Trade liberalization and its impact on leather footwear and garment industries in Vietnam.

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1. Overview

Vietnam's consistently high levels of growth in manufacturing in recent years have contributed significantly to reducing poverty as well as increasing foreign exchange revenues. The garment and footwear industries have played a prominent role in this process; they are the two manufacturing sectors with the largest market share and also are among the sectors experiencing highest growth. Vietnam is expected to join the WTO in late 2006 and has already completed the 28 bilateral trade agreements necessary for accession. Any major impacts (positive or negative) to the manufacturing sector as a result of trade liberalization will have major implications for the large numbers of low waged, unskilled, female, migrant workers who represent a large proportion of the total workers in the sector. That this group of workers were very recently lifted out of poverty by the opportunity of waged labor in the garment and footwear sectors is also significant, since it increases the likelihood that downwards pressure on wages and/or productivity will cause them and their family members to return to their previous poverty levels.

(table taken from *Taking Stock; an update on Vietnam's economic developments and reforms*, World Bank 2006)

Table 2: Export Structure and Growth

	Value ($mn) 2005	Share %			Growth %		
		2004	2005	5M-06	2004	2005	5M-06
Total export earnings	**32,442**	**100.0**	**100.0**	**100.0**	**31.4**	**22.4**	**24.2**
Crude oil	7,373	21.4	22.7	22.4	48.4	30.1	20.6
Non-oil	25,068	78.6	77.3	77.6	27.4	20.3	25.3
Rice	1,407	3.6	4.3	4.0	31.9	48.2	-6.1
Other agriculture	2,557	8.0	7.9	8.5	39.0	20.2	31.5
Seafood	2,739	9.1	8.4	7.3	9.2	14.1	23.2
Coal	669	1.3	2.1	2.2	92.6	88.4	34.5
Garments	4,838	16.5	14.9	14.1	19.0	10.3	31.1
Footwear	3,040	10.2	9.4	9.0	18.7	13.0	21.1
Electronics & computers	1,427	4.1	4.4	4.2	60.0	32.7	18.0
Handicrafts	569	1.6	1.8	1.4	16.1	9.2	29.9
Wood products	1,563	4.3	4.8	5.3	100.9	37.2	29.8
Other	6,259	19.9	19.3	21.6	27.0	20.5	28.9

Source: General Department of Customs (GDC) and GSO.

2.1. Overview of the garments and footwear sector

Garments and footwear industries in Vietnam constitute the largest export manufacturing sectors. Over the last 3 years both sectors have experienced consistently high growth rates (see table. In the first 5 months of 2006 the combined market share of both sectors stood at 16% of total exports. In the same period, the garments and footwear sectors grew by an enormous 31.1 and 21.1% respectively. The labor force is also growing rapidly in both sectors.

Number of Workers by sector

	2003	2004	2005
Footwear	450,000	500,000	580,000
Garments		2,000,000	2,100,000

(source: leather footwear association and garment association, and ministry of finance))

These sectors employ a significant amount of the waged labor force and in this way have played an important role in reducing unemployment, and therefore poverty. Research in the garment sector has shown that the work is relatively unstable, with significant amount of workers experiencing periods without work. whilst periods with work tend to involve long hours (11 hours per day in many cases (Kabeer and Van Anh 2006). The extended working times characteristic of the garment (and footwear) sector is far longer than in other manufacturing sectors, and far longer than the eight-hour day stated in Vietnam's labor code (ibid). The nature and conditions of work for employees in the garment and footwear industries in Vietnam are in sharp contrast to the widely held view that the most stable route out of poverty is by means of regular wage income (Sender Cramer and Oya 2005).

