EXECUTIVE SUMMARY

CLS+ Country Study Vietnam

Ready-made garment, footwear and electronics industries

Do Quynh Chi

CLS+

Core Labour Standard Plus

Linking Trade and Shared Prosperity in Global Supply Chains in Asia

FRIEDRICH EBERT STIFTUNG

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Introduction

In Asia, countries with export-oriented industries such as Bangladesh, Pakistan, Cambodia, and Vietnam use cheap labour costs and a growing workforce to ensure their participation in the new global trade regimes. In these new global trade regimes, traditional forms of protectionism as a means to develop domestic industries (as used by their Asian peers, namely South Korea and Taiwan) may no longer be possible as a development trajectory. Preferential trade access and trade agreements are especially conducive to the growth of global supply chains (GSCs), since 80 percent of world trade now takes place through GSCs.

However, trade liberalisation and trade agreements in their current form have unleashed hyper-competitive pressure in products such as ready-made garments (RMGs), footwear, and consumer electronics. Social clauses linked to trade have provided little protection for workers on core labour standards, let alone safety, fair wages, or social protection. The power imbalance between the multinational corporations (at the top of the GSCs) and their suppliers (at the bottom of the GSCs) allow multinational corporations (MNCs) to impose low production prices that contribute to low wages, low profits, and unsafe working conditions (for example, dilapidated buildings). In the textiles and garment sector, there is empirical evidence of a relationship between the declining respect of workers' rights and a decline in the price paid for apparel imported by international brands into the United States, for the period from 1989–2014. The race to the bottom is therefore not a slogan but an economic reality.

The Core Labour Standards Plus (CLS+) project, coordinated and implemented by the Friedrich-Ebert-Stiftung (FES) and labour research institutes in the participating countries, aims to promote the implementation of comprehensive labour and social standards, including but also beyond the Core Labour Standards (CLS), in export-oriented industries in four Asian countries: Pakistan, Cambodia, Bangladesh, and Vietnam. These standards will be implemented within the framework of trade agreements and preference systems. In addition to the CLS, the project also covers: the concept of living wages, occupational safety and health standards, and the limitation of work hours.

The country study for Vietnam, coordinated by the FES Office in Vietnam and conducted by the research team from the Research Center for Employment Relations (ERC), explored the labour practices in the GSCs of three key exporting industries in Vietnam: RMGs, footwear (focusing on sports shoes), and electronics (focusing on hand phones and parts), within the context of the industrial and labour relations systems of the country. Apart from an extensive review of the relevant literature, both in English and Vietnamese, the study was also based on multi-level empirical research (see Figure 1).

