2017). EU-Vietnam Free Trade Agreement: Agreed text as of January 2016

Additionally, given rules of origin, Vietnam may benefit from EU textile producers with fabrics originating in the EU and some types of extended accumulation with South Korean fabrics after complying with certain administrative requirements. In the future, Vietnamese exporters may be able to move from certificates of origin issued by government to self-certification to the EU whenever Vietnamese exporters are ready to do so.

3. Analytical framework

3.1. Model framework

WITS-SMART model

Many studies have used different analysis models to estimate the impacts of FTAs on trade. As for equilibrium models, a partial-equilibrium (PE) or general-equilibrium (GE) model can be chosen with its own advantages and disadvantages. Partial equilibrium models are well-suited for analysis focusing on a specific sector, while general equilibrium models are more suitable for estimating the second focus (Mikic, 2005). Some partial equilibrium models have been developed to simulate international trade policy changes, including SMART, GSIM, ATPSM, SWOPSIM, etc.

WITS-SMART model is the partial equilibrium approach developed by the World Bank and UNCTAD. It can calculate trade creation, trade diversion, welfare effects of a tariff change for a single product to enable better implications for governments and enterprises (Amjadi et al., 2011). Many scientists have spent a great deal of efforts to investigate theoretical models that would map into the WITS-SMART Simulation, including Veeramani and Saini (2010), Othieno and Shinyekwa (2011), Vu (2016), Nguyen (2015), Cassing et al.(2010), Baker et al. (2014).

Veeramani and Saini (2010) used PE modeling approach (SMART model and gravity model) to assess the impact of the Asian-India Free Trade Area (AIFTA) on agricultural commodities and suggested that this agreement would lead to an increasing trade creation in such imports by India and new imports may have adverse impact for the livelihood of the Indian farmers engaged in the production of these commodities. Othieno and Shinyekwa (2011) used the WITS-SMART simulation model to improve the effects of the East African Community Customs Union on Uganda to trade, welfare and revenue effects since 2005.

In Vietnam, Vu (2016) adopted the WITS-SMART model to foresee the impact of tariff liberalization under EVFTA on Vietnam's pharmaceutical imports. In the MUTRAP project, Cassing et al. (2010) applied this model to analyze the potential effects of FTAs on Vietnamese economy by evaluating some indicators such as trade creation, trade diversion, revenue effect, welfare effect, export and import effect. The study of "Assessing the long-term impacts of EU-Vietnam FTA" by Baker et al. (2014) applied both the SMART and CGE model to estimate how EVFTA would affects Vietnam's trade by 2025 and found out that textiles, apparels and agricultural products would get the most advantages from tariff elimination under the EVFTA.

We adopted the PE simulation model to identify the change of Vietnam's apparel exports and to identify the most affected products by EVFTA which comes into force in early 2018. This model is suitable for the purposes of this study.

First, PE model allows an analysis at a fairly disaggregated (or detailed) level, even at 6-digit HS level. As the negotiations of recent free trade agreements are conducted at a very

disaggregated level, the PE may be more appropriate and accurate than the framework of a general equilibrium models. Secondly, PE models require minimal data such as some parameters of elasticity and data for the tariff applied in new trade policy, which is timely and able to capture short- and medium-term effects. Thirdly, their results are relatively straightforward to interpret, since only a relatively limited number of equations are used to calculate changes in demand and supply (Amjadi et al., 2011).

One of PE approach is Single Market Partial Equilibrium Modelling Tool (SMART) developed by the World Bank. The model can calculate the effect of trade policy changes on tariff revenue, consumer surplus. It is also a simple means of measuring trade creation, trade diversion, welfare effects of a tariff change for a single product. One main drawback with the online version of the SMART model is that it does not allow different tariff changes per tariff line (i.e. individual products), therefore we need to set all tariffs to a new base level.

Model assumptions

The SMART model requires three parameters as inputs: (1) import demand elasticity; (2) import substitution elasticity and (3) export supply elasticity. These elasticities are based on three important assumptions: (1) the assumption of import demand proposed by Armington (1969), (2) the two-stage optimization process of consumers, and (3) the assumption of infinite export supply elasticity.

