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# Segmentation and informality in Vietnam: A survey of the literature

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# SEGMENTATION AND INFORMALITY IN VIETNAM: A SURVEY OF THE LITERATURE

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## **Abstract**

Labour market segmentation is usually defined as the division of the labour markets into separate sub-markets or segments, distinguished by different characteristics and behavioural rules (incomes, contracts, etc.). The economic debate on the segmentation issue has been focusing in developed countries, and especially in Europe, on contractual segmentation and dualism. However, in developing countries such as Vietnam which is the focus of this study, wage work is marginal and the approach to labour market segmentation is necessarily slightly different. Indeed, most workers are engaged in the informal economy and many of them are self-employed in their own household business. Starting with an analysis of the main characteristics of the national labour market, this paper presents a survey of the literature on informality and labour market segmentation in Vietnam (section 2). Section 3 describes the institutional background related to firm registration and social protection in Vietnam, and analyses the reasons for informality in relationship with the institutional framework. Section 4 describes the reforms being put in place and employment strategies related to the informal economy. Policy recommendations are proposed in the last section.

**Key words:** Informality, Labour market, segmentation, Vietnam

## **Résumé**

La segmentation sur le marché du travail est usuellement définie comme la coexistence de deux segments ou secteurs qui se distinguent par leurs caractéristiques et les comportements qui y prévalent (niveau de revenus, contrats, etc.). Le débat économique sur la segmentation s'est focalisé dans les pays développés, et en particulier en Europe, sur le dualisme résultant des contrats. Cependant, dans les pays en développement comme le Vietnam, les emplois salariés étant marginaux, la segmentation sur le marché du travail doit nécessairement être appréhendée de manière différente. La majorité des emplois relève de l'économie informelle et une grande partie est constituée d'auto-emploi dans des entreprises individuelles. Partant d'une analyse des principales caractéristiques du marché du travail national, ce document présente ensuite une revue de la littérature sur l'informalité et la segmentation sur le marché du travail au Vietnam (section 2). La section 3 décrit le cadre institutionnel en matière d'enregistrement et de protection sociale au Vietnam, et analyse les raisons de l'informalité. La section 4 examine les réformes qui ont été mises en place et les stratégies en termes d'emploi touchant l'économie informelle. Enfin, des recommandations politiques sont proposées dans la dernière section.

**Mots Clés :** Informel, marché du travail, segmentation, Vietnam

**JEL Code:** J24, J31, O53, O17

# 1. Introduction

Labour market segmentation is usually defined as the division of the labour markets into separate sub-markets or segments, distinguished by different characteristics and behavioural rules (incomes, contracts, etc.). The economic debate on the segmentation issue has been focusing in developed countries, and especially in Europe, on contractual segmentation and dualism. However, in developing countries such as Vietnam which is the focus of this study, wage work (even more so formal wage work) is marginal and the approach to labour market segmentation is necessarily slightly different. Indeed, most workers are engaged in the informal economy and many of them are self-employed in their own household business.

These specificities make the analysis of labour segmentation more complex: segmentation does not refer to labour contracts only (as they are marginal) but it must take into account more generally the degree of enforcement of labour market institutions according to different employment modalities. This means especially analysing potential discriminations (in terms of income and labour conditions) as well as their determinants, in order to detect dualism on the labour market between coexisting formal and informal segments, the latter representing a predominant share of employment (see especially Lewis (1954) on duality).

Given the blurred contours of this concept in academic work, it is important to start with giving it the precise definition of informality adopted in Vietnam and used in this study. In keeping with international definitions (ILO 1993, 2003), the informal sector is defined as the whole of non-agricultural individual enterprises which produce at least in part for the market and are not registered (no business license), and this stands for wherever the activity is carried out (on professional premises, in the street, or at home). The non-registration of certain activities does in no way suppose that they are illegal, to the extent that when operating within a certain level of activity, individual enterprises are not obliged to be registered nor to pay taxes. Informal employment is, for its part, defined as work without any social protection. On account of these definitions,<sup>2</sup> informal employment is comprised of two distinct principal components, namely employment in the informal sector, as well as unprotected employment in the formal sector. In conformity with the definitions of the ILO (2003), the informal sector and employment together make up what is designated as the informal economy. According to Cling *et al.* (2012a), the informal sector represents 24 per cent of total employment (that is nearly half of non-agricultural employment) and informal employment 81 per cent of total employment in Vietnam in 2009.

Following Fields (2007), the concept of income segmentation is used here to refer to labour income differentials that are not explained by the workers' individual attributes. That is to say, income gaps associated with certain characteristics of the job. In particular, the question addressed in this report is whether two workers with equal personal attributes obtain different remunerations because one works in the formal sector and the other in the informal sector. The same way of reasoning is applied to labour income differentials between informal and formal employment (for the study of South

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<sup>2</sup> These operational definitions have been adopted by the GSO and used in the Labour force surveys since 2007 (ILO, 2010, p. 16).

America, see Maurizio, 2012). Segmentation is also related to a lack of connection between sectors, as indicated by low mobility from one segment to another.

To our knowledge, there are only two econometric studies on this subject in Vietnam, both concluding that there is indeed income segmentation between the informal/formal economy (Nguyen et al., 2011; Rand and Torm, 2012a). However, Nguyen et al. (ibid), consider that labour market segmentation is close to Latin American countries (which are middle income countries like Vietnam since 2010) and much less pronounced than in Sub-Saharan Africa where segmentation is very high.

As underlined by Maurizio (2012), informality defined according to any of the two approaches (informal sector or employment) is consistent with both situations – with and without income segmentation. For example, informality without segmentation could take place in at least two cases: were there no restrictions, the excess of labour that cannot enter the formal sector and thus goes to the informal sector with its lower levels of productivity, would cause a global fall in wages, both in the formal and informal sectors; or if formal and informal wage earners ended up receiving equal net remunerations even when in the second case the employers face additional costs related to labour regulations. In the latter case, workers might voluntarily choose informality because of their (often non-monetary) preferences (see the case of women discussed here below).

The labour market segmentation issue therefore raises the question of the determinants of informality, knowing that two competing theories have traditionally been debated by development economists. The “dualist” approach is based on the model of a dual labour market (Lewis, 1954; Harris and Todaro, 1970), where the informal sector is considered as a subsistence economy which only exists because the formal economy is incapable of offering a sufficient number of jobs (“rationing out of workers”). The alternative view is proposed by the “legalist” approach, which considers that the informal sector is constituted of micro-entrepreneurs who prefer to operate informally in order to escape from economic regulations (de Soto, 1989); this liberal approach contrasts sharply with the two preceding ones in so much as the choice of informality is voluntary and linked to the excessive costs of the legalization process associated with registering and obtaining a formal status. Combining these two contrasting views leads to a multi-segmented approach of the informal economy, composed of a competitive voluntary upper-tier (« exit hypothesis ») coexisting with a lower-tier segment of individuals who do not have access to the formal market (“exclusion hypothesis”) (Rand and Torm, 2012a).

The remainder of this report is organized as follows. Starting with an analysis of the main characteristics of the national labour market, this report presents a survey of the literature on informality and labour market segmentation in Vietnam (section 2). Section 3 describes the institutional background related to firm registration and social protection in Vietnam, and analyses the reasons for informality in relationship with the institutional framework. Section 4 describes the reforms being put in place and employment strategies related to the informal economy. Policy recommendations are proposed in section 5. Five main messages come out from our study:

(1) The analysis of employment in Vietnam conducted in this report confirms that the informal economy provides low earnings and precarious working conditions, without any protection (contract, social protection, etc.) and with a low level of satisfaction. Indicators and econometric estimates available evidence labour market segmentation between the informal and formal economy: one can observe both significant income gaps, especially to the detriment of women, and low mobility from one sector to another. In spite of high economic growth in Vietnam, we do not foresee any decreasing trend of the share of the informal sector in total employment.

(2) The rules for registration of household businesses in Vietnam are vague and not transparent, creating a “grey zone”; not all household businesses have to register, and those earning less than a certain amount set at district level are exempt; however, up to 78 per cent of businesses in the informal sector could be operating illegally, as they are above the threshold and should therefore register. This partly explains the lack of formalization of informal household businesses, knowing that staying informal reduces growth perspectives and productivity, hence increasing segmentation.

(3) Turning now to informal employment (employment without social protection), there is a specific issue concerning formal enterprises where this kind of employment is widely used; although the exact numbers are not precisely known, the majority of informal employment in formal enterprises seems to be related to short term contracts (under 3 months), which do not include social protection. For other employees, social protection is compulsory by law. Direct fraud is not so much on non-declaration as on to the amount to be paid. Under-declaration of wages by enterprises benefits workers who get higher wages, but this above all reflects a lack of knowledge of (or trust in) the advantage of pension systems.

(4) The good news is that employment policies are starting to acknowledge informality in Vietnam, which is a substantial progress (see ‘New Law focuses on young workers, disadvantaged groups’, 2013). However, public policy measures have still to be defined and implemented. Moreover, they are confronted to the usual dilemma on this subject: if they focus on high productivity sectors in order to speed up economic development, they abandon the majority of the population which is still involved in traditional low productivity activities; the alternative strategy might increase welfare in the short term but to the detriment of long term development.

(5) Our own list of recommendations suggests to fully recognize the role of the informal economy which is here to stay, encourage the formalisation of the informal sector through increased rule transparency, and support the informal sector through targeted policies and an extension of social protection discussed between enterprises and employees. By reducing earning gaps and increasing mobility towards the formal sector, these policies would reduce segmentation on the labour market.

## **2. Main characteristics of the labour market in Vietnam**

This section analyses the main characteristics of the labour market in Vietnam in terms of quantity and quality of jobs, underlines the predominant weight of the informal sector and informal employment in Vietnam, and analyses the segmentation of the labour market related to informality. It relies principally on data from the official Labour Force Survey (LFS), carried out annually by the General Statistics Office of Vietnam (GSO) since 2007 (see box 1 here below). We also base our analysis on the Vietnam Household Labour Standard Survey (VHLSS), which has been conducted by the GSO every other year since the 1990s. Although it is not an employment survey, it is the only one providing panel data used to measure segmentation.

### **2.1. Structure of employment by industry and by institutional sector**

In Vietnam, as in most developing countries, no time series providing detailed employment data are available, so it is impossible to conduct a reliable in-depth study on employment past trends. Indeed, the first reliable employment survey was conducted by the General Statistics Office (GSO) in 2007 only (LFS2007). There is a large consensus over this diagnostic, which is the reason why the ILO/MOLISA Vietnam Employment Trends report is constrained to study employment dynamics over a very short period going back to 2007 (ILO, 2010).

Some selected key indicators drawn for the Vietnam Employment Trends report are presented in table 1 for 2007-2009. The labour force participation rate, defined as the ratio of the labour force to the working-age population (aged 15 years and above) stands at 76.5 per cent in 2009 (+2.1 percentage points compared to 2007), which is considered to be high if considered from an international perspective, and among the highest in South-East Asia (ILO, 2010; World Bank, 2008). As in other developing countries, because there are almost no public transfers (pensions, unemployment allocations, family allowances, etc.) participation in the labour market is essential to survive. This is also the reason why the unemployment rate is marginal (2.6 per cent at the national level in 2009). The share of wage and salaried employees is still very low (33.9 per cent in 2009) but increasing. This latter characteristic is due to the high share of self-employment in agriculture and the informal sector (see below).

