Spillover Effects of International Standards: Working Conditions in the Vietnamese SMEs

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Summary. — Private international standards are commonly applied to improve market access and competitiveness. While most studies focus on trade effects and organizational outcomes, very few studies look at the effect of standards on employees. Using a three-year matched employer–employee panel dataset, this paper finds that the application of management standards improves working conditions in small and medium enterprises (SMEs) in Vietnam. Certified firms pay higher wages on average, implying that the adoption of standards could boost labor productivity. They are also more likely to offer formal contracts, illustrating that benefits from standards also have non-monetary aspects. These effects come from higher investment in employee training, adherence to national labor laws, and engagement of non-technical workforce. There is, however, no systematic impact of standards on the provision of fringe benefits, such as paid sick leave and health, social, unemployment, and accident insurance. The estimation accounts for endogenous matching of workers with firms and unobserved heterogeneity using an instrumental variable approach. The study reveals unexpected benefits from certification.

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1. INTRODUCTION

Private standards that regulate characteristics of products and production processes are a prominent part of discourse in international trade, business, and development circles. Developed to resolve asymmetric information problem between buyers and suppliers, standards are seen as facilitators of global market access, especially for producers from developing countries (Henson & Reardon, 2003; Jaffee & Masakure, 2005). Development of private standards by various stakeholders, such as international organizations, retailers, or producers and their implementation at the firm level have greatly increased over the last few decades of globalization. Counting more than one million certificates issued worldwide, private management standards, such as ISO 9001 for quality and ISO 14000 for environmental management dominate the private standards arena (ISO, 2016). Certification of these standards assumes that a firm demonstrates compliance with a set of requirements for products or production processes, which is further verified in a third-party audit.

At the firm level, management standards play a key role in improving managerial and operational practices, as well as productivity (Delmas, 2001; Goedhuys & Sleuwaegen, 2013). Their relationship with working conditions in general is less clear. While typically designed to address various aspects of the production process and product quality, the requirements of certification may include some components related to labor, such as compliance with national labor laws and employee training, which can affect working conditions. Better compliance with national labor laws may increase the provision of formal contracts and fringe benefits. Training may improve employee effort and skills if it is linked to more specialized work positions that are usually better paid than routine tasks (Helper, Levine, & Bendoly, 2002). The effect can also come indirectly from changing the overall firm performance and transmitting the benefits to employees. If, however, the implementation of standards costs too much, the additional

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conditions in manufacturing SMEs. Most of the literature on the implications of standards focuses on trade and organizational outcomes (e.g., Blind, Mangelsdorf, & Wilson, 2013; Corbett, Montes-Sancho, & Kirsch, 2005; Fontagné, Orefice, Piermartini, & Rocha, 2015; Henson, Masakure, & Cranfield, 2011; Martincus, Castresana, & Castagnino, 2010; Schuster & Maertens, 2015; Terlaak & King, 2006). Various ethical, labor, and social accountability standards in global supply chains have also received considerable attention (e.g., Barrientos & Smith, 2007; Knudsen, 2012; Llach, Marimon, & Alonso-Almeida, 2015; Locke, Amengual, & Mangla, 2009; Sartor, Orzes, Di Mauro, Ebrahimpour, & Nessimbeni, 2016). Very few studies have, however, quantitatively assessed the impact of private non-labor standards on employee outcomes.

Some of the studies are based on aggregate firm-level data (Levine & Toffel, 2010; Ullah, Wei, & Xie, 2014), which cannot account for complementarities in the match between the worker and the firm that affect worker wages irrespective of the application of standards. Studies using matched employer–employee data have so far been cross-sectional and focused on developed countries (see, e.g., Delmas & Pekovic, 2013). To the best of my knowledge, only Schuster and Maertens (2016) have used matched employer–employee panel data from the horticultural export sector in Peru to study labor benefits of private standards. The present study, in contrast, uses several manufacturing sectors and a wider range of measures of working conditions. Schuster and Maertens (2016) also focus on employees in the age group 17–21, while the present study does not impose any age restrictions. The matched firm–employee data used in this study enable controlling for observed worker and firm characteristics that are correlated with standards and working conditions, while employee fixed effects account for individual time-invariant unobserved heterogeneity such as worker ability, which is likely to influence both working conditions and possible selection of workers into firms with standards. I also correct for time-varying unobserved heterogeneity using the instrumental variable (IV) estimation and show evidence of adverse selection into standards, implying that lower ability workers and firms are more likely to select into certification and that not controlling for unobservables underestimates the true effect size.

