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SPECIAL REPORT

The Future of Global Trade

The fallout from the chaos unleashed by Trump's tariffs is set to be significant, with governments, multinational organisations and companies all scrambling to respond. But some consequences may prove surprising.

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Trump's tariff thunderbolt strikes a world with proven resilience

Written by Alan Beattie

It is tempting to see Donald Trump and his wrecking policies on trade as a destructive thunderbolt from a clear blue sky. Certainly many of his domestic policies, even compared with his first term, have taken a sharper and more definitive turn towards the extreme.

In the case of trade and globalisation, however, there is perhaps a little more continuity, not just with his first time in office but with previous US administrations. Regardless of whether it was actually reflected in broad US public opinion, there were clear strands of thought in US politics which had already begun to treat trade deals and often trade itself as toxic.

Trump's tariffs are the most extraordinary act of far-reaching protectionism since at least the Great Depression, but there has been a latent inclination in US politics towards blaming trade for everything that has gone wrong with the US economy and society.

The effect of Trump on the global trading system and particularly multilateral institutions like the World Trade Organization is likely to be profound. The US was instrumental in setting up that system and was traditionally one of its most active users. Its departure from rule-setting, and even more the direct effect of its tariffs and other interventions on world trade, are the system's biggest test since the Depression.

There are, however, several causes for optimism that Trump's measures will not prove anything like as destructive as the high US tariffs of the early 1930s which set off a spiral of protectionism. Firstly, no other major economy, including the US's great commercial rival China, has the same huge political aversion to globalisation. Unlike the 1930s, other economic policy institutions, particularly central banks, have tools to cushion the impact of a trade shock and prevent it from deepening a global recession.

And the lesson of the 35 years since the post-cold war wave of globalisation took off is that actual trade — not just cross-border movement of goods, but also of services, foreign direct investment, capital, people and data — has proved resilient to a whole variety of shocks.

While Trump's disdain for the WTO and the system it represents are dramatic, it also remains the case that the US's attachment to it was always somewhat transactional.

When the WTO was created in 1995 out of the more informal General Agreement on Tariffs and Trade (Gatt), there was suspicion in Washington right from the beginning that it was creating a system of supranational law which would reduce the US's sovereignty.

In particular, although the US was an active user of the WTO's dispute resolution system and won many cases, there was resentment particularly on Capitol Hill over rulings that seemed to interfere with the US's right to tax and its ability to deal with unfair trade practices as it saw fit. Once the negotiating function of the WTO seized up in the 2000s — it has never completed a broad and deep multilateral agreement — the US became increasingly disillusioned.

It was Trump's first administration that froze the dispute resolution system by refusing to approve new judges. But his successor Joe Biden thereafter continued the same policy, his administration insisting that it would be willing to unfreeze the mechanism only if the rest of the WTO's membership would agree to changes that other countries said it never properly got around to articulating.

Today, the WTO still struggles to conclude large-scale binding agreements, even among a subset of membership — in part due to India's obstructionism, driven by its own institutional grievances and political calculus. Still, a coalition including the EU, China and Japan has created a workaround dispute mechanism to keep things moving.

The same kind of pragmatism might well save global trade itself as well as its formal mechanisms of governance. Doomsters have been talking for a long time about the global trading system splitting into geopolitical blocs, perhaps two centred on the US and China or three if there is also a grouping led by the EU. There has certainly been some movement in that direction, according to studies by the WTO and the IMF. The first Trump administration put hefty tariffs on China, which certainly diminished bilateral trade between the two. But the IMF has also talked about the emergence of "connector countries", especially emerging markets such as Vietnam and Mexico, which managed to trade with both the US and China.

The Biden administration made more subtle and targeted attempts to pull other economies, particularly its foreign policy allies, out of China's economic and technological orbit, especially in areas like electric vehicles.

But even its supposed close allies such as the EU preferred to operate in both the US and Chinese orbits. The Trump administration's attempts to force countries to cut China off as the price of reducing threatened tariffs is similarly unlikely to work.

