

The employment and social consequences of Vietnam's international economic integration

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1. What are we talking about?

The social consequences of restructuring can largely be understood in terms of the net employment impact and the impact on government expenditures and revenues. When restructuring entails unemployment, government expenditure can mitigate the financial costs faced by those losing jobs at the opportunity cost of overall welfare (other opportunities for government welfare spending). Government can also initiate job-creating reforms and target expenditures to help job search, retraining and business start-up activities.

Restructuring, however, does not create unemployment *per se*. Restructuring involves changes to the “rules of the game” (or new rules) by which economic activity is conducted. Restructuring describes institutional change and the consequences of such changes. By implication these changes are substantial. They can be firm-specific (privatisation), or universal changes to government laws and regulations. These changes can create or lessen unemployment in the short-run, and the longer-run net employment impact may be the same or different.

In the context of a discussion about Vietnam, “restructuring” is generally understood to mean a reduction in the scope and scale of state sector commercial activity through equitisation¹ and similar reforms. It is a dialogue focused on formal mechanisms for restructuring (e.g. regulatory changes) that ignores informal mechanisms (such as “spontaneous privatisation”). This is an acceptable approach, although a full understanding of the nature and extent of informal processes is necessary to evaluate the impact of formal changes to the “rules of the game”, and to design the steps to make change happen (e.g. equitisation). Often, of course, formal changes are merely making official what has happened already informally.

An important distinction must be made between restructuring and market-based shocks to the economy. Vietnam is presently grappling with the consequences of the Asian financial crisis – a collapse in foreign direct investment, stagnant levels of trade, slow GDP and slow government revenue growth. These problems are largely due to dramatic changes in international relative prices. A contagion of more skeptical country-risk assessments and universal down-gradings of growth and consumption forecasts are making the road to recovery a long one. The market-based shock of the Asian financial crisis is the first substantial test of the Vietnamese economy’s ability to change – to restructure - since the collapse of CMEA trade in the late 1980s. The results, thus far, are not very impressive. Vietnam has a long way to go before it has an internationally competitive and “change friendly” economy.

A final distinction is that market-based shocks cannot be avoided (unless you avoid having markets themselves, such as Vietnam’s dubious virtue in not having a capital

¹ “Equitisation” is the politically palatable Vietnamese term for describing sale of a specified share of enterprise shares to the non-state sector, typically 49 percent. Given this, we may understand “privatisation” to mean 100 percent sale of a state enterprise to non-state organisations and individuals.

market and hence “avoiding” portfolio capital outflows during the Asian financial crisis), while restructuring is generally chosen. Of course this can be a matter of causal semantics: restructuring policy changes can be induced by informal structural change or market-based shocks. The plummeting foreign direct investment data, for example, has stimulated a flurry of administrative and policy changes. Nevertheless, formal restructuring is unique in that at one point in time the government decides to “do it”.

2. Keeping a national welfare perspective on restructuring

In the “rush” to equitise and restructure there is a tendency amongst some commentators to forget that Vietnam is a very poor developing country. The focus on restructuring the formal sector, most of which is state-run, also draws attention away from the fact that most Vietnamese are excluded from this privileged group of workers. The resources available to lessen the negative social consequences of formal sector restructuring are limited. Further, and more importantly, the funds devoted to a formal state sector restructuring package should be weighed against the opportunity cost of increased national welfare from greater health and education spending on the vast majority of Vietnam’s population outside the state sector.

Vietnam remains an economy with much of its GDP coming from agriculture, and, as Tables 1 and 2 show, most of its labour force employed in agriculture. The state sector employs only nine percent of Vietnam’s workforce, but that percentage varies considerably across economic sectors. About one-quarter of industry sector workers have been employed by the state throughout 1991-97. In commercial service areas, however, the share of state employment has halved from 26 percent in 1991 to 13 percent in 1997. It has also fallen, but less quickly, in other sectors.

Table 1: Employed population by sectors and employer, 1991 to 1997
(thousands of persons and percent)

	1991	1992	1993	1994	1995	1996	1997 est.
Total	30,974	31,815	32,718	33,664	34,590	35,792	36,994
<i>Percent state sector employees</i>	<i>10.1</i>	<i>9.4</i>	<i>9.0</i>	<i>8.7</i>	<i>8.8</i>	<i>8.8</i>	<i>8.9</i>
Agriculture, forestry & fisheries	23,122	23,160	23,425	23,565	24,106	24,776	25,444
<i>Percent state sector employees</i>	<i>1.7</i>	<i>1.5</i>	<i>1.4</i>	<i>1.3</i>	<i>1.2</i>	<i>1.0</i>	<i>1.0</i>
Industry	3,736	3,847	4,140	4,326	4,493	4,629	4,634
<i>Percent state sector employees</i>	<i>27</i>	<i>25</i>	<i>24</i>	<i>23</i>	<i>23</i>	<i>23</i>	<i>25</i>
Trade, transport, hotels, services	2,485	2,833	3,033	3,363	3,493	3,773	4,291
<i>Percent state sector employees</i>	<i>26</i>	<i>21</i>	<i>18</i>	<i>16</i>	<i>15</i>	<i>15</i>	<i>13</i>
Health and education	1,010	1,094	1,143	1,218	1,259	1,287	1,295
<i>Percent state sector employees</i>	<i>85</i>	<i>75</i>	<i>73</i>	<i>68</i>	<i>69</i>	<i>71</i>	<i>72</i>
Others	623	881	975	1,191	1,238	1,327	1,334
<i>Percent state sector employees</i>	<i>41</i>	<i>30</i>	<i>27</i>	<i>23</i>	<i>25</i>	<i>24</i>	<i>27</i>

Sources: MOLISA, (1997), *Statistical Yearbook of Labour-Invalids and Social Affairs, 1996*. Statistical Publishing House, Hanoi [for data to 1994].

GSO (1998), *Vietnam Statistical Yearbook*. Statistical Publishing House, Hanoi [1995-97 data].

Despite the slowly falling share of total employment, the number of persons in the state sector has risen during 1991-97. The workforce increased by 6 million persons during 1991-97, of whom the state sector absorbed 155,000 (3 percent), and the non-state sector the remaining 5,865,000 – mostly in agriculture (2 million), but also in industry (898,000), trade (1.38 million), and across most other sectors.

Table 2: Employed population by sectors and employer. 1991 and 1997
(thousands of persons)

	Total employment		State sector employment	
	1991	1997 est.	1991	1997 (est.)
Total	30,974	36,994	3,136	3,291
Agriculture and forestry	22,841	24,814	371	243
Fishery	281	630	12	9
Industry	3,736	4,634	999	1,160
Of which:				
Mining	325	211	89	99
Manufacturing	2,727	3,293	560	672
Electricity, gas and water supply	104	153	48	61
Construction	579	977	302	328
Wholesale and retail trade, repairing.	1,292	2,672	278	209
Hotels and restaurants	519	519	44	45
Transport, storage and communication	533	856	191	208
Finance, credit	73	126	74	52
Science and technology	45	41	45	33
Property business and consulting services	23	77	14	31
State management, defense and social security*	295	411	144	252
Training and Education	770	999	674	768
Health and social work	240	296	186	170
Culture and sporting activities	56	96	28	33
Activities of party, mass organisations	82	100	57	59
Activities of personal and public service	135	595	24	19
Others**	55	132	0	0

Sources: same as Table 1.

* The total employment data for "State Management, Defense, and Social Security" differs between sources. MOLISA (1997, p.35) data is reported to 1995, and GSO (1998) thereafter. These two sources overlap in reporting 1995 data for this sector. MOLISA reports 307,200 persons, while GSO report 392,500 persons. Similar changes in the data for "Activities of Party and Mass Organisations" account for the difference, so it would seem that some employment groups under the latter heading are now counted as state employees.

** What MOLISA (1997) describes as "others" [data to 1994] is explained as mostly as "Private households with employed persons" by the GSO (1998).

In terms of employment, therefore, the state sector has been stagnating. This is despite priority still being given to state sector development, and a reported marginal rising state sector share of GDP in recent years (Table 3). The state sector and its enterprises, even with protection and access to state funds, foreign investment, land, and bank credit has failed to produce jobs.