**Table 1. Selected key indicators of the labour market (2007-2009)**

|   | <b>2007</b> | <b>2009</b> | <b>Percentage point change</b> |
|---|-------------|-------------|--------------------------------|
| <b>Labour force participation (15+)</b>                         |             |             |                                |
| Both sexes  | 74,3        | 76,5        | 2,2                            |
| Males   | 78,4        | 81          | 2,6                            |
| Females   | 70,5        | 72,3        | 1,8                            |
| <b>Employment to population ratio (15+)</b>                     |             |             |                                |
| Both sexes  | 72,8        | 74,5        | 1,7                            |
| Males   | 76,8        | 79          | 2,2                            |
| Females   | 69,2        | 70,4        | 1,2                            |
| <b>Unemployment rate (15+)</b>                                  |             |             |                                |
| Both sexes  | 2           | 2,6         | 0,6                            |
| Males   | 1,9         | 2,5         | 0,6                            |
| Females   | 2           | 2,7         | 0,7                            |
| <b>Youth unemployment rate (15-24)</b>                          |             |             |                                |
| Both sexes  | 6           | 6,2         | 0,2                            |
| Males   | 6,2         | 6,3         | 0,1                            |
| Females   | 5,9         | 6,1         | 0,2                            |
| <b>Share of industry in total employment (15-)</b>              |             |             |                                |
| Both sexes  | 20,4        | 21,8        | 1,4                            |
| Males   | 24,5        | 26,4        | 1,9                            |
| Females   | 16,1        | 17          | 0,9                            |
| <b>Share of agriculture in total employment (15+)</b>           |             |             |                                |
| Both sexes  | 49,3        | 47,6        | -1,7                           |
| Males   | 47,2        | 45,4        | -1,8                           |
| Females   | 51,5        | 50          | -1,5                           |
| <b>Share of services in total employment (15+)</b>              |             |             |                                |
| Both sexes  | 30,3        | 30,6        | 0,2                            |
| Males   | 28,3        | 28,2        | -0,1                           |
| Females   | 32,4        | 33,1        | 0,7                            |
| <b>Share of wage and salaried employees (15+)</b>               |             |             |                                |
| Both sexes  | 30,5        | 33,4        | 2,9                            |
| Males   | 35,8        | 38,9        | 3,1                            |
| Females   | 25          | 27,5        | 2,5                            |
| <b>Share of vulnerable employment in total employment (15+)</b> |             |             |                                |
| Both sexes  | 65,8        | 61,5        | -4,3                           |
| Males   | 59,9        | 54,4        | -5,5                           |
| Females   | 72          | 69,1        | -2,9                           |

Source: ILO (2010)



### **Box 1: Measuring informality and job quality/satisfaction in Vietnam**

The LFS2009 is a survey carried out among households which follows the plan of a classical survey stratified in two tiers (GSO, 2010). It is representative at the national level, as well as for each of the 16 domains of stratification, by zone (rural and urban) and by region (the 6 official regions, plus Hanoi and Ho Chi Minh City). 66 185 individuals belonging to 17 884 households were interviewed. Among them, 35 528 were aged 15 and over (the lower age limit to be part of the labour force in Vietnam), and hold a job.

Outside the standard indicators on the labour market (activity, unemployment, under-employment, work status, branch of activity, multi-activities, etc.) two sets of questions, essential for this study, have been introduced into the questionnaire, at the instigation of a joint research project between the GSO and the French Institute for Research and Development (IRD). [*The author of this report was a member of this project between 2007 and 2010*].

First of all, the survey was especially conceived to measure employment in the informal sector and more widely informal employment. A battery of questions put to each member of the working population allows us to identify those working in the informal sector. These questions cover the whole spectrum of internationally recommended criteria (ILO, 1993): the number of employees in the enterprise, the type of administrative registering and accountancy. This information has been collected not only for the principal job but also for secondary ones. It provides a great flexibility as to the operational definition of the informal sector (for more details, see Cling *et al.*, 2010a). In accordance with the terminology in use in Vietnam, we shall call these production units:

- “informal household businesses” (IHBs), for those which are not registered and compose the informal sector;
- those which are registered are called “formal household businesses” (FHBs).

The exclusion of agricultural activities is justified by their profound differences to non- agricultural activities (in terms of their seasonal nature, of their organization of production, salary levels, etc.). This definition of the informal sector has the advantage of falling within the larger context of institutional sectors, which constitute the preferred point of departure for our analysis. The LFS2009 also provides a measure of informal employment, defined in conformity with international recommendations as the whole of jobs not covered by a system of social protection, whatever the sector of activity (formal or informal sector).

Secondly, a specific question about job satisfaction has been introduced into the questionnaire. The question which has been inspired by international experience in the subject is posed thus: “All things considered, to what extent are you satisfied with your job?” Five different types of ordered answer are proposed: “Very dissatisfied”, “Rather dissatisfied”, “Neither satisfied nor dissatisfied”, “Rather satisfied”, “Very satisfied”. The question was asked to all employed workers over the age of 15 and refers to their principal job. A question formulated in such a way, the most general of the existing possibilities, does not allow us to precisely identify the reasons which lead a worker to prefer such or such a job. On the other hand, it presents three principal advantages: it has the merit of remaining simple in a context where the size of the questionnaire was a major constraint; it can be considered as a synthetic indicator of the different advantages and disadvantages linked to each type of job, finally, it leads the way to analytical comparative perspectives.

Source: Razafindrakoto, Roubaud and Wachsberger (2012)

Although as mentioned before no reliable employment time series are available, a comparison of the sector structure of employment between 1997 and 2009 has been made by Papola (2010) using two different sources (MOLISA survey for 1997; LFS survey for 2009). According to the comparison presented in table 2, the share of agriculture has declined drastically over this period (from 65.3 to 47.6 per cent). The share of industry has nearly doubled (from 12.7 to 21.8 per cent). The share of services has increased by nearly 10 points (from 22 to 30.6 per cent). Whereas the share of trade has remained constant (10.3 to 11.9 per cent), the one of public services (education, etc.) has increased as well as of hotel-restaurants (1.7 to 4.1 per cent).

**Table 2. Breakdown of employment by sector of activity**

|                          | Employment ('000) |               | Growth in 2009/97 (%) | Shares in Employment (%) |             |
|--------------------------|-------------------|---------------|-----------------------|--------------------------|-------------|
|                          | 1997              | 2009          |                       | 1997                     | 2009        |
| <b>Total</b>             | <b>35 603</b>     | <b>48 015</b> | <b>34,86</b>          | <b>100</b>               | <b>100</b>  |
| <b>Agriculture</b>       | <b>23 242</b>     | <b>22850</b>  | <b>-1,67</b>          | <b>65,3</b>              | <b>47,6</b> |
| <b>Industry</b>          | <b>4 512</b>      | <b>10 489</b> | <b>132</b>            | <b>12,7</b>              | <b>21,8</b> |
| Mining                   | 131               | 227           | 73                    | 0,4                      | 0,5         |
| Manufacturing            | 3 460             | 6 950         | 100                   | 9,7                      | 14,5        |
| Electricity, Gas & Water | 74                | 274           | 270                   | 0,2                      | 0,5         |
| Construction             | 847               | 3 038         | 259                   | 2,4                      | 6,3         |
| <b>Services</b>          | <b>7 849</b>      | <b>14 676</b> | <b>87</b>             | <b>22,0</b>              | <b>30,6</b> |
| Trade                    | 3 676             | 5 708         | 55                    | 10,3                     | 11,9        |
| Hotels & Restaurants     | 601               | 1 979         | 229                   | 1,7                      | 4,1         |
| Transport                | 935               | 1 721         | 84                    | 2,6                      | 3,6         |
| Finance                  | 118               | 229           | 94                    | 0,3                      | 0,5         |
| Science & Technology     | 17                | 238           | 1 300                 | 0                        | 0,5         |
| Real Estate              | 38                | 101           | 165                   | 0,1                      | 0,2         |
| Public Administration    | 425               | 1 135         | 167                   | 1,2                      | 2,4         |
| Education                | 828               | 1 663         | 94                    | 2,3                      | 3,5         |
| Health                   | 243               | 435           | 79                    | 0,7                      | 0,9         |
| Culture Reports          | 107               | 290           | 171                   | 0,3                      | 0,6         |
| Politics (Party)         | 94                | 186           | 98                    | 0,3                      | 0,4         |
| Other Services           | 623               | 737           | 18                    | 1,8                      | 1,5         |
| Household Employees      | 141               | 242           | 72                    | 0,4                      | 0,5         |
| Other-Intern. Org.       | 3                 | 5             | 66                    | 0                        | 0           |

Source: Papola (2011)

Table 3 presents the principal characteristics of employment in Vietnam by institutional sector in 2009, as well as the main characteristics of the workforce, based on the LFS2009. We distinguish six institutional sectors according to the nature of the capital of the enterprises, forming a partition of enterprises within which all types of job are done: the public sector (government and public enterprises), enterprises with foreign capital, domestic enterprises, formal and informal individual household businesses (also called formal/informal individual enterprises) and agriculture (overwhelmingly dominated by family smallholdings). This approach according to institutional sector allows us to go beyond the binary and over simplified contrast of the situation of the informal sector which only distinguishes formal/informal.

As mentioned before, agriculture continues to count for nearly half (48 per cent) of employment with 22.8 million people working in this sector out of an employed population totalling almost 50 million. With more than 11 million jobs, the informal sector represents nearly a quarter (24 per cent) of total employment and is the first source of non-agricultural jobs (half of jobs outside agriculture). Outside these two predominant sectors, the weight of the other sectors is relatively minor, given that domestic enterprises and formal household businesses represent an equal share of employment (each less than 10 per cent).

**Table 3. Characteristics of the workforce and of employment by institutional sector in Vietnam (2009)**

|                                 | Public sector | Foreign enterpr. | Domest. enterpri. | Formal house-hold business | <b>Informal sector</b> | Agri-culture | TOTAL  |
|---------------------------------|---------------|------------------|-------------------|----------------------------|------------------------|--------------|--------|
| Number of jobs (1 000)          | 4,615         | 1,376            | 3,669             | 3,688                      | <b>11,313</b>          | 22,838       | 47,548 |
| Structure (%)                   | 9.7           | 2.9              | 7.7               | 7.8                        | <b>23.8</b>            | 48.0         | 100    |
| Migrant (%)                     | 10.4          | 32.1             | 16.0              | 8.4                        | <b>5.6</b>             | 2.4          | 6.3    |
| Head of Household (%)           | 43.6          | 25.4             | 33.0              | 37.6                       | <b>42.9</b>            | 39.7         | 39.7   |
| Salaried workers (%)            | 99.7          | 99.9             | 93.6              | 36.4                       | <b>26.7</b>            | 9.6          | 33.6   |
| Professional premises (%)       | 96.4          | 97.6             | 86.4              | 33.8                       | <b>7.8</b>             | 1.1          | 23.8   |
| Informal job <sup>(1)</sup> (%) | 12.5          | 12.9             | 48.1              | 51.5                       | <b>100</b>             | 98.6         | 80.5   |
| Rural (%)                       | 42.8          | 63.4             | 48.1              | 46.4                       | <b>63.2</b>            | 91.7         | 72.6   |
| Female (%)                      | 47.1          | 64.7             | 39.1              | 46.0                       | <b>48.0</b>            | 51.1         | 49.1   |
| Ethnic minorities (%)           | 8.9           | 5.1              | 5.8               | 7.2                        | <b>5.7</b>             | 27.2         | 16.5   |
| Age (years)                     | 37.6          | 26.8             | 31.6              | 36.4                       | <b>38.4</b>            | 39.8         | 38.0   |
| Higher education (%)            | 48.0          | 8.0              | 15.3              | 3.6                        | <b>1.0</b>             | 0.6          | 6.8    |
| Seniority (years)               | 10.5          | 3.5              | 4.4               | 7.1                        | <b>7.7</b>             | 15.8         | 11.4   |
| Hours/week                      | 44.0          | 53.0             | 51.8              | 51.8                       | <b>45.9</b>            | 37.0         | 42.6   |
| Average income/m (1 000 VND)    | 1,964         | 1,735            | 2,093             | 1,805                      | <b>1,273</b>           | 703          | 1,185  |

Source: Cling, Lagrée, Razafindrakoto and Roubaud (2012); based on LFS2009, authors' calculations.

<sup>(1)</sup> No social protection

Job composition by gender is globally balanced in the different sectors of activity, with the exception of employment in foreign enterprises which is dominated by females. The same is true for age where workers in the informal sector have an average age (38.4 years) very near to that of the general working population (38 years), whereas there again foreign enterprises distinguish themselves by the young age of their workers. Furthermore, the population usually composing the most precarious population groups (women, children, migrants) is not over-represented in the informal sector workforce, as testified by the high proportion of heads of household and the low proportion of migrants working there: the former is among the highest of all the sectors together (after the public sector), while the latter is among the lowest of all the sectors (before agriculture).

Although the socio-economic characteristics of the workforce employed in the informal sector are near to the national average (with the exception of levels of education), the attributes of the posts occupied are indeed very different and generally of worse quality than those in other sectors (except for agriculture). The rate of salaried employment is low (27 per cent) and the forms of salaried work clearly more precarious: more than 99 per cent have at best a verbal contract (25 per cent have no contract at all), compared with only 3 per cent in the public sector; 10 per cent are paid on a monthly basis (which constitutes the norm in the other sectors), the majority being remunerated on a daily basis, on an hourly basis, by piecework or on commission. For the whole of the workers in this sector, the rate of social protection is negligible (0.1 per cent), whereas it reaches 87 per cent in the public sector and in foreign enterprises, and nearly one in two workers in domestic enterprises. Workers in the informal sector earn the lowest salaries outside agriculture, which is linked to their low level of education (also the lowest outside agriculture). One can also add that almost all of the jobs in the informal sector are carried out without specific professional premises (at home or in the street), which constitutes another indicator of the precariousness of jobs in this sector.