The threat from Trump to world trade is undoubtedly the greatest since the second world war. But assuming that the US's tariff pathology is also infecting the rest of the world looks like a mistake.

> **"Trump's tariffs are the most extraordinary act of far-reaching protectionism since at least the Great Depression, but there has been a latent inclination in US politics towards blaming trade for everything that has gone wrong with the US economy and society.**

Emerging markets set to become battlegrounds in trade war

Written by Joseph Cotterill

On a recent trip to Pakistan, emerging markets investor James Johnstone travelled around in a Chinese-made BYD car to visit production facilities built by China's Xiaomi to make cheap mobile phones.

The reach of some of China's biggest brand names into the south Asian economy is symbolic of a shift in global trade that has been obscured by US-China tariff tensions.

It has been characterised not only by Beijing's relocation of exports, but also by China shifting investments in low-cost manufacturing to developing nations, as it gears up for a wider trade war with the US.

It is also evidence of Beijing's potential arsenal to fight back against Donald Trump's imposition of tariffs that, at well over 100 per cent, could leave many Chinese goods out of the reach of US consumers who fuelled China's export machine for decades.

"China is really interested in selling to the 7.5bn people who don't live in the US", says Johnstone, co-head of emerging and frontier markets at Redwheel, the investment manager. "And China is putting in the manufacturing capacity to sell to that global consumption base."

With a trade surplus of more than $1tn over the past year to sustain, Beijing will soon be under pressure to replace now heavily restricted access to the US, home of world's largest trade deficit, with new sources of demand.

China's exports to big developing economies have already more than doubled since Trump was first elected president, from below $670bn in 2017 to $1.35tn in the year to February, representing more than a third of total exports, according to Jefferies analysts.

The share of China's exports to G7 economies meanwhile fell below a third in the same period. "This is why China is less threatened by the Trump administration's tariff agenda than many other countries," Jefferies added.

This might also explain why Beijing has been so confident in retaliating against US tariffs. "China can do this because they think their economy is sufficiently diversified from manufacturing exports to the US," Johnstone says.

Some of the trade diversion away from the US to other markets reflected Chinese investment in economies that were expanding trade with the US, such as Vietnam or Malaysia. This in turn has brought US accusations of Chinese goods being rerouted, sometimes via other countries' assembly lines.

Yet these countries' trade surpluses now stand to increase. "Targeting just China implies the US trade deficit with key partners will likely rise further," says Gabriel Sterne, head of global emerging markets at Oxford Economics.

"In part, that's because China now has huge incentives to circumvent tariffs by further integrating countries such as Vietnam into supply chains. And Trump would then respond," Sterne adds.

A full-scale trade war fought by the US and China across international supply chains can still punish developing economies whose growth has tracked global trade volumes for decades.

"Over the last 25 years, there have rarely been occasions when the two have not been inextricably tied," says Jahangir Aziz, emerging markets economist at JPMorgan.

"China and [emerging markets outside China] stand directly in the firing line: not just through near-term cyclical damage, but also damage to their growth models that are still fundamentally based on trade," he adds.

"There are signs China wants to make the most of this moment," says David Lubin, senior research fellow in global economy and finance at Chatham House, adding that there is evidence of growing trade with emerging markets.

In recent years, countries such as Pakistan and South Africa loaded up on imports of cut-price Chinese solar panels to help overcome rolling power blackouts and energy shortages.

Chinese-made panels and batteries are also enabling the rollout of solar energy in Saudi Arabia with some of the lowest costs in the world as the kingdom tries to diversify beyond oil.

But it has been a different story for emerging-market makers of steel, chemicals, textiles and low-cost electronics. These are classic examples of export industries that traditionally helped countries climb the ladder of economic development.

They have been hit by waves of cheap Chinese supply as Beijing has continued to support manufacturers in these areas, even as it is pursuing production of goods further up that ladder, such as electric cars.