Table 3: GDP by ownership (US\$ and percentages)

	US\$millions*			Percentage shares	
	1995	1996	1997 est.	1995	1997 est.
Total	20,076	22,488	22,855	100	100
State	7,535	8,574	8,887	37.5	38.1
Household	7,547	8,280	8,309	37.6	36.8
Collective	2,168	2,301	2,217	10.8	10.2
Private	615	751	791	3.1	3.3
Mixed	888	948	983	4.4	4.2
Foreign invested sector	1,321	1,634	1,709	6.6	7.3
<i>(dong per US\$)</i>	<i>(11,100)</i>	<i>(11,500)</i>	<i>(12,938)</i>		

Sources: GSO (1998)., *Vietnam Statistical Yearbook*. Statistical Publishing House, Hanoi
World Bank (1998)., *Vietnam: Rising to the challenge*. Hanoi. [exchange rate data].

* Current GDP data divided by average exchange rate.

Table 4 places Vietnam's development in regional context. It shows that Vietnam remains far behind ASEAN neighbours despite a period of rapid growth rates in the 1990s. While there has been much praise, for example, at the rapid growth of Vietnam's volume of international trade in recent years, the volume of trade per capita still remains about half of Indonesia's and less than ten percent of Thailand's. Comparison of per capita data about cement and electricity production present a similar picture: the path to "catching up" is long indeed, and a period of relative stagnation – say, of GDP growth less than 5 percent each year – could add decades to the task.

Table 4: Vietnam compared to some ASEAN economies (1995 data unless specified)

	Vietnam	Indonesia	Thailand	Malaysia
% of labour force in agriculture (1994)	68	51	57	45
% of GDP in:				
Agriculture	28	16	11	14
Manufacturing	16	24	32	33
US\$ trade per capita	172	441	2,148	6,053
Per capita production of:				
rice (kg)	338	255	346	52
cement (kg)	73	114	563	509
electricity (kwh - 1993)	147	247	1,093	2,055

Source: GSO (1998)., *Vietnam Statistical Yearbook*. Statistical Publishing House, Hanoi

Vietnam is a poor rice-based economy with a small and largely state-owned industrial sector. It has few resources to fund state sector restructuring, although the scale of restructuring required is not as daunting as in other transitional economies, including China. Nevertheless, state enterprise reform will create unemployment and social tensions that cannot be ignored. State enterprise workers, many of whom are Communist Party members, are an influential interest group that, amongst others, appears to have the potential to stall the whole equitisation process. Yet they cannot all be “winners” from an equitisation process unless vast once-off government expenditures are involved. From a national welfare perspective, however, such levels of expenditure cannot be justified. A balance must be struck where a *justifiable level of expenditure* is used efficiently to allow meaningful restructuring to proceed while minimising the social and political costs of the process.

3. Restructuring as a zero-sum employment game?

As the experience in agriculture shows, restructuring (or “institutional change”), when taken as once-off changes to the “rules of the game” for one or more economic units, can be income and employment creating.

How then to approach restructuring of the state industry sector? It is certainly possible that restructuring could be designed such that changes causing unemployment may be partly or wholly compensated for by changes that create employment. This, in fact, is what happened in Vietnam during 1988-1991, when workers being shed by state enterprises were largely absorbed into the fast growing private household sector (Table 5).

Table 5: Employment trends by sectors, 1989-91
(thousands of persons)

	1986	1989	1990	1991
Total employed labour force	27,398	28,941	30,294	30,974
<i>State sector</i>	4,027	3,801	3,421	3,144
<i>Co-operatives</i>	19,730	19,750	20,414	18,071
<i>Private</i>	3,641	5,390	6,459	9,759
State enterprises	2,658	2,506	2,180	1,916
<i>Central</i>	1,278	1,188	1,091	1,018
<i>Local</i>	1,380	1,318	1,089	898
Share of total employment (%)				
State sector	14.7	13.1	11.3	10.2
State enterprises	9.7	8.7	7.2	6.2

Source: World Bank (1995)., *Vietnam: Poverty Assessment and Strategy*. Washington, DC.

The 1989-91 shedding of workers was mostly due to the collapse of CMEA trade (a market-based shock), and because of a tightening of state enterprise budget constraints during the 1989 stabilisation period (restructuring). At about the same time, however, removal of internal trade barriers and official Decrees supporting the development of the private sector created incentives and opportunities for Vietnam's household businesses. This process a coordinated reform allowed state enterprise employment to fall from 8.7 percent of total employment in 1989 to 6.2 percent in 1991, but without a huge rise in unemployment as the private sector created jobs for 4,369,000 workers.

The capacity for the private sector to absorb more employment is, however, very limited without further institutional change. Value-added and profit margins in private household activities are very low. Household economic activities are also very competitive, so the scope for once-off household-based employment generation through institutional reforms is limited. The only open avenue is up: the promotion of private small-and-medium enterprises – or what may be better described as the private corporate sector.

A set of policy reforms that enable the private corporate sector to develop and to openly compete with state enterprises would precipitate a bout of employment-creating restructuring. So would policies that enable state enterprises and state Corporations to compete more against each other. Such a package would have the potential to increase overall employment, even if state enterprise restructuring was actively pursued. Therefore, if we are concerned about the aggregate level of unemployment, the best and sustainable solution is to develop the private corporate sector as quickly as possible. Government expenditure to compensate those leaving state enterprises is generally not sustainable, although it is targeted and is probably necessary to compensate those workers with poor prospects for finding new employment (e.g. those near retirement).

4. Why “choose” to restructure?

There is a vast conceptual divide between the arguments of Vietnam's policy makers and those of us who provide comments from the outside. The whole vision of development is different, and this, in part, explains differences in the priority attached to restructuring state enterprises. The Vietnamese vision, which can be traced back to the economics of Marx and Lenin, is one of steady accumulation: step-by-step, more of everything. This is in contrast to more contemporary arguments based on an understanding of scarcity, opportunity cost, and the pace of technological change. The crucial ingredient to success for a modern economy is its ability to change – to open new businesses, and to close old ones.

A major criticism of commercial state enterprises, therefore, is that they are slow to change and innovate. They get protection in many forms because of close links to those who give protection – the government. Protection can be from international competition (foreign trade and investors), and from internal competition (other state enterprises or the private sector). Without competition, change is slow. Change is delayed and avoided at every turn: another loan is given, taxes written off, trade barriers and monopoly controls

increased.

Vietnam's policy makers readily admit that state enterprises are inefficient, but they also seem to think that the solution can be found by adding more capital and technology. The causes of inefficiency are not explored deeply enough. The truth is that state enterprises are inefficient *because they are state owned* – because as state enterprises they come under an umbrella of protection that cushions them from competition and change. If Vietnam is to sustain state enterprises as the “leading sector” of the productive economy, then it must accept that it will always be burdened with large numbers of inefficient enterprises.

Meaningful restructuring of state enterprises will create unemployment. The apparent success of the 16 pilot equitisations is misleading as they were far from representative state enterprises. Restructuring that entails greater competition and “hard” budgets for state enterprises will mean retrenchments and even closures. So why do it? The answer is that state enterprises tie up valuable resources, notably land and skilled workers, from moving into new economic activities. Further, state enterprises “crowd out” the private sector, minimise competition, and stop new entrants into various industries. They stop change from happening.

Restructuring is necessary to breathe life into many of Vietnam's stagnant industries. That “life” can come from revitalised state enterprises through equitisation, or from non-state enterprises that grab opportunities as barriers to competition are removed.

That privatisation is no panacea for creating a competitive industrial sector has developed into a cliché over the years. It is true, of course, for a change in the form of ownership is only the means to an end: a competitive industrial structure without compromising links to regulators (the government)². It is a mechanism for solving the principle-agent problem where government is both regulator and owner. Privatisation is not the only mechanism but, done conclusively, it draws a clear line between the two.

With these objectives of “divorce” and competition in mind, it is not clear, therefore, what equitisation achieves. If the state remains the majority or even minority shareholder in an equitised company, the scope for economic games and moral hazard clearly remains. The presence of non-state shareholders, however, may lead to greater transparency of information about the enterprise, but progress here would have to be limited without international standard accounting, auditing and annual reporting.