The informal sector is not an exclusively urban phenomenon: there are more workers in the informal sector in rural and peri-urban zones (63 per cent). This characteristic is in part an artefact due to the administrative definition of rural zones in Vietnam, of which a high number would have been classed as urban in other countries. Nevertheless, it is also largely linked to the diversification of revenues strategy implemented by farmers.

Contrary to the theory of the compensating salary (for bad working conditions), the disadvantages of jobs in the informal sector seem to be cumulative. Thus, in spite of long working hours (46 hours a week compared to an average of 43), and long average length of service (almost 8 years), remuneration is low. The average monthly salary is 1.7 million dong (about 75 Euros), the formal sector (private or public) pays salaries which are 50 per cent higher. The informal sector thus occupies an intermediary position between the non-agricultural formal sector (at the top of the distribution) and agriculture (at the bottom).

The survey also provides a measure of informal employment, defined in conformity with international recommendations as the whole of jobs not covered by a system of social protection, whatever the sector of activity (Cling *et al.*, 2012b). On a national level, informal employment represented 80.5 per cent of total employment in 2009, which signifies that only 9 million workers are covered by social security (mandatory or voluntary; Castel, 2012) The totality of jobs in the informal sector are of an informal nature, as well as most jobs in agriculture (98.6 per cent). However, informal jobs are of very diverse importance in all sectors of activity: they represent nearly half of jobs in domestic enterprises and individual formal enterprises and more than 10 per cent in the public sector and in foreign enterprises (Razafindrakoto *et al.*, 2011).

## **2.2. Segmentation and incomes**

The study by Nguyen *et al.* (2013) is the first to measure informal-formal earning gaps in Vietnam on panel data drawn from a nationally statistically representative household survey. Their estimates use OLS (ordinary least squares), fixed effects and quantile regressions (QR) econometric methods. They use a worker level definition of informality, drawn from the VHLSS 2002, 2004 and 2006. Their results suggest that the informal earnings gap highly depends on the workers' job status (wage employment vs. self-employment) and on their relative position in the earnings distribution, as well as gender (Table 4).

**Table 4. Informal/Formal Workers Earnings Gaps**

|                                | <b>Informal/formal workers</b> |                                  |                         |   |
|--------------------------------|--------------------------------|----------------------------------|-------------------------|---|
|                                | <b>All Workers (1)</b>         | <b>Self-employed workers (2)</b> | <b>Wage workers (3)</b> | <b>Informal self-employed / formal wage workers (4)</b> |
| <u>OLS estimates:</u>          |                                |                                  |                         |   |
| <b>Total</b>                   | <b>-22%</b>                    | <b>-30%</b>                      | <b>-21%</b>             | <b>+6%</b>  |
| - Men                          | -17%                           | -30%                             | -16%                    | 13%   |
| - Women                        | -27%                           | -30%                             | -28%                    | 0% (ns)   |
| <u>Fixed effect estimates:</u> |                                |                                  |                         |   |
| <b>Total</b>                   | <b>-14%</b>                    | <b>-17%</b>                      | <b>-11%</b>             | <b>+16%</b>   |
| - Men                          | -10%                           | -15%                             | 0% (ns)                 | 22%   |
| - Women                        | -18%                           | -20%                             | -17%                    | 16%   |

Source : Nguyen et al. (2011)

Their main conclusion is that informal workers earn less than formal workers, all other things being equal (that is to say, for the same qualifications, experience, sex, industry and other observable characteristics); on average (OLS estimates), the earning gap is -22 per cent (column 1). Once unobserved individual characteristics (such as entrepreneurial skills) are controlled for, the penalty for being informal is smaller (-14 per cent globally). The earnings gaps look more like those observed in emerging countries, not characterized by considerable segmentation between formal and informal jobs, compared to the standard dualistic Sub-Saharan labour markets (Dimova *et al.*, 2010; Bocquier *et al.*, 2010).

Females always financially suffer more (or benefit less) when they are informally employed. At the aggregate level, the OLS gap is -17 per cent for male and -27 per cent for female (respectively -10 per cent and -18 per cent with fixed effects); according to the authors, this feature suggests that women might accept lower wages in the informal sector because it provides other non-pecuniary advantages, relatively more valuable to them; this result opens space for specific policies to align the functioning of labour market for women with that of men (reduction in entry barriers to formal jobs, improvement of access to physical capital, etc.).

The systematic premium at all points of the distribution of formal self-employed workers over their informal counterparts (column 2 presents global results only) suggests that formalization of non-farm household businesses seems to be beneficial. Policies aiming at easing administrative procedures to register informal firms should be encouraged. The same holds for formal vs. informal wage workers (column 3).

However, this study also obtains some puzzling results. At odds with the “exclusion” hypothesis and what would show the observed raw earnings gaps, some informal jobs are more rewarding (self-employment) or as rewarding (male wage workers) as formal wage jobs. Once unobserved individual characteristics are controlled for, the penalty for being informal is no longer significant for male wage workers: for them working informally is at least financially as rewarding as having a formal wage job. This feature is due to the relatively low wages of formal wage jobs. The reason for such a specificity should be investigated further (international competition pressure? wage repression policy?).

To sum it up, although they tend to globally nuance the segmentation of the labour market in Vietnam, Nguyen et al. emphasize that it is especially strong for women, and that there is also a multi-segmentation phenomenon within the informal sector, as already suggested by Cling et al. (2010) based on a principal component analysis: there is a clear distinction within the informal sector between “survivors” which are constrained to work there and are the poorest and the most vulnerable (also called the “free entry” informal sector) and the “professionals” at the high-end (the “upper tier” informal sector), which have often chosen to work there and are better off.

The results obtained by Rand and Torm (2012a) are consistent with those by Nguyen et al. (ibid). Their study is based on (non-representative) survey data on 1,098 manufacturing small and medium firms (SMEs) collected in 2009. Using the traditional Blinder-Oaxaca decomposition method, they show that average wages are about 10 to 20 per cent higher in formal firms compared with informal ones and that the gap remains when standard earnings determinants are added. According to the results, most of the wage gap is attributed to differences in characteristics between firms in the formal and informal sectors (the survey does not provide information on individual worker characteristics). The authors consider that the fact that the wage gap remains when firm level workforce characteristics are included could be an indication that formal firms pay higher wages so as to attract more productive workers (efficiency wages). Rand and Torm (2012b) also show (based on the same survey data) that formal firms have higher profits and investments and a lower share of casual workers, but find no evidence of a higher share of wages in total value added.

The mobility between sectors is measured by Nguyen et al. (ibid.) by constructing transition matrixes based on panel data. The mobility from the informal to the formal sector appears to be limited: between 2002 and 2006, only 8 per cent of informal wage workers became employed in the formal sector (either as formal wage workers of formally self-employed); 12.7 per cent of informal self-employed workers joined the formal sector; among them, 3 per cent became formal wage workers and 9.7 per cent formally self-employed (Table 5).

**Table 5. Transition matrix of employment status between 2002 and 2006 (per cent)**

| 2002                          | 2006        |                    |             |               |                      |                        | Total      |
|-------------------------------|-------------|--------------------|-------------|---------------|----------------------|------------------------|------------|
|                               | Not-working | Agricultural empl. | Formal wage | Informal wage | Formal self-employed | Informal self-employed |            |
| Not-working                   | 55.29       | 17.65              | 6.87        | 9.62          | 2.64                 | 7.93                   | 100 (19.9) |
| Agricultural empl.            | 7.32        | 76.44              | 2.76        | 6.44          | 1.12                 | 5.92                   | 100 (52.5) |
| Formal wage worker            | 4.29        | 5.81               | 74.49       | 11.87         | 0.76                 | 2.78                   | 100 (8.3)  |
| Informal wage worker          | 5.35        | 17.06              | 4.35        | 55.18         | 3.68                 | 14.38                  | 100 (6.2)  |
| Formal self-employed worker   | 13.1        | 7.59               | 2.07        | 2.07          | 51.03                | 24.14                  | 100 (3.2)  |
| Informal self-employed worker | 10.34       | 20.46              | 2.95        | 7.38          | 9.7                  | 49.16                  | 100 (9.9)  |
| Total                         | 16.95       | 47.48              | 9.64        | 10.55         | 3.03                 | 11.45                  | 100 (100)  |

Source: Nguyen et al. (2011), based on VHLSS, 2002 and 2006 (GSO).

Some more recent results on mobility have been presented by Demenet et al. (2010) who built the same kind of transition matrixes based on panel data for Hanoi and Ho Chi Minh City covering the 2007-2009 period. The data was drawn from the *Household*

*Business and Informal Sector* surveys (HB&IS) conducted in these two hubs by GSO in partnership with the French Institut de Recherche pour le Développement (IRD/DIAL team). According to their results, which are consistent with those of Nguyen et al., around one informal household business (IHB) out of ten got formalized between 2007 and 2009; respectively 31 per cent and 15 per cent got informal in Hanoi and HCMC during the same period (Table 6). This important informalisation process has probably a lot to do with the economic crisis.

**Table 6. Transition matrix of employment status between 2007 and 2009 Hanoi and HCMC (per cent)**

|              | Hanoi (2009) |          |                   |              | HCMC (2009) |          |                   |
|--------------|--------------|----------|-------------------|--------------|-------------|----------|-------------------|
| 2007         | Formal       | Informal | Total             | 2007         | Formal      | Informal | Total             |
| Formal       | 68.9         | 31.1     | <b>100 (18.8)</b> | Formal       | 84.7        | 15.3     | <b>100 (26.3)</b> |
| Informal     | 8.3          | 91.7     | <b>100 (81.2)</b> | Informal     | 10.2        | 89.8     | <b>100 (73.7)</b> |
| <b>Total</b> | 19.7         | 80.3     | <b>100</b>        | <b>Total</b> | 29.8        | 70.2     | <b>100</b>        |

Source : HB&IS surveys, Hanoi and HCMC, 2007 ; 2009, OGS / IRD-DIAL.

Not surprisingly, the IHBs which became formal were on average bigger, more productive and less precarious than their counterparts which remained in the informal sector. Demenet et al. (2013) evaluate rigorously, using data matching techniques, the impact of formalization on household businesses performances and mode of operation in Hanoi and HCMC. The results are drawn from a panel of representative data (2007-2009) which allows measuring the performance and intermediate incomes of household businesses with great precision. They come to similar conclusions as Rand and Torm (2012b) mentioned here above. According to the authors, leaving the informal sector increases annual value added by 22 per cent on average. More importantly, this improvement is made possible by associated changes in operating conditions, such as better access to equipment, size, type of premises and type of accounts. Formalization thus allows household businesses to have better equipment and increase their scale of operation. As pointed out by the authors, “These findings raise important questions concerning the types of businesses likely to formalize and the potential incentive policies targeted towards the informal sector” (see section 5 below).

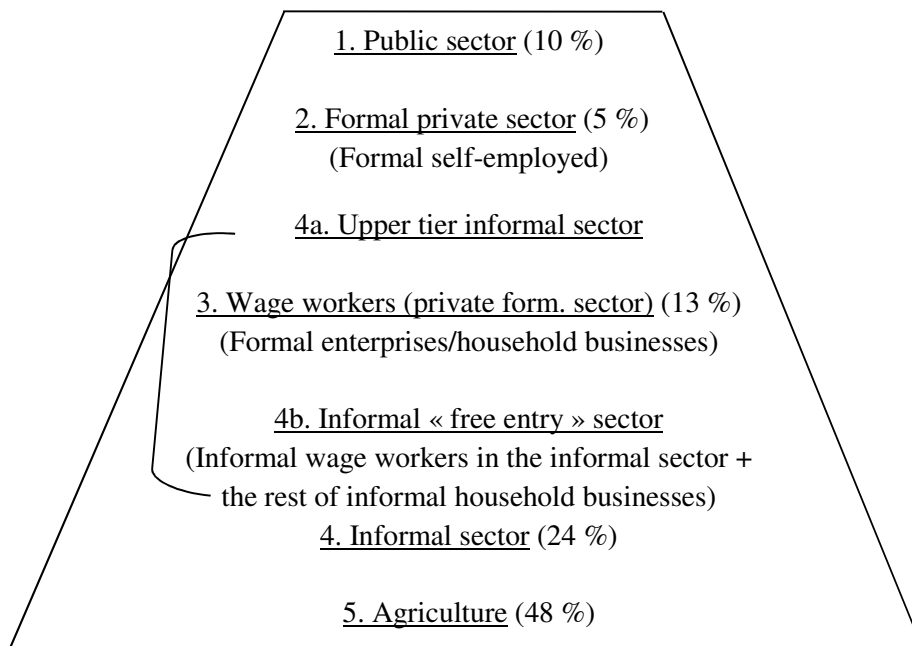
A last source of segmentation is due to the public/private sector segmentation. According to Imbert (2011) who limits his comparison to wage workers, not only public sector employees are more skilled than private sector ones, but they also benefit from higher returns on their skills. The author also puts in evidence the low mobility of workers from the private to the public sector, which is another indicator of the public/private sector segmentation. The analysis in terms of job satisfaction conducted here below confirms this highest status of the public sector.