Firstly, the smart model relies on the assumption that similar products from different countries are imperfect substitutes (the assumption of Armington (1969)). This assumption rules out the possibility that the entire import demand for apparels by the tariff eliminating country (EU members) would be met by the beneficiary country (Vietnam). In other words, EU countries would continue to depend on no beneficiary countries for meeting the rest of their import demand.

Secondly, the next assumption of SMART model is that buying decision of consumers follows a two-stage optimization process. At the first phase, customers' demand for the commodity will be changed by import demand elasticity. The value of import demand elasticity is primarily based on the calculations of the World Bank research team. At the second phase, the level of spending for this commodity depends on the relative price of national variety. The extent of the between-variety allocative response to a change in the relative price is determined by the import substitution elasticity (Amjadi et al., 2011). The default value of substitution elasticity imposed by SMART for all goods is set at 1.5, but for apparels, this average number seems to be less than reality (Baker et al., 2014). Calculating the accurate substitution elasticity value of a specific sector is very complicated and need micro data. Base parameters estimated on the studies of Stone (1979), Cline (1987), Suphachalasai (1989) and Yang (2007) calculated substitution elasticity of clothing and textile in many areas, including: US, Europe, China, Japan,…and with the textile substitution elasticity in EU market supposed to be equal to 4. Therefore, this research has adopted this value as the input of substitution elasticity to estimate the trade creation and diversion effects.

Finally, the degree of responsiveness of the foreign exporter's supply to change in the export price is evaluated by the export supply elasticity. The SMART model in this study assumes infinite export supply elasticity (i.e. 99). This assumption allows the calculation of the effect of a tariff elimination while the price effect is remained at zero which means that all nations are faced with fixed world prices which implies small country case like the case of Vietnam (Lang, 2006; Veeramani & Saini 2010; Othieno & Shinyekwa, 2011; Amjadi et al. 2011).

Model specification

Depending on different objectives, scientists approach the partial equilibrium model in supplier or consumer side. Specifically, the trade creation and diversion effect is evaluated for both exporter and importer; while other indicators including revenue, welfare, import and export effects, are only calculated for importer. Therefore, in this study, we apply this model to Vietnam as an exporter of apparel products to EU, and estimate the impact of trade creation, diversion and total export to EU.

Trade creation

Trade creation in this model is estimated as the direct increase in imports due to a tariff reduction. The study adopted the below equation for trade creation which was derived by Laird and Yeats (1986):

$$TC_{ijk} = M_{ijk}.E_x.\frac{dt_{ijk}}{(1 + t_{ijk})(1 + \frac{E_m}{E_x})}$$

Trade diversion

Laird and Yates (1986) also calculated the trade diversion by using the elasticity of substitution. The diversion is the increase in imports from the FTAs partners' sources that replaces imports from efficiently producing sources in other countries.

$$TD_{ijk} = \frac{M_{ijk}}{\sum M_{ijk}} . \frac{\sum M_{ijk} . \sum M_{ijK} . E_s . \frac{d(\frac{P_{ijk}}{P_{ijK}})}{\frac{P_{ijk}}{P_{ijK}}}}{\sum M_{ijk} + \sum M_{ijK} + \sum M_{ijk}.E_s.\frac{d(\frac{P_{ijk}}{P_{ijK}})}{\frac{P_{ijk}}{P_{ijK}}}}$$

where,

TC: Trade creation

i: Subscript denoting commodity; in this case, it is apparels

j: Subscript denoting importing country; in this case, it is EU

k: Subscript denoting importing country; in this case, it is Vietnam

M: Imports

Ex: Elasticity of export supply

Em: Elasticity of import demand

t: Tariff rate distortion

d: Prefix denoting change

Es: Elasticity of substitution

P: Price

K: Subscript denoting alternative foreign country.

3.2. Input Data

In this paper, all data of export and import values of T&A were extracted from UN COMTRADE and Trade Map[1] database and some trade flow and existing tariff level data contained in the interface already.

The impact of changes in tariffs compared to base year tariff in 2015 were simulated for the apparel products of Chapter 61 and 62 at HS 4, 6-digit level. The simulation eliminates duties on the HS classifications for apparel products, including 218 HS code at 6-digit level.

3.3. Sensitive Analysis and Robustness test

After estimating the effect of FTAs on trade by SMART model, sensitivity analysis and robustness test should be carried out to ensure that the simulation results are accurate and can be used to guide the policy making.