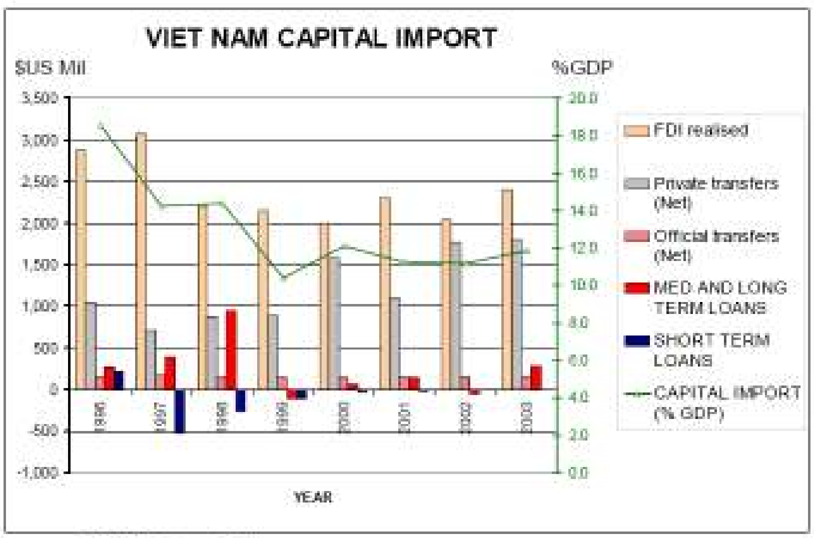
The garment and leather footwear sectors employ large numbers of relatively low paid, unskilled, young women. The vast majority of these workers in both sectors are migrants. These features of the workforce are significant and essential to assessing the implications of further trade liberalization in this sector.

- Low skilled workers
  - have few marketable skills or alternatives
  - are likely to fall below the poverty line if firms shed workers
  - prominence of export manufacturing sectors with female low-skilled workers reinforces gender wage gaps and contributes to furthering gender inequality
- Migrant workers
  - tend to be more vulnerable in terms of access to services, wage levels
  - are depended upon for their remittances by family members

The fact that the majority of workers in both garments and footwear are female is significant for several reasons. Firstly, data from the 1997/8 VLSS shows that in terms of wage labor, women's earnings are considerably lower than men's, causing a 'crowding in' affect for women in lower value added work (Kabeer and Van Anh 2006). This gendered wage differential has both positive and negative implications. The demand for labor from this group in the garments and footwear sectors has lifted large numbers of rural women and their dependents out of poverty (Thoburn & Jones 2005). At the same time, due to the fact that this category of workers were previously below the poverty line, the likelihood that they will return to poverty in the event of external shocks or structural changes to the industry is increased.

The increased level of vulnerability of workers in garments and footwear is due to the combination of factors mentioned above. Firstly, the fact that they are migrants means that their real wages are substantially lower than those of their counterparts who have permanent resident status. It has been shown that migrant workers in Vietnam do not have the same rights as permanent residents. Their non-resident status means that the user fees they incur when accessing healthcare or education are higher (Dang Nguyen Anh 2004). Research into both garment and footwear sectors indicates that there a high numbers of migrant workers with non-resident status (Kabeer and Van Anh 2006, ActionAid 2006). The second reason why migrants are more vulnerable to poverty is that they tend to be the only source or main source of income for several other family members in the rural areas. ActionAid research found that the mean number of family members being supported by remittances was 3. A typical worker was found to send between 30 and 40% of their wages in remittances, which caused major a strain on the workers' ability to adequately feed themselves. The fact that the garment and footwear sectors employ predominantly migrant workers means that these employees are more susceptible to poverty if their employment is threatened. Any external shocks which cause a sharp decline in productivity, resulting in firms shedding workers may lead to increased poverty levels since the workforce tends to be highly vulnerable.

2.2. Structure of Firms



Source: SBV, Ministry of Finance.

te firms active in the sector. However, macroeconomic commitments under bilateral and multilateral agreements mean increased privatization and also increased foreign direct investment (FDI). There has been a recent increase of private firms in the market, particularly from FDI, and this trend is set to continue. The government is committed to increasing capital flows into the country from both FDI and Foreign Portfolio Investment (FPI), and the success of the garment and footwear industries could be a major pull factor for foreign firms.

The number of enterprises in the two sectors has risen in the past several years. In 2002, 1,792 enterprises were in operation in the two sectors; 1,622 for garments and 350 for footwear). This amounted to 3% of the country's total existing enterprises and 12% of industrial ones. By 2004 the number had risen to about 2000 garment and 380 footwear enterprises. There was also an increase in household enterprises and small workshops in these sectors, though accurate data is not available.