To sum it up, there is a double duality in the labour market between sectors and also within the (multi-segmented) informal sector, as underlined by Fields (2007). Adapting the typology proposed by Fields to the case of Vietnam, we build a “pyramid” of the labour market, by analogy with population pyramids widely used in demographic studies. This pyramid consists of 5 main segments (or “labour market states”): 1/public sector; 2/formal private sector (formally self-employed, excluding formal wage workers); 3/wage workers employed in the private formal sector; 4/informal sector (broken down between “upper tier” and “free entry” part); 5/and agriculture (Figure 1). The bottom of

the pyramid represents the biggest share (nearly half) of total employment and the share of each segment tends to decrease (with some exceptions) going upward.

In this pyramid, the wage workers in formal enterprises and household businesses are squeezed between the two categories of informal sector: their income is inferior to the “upper tier” of informal household businesses (which is also found by World Bank, 2008); but it is superior to the “free entry” section of the informal sector, composed of informal wage workers in the informal sector and other informal household businesses.<sup>3</sup>

**Figure 1: The “Pyramid” of the labour market in Vietnam**



Note: the numbers in brackets represent the share of each sector in total employment in 2009

Source: LFS2009.

### 2.3. Job satisfaction

If we now examine job satisfaction, we shall comment the balance of satisfaction indicator (percentage of satisfied workers minus percentage of unsatisfied workers). This “balance of opinion” technique is widely used in the analysis of opinion surveys. This sub-section presents the results of a study by Razafindrakoto et al. (2012) using this methodology.

First of all, the extreme values (very satisfied and very unsatisfied) only represent a very marginal part of the distribution of replies. For the whole workforce only 2.4 per

<sup>3</sup> The econometric estimates conducted by Nguyen et al. (2013) put informal household businesses above formal wage workers (see the sign of the earning gap) and formal wage workers above informal wage workers. But we also know from other studies that some informal household businesses (“free entry”) are below formal wage workers. We also make the hypothesis that informal wage workers in the private formal sector are above the same kind of workers employed in the informal sector.



cent declared that they were very satisfied with their job, while the proportion of those who affirm that they are very unsatisfied is negligible (0.2 per cent). Regardless of anything else, these results show that working conditions in Vietnam are more or less satisfactory or they at least correspond globally to the expectations of Vietnamese workers. But we may also evoke a cultural (or political) characteristic linked to the Vietnamese context: citizens are not very willing to express attitudes or opinions which are too clear-cut, either because they do wish to provoke feelings of envy or stigmatization in others or because they fear some sort of “punitive” reaction from the authorities for having formulated implicit criticisms about working conditions in force in Vietnam. This behaviour is observed in many cases, especially in surveys with household businesses: for example, the percentage who declare they meet difficulties is very low compared to other developing countries, in spite of similar difficult operating conditions (Cling *et al.*, 2010).

Next, the results highlight a very clear hierarchy depending on institutional sector, which can be broken down into three big categories.

- The public sector is found at the top of the ladder: nearly three quarters (72 per cent) of employees in the public sector (civil servants or salaried workers in public or para-public enterprises) declare themselves to be satisfied or very satisfied with their job (70 per cent for the balance of opinion).
- Then come workers from the private formal sector, of which a little more than half show themselves to be at least satisfied, without any significant difference between those who work in foreign, domestic or individual enterprises (with a balance of opinion of respectively 49 per cent, 45 per cent and 47 per cent).
- Finally, workers in the informal sector and in agriculture are the most critical, the proportion of those declaring themselves satisfied being around one third, with an advantage to the former (38 per cent and 29 per cent respectively, and a balance of opinion of 30 per cent and 19 per cent in agriculture, the lowest of all sectors).

The hierarchy of job satisfaction according to institutional sector partially respects working conditions and average remuneration offered in each sector, commented here above. As they benefit from higher salaries, shorter working hours and better welfare protection (social security, long-term contracts, paid holidays, etc.), public service employees are by far the best treated; and this in spite of the adjustment policies which aim to control salaries and the public/private remuneration differential.

Less trivial is the far from favourable position of informal sector workers, the principal centre of interest of this study, at least with regards to supporters of the theory that workers freely choose the informal sector. It can be supposed that vulnerability and precariousness of everyday life exercises some pressure on the fall in the level of satisfaction. Finally, the stylized facts taken from this first descriptive analysis of job satisfaction seem to validate the hypothesis of the queue before the gates leading to the formal sector, based on the inferior status of jobs in the informal sector. Overall, it is quite consistent with our “pyramid” presented in Figure 1 here above.

## 2.4. Long term trends

In the long term, it is expected that a country’s development is accompanied by a progressive reduction of the weight of its informal sector, in conformity with the observation of the marginal weight of this sector in developed countries (La Porta and Schleifer, 2008; Bacchetta *et al.*, 2009). Indeed, these countries possess systems of

regulation and fiscal control which are relatively efficient and from which it is difficult to escape for small entrepreneurs. However, this mechanism only works in the long term, as Bacchetta et al. stated (2009): “it has been shown that informality rates evolve very little with the passage of time and only have a very weak reaction to the acceleration of economic growth or to the opening up of commercial exchanges”. Given the rapid rates of growth of the Vietnamese economy since the 1980s and the launch of *Doi Moi*, one would thus think that the informal sector’s weight on the job market would have tended to diminish somewhat.

When one attempts to verify if this hypothesis is valid, one does not have at hand the precise, coherent data with the job survey commented upon here concerning employment in the informal sector before 2007. The VHLSS survey (Vietnam Household Living Standards Survey), which has been carried out with the support of the World Bank by the GSO since the 1990s, allows us however to measure approximately the evolution of employment in this sector over the last years. According to Nguyen (2012), while the share of agriculture declined progressively (it is now less than 50 per cent of total employment), the share of the informal sector in total employment rose from 23.2 to 26.6 per cent between 1998 and 2008. What’s more, it is in the two most industrialized regions in the country, the Red river Delta (Hanoi region) and the South-East (HCMC region) that this share is the biggest. In spite of the rise in the rate of salaried workers and the expansion of the private formal sector, the informal sector will thus continue to grow in Vietnam, the consequence of a phenomenon of rapid agrarian, urban and demographic transition<sup>4</sup>.

What’s more, forecasts for employment in 2015 that we made using past trends - before the arrival of the crisis - show that employment in the informal sector and its relative weight in total employment are going to continue growing over the next few years (Cling et al., 2012a). As far as workforce supply is concerned, firstly Vietnam has found itself in a period of “demographic dividend” when there is a huge number of young people arriving on the labour market (more than one million per year) and the situation is going to remain so until 2015. At the same time, the growth of the formal private sector (if it continues), which is nevertheless rapid, is not high enough to absorb all the new arrivals on the labour market given that agricultural employment (which represents nearly half of total employment) is following a falling trend. Even if a return to strong growth scenario is envisaged for the Vietnamese economy, once the effects of the crisis are in the past, these forecasts suggest that the informal sector will continue to represent a considerable share of employment in the years to come.

### **3. Links between institutional setting and informality**

In order to understand the institutional background of the informal economy, we need to describe two main kinds of legislation in this section: first, the rules for registration of household businesses, which determine the legality or not of the informal sector businesses; second, laws on social protection, which establish who should benefit from social protection and who should not (the latter having informal employment by definition). After presenting the institutional setting, this section analyses the possible

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<sup>4</sup> This conclusion is not shared by McCaig and Pavcnik (2011) who, on the contrary, conclude there was a fall in the number of jobs in the informal sector at the beginning of the 2000s, which they attributed to an increased opening up to international markets.

links between institutional setting that lead to current segmentation and quantity and quality of jobs. More specifically, it presents survey data on the reasons why household businesses do not register and are therefore sometimes illegal. The impact of the international crisis on the informal sector, which is the most vulnerable segment of the economy, is also studied.

### **3.1. Registration of business households<sup>5</sup>**

The Ministry of Planning and Investment (MPI) is in charge of fixing the rules for registration of household businesses. Provincial directorates of the MPI are in charge of registration, which is conducted in practice by the districts. Decision N°88/2006/ND-CP dated 29 August 2006 of the government on business registration fixes general rules on this subject (see Box 2). The decree is relatively vague on the exceptions for specific businesses and the threshold which is fixed at district level (it cannot be higher than the threshold at which income tax is payable). In fact, one can consider that almost all household businesses should theoretically be registered. As the thresholds are very low, there are almost no household businesses below them which are therefore exempted from registration. But this is far from being the case as is shown by the results of surveys described in this study. Around three quarters of household businesses are not registered at the national level. Interviews conducted at MPI show that this Ministry is aware of this situation but does not seem to consider that addressing this issue should be a priority (especially because of the lack of human resources needed to increase controls).

The Ministry of Finance (MoF) is in charge of household business's taxation. Three kinds of taxes are collected: the registration tax, the VAT and the income tax. From our interviews with MoF's experts, it appears that the poorest HBs are exempt for social purposes. The key question is how to identify these low income HBs. MoF's interlocutors are quite confident tax evasion is not an issue in Vietnam. Concretely in the field, the exhaustive list of HBs (whether registered or not) is established at the local level by the tax administration in collaboration with the local People's Committee. HB's heads are supposed to self-declare their activity (industry, turn-over, income for example), according to the HB's books. Then, this information is cross-checked by the local administration, which decides who should pay and for which amount. Furthermore, the list of tax payers and the nominative tax amount is publicly posted to the scrutiny of the neighbourhood.

This process of peer review is supposed to equalize the tax burden, as each HB can claim for unfair treatment, if it considers it is paying more than it should compared to others operating with the same conditions. Nevertheless, we are less sure whether these procedures really ensure horizontal equity among the HBs. The empirical evidence suggests that the correlation between taxation and the true level of activity is quite fuzzy, the most visible ones being taxed more often, whatever their income. The huge discrepancy between the number of HBs controlled for tax purposes (around 1.2 million) and the total number of HBs captured through the statistical surveys (8.4 million) is compatible with a substantial phenomenon of tax evasion.

The government's approach towards household businesses seems to be changing progressively, with an increased interest towards them. In June 2009, the government adopted Decree N°56/2009/ND-CP on Support to Development of Small and Medium-

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<sup>5</sup> This presentation of registration of business households is based on Cling et al. (2011).

sized Enterprises, (SMEs). SMEs are defined according to different thresholds. The employment threshold is of 300 employees in general and 100 employees in trade and services. SMEs employing less than ten employees are considered no longer as household businesses, but as micro-enterprises. This could mean that in the future micro-enterprises will fall under the Law of Enterprise and not be considered apart anymore.

### **Box 2: Business registration of household businesses**

1. A household business as owned by one Vietnamese citizen, by one group of persons or one individual household may be registered for business at one location only, may employ only up to ten (10) employees, shall not have a seal, and shall be liable for its business activities to the full extent of its assets.
2. Household businesses which engage in agricultural, forestry, fishery or salt production or which are street hawkers, nosh vendors, long-distance traders, itinerant traders or service providers earning low income shall not be required to register their businesses, unless they conduct business in conditional lines of business. People's committees of cities and provinces under central authority shall stipulate the applicable level of low income within their locality. The stipulated level of low income may not be higher than the stipulated threshold at which personal income tax is payable in accordance with the law on tax.
3. Any household business which employs regularly more than ten (10) employees must register business as an enterprise.

Source: Decree N°88 on Business Registration, Article 36, dated 29 August 2006.

Decree N°56 considers three main kinds of support policies towards SMEs, especially for micro-enterprises: financial support (legitimate credits), training and technical assistance. As it is the case for policies conducted by MoLISA, the informal sector is not specifically targeted by MPI's policies. One might even consider that it is excluded from them, as all SMEs are supposed to be registered according to this decree, (which is not the case for household businesses). Indeed, whereas micro-enterprises (FHBs) have largely benefitted from legitimate credits granted within the Stimulus Package launched by the Vietnamese government in 2009, IHBs have not benefitted at all from this assistance according to our surveys.

## **3.2. Law enforcement and the informal sector**

In Vietnam, not all household businesses have to register. Two kinds of households are exempt: those earning less than a certain amount set at district level (which cannot be below the minimum wage), and street vendors and *xé ôm* (motorbike taxis).