To conduct sensitivity analysis, according to the previous literature by Ratisai (2014) and Zgovu and Kweka (2008), the simulation is repeated under different scenario with applying differing substitution elasticities. This analysis is required before assessing the robustness of the results in the base case.

In the following sensitivity analysis, the elasticities are halved and then doubled to show how uncertain we are about modelling results (Huff et al., 1997).

Table 3.

Elasticities used in sensitivity analysis

Elasticity	Lower bound	Base case	Upper bound	Best case
Substitution Elasticity	2	4	6	8
Export supply elasticity	99	99	99	99

As shown in the Table 3, the base case has the substitution elasticity of 4. The other scenarios used in the robustness test are lower bound, upper bound and best case, (be equal to 2, 6 and 8 respectively). The export supply elasticities remained at 99 (as explained in the model assumption).

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[1] UN Comtrade (https://comtrade.un.org/), Trade Map (https://www.trademap.org/)

4. Results And Discussion

4.1. *Trade creation and trade diversion*

Trade creation, according to the results from the WITS-SMART model, shown in table 4 illustrates that the positive trade creation effect and total export change are consistent with economic theory.

Table 4.

Trade creation and trade diversion effects of Vietnam's apparel exports in EVFTA

Indicators	Effects (US$ Million)
Initial Exports Value in 2015	2,969.70
Exports Value in 2026	4,219.60
Total Export Change	1,249.90
Trade Creation	268.6
Trade Diversion	981.3
Increase in exports (%)	42%
Trade creation/Total Export change (%)	21.50%

In general, with the subsequent reduction in the tariff line to 0% in 2026, Vietnam's apparel exports to EU will increase significantly by 42% compared to the base year, reaching US$4.22 billion in the next 8 years. However, this skyrocketing increase is primarily attributed to the effect of trade diversion, whose value is nearly fourfold that of trade creation (US$981.3 and 268.6 million respectively).

It is evident from Table 5 that the total trade effect has been rising over time with varied impacts across the product line of Vietnamese apparels. Table 5 presents a summary of the aggregate results obtained in the PE analysis at the level in 2-digit and 4-digit HS code.

In the Table 5, column (1) shows HS code of apparels; column (2) focuses on the value of exports to the EU in the base year; columns (3) and (4) shows the effects of trade creation and trade diversion; column (5) indicates the total trade effect and the impact in the EU market as percentage of exports is shown in column (6). The two final columns (7) and (8) show the duty rate before and after the implementation of the EVFTA.

Table 5.

Trade creation and trade diversion effects of Vietnam's apparel exports in EVFTA at level 4-digit of HS. (US$ Million)

HS code	Export before (2015)	Trade creation	Trade diversion	Total trade effect	% change	Old Simple Duty Rate (%) (2015)	New Simple Duty Rate (%) (2026)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
61	793.93	80.73	270.15	350.88	44.20%	9.34	0
6101	16.59	1.27	5.67	6.94	41.83%	9.6	0
6102	44.8	3.03	15.09	18.12	40.45%	9.6	0
6103	24.28	7.38	8.4	15.78	64.99%	9.6	0
6104	137.41	14.11	47.33	61.44	44.71%	9.6	0
6105	76.08	5.25	25.8	31.06	40.83%	9.6	0
6106	24.78	7.4	8.69	16.09	64.93%	9.6	0
6107	25.93	3.15	9.03	12.18	46.97%	9.6	0
6108	41	2.23	14.2	16.43	40.07%	9.6	0
6109	130.21	9.95	45.85	55.8	42.85%	9.6	0
6110	160.19	13.21	56.48	69.7	43.51%	9.2	0
6111	10.08	0.92	3.14	4.06	40.28%	8.35	0
6112	53.12	7.41	16.13	23.54	44.31%	9.6	0
6113	8.43	0.96	2.42	3.38	40.09%	8	0
6114	9.12	0.57	3.21	3.78	41.45%	9.6	0
6115	4.83	0.82	1.71	2.53	52.38%	8	0
6116	25.41	1.83	6.44	8.27	32.55%	6.75	0
6117	1.66	1.22	0.55	1.77	106.63%	9.6	0
62	2,175.76	187.86	711.13	898.99	41.32%	9.04	0
6201	322.3	25.97	105.43	131.4	40.77%	9.6	0
6202	345.03	32.52	118.26	150.78	43.70%	9.6	0
6203	404.54	35.38	132.79	168.17	41.57%	9.6	0
6204	423.64	34.46	140.2	174.66	41.23%	9.6	0
6205	200.52	20.09	67.09	87.18	43.48%	9.6	0
6206	104.86	9.26	35.95	45.22	43.12%	9.6	0