² This may be contrasted to the Socialist vision of transition (from private to state ownership), where it was argued that the act of ownership transfer was in and of itself sufficient to generate growth and productivity.

5. Labour issues in restructuring Vietnam's state sector

Multiple objectives in a schizophrenic economy

Vietnam maintains a dual economy – a moribund state sector alongside a vigorous mostly-household private sector. Government policies are divided between each sector and labour market policies are no exception. A third division, policies applying to foreign invested enterprises, may also be added.

Vietnam's state enterprise labour market policies are, like other state enterprises policies, focused mainly on controlling economic activity to ensure that a reasonable share of profits (or economic rents) accrue to the government. State enterprises, if left on their own, would be "leaky buckets" requiring continuous subsidisation from the state. For this reason controls on management, trade, production, investment, expenses and wages are imposed to micro-manage state enterprises and to try and make them net contributors to government revenue. From this perspective, protection is viewed as a useful mechanism for helping state enterprises make a profit (or at least to cost the state less). The challenge, it would seem, is to "step by step" expand production in all sectors such that everybody can be employed. While, of course, perfecting the mechanisms of micro-management.

This vision of industrial development is wrong and completely incapable of producing a competitive industrial sector. A minority of privileged workers may be employed in this state enterprise sector to the extent that government support can afford it. In Vietnam, with limited resources and weak domestic demand, this "welfare state pocket" employs only about 6 percent of the workforce. Ongoing protection might squeeze this figure up to 8 percent, but only at the cost of removing incomes and opportunities from the other 92 percent of workers in Vietnam.

Vietnam's labour market policies remain focused mainly on controlling state enterprises. There is also a drive to extend the welfare and "workers paradise" aspects of state enterprises throughout the economy: labour contracts, union dictatorship, generous social security benefits, etc. Policies to promote a competitive and flexible labour market are notable in their absence.

Time to shake up paradise?

Policies aimed at stimulating industrialisation have had little impact on employment levels and wages³. Further, there remains excess labour and low productivity in many state owned enterprises. Available data does not allow a precise answer concerning ongoing surplus labour in state enterprises. A survey in 1994, reported surplus labour in 22 of 67 Hanoi state enterprises, and in only five of 81 Ho Chi Minh city state enterprises⁴.

The enterprise surveys on excess labour generally do not account for the less demanding working conditions in most state enterprises relative to joint venture enterprises or the private sector. The comments of Nguyen Thi Hang are typical of those to be found in the media:

"To earn US\$100 per month, which is relatively higher than what is offered by a State run enterprise, requires hard work. We work 8 hours everyday, sometimes even more. I'm always tense, which hardly happens in a Vietnamese company ... Employees in JVs with foreigners must fulfil their assigned job, otherwise they will get sacked." (Vietnam Economic News, No. 13, 1997. p. 30)

Tran Dinh Hoan, Minister of Labour, Invalids and Social Affairs, has observed that "employees in foreign enterprise have to work harder under labour requirements similar to those of enterprises abroad" (Vietnam Economic Times, March 1996. p.15).

If labour in SOEs worked at a similar intensity as observed in the joint ventures, it is arguable that some 30-40% of the labour force in these enterprises could be released without a net loss in output.

³ Including foreign direct investment which created, by 1996, 146,000 jobs from US\$5.3 billion of disbursed foreign partner capital (US\$36,000 per job).

⁴ OECD, Labour Market Aspects of State Enterprise Reform in Viet Nam, Technical Paper No. 117, 1996, Paris, p. 25.

5.1 The Labour Code: ensuring stability by removing change

The revised 1992 Constitution of the Socialist Republic of Vietnam laid the foundation for the formulation of a new Labour Code, which came into effect on 1 January, 1995. The Labour Code is designed to provide a framework by which:

- “The State carries out the unified management of human resources, and administration of labour through legislation, and formulates policies to develop, allocate human resources, and to develop various forms of labour utilisation and employment services.
- The State provides guidance for workers and employers to establish harmonious and stable labour relations and mutual co-operation for the development of undertakings”⁵.

The labour code and a long list of implementing decrees and regulations amount to a very comprehensive regulatory framework for the state management of the labour market.

While the regulatory framework is comprehensive *on paper*, only parts of the system can be supervised or enforced *in practice*. The following assessment therefore includes not only an evaluation of the underlying logic of the labour market regulatory framework but also of its actual impact given the very limited scope for enforcement.

Employment Regulations

At present the capacity for implementing this framework is very limited and focused mainly on the state enterprises, their joint ventures with foreign firms and the very limited number of private sector firms that employ more than 10 workers and that have registered under various company laws⁶. Some of the most important regulatory issues concern labour contracts and control of contract termination processes, the use of placement services, and the control of expatriate labour.

⁵ Ministry of Labour, Invalids and Social Affairs, Labour Code of the Socialist Republic of Vietnam, The Bioi Publishers, 1995, Article 10.

⁶ It is not the case that the Labour Code applies to only firms with 10 or more workers. Only some articles of the code are restricted this way, mainly those requiring such firms to participate in the collection and management of the social insurance fund, to keep labour records, wage records and social security records.

Labour Contracts

All workers are to be employed on contracts that clearly specify the terms and conditions of employment. Contracts can be for an indefinite term, from one to three years, or less than one year for seasonal employment activities. The law prohibits the use of short-term contracts to fill jobs that are "of a permanent character lasting more than one year" (Article 27)⁷. Other terms of the contract include: hours of work, place of work, working conditions, social insurance provisions, and duration of contract.

A 1994 survey of state enterprises found that 42 percent of their staff were still considered lifetime employees, although only 33 percent were on indefinite contracts, 16 percent on fixed-term contracts, and the remainder on short-term contracts. Table 6 presents some more recent data from another survey of 2,682 state enterprises in 1996. Only 79 percent of workers covered by the survey were on labour contracts, although 92 percent of workers in joint-ventures were contracted. Indefinite time period contracts were signed with 49 percent of all workers (57 percent of central state enterprise workers), an apparent increase on the 1994 survey finding.

Table 6: Labour in surveyed state enterprises and joint-venture enterprises, 1996.

	No. of state enterprises	No. of labour in 1 October 96		Signed labour contracts			
		total	Of which: female	Unlimited	From 1 to 3 years	Under 1 year	No contracts
Central	693	319,863	131,828	181,170	63,643	16,320	58,730
Local	1,859	324,162	146,805	139,332	75,574	29,774	79,482
Joint venture	130	14,493	6,068	3,072	6,818	3,427	1,176
Totals	2,682	658,518	284,701	323,574	146,035	49,521	139,388

Source: MOLISA, (1997)., Statistical Yearbook of Labour-Invalids and Social Affairs, 1996. Statistical Publishing House, Hanoi.

⁷ Decree 198/CP (31/12/94) states that "full-time state enterprise workers will sign labour contracts with indefinite terms". This is the only aspect of the Labour Code which provides discrimination by form of enterprise ownership. It should be removed.

Unions

The Labour Code has also formalised and greatly strengthened the role of labour unions in Vietnam. It not only protects the right of workers to form unions, but it requires unions to be formed within six months in all enterprises (Article 153). Further provisions include:

- Workers can only be retrenched "after consultation and agreement with the Executive Committee of the trade union of the undertaking" (Article 17).
- Disputes incur a protracted process of conciliation and arbitration (Article 38) which can ultimately entail a strike.
- Enterprises must provide a "loss of employment allowance" of one month's salary for each year of employment to retrenched workers (Article 17).
- Termination of contracts for disciplinary or poor performance reasons still requires agreement from the trade union (Article 38).
- Penalties are prescribed for illegal termination of contracts by employers (Articles 41 and 42).
- "The employer shall not impose penalties by way of deductions from workers wages" (Article 60).
- "If stoppage is due to the fault of the employer, the worker shall be paid wages in full" (Article 62).
- "In the event of the employer's bankruptcy, ... labour contracts shall be treated as a privileged debt and must be settled as first priority." (Article 66).
- "When proceeding with disciplinary action, the employer must bring proof of the fault of the worker" (Article 87).
- "Workers are exempted from court expenses" (Article 166).