Below a certain level of business done, household businesses are not required to get a business licence and can operate freely. Household businesses are exempt from business tax (and now from personal income tax) if their turnover is too small. The empirical evidence suggests that the informal sector as a whole is unknown to the State registration services. Nevertheless, the absence of registration (*business licence*) does not mean that the informal sector is not taxed; more than one-third of IHBs pay one sort of tax in Hanoi (mostly local taxes), although this proportion is much lower in HCMC.

The Ministry of Planning and Investment (MPI) is in charge of fixing the rules for registration of household businesses. Provincial MPI directorates are in charge of registration, which is conducted in practice by the districts. The problem is that the conditions are vague: there are numerous criteria, exceptions and different thresholds. Almost no IHBs (less than 1 per cent) know the threshold above which HBs have to register. Even among the formal HBs, only a minority claim that they know the registration legislation (10 per cent of FHBs in Hanoi and 20 per cent in HCMC), and their knowledge appears to be limited since the magnitude of the registration threshold that they put forward varies substantially (from 2 million to 15 million per month).

We can compute the proportion of IHBs that should be registered by law and, conversely, the proportion of FHBs that need not. These calculations should be viewed with caution, as the law itself is not very clear about which HBs should legally have a business licence and we do not know exactly what the actual locally adopted threshold is above which HBs have to register. Excluding the sectors exempt from registration, the proportion of IHB heads earning more than the minimum wage then provides an indicator of the percentage of ‘illegal’ IHBs (upper bound estimator). In fact, one can consider that almost all household businesses (HBs) should theoretically be registered: as the thresholds are very low, there are almost no household businesses below them that are therefore exempted from registration, with haziness subsisting as to the legal need for roving HBs to register (Cling et al., 2012c).

Our calculations have been undertaken using the *HB&IS* surveys conducted in Hanoi and Ho Chi Minh City (see here above). The selected income variable is the operating surplus taken from the *HB&IS* Surveys (we prefer not to use earnings as the declarations are notoriously underestimated). We consider three legislative hypotheses: a) all HBs should have a business licence when they earn more than the minimum wage (450,000 VND/month; b) this income criterion does not apply to mobile HBs or HBs with improvised street pitches (it applies only to businesses working at home or with professional premises); c) this income criterion applies only to “located” HBs (with professional premises).

Under the first hypothesis, 95 per cent of IHBs should be registered in both cities (Table 7). If we relax the hypothesis by considering that only those with fixed premises fulfilling the income threshold should register, the share of ‘illegally’ operating IHBs drops significantly to around 70 per cent under the loose definition of ‘premises’ (including homes), and dramatically to 10 per cent-15 per cent in the more restrictive case (considering only HBs with professional premises). These results merely reflect the fact that IHBs rarely operate on premises. ‘Manufacturing’ IHBs are the most advantaged in this respect (followed by ‘services’ and lastly ‘trade’, the most precarious). The figures are extremely close in the two cities. The only clear-cut conclusion to be drawn from this exercise is that HB registration legislation is unclear and all the more confusing for HB heads. This lack of transparency forms a breeding ground for discretionary decisions and for potential harassment and corruption by public officials.

**Table 7. Registration and ‘legality’ in the informal sector (percentage)**

| <i>Hypothesis: Income threshold applies to:</i> |                            |   |   |
|---|----------------------------|---|---|
|   | <b>H1-all kinds of HBs</b> | <b>H2-HBs at home or with professional premises</b> | <b>H3-only HBs with professional premises</b> |
| <b>Hanoi</b>                                    |                            |   |   |
| <b>% of IHBs that should be registered</b>      |                            |   |   |
| Manufacturing                                   | 95.9                       | 90.0  | 7.3   |
| Trade   | 93.1                       | 60.3  | 21.8  |
| Services  | 96.0                       | 65.7  | 13.0  |
| <b>Total IHB</b>                                | <b>96.9</b>                | <b>68.1</b>   | <b>15.2</b>                                   |
| <b>% FHB*</b>                                   | <b>2.7</b>                 | <b>5.5</b>  | <b>42.0</b>                                   |
| <b>Ho Chi Minh City</b>                         |                            |   |   |
| <b>% of IHBs that should be registered</b>      |                            |   |   |
| Manufacturing                                   | 95.4                       | 93.8  | 6.0   |
| Trade   | 93.4                       | 64.0  | 16.0  |
| Services  | 98.6                       | 65.6  | 11.1  |
| <b>Total IHB</b>                                | <b>95.4</b>                | <b>71.3</b>   | <b>11.6</b>                                   |
| <b>% FHB*</b>                                   | <b>2.4</b>                 | <b>3.8</b>  | <b>40.8</b>                                   |

Note: \*: for FHBs, the reported figures are the % of HBs that are registered while it is not compulsory for them to be so.

Source: Cling et al. (2012c) based on HB&IS Survey, Hanoi (2007), Ho Chi Minh City (2008), GSO-ISS/IRD-DIAL; authors' calculations.

Turning to the FHBs, we ask why some HBs get a business licence when they do not have to. Based on the first hypothesis, less than 3 per cent of FHBs earn less than the minimum wage, which means that they are complying with the legislation. However, if we consider that the income condition applies only to HBs with premises (or, in particular, industries), the diagnosis is quite different. For instance, under Hypothesis 3, more than 40 per cent in both cities are registered when they need not be. In this case, one interpretation could be that the cost/benefit analysis of registering leads HB heads to register in order to benefit from the expected advantages of operating in the formal sector.

Lastly, whatever the “true” scope of the registration formalities, legislation and procedures should be clarified to eradicate the grey area between formality/informality and legality/illegality. Indeed, this is a source of both economic inefficiencies and inequities, and therefore of increased segmentation on the labour market through reduced efficiency and then earnings in the informal sector.

In terms of business registration, there are two distinct situations that are, by definition, opposite: the situation of the IHBs, which are not registered, and the situation of the FHBs, which are registered. The vast majority of IHBs (72 per cent in Hanoi and 79 per cent in HCMC) believe that registration is not compulsory (Table 8). In addition to this huge proportion, 18 per cent do not know whether they need to register in the capital city (7 per cent in HCMC). All in all, regardless of the type of register considered (business, tax and social security registration), from 85 per cent to 90 per cent of IHBs are not aware of the regulations. It is therefore essentially ignorance of their legal obligations that leads the heads of IHBs to fail to register.

Neither the complexity nor the cost of the registration procedures appears to be a problem and there is no overt reluctance to cooperate with the public services. Only a tiny minority of less than 2 per cent of IHBs openly refuse all cooperation with the State. Again, less than 2 per cent of IHBs feel that the formalities are too complicated. Lastly, the monetary cost of registration is only raised by a maximum of 2 per cent of those who have not registered. A not-inconsiderable proportion of IHBs (16 per cent in Hanoi and 19 per cent in HCMC) even say that they are willing to get a business licence.

**Table 8. Reasons for not being registered (per cent)**

|                         | Reasons why not registered |               |                      |                |                                |                                    |             | Total      | Prepared to register<br>( <i>business licence</i> ) |
|-------------------------|----------------------------|---------------|----------------------|----------------|--------------------------------|------------------------------------|-------------|------------|---|
|                         | Too complicated            | Too expensive | Registr. in progress | Not compulsory | Don't know if have to register | Don't want to cooperate with State | Other       |            |   |
| <b>Hanoi</b>            |                            |               |                      |                |                                |                                    |             |            |   |
| Manufacturing           | 1.0                        | 0.8           | 0.5                  | 66.5           | 25.5                           | 2.1                                | 3.6         | 100        | 18.9  |
| Trade                   | 2.8                        | 0.6           | 2.0                  | 69.3           | 18.2                           | 2.7                                | 4.4         | 100        | 17.6  |
| Services                | 1.0                        | 0.6           | 0.2                  | 76.5           | 14.1                           | 2.0                                | 5.7         | 100        | 14.1  |
| <b>Total IHB</b>        | <b>1.7</b>                 | <b>0.6</b>    | <b>0.9</b>           | <b>72.0</b>    | <b>17.7</b>                    | <b>2.3</b>                         | <b>4.8</b>  | <b>100</b> | <b>16.3</b>   |
| <b>Ho Chi Minh City</b> |                            |               |                      |                |                                |                                    |             |            |   |
| Manufacturing           | 1.3                        | 0.3           | 0.6                  | 83.0           | 4.9                            | 0.0                                | 9.8         | 100        | 19.2  |
| Trade                   | 0.9                        | 2.0           | 1.7                  | 75.1           | 9.3                            | 0.0                                | 11.1        | 100        | 21.0  |
| Services                | 0.4                        | 1.7           | 1.2                  | 80.1           | 7.1                            | 0.2                                | 9.4         | 100        | 18.4  |
| <b>Total IHB</b>        | <b>0.8</b>                 | <b>1.5</b>    | <b>1.2</b>           | <b>79.1</b>    | <b>7.3</b>                     | <b>0.1</b>                         | <b>10.0</b> | <b>100</b> | <b>19.4</b>   |

Source: *Cling et al. (2012c)* based on HB&IS Survey, Hanoi (2007), Ho Chi Minh City (2008), GSO-ISS/IRD-DIAL; authors' calculations.

The qualitative survey conducted by Razafindrakoto and Nguyen (2010) with HBs in Hanoi and Ho Chi Minh city assesses and illustrates the findings of the quantitative *HB&IS* survey (see Box 1). The analysis made before showed that, if legislation were strictly enforced, almost all the interviewed HBs would have to register. However, most of the informal HBs argue that their business is too small, claim that registration is not compulsory for them, and assert that nobody has asked them to register. Most of the informal HBs put forward the case of the small scale of their activity. The heads of HBs argue that they do not really run a business, just a 'household activity'. So, according to them, registration is not compulsory, though they acknowledge their limited knowledge of the legislation, which is clearly illustrated by their declaration.

The case of street vendors and service providers conducting their business in a public place like pavements and small lanes in the middle of a crowded neighbourhood merits special attention. Normally, they are not obliged to be registered, but they are banned in some streets. Due to both their personal circumstances and business conditions, those micro-entrepreneurs are not in a position to learn about and familiarize themselves with the laws concerning business registration. Not surprisingly, their limited knowledge of the regulations puts them in a difficult situation and is more problematic.

On the whole, IHBs stress the fact that they have never been controlled by the authorities: they have had no contact with public officials or no one has asked them to

register. They have a small business located in a small street (mostly at home), so the authorities simply ignore them.

Informal activities therefore look to be more a sector of spontaneous development of economic activities by households rather than the result of a strategy to 'evade' legislation in force deemed inhibiting. The solution to the problem of non-registration in the informal sector calls first and foremost for an active communication policy by the State and probably for an administrative simplification of registration formalities. However, it would not be advisable to seek to indiscriminately increase tax pressure on the informal sector, given the meagre profitability of most IHBs.

### 3.3. Social protection and informal employment

As the case of registration of informal household businesses (the informal sector) has been discussed in detail in the 2 previous sub-sections, we will limit our analysis of informal employment in this sub-section to the formal sector. By definition, informal employment concerns employment without social protection. In this study, social protection will mostly mean pensions, as unemployment insurance is marginal and as health insurance relates in our view mostly to another issue, not directly connected to employment.<sup>6</sup>

The social security system in Vietnam has been established under its present form by the Social Security Law of 2006 and has two components: a mandatory system covering all enterprises with 10 employees or more; a voluntary system created with the Social Security Law of 2006, covers all the other workers. It consists only of a pension system with survivorship benefits. Both systems require a minimum contribution calculated on the minimum wage.

The mandatory system covers only the wage employed with labour contracts of 3 months and above. It includes a large range of programs: short-term benefits, compensation for work accident and professional disease, old-age pension and survivorship; cross-checking the data of the Census of Enterprises with the figures of Vietnam Social Security, Castel and To (2012) consider that 24 per cent of the employees in the enterprise sector (totalling 1.1 million) are employed under short-term contracts and are therefore excluded from any social security ; this proportion even amounts to 32 per cent in domestic private enterprises. The World Bank (IFC, 2011) even comes to a higher estimate (based on enterprise surveys) of 36 per cent of employees in the private enterprise sector (domestic and foreign enterprises), compared with only 8 per cent in lower-middle-income countries.

Because of the massive share of temporary work in the private sector in Vietnam, it is a priority to analyse the legal framework on this subject; it is very easy to employ workers on a short term contract, knowing that a significant part of these contracts are signed through *subletting* (labour subcontracting), which has just been recognized legally (see box 3 below); however, no precise statistical information is available on this subject, even in the building industry where subletting seems to be the norm. The New Labour Code passed by the National Assembly in June 2012 (which will come into force in June

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<sup>6</sup> In Vietnam, health insurance is free and universal for the poor, children under 6 and the elderly (over 80 years old). The rest of the population often contributes to voluntary schemes. The health insurance law (2008) plans to achieve universal coverage by 2015. According to Castel (2012), approximately a quarter of the population, corresponding to farmers and people working in the informal sector who are not considered as being poor, would still remain uncovered.