HS code	Export before (2015)	Trade creation	Trade diversion	Total trade effect	% change	Old Simple Duty Rate (%) (2015)	New Simple Duty Rate (%) (2026)
6207	7	0.62	2.33	2.95	42.14%	9.6	0
6208	2.79	0.41	0.98	1.39	49.82%	9.6	0
6209	20.05	1.27	6.04	7.31	36.46%	8.4	0
6210	177.04	19.11	58.64	77.75	43.92%	9.6	0
6211	71.23	3.88	24.21	28.09	39.44%	9.6	0
6212	59.81	2.77	11.59	14.36	24.01%	5.2	0
6213	0.44	0.02	0.13	0.15	34.09%	8	0
6214	0.91	0.09	0.22	0.31	34.07%	6.4	0
6215	7.14	0.33	1.31	1.65	23.11%	5	0
6216	26.8	1.62	5.59	7.21	26.90%	6	0
6217	1.67	0.06	0.36	0.42	25.15%	5	0
Total	5,939.40	537.18	1,962.56	2,499.74	42.09%		

Specifically, standing at 793.93 in 2015, Vietnamese HS 61 products exporting to the EU are expected to rise by US$350.88 million in the 8-year period. Whereas, HS 62 exports will increase by US$898.99 million, at the tax rate of 0% in 2026. Nearly 50% of increases in Vietnam's apparel exporting to the EU would fall into the groups of HS 6104, 6109, 6110 and 6201, 6202, 6203, 6204.

Thus, it is clear that EVFTA will lead to trade diversion effect which dominates over trade creation effect when Vietnam's apparels are exported to the EU. The increase in Vietnam's exports to the EU due to the reduction of the Vietnam's apparels relative price is called trade diversion, which lead to lowers welfare of the EU because the low-cost production from the rest of the word is replaced by less efficient FTA member (Vietnam). The explanation for this could be that though Vietnam textile and apparel industry has witnessed significant development during the recent years, apparel manufacturing still belongs to imported materials. About 70 percent of Vietnam's textile and apparel production is via "processing trade" using imported materials and other inputs, predominantly from China. The results are inactive production and limited response ability. Moreover, the sector remains among the most labor- intensive industries while wages in Vietnam increase over the years.

While Vietnam will take a lot of gains when exporting to the EU, it is of interest to identify the non-EVFTA countries whose trade is being diverted to the EU as a result of the preferential tariff liberalization for Vietnamese apparels. Table 6 provides a list of top 10 non-EVFTA countries that account for the largest extent of trade diversion.

Table 6.

List of top 10 non-EVFTA countries whose trade is being diverted to EU

No	Nations	Value (Million US$)
1	China	–1015.69
2	Bangladesh	–212.03
3	Turkey	–171.83
4	India	–90.55
5	Morocco	–67.95
6	Cambodia	–52.09
7	Tunisia	–48.73
8	Indonesia	–43.50
9	Pakistan	–34.36
10	Sri Lanka	–31.74

As expected, the list in Table 6 indicates the majority of nations affected by EVFTA are least developed or developing countries. The most affected countries are China, Bangladesh, Turkey and India. These also are the top apparels suppliers in the world.

4.2. Sensitive Analysis and Robustness test

As stated in Chapter 3, three different scenarios are repeated under the SMART model to check the robustness of the base case results.

The substitution elasticity value to 2 (the lower bound) reveals no change in trade creation effect from the base case. Moreover, the increase of the elasticities to 6 (upper bound) and 8 (best case) shows no changes in trade creation. As for the total export after EVFTA, the values are forecast to vary from US$3,728.30 million (best case) to US$5,207.40 million.

Table 7.

