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Regional Labor Market Integration, Shadow Wages and Poverty in Vietnam

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Summary. — Poor workers suffer from low returns to their most abundant resource, labor. In this paper we show that labor market integration strongly affects these returns for poor workers in Vietnam. Using seven representative household surveys, it is shown that while regional labor markets have become increasingly integrated over the period 1993–2010 considering *market wages* of workers in wage employment, there remains a strong lack of integration considering *shadow wages* of workers in farm self-employment. Shadow wages have been increasing as a proportion of market wages during 1993–2010, but they remain only 22–28% of rural market wages by 2010. Using a decomposition technique, it is shown that the lack of integration between the farm self-employment segment with various segments of wage employment (regional, urban *versus* rural, non-farm household *versus* other enterprises), explains primarily the gap in returns to labor between poor and non-poor workers. These findings show that labor market integration studies should not only focus on observed market wages but also on shadow wages in order to understand the relationship between labor market integration and the returns to labor.

Key words — labor market integration, wages, poverty, Vietnam

1. INTRODUCTION

Labor is key to understanding poverty as it forms the most plentiful resource that poor households have and jobs form the most important source of household income. The main problem for the poor is not the lack of jobs, however (they often have multiple jobs and work long hours), but the fact that the returns to their labor are low. Changes in poverty are therefore linked to increases in the value of work, either due to increases in productivity (in farm and non-farm self-employment) or higher real wages (in wage employment) (World Bank, 2013).

A number of strategies have been identified to increase productivity and/or wages, such as diversification, skill formation, improvements in farming and better access to agricultural input and output markets, and labor migration (Clemens, 2011; Inchauste, 2012; Inchauste, Olivieri, Saavedra-Chanduvi, & Winkler, 2012).

In this paper we suggest that there may be another and relatively less studied reason why the returns to labor, or value of labor time, are relatively low for poor people - segmentation of labor markets, in the sense that workers with identical levels of human capital face different rates of return depending on where they work. For instance, if the poor are disproportionally employed in (rural) regional labor markets that are poorly integrated with more developed (and better paid) regional labor markets, then improved labor market integration will reduce poverty. [1]

There are a number of studies which have analyzed regional labor market integration looking at wage differentials (e.g,. Freeman & Oostendorp, 2002; Robertson, 2000; Williamson, 1992). These studies analyze differentials in *market* wages earned in wage employment. However, many workers in developing countries are not employed in wage employment, and this is especially the case for poor workers in these countries. Their value of labor time is therefore not given by the market wage, but by their *shadow* wage, which depends on the productivity of their time in farm or non-farm activities. Only if the market for wage employment is perfectly integrated with the market for self-employment, market wages will reflect the value of labor time in self-employment. However, the value of labor time is often (much) lower in the market for self-employment, especially in developing countries, explaining why getting a wage employment job is often linked with a transition out of poverty. Therefore, in order to understand the link between labor market segmentation or integration and poverty, it is important to study not only market wages earned in wage employment but also the shadow wages earned in self-employment.

This paper seeks to make the following contributions to the literature based on 7 representative household surveys for Vietnam spanning a period of more than 15 years (1993–2010). First, we will estimate the value of labor time for self-employed farmers in Vietnam across regions. Most of the labor force in Vietnam was until recently in farming (Oostendorp, 2009) and therefore the value of labor time in farming will be an important determinant of poverty. No previous study has estimated the shadow value of time over such a long period (17 years) in Vietnam (or probably any other country for that matter). Also we are not aware of any previous study looking at regional labor market integration considering *shadow* wages.

Second, we will compare the estimated shadow wages with the (counterfactual) market wage that farmers could have earned in each region as an indicator of labor market integration between wage employment and farm self-employment. We find that shadow wages are only about 12–28% of the market wages within a region, but the gap between these wages has been falling over the 1993–2010 period, suggesting increasing integration.

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Third, we analyze the impact of labor market integration on the value of labor time of poor workers in Vietnam. After introducing a new decomposition technique, we find that most of the difference in the value of labor time between poor and non-poor workers can be attributed to differences between shadow wages in farming and market wages rather than regional differences in market wages. However, the importance of this gap between shadow and market wages has been declining since 1993, as the increasing integration of the farm self- and wage employment labor markets in Vietnam has led to a reduction in the overall gap in the value of labor time between poor and non-poor workers. Also wage gaps within wage employment, between urban and rural jobs and between jobs in non-farm household and other enterprises, explain only a very small part of the difference in the value of labor time between poor and non-poor workers.