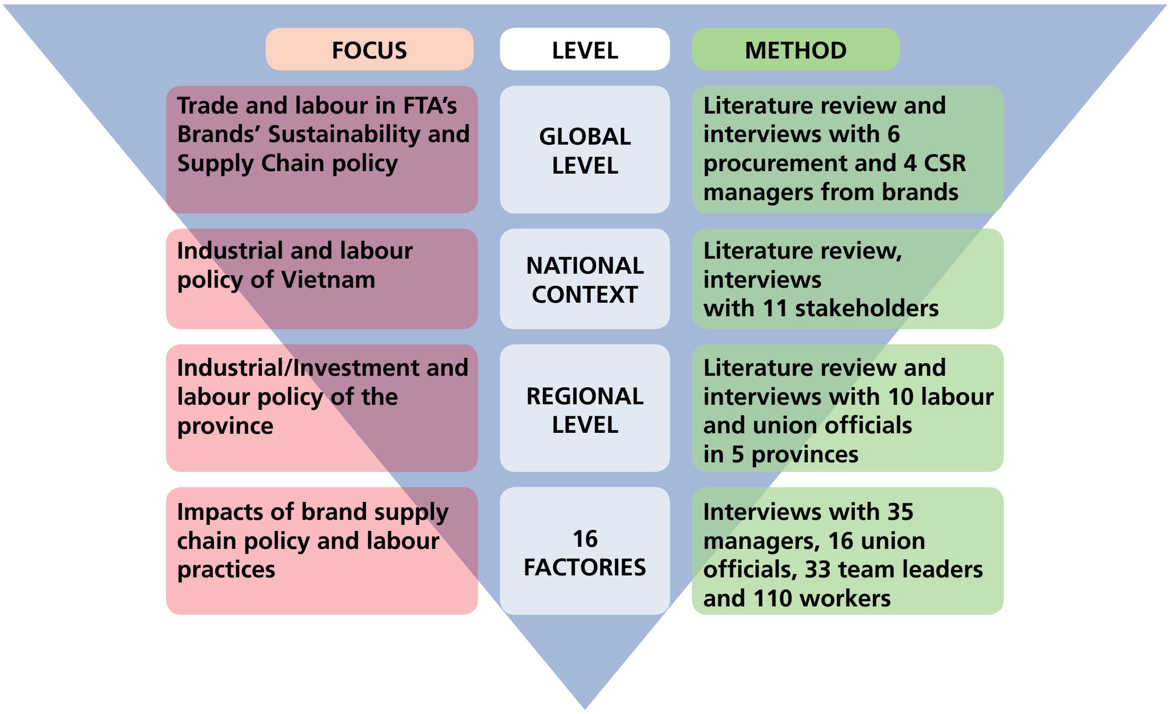
At the international level, the research team conducted in-depth interviews with the corporate social responsibility (CSR) and procurement managers of major garment, footwear, and electronics brands that source their products from Vietnam. At the national and provincial levels, the researchers interviewed 11 national and provincial labour administrators, labour inspectors, and union officials. At the workplace level, the research team visited 16 factories in four provinces, including Ho Chi Minh City, Long An, Da Nang, and Bac Ninh, interviewing 35 managers, 16 enterprise union leaders, 33 team leaders, and 110 rank and file workers.

This briefing note summarises the key findings from the Vietnam country study. The full report will be published in early 2017 and used, together with the studies from the three other Asian countries in the project, to inform the national stakeholders in Vietnam, as well as legislators, employers' organisations, trade unions, and civil society in the European Union, which is a major export market for Vietnam in the three above-mentioned sectors.

Overview of the RMGs, Footwear, and Electronics Supply Chains in Vietnam

RMGs, footwear, and electronics are Vietnam's three biggest export industries. The country's export 'champion' is electronics, which accounted for 28.25 percent of total export value in 2015 (with hand phones and parts alone making up 18.62 percent of the national export value), followed by textiles and RMGs, which contributed 17.42 percent. Footwear is the fourth-largest export industry, accounting for 7.41 percent of the total export value

Figure 1: Research Methodology of the Vietnam Country Study



in 2015. The majority of exporting companies in the three industries, however, are small and medium-sized companies, employing fewer than 500 workers. Most of the large-sized companies exporting garments, footwear, and electronics are foreign-owned. Altogether, the three industries employ approximately 3 million people, 70 percent of whom are women.

Despite their rapid growth, all three industries rely substantially on imported components and processed materials. In 2015, the RMG industry imported 60 percent of its materials, while the footwear industry imported 55 percent of its materials. The electronics industry imported nearly 90 percent of its materials for hand phones and parts (World Bank, 2015). With the majority of components and materials imported, the manufacturers in Vietnam are participating at the lowest value-added stage of the global value chain – the assembly stage. As such, low labour costs have been the decisive factor in maintaining the profitability of these factories.

Key Findings

1. The RMG, footwear, and electronic supply chains are characterised by a "monopsony relationship" between the brands and the suppliers in which the brands dictate the purchasing prices and in which suppliers participate in the value chain. The monopsony power of the brands is less intense in the garment and footwear industries, compared to the electronics industry, as there are more brands sourcing from Vietnam in the garment and footwear industries and each garment and footwear factory supplies to a number of different brands. In the electronics industry, however, there are fewer brands and these brands are also highly competitive. Therefore, most suppliers tend to supply to one or a very small number of brands.