Sensitive Analysis and Robustness test using varying trade elasticities

Impact	Lower bound	Base case	Upper bound	Best case
Trade creation	268.6	268.6	268.6	268.6
Export after	3,728.30	4,219.60	4,712.50	5,207.40

Using the results of robustness and sensitivity test in Table 7, the percentage changes of these scenarios are calculated as follows:

$$\% \ change = \frac{Base \ case - Scenarios \ value}{Base \ case} \ x \ 100\%$$

Table 8.

Percentage changes from of scenario simulations from the base case

Impact	Lower bound	Upper bound	Best case
Trade creation	0	0	0
Export after	11.6	11.6	23.2

As can be noted, on the lower bound and upper bounds, the changes of trade creation fall within the 5% level of significance which means that the results from the base case are appropriate and can be used to propose the implications.

In relative terms, this future export change is profound; though not significant in absolute terms. The 11.6% change between the base case and lower case is considered minimal and the best case was considered robust.

5. Conclusion and Implications

Vietnam is considered as one of the dominant exporters of textile and apparel to major economies in the world, including the EU. As EVFTA comes into force in 2018 and by 2026, tariff rate of Vietnam's apparel to EU will be eliminated.

The study set out to find the potential effect of EVFTA using WITS-SMART model. Consequently, Vietnam's apparel exports to EU will increase significantly by 42% compared to the base year, reaching US$4.220 billion in 2026. Specifically, nearly 50% of the increase would fall into the groups of HS 6104, 6109, 6110 and 6201, 6202, 6203, 6204. Despite the remarkable change in apparel export of Vietnam to EU, there is a very small attribution of trade creation in comparison to the size of trade diversion, with US$268.6 million for the former and US$981.3 million for the latter. Though Vietnam's apparels will get more gains than non-EVFTA members, it is not because of an effective allocation of resources. It is due to vast majority of increases in the EU imports from Vietnam attributable to duty elimination.

Therefore, some measures should be implemented to improve the competitiveness of Vietnam's apparels, to reduce the production price in order to bring advantages for both parties (Vietnam and EU), such as investing more in fiber, yarn and textile manufacturing, particularly for spinning and weaving, so the quality and quantity of apparel production is likely to increase. Moreover, Vietnamese government should develop supportive government policies, began to implement major infrastructure projects and introduced incentives for foreign producers to attract foreign direct investment.

Although Vietnam's apparel and textile industry is currently the world's third largest

exporter, the country does not yet have international apparel brands that produce high value-added. Therefore, textile and apparel enterprises should have a strategy to build strong brands as well as develop brand values to increase competitiveness in the global market.

Besides that, regarding rules of origin, to benefit from EVFTA, after complying with certain administrative requirements, Vietnam's apparels must meet the demand for "fabrics originating". In the present, Vietnamese producers depend largely on fabric imported from China; however, with the EVFTA agreement coming into force, this trade could to shift to other producers such as South Korean fabrics.

Limitation

Regarding the research method used, SMART as a partial equilibrium model is static since it uses current data to make predictions without considering how other factors may change over time. Moreover, the results of PE models can be very sensitive to the values used for the elasticities, for which the empirical literature is still limited■

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Appendix A

Description of Apparel's HS code

HS code	Description
61	Articles of apparel and clothing accessories, knitted or crocheted
6101	Men's or boys' overcoats, car coats, capes, cloaks, anoraks (including ski jackets), windcheaters, wind jackets and similar articles, knitted or crocheted, other than those of heading 6103
6101 20	- Of cotton
6101 30	- Of man-made fibers
6101 90	- Of other textile materials
6102	Women's or girls' overcoats, car coats, capes, cloaks, anoraks (including ski jackets), windcheaters, wind-jackets and similar articles, knitted or crocheted, other than those of heading 6104
6102 10	- Of wool or fine animal hair
6102 20	- Of cotton
6102 30	- Of man-made fibers
6102 90	- Of other textile materials
6103	Men's or boys' suits, ensembles, jackets, blazers, trousers, bib and brace overalls, breeches and shorts (other than swimwear), knitted or crocheted
6103 10	- Suits
	- Ensembles
6103 22	-- Of cotton
6103 23	-- Of synthetic fibers
6103 29	-- Of other textile materials
	- Jackets and blazers
6103 31	-- Of wool or fine animal hair
6103 32	-- Of cotton
6103 33	-- Of synthetic fibers
	-- Of other textile materials
6103 39	- Trousers, bib and brace overalls, breeches and shorts