"Developing countries have different attitudes about the penetration of Chinese goods into their markets," Lubin says. "In one sense, they are happy to have access to cheap goods. But at the same time, there is also evidence to suggest that they are getting a bit frustrated with China's market share in their domestic markets."

South Africa imposed anti-dumping duties on Chinese steel last year as it battled to save its largest mill. Brazil, Turkey, and most recently India have taken similar measures. Countries such as Mexico, Indonesia, Thailand and Malaysia have also put up barriers on low-value imports such as garments, responding to the entry of Chinese ecommerce giants into their markets.

"Trade imbalances are not just a US-China irritant any more…emerging countries including India, Brazil, South Africa, and Turkey are launching trade defence cases to stave off what they see as injurious imports," Rhodium Group, the research firm, said in March.

Beijing recently removed tariffs on imports from dozens of Africa's poorest countries, after complaints on the continent about widening trade deficits with China.

But many of these nations will lack manufacturing capacity to take advantage. Larger developing economies will meanwhile be bracing for another influx of Chinese goods, diverted from US markets due to the steep increase in tariffs.

"It's a slightly paradoxical situation, where everything Trump does seems to be a gift to China for delivering the global south into its lap," Lubin says. "But China's trade strategy is also a source of this conflict."

"Trade imbalances are not just a US-China irritant any more…emerging countries including India, Brazil, South Africa, and Turkey are launching trade defence cases to stave off what they see as injurious imports.

An ever riskier world economy

Written by Martin Wolf

We are living in the early stages of a revolution — the attempted conversion of the American republic into an arbitrary dictatorship. Whether Donald Trump will succeed in this attempt is, as yet, unclear. But what he wants to do seems self-evident. His way of governing — lawless, unpredictable, anti-intellectual, nationalist — will have the greatest impact on the US itself. But it is, inevitably, having a huge impact on the rest of the world, too, given the hegemonic role of the US since the second world war. No other country or group of countries can — or wants — to take its place. This revolution threatens chaos.

It is far too early to know what the full consequences will be. But it is not too early to make informed guesses on some aspects, notably the unpredictability and consequent loss of confidence being created by Trump's tariff war. This loss of confidence was the theme of a podcast I did recently with Paul Krugman. Without predictable policies, a market economy cannot function well. If the uncertainty comes from the hegemon, the world economy as a whole will not function well either.

In its latest Global Economic Prospects, the World Bank has analysed just this. Its conclusions are inevitably provisional, but the direction of travel must be correct. It starts from the assumption that the tariffs in place in late May will remain over its forecast horizon. This might be too optimistic or too pessimistic. Nobody, perhaps not even Trump, knows. "In this context", it judges, "global growth is projected to slow markedly to 2.3 per cent in 2025 [0.4 percentage points below the January 2025 forecast]— the slowest pace since 2008, aside from two years of outright global recession in 2009 and 2020. Over 2026-27, a pick-up in domestic demand is expected to lift global growth to a still subdued 2.5 per cent — far below the pre-pandemic decadal average of 3.1 per cent."

All this is bad enough. But risks seem overwhelmingly to the downside. Thus, the uncertainty created by Trump's trade war could lead to far greater declines in trade and investment than projected. Certainly, it will be hard to trust in any supposed "deals" now announced. Again, lower growth will increase social, political and fiscal fragility, so raising perceptions of risk in markets. This might create a doom-loop, with higher costs of finance increasing risk and lowering growth. Weak borrowers, private and public, might be driven into default. Shocks from natural disasters or conflict would then be even more economically damaging.

Upsides can be imagined. New trade deals might be reached, in which many might, courageously, trust. AI-fairy-dust might cause a surge in global productivity and investment. Also, everything might just calm down. A difficulty for this is that today's Trump shock comes after almost two decades of shocks: global and Eurozone financial crises; pandemic; post-pandemic inflation; and Ukraine-Russia war. Animal spirits must have been impaired.