Recent research has shown that SOEs tend to be larger than private sector firms (Kabeer and Van Anh 2006, Jenkins 2005). The implication is that SOEs would be better placed to deal with short term price fluctuations and less likely to shed workers. There is some evidence that supports this; in the study of the garment sector by Kabeer and Anh, workers in SOEs were less likely to experience periods without work and SOE workers also received higher maximum monthly payments. It would appear that the conditions in SOEs are marginally better than those in the private sector.

However, with increased trade liberalization there are a number of macroeconomic implications which may reduce the competitiveness of these sectors. Their wage elasticity is high, which means they are highly vulnerable to price increases and demand shocks. The two likely structural changes that are normally experienced with liberalization of trade are:

i) increased privatization
ii) increased FDI activity

The private sector in the Vietnamese garment and footwear industries is characterized by smaller firms than SOEs (Kabeer and Van Anh 2006). Smaller firms by nature are less able to mitigate short run external shocks associated with input price fluctuations, or increased import duty's imposed as a result of anti-dumping claims. This is supported empirically by the recent impact of EU anti-dumping case in the footwear industry (ActionAid 2006), where it was found that private sector firms either shed more workers or reduced working time more than the SOEs, which tend to be larger and in a stronger position to deal with sudden falls in orders and price increases.

Other research has shown that FDI in Vietnam tends to be more capital intensive, which means there is less demand in these firms for unskilled cheap female labor (Jenkins 2005). Thus the implication is that with increased trade liberalization and the increased FDI inflows that come with it the demand for unskilled labor of this type will fall.

2.3. Firms' awareness and capacity to deal with increasingly liberalized markets

Our research of 10 enterprises across Vietnam in the garment and footwear sectors found that in general firms felt that the challenges outweighed the opportunities associated with further trade liberalization and forthcoming accession to WTO. Details of firm structures are given in the box below.

Structure of firm	**Garment**	**Leather footwear**
State Owned Enterprise	1	2
Private	2	3
Joint Venture	0	1
100% foreign owned	0	1
Total	3	7

Taken from a sample of 3 garment and 7 leather footwear enterprises.

The following box details the most cited opportunities and challenges from the firms' perspectives.

Findings from case study of 10 nationwide enterprises

Opportunities	challenges
• increased investment from material and accessories importers and producers via FDI • favorable conditions from government policies in production and export promotion • increased demand of footwear and garments due to increased living standards • quota removal to EU market and increased quota to US market will increase market share • greater autonomy of firms, less government interference in decision making • increased capacity of production and market awareness	• lower competitiveness than neighboring countries (China) • lack of capacity for value chain participation, (i.e. marketing, design, sales) • lack of direct communication with customers • increased prices of power, water, wages and obligations for improving working conditions • lack of training among workers • increased labor competition • low labor retention rates • inability to comply with international standards and regulations

Responses considered by enterprises to perceived impacts of trade liberalization
• increased investment in improving production capacity • improved working conditions to meet increased labor standards and product quality • increasing worker capacity

The position of SMEs

It should be noted that the position of SMEs in dealing with the impact of trade liberalization is quite different to other firm structures. An extensive survey of SMEs carried out in 2004, found that SMEs were severely underrepresented in export sectors (Kokko 2004). The survey found that only 3% of SMEs studied were involved in export markets. Further findings show that SMEs tend to be uninformed and unconnected to international markets and that there is huge scope for government policy to provide information on foreign market opportunities and export infrastructure (ibid). Thus, if the government wishes SMEs to play a prominent role in economic growth, particularly in a liberalized market, there is a need for strategic policies to enable these firms to access markets, compete and meet necessary international requirements and regulations. Since fostering the development of SMEs has been posited as a way to reduce poverty in Vietnam, these findings have particular significance. It seems that without significant state support, the SME sector may be unable to adequately meet the challenges of trade liberalization.

3. Characteristics of destination markets

Both the garments and footwear sectors tend to have highly concentrated shares in a small number of foreign markets, with one single major concentration of shares (EU for footwear and US for garments). This adds to the vulnerability of the sectors to external shocks. It also has implications for competitiveness. A more diversified export structure or more equal share of the major destination markets such as is found in the seafood sector would reduce risks significantly. Furthermore, the two markets where Vietnamese footwear and garments are most prominent (EU and US) are also associated with a higher incidence of protectionism, in the form of anti-dumping legislation that is biased towards outside producers (Nguyen Thi Thanh 2006).