2013) recognizes officially this activity. This represents a significant progress, which could help extending social protection (and reducing informal employment) for the sublet workers. Although the finalised Labour Code that was enacted by the National Assembly is not yet publicly available when writing, box 3 presents the main elements on this subject drawn from a draft presented to the Assembly (Fraser, 2012).

**Box 3: Labour subletting - A new legal term**

A labour sublease contract is a new legal concept in Vietnam first introduced by the New Labour Code, but which will be familiar to employers in other jurisdictions who are used to hiring temporary agency employees to cover short term labour needs.

A labour sublease means assigning an employee recruited by the labour sublessor to work for, and be subject to the management of, the labour sublessee, however, the labour relationship between the employee and the labour sublessor remains intact and no employment relationship is created between the employee and the labour sublessee (i.e. end user entity). This means that the sublessor has to implement rights and obligations of an employer towards the employee and vice versa.

Pursuant to the New Labour Code, the business of labour subleasing is a conditional business activity and may only be applied for certain types of employment. For businesses, this can be a highly useful means of responding to short term labour requirements, but without having to undertake the responsibilities attached to taking on employees directly. It also permits businesses to take on staff with particular skill sets, again without the associated labour recruitment costs and responsibilities.

Source: Fraser Lawyers (2012)

The question of law enforcement only concerns then employees with a permanent labour contract, but who do not benefit from social protection. No precise estimate is available for the size of this group. Using the World Bank estimate of the share of short term contracts and the share of informal employment in private enterprises drawn from the LFS2009, we estimate that around 600,000 workers fall into this group. Estimates from Castel and To (2012) are a bit higher (around 1 million) but still relatively marginal (the formal private enterprises employ more than 5 million workers).<sup>7</sup> The whole discussion of this section 4 on law enforcement suggests focusing on the question of registration of household businesses and short term contracts, in order to reduce segmentation.

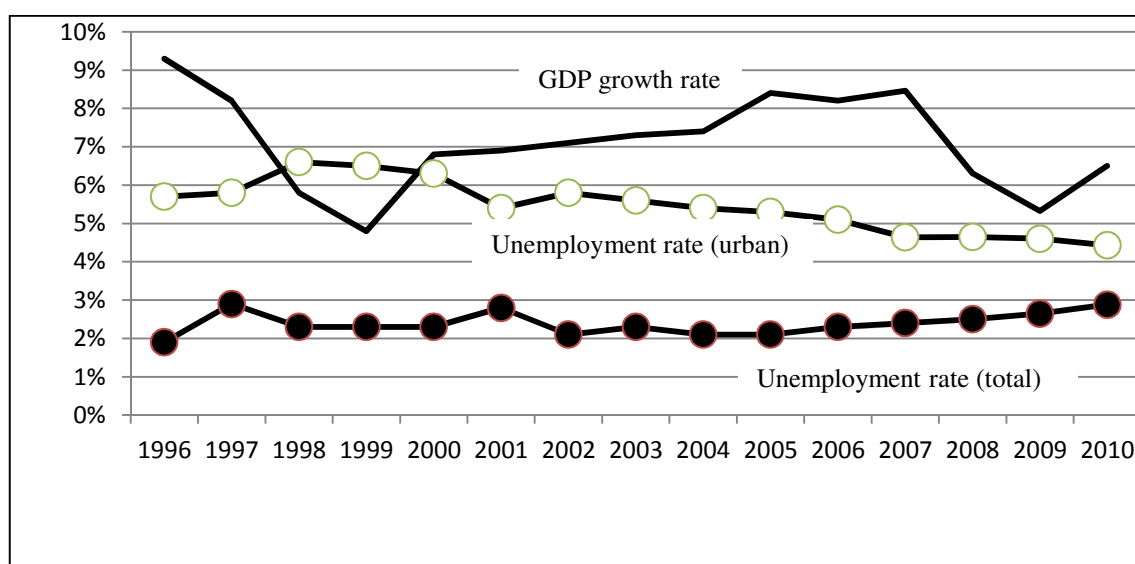
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<sup>7</sup> According to Castel and To (2012), only 44 % of private domestic enterprises paid social contributions in Vietnam in 2005, representing 62 % of the total employment of this sector. An unknown part of this percentage corresponds to short term contracts for which social contributions are not obligatory. The rest is fraud. Moreover, most enterprises which contribute for their workers under-declare their wages which are the base for their contribution. This reduces the protection granted to these workers.

### 3.4. Impact of the crisis

In Vietnam, as is the case generally in other developing countries<sup>8</sup>, the unemployment rate is relatively inelastic to economic growth (Figure 2). What's more, not only was the turnaround not accompanied by a rise in unemployment but the latter even fell: the unemployment rate fell from 2 per cent in 2007 to 1.7 per cent in 2009, an insignificant variation given the margin of error. If the evolution of the rates of urban unemployment (a more pertinent concept in Vietnam) are analysed, a significant fall is observed, the rate falling from 3.6 per cent in 2007 to 2.8 per cent in 2009. The unemployment rate is not generally the best indicator for measuring adjustments on the labour market. In a country like Vietnam, where salaried work accounts for only a small percentage of the working population and where the risk of unemployment is not covered by social institutions, the impact of an insufficient labour demand has other effects than a rise in unemployment.

**Figure 2. Unemployment rates and GDP growth in Vietnam (1996-2010) in percentage**



Sources: Cling et al. (2012a) based on MoLISA and GSO (1996-2011); authors' calculations.

Between 2007 and 2009, almost 2 million jobs were created and job structure by sector remained relatively stable in spite of the crisis. The number of agricultural jobs continued to fall both in actual number and in share of the labour market (from 50.4 to 48.1 per cent). The informal sector saw the creation of 639 000 jobs (+6 per cent), which was a slight rise in its share of total employment (from 23.4 to 23.8 per cent). However, it was the private formal sector in particular which was the most dynamic: more than 1 million new jobs (+41 per cent) in domestic enterprises and 480 000 jobs (+53 per cent) in foreign investment enterprises (the respective share of these sectors in employment rising from 5.7 per cent to 7.7 per cent and from 2 to 2.9 per cent). Employment in individual informal enterprises has for its part varied little (+183 000 jobs, its share of this sector rising from 7.7 to 7.8 per cent). These evolutions resulted in a continuation in the rise of the number of salaried workers (29.8 to 33.6 per cent) as well as in the share of the working population covered by social protection. Consequently, the share of informal employment fell slightly (from 81.9 to 80.5 per cent).

<sup>8</sup> At least in low income countries, which was the case of Vietnam at the time of the crisis.

In fact, the adjustment on the labour market essentially passed through other channels than by the reduction of the number of full-time working hours: the economic slowdown thus resulted in a drop in the average number of hours worked (from 43.9 to 42.6 hours per week between 2007 and 2009) and by a rise in part-time employment (less than 35 hours per week): 13.2 per cent of workers were concerned by this in 2007 and 26.7 in 2009. Paradoxically, this average evolution also went hand in hand with a lengthening of working hours for the most vulnerable part of the population: the percentage of the labour force working more than 60 hours per week rose from 5.6 per cent to 9.3 per cent in two years. Finally, a very high rise in the number of workers with more than one job was observed: having more than one job constituted a strategy to compensate for the reduction in working hours by seeking an alternative source of income. The rate of workers with more than one job thus rose from 18.2 per cent to 25.4 per cent between 2007 and 2009, this rise was observed both in urban and rural areas.

The impact of the crisis on income can *a priori* pass through several channels: through a fall in salaries or the moderating of salaries in the formal sector, or through adjustments in price or quantities (employment) in the informal sector. In this latter sector, several mechanisms can play a role. On the labour supply side, additional employment in the informal sector might have sharpened competition between individual enterprises and put downward pressure on turnover and income. On the demand side, there may have been a structural change in household consumption to the detriment of formal products and to the benefit of supposedly cheaper informal products this having the opposite effect; but as the informal sector already satisfies the essential of household consumption, this effect was only a modest one so that one was expecting a reduction of demand in the informal sector and thus incomes. Owing to the great flexibility of this sector, the recessive impact on incomes should have been logically greater than on formal salaries.

In fact, the evolution of income observed between 2007 and 2009 was positive in all job sectors, except agriculture. The average monthly salary (for principal jobs) thus rose from 1.06 million VND to 1.60 million VND, that is to say a rise of 52 per cent in two years. This result is robust on a scale of used income since the rise in median income is very close (+50.5 per cent). When the rise in nominal incomes is reduced by subtracting the rate of inflation (+30.9 per cent between the two surveys) we arrive at an average rise of 15.3 per cent for real income and 13.6 per cent for the real median income<sup>9</sup>. Quite surprisingly, this dynamic is not only positive but also relatively close to the previous trends for average income. In periods of high inflation, measurements of the evolution of real income must nevertheless be interpreted with precaution: between 2007 and 2009, the rise in the price of rice and cereal (+54 per cent) which constitute staples for the poor in Vietnam, was almost twice the average rise of consumer prices. Consequently, the application of a common deflator tends to overestimate the rise in real income for the poorest categories of the population who constitute the base of the informal sector.

With the help of the statistical reserves above, it can be remarked that the informal sector does not seem to have been the sector most badly affected by the crisis as far as income is concerned, given that there is no observable divergence between the formal and informal sectors. In volume, both average and median income growth in the informal sector are higher than that of incomes in the whole of the economy.

The globally positive image of the impact of the crisis on the Vietnamese labour market presented in part one needs to be balanced if we look at things from a more

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<sup>9</sup> To calculate real income growth, we have elaborated a price deflator which takes into account special differences in price levels, as well as their variation over a given period.

precise geographical level. In order to do this, we shall concentrate our analysis on the country's political and economic capitals (Hanoi and HCMC). A specific survey into the informal sector (HB&IS) was carried out in the two cities in 2007 and 2009, concurrently with the employment survey. Compared to the latter, the HB&IS survey has three strong points: firstly, it broadens the perspective as it is not limited to questions concerning employment but also includes questions to informal enterprises about supply (production, finances, difficulties, requests for help, etc.); secondly, it provides a more reliable measure of income than the employment survey which tends to systematically underestimate it; finally, the sample group is composed of a panel dimension which allows us to evaluate the economic and demographic dynamic of individual enterprises, which the employment survey does not allow.

Two key conclusions can be drawn from the analysis of the results from the survey into the two cities: on the one hand, the high employment growth in the informal sector between 2007 and 2009, as well as the rise in the number of individual informal enterprises, were stimulated by the crisis; on the other hand, there is a striking difference between Hanoi and HCMC, in so far as individual informal enterprises in the South were more greatly affected by the crisis, particularly as far as incomes are concerned: twice as many informal household businesses declared a decrease of their real income between 2008 and 2009 in HCMC than in Hanoi (46 per cent compared to 23 per cent). Although this last result needs to be more deeply analysed, it suggests that the economic capital of the country was globally more affected by the crisis owing to its dependence on foreign markets, and this greater openness to the exterior had a direct impact on the informal sector (Cling et al. 2010).

#### **4. Employment strategies implemented towards informality and segmentation**

Apart from social protection where clear and specific objectives have been defined (universal health protection by 2015, 3 million people enrolled in voluntary pension schemes by 2020, etc.), employment strategies are currently rather blurred in Vietnam. At the time of writing, the Vietnam employment strategy for 2011-2020 has still not been presented by the Ministry of Labour and Social Affairs (MOLISA) to Parliament and no draft of this strategy is publicly available. Interviews conducted by one of the authors of this study in January 2013 at the ILO Office in Hanoi did not bring any light on the reasons for this delay. Obviously, Vietnam having become a middle-income country brings new demands (such as concerning informality or social protection) that the government has difficulty to meet or even to define a strategy to reach the objectives.<sup>10</sup>

Firstly, it is interesting to note that the informal sector remains a terra incognita for economic policies, totally ignored by the authorities. None of the temporary measures included in the aid plan aiming to provide compensation for the negative effects of the crisis from an economic and social point of view has included the informal sector. This is all the more regrettable as poverty is progressively changing face and is increasingly affecting the marginal populations of the big rapidly developing urban hubs which are the hard core for the urban informal sector. The lack of real policy for the informal sector goes beyond the framework of the crisis and really appears to constitute a permanent concern for economic policy. Thus, the socio-economic development plan (SEDP) for

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<sup>10</sup> Complementary information added in April 2014: The Vietnam employment strategy for 2011-2020 has eventually not been adopted. This means that the principle of defining a specific ten-year strategy for employment has eventually been abandoned by the government.

the 2011-2015 period does not once mention the informal sector and makes do with the standard targets of lowering urban unemployment, providing support to small and medium-sized enterprises (credits and training for example) and, more daringly, the implementation of social protection in employment (MPI, 2010).