The prescribed role of unions, and the requirement to pay social security contributions, explain much of the reluctance towards adopting the Labour Code throughout Vietnam. By 1995, most state enterprises were unionised, compared to only 1,200 of 18,000 large and medium sized non-state enterprises⁸. Recently, however, it was announced that 150,000 non-state workers had labour contracts, up from 75,000 in 1997 (these would mostly be in foreign-invested enterprises). In 1996, MOLISA announced that half of all joint-venture enterprises had established trade unions⁹, although a more recent report stated that only 25 percent of Hanoi joint-venture enterprises had unionised¹⁰.

The rights of workers and labour users to enter contracts and the rights of workers to form unions needs to be respected. However, detailed regulations forcing such rigid contracts are counterproductive. Such contracts reduce the flexibility of firms to deal with changing labour market conditions, raise costs to firms of formalised labour

⁸ EIU (1995)., Country Report: Vietnam, 1st Quarter 1995. The Economist Intelligence Unit, London.

⁹ VN Economic News, No. 32, 1996. p.23

¹⁰ VN Economic News, No. 13. 1996, p.31.

relations and discourage enterprise formation and growth. In particular, such regulations increase the costs to the expansion of employment to levels where firms become subject to such regulations. While the contract and labour union regulations are not specifically restricted to medium or large sized firms, it is impractical to enforce these decrees for small firms. These contract and labour union regulations are disincentives to enterprise formation and growth. Even if such regulations benefit some workers in established firms, they tend to limit the opportunities of much larger numbers of workers in the informal sector of the economy.

5.2 Policies for foreign invested enterprises

Control of Recruitment and Placement

Article 18 of the Labour Code allows the Ministry of Labour, Invalids and Social Welfare to “exercise unified State management of the job-seeking service organisations throughout the country”. Article 132 requires all firms operating under the law on foreign investment to use the employment service system set up by Article 18. This often results in attempts to influence the enterprise with respect to the source and number of workers used (often so as to give preference to workers from the joint venture partner or other state organisations with excess labour). The labour code does state that;

“If the employment service introduces or recruits labourers who do not meet their requirements, these businesses, or organisations are entitled to directly recruit their labourers but they must notify the labour office at the provincial level or another authorised office”. (Article 132)

In practice, employment options for foreign-invested enterprises (and state enterprises) remain highly restricted. This can be a serious burden on their ability to operate competitively. There is no need to restrict any employer in their search for the best person for a particular job. To do so can turn an employment service into just another obstacle for investors.

Use of Expatriate Labour

Given the shortage of management and technical skills in the Vietnamese economy, the control of access to ex patriate workers is an important issue. Both firms with direct foreign investment and local firms have the right to hire foreign workers and overseas Vietnamese. However, this right is limited in time and tightly regulated. The maximum period of employment for an individual worker is limited to three years.

Firms with direct foreign investment have to set out their requirements for foreign labour in their initial investment plan or feasibility study. The plan must be approved by the Ministry of Planning and Investment. Foreigners can be hired for a given period of time in line with these approved plans, but these firms must also have an

approved plan or program of training so that a Vietnamese may soon carry out this job and replace the foreigner. The threat of 'forced localisation' of skilled labour positions imposes further uncertainties and costs on investors and is in many cases impractical.

Access to foreign expertise is also a serious problem for state enterprises and other domestic firms. The labour code allows all domestic firms to employ foreign workers as long as they are properly licensed. The implementing decree¹¹ sets out the procedures and conditions for obtaining the license, and the subsequent labour permit. The procedures are however unnecessarily complex and restrictive. State owned enterprises also have salary controls, and controls on their overall wage fund, which impose further constraints on their ability to recruit foreign expertise.

The regulatory constraints and costs on the use of foreign labour are a very inefficient method of encouraging firms to develop and use local skills. The lower cost of Vietnamese labour provides a better incentive if it is not distorted by tax disincentives operating against the use of local highly skilled staff. Unfortunately, there are significant tax disincentives operating against greater use of high skilled (and therefore high wage) Vietnamese. The disincentives to using high skilled Vietnamese results from the higher tax rates applied to incomes earned by Vietnamese relative to the rates applied to incomes earned by non-resident foreigners. This results because;

- the threshold for taxable income is lower for Vietnamese than for foreigners (2 million dong per month versus 5 million);
- the tax rate rises progressively to a higher rate for locals at a lower income level (60 percent bracket for incomes over 10 million dong per month for Vietnamese compared to a rate that increases to a highest bracket of 50 percent at incomes of 70 million dong per month for foreigners);
- a surcharge tax is imposed on high income Vietnamese at a 30% rate for incomes over 8 million dong per month.

The effect of the surcharge on high incomes of locals is that the effective marginal tax rate becomes 72 percent at a monthly income of 12 million dong (the marginal rate for the foreigner at this level of income is just 20 percent).

The implications of the income tax system for the firm can be illustrated with an example. If a firm were to provide a 24 million dong per month *after tax* income to a high skilled employee, it would cost the firm 26.6 million dong if the employee was a non resident foreigner, and 70 million dong if he was a Vietnamese resident.

It would be better to avoid restrictive regulation of the use of ex patriate workers, remove the tax disincentives to using local versus foreign labour and rely on normal market forces and competition to encourage firms to search for lower cost workers in the local economy.

¹¹ Decree 58/CP, October 3, 1996.

Minimum Wage Policy

The government sets a minimum wage rate intended for “the labourer doing the simplest work in normal working conditions”. The minimum wage rate is intended to allow the labourer to both meet basic needs and to permit savings to finance some accumulation of human or physical capital.¹² The minimum wage is supposed to be periodically adjusted for changes in the cost of living.

Minimum wage rates are justifiable on social and political grounds, although they can have negative net welfare effects on the economy. The minimum wage rate might raise the wages of workers effectively covered by the legislation but, by discouraging employment, create or worsen an unemployment problem. In Vietnam, the minimum wage of 144,000 dong is very low, but it is used to calculate the complex matrix of state enterprise (and foreign invested enterprise) wages for skilled workers. The negative employment impact may, therefore, be substantial.

The minimum wage is different for joint venture and 100 percent foreign-owned enterprises based on some perception of what Vietnam can reasonably charge given wage rates in countries competing for foreign investment. This wage rate is considerably higher than the minimum wage for domestic labour users. It is at present set at US\$45 per month in Hanoi and Ho Chi Minh City; US\$40 in other specified cities; and US\$35 in the rest of the country in comparison to the domestic minimum wage of VND144,000 (about \$10 per month at current exchange rates).

The minimum wage for foreign-invested enterprises is defined as “the wage paid to the doer of the simplest jobs (untrained labour) in normal labour conditions and environment”¹³. Firms with foreign investment, “are allowed to work out and apply their own wage scales and wage brackets” to determine wages for more skilled work or in more difficult conditions or environments, but these wages cannot be lower than would be given by the wage guidelines (wage matrices) that are applicable to domestic enterprises. While the wage guidelines for domestic firms have been relaxed to allow more flexibility in setting incomes in domestic firms (discussed below), this means that there is not only a minimum wage rate for untrained labour but also a higher minimum wage rate for all higher skilled workers. The only exception to this is “for newly founded enterprises which still meet with difficulties in production and business activities and which cannot apply immediately the system of wage scales and brackets prescribed by the State”¹⁴.

¹² This is interpreted to be the meaning of article 55 in the Labour Code which states that the minimum wage must be sufficient to allow the worker “to recuperate his simple labour and also to accumulate for the reproduction of expanded labour”.

¹³ MOLISA, Circular No. 11/LD TBXH-TT, May 3, 1995 on “Guiding the implementation of decree No. 197/CP of the Government concerning the wages of Vietnamese labour in foreign-invested enterprises, and foreign or international agencies and organisations in Vietnam”.

¹⁴ MOLISA, Circular No. 11/LD TBXH-TT, May 3, 1995, *ibid*.

5.3 Incomes Policy

Under the centrally planned economy, the wage levels in the state enterprises were centrally controlled to capture profits for the state budget. Even with central planning, workers were able to find ways to share in the profits of the successful enterprises¹⁵. With reform, these state enterprises were given more autonomy and hence there was a further erosion of control over SOE resources, including payments to workers.

