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SỰ XÓI MÒN CỦA DƯ ĐỊA THUẾ QUAN VÀ TÍNH LINH HOẠT CHÍNH SÁCH: TÁC ĐỘNG ĐỐI VỚI NGÀNH CÔNG NGHIỆP Ô TÔ VIỆT NAM DƯỚI KHUÔN KHỔ CỦA HIỆP ĐỊNH EVFTA

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Tóm tắt

Ngành công nghiệp ô tô Việt Nam từ lâu đã dựa vào dư địa thuế quan - chênh lệch giữa mức thuế trần WTO và thuế MFN như một công cụ chính sách chủ chốt để bảo hộ sản xuất nội địa. Tuy nhiên, hiệp định Thương mại tự do EU-Việt Nam (EVFTA) đã xói mòn đáng kể khoảng cách thuế quan cùng tính linh hoạt của chính sách này thông qua lộ trình giảm thuế ràng buộc. Bằng phương pháp định tính tập trung vào các nhóm HS 8703, HS 8704 và HS 8705, nghiên cứu làm rõ khái niệm và vai trò của dư địa thuế quan trong lĩnh vực ô tô, phân tích sự xói mòn dư địa thuế quan dưới tác động của EVFTA, xác định rào cản phát sinh từ việc thu hẹp không gian chính sách, và đề xuất giải pháp khả thi cho Chính phủ. Kết quả nghiên cứu chỉ ra rằng dư địa thuế quan sụp đổ hoàn toàn ở nhóm HS 8703, thu hẹp mạnh ở nhóm HS 8704 và HS 8705, gây ra ba thách thức chính, bao gồm sự cạnh tranh gay gắt từ xe nhập khẩu EU, chi phí sản xuất cao, và áp lực hiện đại hóa công nghệ. Từ đó, nhóm tác giả đề xuất một số khuyến

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nghị nhằm thúc đẩy mục tiêu phát triển bền vững cho ngành công nghiệp ô tô trong bối cảnh hậu EVFTA.

Từ khóa: dư địa thuế quan, EVFTA, ngành công nghiệp ô tô, linh hoạt chính sách, Việt Nam

THE EROSION OF TARIFF OVERHANG AND POLICY FLEXIBILITY: IMPLICATIONS FOR VIETNAM'S AUTOMOTIVE INDUSTRY UNDER EVFTA

Abstract

Vietnam's automotive industry has long relied on tariff overhang - the difference between WTO-bound and applied most-favored-nation (MFN) tariff rates - as a key policy tool to protect domestic manufacturers. However, the EU-Vietnam Free Trade Agreement (EVFTA) significantly erodes the tariff overhang and this policy flexibility by enforcing a binding tariff reduction schedule. Using a qualitative approach focused on HS Code 8703, 8704, and 8705, this paper aims to clarify the concept and role of tariff overhang in the automotive sector, to analyze the weakening of tariff overhang under EVFTA, to identify obstacles resulting from the erosion of policy flexibility, and to propose feasible solutions for the Vietnamese government. Findings reveal that tariff overhang collapsed entirely in HS Code 8703, and significantly narrowed in HS 8704 and 8705. This erosion of policy space creates several challenges for Vietnam, including intense competition from EU imported vehicles, higher production costs, and pressure to modernize. To address these obstacles, short-term and long-term are proposed to help promote sustainable growth of the automotive sector in the post-EVFTA context.

Keywords: tariff overhang, EVFTA, automotive industry, policy flexibility, Vietnam

1. Introduction

The gradual erosion of tariff overhang that ensued from Vietnam's engagement with FTAs (Free Trade Agreement), especially the EU-Vietnam Free Trade Agreements (EVFTA), has significantly impacted Vietnam's automotive industry. Tariff overhang has always been crucial in Vietnam's automotive sector as a protective policy to shield domestic manufacturers from foreign competition. Although his concept of tariff overhang facilitated space for local producers to grow, it also mitigated the competition, thus taking away the pressure manufacturers faced to thrive for efficiency and innovation.

However, with the implementation of EVFTA and the enforcement of preferential tariffs, the tariffs on imported vehicles and other automotive parts are progressively decreasing, scheduled to reach 0% within a specific timeline (VCCI, no date). Not only can this shift in tariffs reduce tariff overhang, but this can also weaken its role as a protective measure against foreign competition. In this evolving landscape where market competition is intensifying, a question is raised over how domestic automotive manufacturers will survive.

Employing a qualitative research method, this paper aims to: (i) clarify the concept and role of tariff overhang as a key policy tool, specifically in the automotive sector, (ii) analyze the gradual weakening of tariff overhang under EVFTA, (iii) identify the key policy challenges arising from the erosion of policy flexibility, and (iv) propose alternative industrial policy tools that Vietnamese government could adopt to facilitate the growth of the automotive industry in the post-FTA context.

2. Theoretical framework and literature review

2.1. Theoretical framework

2.1.1. Tariff overhang

Tariff overhang is defined as the difference between a country's legally bound tariff rates under WTO and its applied most-favoured-nation (MFN) tariff (Bchir et al., 2005; Kuenzel, 2017). Bound tariffs refer to the maximum rates which a country commits not to exceed (UNCTAD, 2025), while applied MFN tariffs are defined as the rates actually imposed on imported goods from WTO members. Thanks to the existence of tariff overhang, the countries have flexibility to raise tariffs up to the bound level without violating WTO commitments.