The main finding of this paper is therefore that an analysis of both market *and* shadow wages is essential to understand the impact of labor market segmentation on the returns to labor for the poor, and hence, poverty. As a corollary, labor market policies should not only focus on reducing (regional) segmentation within the wage labor market (e.g., by reducing interregional migration costs) but also on reducing the (within-region) segmentation between farm self-employment and wage employment (e.g., by reducing rural–urban migration costs such as improved access to urban housing and social services for rural migrants or increasing farm productivity). Also the finding that the wage gap between jobs in non-farm household and other enterprises explains only a very small part of the low value of labor time of poor workers, suggests that diversification into non-farm self-employment is another important strategy for increasing the value of time of poor workers.

The remainder of the paper is structured as follows. In the next section we provide background information on labor markets in Vietnam and introduce the data for the empirical analysis. We also show that in terms of market wages, labor markets have become increasingly integrated across regions over the period 1993–2010 in Vietnam. In Section 3 we develop an econometric framework for estimating the shadow wage for workers in farm self-employment. These shadow wages are compared with estimated counterfactual market wages to analyze the degree of integration between wage employment and farm self-employment labor markets. In Section 4 we apply a decomposition framework to measure how much of the mean gap in the value of labor time between poor *versus* non-poor workers can be attributed to either regional variation in market wages, variation between shadow and market wages, and wage gaps between urban and rural jobs and between jobs in non-farm household and other enterprises. Section 5 concludes the paper with a discussion of the results and policy implications.

2. VIETNAM: LABOR MARKETS, DATA AND REGIONAL LABOR MARKET INTEGRATION

Starting from a centrally planned economy, Vietnam initiated a sequence of economic reform measures in 1986 (“Doi Moi” or “Renovation”). Multiple reform measures were introduced, such as agricultural decollectivization, exchange rate depreciation and unification, price liberalization, land reforms, reducing subsidies to and increasing autonomy of state-owned enterprises, encouragement of private sector development, as well as trade liberalization. The success of these reform measures has proven to be remarkable, with an average annual economic growth rate of 6.9% during 1993–2013 combined with only a very small increase in inequality [2]; consequently, poverty has been declining at a high rate during this period, from 58.1% in 1993 to 14.2% in 2010 (World Bank, 2012).

The economic reforms had also a profound impact on the functioning of labor markets in Vietnam. Before 1986, there were almost no labor markets functioning in Vietnam. The economy was dominated by SOEs in manufacturing and services and by cooperatives in agriculture. The private sector was very small and made up mainly of small-scale services businesses employing just a few workers. In the formal non-agricultural sector, the employment decisions were made by line ministries instead of by actual employers. It was very hard for a worker to change his or her job without having the right connections. At the same time, during this period, administrative procedures and the household registration system were very cumbersome and complicated; hence further limiting the movement of labor (ADB, 2005).

With the shift away from a centrally planned economy toward a market economy, the private sector started to develop and SOE managers were allowed to make employment decisions without waiting for bureaucratic approval. This created a functioning labor market as workers were increasingly hired on the basis of economic considerations and labor became more flexible as well. Currently, while Vietnam is still a communist country, the role of the state in the labor market has become much less important—employment in SOEs fell from 59% to 17% during 2000–10 (GSO Enterprise Census Data) and while minimum wages are relatively strictly enforced in SOEs (and foreign-owned firms), enforcement in the growing private sector is much weaker. Therefore, labor markets are now very much following demand and supply forces.

The economic reforms also led to a change in the structure of employment in Vietnam. Information on the employment structure as well as their changes over time can be derived from seven large-scale household surveys in Vietnam, namely, the Vietnam Living Standards Survey in 1992–93 (VLSS 1993) and 1997–98 (VLSS 1998), and the Vietnam Household Living Standards Surveys in 2002, 2004, 2006, 2008, and 2010 (VHLSS 2002, VHLSS 2004, VHLSS 2006, VHLSS 2008, VHLSS 2010). The total number of households interviewed was respectively 4,800, 6,000, 3,0000, 9,200, 9,200, 9,200, and 9,400, and these surveys are representative for Vietnam (GSO, 2011; Phung & Nguyen, 2008). [3]

In the next table we present the structure of employment as captured by these surveys for the period 1993–2010. We distinguish between 4 categories, namely wage employment, farm self-employment, non-farm self-employment, and unemployment/not in labor force (because students, disabled, housework, retired, ill, and for other reasons). The figures are for all respondents between 15 and 65 years, and they are related to the primary activity in the past 12 months.

Over the period from 1993 to 2010, self-employment in agriculture has been steadily shrinking compared with wage employment. In 1990s, nearly half of the employment came from farm self-employment, while wage employment accounted for only about 18%. Since the 1990s, the share of wage employment has increased substantially. Most of the increase happened during 1993–2004. Since 2004, the share of wage employment has been stable, around 28%. [4]

An interesting question is whether the economic reforms with the subsequent rise of wage employment in Vietnam has gone hand-in-hand with increasing regional labor market integration. Several economic theories suggest different reasons why labor markets can be segmented (in the sense that