Table 3: Destination and Growth of Selected Exports

	Footwear			Garments			Seafood		
	2004	2005	Q1-06	2004	2005	Q1-06	2004	2005	Q1-06
Japan									
Share	2.6	3.1	3.8	12.1	13.0	11.4	31.1	29.9	22.0
Growth	14.5	32.8	24.1	11.1	18.8	3.7	18.2	6.6	-10.1
US									
Share	15.4	20.1	22.7	56.4	23.8	55.8	25.0	23	20.2
Growth	47.0	47.1	63.6	25.4	5.2	41.8	-22.7	5.3	-1.0
EU									
Share	65.5	58.1	53.9	15.8	16.9	19.0	10.7	15.1	20.4
Growth	10.5	0.2	11.5	28.0	18.2	81.0	57.1	60.8	65.6

Source: GSO and GDC.
Note: Share in percent. Growth rates in percent per year.

4. Likely sources of external shocks

4.1. Anti-dumping investigations

In the absence of other trade barriers, anti-dumping is a mechanism that can be used to protect domestic markets, and is increasingly used by the U.S. and the E.U(Nguyen Thi Thang 2006). If a country's export prices are considered to be lower than domestic prices then a case for anti-dumping may be brought. Since Vietnam's largest export markets are the U.S. and the E.U., there is reasonable grounds to expect an increase in anti-dumping claims from those WTO members in particular, as Vietnamese markets are further liberalized (ibid). Another aspect that makes Vietnam more susceptible to anti-dumping claims is the fact that it must retain its Non Market Economy (NME) status under the accession agreement. The NME status means that a 'surrogate' market economy country can be chosen in order to assess the price levels and determine whether dumping is in fact occurring. This system has been shown to be inherently flawed, and allows the investigating country to significantly bias the results of the investigation (Nguyen Thi Thang 2006). It has also been shown that the decisions of anti-dumping claims, particularly in the E.U. and U.S. are often politically motivated rather than technically determined (ibid).

The recent anti-dumping case brought against Vietnam's footwear industry is a case in point. The surrogate country mechanism was applied and Brazil was the surrogate country. Since the cost of labor and materials in Brazil are considerably higher than in Vietnam, the decision was arguably biased against Vietnam (ActionAid 2006). Furthermore, the adverse impact of the anti-dumping case in the footwear industry has been severe. The research from ActionAid which covered 5% of the total footwear industry, found that:

- orders have fallen considerably since the lawsuit, increasingly so in the first quarter of 2006 (by 50-60% for several firms studied).
- firms involved in processing for foreign partners have lost the most orders, and in some cases their partners have found alternative suppliers in Cambodia, Indonesia and Thailand
- firms have narrowed production as a result and many are operating at 60-70% of their capacity
- firms have been forced to divert resources to covering legal costs associated with the proceeding
- 76% of firms studies suffered a drop in income of between 15% and 60%
- firms have made large sections of their workforce redundant, and/or significantly reduced working time (in some cases 30-50% of workers were temporarily laid off)

The labor force in the footwear industry is again largely low skilled, young, rural migrants, whose remittances are often support several other family members. The increased linkages to the rural unemployed and underemployed in this industry mean that the knock-on effects are severe. The loss of earnings of one worker will likely have a severe impact on other rural poor. Case studies detailed in the ActionAid study reaffirm this point and reveal migrant workers tend to come from extremely poor families. The resulting unemployment and underemployment caused by the anti-dumping import duty rates imposed by the EU, is exacerbating poverty for both workers and the family members who depend on their incomes. ActionAid found high levels of undernourishment and malnutrition among employees in firms affected by the EU anti-dumping case. A significant amount of workers had poor health and could not afford to access health care. Many employees were finding it increasingly difficult to pay school fees for their children and were sending them back to the rural areas as a result.

It is clear from the 2006 case of anti-dumping in the footwear industry brought by the E.U. that the impact of such external shocks causes many workers and their families to fall into poverty. Since private sector firms are less able to mitigate the effects of such shocks, it can be expected that increased privatization will serve to exacerbate this. It is also significant that private firms in this sector tend to be considerably smaller than SOEs. These factors, combined with the high numbers of low skilled low wage employees characteristic of the sector, means that Vietnam is particularly vulnerable to such external shocks.