2.1.2. Preferential tariff under FTAs

Preferential tariffs are defined as reduced or zero tariffs offered to certain trading partners under FTAs, as opposed to MFN tariffs which are applied to all members of the WTO. FTAs generally expect members to remove tariffs on goods traded among themselves, in order to promote deeper regional integration. However, the existence of preferential tariffs can impact external trade policy since members of the FTA may alter their external tariffs due to an internal liberalization. The need to eliminate internal borders due to WTO regulations can incentivise members of the FTA to reduce their external borders, although this might reduce the non-members' incentives to join the global free trade initiative. (Saggi et al., 2019; Lake et al., 2020).

2.1.3. Policy space under WTO *and FTAs*

Policy space refers to the flexibility governments have to implement trade policies in accordance with their development goals. Under the WTO, policy space is shaped by the tariff overhang, which allows countries to respond to shocks or protect sensitive sectors within agreed limits (Bchir et al., 2005; Kuenzel, 2020). By contrast, FTAs often require the elimination of tariffs on goods traded among themselves, reducing policy space among members and then potentially encouraging external liberalization. The interplay between multilateral binding overhang and preferential tariffs influences the formation and expansion of FTAs, as well as the pursuit of global free trade (Saggi et al., 2019).

2.2. Literature review

2.2.1. Global perspectives on tariff overhang in the post-WTO, pre-FTA era

Numerous studies have highlighted general trend of tariff overhang after countries' accession to the WTO. After joining WTO, many countries applied tariffs at levels lower than their WTO commitments, thereby creating tariff overhang, which was a form of policy space for the protection of domestic industry (Beshkar, Bond and Rho, 2015; UNCTAD, 2024).

Besides, some studies have also shown that these tariff gaps are not merely technical but also strategic policy tools. Utilization of overhang in this strategic manner allows governments to protect infant industries without technically departing from WTO commitments (UNCTAD, 2024).

In general, these studies emphasize that in this period, tariff overhang plays an important policy tool, enabling countries to reconcile their global trade commitments with domestic development objectives.

2.2.2. Eroding tariff policy flexibility in an era of deepened FTA integration

However, deeper integration into FTAs soon removes such safety valves as these agreements often require specific terms that can not only force down the tariffs but also allow for domestic policy implications (Ahn and Shin, 2010; Saggi, Stoyanov and Yildiz, 2018). Overlapping commitments across multiple FTAs create a complex “spaghetti-bowl” of rules, which was first warned by Bhagwati (1995) to be further eroding policy autonomy. It is also worth noting that, with objective of all parties reaching preferential tariff rate, bilateral and regional trade agreements often distort each party’s policy space more than the WTO rules do (Aggarwal and Evenett, 2014; Rodrik, 2004; UNECA, 2015).

The existing literature seems to be possessing a similar school of thought in terms of how signing FTAs brings about a paradox, where trade volumes are boosted yet national sovereignty is under threat. Being a party to such agreements, countries are bound to reduce tariffs to a very low level or even to 0 and are faced with restrictions where they do not have the right to raise the tariff back when domestic industries face adverse shocks; all of which may result in diminished policy flexibility and may call for greater compensations in the long run

(Ahn and Shin, 2010; Saggi, Stoyanov and Yildiz, 2018). In addition, it has been suggested that the emergence of FTAs is negatively correlated with the frequency of countries reducing tariffs for external countries outside the FTAs listed (Gnangnon, 2019; Goldberg & Pavcnik, 2016).

Nonetheless, developing countries can make use of the years allowed in the tariff schedule to enjoy current policy space in order to be better prepared for the future market with their agility to adjust tariff policies significantly deteriorate (WTO, 2009).

2.2.3. Vietnam-specific literature on automotive trade liberalization

In the context of FTAs such as the EVFTA, Vietnam's automotive sector has undergone significant changes due to trade liberalization policies. According to Vũ and Phạm (2017), the gradual reduction towards 0% of tariffs on imported automobiles is expected to increase vehicle imports. While this transformation promotes trade, it also heightens competition for domestic producers. Similarly, Nguyễn and Đỗ (2021) highlight that trade liberalization reduces the government's ability to protect domestic manufacturers by removing the option to raise tariffs. Together, these studies underline the adverse impact of liberalization on the automotive field.

2.2.4. Research gap

The existing literature still lacks several empirical and policy gaps. The first one is a lack of HS Code-specific studies on tariff overhang, particularly for HS Codes 8703, 8704, and 8705, making it hard for Vietnam to assess product-level impacts. The second one is the limited specification on the legal industrial policy tools that Vietnam can utilize in the post-FTA context. The final is the lack of analysis on the impact of liberalization on domestic value chains, such as supplier integration and employment.

3. Overview about Vietnam's automotive industry and EVFTA

3.1. Overview about Vietnam's automotive industry

In recent years, Vietnam is considered as an emerging automotive market in Asia. Vietnam's automotive sector is going through an important phase of growth with strong assistance from the government, increasing foreign investment and high demand, especially for electric vehicles.