2. As a result of the monopsony of the brands, the assembly supplier gets the smallest share in the GSC, which forces them to lower labour costs even more. The brands earn the largest share of the profits – ranging from 9 percent in footwear, 16 percent in garments, and 60 percent in hand phone production. The assembly supplier, which participates in the final and lowest value-added stage of the global value chain struggles with profit margins ranging from 2 percent in garments, 3 percent in footwear, and 6 percent or lower in electronics (of the net selling price). The direct labour cost, which includes the wages and other wage-related expenses for workers, makes up only 3 percent of the net selling price in garments, 9 percent in footwear, and 3.8 percent in electronics.

Table 1: Overview of RMG, Footwear and Electronics Industries in Vietnam (2015)

	Garment	Footwear	Electronics
No. of exporting firms in Vietnam	2,500	1,382	1,100
Labour force	2,500,000	930,000	325,583
Contribution to export value (%)	17.42%	7.41%	28.25%

Source: Compiled by the authors from various sources, updated by August 2016

3. Labour cost is a 'take it or leave it' situation, rather than a factor of negotiations between the brands and suppliers in all three industries. All of the garment and footwear suppliers claimed that the purchasing prices for the brands had not increased for the past five years; a few even faced pressure from the brands to lower their prices by 5-10 percent each year. The prices for the electronics suppliers were mostly imposed by the brands and reduced every quarter. With purchasing prices frozen for the past five years, the actual wages of workers in a supplying firm have not been a factor in price negotiation between the supplier and the brand. However, all the brands interviewed required their suppliers to comply with the legal minimum wages set by the Vietnamese government.

4. The suppliers responded to price pressure from the brands by increasing factory efficiency and minimising labour costs. Since the purchasing prices for brands have remained unchanged for the last five years, to keep their profitability, the suppliers have had to increase their efficiency by increasing the level of automation; reducing the number of workers per line while increasing the total production; and minimising the actual wages paid to workers. The result was that many workers lost their jobs and those that remained had to work harder without a commensurate increase in pay. The following is an example of a foreign-owned footwear supplier: between 2013 and 2015, the factory was able to double their monthly production value while reducing 25 percent of their labour force per production line (Table 2). However, the wages paid to the rank and file workers were anchored to the minimum wages and workers' seniority without considering the increase in work intensity and workers' productivity.

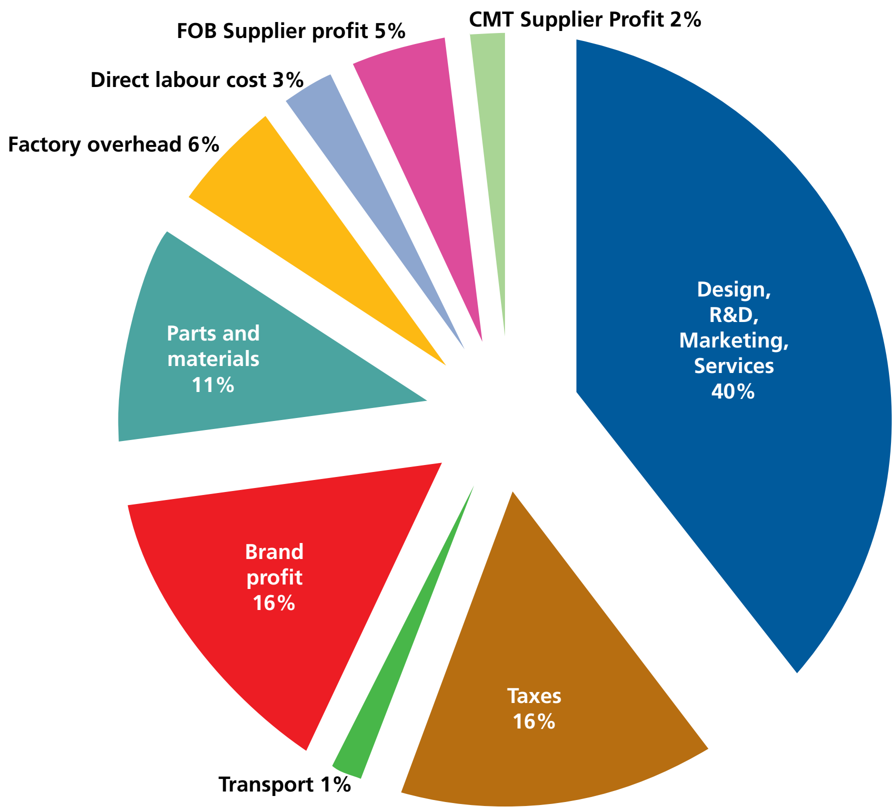
5. The conflict between the business model of low-cost, fast-fashion brands and CSR standards prevents the brands from making genuine efforts towards improving sustainability standards in their supply chain. The study found little linkage between the brands' CSR policy and procurement strategy in all three industries. On the one hand, all of the brands require their 1st tier and 2nd tier suppliers to comply with Vietnam's labour legislation and the brands' CSR standards, and to monitor their own compliance through CSR audits. Compliance with CSR standards (with suppliers paying for the audits in many cases) results in rising costs for the suppliers. However, suppliers are rarely rewarded for their compliance with, or for doing better than the standards. On the other hand, the brands put constant