HS code	Description
6103 41	-- Of wool or fine animal hair
6103 42	-- Of cotton
6103 43	-- Of synthetic fibers
6103 49	-- Of other textile materials
6104	Women's or girls' suits, ensembles, jackets, blazers, dresses, skirts, divided skirts, trousers, bib and brace overalls, breeches and shorts (other than swimwear), knitted or crocheted
	- Suits
6104 13	-- Of synthetic fibers
6104 19	-- Of other textile materials
	- Ensembles
6104 22	-- Of cotton
6104 23	-- Of synthetic fibers
6104 29	-- Of other textile materials
	- Jackets and blazers
6104 31	-- Of wool or fine animal hair
6104 32	-- Of cotton
6104 33	-- Of synthetic fibers
6104 39	-- Of other textile materials
	- Dresses
6104 41	-- Of wool or fine animal hair
6104 42	-- Of cotton
6104 43	-- Of synthetic fibers
6104 44	-- Of artificial fibers
6104 49	-- Of other textile materials
	- Skirts and divided skirts
6104 51	-- Of wool or fine animal hair
6104 52	-- Of cotton
6104 53	-- Of synthetic fibers
6104 59	-- Of other textile materials
	- Trousers, bib and brace overalls, breeches and shorts

6104 61	-- Of wool or fine animal hair			- Briefs and panties
6104 62	-- Of cotton	6108 21	-- Of cotton
6104 63	-- Of synthetic fibers	6108 22	-- Of man-made fibres
6104 69	-- Of other textile materials	6108 29	-- Of other textile materials
6105	Men's or boys' shirts, knitted or crocheted			- Nightdresses and pyjamas
6105 10	- Of cotton	6108 31	-- Of cotton
6105 20	- Of man-made fibers	6108 32	-- Of man-made fibres
6105 90	- Of other textile materials	6108 39	-- Of other textile materials
6106	Women's or girls' blouses, shirts and shirt-blouses, knitted or crocheted			- Other
6106 10	- Of cotton	6108 91	-- Of cotton
6106 20	- Of man-made fibers	6108 92	-- Of man-made fibres
6106 90	- Of other textile materials	6108 99	-- Of other textile materials
6107	Men's or boys' underpants, briefs, nightshirts, pyjamas, bathrobes, dressing gowns and similar articles, knitted or crocheted	6109	T-shirts, singlets and other vests, knitted or crocheted
		6109 10	- Of cotton
	- Underpants and briefs	6109 90	- Of other textile materials
6107 11	-- Of cotton	6110	Jerseys, pullovers, cardigans, waistcoats and similar articles, knitted or crocheted
6107 12	-- Of man-made fibres		
6107 19	-- Of other textile materials		- Of wool or fine animal hair
	- Nightshirts and pyjamas	6110 11	-- Of wool
6107 21	-- Of cotton	6110 12	-- Of Kashmir (cashmere) goats
6107 22	-- Of man-made fibres	6110 19	-- Other
6107 29	-- Of other textile materials	6110 20	- Of cotton
	- Other	6110 30	- Of man-made fibres
6107 91	-- Of cotton	6110 90	- Of other textile materials
6107 99	-- Of other textile materials	6111	Babies' garments and clothing accessories, knitted or crocheted
6108	Women's or girls' slips, petticoats, briefs, panties, nightdresses, pyjamas, négligés, bathrobes, dressing gowns and similar articles, knitted or crocheted	6111 20	- Of cotton
		6111 30	- Of synthetic fibers
		6111 90	- Of other textile materials
	- Slips and petticoats	6112	Tracksuits, ski suits and swimwear, knitted or crocheted
6108 11	-- Of man-made fibres		- Tracksuits
6108 19	-- Of other textile materials	6112 11	-- Of cotton

