

VIETNAM AND FOREIGN DIRECT INVESTMENT: POTENTIALS AND CHALLENGES ON THE LABOR MARKET

Nathalie Homlong

Volda University College, Norway
Associate Professor
nh@hivolda.no

Elisabeth Springler

University of Applied Sciences bfi Vienna, Austria
Director of Study Programme
elisabeth.springler@fh-vie.ac.at

—Abstract—

For several years Vietnam has been receiving attention as an attractive business location for foreign companies. But in spite of overall positive economic developments, foreign companies in Vietnam also experience challenges, e.g. connected to bureaucracy and corruption. Another issue that is of crucial importance for foreign companies in foreign markets are the conditions on the labor market. This paper investigates questions about the potentials and challenges for foreign companies on the Vietnamese labor market, and of how attractive Vietnam's labor market is compared to India and China. Education levels, productivity, wage levels, and number of strikes are among the indicators that are used to compare the attractiveness of Vietnam's labor market to the labor markets of China and India. Furthermore the results of almost 30 interviews conducted with companies from Austria, Germany and Switzerland on their experiences with doing business in Vietnam are used to shed light on the strengths and weaknesses of the labor market in Vietnam.

Key Words: *labor market, Vietnam, China, India, country evaluation, macroeconomics*

JEL Classification: **F01, F66, O57**

1. INTRODUCTION

Foreign direct investment has been of great importance for the economic development of Vietnam. A major factor for Vietnam's attractiveness for foreign companies has been the abundance of cheap labor. Like many other Asian countries, also Vietnam has been strongly affected by the global economic crisis. In contrast to many other Asian economies, however, Vietnam's economic growth is still lagging behind pre-crisis levels, and inflows of foreign direct investments have been stagnating. This raises the question of which role the labor market plays in this development, and how Vietnam's labor market compares to other major recipients of FDI in Asia. Therefore this paper analyses the following research questions:

- What are the potentials and challenges for foreign companies on the Vietnamese labor market?
- How attractive is Vietnam's labor market compared to India and China?

First stylized facts on China's, India's and Vietnam's overall economic development are presented. After that a comparative analysis of labor conditions in China, India and Vietnam is carried out. Finally the results of the assessment are compared to the results of almost 30 interviews with Austrian, German and Swiss companies with business experience in Vietnam.

2. STYLIZED FACTS: ECONOMIC DEVELOPMENT AND FDI IN VIETNAM, CHINA AND INDIA

In the following section a brief overview over the basic economic trends throughout the global economic crisis is given.

2.1. Vietnam

Starting in 1986 Vietnam followed China's example of opening its economy to international trade and foreign investments. In the years leading up to the global economic crisis, Vietnam experienced strong GDP growth rates. With an increase in economic growth by 7.8%, Vietnam recorded the highest GDP growth rate in this decade in 2004. However, starting from 2007, Vietnam experienced high inflation rates and other signs of economic instability. Inflation peaked at 23% in August 2011. Policy makers focused on stabilizing Vietnam's economy, this is reflected in lower inflation rates (6.7% in June 2013) and more stable exchange rates from mid-2011. However, economic growth rates have not returned to pre-

crisis levels. With a GDP growth rate of 5.25% in 2012, Vietnam experienced the lowest growth since 1998, when Vietnam's economy had been hit by the East Asian crisis, and economic growth had dropped to 4.8%. Besides China, Vietnam is the only large country among developing and emerging markets in East Asia where GDP growth rates after the crisis did not manage to reach or surpass pre-crisis levels.

Foreign direct investments have played an important role in Vietnam's economic development in the last two decades. During and after the global economic crisis the volume of implemented FDI has remained relatively stable, but the share of FDI of the GDP has been declining steadily from 2008, when it reached 12% of Vietnam's GDP, to 7% in 2012 (World Bank, 2013). This loss in attractiveness for foreign investors is also reflected in the FDI Confidence Index ranking by A.T.Kearney. While Vietnam was on rank 12 among the most attractive countries for FDI in 2010 (A.T.Kearney, 2010), and still on rank 14 in 2012 (A.T.Kearney, 2012), the country was not even among the top-25 in 2013 (A.T.Kearney, 2013). Among the key strengths of Vietnam from the viewpoint of foreign investors is the potential for cheap labor-intensive production (World Bank, 2013). On the other hand, poor government effectiveness, high levels of corruption, and partly underdeveloped infrastructure are limiting factors (Homlong and Springler, 2012).