Table 2: Cost minimisation in a footwear supplier

Year	2013	2014	2015
Monthly production (*in USD*)	1.6 million	2.8 million	3.1 million
No. of workers per line	80	70	60
Wages	MW+5%/year	MW+5%/year	MW+5%/year

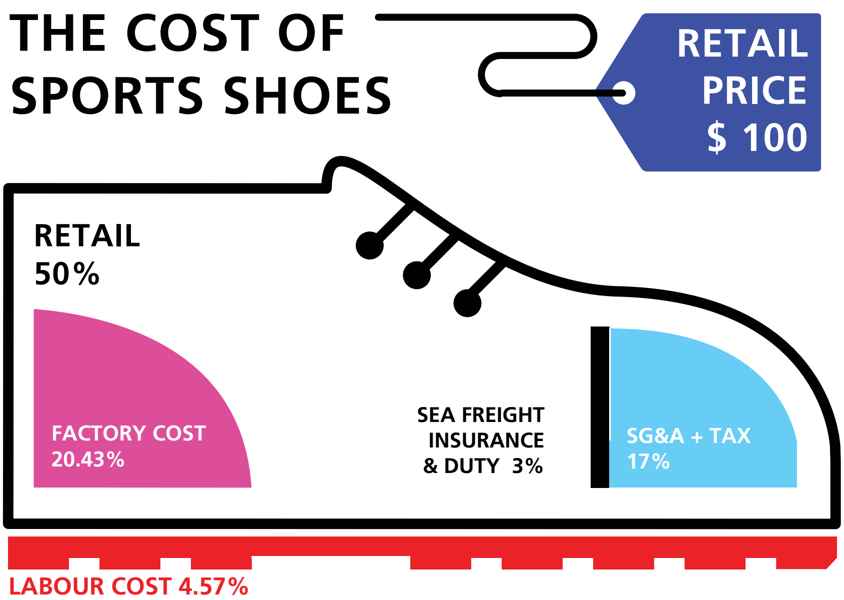
Source: compiled by the authors based on the interviews with the management of a footwear company, July 2016

Figure 2: Price Structure and Profit margin of fashion brands, 1st tier suppliers and 2nd tier suppliers in Vietnam



Source: Calculated by the authors based on interviews with the managers of apparel suppliers

Figure 3: Cost break down of a pair of sport shoes



Source: compiled by the author based on interviews with footwear suppliers and information from UNIDO (2000)[1] and Solereview (2015)[2]

- 'If the minimum wage (MW) continues to rise at this rate and Cut-Make-Trim (CMT) price still frozen, **our company can last for at most 3 years more**' (Deputy Director of a Vietnamese garment company)

- 'We conduct CSR audits and inform the procurement team. **We have no idea about how prices are determined.** It's another department's job' (Sustainability manager of a US garment brand)

- 'Labour cost is just one of the factors that affect (CMT) prices. We also require the suppliers to raise productivity, reduce waste and increase efficiency'**That's why we do not have to raise our price.** (Regional procurement manager of an European footwear brand)