Enterprises can avoid profits tax by increasing apparent or even actual expenditures. Most do it legally, some illegally. In many cases, the regulations are unclear or not detailed enough to decide if an action is strictly illegal. In 1993, the government passed two resolutions aimed at putting "the payroll and wage fund under strict state management"¹⁶. These resolutions specified the exact "basic wages" to be paid to all state sector employees calculated based on a multiple of the minimum wage rate. At the same time, all monetary non-wage income has been abolished, including compensation for higher electricity prices, education and training cost payments, transport costs, and annual holiday payments. Performance-related bonus payments were allowed of up to six months (50 percent) of the annual basic wage.

The "basic wages" used to be calculated using 72 different wages tables, each of which presented a matrix of different salaries based on skill levels and grades (typically reflecting years of experience and skills). Salaries were calculated as a multiple of the minimum wage, set at 144,000 dong per month. Of the 72 wages tables, 21 were for the "direct production sector" and 24 were for the "trade and service sector". One table applied to "enterprise management", and this is presented as an example in table 7.

Table 7: Salary Table for Enterprise Managers

	Categories of enterprises:				
	"Special"	Type 1	Type 2	Type 3	Type 4
Director: coefficient	6.72-7.06	5.72-6.03	4.98-5.26	4.32-4.6	3.66-3.94
<i>Salary ('000 dong)</i>	<i>806-847</i>	<i>686-724</i>	<i>598-631</i>	<i>518-552</i>	<i>439-473</i>
Vice-Director, or Chief Accountant:	6.03-6.34	4.98-5.26	4.32-4.6	3.66-3.94	3.04-3.28
coefficient					
<i>Salary ('000 dong)</i>	<i>724-761</i>	<i>598-631</i>	<i>518-552</i>	<i>439-473</i>	<i>365-394</i>

Source: MOLISA, 1997.

Note: The coefficient is the multiple of the minimum wage, which was 120,000 dong per month until January 1997.

¹⁵ See Fforde & de Vylder, *From Plan to Market: Vietnam in Transition*, 1996. p.262.

¹⁶ Resolutions 25/CP and 26/CP [23/5/93].

The attempt to centrally determine both absolute and relative wages has not proved practical. The system was modified in January 1997¹⁷;

- to raise the minimum wage to 144,000 dong¹⁸ (to rise to 157,000 dong in 1999);
- to allow production enterprises more freedom in setting their own enterprise specific minimum wage as determined by productivity performance within the enterprise.

The relaxation of minimum wage controls on state enterprises was a decisive act of deregulation. There had been pressure to do so for some time, particularly from the more successful state enterprises. Wage and bonus controls had pushed profitable enterprises to seek alternative mechanisms for increasing worker remuneration, such as providing health and education services, or clothing and food.

State enterprises have managed to negotiate the right to use a minimum wage in calculating the “basic wage” that is up to 1.5 times the economy wide minimum wage (Decree 28/CP; 28 March, 1997). The attempt now is to try and maintain the aggregate wage fund in line with enterprise profits, i.e. increases in profits are the key to increasing wages. While this would appear to be a possible basis for a constraint system that allows for reasonable incentives, such a system is easily manipulated when there is easy access to credit and when accounting practices are lax.

The wage matrices used in determining relative rewards should ideally account for skill, knowledge and productivity differences within the workplace as well as for changing supply and demand conditions for different skills. This is difficult to do at the economy wide level. Enterprises have been able to establish the right to set their own enterprise specific matrices for calculation of the different ‘basic wage’ for different skills. Again, this may provide the flexibility needed for getting relative rewards to reflect relative contributions to the operations of the SOE, but this flexibility can easily slide into even less efficient outcomes if the process becomes highly politicised or corrupted.

Many of the SOE’s are operated on a system where the enterprise’s main target is a level of contribution to government revenue. Most of the enterprises are unable to make much of a contribution. Some 360 enterprises (out of a total of about 6000) account for some 80% of SOE contributions to the budget¹⁹. The major determinant in wages within the SOE’s is the level of profits being achieved. Wages for similar skilled labour can differ by thousands of dollars per year in different enterprises

¹⁷ Resolution 06/CP [21/1/97]

¹⁸ The 20 percent increase in the nominal minimum wage only partially compensated for increasing consumer prices, which had risen by 36 percent since May 1993.

¹⁹ World Bank, “Vietnam: Deepening Reform for Growth”, Report No 17031-VN, Oct. 31, 1997 p.

depending on their profitability²⁰. The dispersion of wages is also much greater in the more successful SOE's relative to that in the unprofitable ones²¹. A 1995 survey of 360 state enterprises found that average worker incomes were 1.1 million dong, and that many were already applying a minimum wage of 350,000 dong²².

The conditions are now more favourable for increasing worker shares of economic rents. State enterprise workers are already a small minority of workers, accounting for nine percent of the total labour force. If one excludes those employed in educational institutions, this is reduced to seven percent. If we focus only on state manufacturing enterprises, the 608 thousand in 1995 were only 1.7 percent of total employment. With a restructuring program that divested or privatised loss making enterprises, the privileged minority in joint ventures between state enterprises and foreign investors and in the three or four hundred highly profitable SOE's would be below 1 percent of the working population. This privileged minority of workers is, however, likely to have a disproportionate influence on maintaining the many forms of protection and preferential treatment for these enterprises.

Incomes policy applies mainly to state organisations, including commercial state enterprises. However, article 57 in the Labour Code does not specifically limit incomes policy to just the state sector. Article 4 of Decree 197 (Dec. 31, 1994) also states that "the Ministry of Labour, War Invalids and Social Affairs, based on the State's salary policies, shall make guidance on the implementation of salary regime in enterprises and production, business or service organisations belonging to the other sectors of the economy". The rationale for controls on non-state salaries is to ensure that worker and management costs are not inflated to reduce reported profits and the profits tax due to the state. This is impossible to enforce given the many other mechanisms open for "hiding" profits. In practice, non-state enterprises seem to have full autonomy to set salaries above a specified minimum as detailed in the Labour Code. So do foreign direct investments, including joint ventures, except again for a specified minimum wage.

The attempt to control incomes by linking them to the minimum wage rate has not been very successful. Wage distortions have made it more difficult for state owned enterprises to operate more efficiently. Efforts to allow more flexibility have eroded controls aimed at assuring an adequate return on state assets. Inflated wages in potentially highly profitable SOE's will make it more difficult to generate support for 'equitisation' or to progressively reduce barriers to competition by domestic or foreign investors or by imports..

The direct linkage between the minimum wage rate and incomes throughout the state sector (and pensions paid by the Social Insurance Fund) means that adjustments in minimum wage rates have important implications for government finance. Any

²⁰ See Le Thanh Nghiep, "The Determinant Factors of Wage Incomes in the Public Enterprises of Vietnam", in *Renovation of Financial and currency Policy and Control of the inflation in Vietnam*, National Political Publishing House, Hanoi, 1997 p. 143-170.

²¹ See Osamu Nariai, "Wages and the International Competitiveness of Vietnam", *ibid*, p. 174.

²² Labour and Social Affairs Journal, Sep. 1997. p.16.

adjustment in the minimum wage rate implies a general increase in all incomes and payments linked to the minimum wage. The commitment to adjust the minimum wage rate for inflation may require a substantial expenditure to adjust all of the state incomes and other payments linked to the minimum wage. This may imply tax increases or budget reallocations that will slow the development process and imply burdens on much larger and lower income groups elsewhere in the economy²³.

6. The Social Protection System

Health care, retirement, housing, child-care, education and other benefits have traditionally been linked to state enterprises. This linkage is of concern for several reasons;

- there is a need to address the needs of workers in these other sectors as well;
- such linkages make it more difficult to restructure SOE's when this would imply the need to reduce excess labour;
- such linkages interfere with the ability of workers to take advantage of alternative employment opportunities and with the general development of flexible labour markets.

This section looks at ways in which these different social programs might be adjusted to include other sectors of the economy, to facilitate SOE restructuring and to increase the efficiency of the labour market.

