



Informal sector in Vietnam

Due to historical reasons, Vietnam lately started growing at a very low level. When Vietnam started growing, her neighboring economies such as Singapore, Malaysia, Thailand, Korea, China, etc. have far developed ahead. In order to catch-up, Vietnam needs growing faster than neighbors and be able to sustain its high growth rates for a long time. Today, Vietnam's labor force has come to a stable level without growing. Hence, economic growth depends crucially on productivity growth. The biggest challenge for Vietnam's economy is low productivity growth. During the last 10 years, the average productivity growth in Vietnam is less than 4% per annum. In our estimates, if Vietnam can maintain its productivity growth of 5% per year for the next 20 years, Vietnam's GDP per capita in 2035 is still less than Thailand's GDP per capita in 2014. How to enhance productivity growth and sustain it for a long time is now the most important policy question in Vietnam.

In this study, we document that the informal sector in Vietnam has an important role in giving work to earn a living for a quite large portion of the overall labor force. However, the quality of jobs and productivity in the informal sector is far below those in the formal sector. Micro, small and medium firms now become the biggest creator of new jobs in the formal sector while larger enterprises are still the biggest employment pools. We show that in the short run, large enterprises, not small firms, are still the most crucial base for formal jobs in Vietnam. However, in the long run, Vietnamese micro and small enterprises will play an increasingly important role in creating new jobs, and therefore also helping in formalizing employment in Vietnam.

Our paper shows that Vietnamese private MSMEs' expansion accompanies with equipment modernization. In the meantime, MSMEs in Vietnam have been employing less skilled labor. However, interestingly enough, MSMEs with the investments in equipment are likely to employ more highly skilled labor. It implies that formalizing jobs needs improving labor force. Lack of necessary skills will be the main obstacle for labor to get a job in the formal sector.

We also find evidence that investment in education has an impact on the opportunity of getting a decent job in Vietnam. However, the impact is not fairly high. We document the mismatch between the demand of employers and the supply of education providers. Vocational training graduates tend to have more satisfied jobs. In brief, education and training are vital for employment, but there should be a harmonization between training and education institutions and employers so that the mismatch should be kept at minimum in order to increase the socio-economic efficiency.



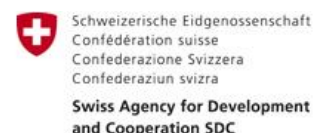
Based on the evidence from this study we propose a set of policies to promote and sustain productivity in Vietnam:

1. Since productivity in the informal sector is quite low and hardly grows, the large informal sector is the main obstacle for enhancing productivity in Vietnam. Formalization by promoting business start-ups is crucial policy to improve productivity and quality of jobs, hence standards of living. Vietnam needs strongly improving its business environment for business start-up, attracting more FDI to utilize cheap labor, TPP membership, and the strategic location... The labor-intensive industries should be encouraged to exploit effectively the labor surplus in Vietnam's informal sector.

2. There is also a labor surplus in agriculture which impedes reforming agricultural production from small scale to large scale. Currently, every household in Vietnam has small pieces of land for their living. This land policy provides farmers the most important asset to lift themselves out of poverty. However, small and scattered pieces of land cause applying new technology (irrigation, fertilizing, cultivating, harvesting,...) costly. If land accumulation was encouraged, many farmers might fall into poverty again because they would lose necessary assets. Therefore, in order to help transforming agricultural production from small scale to large scale, it is necessary to withdraw labor out of agricultural sector to a critical level. Currently, productivity in agriculture is around one fourth of those in manufacturing and construction sector or equal to one third of productivity in service sector, hence moving labor from agricultural sector to manufacturing and service sectors not only improve labor productivity in agricultural sector but also improve productivity of migrating labors. Vietnam needs removing all hindrance to labor migration from agricultural sector to manufacturing and service sectors. The most important hindrances should be removed: formalities to have household registration; housing for migrating workers; necessary facilities and services for migrating workers such as schooling for their children, healthcare,... Enterprises should be agglomerating into industrial parks, Economic Zones to facilitate government effectively providing housing, healthcare, and education for migrating workers.

3. In the formal sectors, the most innovative and dynamic in improving productivity are medium and large enterprises. These enterprises have to compete with international firms either in domestic market or in international market. They have incentive and resources to invest in R&D. In order to keep the formal sector improving productivity, Vietnam, on the one hand, needs policy to encourage small enterprises to graduate to medium and large ones. On the other hand, Vietnam needs promoting these enterprises investing more in R&D to sustain competitiveness against international rivals.

4. Education and training play a crucial role in formalizing jobs and improving productivity. However, quality of education does matter. The more competitive labor market, the more demand for education. The mismatch between skills provided by schools and those demanded by firms sharply reduces effectiveness of investment in education. On the one hand, Vietnam needs encouraging all sectors

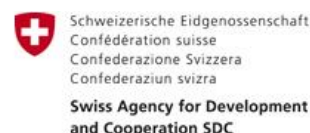




(private, foreign and state) to invest in education, especially in vocational training to meet demand for labor-intensive industries. On the other hand, Vietnam needs policies to remove the gap between training and education institutions and enterprises; training and education institutions have to cooperate with enterprises closely to minimize the gap.

5. The leading enterprises in the informal sector should go global to expose to competitive pressure and fast changing of technology. To sustain productivity growth, the leading domestic enterprises should be closing to frontiers and have mechanisms to transfer productivity dynamics to other enterprises in the economy. There are many TNCs operating in Vietnam such as Samsung, Cannon, Intel, Microsoft,...; and getting local enterprises into these TNC's global value chain (GVC) is the important policy option. The Government should work with these TNCs and local enterprises to bridge the cooperation. Another option is to encourage local big corporations to build their own GVCs. To implement these policies, building up the industrial clusters is necessary condition. Therefore, Vietnam, on the one hand, needs supporting the leading enterprises to engage in R&D and technological upgrading to close the gap with global frontiers; and on the other hand, encouraging those leading enterprises and SMEs to form industrial clusters, which are necessary to spill over productivity to other enterprises in the economy.

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