Interviews conducted between July and September 2016

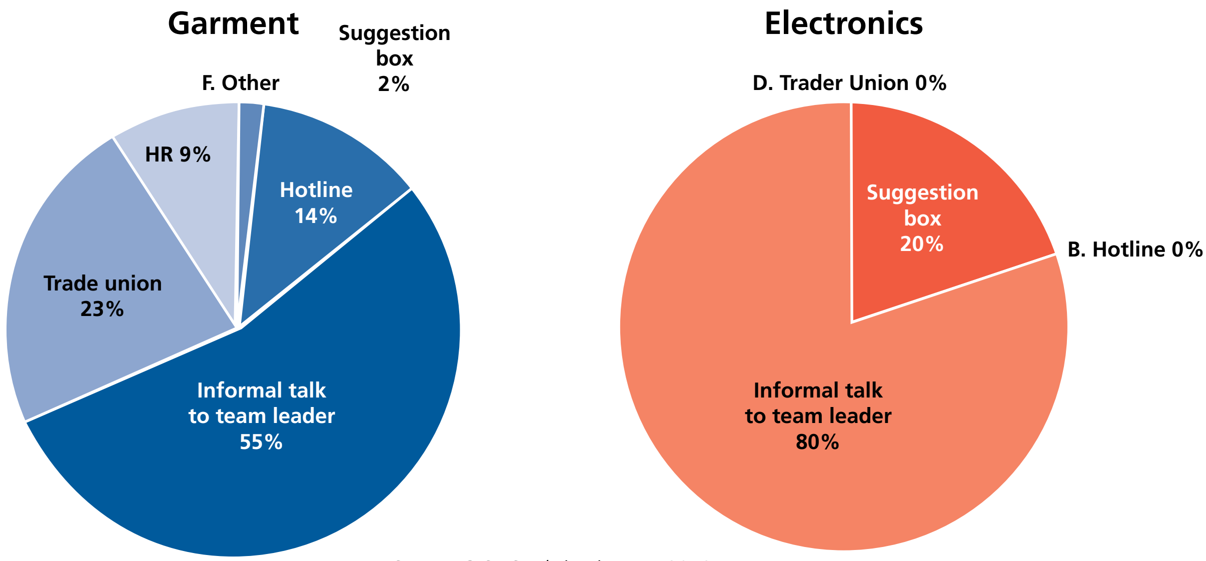
pressure on the suppliers to keep the same production prices, or to further lower prices. These conflicting pressures from the brands have gradually driven out the suppliers with good labour practices (who were unable to keep costs down), while encouraging those with lower labour standards to minimise labour costs.

6. Apart from the brands, the vendors[3] and major 1st tier suppliers played a critical role in intensifying the downward cost pressure on their subcontractors. While the brands have not adjusted the purchasing price for the last five years, the vendors and 1st tier suppliers pushed harder on the 2nd tier suppliers to lower costs. A Vietnamese garment subcontractor said: "*We cannot work directly with the brands so we have to work through vendors, but the vendors are pushing too hard on us [to lower costs]*. A few years ago, our profit margin was still higher than the bank interest rate, but now it is lower.[4] But if we don't accept the prices, we don't have enough work for the workers." At the same time, the brands cannot ensure the monitoring of all the subcontracting activities within the supply chain.

7. Despite the cost pressure from the brands, the domestic suppliers chose to adopt a more sustainable approach to labour standards than the foreign direct invested firms. The study found that the actual working conditions and wages of workers in the supply firms did not necessarily correspond to the factories' value-added or profit margin. The Vietnamese enterprises, especially the former state-owned enterprises (SOEs), were found to have better labour practices than the foreign direct invested firms, despite their profit margin being the lowest in the supply chain. In particular, the former SOEs in the garment industry were paying workers higher than the foreign direct invested firms, invested more in labour upskilling, provided a wide range of labour management communication and grievance mechanisms, and offered more generous welfare benefits. The rank and file workers in the foreign direct invested firms of all three industries had little chance or incentive to improve their labour skills. The wages of workers in foreign direct invested firms depended more on attendance and seniority than on individual skills and productivity.