2.2. China

Despite the fact that China's GDP growth is slowing down, the economy is still experiencing growth rates far above European levels after the crisis. The main reason for the slowdown in GDP growth from 9.3% in 2011 to 7.8% in 2012 (ADB 2013: 154ff) is the decrease in fixed asset investment, which in turn affects the amounts of total investment. Seen from the production side, the decrease in the industry sector (by 2.2 percentage points) contributes most to the deterioration in GDP growth. Foreign direct investments (FDI) in China do not seem to be affected by the global economic crisis. In the peak year of global economic slowdown FDI increased to 997.4 billion US-Dollars. While China's trade surplus was decreasing sharply from 2008 to 2009 – with a continuing decreasing trend in 2010, foreign reserves were still increasing. The high level of FDI accounts for this (Zhongmin 2013:1). However, another trend in FDI seems to be of increasing importance for the Chinese economy: outward foreign direct investment. A large percentage of outward FDI is conducted by central state owned enterprises (varying between 75-85% of total FDI outflows between 2004 and 2009) (Zhongmin 2013: 11). The largest share of outward FDI is directed to developed economies, this also holds for FDI inflows to China. Nevertheless, also the amounts of FDI outflows to developing economies are increasing. While FDI

inflows accounted for positive effects in economic development in export sectors, spillovers to the labor market are of minor importance, as only a very small fraction of the labor force is employed in a foreign owned enterprise.

2.3. India

Similar to China also India experienced its weakest GDP growth of the last decade in 2012. Nevertheless, the reasons are different. In India especially service activities declined simultaneously to a drop in private consumption and public expenditure (ADB 2013: 190). Aspects of the global crisis are also visible in India, as its trade balance deteriorated and accounts for an estimated current balance deficit of 5% in 2012. The aim of India's government to reduce public deficit resulted in money tightening, which aimed to decrease inflation. However, bad weather conditions (deficient monsoon) led to a sharp increase in food prices and resulted in an overall higher consumer price index of almost 10% (ADB 2013: 191). FDI inflows are of major importance for the development of India's economy. Especially the backward and forward linkages of investments in the service sector are important, and account for the largest share in India's FDI inflows and outflows (Mukherjee 2013: 1). Therefore the slump in service sector activities that is visible in 2012 leads to persisting negative effects.

3. COMPARATIVE ANALYSIS

3.1. Methodological background and indicators

Based on data from the Human Development Index (International Human Development Indicators), various National Statistical Surveys and the International Labour Organisation, a *structure index* is developed, which comprises variables indicating the *educational background* of the national labor force and the respective national labor market conditions in terms of *remuneration and costs*. As mentioned above, developing economies often aim to increase economic development by increasing export sectors, as highly innovative sectors are missing and capital accumulation is lagging behind; sectors utilizing the labor abundance of the economy are fostered.

To give a picture of the level of skilled/unskilled labor in Vietnam in relation to China and India, the field *educational background* sums up the results of the following indicators: the indicator *primary school drop-out rate* aims to show how high the potential for illiteracy is in the economy, as data for the literacy rate were not available for all economies. To reflect on the level of education, the indicators *population with at least secondary education*, *gross enrolment ratio tertiary education* and *combined gross enrolment in education* are introduced.

While the indicator *population with at least secondary education* focuses on the population 25 years and older and shows the development in a time series of a relatively young population (as these economies have), the indicator *combined gross enrolment in education* pictures the enrolment rate regardless of age as a percentage of the population of theoretical school age for the three levels. The potential as well as legally enforced duration of schooling is shown with the indicator *expected years of schooling*, which reflects the years of schooling a pupil can expect to receive when entering primary school. As it turns out that *expected years of schooling* might deviate from the mean duration of schooling, the indicator *deviation mean and expected years of schooling* measures this difference. Reasons for the deviation might be that children have to support their families from an early age at home; direct and indirect costs of schooling might as well cause this difference.