Alas, as Indermit Gill, World Bank chief economist, stresses in his foreword, "the poorest countries will suffer the most". "By 2027, the per capita GDP of high-income economies will be roughly where it had been expected to be before the Covid-19 pandemic. But developing economies would be worse off, with per capita GDP levels 6 per cent lower." With the exception of China, it might take two decades for these countries to recoup their losses of the 2020s.

This is not just a result of recent shocks. Thus, "Growth in developing economies has been ratcheting downward for three decades in a row — from an average of 5.9 per cent in the 2000s, to 5.1 per cent in the 2010s to 3.7 per cent in the 2020s." This tracks the declining growth of world trade, from an average of 5.1 per cent in the 2000s to 4.6 per cent in the 2010s to 2.6 per cent in the 2020s. Meanwhile, debt is piling up. In the long run, it will not help that Trump insists climate change is a myth, too.

So, what is to be done? First, liberalise trade. While developing countries have liberalised substantially in recent years, most of them still have far higher tariffs than high-income economies. Targeted infant-industry promotion can work. But if a country has little international leverage, the best policy remains one of free trade, coupled with the best possible policies for attracting investment, improving human capital and preserving economic stability. In a bad environment, as now, this is even more important than in a benign one.

The choices for bigger powers — China, the EU, Japan, India, the UK and others — are more complex. First, they, too, need to improve their own policies to the greatest possible extent. They also need to co-operate in trying to sustain global rules among themselves, not least on trade. Some powers need to recognise that global imbalances are indeed a significant issue, though they are not about trade policy but rather global macroeconomic imbalances.

This is far from all. As the US retreats from its historic role, others are having greatness thrust upon them. Continued progress on addressing the challenges of climate change and economic development depends on these powers. A better way to resolve excessive debts is necessary, for example. That requires going against today's trend towards ever greater suspicion of one another.

It is possible — even likely — that we are witnessing the withering away of a great effort to promote a more prosperous and co-operative world. Some people will say that such an ending would just signal healthy "realism". But it would be a folly: we share one planet; and so our destinies are intertwined. Modern technology has made this inescapable. We are at a turning point: we must choose wisely.

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EU faces trade war on many fronts

Written by Andy Bounds

The EU grew to become the world's biggest trading bloc in an era of globalisation that suited its rules-based policymaking.

Now it faces a world in which trade is a tool of naked power, with the US prepared to force favourable terms with arbitrary tariffs, export controls and threats — the world of "Don Corleone Trump" as John Clarke, former head of the EU's delegation to the WTO, calls him.

A quick way to eliminate tariffs, Trump said in April, would be for the EU to buy $350bn of liquefied natural gas and close the trade deficit with the US. The fact the EU cannot absorb that much was overlooked. In 2024, US LNG exports to the EU were around $13bn and met half its demand, according to Columbia University.

Trump has hit the EU with a volley of tariffs since his inauguration in January. So-called reciprocal tariffs of 20 per cent have been halved until July to give time for talks. But levies of 25 per cent on steel, aluminium and cars remain in effect as Trump rails against the EU for not buying enough American goods.

European Commission president Ursula von der Leyen, whose body runs trade policy, has to corral 27 nervous member states behind a joint position while running talks with the US and avoiding a fresh recession for an already struggling economy.

She has favoured a threefold strategy from the start. First, negotiate with Trump and retaliate when that does not work. Second, deepen trade ties with other countries to provide alternative markets for EU exporters. Third, cut barriers in the internal market.

Mario Draghi, the former Italian prime minister who authored a landmark report on EU competitiveness, cited IMF estimates that the barriers amount to tariffs of 45 per cent for manufacturing and 110 per cent for services.

None of this is easy. If it was, it would have happened already. But the shock of Trump can force politicians to do the once unthinkable.

In December, the EU finally clinched a deal with Mercosur, the trade bloc that includes Brazil and Argentina. For five years Brussels had been unable to ink a deal agreed in principle in 2019 because of domestic opposition.