The Social Insurance System

The social insurance system is funded by obligatory payment of social insurance premiums by the employer (15% of the wage fund) and the employee (5% of the wage) in all enterprises with 10 or more employees. For all other arrangements involving hired labour, the social insurance allowances shall be included in the salary paid by the labour user so that the worker can join a social insurance scheme of his choice or look after his own insurance.

The social insurance fund provides pensions for workers as well as benefits for childbirth, sickness, disabilities related to work-related accidents or occupational diseases. We focus on the pension benefits and return to the other benefits financed by the pension fund and employers below. Workers become eligible for pensions at the age

²³ The VND2,500 billion earmarked to account for the impact of the adjustment of the minimum wage from VND120,000 to VND144,000 per month reportedly was 30% higher than the total anticipated increase in revenues in 1997, even though this adjustment made up only two thirds of the fall in real wages. See Vietnam Investment Review, "Budget Strained by Salary Crisis", Ministry of Planning and Investment, April 11, 1996.

of 60 for men and 55 for women if they have paid social insurance premiums for at least 15 years. The benefit is equal to 45% of the salary earned in the past 5 years with an additional 2% payable for every additional year worked (up to 30 years). The maximum pension is therefore 75% of the salary in the past five years. More favourable pension benefits are available to the disabled and to those in especially heavy or noxious jobs²⁴.

Workers not qualified for pensions but who have had contributions to the system are entitled to a onetime payment set by Government, currently one month of salary for each year of contributions.²⁵ Some 146,000 of the 236,000 retirees receiving benefits in 1996 were handled with lump sum payments. This might be because they were retrenched without rights to a normal pension. Reportedly, many workers preferred to obtain the one time payoff, even in cases where there were rights to a pension. This might be expected when discount rates are high or when there are risks attached to claims for future payments.

The coverage of the social insurance system is limited by the unwillingness of many employers and employees to make the required payments. Such payments can be legally avoided if the employment is in enterprises or operations with less than 10 employees, a category that accounts for the vast majority of enterprises in agriculture, fisheries and private sector operations in all other sectors of the economy. It is estimated that the vast majority of workers - 30 million out of a workforce of 37 million - fail to pay insurance.²⁶ In 1995, the turnover on Social Insurance premiums was US\$315 million²⁷.

There are important issues that need to be addressed with respect to the social insurance system. The two that we focus on here involve;

- the level of benefits and financial viability of the social insurance fund;
- effects on labour mobility and the growth in employment opportunities, particularly through the expansion and growth of small private sector firms.

Financial Viability:

A sound social security system should be financially sustainable over the long run without becoming a drain on budgetary resources. In many countries, the savings generated by the pension funds make a significant contribution to aggregate domestic saving.

²⁴ Workers with 61% disability (in heavy or noxious jobs) can get pension benefits 10 years earlier (at any age) if they have had 20 years of contributions.

²⁵ The monthly salary is calculated as the average of the past five years of employment

²⁶ Vietnam Investment Review, Issue 277, March 2, 1997.

²⁷ NQH & Associates, (1997)., Preliminary Report on Health and Personal Line Insurance Market Survey in Vietnam. Unpublished, April, p.137.

Even though the Government is covering the costs of the benefits provided to state workers with qualifying years of employment prior to the start of contributions, the long-term financial viability of the existing social security system needs further examination for several reasons:

- The levels of benefits relative to contributions are claimed to be generous by Asian standards, more comparable to developed countries such as Canada and the United States²⁸.
- The system is vulnerable when the average wage over the past five years is well above the average wages during which payments into the system were collected (or would have been collected given the coverage being provided to workers based on years worked prior to the introduction of the system).
- The system is vulnerable when payments can be claimed in circumstances that may be difficult or costly to control (as, for example, with sickness allowances to be paid by the social insurance fund on the basis of a doctor's certification).
- The surplus funds now being accumulated are deposited with state banks at a very low interest rate of 0.3% per month²⁹.

There has already had to be *ad hoc* adjustments to the system to take account of unanticipated problems with the design of the system. For instance, the use of the average wage over the past five years criteria has been set aside for workers in joint ventures between the SOE's and foreign investors where wages are much higher than those previously earned. Instead, the wage is taken as the average wage over the entire life of employment. Because of inflation, wages in the earlier years are calculated using the present minimum wage times the matrices that are supposed to be used to calculate basic wages³⁰.

It would seem that workers in non-state enterprise which has just joined the social insurance system will never get a pension if they have less than 15 years before they retire. The benefit from joining would therefore seem questionable for such enterprises and their workers (except the youngest workers - who would not be the decision makers). This may be another explanation for the slow adoption of the Labour Code outside the state sector.

²⁸ OECD (1996), Labour market aspects of State Enterprise reform in Viet Nam. Technical Paper No. 117, Paris, p. 34.

²⁹ Molisa interview.

³⁰ See the section above on incomes policies.

Effects on Labour Mobility and Employment Opportunities

Without nation-wide coverage, the social security system can become a substantial barrier to labour mobility. And as with any factor of production, allowing workers to move from less productive to more productive employment is an important ingredient in making markets efficient and the economy strong. Workers, however, are unlikely to move to another enterprise if they are unable to transfer pension rights and other benefits. In practice this problem is sometimes circumvented by "leasing" workers. For example, many Vietnamese full-time employees in foreign companies remain officially employed by their former state enterprises. These workers still get their official state sector salary and other benefits, and in return the foreign company pays a "tax" to the state enterprise. This is a cumbersome and inefficient mechanism for resolving labour mobility problems, and is only viable with regard to highly skilled workers. More generally, labour mobility between the state and non-state sectors is considerably constrained by the lack of a universal social insurance system.

A related concern is the continued enterprise-specific provision of land or housing as long-term employment benefits. The extent to which this continues remains unclear. It is possible that most of the available land has been distributed. The ongoing frequency of house construction for workers is also unclear, but is likely to be much less as it was closely linked to land distribution. The government has also been discouraging the practice, which has often been illegal. It may, therefore, be a problem which is solving itself. Nevertheless, it should be something which is surveyed and studied in detail. Such payments, or even expectations of possible payments, hinder labour mobility.

Policy Implications:

Many of the problems with the social insurance system would be greatly moderated;

- if the system was based more directly on past contributions; and
- if the rights to these pension funds were fully vested with the worker.

This would solve both the financial viability and constraint on labour mobility problem.

Social insurance accounts could be set up based on these contributions. If the individual moved out of a job covered by the social insurance system, the worker would still retain a claim on the funds accumulated in this account at the time of his retirement. Contributions up to 20% percent of wages could still be invested in the fund if the worker were employed in a firm with less than ten workers. This would eliminate the disincentive to leave jobs in covered sectors of the economy for fear of losing all benefits (if the worker left prior to having been covered for 15 years) or having to take a lump sum payment rather than a pension if the worker left prior to reaching retirement age.

This would also eliminate some of incentive of new workers unlikely to reach the prescribed 15 eligibility requirement and their prospective employees from entering the system, by evasion of the regulations or by remaining a small enterprise with less than 10 employees.

If progress can be made in developing a sound financial system, much of the benefits from pensions would arise due to positive returns to saving in the pension accounts. This would also give ordinary Vietnamese a strong self interest in the development of such a system.

7. Options for State Enterprise Reform

To date, the main elements of the enterprise restructuring program have included;

- re-registration of only profitable or potentially profitable SOE's;
- increased managerial autonomy;
- an attempt to establish "hard" budget constraints; and
- establishing a *Labour Code* defining the rights of workers and obligations of firms.

Under this system, the management and unions in the SOE's were expected to jointly resolve issues of excess employment or low productivity. In particular, firms were expected to set aside funds to enable them to meet their obligations as excess workers are retrenched.

It appears that SOE's have not been able to adjust either the level or structure of their labour force in line with the requirements for economic efficiency. There is limited financial resources for compensating retrenched workers and because of limited incentive for firms to make these adjustments when they continue to have access to support through loans from state banks and limited incentives for government to encourage such restructuring given concerns about unemployment and the political importance of unions. Without support for such structural change, many skilled workers - a valuable resource - will remain under-utilised and underemployed in state enterprises.

7.1 Restructuring Employment Within State Owned Enterprises

The options for a new round of enterprise reform may remain constrained by the continuing commitment to a leading role for SOE's. Even if this is so, there may be some scope for addressing the issue of continued excessive employment and low productivity within state enterprises.