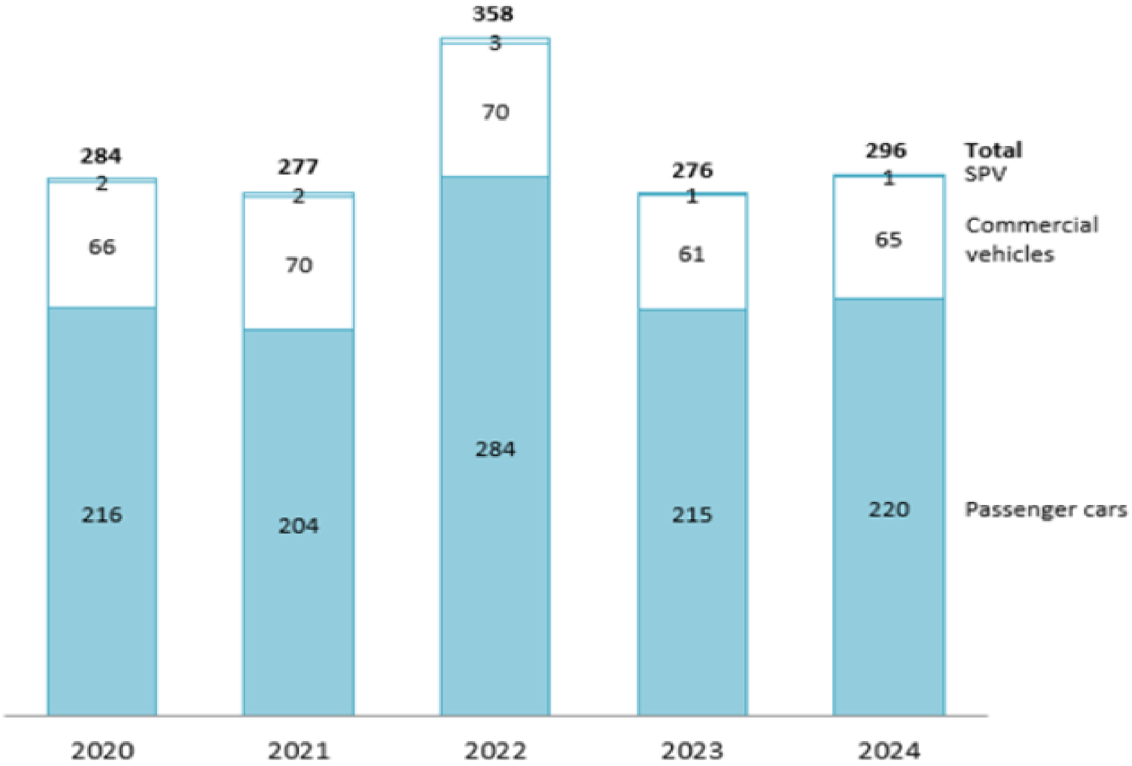

Figure 1. Vietnam's automobile sales by types from 2020 to 2024 (Unit: thousand cars)

Source: Vietnam Automobile Manufacturers' Association (VAMA)

It is clear to see that the growth of Vietnam's automotive industry peaked in 2022, while remaining years remaining stable at over 270,000 cars. Vietnam's government has positioned the automotive sector as a strategic industry, with clear goals: (1) reach an annual production capacity of 466,400 vehicles by 2025, meeting 70% of domestic demand and exporting 37,000 units; (2) target 30% of four-wheeled and 22% of two-wheeled vehicles are electric by 2030, (3) boost collaboration between domestic and international manufacturers, enhance traffic infrastructure and improve the country's competitiveness in the global supply chain.

To achieve these goals, the government has applied various support policies such as: Decree 109/2024/ND-CP which reduces 50% in registration fees for domestically assembled cars, Decree 51/2025/ND-CP which applies full exemption on EV registration fees for two years. The authority also signed many FTAs to reduce trade barriers and improve technology access.

Nevertheless, Vietnam's automotive sector still heavily relies on imported components from other countries. Currently, many automotive components imported from South Korea are subject to a 0% tariff from 2022 while tariff rates for components imported from 27 EU countries are relatively high.

3.2. Overview about EVFTA

The EU-Vietnam Free Trade Agreement is a new generation FTA between Vietnam and 27 European Union member states. It was signed on 30 June 2019 and officially went into effect on 1 August 2020, with an objective to eliminate trade barriers and facilitate unrestricted trade in products & services between the EU and Vietnam. Moreover, this FTA also deepens economic integration by encouraging investment, improving market access and reducing tariffs.

As soon as EVFTA comes into effect, the EU commits to eliminate tariffs on 85.6% of tariff lines for Vietnamese goods. Within 7 years since EVFTA takes effect, the EU will eliminate 99.2% of tariff lines. In exchange, Vietnam commits to eliminating 48.5% of tariff lines. And within 10 years, Vietnam commits to eliminate about 98.3% of tariff lines.