8. Compliance with labour standards was the best in the garment industry, followed by the footwear industry. The situation in the electronics industry was the worst, especially in the areas of occupational safety and health (OSH), working hours, and living wages. The workers in the electronics industry were faced with forced overtime of up to 100 hours/month. The overtime worked accounted for up to 50 percent of their take-home income, while their basic wages were tied to the minimum wage. Compared with the firms in the other two industries, the electronics firms are at the infancy level in terms of social dialogue. The electronic industry workers had so few effective formal communication and grievance handling channels that 80 percent of them relied on their production team leaders as an informal alternative (see Figure 5). Conversely, the garment workers had many more formal and informal options for voicing their feedback. The study also found signs of systematic gender-based discrimination in employment and occupation in the electronics firms surveyed, which all had policies of only recruiting female workers for the rank and file work, while appointing mostly men for managerial positions.

Figure 5: Most trusted channel for grievance handling by garment and electronics workers



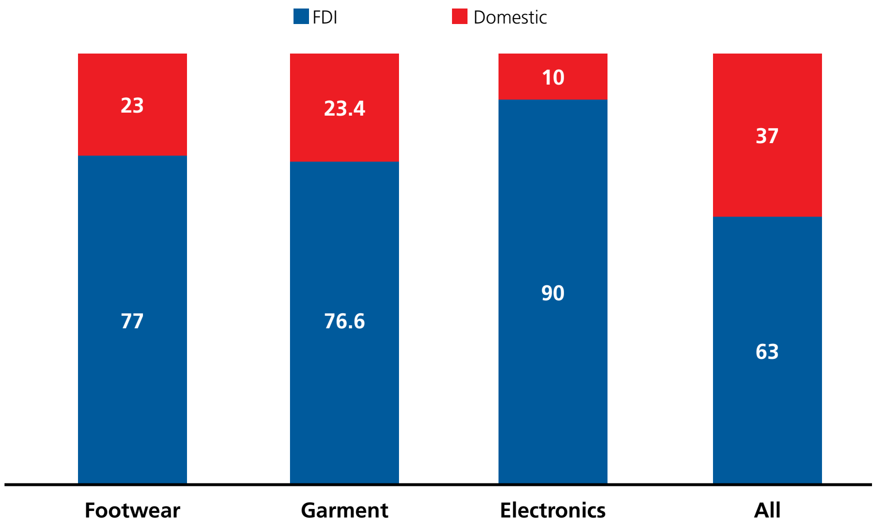
Source: CLS+ Study in Vietnam, 2016

9. The supply chain in the garment, footwear, and electronics industries in Vietnam was dominated by the East Asian suppliers, while the domestic firms participated mostly at the 2nd tier level. Prior to 1997, foreign direct investment (FDI) projects had to take the form of joint ventures between the foreign investors and SOEs. Since 1997, ownership restriction has been removed, which has had a lasting impact on the ownership structure of FDI. In 2006, joint venture projects decreased to just 42.5 percent of total registered foreign capital, while projects with 100 percent foreign capital accounted for 45.5 percent (*Herr et al.*, 2016). While the model of joint ventures has faded, both the national and provincial governments have offered incentives to encourage FDI at the expense of domestic investors. For instance, the national government offers a reduction in corporate income tax for projects of over US$300 million, for which mostly FDI projects are eligible as few domestic firms are able to make such large-scale investments.[5] In addition, to attract FDI, provincial governments have been offering even bigger incentives to foreign investors, as in the case of Samsung in Thai Nguyen Province.[6] In other words, the FDI policy at national and provincial levels has been discriminatory towards domestic investment while granting advantages to FDI projects, without any obligation for technological transfer. Consequently, the GSCs in RMGs, footwear, and electronics in Vietnam have been dominated by the foreign direct invested firms, mostly consisting of East Asian investors (see Figure 6). Foreign-owned firms dominate the exports-oriented electronics sector, with domestic firms accounting for only 10 percent of the sector's export value.