> **"You have to negotiate with a gun on the table even if you don't use it" EU diplomat.**

Green campaigners wanted binding commitments to protect the rainforest, while farmers wanted to keep out cheap imports.

An updated agreement with Mexico soon followed.

Discussions with Australia, which ended in 2023 over beef exports, are likely to restart soon, EU officials told the FT.

The EU is also accelerating talks with India, Thailand, Malaysia, Indonesia and the Philippines. In April it agreed to negotiate with the UAE.

It is working on a veterinary deal with the UK that would improve trade flows. And von der Leyen has discussed closer co-operation with the 12-member Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) with the prime ministers of New Zealand and Singapore.

The EU already has the world's largest network of trade agreements, with 74 countries. Some 44 per cent of its trade was covered by these preferential arrangements, according to a 2023 European Commission report.

But it has recently struggled to conclude them, as environmentalists team up with farmers to keep out imports from the developing world.

Although the bloc sells more than €64bn more agrifood products than it buys, trade negotiators are limited in how much access for chicken, beef and sugar they can grant trade partners after huge protests by farmers over the past two years.

Paris, Vienna and The Hague have yet to back the Mercosur accord, saying they need greater protection for farmers, although it contains a mechanism to choke off imports if they disrupt the market.

Sabine Weyand, the EU's top trade official, admitted recently that some green rules had alienated trading partners. Brussels has already delayed a deforestation law that would have banned imports of palm oil and lumber from countries it was negotiating with such as Brazil and Indonesia.

"We thought that we could set the standards for the rest of the world," she said. "What we need is a more co-operative approach where we say we have to agree on the objectives. We have to leave room for different ways of getting there."

However, officials say this new approach does not have the full backing of the Commission and many member states. The bloc will need to move fast. According to ING bank, about 2 per cent of the EU's GDP depends on US demand. With tariffs of 20 per cent, volumes to the US would decline by about 15 per cent, cutting GDP by 0.3 per cent in the short run.

Ireland, Germany and Italy, which have big surpluses with the US, would be most affected.

"Lower exports, more competition from Asian imports and higher uncertainty will lead to lower investments and wage increases, which may lead to some job losses in Europe," the bank said in a note. "These negative effects will be felt in 2025 and 2026."

If the EU retaliated, that would reduce the size of the economy further. It might yet come to that. The Commission has said that it was unclear what the US wanted in order for it to reduce the tariffs, and EU officials have been told that at least some of them will remain. Some are already pushing for the EU to use its Anti-Coercion Instrument for the first time, which would allow measures against services, where the US has a surplus.

"Our only salvation lies in collective action. In the schoolyard, when there is a bully everybody has to stick together," says an EU diplomat. But, the diplomat adds, "you have to negotiate with a gun on the table even if you don't use it".

However, keeping unity can mean diluting the response. Italy, Ireland and France lobbied heavily to reduce the scope of the initial retaliation, fearing Trump would up the ante. Clarke, the former head of the EU delegation to the WTO, says Brussels should co ordinate its response with other partners.

"I think it was a mistake for the EU to suspend its very limited retaliatory measures," says Clarke. "Trump took this as a sign of weakness and division between EU member states and it will harden his approach as a result."

"The single market in the very end is the safe harbour for our companies," von der Leyen told the FT earlier this month. "So we're getting rid of internal barriers."

Vietnam risks being the trade war's biggest loser. Does it have a plan B?

Written by A. Anantha Lakshmi

The election of Donald Trump in 2016 was a watershed moment for Bao Phung.

His family's business A&M Flooring, a Vietnamese producer of premium wooden flooring, had initially struggled to compete against Chinese businesses when it was founded the year before.

But after Trump came to power and unleashed a trade war on China, Bao saw A&M's business flourish as American buyers rushed to source products from elsewhere.

Profits rose even as local competition increased. Bao says dozens of Chinese companies have moved to Vietnam to avoid US tariffs, estimating there are now 20 times more competitors than a decade ago.

As trade tensions between the US and China lingered during the Biden administration, business remained good. The US accounted for 95 per cent of the company's total sales — until April 2.