4. From overhang to erosion tariff policy flexibility

4.1. Phase 1: WTO membership and the era of tariff overhang for Vietnam's automotive industry (2007–2019)

Following Vietnam's WTO accession in 2007 and before the signing of the EVFTA, the country's automotive tariff policies were shaped by WTO commitments. As the WTO sets varying bound duty rates across vehicle types, MFN applied rates and the resulting tariff overhang also varied, ranging from 0% to 30%.

HS Code 8703: Motor cars and other vehicles for passenger transport (excluding those under 87.02), including station wagons and racing cars

Between 2007 and 2019, the duty rates applicable to the products under this HS code calculated using two methods: (1) ad valorem duties (percentage-based) for new motor vehicles, and (2) fixed duties in USD for used motor vehicles.

For new motor vehicles, most of the product lines have the MFN applied duty equivalent to the bound duty set by WTO, signaling a rather limited flexibility of Vietnam in adjusting tariff policy when necessary.

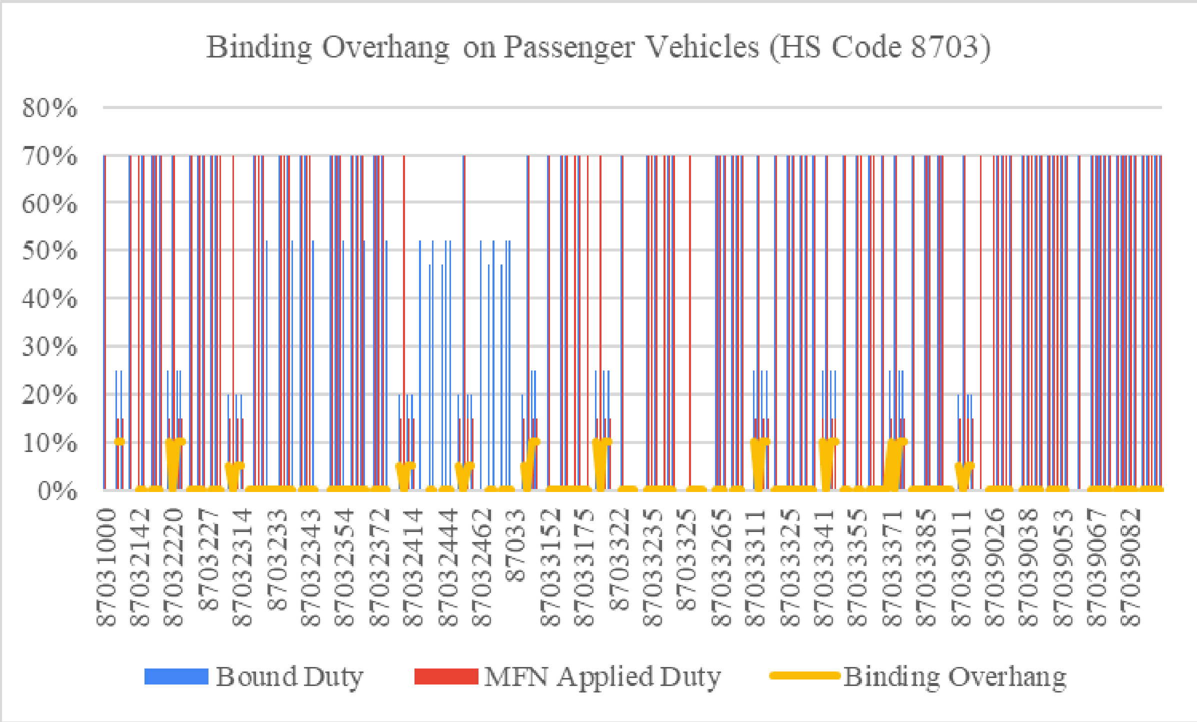

Figure 2. Tariff overhang on passenger vehicles (HS Code 8703)

Source: Author's calculations based on WTO TAO data

Regarding the main lines of four-wheel drive, motor-homes, other vehicles with compression-ignition internal combustion piston engine and other vehicles, with spark-ignition internal combustion reciprocating piston engine, Vietnam has set the tariff at 70%, exactly as high as the bound rate, leaving the overhang at 0%. However, for ambulances, Vietnam still has a starting point of 5% of tariff binding overhang to utilize in case of incurred amendment.

This approach to setting MFN applied tariff suggests Vietnam is applying a highly protectionist and rigid structure, for there is a want to restrict liberalization in the passenger vehicle market to a limited extent.

For used motor vehicles, Vietnam places significant emphasis on fixed duty rates, diverging from the more common ad valorem regime. The table below shows the alterations of such rates through years with data compiled from official decisions and decrees.

Table 1. Tariff rates for used passenger vehicles – classification by seating capacity and engine displacement (Unit: USD)

	Bound Duty	MFN Applied Duty				
		2007	2008	2011	2013	2016
≤5 seats, <1.0L	200 or 150+10,000 USD, whichever is lower	2,700	3,000	3,500	3,500	3,500
≤5 seats, 1.0–1.5L	200 or 150+10,000 USD, whichever is lower	6,300	7,000	8,000	8,000	8,000
≤5 seats, 1.5–2.0L	200 or 150+10,000 USD, whichever is lower	8,000	9,000	X[2]+5,000	X+5,000	X+5,000
≤5 seats, 2.0–2.5L	200 or 150+10,000 USD, whichever is lower	12,000	13,500	X+5,000	X+5,000	X+5,000
≤5 seats, 2.5–3.0L	200 or 150+15,000 USD, whichever is lower	13,500	15,000	X+15,000	X+15,000	X+15,000

[2] X = Taxable value of used vehicle × duty rate for new vehicles of the same type, effective at the time of customs declaration.