   However, as this study found, while most foreign direct invested firms in the three surveyed industries showed little interest in labour upskilling and kept wages and working conditions at minimum levels, the domestic firms are more committed to the local labour force and tend to have more a sustainable approach to labour standards. Increasing the participation of the domestic firms in the GSCs in the key exporting industries, therefore, tends to have positive impacts on the labour quality and labour standards for workers in these sectors. This is also reinforced by the fact that the former state-owned garment sector under the conglomerate Vinatex tends to invest more than foreign direct invested firms into upstream and downstream segments like spinning, weaving, and dyeing, thus increasing the national value-added.

10. Vietnam's industrial policy has been largely ineffective. Vietnam's growth model is heavily reliant on trade in natural resources. Crude oil accounts for 20 percent of total exports. The proportion of exported services in relation to total exports went down from 11.6 percent

Figure 6: FDI and domestic sectors' contribution to export value (%)



Source: Vietnam Customs Office, 2015

in 2005 to 7.6 percent in 2012, and was again at 7.6 percent in 2014. In the industrial sector, Vietnam mainly exports low-tech, labour-intensive products such as garments, furniture, footwear, and electronics. The domestic content of these products, however, remains low, ranging from 40-55 percent (CNV International, 2016). In the meantime, the domestic private sector faces a lot of difficulties, including limited access to bank credits, land, etc., resulting in discriminatory treatment compared to the FDI sector. Without an effective industrial policy, more international trade threatens to deepen under-development and prevent economic catch-up (Herr et al., 2016). One of the key reasons for the ineffectiveness of Vietnam's industrial policy is the high level of decentralisation. The study found significant divergences among provinces in terms of industries, investment, and labour policy, as in the cases of Long An Province in South Vietnam and Da Nang Province in Central Vietnam.

11. Strong industrial policies and selective investment strategies are conducive to better labour standards. By comparing the investment and industrial policies of Long An and Da Nang Provinces, the study found significant differences between the two provinces which have led to diverging approaches to labour standards. On the one hand, Long An Province strived to attract FDI quickly and unselectively, while not investing enough into the strengthening of labour administration, inspection, and trade unions. On the other hand, Da Nang Province took a high-road approach. The province had strong industrial policies with a clear and selective investment approach, while still maintaining high FDI flows and encouraging more investment into cleaner and higher-technology industries. At the same time, in order to prevent labour problems that may damage the investment environment of the city, the authorities in Da Nang Province have been active in building the capacity of labour inspectors while strengthening the local trade unions.

12. By the end of 2015, after years of negotiations, Vietnam concluded two important Free Trade Agreements (FTAs) in parallel: the Trans-Pacific Partnership (TPP) with the United States, and the FTA with the European Union (EVFTA). Both FTAs are considered to be 'new generation agreements' as they are not only comprehensive but also contain detailed sustainability (environmental and labour) chapters. However, while the European Union has taken a promotional approach, as it has always done, in handling the sustainability issues associated with the FTA with Vietnam, the United States had opted for a sanctions-based approach in the TPP. While both FTAs await ratification, they have had an initial impact, as the Vietnamese government is committed to revising the legislative framework, including the Labour Code, in compliance with international labour standards to integrate deeper into the global value chain.

Notes

1. Ferenc Schmél, "Structure of Production Cost in Footwear Manufacture," United Nations Industrial Development Organization, 2000, http://www.unido.org/fileadmin/import/userfiles/timminsk/leatherpanel14schmelcosts.pdf.
2. "What does it cost to make a running shoe?" SoleReview, May 22, 2016, https://www.solereview.com/what-does-it-cost-to-make-a-running-shoe/.
3. Vendors are the intermediaries that take orders from the brands and subcontract to different manufacturing factories.
4. The bank interest rate in Vietnam in 2015 and 2016 ranged from 6-7 percent per year.
5. http://www.hepza.hochiminhcity.gov.vn/web/guest/84
6. http://kinhdoanh.vnexpress.net/tin-tuc/doanh-nghiep/de-xuat-uu-dai-dac-biet-cho-samsung-thai-nguyen-3110403.html
7. When this Executive Summary was published, US President-elect Donald Trump had announced he would withdraw the participation of the United States in the TPP on his first day in office.

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