On Trump's so-called "liberation day", he announced Vietnam would face a 46 per cent tariff rate, one of the highest in the world. For A&M and its 120 employees, new orders from American clients slowed to a trickle. Like thousands of companies across Vietnam, it is now frantically trying to figure out its future.

"Some of us [in the industry] are trying as best as we can to diversify," says Bao, A&M's assistant director. The company is seeking new customers in Japan and Europe. "But other than that, right now, we are on our hands and knees to pray that the negotiation between the US and Vietnam goes well."

Vietnam was one of the biggest winners from Trump's first term as manufacturers moved production in droves to the country as part of their "China plus one" diversification strategy.

The country's recent economic success — with GDP growth at 7 per cent last year — has been driven primarily by exports to the US and surging investments from companies fleeing China. Foreign direct investment in Vietnam surged from $15.8bn in 2016 to $38.2bn in 2024, and it has become a critical link to global supply chains, hosting manufacturing heavyweights such as Apple, Intel, Samsung and Nike.

As a result, the south-east Asian country is one of the most trade-dependent countries in the world, with the US accounting for nearly a third of its total exports. Now, its "China plus one" success has backfired as the US president takes issue with trading partners who have large surpluses with the US. Vietnam has the third largest, after China and Mexico.

Vietnam's ruling Communist party is acting with urgency to address the tariff threat. Party chief To Lam was one of the first world leaders to call Trump after the "reciprocal tariff" announcements, promising to remove all Vietnamese tariffs on American goods. But Trump's actions have also served as a wake-up call — for local factories relying on the US, for American companies sourcing from Vietnam, and for the Communist party — about the vulnerability of the Vietnamese economy to external shocks.

Many now fear its export-led growth model will soon run its course, throwing a wrench in Vietnam's plans to become a developed country by 2045. In late April, the World Bank revised Vietnam's growth forecast for this year down from 6.8 per cent to 5.8 per cent.

"Vietnam suddenly woke up on April 3 and realised that if they continued to rely on one single export market in the US, they might be very vulnerable, be it under Trump or under another president," says Nguyen Khac Giang, a visiting fellow at Singapore's Iseas-Yusof Ishak Institute.

Vietnam should not only diversify trade partnership, he adds, "but also think about how to really build its domestic economy much stronger and to make it more resilient to external shocks". Accordingly, the government is fast-tracking economic reforms, with an eye on prioritising the domestic sector.

"Rising trade protectionism… is likely to impact our export-driven model," says Long Pham Vu Thang, head of macroeconomics research at HSC Securities. "The Vietnamese government [is] trying to diversify from that type of risk by finding a different growth model" through institutional reforms, focusing on innovation and high-technology investments, and pursuing growth from the private sector, he adds.

Vietnam has undergone an economic revolution since the civil war ended 50 years ago. In the postwar period, it pursued a Soviet-style model of a centrally planned economy in which the government controlled all production, trade and prices. The collectivisation of farming, its primary sector, resulted in abject poverty, making Vietnam the poorest country in the world in the early 1980s.

In 1986, the government launched a liberalisation effort called Doi Moi, or "restoration". The country gradually turned itself into a market-orientated economy by easing rules for foreign investments, removing price controls and export quotas and reducing subsidies for state-owned enterprises that controlled much of the manufacturing.

After a US trade embargo was lifted in 1994, foreign investors began to enter Vietnam to take advantage of cheap labour. In 2001, a bilateral trade deal between the US and Vietnam came into force, opening up the south-east Asian country's market to American goods and services, and vice versa.

Robert Zoellick, then the US trade representative, hailed the agreement as "an example of how two nations once divided by war can employ trade as a tool to work toward reconciliation". Trump's first term unleashed another transformative wave of foreign investment. Companies looking to avoid the punitive US tariffs on China moved just across the southern border to Vietnam. Strict lockdowns in China during the Covid-19 pandemic prompted more companies to pile into Vietnam.