In many developing countries, the SME sector is the main driver of employment and economic growth (Beck, Demirgüç-Kunt, & Levine, 2005). As value chains extend both economically and geographically, understanding how private standards affect working conditions uncovers the hidden implications of certification. The application of management standards is not usually guided by a desire to improve worker conditions, but by a desire to increase efficiency, profit or market access (Manders, de Vries, & Blind, 2016; Martinez-Costa, Martinez-Lorente, & Choi, 2008). By linking standards and working conditions, this paper brings evidence on the externalities of certification and a policy-relevant perspective on worker welfare. This knowledge is important for increasing the capacity of the SME sector for participation in global trade flows.

2. BACKGROUND

(a) Management standards

Standards are measures by which products, processes, and producers are judged. They formalize consumers’ requirements about specific aspects of the production process (e.g., ethics, environment) or products (e.g., safe, organic) and communicate additional, otherwise not easily verifiable, information about the attributes of products and production processes. This can provide reassurance that threats to product safety or sustainability have been identified and managed appropriately (Lockie, Travero, & Tennent, 2015). With standards, it is easier for buyers to validate product quality and trust the producer, so standards can increase sales by reducing transaction costs. Where firms are likely to take advantage of cross-country differences of national government regulations, international standards can be a useful governance mechanism for firm behavior (Christmann & Taylor, 2006). This is possible as certification based on third-party auditing system lowers transaction costs for customers in global value chains (Hatanaka, Bain, & Busch, 2005). Although not mandatory, standards are equally important as they are requested by buyers in developed countries, becoming de facto obligatory for accessing major markets (Henson & Humphrey, 2010). Non-exporting firms can likewise use standards in domestic markets to signal better quality or to increase competitiveness (Caswell, Bredahl, & Hooker, 1998).

Traditionally, standards were devised by individual governments, but more recently, the non-governmental, international, and private bodies have gained an increasing importance in their design and implementation. For example, the International Organization for Standardization (ISO) develops standards for quality (ISO 9001) and environmental management (ISO 14000). The chief aim of these systems is to establish adherence of firms with specific processes that improve quality or environmental performance. These standards are best understood as management standards. Independent third-party auditors monitor firm performance and certify compliance with standard requirements. Irrespective of the main focus of standards (be it quality, safety, or environment), there are some shared components between them, such as adherence to national laws or employee training, which could affect employment conditions, such as worker wages, contracts, and insurance contributions (more on this in Section 4).

(b) Vietnamese context

Vietnam primarily exports manufactured goods, which make up around two-thirds of total export value (GSO, 2015b). The key exported product groups are: electrical machinery and equipment, footwear, and apparel (UN, 2016). The Vietnamese economy has gone through a wide range of reforms in enterprise, market, and investment regulation in the past couple of decades. Changes such as membership in the Association of Southeast Asian Nations (ASEAN) since 1997 and accession to the World Trade Organization in 2007 have opened up the Vietnamese economy, transforming both the landscape for trading opportunities and the terms of participation in global value chains. One aspect of the regulatory reform included formalizing employment conditions and social protection.

Vietnam has introduced a labor contract system in 1994 (Liu, 2004). The Vietnamese Labor Code (10/2012/QH13) regulates the length of working hours, the content of contracts, the rules for hiring, the payment of social and medical insurance, and the minimum salary level. Contracts can be for an indefinite term, from one to three years, or for less than one year for seasonal employment. It is believed that the contract regime has enabled more autonomy to firms in terms of hiring and firing (Liu, 2004) as it has replaced the
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