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Impact of Minimum Wages on Employment and Wage Distribution in Vietnam

Introduction

Vietnam significantly reformed minimum wages for the domestic sector in 2008. The minimum wage for the domestic business sector was separated from the basic salary for the state sector and regionalised to reflect differences in local conditions (e.g. prices, labour market, level of development). Three minimum wage levels were established, bringing the domestic sector into line with the FDI sector, then a fourth wage level for both sectors was added in 2009. However, huge gaps in minimum wage rates between the FDI and the domestic sectors persisted.

In subsequent years, minimum wages increased rapidly in both FDI and domestic business sectors, with higher minimum wage growth in the latter shrinking the gap in minimum wages between the two (Figure 1). This led to the gradual unification of minimum wages, culminating in domestic and foreign firms having the same minimum wage levels from October 2011. The unification of minimum wages was induced by the commitment to non-discrimination between foreign and domestic sectors made by Vietnam under the terms of its accession to the World Trade Organization in 2007. However, the four regional minimum wage levels were kept.

Between 2011 and 2015, minimum wages increased by about 15 percent annually, reaching VND2,150,000 (USD100) to VND3,100,000 (USD144) a month in 2015. Minimum wage rates rose significantly faster than labour productivity (World Bank Vietnam 2015). Before 2010, the minimum wage was found to reduce formal sector employment (i.e. in state-owned enterprises, foreign and domestic firms) and increase self-employment. But the rise in self-employment did not fully offset the fall in wage employment (Carpio, Nguyen and Choon 2013 cited in Carpio and Pabon 2013). Arguably, therefore, it would seem that total employment decreases as the minimum wage increases.

Given the minimum wage coverage in Vietnam since 2010, it is important to revisit the effects of minimum wages on employment and wage distribution. This policy brief draws on a study conducted to investigate the effects of the increases in minimum wages between 2010 and 2014 on total employment, labour movement between formal and informal sectors, and wage distribution in formal and informal sectors, with disaggregation in terms of gender and age (Vu, Pham and La forthcoming).

The research study

The study uses data from the Vietnam Household Living Standard Survey (VHLSS) for 2010, 2012 and 2014 and the Labour Force Survey (LFS) for 2011, 2012, 2013 and 2014.

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Both survey series are nationally representative. The former covers more than 9,000 households across the country following the standardised contents of the Living Standards Measurement Study (LSMS) of the World Bank. The latter has large sample sizes of more than 500,000 per year, providing sufficient information to investigate the questions. Appropriate econometric models are employed. We use standard difference-in-differences models to evaluate the discrete and simultaneous effects of the minimum wage on total employment and labour movement across sectors. We use the model developed by Lee (1999)[1] to investigate the effects of the minimum wage on wage distribution.

In addition, a qualitative survey was conducted in Hanoi and Ho Chi Minh City in 2016–17 to learn about the impacts and responses of firms to the increase in the minimum wage. Different aspects such as firms' implementation of the minimum wage, its impacts on labour cost and firms' responses to the increase in the minimum wage were captured from interviews with 35 firms in different industries in each city.

[1] This model has been used in a number of studies on the same topic (e.g. Hansen, Rand and Torm 2015; Hohberg and Lay 2015; Bosch and Manacorda 2010).

The findings

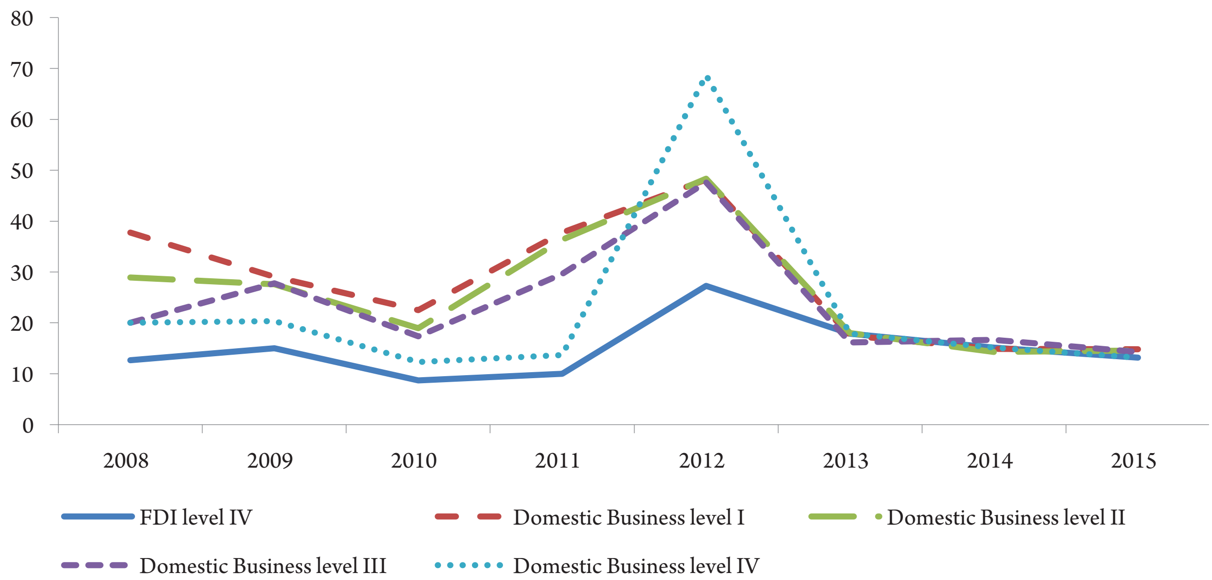
Effects on total employment and movement across sectors