The country's investment boom is reflected in the expansion of industrial parks developed by Belgian company Deep C in Vietnam. The company, which operates mostly in northern Vietnam close to the Chinese border, has seen total investments rise from $1bn to $8bn in seven years. Growth was "fuelled by the fact that Trump won and unleashed the first trade war. Biden did not really tone it down," says CEO Bruno Jaspaert. The company has been reclaiming land from the sea to accommodate growing demand, much of it for manufacturing.

Vietnam offered more than just a great location. The government was quick to provide incentives on taxes and import duties on raw material needed for manufacturing. Many foreign companies are not required to pay any corporate tax for their first four years in operation.

> **Rising trade protectionism… is likely to impact our export-driven model.**

Foreign investors also faced less red tape than in some of the bigger economies in the region such as Indonesia, which has strict local-content rules and a lengthy bureaucratic process. The country's gaps in infrastructure and power supply proved to be little obstacle to manufacturers pumping in record amounts of investment as they fled China due to the high tariffs.

But that also posed a problem: susceptibility to global trade uncertainties. In 2023, Vietnam's exports-to-GDP ratio was close to 90 per cent — much higher than south-east Asian rivals such as Indonesia (22 per cent) and Thailand (65 per cent), and China (20 per cent), according to the World Bank. That is why America's new tariff regime is likely to have an outsized impact on economic growth, jobs and investments. More than half of Vietnam's total workforce of 57mn is in export industries, according to the World Bank. If 46 per cent tariffs were sustained, the country's economic growth would decline by 1.8 percentage points this year, according to HSC Securities.

But there is huge uncertainty over the Trump administration's trade policies. Economists believe Vietnam could end up with a 20-25 per cent tariff rate after intense negotiations with the US.

However, this may rest on Vietnam not only narrowing its trade surplus, but also cracking down on alleged Chinese trans-shipment of goods through its borders.

Even if it does so, higher tariffs will erode Vietnam's appeal as a centre for exports. "Much of the manufacturing investment entering Vietnam was never intended for its domestic market but rather to establish the country as an export hub, primarily for shipments to the US," says Marco Förster, Asean director at Dezan Shira & Associates in Ho Chi Minh City who advises investors.

While those who have already invested heavily in the country will probably stay, he says, new FDI could slow down as companies may look at India or south-east Asian countries that have lower tariffs. "Companies that previously considered 'China plus one' production but have yet to act are now reconsidering whether relocating is even worthwhile, especially as tariff gaps with other destinations narrow," he adds.

Vietnamese companies are already making plans for the worst-case scenario of 46 per cent.

Bao from A&M Flooring says he is thinking about selling his products to the US via another country that has lower tariffs than Vietnam. He is considering sending semi-finished goods to Colombia, for which Trump announced a 10 per cent tariff, and then assembling the final product there to be eligible for the lower tariff rate.

"We do not want to go that route because it's a logistical nightmare...[but] you have to work out [the difference] between paying for the tariffs and paying for the extra logistics." He also wants to reduce the company's US dependence from 95 per cent to 30 per cent.

Le Hang, deputy general secretary of Vietnam Association of Seafood Exporters and Producers, says companies in the industry are rushing to find other markets. The US accounts for a fifth of Vietnam's seafood exports. "Some say they will change direction or diversify the market, but finding a partner is a matter of years," she says.

American companies are also struggling. Honey-Can-Do, which sells housewares such as drying racks and shelving units, is one of the many companies that shifted production from China to Vietnam during Trump's first term. It partnered with its Chinese suppliers to co-invest in factories in Vietnam, spending millions of dollars. It now sources roughly 60 per cent of its goods from Vietnam, from less than 5 per cent in 2017.

"We got the message from President Trump, and it kind of continued under President Biden... the signal was 'China bad, Vietnam and other countries, good'," says founder Steve Greenspon. "So when the large tariff was announced for Vietnam, it was crushing."