This section is dedicated to three key issues concerning employment public policies and the informal sector and employment in Vietnam: first of all, the challenges of implementing an employment strategy addressing informality; second, the (marginal) inclusion of employment in the Socio-economic development strategy (SEDS) 2011-2020, which defines the main lines of economic policy by 2020 ; last of all, as in other Asian emerging countries (China especially), there is an important current debate around universal protection (pensions, health, etc.), which will lead to significantly reduce informal employment.

#### **4.1. The challenges of an employment strategy addressing informality in Vietnam**

Salvini (2012) has conducted an extensive review of a provisional draft of the Vietnam employment strategy 2011-2020 in relation with informality. It has to be repeated that when writing the VES has still not been made public and that comments below only reflect some attempts to define a strategy, which have not been approved yet (see footnote N°9 on previous page).

The author starts by pointing out the fact that defining and conducting direct policies aiming at reducing informality would be rather unrealistic in Vietnam, because informal agents are by definition difficult to detect and to observe. Moreover, in a country like Viet Nam, with informality endemic in the system, and with approximately one labour inspector out of 350,000 people, one cannot expect that enforcement of labour standards can play a major role in formalization strategies. We are left with two alternative strategies towards informality.

*The first strategy* assumes that formalization is a by-product of development, and that Labour Code protection and registration rules will automatically extend to all workers and economic units without the need of specific policies. But, unfortunately, this approach is contradicted by evidence from almost every developing country as well as by prospective analysis presented here above.

*The second strategy* consists in defining indirect instruments of interventions on the labour market (territorial development policies, services and social transfers, etc.) to promote formalisation of employment. All in all, without coordination between labour market policies and other socio-economic policies, the only incentive to formalization may be given by the option of closing down the informal activity to find a job in the formal sector.

We concur with Salvini (ibid.) that “there is a long way to go for institutions to detect and address in practice workers in the informal economy. In this regard, one of the major labour market programmes for informal workers has been in place since 2010 and aims to provide training to at least 1 million rural labourers every year. On the one hand, this programme succeeded in detecting and identifying informal workers through community-based institutions. On the other hand, its implementation arrangements are vague and, in few words, the strategy is represented by a lump sum to be spent on training and re-training services. If training programmes offered by private and public providers are based on skills needs of large-scale formal enterprises, the programme ends up being an incentive for inter-provincial migration towards industrial parks and export

processing zones, rather than supporting increases of labour-productivity for endogenous rural development. Such a strategy would be contingent on the assumption that there would be sufficient formal sector jobs for those who will have received skill training”.

## **4.2. The marginal place of employment in the Socio-economic development strategy**

As mentioned before, the SEDS does not mention explicitly the informal economy. It considers implicitly that employment restructuring in Vietnam follows a dual model (Lewis, 1954), where labour progressively leaves the traditional subsistence agricultural sector with low productivity towards modern industries with high productivity.

In the case of Vietnam, the modern industries correspond mostly to foreign-owned enterprises, which accounted for 42 per cent of total industrial production, while employing only 4 per cent of total employment in 2009. The implication is that FDI alone is unlikely to act as the only absorber. On the other hand, domestic-owned private economic units (enterprises and household businesses) represent approximately four fifths of total employment. One must also take into account the additional impact of transition and restructuring of State owned enterprises (SOEs), with a progressive transfer of employment from the public to the private sector.

This model raises the well-known dilemma of public economic policy (not only in developing countries), when there is a structural disequilibrium on the labour market: should we speed up employment restructuring in order to promote economic growth through productivity gains, knowing that employment demand will be insufficient to absorb the labour surplus? Or should we rather define targeted policies towards disadvantaged zones and low-productivity sectors, which will slow down economic restructuring but will support the poor?

These policies are included in the SEDS. In a wise and considerate way, the SEDS mentions that, “labour-intensive production will continue to play a role in the next ten years in Viet Nam”. From a technical point of view, this sentence is an implicit incentive to re-orient policies to support economic activities which are currently labour-intensive, mostly informal and localized in poor areas of Viet Nam.<sup>11</sup>

## **4.3. Beyond the employment strategy, towards an extension of social protection**

In Vietnam, a large proportion of the population does not benefit from social or health insurance (Castel, 2012). This is not unusual for a low middle income country of around USD 1,200 income per capita. What is unusual is the government’s set of policies to rapidly develop “strong social insurance and health systems towards health and social insurances for all” (ILSSA, 2010). Participation in health insurance of large sectors of the population (children, students, the elderly and the poor) is already subsidized and, the

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<sup>11</sup> The SEDS calls upon the Government to find ways to promote endogenous economic development of communities through domestic savings and investment, implemented in tandem with policies aimed to urbanize, industrialize and “modernize” the Vietnamese economy. On the other hand, even if one country misses the goal of providing decent job opportunities for all, those left out by poorly inclusive growth usually lack the possibility to express their dissent, as these workers and enterprises tend to be less well organized than those of urban and large-scale enterprises.

health insurance law of 2008 paves the way for achieving universal coverage by 2015. Regarding social insurance (pensions, sick and maternity leaves, etc.) the whole strategy to reach universal coverage has not been developed yet. So far, government's policies have focused on enlarging access and on improving the system's long-term viability. In 1995, mandatory participation in Vietnam Social Security initially reserved to public sector employees was extended to the employees of the private sector. The 2006 Social Insurance Law expanded the system to the farmers and the self-employed but on a voluntary basis. Designing a strategy to reach universal coverage in social insurance is more complex than in the case of health insurance because it requires commitments over long periods. The share of the population non-waged employed or working in household enterprises is, moreover, very large in Vietnam and subsidizing participation in social insurance is much more expensive than in the case of health insurance (Castel, *ibid.*).

Most debates on informal employment in Vietnam are therefore related to the extension of social protection (pensions, health). The National assembly has committed to improving the Social security law by the end of 2013, and the government recognizes that some important reforms are necessary (ILO, 2012). According to ILO (*ibid.*), *"it is recommended that another study should be carried out for identifying alternatives to protect informal workers, using a combination of voluntary insurance and non-contributory pensions"*.

The extension of social protection is actually confronted to a general trade off put in evidence by many studies on the subject (World Bank, 2008; VASS, 2010; Castel, 2012): except to a certain extent for voluntary measures (which still need incentives provided by the Government and therefore also implies increased receipts), this extension requires an increase of taxation on wages or global incomes (income tax), which goes against the formalization of the informal economy.

More specifically three kinds of difficulties can be distinguished, corresponding to the different modalities of informal employment:

- A major share of informal employment is engaged in the informal sector within individual household businesses. Currently, these workers have the option to contribute to the Voluntary Social Insurance Fund (VSIF); however, workers in this sector usually do not have a sufficient income to be able to contribute to a voluntary (or mandatory) protection system; taking into account all their problems (see section 5 here after), it is not certain that they perceive social protection (especially pension) as their priority.
- Another group consists of informal workers employed in formal private enterprises, with an important category corresponding to short term contracts (less than 3 months) for which enterprises are not obliged to pay social contributions ; according to available estimates, these short term workers represent between one fourth and one third of workers employed in formal enterprises, which is huge (Castel, 2012) ; a precise study of the determinants and modalities of these short-term contracts is needed, in order to check whether this is not a way for enterprises of rolling over short term contracts indefinitely, in order not to pay social contributions.
- The last category corresponds to workers having a permanent labour contract, but for whom their employer (an enterprise or a formal household business) does not pay any social contribution. As aforementioned, this is probably relatively marginal (less than one million employees), although there are not any precise estimates of the number of workers concerned. It is only for this last category of workers that law enforcement should be increased.

## 5. Policy recommendations

In this section, we draw some conclusions from the analysis made in this report concerning the issue of labour market segmentation and informality. Most of our comments (drawn from Cling et al., 2012a) focus on the informal sector, which corresponds also to a major share of informal employment; proposals on social protection are directly linked to informal employment on the whole.

The informal sector is an essential component of the Vietnamese economy which has even grown since the advent of the crisis. Whatever the scenarios for growth in the coming years, the informal sector is here to stay. In spite of its high flexibility, the informal sector suffered from the difficult economic situation in 2008-2009. It is particularly the case in HCMC, where a recession has been clearly observed, with a strong effect on the living conditions of households which emphasizes the necessity of taking local circumstances into account. Beyond these short-term difficulties, analysis of the informal sector leads us to the important question of the need for an economic policy that we shall attempt to outline in this last part.

We shall distinguish here four types of measure:

- the first type of measure aims at having the existence of the informal sector legally recognized, having it precisely defined and assuring that it is continuously measured in official statistics; this is an imperative requirement for defining adapted policies;
- the second type of policy seeks to clarify and render transparent and intelligible by everyone the criteria for registering individual enterprises, and at the same time simplifying the bureaucracy required to do so; as it has been shown in this report, promoting the formalization of informal household businesses is a way to increase flows from the informal to the formal sector and thus to reduce segmentation on the labour market;
- the third type of measure concerns proposals for policies aimed at the informal sector (tax measures and subsidies); as increasing mobility from one sector to another can only be a partial solution (in the absence of enough formal jobs), this is another requirement for fighting segmentation by reducing the earning gap between formal and informal employment (especially for women);
- the fourth and last type of measures concerns social protection. This is part of a strategy to reduce vulnerability in employment, and especially to reduce segmentation for wage workers through a unification of the wage market (currently approximately divided in two between formal and informal wage workers).

### 5.1. Recognition of the informal sector

Before support policies can be implemented, the concept of an informal economy (informal employment and sector) must therefore acquire a recognized, legal existence in Vietnam, which is not currently the case. It must be defined in a juridically recognized document at the most pertinent level in legal terms (law, decree, circular, etc.). This definition should first adopted by the Ministry of Planning and Investment, by the Ministry of Finance, the Ministry of Labour Invalids and Social Affairs and, of course, by the General Statistics Office of Vietnam, and other public and private institutions



would be able to base themselves on it. It is a preliminary condition so that the different agencies (public and private) may target the informal sector with their interventions. So, for example, it is the case, even today, that different ministries maintain that they are unable to implement policies in favour of the informal sector because it does not legally exist. Its legal recognition is also a prerequisite, if the GSO is to monitor and measure regularly and continually the sector and thus allows the elaboration of efficient policies founded on robust empirical information. This official recognition would evidently not be equivalent to legalizing the informal sector. Indeed, a large number of individual enterprises operate “illegally” in so far as their income is higher than the legal threshold which requires them to be registered (Cling et al., 2010). These enterprises are liable to be sanctioned; but it would still be better for everyone if this threshold was clearly and appropriately defined (see below). As far as statistical monitoring is concerned, the GSO-IRD research project (see box 1) has resulted in some substantial progress. Since 2012, the employment-survey provides a continuous and accurate measure of employment in the informal sector, and corresponds to the recommendations made in 2007 (Razafindrakoto and Roubaud, 2007). However, launching a national informal sector survey is always hindered by the absence of any official recognition of the sector, in spite of the Prime Minister’s decision in 2008 to carry out such a survey every two years (Decision 144/2008/QD-TTg).

It is of vital importance to adopt a unique concept of the sector, not only to define targeted policies, but also to give the millions of workers in the sector a minimum of official recognition and to remedy their exclusion from economic and social life. This legal recognition would be a strong mobilizing factor for the informal sector workers themselves. This would especially favour the creation of producers’ associations. These associations would be a means of giving voice to informal workers in negotiations and in the dialogue between workers and the government and would also make targeted support policies more efficient (see below). The “missing link”, which is currently neglected in policies of development and combat against poverty, a link between the shiny, globalised façade of Vietnamese growth (direct foreign investment, exports, new technologies, etc.) and the traditional workers, would in this way be put in place.

We also insist on the necessity of conducting more systematic impact evaluations of policies aimed at the informal sector (also of the potential indirect impact of public policies on this sector), a procedure which still remains exceptional in Vietnam. Beside the traditional arguments in favour of policy impact evaluations in general, can be added two specific arguments for the case of the informal sector in Vietnam. Firstly, the fact that these evaluations do not currently exist is a valuable argument for the need for such an evaluation. Indeed, one of the required conditions to evaluate a policy rigorously is to have in hand a measure of the current state of affairs before its implementation. Next, given the size of the needs for support compared to the lack of available resources, and the lack of previous experience, these policies should be tested on small-scale pilot schemes, before an eventual extension (depending on the results) is envisaged. This progressive temporal sequencing of policy coverage is also a favourable condition for the elaboration of rigorous impact evaluation measures

## **5.2. Registration: Suppressing the grey zone where rights are not respected**

In fact, if the State does not really understand the informal sector, the reverse is also true. Nobody really knows who should be registered and pay taxes. This blurred frontier between formal and informal individual enterprises and the lack of transparency lead to the creation of a grey zone favourable to informal arrangements, negotiations and even to corruption. As a street seller declared, *“I don’t know anything about regulations but I apply one rule: when the police arrive I run off”* (Razafindrakoto and Nguyen Huu Chi,

2010). Establishing clear, known rules would thus contribute to the reduction in the arbitrariness of decisions and harassment by civil servants, while at the same time allowing the authorities to rigorously enforce laws.