As shown in Table 1, the binding ratio (the ratio of workers earning below the minimum wage) increased rapidly between 2011 and 2014. The binding ratio of all non-farm wage workers almost tripled, from 3.8 percent to 11.6 percent. This increase is observed for all years but unevenly. The breaking increase was in 2012, when the binding ratio doubled. This pattern is consistent with the pattern of increases in real minimum wages. At almost 18 percent, the binding ratio for female informal sector workers was already high in 2011, yet more than doubled to 42 percent in 2014. This result implies that the increase in the minimum wage hit the labour market but whether its effects on employment and wage distribution are significant remain to be seen.

The results suggest that an increase in the minimum wage does not have any significant impact on total employment or labour movement across sectors. This holds true for the whole sample and for the subgroups in terms of age and gender as defined in Table 1.

That an increase in the minimum wage has no simultaneous effects on total employment and movement across types of employment can be

Figure 1: Minimum wage growth in Vietnam (VND '000)



Source: Authors' calculation from minimum wages stipulated in government documents

Table 1: Proportion of workers earning below the minimum wage (%)

	2011			2012		
	All non-farm wage	Non-farm formal	Non-farm informal	All non-farm wage	Non-farm formal	Non-farm informal
Whole sample	3.78	1.36	6.94	7.87	3.13	14.15
Female	6.82	1.82	17.56	12.52	3.75	31.36
Male	1.94	0.99	2.88	4.97	2.60	7.35
Older (30–65)	3.92	1.33	6.75	8.04	3.09	13.61
Young (15–29)	3.62	1.40	7.23	7.62	3.17	15.08
	2013			2014		
Whole sample	10.55	4.24	18.61	11.60	5.06	20.55
Female	16.60	5.14	40.94	16.89	5.83	42.14
Male	6.69	3.43	9.75	8.10	4.35	11.83
Older (30–65)	10.61	3.86	18.05	11.71	4.76	19.82
Young (30–65)	10.46	4.71	19.62	11.44	5.45	21.97

Source: Authors' calculation using data from LFS 2011, 2012, 2013 and 2014

explained by several factors. First, the significant decrease in net increments to the working-age population reduces pressure on employment creation in the labour market. This also has a positive impact on employment in the formal sector, as low population growth reduces both demand for informal sector goods and services and the supply of informal workers (Porta and Shleifer 2014).

Second is weak compliance with labour regulations. Estimates from the 2012 Enterprise Census indicate that about 40 percent of firms do not contribute to the social insurance scheme even though employees with a labour contract of more than three months are subject to mandatory social insurance.

Third, a majority of firms in our qualitative survey in Hanoi and Ho Chi Minh City reported that they pay their workers more than the minimum wage. In this case, minimum wages are used only for calculating social and health insurance and other wage-related contributions. Firms' social insurance contributions amount to about 22 percent of the compensation indicated in labour contracts. Therefore, when the minimum wage increases, a majority of firms face only 22 percent of the real increase.

Effects on wage distribution

The results indicate that minimum wages positively affect wage distribution in the formal sector, up to the 80th percentile. Put differently, minimum wage compresses wage distribution, bringing lower percentiles closer to the 80th one. The effect is stronger for young workers than for older workers. Meanwhile, the model does not work well for male workers or wage earners in the informal sector.

Policy implications

Increases in minimum wages have not yet had significantly negative effects on the labour market. However, the labour market may not be able to mitigate the negative impact of further increases in minimum wages. This possibility should be considered when determining minimum wage policy in the future. Furthermore, the insignificant effect could be due to low levels of regulatory compliance. The effect may be different if compliance is improved, especially in the informal sector where regulatory enforcement is very weak.

The joint effects of minimum wage increases and other policy reforms such as changes in the base and incidence of social contributions should be also considered. Since January 2018, social insurance contributions have been calculated based on the real total income of workers rather than reported income. In addition, workers with a contract of one month (changed from three months) or more are now subject to mandatory social insurance. Therefore, the interlinking of minimum wage increases with these policies would significantly increase firms' labour costs and is likely to impact negatively on employment.

An increase in minimum wages can help reduce wage inequality in the formal sector, though at relatively high percentiles of the wage distribution. This implies that the minimum wage has a fairly strong effect on the formal sector and may distort the efficiencies and labour market behaviours of firms. For example, firms in the formal sector may invest more in capital as labour costs increase. An important implication of this is that investment exceeds the optimal point caused by distortion in the labour market, resulting in higher production costs.

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