Honey-Can-Do has cut costs and let go of employees in the US due to the tariff uncertainty, and Greenspon says its suppliers in Vietnam may resort to the same measures to save costs.

> **Companies that previously considered 'China plus one' production but have yet to act are now reconsidering whether relocating is even worthwhile, especially as tariff gaps with other destinations narrow.**

Hanoi is also seeking to re-engineer the country's economic model to make it less dependent on the US. Economists say bureaucratic and economic reforms under way in Vietnam could blunt some of the impact of the tariffs. Vietnam is in the midst of a bureaucratic overhaul that is expected to trim the size of the government by a fifth. It is reducing the number of ministries and government bodies, merging provinces and cutting 100,000 jobs.

VinaCapital, an investment management firm in Ho Chi Minh City, says a more efficient government could have an impact on domestic activity, resulting in faster approvals for investments in real estate and infrastructure projects.

"Fortuitously, before all this tariff stuff came up, they were already starting to push the agenda of... trying to make the whole machinery of both the private sector and the public sector more efficient," says VinaCapital's chief economist, Michael Kokalari.

In addition to the government restructuring, Lam, who took over the country's most powerful position last August, has also launched an ambitious plan to make the Vietnamese private sector the country's "most important force", further shifting away from previous preferential treatment for state-owned companies and the FDI sector.

Through this initiative, Vietnam aims to boost the number of private enterprises in the country from nearly 1mn at present to at least 3mn by 2045. It also wants to foster the creation of 20 large private companies that are integrated into global value chains by 2030. To accomplish these goals, industry figures say the government is likely to deregulate further. The reforms are seen as part of efforts to help Vietnam avoid the middle-income trap where developing countries see growth stagnate, and achieve developed nation status by 2045.

It is also an effort to address demographic issues, as the country's working-age population is projected to shrink. This month, Vietnam also lifted its long-standing two-child policy.

"There was already a growing feeling that we have a golden demographic window for the next decade or so, and that we have an opportunity to try to break out of the middle-income trap. And then, of course, the Trump tariff thing has just dramatically accelerated that," says Kokalari. For now, though, the government's focus is firmly on lowering tariffs. Vietnam is set to hold a third round of talks by mid-June. Vietnam was one of the biggest winners from Trump's first term as manufacturers moved production in droves to the country as part of their 'China plus one' diversification strategy.

There is some optimism that Vietnam can strike a deal, given proactive steps taken by the government and the Trump Organization's growing interest in investing in the country. The US president's son Eric visited Vietnam last month to attend a groundbreaking ceremony for a $1.5bn resort outside Hanoi being developed in partnership with the Trump Organization.

The company is also in talks to build a new Trump Tower. Vietnam is also strategically important for the US in the South China Sea as Hanoi has been one of the most vocal opponents of Chinese aggression in the disputed waters.

But Vietnam will also face difficulties meeting US demands to reduce dependence on Chinese raw materials and investments as Hanoi tries to delicately balance its ties with the superpowers. Despite diversification efforts and reforms, the US will still be an important market in the medium term, says Iseas' Giang.

"It's not only about the economic benefits no, it's not only about the state budget, it's also about social stability in Vietnam, which the Communist party is very concerned with. So this is extremely crucial for Vietnam," he says.

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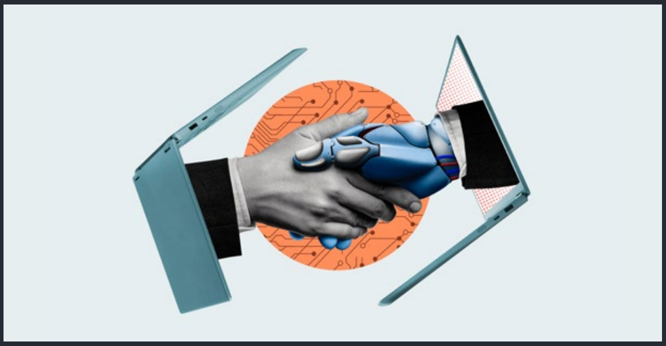

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