6112 12	-- Of synthetic fibers		6115 99	-- Of other textile materials
6112 19	-- Of other textile materials		6116	Gloves, mittens and mitts, knitted or crocheted
6112 20	- Ski suits			
	- Men's or boys' swimwear		6116 10	- Impregnated, coated or covered with plastics or rubber
6112 31	-- Of synthetic fibres			
6112 39	-- Of other textile materials			- Other
	- Women's or girls' swimwear		6116 91	-- Of wool or fine animal hair
6112 41	-- Of synthetic fibres		6116 92	-- Of cotton
6112 49	-- Of other textile materials		6116 93	-- Of synthetic fibers
			6116 99	-- Of other textile materials
6113 00	Garments, made up of knitted or crocheted fabric of heading 5903, 5906 or 5907		6117	Other made-up clothing accessories, knitted or crocheted; knitted or crocheted parts of garments or of clothing accessories
6114	Other garments, knitted or crocheted			
6114 20	- Of cotton		6117 10	- Shawls, scarves, mufflers, mantillas, veils and the like
6114 30	- Of man-made fibres			
6114 90	- Of other textile materials		6117 80	- Other accessories
			6117 90	- Parts
6115	Pantyhose, tights, stockings, socks and other hosiery, including graduated compression hosiery (for example, stockings for varicose veins) and footwear without applied soles, knitted or crocheted		62	ARTICLES OF APPAREL AND CLOTHING ACCESSORIES, NOT KNITTED OR CROCHETED
			6201	Men's or boys' overcoats, car coats, capes, cloaks, anoraks (including ski jackets), windcheaters, wind jackets and similar articles, other than those of heading 6203
6115 10	- Graduated compression hosiery (for example, stockings for varicose veins)			
	- Other pantyhose and tights			- Overcoats, raincoats, car coats, capes, cloaks and similar articles
6115 21	-- Of synthetic fibres, measuring per single yarn less than 67 decitex		6201 11	-- Of wool or fine animal hair
			6201 12	-- Of cotton
6115 22	-- Of synthetic fibres, measuring per single yarn 67 decitex or more		6201 13	-- Of man-made fibers
			6201 19	-- Of other textile materials
6115 29	-- Of other textile materials			- Other
6115 30	- Other women's full-length or knee-length hosiery, measuring per single yarn less than 67 decitex		6201 91	-- Of wool or fine animal hair
			6201 92	-- Of cotton
	- Other		6201 93	-- Of man-made fibres
6115 94	-- Of wool or fine animal hair		6201 99	-- Of other textile materials
6115 95	-- Of cotton			
6115 96	-- Of synthetic fibers			

6202	Women's or girls' overcoats, car coats, capes, cloaks, anoraks (including ski jackets), windcheaters, wind-jackets and similar articles, other than those of heading 6204		6203 42	-- Of cotton
			6203 43	-- Of synthetic fibers
			6203 49	--- Of artificial fibers
	- Overcoats, raincoats, car coats, capes, cloaks and similar articles		6204	Women's or girls' suits, ensembles, jackets, blazers, dresses, skirts, divided skirts, trousers, bib and brace overalls, breeches and shorts (other than swimwear)
6202 11	-- Of wool or fine animal hair			
6202 12	-- Of cotton			
6202 13	-- Of man-made fibres			
6202 19	-- Of other textile materials			- Suits
	- Other		6204 11	-- Of wool or fine animal hair
6202 91	-- Of wool or fine animal hair		6204 12	-- Of cotton
6202 92	-- Of cotton		6204 13	-- Of synthetic fibers
6202 93	-- Of man-made fibers		6204 19	-- Of other textile materials
6202 99	-- Of other textile materials			- Ensembles
6203	Men's or boys' suits, ensembles, jackets, blazers, trousers, bib and brace overalls, breeches and shorts (other than swimwear)		6204 21	-- Of wool or fine animal hair
			6204 22	-- Of cotton
			6204 23	-- Of synthetic fibers
			6204 29	-- Of other textile materials
			6204 31	-- Of wool or fine animal hair
	- Suits		6204 32	-- Of cotton
6203 11	-- Of wool or fine animal hair		6204 33	-- Of synthetic fibers
6203 12	-- Of synthetic fibers		6204 39	-- Of other textile materials
6203 19	-- Of other textile materials			- Dresses
	- Ensembles		6204 41	-- Of wool or fine animal hair
6203 22	-- Of cotton		6204 42	-- Of cotton
6203 23	-- Of synthetic fibers		6204 43	-- Of synthetic fibers
6203 29	-- Of other textile materials		6204 44	-- Of artificial fibers
	- Jackets and blazers		6204 49	-- Of other textile materials
6203 31	-- Of wool or fine animal hair			- Skirts and divided skirts
6203 32	-- Of cotton		6204 51	-- Of wool or fine animal hair
6203 33	-- Of synthetic fibers		6204 52	-- Of cotton
6203 39	-- Of other textile materials		6204 53	-- Of synthetic fibers
	- Trousers, bib and brace overalls, breeches and shorts		6204 59	-- Of other textile materials
6203 41	-- Of wool or fine animal hair			- Trousers, bib and brace overalls, breeches and shorts