Subsidies for Retrenching and Retraining Workers

One option is to develop programs to mitigate adjustment costs and gain popular support for restructuring. This could be done by providing subsidies to cover part of the costs of retrenchment or retraining programs for workers willing to give up their jobs.

Between 1989 and 1993, state enterprises shed 970,000 workers involving severance payments totalling around US\$60 million. The state enterprise sector now employs about 1.7 million workers. How many of these are surplus? As discussed above, state enterprises are a more heterogeneous group now, and those with the classic problem of over-employment are fewer. Surplus employment is likely to still be a problem, particularly if the gap in labour productivity within the SOE's and the joint venture enterprises could be reduced. As also noted above, such surplus employment might be as high as 40 percent of the labour force. However, more work needs to be done on clarifying the existing situation. Enterprises with surplus labour need to be defined, as do the numbers, age, and retraining needs and desires of these people.

To give some perspective on the possible costs of any initiative aimed at reducing surplus employment in SOE's, let us assume that the worst 20 percent of state enterprises employ about 350,000 persons of which 40 percent, on average, are surplus. That means 160,000 surplus workers to be paid one month's salary per year of employment upon retrenchment (Labour Code, Article 17). With an average monthly salary of 350,000 dong (US\$29.7), and an average employment history of, say, 15 years, that would cost US\$445 per worker, or US\$71.2 million for all 160,000.

As in the earlier period, state enterprise retrenchments would probably be largely absorbed into low-productivity private sector employment. A challenge, therefore, is to support restructuring which moves workers into relatively high productivity employment. This is particularly important for young and highly educated workers who, with some additional investment in human capital (training), support during a job-search period, and possibly access to loan financing, could move to high-productivity employment rather than earn a meagre income in some unskilled household-based activity.

All non-pensioned surplus workers could be provided with the opportunity to undertake retraining at a subsidised rate. Part of the retrenchment payments could be converted to retraining vouchers at a favourable rate. Even if 2000 dong of retraining vouchers were offered for every thousand dong reduction in retrenchment benefits, many or most would probably choose the higher cash pay out reflecting their perceptions that retraining might have a limited return or that they have opportunities elsewhere for using their present skills or developing new ones on their own. Options for such training schemes through a system of VOTECH scholarships have been discussed above. Retrenched workers should be given a wide range of training courses and institutions to choose from.

Pension Costs

What about older workers? Many of these would be unwilling or unable to be retrained. Even then, investments in retraining can only bring modest returns as they have few years of active employment left. Further, the cost of retrenching such persons is higher (more years of employment). This is just one example where the regulations set out in the *Labour Code* could well interfere with efficient restructuring in the SOE's. Efficiency may require that older workers are retrenched but this might not be profitable because of the required higher compensation payments for such workers. This is why it would be preferable if separation packages were worked out at the enterprise level.

Surplus workers, once identified (in agreement with the trade union), should be presented with choices, and the pension provisions of the Labour Code set the parameters for establishing these choices (Article 145). While we have recommended that substantial changes in the regulatory framework to allow for freedom of workers and employers to negotiate mutually acceptable terms of employment in section 2 above, it will be difficult to carry out explicit retrenchment programs in the immediate future on terms for workers that are less favourable than those set out in the existing regulatory framework.

Under the existing labour code, workers need at least 15 years of social insurance contributions to be entitled to a pension, so surplus workers with 15 or more years employment can be retired early. It should be noted that these people have not already volunteered for early retirement, despite being surplus. A degree of compulsion will be required to implement a restructuring package at reasonable cost. Some surplus workers will lose more than others, but all will be comfortably compensated compared to the average worker in Vietnam. It is a matter of privileged workers settling for slightly less.

Surplus workers with 6 to 14 years of employment would generally wish to remain in order to collect pensions. The once-off retrenchment payment is poor compensation for loss of pension rights. Here the ability to transfer pension rights from one enterprise to another becomes important. It is unlikely, however, that many of these people will find new jobs in other state enterprises, or in non-state enterprises with social insurance schemes, even at lower salaries. In many countries, workers can be refunded their nominal contributions to pensions schemes, or have the whole amount (including employer contributions) transferred into a private pension scheme which requires continued payments by the worker. Without these or similar options, the loss of pension rights becomes an obstacle to labour retrenchment in particular, and labour mobility in general.

One option would be to refund the worker's share of pension contributions, i.e. 5 percent of the annual average salary multiplied by years of service. In our example involving 160,000 surplus workers, maybe 30,000 could take early retirement. The remaining 130,000 may average 9 years of employment, which would add US\$160 per

worker, and US\$20.8 million overall. The average retrenched worker would now receive US\$605, equivalent to 20 month's salary, but much better than paying them for doing nothing for many more years. Alternatively, workers could be offered the opportunity to maintain their rights to a pension at normal retirement age with the pension set at 3% of the relevant pension wage³¹ for each year of employment. If those taking this option had an average of 9 years of employment, on average there would be an entitlement to a pension equal to 27% of the wage.

All non-pensioned surplus workers should be provided with the opportunity to undertake retraining at a subsidised rate. Part of the retrenchment benefits could be converted to retraining vouchers at a favourable rate. Even if 2,000 dong of vouchers were offered for every 1,000 dong reduction in retrenchment benefits, many or most would probably choose the cash option. This reflects perceptions that retraining might have a limited return, or that they have opportunities elsewhere for using their present skills or developing new ones on their own. Retrenched workers should be able to use retraining vouchers in a wide range of training courses and institutions. They should not be used to subsidise the public sector provision of such training in a way that discourages the development of private sector alternatives.

7.2 Pilot Projects

In terms of pilot projects, the government could begin by implementing a labour restructuring package as outlined above for a selection of Hanoi state enterprises (where alternative employment options are greater). The first task is to determine the nature of the problem. "Surplus" workers should be identified. Are they concentrated in a few hundred enterprises? What is the demographic profile of these workers (which will shape the approach and costs involved)?

A Hanoi Pilot Scheme could feature:

- Early retirement at reduced rates or lump-sum refunds of worker social insurance payments (5% of base salary multiplied by years of service). Choice compulsory.
- Lump-sum retrenchment payment (one month of salary multiplied by years of service).
- Opportunity to access small and medium (SME) business development technical assistance and loan funds.
- Payment of fees for up to one year of vocational and technical training, and a "scholarship" equal to the minimum salary for that period.

³¹ The relevant pension wage would be calculated by the prevailing system used for those who are eligible for retirement.

This project should be accompanied by research which evaluates the costs and benefits by tracing the actions and achievements of retrenched workers for some years. The once-off cost of retrenchment needs to be shown to be justified by long-term financial savings.

Improved Enterprise Governance

Any effort to address excess employment in SOEs needs to be part of a broader effort to strengthen governance and management capability in these enterprises. Key elements in this effort should include;

- the clarification of ownership and oversight responsibility for enterprises;
- increased managerial autonomy and authority disciplined by performance contracts with the agency exercising ownership and oversight responsibility;
- enhanced financial discipline with an end to all subsidies (including easy access to credit and conversion of loans that can't be repaid into equity);
- development of an "arms length" relationship between government and enterprises with an end to all preferential treatment of SOEs relative to other types of enterprises;
- increased authority for enterprises management to 'hire' and 'fire' staff based on their needs and on objective evaluation of job performance;
- a major effort to establish international-standard accounting, reporting and auditing systems.

Such an effort to improve the efficiency of SOEs will be difficult to carry out in practice. It is important that lack of success in achieving increased efficiency does not result in continued inability to monitor performance of state enterprises and continued hidden subsidies or support. There will be much opposition. The "information rich" can be expected to be unwilling participants in this process. That is why it will require a campaign with support from the highest levels with a profile equivalent to those against corruption and smuggling.

7.3 A Revitalised Equitisation Program

The government has recently declared that equitisation will be pursued with greater vigour, and compulsion will be introduced to increase the pace of equitisation. This is encouraging, as "equitisation through consensus" cannot promote significant structural change in enterprises. Structural change must be imposed. In relation to workers, equitisation should be accompanied by either;

- transferring all 'indefinite' term workers on to fixed term contracts which might not be renewed if commercial conditions required a reduction in the labour force or if performance was not satisfactory; or

- by allowing negotiated agreements between workers (and their unions) and owners of the enterprise determine the nature of employment contracts and any compensation due to workers whose contracts are not renewed.