In theory, nearly all individual enterprises should be registered in Vietnam, in so far as registering thresholds (very vague) are very low. The fact that it is not the case is especially due to the ignorance of these thresholds by the population. Thus, less than 1 per cent of Informal operators declare that they are aware of them (Demenet et al., 2010). This rate is scarcely higher within formal household businesses: 10 per cent in Hanoi and 20 per cent in HCMC. As for the actual threshold amount, among the small minority of those who claim to know it, it is evaluated at between 2 and 15 million Dong per month. One might as well say that the application of the law is totally discretionary, thus creating an unpredictable business environment which is unfavourable to confidence and consequently counterproductive.

One way of encouraging formalization would be to improve the transparency and communication of these rules. Among the two criteria currently used for registering in Vietnam (number of employees and income) which vary according to communes, each one has its advantages and disadvantages (economic pertinence, monitoring easiness etc.) and arbitration must consequently be carried out. What's more, the dynamic approach presented in this study shows that there is a lot of mobility between the informal and formal sectors with numerous enterprises changing status. Given the advantages expected of formalization (better access to credit, less vulnerability to corruption, better economic performance, etc. (Rand and Torm, 2012b), policies encouraging enterprises to register accompanying the fixing of these rules would favour the flow from the informal to the formal sector. One might also highlight the fact the constraints which weigh heavily on migrant workers (residential registering) constitute a barrier for the formalization of individual enterprises (migrants who are not registered in a city may not register their enterprises there).

Outlining in a precise manner the informal sector and the rules for registering enterprises should facilitate the implementation of an incentive fiscal policy adapted to the specificities of this sector. These two processes are complementary: on the one hand, the acceptance of taxation by individual entrepreneurs goes with the implementation of support policies for their benefit and these policies thus constitute to a certain extent the necessary and logical counterpart to this taxation, on the other hand, the taxes collected from individual enterprises (in spite of the habitual "fungibility" of public finances) should naturally contribute to the partial funding of these policies.

The fiscal potential of the informal sector is far from negligible: out of the 8.4 million individual enterprises (=household businesses) in Vietnam, only 1.2 million are registered with the fiscal authorities. In reality, the number of enterprises which effectively contribute is higher owing to the multiplicity of local taxes. Thus, in Hanoi and HCMC, about a quarter of informal businesses already pay taxes in one form or another, whereas almost all formal ones do so. But the correlation between the rate and level of taxation on the one hand and the level of economic activity on the other is low as the more "visible" enterprises suffer the highest tax burden whatever their economic performance. Furthermore, a large part of the heads of informal enterprises declare that they are ready to pay taxes, a part which might increase even more if they received assurance that at least a part of the money collected went towards lifting the constraints which weigh heavily on them.

Three principles should guide the informal sector taxation policy. On the one hand, it should be equitable and depend on the enterprises' ability to contribute. On the other hand, the amount of tax should be sufficiently low so as not to stifle an already limited

economic profitability and push enterprises out of the legal sphere. Finally, it should be based on “a new social contract” between the State and the informal sector so that the latter is not only (or does not have the impression of being) taxed but also receives tangible benefits from its contributory efforts. A synthetic tax which would be both easy to calculate and collect, as near as possible to the zone of activity (on a local level) seems to be, from this point of view, the best idea.

### **5.3. The implementation of targeted support policies**

The problems and requests the heads of informal enterprises expressed constitute a valuable guide to identify all the different constraints they are placed under and to give the right direction to the support policies in favour of the informal sector. Nevertheless, it is necessary to supplement them with additional propositions, in so far as informal entrepreneurs only perceive the world as it functions (or dysfunctions), and not as it could function. Consequently, the latter have the impression of being totally atomized and abandoned by the State and are inclined to expect nothing and only count on their own force. What’s more, this is indeed what can be observed in reality: the proportion of those who desire State help is astonishingly low considering the difficulties they face. Formal individual enterprises are a lot more likely to complain and ask for State aid than those in the informal sector, in spite of their much superior economic performances; this is an example of the preference attrition phenomenon, the capacity to protest being inversely proportional to the power one has. The restoration of a climate of confidence between the informal sector and the State is a prerequisite to any support policy. Cling et al. (2012a) compare and contrast the difficulties faced by informal operators and the requests for aid addressed to the authorities, these two dimensions being closely linked as the results presented here demonstrate.

Armed with this empirical data and the existing research in this domain, it is possible to outline the guiding lines for a package of measures that it would be advisable to prioritize. The latter may be organized according to the two principal functions to be developed: on the one hand increasing the productivity of the informal sector (at the same time maintaining its flexibility) and on the other hand, protecting its workers. On the first front, and among the required support policies aimed at (formal and informal) individual enterprises, three types of action should be favoured.

Improving access to and information about markets, and promoting producers’ associations. The informal sector is only marginally integrated into the rest of the economy, whether it is in terms of subcontracting or of access to large orders. Coherently, one of the principal requests for help expressed by the informal sector concerns access to big orders. Policies aiming to improve access to markets, particularly via an improved dissemination of information, would therefore be recommended. Evidently, excessive competition and a lack of clients – considered to be among the principal problems facing informal operators –cannot be resolved only by sectional policies, as they indicate a problem of insufficient aggregate demand. Nevertheless, an improved articulation accompanied by the potential (and dynamic) demand of the formal sector would be likely to reduce market constraints. Thus, the informal sector should be given preferential access to certain public markets (both State ones and local ones), from which it is currently excluded. Likewise, the reinforcement of subcontracting links with large enterprises (on the domestic market or for export) is likely to supply valuable outlets for the informal sector, such as the relationships in force in the craft villages (Fanchette, 2012). However, in order to do this, contracts cannot be individually negotiated as informal operators are too small in size. In order to reduce transaction costs the latter should group themselves together into associations of producers which are currently almost inexistent (1 per cent of informal enterprises). International experience

shows that these associations play an essential role in the setting up of professional networks and social capital, a factor which determines entrepreneurial success. Other than the direct economic interest of policies aiming to favour the emergence of groups of operators, these networks would be a means of giving a voice to workers in the informal sector and defending their interests before the other organized forces they must face (public powers, employers' associations, NGOs etc.).

Favouring credit access. Informal enterprises suffer from the serious problem of financial exclusion: only 2 per cent have been able to obtain bank loans in order to create their own enterprise (essentially financed by their own capital); less than 10 per cent (7 per cent in Hanoi and 4 per cent in HCMC) obtained credit in 2009, as was the case in 2007; finally, a negligible proportion (between 2 per cent and 3 per cent) obtained a loan from microfinance institutions. Better access to credit would allow them to improve equipment and productivity, in full knowledge that credit constraints hinder the development of activities in the formal sector and that access to credit constitutes one of the principal constraints and requests for help of informal entrepreneurs. In so far as they cannot provide the (collateral) guarantees necessary to obtain credit from banks, informal enterprises largely benefit from the implementation of loans from microfinance organizations. The experience of other developing countries where these organizations play a significant role might provide a useful example to follow.

Developing training. Along with access to credit, the lack of competences to manage individual enterprises constitutes a second major barrier to the development of the informal sector. It is interesting to note that this demand is not greatly made by informal operators. Yet, the overwhelming majority of them do not have any element of accountancy management for their activity: 62 per cent of individual enterprises in Hanoi and 79 per cent of those in HCMC do not keep any form of written accountancy, not even a simple personal cash book. The implementation of training programmes in accountancy and finance, and more largely in technical training, which are adapted to this sector, would result in an improvement in productivity. Such programmes do not currently exist in Vietnam; existing professional training programmes are uniquely for the benefit of large-sized enterprises and agriculture, and the informal sector once again represents the missing link between these two segments. Thus, only a quarter (23 per cent) of workers in the informal sector have participated in any professional training (only 8 per cent if only training periods longer than three months are counted), and what's more, there is nothing to prove whether the training was in anyway linked to the job currently exercised.

In parallel to these targeted policies, it is necessary to reorient the general education system. Indeed, the latter does not provide any place for activities in the informal sector. It incites the young to envisage salaried work in the formal sector (more particularly the public sector; see Razafindrakoto et al., 2012) as the only conceivable finality to a successful educational course, in spite of the fact that only a minority will succeed in gaining access to it. In order to improve the training-work relationship, it would be a good idea to integrate into the general educational curriculum (and the technical one a fortiori) a better understanding of the informal sector by drawing its existence and its specificities to the attention of pupils. Training periods in "enterprises" could be organized, informal entrepreneurs could tell pupils about their experiences, etc. These policies would without doubt help to prepare better the majority of those who will one day work in the sector and would also certainly help in the struggle against the negative image of the sector which the education system is currently helping to create.

## 5.4. Social protection

The last kind of recommendations concerns the implementation of a system of social protection adapted to the characteristics of the informal sector. At present the whole of the informal sector (and informal employment within the formal sector by definition) does not benefit from any social protection. Including the informal sector in the social protection system would lead to the reduction of the precariousness and vulnerability of workers in this sector. For some years now the Vietnamese government has been moving resolutely in this direction. In 2008, a system of voluntary social protection for all those not covered by the obligatory system (salaried workers whose contract is for less than three months and all non-salaried workers) was implemented. It falls within the framework of an ambitious aim to provide universal social protection by 2020. Yet, in 2010, 41.4 million workers out of a total of 50 million did not benefit from any protection, that is to say 83 per cent of the workforce. What's more, fewer than 50.000 workers had joined the voluntary scheme, that is to say a negligible number when compared to the tens of millions of potential beneficiaries. It thus appears that the current voluntary system does not cater for informal sector workers' needs, on top of the fact that its financial viability is also in doubt. It is therefore urgent to carry out an in-depth evaluation of the reasons for this failure in order to outline viable ideas for its reform.

The problem of lack of social protection for workers in formal enterprises, and therefore the solution for extending social protection, is slightly different. According to Castel and To (2012), enterprises that partly (or even totally) evade social security (through under-declaration of wages) are more likely to have higher average wages.<sup>12</sup> These enterprises also make higher profit or revenues per worker. This suggests that in Vietnam, workers are more likely the ones who benefit from evasion through higher wages. As the authors point out, "*since social security is a new concept in Vietnam, it is difficult to figure out whether the results reflect the workers' low valuation of social security or rather a lack of awareness on their part.*" Whatever the case might be, this result shows that expanding coverage in Vietnam is not just an issue related to law enforcement. The authors also consider that policymakers should also take into account workers' motivations, as expanding coverage requires workers to be willing to forego part of their wage for social security benefits. Also, reducing informality requires coordination and consensus-building among enterprises as regards social security, at least at the industry level, in order to "level the playing field." To sum it up, workers and enterprises should therefore be both involved in the process of social security reform; to increase ownership of this reform.

Four additional policy recommendations, that we fully endorse, have also been made by the Vietnamese Academy of Social Sciences in its policy report on *Employment and social protection in Vietnam* already mentioned (VASS, 2011):<sup>13</sup>

- Introducing a single social security system number (SSN), issued at birth; this would ensure the "benefit portability" when one worker moves from one province or region to another (whereas migrants lose benefits with the

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<sup>12</sup> This result does not contradict the earning gap which benefits formal wage workers compared to informal wage workers in general (see section 3). This is because the "informal wage workers" category in the estimates by Nguyen et al. (2013) includes informal wage workers both in the formal and the informal sector (the latter being the lowest paid of all sectors).

<sup>13</sup> VASS also recommends moving from the "pay-as-you-go" scheme toward a fully funded system. We do not endorse this recommendation which is still being strongly debated.

existing system); this would then help broaden the coverage of the social security system;

- Encouraging unregistered enterprises to become registered to social security; this requires especially to solve the “threshold problem” as there is a disincentive connected to the fact that enterprises have to pay mandatory social security contributions as soon as the threshold of 10 employees is reached; a more progressive system of social protection could be considered;
- Improving enforcement of the Social Security Law, by strengthening the labour inspection system, as well as by facilitating some of global initiatives on decent work;
- Extending the voluntary schemes; voluntary schemes should be made more flexible in order to achieve this objective.

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