≤5 seats, 3.0–4.0L	200 or 150+15,000 USD, whichever is lower	16,200	18,000	X+15,000	X+15,000	X+15,000
≤5 seats, 4.0–5.0L	200 or 150+15,000 USD, whichever is lower	26,400	26,400	X+15,000	X+15,000	X+15,000
≤5 seats, >5.0L	200 or 150+15,000 USD, whichever is lower	30,000	30,000	X+15,000	X+15,000	X+15,000
6–9 seats, ≤2.0L	200 or 150+10,000 USD, whichever is lower	7,200	8,100	X+5,000	X+5,000	X+5,000
6–9 seats, 2.0–3.0L	200 or 150+15,000 USD, whichever is lower	11,200	12,600	X+5,000	X+5,000	X+5,000
6–9 seats, 3.0–4.0L	200 or 150+15,000 USD, whichever is lower	14,400	16,000	X+15,000	X+15,000	X+15,000
6–9 seats, >4.0L	200 or 150+15,000 USD, whichever is lower	24,000	24,000	X+15,000	X+15,000	X+15,000

Source: Adapted from Decision No. 92/2007/QD-BTC; Decision No. 14/2008/QD-BTC; Decision No. 36/2011/QD-TTg; Decision No. 24/2013/QD-TTg; Decree No. 122/2016/ND CP

Between 2007 and 2019, the government issued multiple decisions and decrees amending tariffs on used vehicles under HS 8703. Each new document enforced comes with a higher level of duty across most of product lines. Especially, from 2013 onwards, many tariff lines began to incorporate a value-based formula ("X+5,000" or "X+15,000") where X denotes the duty on new vehicles of the same type. Using either way of calculation, fixed rates or value-based formulas tend to go up as the seating capacity and engine displacements increase. For example, in 2007, the duty for a vehicle with no more than five seats and an engine size under 1.0L was just 2,700 USD-only about one-tenth of the 24,000 USD duty imposed on larger vehicles with 6–9 seats and engine displacements over 4.0L in the same year. Despite these increases, applied duties remain comfortably within WTO-bound tariff ceilings, typically set at either "200 or 150+10,000 USD" or "200 or 150+15,000 USD," whichever is lower.

This demonstrates Vietnam's strategic use of tariff overhang by maintaining a gap between bound and applied rates to preserve policy flexibility, which allows the country to strike a balance between its commitment to trade liberalization with the need to protect domestic industry.

HS Code 8704: Motor vehicles for transport of goods

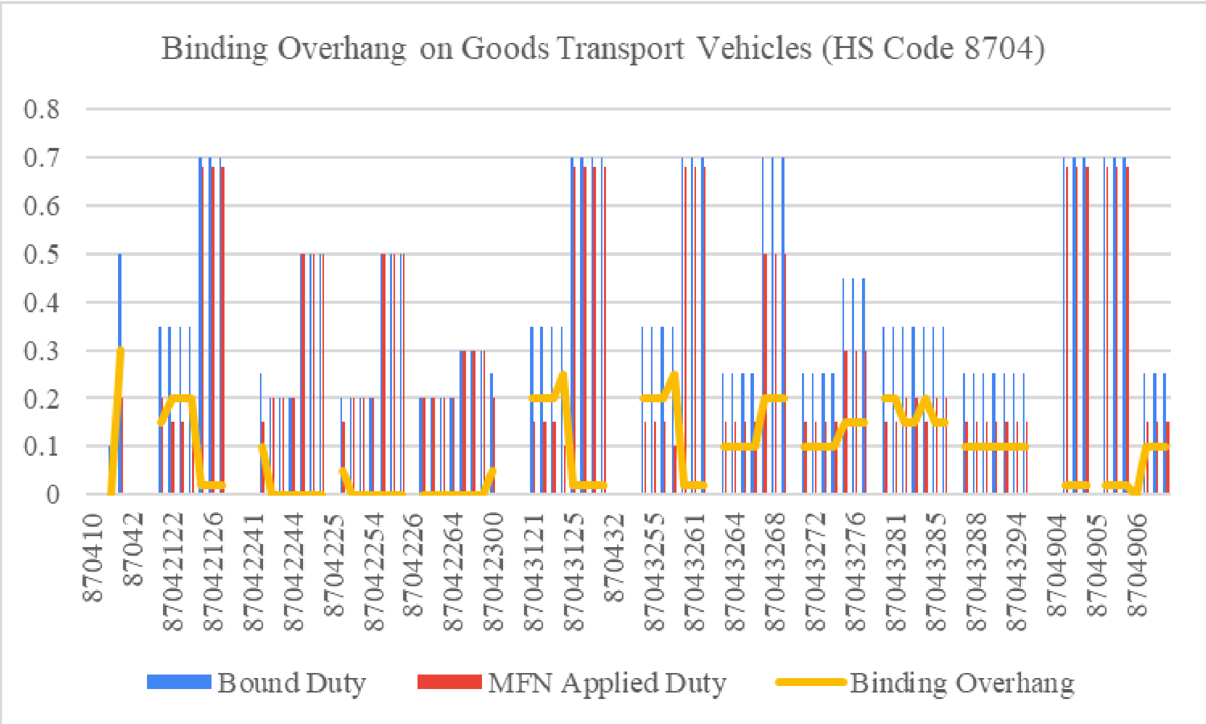

Figure 3. Binding overhang on goods transport vehicles (HS Code 8704)