The former step is consistent with the existing *Labour Code* while the latter approach would be consistent with the alternative *Employment Contracts Act* that we have recommended in Section 2 above.

The recommendation to replace indefinite-term contracts with fixed-term ones is controversial. It is unacceptable according to Decree 198/CP (31/12/94), but we have already recommended that this provision be revoked. Labour policy focused on providing life-time employment is a luxury which no country can afford, least of all Vietnam. Workers gain a direct equity share in their enterprise from equitisation, which can be interpreted as compensation for a move to fixed-term contracts.

We also recommend that the government accept the principle of providing a two-year "window of opportunity" for labour restructuring immediately after equitisation. Equitisation only leads to strengthened or rationalised enterprises if the process is allowed to create structural change. That is why "equitisation through consensus" is generally ineffective. As part of its commitment to compulsory equitisation, the government should introduce policies which facilitate restructuring immediately after equitisation.

The contents of such a "restructuring period" can be debated once the principle is accepted, but it may include, for example, permission to dismiss workers with 2 months' notice, without requiring Trade Union approval.

Divesting Parts of State Owned Enterprises

In Vietnam, *equitisation* is unlikely to be realistic for many small SOEs. Alternative privatisation, divestiture and perhaps leasing options need to be explored. However, these options also need to be explored for units within large scale SOEs that are not immediately being considered for *equitisation*.

There seems to be many activities within large SOEs in Vietnam where this option should be explored. For instance, state enterprises, ministries, and other government organisations often maintain their own construction companies. In part, this seems to be related to "profit hiding" motives or even as a mechanism for skimming off funds for enterprise managers and key officials. Another story told is that they are mechanism for making profits after allocating land to workers. Land use rights must be sold at fixed low prices, but informal compulsory use of a specific (and more expensive) construction company for building effectively increases the price paid for the land and earns the enterprise a share in the economic rent implicit in the controlled land price. As efforts are made to strengthen the commercial focus in SOEs, it makes a lot of sense to spin off these construction companies and let them compete in the market.

8. Towards More Efficient Labour Markets

The nature of Government labour market policies and the design of the restructuring program also has important implications for the development of the private sector and the efficiency of the labour market. An efficient market economy is characterised by its ability to move resources and factors of production quickly from economic activities generating low returns to those generating higher returns. Undistorted price signals, accompanied by a "movement friendly" policy environment, are key ingredients for achieving sustained increases in productivity growth.

Vietnam also faces an aggregate employment problem. That is, simply providing enough jobs for the fast increasing number of unskilled workers. Unemployed or under-employed workers are a wasted resource. Unemployment is also a degrading condition for people eager and willing to work. This adds a social dimension to economic concerns.

Labour Mobility

Vietnam's economic history features the steady migration of people from the crowded Red River Delta down towards the less densely populated Mekong Delta. Under central planning, many state interventions have worked to control movements that would respond to economic incentives in favour of centrally dictated allocations³². For instance, controls on housing and residence have tended to restrict movements towards areas with increasing income and employment opportunities.

Central planning tended to segment the labour market and discourage labour mobility. State employment was lifetime employment, and generally in the same organisation or enterprise. *Doi moi*, and associated structural change, has begun to erode labour market segmentation. Rural-urban migration - much of it informal and seasonal - has increased markedly, as development increased the income gap between cities and villages. Further, with increased opportunities in the private sector and in joint ventures, there has been increased flows between the state and non-state sectors. Nevertheless, there still are significant barriers to developing an efficient labour market in Vietnam.

³² For example, government sponsored migration schemes have moved people from the northern delta area into sparsely populated uplands regions. During the first Five Year Plan, 1976-1980, 706,000 people were moved in formal migration schemes with a further 420,000 during the Second Five Year Plan, 1981-1985.

Getting a Job

Under central planning, a job in the state sector meant a job for life, and in such a distorted policy environment, education and skills were secondary qualities to personal contacts and family background. The mechanisms for recruitment were non-transparent. The non-state sector offered few jobs outside of household enterprises. Most people stayed in their villages, and the populations of urban areas remained stable.

With the *doi moi* reforms, opportunities for "informal" non-state sector employment in urban areas have increased considerably, including shop assistants, domestic helpers, motorbike taxis (*xe om*), and construction workers. State sector employment, after an initial sharp fall in numbers, is rising slowly again. Foreign investment is creating some jobs.

The approach to getting a job in 1999 can therefore range from the traditional (state sector connections) to the international (joint-ventures), as a recent article outlined:

"Presently, graduates can also find jobs by taking advantage of family relations or friends, or by taking part in examinations. And a little bribery doesn't go astray in either case. Students who have relatives working in ministries or other state bodies are often given priority posts after graduation. Students from wealthy or influential families also find advantage through spending sometimes millions of VND to procure a job in a successful company...However, many businesses, especially foreign invested companies, use their own entrance examinations in selecting staff. This way, students compete for jobs fairly, and successful ones are encouraged to improve themselves by further study and training, so that they can work well in different positions in the company." ³³

It seems that the process of entry to the public service has changed little during *doi moi*. Moves to establish a more professional public service, including encouraging mobility between ministries and organisations, are needed. The process of getting jobs in state enterprises is a mix of the old and the new. Some have retained old habits, such as employing the sons and daughters of retiring workers, because incentive structures discourage change. Others have introduced examinations and interviews, and cut back on the arbitrary power of their Personnel Departments in an effort to choose the best persons for new jobs.

More emphasis needs to be given to increase the scope for competition in the search for jobs. For example, all public service job vacancies should be advertised in a single bi-weekly government gazette. The job terms of reference and its conditions would be specified. All public servants would be able to apply for the job, from which the personnel department of the relevant organisation would select a short-list of candidates. A panel of officials would interview the short-listed candidates and choose one. A similar transparent and public system is required for selecting persons to enter the public service.

³³ Vietnam Economic News, Oct. 17, 1997. p.47.

Leaving a Job

Labour mobility can be encouraged by removing constraints to leaving jobs, helping people to find and move to new jobs, and by ensuring that long-term benefits (notably pension claims) are transferable from one job to another. Much of the discussion in this report focuses on achieving these objectives. For example, the recommendations to cease long-term payments of land and buildings to workers and to allow workers to maintain their rights to pensions even if they leave sectors covered by the Social Insurance system are intended to eliminate constraints on labour mobility.

"Permission to leave" is apparently still required in some state organisations. Such restrictions should be abolished. Similarly, restrictions on taking up new jobs must be minimised. For example, it is reportedly very difficult to change residency from one city to another, and this is required before a house can be purchased. Vietnamese citizens should be able to purchase buildings throughout Vietnam, irrespective of their official place of residence.

Facilitating Job Search

The government is beginning to be active in assisting the job search efforts of individuals. Employment offices assist young graduates in their search for first jobs. It is difficult, however, to develop this service in an employment environment still dominated by personal contacts in both the state and the household sectors. It appears that only foreign companies and joint-ventures openly advertise for positions. Private "head-hunting" services are offered by only a few foreign firms. As the commercial environment becomes more competitive, these employment services will expand and improve. There seems little point in directing more government resources into this area, which the private sector should be able to provide in line with growing demand.

9. Conclusion

Vietnam's labour policies remain focused on control of state enterprises: who they employ, how many, and what they pay them. The Labour Code of 1995 saw a move to extend state worker privileges throughout the economy. This is a futile exercise to establish a welfare state in a country with minimal resources to support one. What it does do, however, is stifle competition and mobility in the labour market wherever it is implemented.

State enterprise restructuring must include a fundamental shift in labour policies to be effective. State enterprise restructuring will create unemployment, but the numbers will be small in relation to Vietnam's total workforce. Further, restructuring aimed at stimulating development of the private corporate sector would create jobs in excess of the numbers lost from Vietnam's modest state enterprise sector.

Without "change friendly" labour and other policies, Vietnam will remain trapped with an allocation of resources which grows less relevant by the day.

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