4.2. Other issues relating to bilateral agreements

Under the bilateral trade agreement between the US and Vietnam, for the first year of Vietnam's WTO membership, the US reserves the right to re-impose quotas on Vietnam through the use of a special enforcement mechanism. If the US is not satisfied that Vietnam has eliminated all perceived subsidies in the textile and apparel sector then quotas will be re-imposed (World Bank CG document 2006).

5. Value chain integration

The increased participation and linkages to global value chains that increased trade liberalization brings, has further implications for vulnerability of workers and the likelihood that they will return to below the poverty line. It is has been shown that increased competition puts downward pressure on prices and therefore wages. Changes in working conditions that increase labor flexibility and intensity of work will have an adverse effect on workers livelihoods. In Vietnam's garment sector, SOEs managed to upgrade within the value chain thereby mitigating these adverse effects to workers (Jenkins 2005). However, it is uncertain whether private sector or foreign firms entering the market will be able or willing to make the same adjustments.

The garments and footwear produced in Vietnam tend to be highly price elastic. This too weakens firms ability to compete internationally whilst retaining labor intensive production techniques using unskilled labor. Shifting to the production of goods which are more price inelastic tends to be associated with a shift to capital intensive technology. However, Seguino argues that a shift to labor intensive and more price inelastic exports can be achieved with strong state policies that support such a shift (Seguino 2005). This support includes; improving access to marketing and distribution networks, increasing technological capacity, supporting smaller firms in particular, introducing fair labor practices which has been shown to be a major draw factor for large TNCs concerned with their reputations among their customer base (Cambodia is an example of this policy's success), (ibid). Government policies to attract FDI flows can also have a strong influence on the export structure, in the form of certain tax benefits being offered in certain types of preferred production.

6. Environmental Constraints

According to an analysis by the Ministry of Trade's multilateral trade policy program (MUTRAP) 2004, all three of the major target markets for Vietnamese garments and footwear have strict environmental requirements which constitute major barriers for these industries. Meeting the requirements, regulations and standards in any of the three countries concerned will be costly and time consuming. The table below shows that either footwear, garments or both are present in each box corresponding to each major environmental barriers in Vietnamese largest export markets.

Market	Items	Environmental barriers
The U.S.A	Seafood, textiles, footwear, agricultural products (rice, coffee), wood products	HACCP, SPS, Law on Anti biological terrorism, PPM (Seafood) Textiles, footwear: TBT, SA 8000, PPM, ISO 14000 Agricultural products: Law on Anti biological terrorism, SPS, PPM Wood: ecological labels, CBD, PPM
EU	Seafood, textiles, footwear, agricultural products (rice, coffee), meat, wood products	HACCP, SPS, TBT, ISO 14000, ecological labels
Japan	Seafood, textiles, wood products	HACCP, SPS, ISO 14000
China	Agricultural products, seafood, fruits and vegetable	HACCP, SPS

6. Conclusions

In order to meet the challenges of increased trade liberalization that comes with Vietnam's expected accession to the WTO at the end of 2006, the garment and footwear industries will need extensive government support. This can be seen from two aspects:

- for firms:
  - to enable the development of a competitive private sector that is capable of mitigating short run shocks and increased competitiveness from other countries in the region
  - to raise awareness within the SME sector and develop its capacity to integrate in global value chains

- for workers:
  - increase the skill level of workers whilst increasing technical capacity
  - eradicate inequality and discrimination in accessing services for migrant workers
  - increase social safety nets for family dependents in rural areas
  - reverse gender wage gaps

The increase in foreign capital inflows in the form of FDI, which is projected as a result of favorable macroeconomic environment with further trade liberalization needs to be managed strategically in order to ensure that the FDI sector does not crowd out the SME sector, or in other words the more capital intensive sector does not crowd out the labor intensive one.

The high costs associated with meeting the extensive international requirements, regulations and standards are also an important issue that should not be underestimated as a major constraint to weaker firms, i.e. private sector generally and SMEs in particular. The state has an important role in supporting and educating firms in order to meet these standards which will allow them greater access to larger international markets.

If these supports are provided, then Vietnam's garment sector may be able to benefit considerably from the increased market access and integration into global value chains that are brought about by increased trade liberalization.

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