Source: Author's calculations based on WTO TAO data

Overall, Vietnam can benefit from significant difference between bound duty and MFN applied duty, where the maximum overhang lies at 30% and the average overhang for all the product lines in the subheading is 9%.

Varied levels of binding overhang also suggest different trade policies of Vietnam for various kinds of products. To begin with, Vietnam seems to apply strong protectionist policy onto light commercial vehicles powered by spark-ignition engines, with bound duty at 70% and applied MFN duty at 68%, meaning only 2% of overhang is recorded. In contrast, vehicles for infrastructure development and public services (cement transport or refrigerated logistics) benefit from lower applied tariffs, often in range of 0-20%, despite higher bound ceilings. Therefore, the binding overhangs in such tariff lines, especially heavy vehicles exceeding 10 or 20 tonnes, seem to overshadow the rest.

All of the above insights notices that Vietnam, while making efforts to protect the key sector of low-capacity petrol-engined vehicles, still leaves room for flexibility in tariff adjustment in sectors where imports are integral.

HS Code 8705: Special purpose motor vehicles, other than those principally designed for persons or goods transport

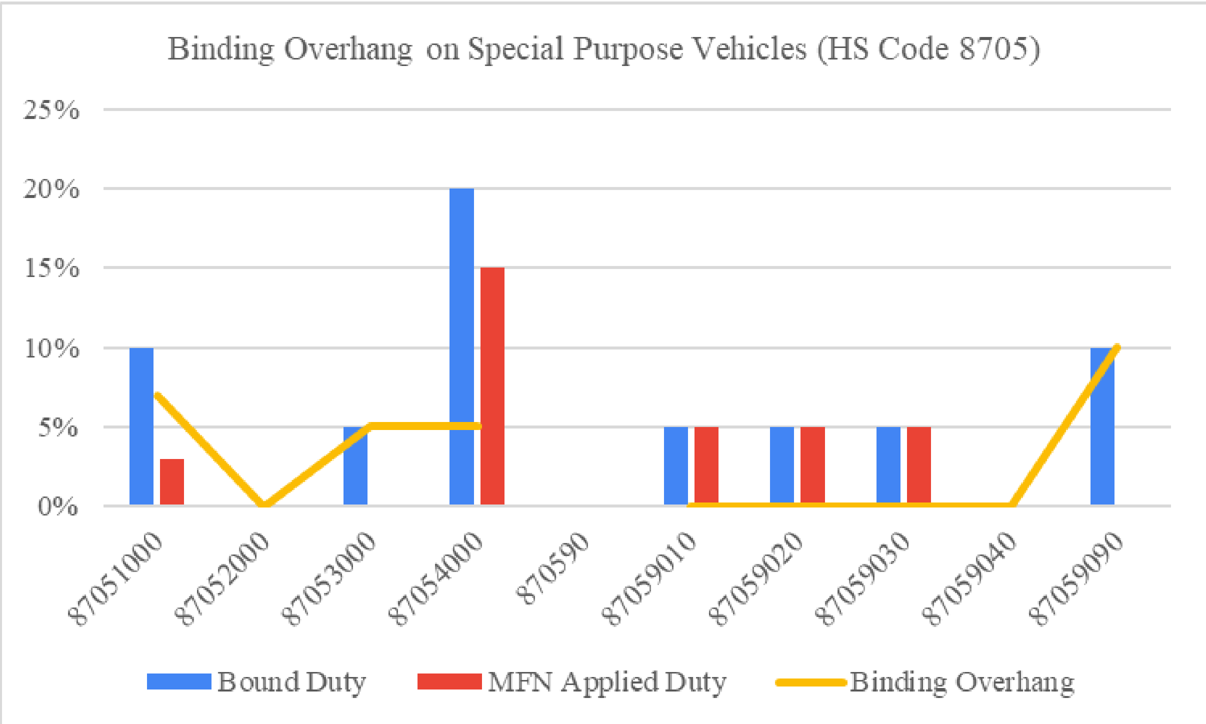

Figure 4. Binding overhang on special purpose vehicles (HS Code 8705)

Source: Author's calculations based on WTO TAO data

The original bound duties required by WTO are low themselves, thereby capping the tariff overhang to a significantly lower amount. As the bound tariff rates range from 0% to a maximum of 20%, the overhangs mirror the same patterns with the differences being 0%, 5%,7% and 10% respectively. The vehicles listed in the subheading 8705 are often not commercially sensitive, which explains a rather low tariff baseline and little to no protectionist policy spotted. Although Vietnam reduced the tariffs gradually under WTO rules, it maintained a significant gap between bound and applied MFN tariffs. In this way, Vietnam preserved the policy space to adjust tariffs when necessary to protect the domestic automotive industry.