The field *remuneration and costs* relies on four indicators: *number of strikes and lockouts*, *labor costs per day*, *average wage rates per month* (employee) and *labor productivity*. As it regards wage levels and labor costs, which are assumed to be costs related to the input factor relying on extra expenses apart from monthly wage rates, Vietnam, China and India will show comparatively good performance, as wage rates are low. In this paper lower wage rates are regarded as boosting economic activity, as this is the development strategy of many less developed economies and one of the reasons for FDI inflows from Europe. To reflect not only on the monetary issues of the labor market, but to show as well the potential weaknesses in social peace and efficiency, two more indicators are introduced. The *number of strikes and lockouts* reflects on the social background of the labor market. It is assumed in this case that a low number of strikes and lockouts indicates higher employee-satisfaction and social peace. *Labor productivity* combines questions of education and remuneration and asks how effectively employees work.

In the following, data of these indicators in the two fields mentioned above are compared. China, India and Vietnam are compared with data from Austria, Germany and Switzerland. This quantitative analysis is enriched in part 3.3 with the results of interviews conducted with representatives of Austrian, German and Swiss companies, who explained their point of view regarding the potentials and weaknesses of the Vietnamese labor market.

3.2. Results of the analysis

Figure-1 presents the results of the field *education*. Most recent available data is used – mostly 2011. Values of each indicator are set in relation to the other economies in the sample. The best value – *lowest for primary school drop-out rate and deviation mean and expected years of schooling*, and *highest for all other indicators* in the field of *education* – scores 1 and the worst 0. In the dataset data is missing for Germany for the *gross enrolment ratio tertiary education* and the *combined enrolment rate*, as well as for the *primary school drop-out rate* for China and Switzerland. Nevertheless it becomes evident that the Asian economies lag behind European levels of education. Especially India has problems with the level and duration of education and scores worst, even behind China and Vietnam. Vietnam scores especially high in the indicator *primary school drop-out rate*, as it reports a drop of rate of 7.9% compared to India with 34.2% (Human Development index report 2013). Nevertheless, Vietnam still lags behind with 26.3% in the indicator *population with at least secondary education*. Here China shows a level of 62.7% and India of 38.7% (Human Development Index report 2013).

The results for the field *remuneration and strikes* show a more disperse picture. As assumed, the Asian economies score high in terms of low wages and low labor costs, but score worse in terms of social peace, measured by *strikes and lockouts*. To have comparable data, the year 2006 is used for comparison in *terms of wages* per month. In 2006 the *average wage* amounted to approx. 47 EUR per employee in Vietnam and 47.8 EUR in India. Despite the fact that wages increased sharply in these economies since then, they are still far below European levels. Therefore the relative ranking is not altered by the use of data from 2006. Developments in *labor costs* can be explained similarly – in this case data from 2004 is used. Especially recent data for *strikes and lockout* show the increasing dissatisfaction of employees in Asian Economies. In this case Vietnam performs lowest with 720 reported strikes according to the International Labor Organization in 2010. For China no data is available, as the workers' right to strike is not clearly defined and official strike statistics do not exist. In India more than 400 strikes and lockouts were reported for 2008. The results for *labor productivity* seem to be surprising at first sight. In this case the growth of labor productivity is measured to show the dynamic of labor market development. In this case Asian economies showed a very good performance. Vietnam could score high, with an annual growth in labor productivity of 6% (average 2005-2009). Only China performed better with an annual increase of 9.6% (average 2005-2009). Compared to this, annual growth rates in productivity (year 2010) were rather poor in Austria, Germany and

Switzerland, with 2.2%, 1.8% and 1.3%. Nevertheless the level of productivity in Vietnam (as well in China and India) is still far below European levels.