6204 61	-- Of wool or fine animal hair		6208 19	-- Of other textile materials
6204 62	-- Of cotton			- Nightdresses and pyjamas
6204 63	-- Of synthetic fibers		6208 21	-- Of cotton
6204 69	-- Of other textile materials		6208 22	-- Of man-made fibers
6205	Men's or boys' shirts		6208 29	-- Of other textile materials
6205 20	- Of cotton			- Other
6205 30	- Of man-made fibers		6208 91	-- Of cotton
6205 90	- Of other textile materials		6208 92	-- Of man-made fibers
6206	Women's or girls' blouses, shirts and shirt-blouses		6208 99	-- Of other textile materials
6206 10	- Of silk or silk waste		6209	Babies' garments and clothing accessories
6206 20	- Of wool or fine animal hair		6209 20	- Of cotton
6206 30	- Of cotton		6209 30	- Of synthetic fibers
6206 40	- Of man-made fibers		6209 90	- Of other textile materials
6206 90	- Of other textile materials		6210	Garments, made up of fabrics of heading 5602, 5603, 5903, 5906 or 5907
6207	Men's or boys' singlets and other vests, underpants, briefs, nightshirts, pyjamas, bathrobes, dressing gowns and similar articles		6210 10	- Of fabrics of heading 5602 or 5603
			6210 20	-- Other garments, of the type described in subheadings 620111 to 620119
	- Underpants and briefs		6210 30	- Other garments, of the type described in subheadings 620211 to 620219
6207 11	-- Of cotton		6210 40	- Other men's or boys' garments
6207 19	-- Of other textile materials		6210 50	- Other women's or girls' garments
	- Nightshirts and pyjamas		6211	Tracksuits, ski suits and swimwear; other garments
6207 21	-- Of cotton			- Swimwear
6207 22	-- Of man-made fibers		6211 11	-- Men's or boys'
6207 29	-- Of other textile materials		6211 12	-- Women's or girls'
	- other		6211 20	- Ski suits
6207 91	-- Of cotton			- Other garments, men's or boys'
6207 99	-- Of other textile materials		6211 32	-- Of cotton
6208	Women's or girls' singlets and other vests, slips, petticoats, briefs, panties, nightdresses, pyjamas, negligee, bathrobes, dressing gowns and similar articles		6211 33	-- Of man-made fibers
			6211 39	-- Of other textile materials
	- Slips and petticoats			- Other garments, women's or girls'
6208 11	-- Of man-made fibers		6211 42	-- Of cotton

6211 43	-- Of man-made fibers		6214 20	- Of wool or fine animal hair
6211 49	-- Of other textile materials		6214 30	- Of synthetic fibers
6212	Brassieres, girdles, corsets, braces, suspenders, garters and similar articles and parts thereof, whether or not knitted or crocheted		6214 40	- Of artificial fibers
			6214 90	- Of other textile materials
			6215	Ties, bow ties and cravats
6212 10	- Brassieres		6215 10	- Of silk or silk waste
6212 20	- Girdles and panty girdles		6215 20	- Of man-made fibers
6212 30	- Corselettes		6215 90	- Of other textile materials
6212 90	- Other		6216 00	Gloves, mittens and mitts
6213	Handkerchiefs		6217	Other made-up clothing accessories; parts of garments or of clothing accessories, other than those of heading 6212
6213 20	- Of cotton			
6213 90	- Of other textile materials			
6214	Shawls, scarves, mufflers, mantillas, veils and the like		6217 10	- Accessories
			6217 90	- Parts
6214 10	- Of silk or silk waste			

Source: The World Customs Organization (WCO), 2012