4.2. Phase 2: EVFTA commitments and the erosion of tariff overhang under EVFTA

4.2.1. Tariff reduction schedule for HS 8703, 8704, 8705 under EVFTA

Table 2. Vietnam's tariffs on automobiles imported from EU

	Base year 2012			**Tariff reduction schedule under the EVFTA**		
HS Code	**Number of tariff lines**	**Number of tariff lines at 0%**	**Simple average tariff rate (%)**	**Tariff lines in schedule A (%)**	**Tariff lines in schedule B9 (%)**	**Tariff lines in schedule B10 (%)**
8703	64	0	61.56	0.00	11.32	28.93
8704	89	16	17.69	10.06	0.00	45.91
8705	6	4	3.33	2.52	0.00	1.26
Total	**159**	**20**	**37.97**	**12.58**	**11.32**	**76.1**

Source: Adapted from Vu and Pham (2017, p. 4)

EVFTA classifies tariff reductions into three groups, based on the base tariff rates of the year 2012.

Schedule A, representing 12.58% of tariff lines, requires the removal of tariffs immediately upon the EVFTA's entry into force. This category includes primarily tariff lines already accorded a 0% rate in base year and mainly concerns motor vehicles for the transport of goods (HS 8704) with a gross vehicle weight exceeding 20 tonnes.

Schedule B9 covers 11.32% of tariff lines, with tariffs to be eliminated over ten years. Motor vehicles for transporting persons (HS 8703), such as ambulances and certain vehicles with large engine displacements, primarily over 3,000cc, fall primarily under this category.

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Schedule B10, accounting for 76.1%, mandates tariff elimination in eleven equal yearly installments from the EVFTA's entry into force. It includes passenger vehicles (HS 8703) with engine displacement ≤ 3,000cc and goods transport vehicles (HS 8704) with gross weight ≤ 5 tonnes.

4.2.2. The erosion of tariff overhang

Table 3. Comparison of tariff room for adjustment: Pre- and Post-EVFTA

HS Code	Base Rate (EVFTA, 2012)	Applied Rate (2023)	Tariff overhang (Pre-EVFTA)	Room (Post-EVFTA)	Room Reduction (%)
8703	61.56%	≈ 46%	0%	15.56%	–15.56% (room increased but was locked)
8704	17.69%	≈ 12%	≈ 9%	≈ 5.69%	≈36.8% (room decreased)
8705	3.33%	≈ 2%	≈ 5–10%	≈ 1.33%	≈60–85% (room decreased)

Source: Author's calculation

The table shows several important metrics, including two significant concepts:

- "Room": Difference between EVFTA-bound rates (2012 base) and applied rates (2023). However, this is not equivalent to the concept of "tariff overhang" under WTO rules
- "Room reduction": Under the WTO framework, tariff overhang allows policy flexibility. However, the framework of the EVFTA does not allow countries to use the "room"- the base rate and applied tariffs difference as actual policy flexibility. EVFTA's binding timelines mandate systematic tariff reductions to zero, eliminating Vietnam's ability to raise tariffs within this range. The term "room reduction" is used

to compare Vietnam's policy space after the EVFTA - which is significantly more restricted - with the more flexible space it had before during the 2012–2015 period.

4.2.3. The erosion of policy flexibility

The EVFTA has introduced a structured and binding roadmap for tariff elimination, significantly eroding Vietnam's policy flexibility.

In HS 8703, the appearance of a 15.56 percentage point margin is deceptive. Although this "room" did not exist pre-EVFTA, it is now entirely predetermined by the agreement, with rates falling to 0% within 10 years. Therefore, Vietnam cannot leverage this margin for shock mitigation or industry protection – rendering it legally unusable.

In HS 8704, the average overhang fell from ~9% pre-EVFTA to just 5.69%, with further reductions ahead. This limits Vietnam's ability to adjust tariffs in response to import surges or domestic needs.

For HS 8705, the already low overhang has diminished further, leaving little to no policy flexibility.

As tariffs are eliminated, Vietnam loses the ability to use them as a shock absorber. Before EVFTA, MFN rates could be raised (within WTO bound) to protect local producers. After EVFTA, that tool is gone-EU cars now enter duty-free, with no option to reinstate tariffs. Though WTO MFN ceilings remain, EVFTA effectively imposes stricter constraints. Only non-EU imports under other FTAs retain some tariff space.

In summary, EVFTA sharply reduces Vietnam's tariff overhang in the auto sector and limits the government's ability to raise duties. While consumers benefit from lower prices, the government loses leverage, narrowing its policy response options and reducing trade-policy flexibility.

4.3. Summary of findings

Group 1: No policy flexibility

HS 8703 subheading demonstrates effectively zero tariff overhang: MFN tariffs (70%) for key vehicles (our-wheel drive, motor-homes and diesel-engine cars) are bound to WTO levels, blocking duty adjustments. Under EVFTA, while the nominal 15.56% "room" exists, it is locked into a legally binding ten-year phase-out schedule. In practical terms, Vietnam has completely lost the ability to regulate taxes in motor vehicles principally designed for the transport of persons – a key area of the automotive industry.