Figure-1: Results field education

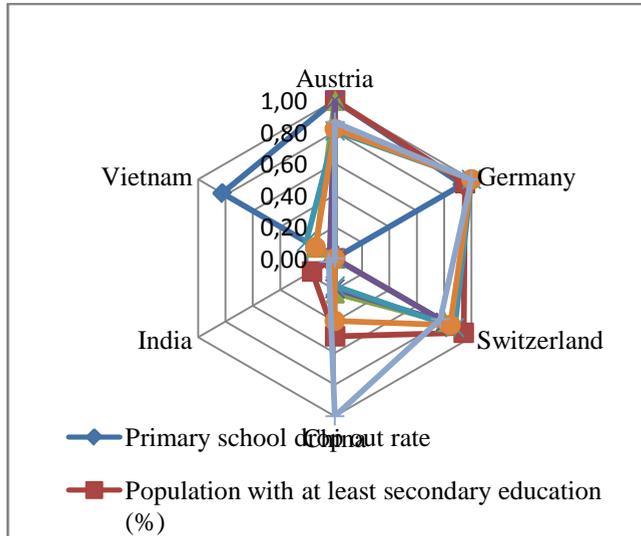


Figure-2: Results field remuneration and costs

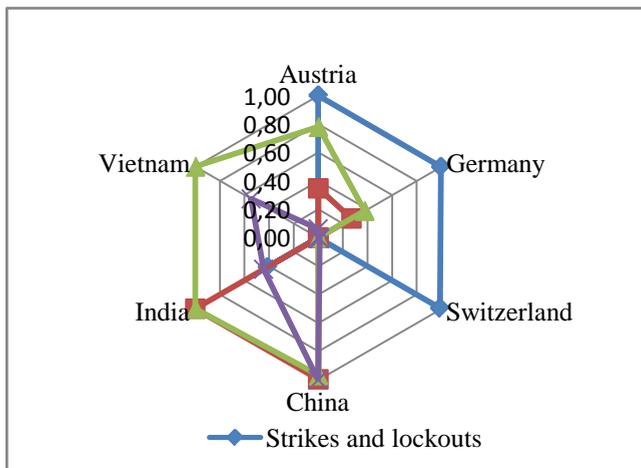
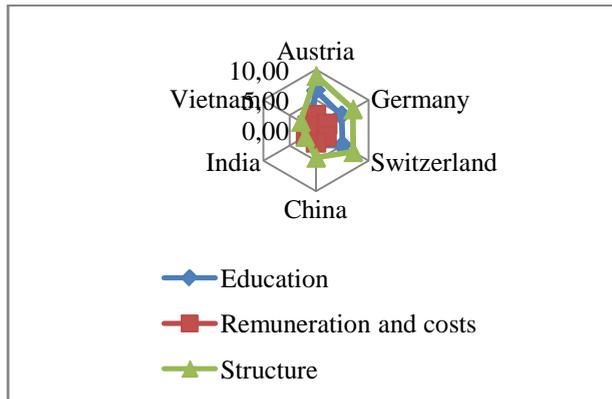


Figure-3 shows the total structure index as well as the respective results from the indicators compiled for the index in the field of education and the index of remuneration and costs.

Figure- 3: Structure index



Compared to China and India, Vietnam is not lagging behind in the overall score. Vietnam performs better than India and shows weaknesses and strengths in both fields. India on the other hand shows weaknesses in the indicators for education. China has a middle position between the level of the European economies and India and Vietnam. In spite of missing data in the field of remuneration and strikes, China shows an overall better performance than the other two economies. Nevertheless, when companies search for cheap and only semi-skilled labor in a dynamic market with increasing labor productivity, Vietnam seems to serve their needs.

3.3. Comparison of results with interviews from Vietnam

Within the field *education*, the interview partners from 29 Austrian, German and Swiss companies with business activity in Vietnam reported mostly that Vietnamese employees – both blue-collar and white-collar workers – frequently need additional training and instructions on the job, regardless of the formal education that they had received in Vietnam. This leads to lower productivity and additional costs. In the field *remuneration and costs*, the initially strong pressure for strong increases in wages has eased since the economic crisis. Strikes however are an increasing problem for manufacturing companies – not just local ones, but also foreign companies. The interviewed companies reported that labor productivity in Vietnam is still clearly lagging behind productivity rates in Western European countries, however combined with the much lower costs for manual labor, compared to Austria, Germany and Switzerland they mostly also stated that there is a marked cost advantage for labor intensive production in Vietnam.

4. CONCLUSION

As the analysis showed, Vietnam is still attractive for labor intensive manufacturing and is performing well both compared to the three European countries in this analysis, and China and Vietnam. It can therefore be assumed that the stagnation of FDI inflows is due to other problems, rather than weaknesses on the labor market. This is also confirmed by interviews conducted with Austrian, German and Swiss companies in Vietnam, where for example concerns about corruption and too slow reforms of bureaucratic procedures were frequently voiced, rather than problems on the labor market.

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Interviews

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