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Group 2: Limited residual flexibility

For HS 8704 and HS 8705, the tariff space still exists but has been significantly narrowed. Although Vietnam still retains some adjustment space for imports not originating from the EU, the tariff commitments in the EVFTA have greatly limited the ability to use tax policies in the near future.

Challenges for Vietnam's automotive industry

The erosion of tariff overhang poses notable challenges for Vietnam's automotive sector. The first and most pressing challenge is the competition from EU imported cars, while there are no longer tax tools to provide support. Under EVFTA, preferential tax rates for HS 8703 are being cut by an average of 7–8% annually - from approximately 78% in 2020 to 0% after 9–10 years. This liberalization has resulted in a surge of EU vehicle imports, with notable spikes in January, June, and November corresponding to scheduled tariff reductions (GSO, 2023).

The second challenge is cost-related. Domestic production costs are 10-20% higher than regional peers due to heavy dependence on imported components and logistics costs, making assembled cars difficult to compete on price.

Finally, companies face pressure to invest heavily in automation, R&D, and adoption of industry 4.0 technologies. However, the sector continues to deal with limited financial resources and a shortage of high-quality human resources, compounding the strain on domestic enterprises and slowing the pace of transformation.

5. Strategic policy options beyond tariffs

5.1. Short-term policies (2025-2030)

5.1.1. Strategic utilization of EVFTA transition periods

During the tariff phase-out window under EVFTA schedule, for completely built-up vehicles, Vietnam should focus on domestic production of high-demand vehicle lines while import tariffs are still high (about 35%) before reaching 0% in 2030 (Appendix 2-A-2 EVFTA; Ministry of Industry and Trade, 2020). For components and spare parts, Vietnam should boost the import of components from the EU that are subject to a tax rate of 0% and also promote localization and technology transfer. To implement this policy, The Ministry of Industry and Trade should publish the tariff reduction roadmap under FTAs, particularly EVFTA, which will assist domestic businesses build production plans, then having an effective investment and importing strategy.

5.1.2. Using Technical Barriers to Trade (TBT)

The TBT Agreement can be applied as a non-tariff measure in order to protect domestic industry. Vietnam now organizes the inspection and evaluation of technical design documents and items of imported vehicles by assessing the conformity of the design and vehicle type with national technical standards according to Decree No.60/2023/ND-CP of the Government, Circular 82/2024/TT-BCA. Regarding emission standards, according to Decision No. 19/2024/QD-TTg, Vietnam is currently applying emission standards level 5 for new imported cars and level 4 for used cars. We recommend that Vietnam should apply the ASEAN NCAP 4-star safety standard and Euro 6 emission standard for imported vehicles, 2 years ahead of the ASEAN roadmap. These measures do not conflict with WTO regulations on TBT, ensuring legitimate objectives and non-discrimination.

5.1.3. Government targeted financial support

The Vietnamese administration may apply tax incentives to provide financial support to domestic businesses, and also boost technological development of the automotive industry. Incentives can be applied including R&D tax incentives to reduce corporate income tax for companies investing in core technology research or manufacturing industrial products on the priority development list. The WTO SCM Agreement (Article 8) allows the subsidy for R&D to cover up to 75% of costs. Moreover, Vietnam can adopt localization incentives which reduce tax for enterprises that reach the state's target rate of localization.

5.2. Long-term policies (Post-2030)

5.2.1. Green automotive industrial policy

According to the Government 2035's vision, Vietnam's automotive industrial sector will develop to be environmentally friendly and green. Therefore, we propose establishing specialized industrial zones for domestic electric vehicle production, supported by incentives such as reduction of land rent for the first 10 years or import tax exemption on electronic components. Moreover, electrification and digitalisation will provide Vietnamese suppliers with increasing opportunities for developing a broader scope of automobile-related businesses, creating the foundation for developing domestic industrial capacity, instead of relying on taxes.

5.2.2. Regional supply chain integration

With tariff overhangs eroding, regional integration is essential to protect the domestic industry. Vietnam should focus on wire component manufacturing—a high-potential sector. According to the Ministry of Industry and Trade, in 2023, the export turnover of the wire components group reached about $1.17 billion, accounting for 38% of export value of automobile components and ranking 3rd globally. Vietnamese's wire products have become an important link in the regional supply chain of automobile assembly materials. This strategy also helps to reduce the negative impact of EVFTA due to increase in imports from EU countries when the tariff reaches 0% because Vietnam still can maintain growth for domestic enterprises, not losing market share completely.

5.2.3. Capability building of local suppliers

Capable suppliers are indispensable to carry out all the above policies successfully. Vietnamese suppliers need to develop more skilled workers, engineers to enhance basic production and total quality management to fulfill the high requirements for quality, cost and transportation. Therefore, we recommend establishing dual training that combines studying theory at university with practicing at the training centre of automobile businesses. Secondly, the State can support 50% of training costs for companies investing in human resource development, supporting labour transition, developing policies to support 30,000 workers from traditional industries to transition to advanced manufacturing sectors.

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