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Influences of Foreign-Owned Enterprises on Domestic Wage: The Case of Vietnam

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Abstract

This research investigates the influences of foreign-owned enterprises on the domestic wage and labor market in Vietnam, employing data of Vietnam Enterprise Surveys for the period 2010-2018. The regression results indicate that foreign-owned enterprises' operations have an effect on increasing domestic wages through backward linkage, while the impact through forward linkage is negative. The analysis of the wage and employment characteristics of foreign-owned enterprises in Vietnam indicates a concern regarding job security and sustainability. Foreign-owned enterprises, concentrating mainly in labor-intensive industries, tend to employ younger workers with shorter employment spells. Therefore, the paper recommends that policymakers should pay more attention to labor relations in foreign-owned enterprises and promote policies that enhance the competitiveness and resilience of domestic firms.

Keywords*:* Foreign-owned enterprise, backward linkage, forward linkage, wage
JEL Classifications: F43, F63

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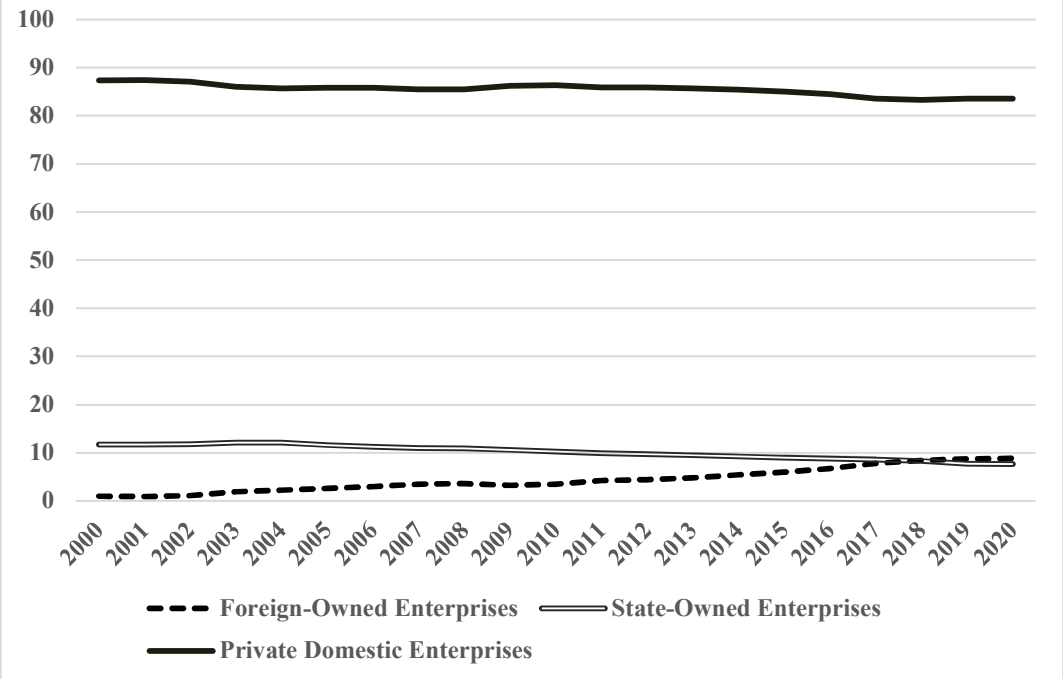
1. Introduction

Empirical studies have shown that foreign-owned enterprises (FOEs) can affect the wages and labor productivity of domestic enterprises through competition or spillover effects. The direct impact of FOEs is related to the number of jobs created by FOEs and the wages and working conditions in FOEs. Indirect effects reflect the spillover effects of foreign direct investment (FDI) on the working conditions of workers in domestic enterprises. OECD (2008) argues that FDI can indirectly affect the wages of workers in domestic enterprises through spillover effects on productivity, especially for domestic firms with strong linkages with multinational companies. Theoretically, FOEs usually have a higher capital-to-laborratio, which helps to increase labor productivity and pay higher wages. In addition, FOEs can indirectly affect wages and labor productivity in the country if there is a spillover effect of technology from FOEs to domestic enterprises, thereby helping domestic enterprises improve labor productivity and workers' wages and increasing demand for skilled labor, which causes wages to rise.

Since the beginning of the 21st century, the foreign-owned business sector has continuously developed and become an important employer in the Vietnamese economy, surpassing the state-owned enterprise sector by 2020 (Figure 1). This would have a significant impact on the structural shift in the Vietnam labor market.

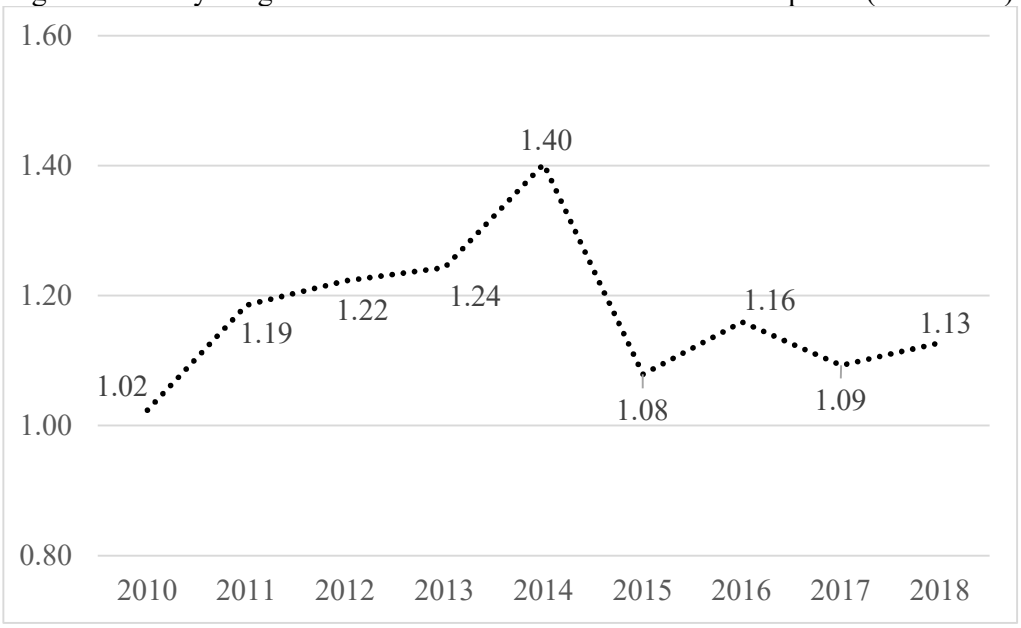
Figure 1: Composition of Working Population in Vietnam by Type of Ownership of Enterprises (%)



Source: Authors' compilation based on data from General Statistic Office of Vietnam

In Vietnam, harmonized hourly wages in FOEs are higher than those of domestic enterprises, but the gap has narrowed down over the years (Figure 2). The wage gap between FOEs and domestic enterprises increased significantly between 2010 and 2014, from 1.02 to 1.40 times, then fell sharply in 2015 and stabilized at 1.13 in 2018.

Figure 2: Hourly Wage Ratio between FOEs and Domestic Enterprises (unit: times)



Source: Authors' calculation from Vietnam Enterprise Surveys data.

In this study, we use a regression analysis based on panel data from Vietnam Enterprise Surveys for the period 2010-2018 to assess the impact of FOEs on wages in domestic enterprises. Then, we compare the characteristics of the wage and employment policies of foreign-owned enterprises with those of domestic ones to interpret the results obtained from the quantitative analysis.

The remaining paper is organized as follows: Section II reviews some empirical research. Section III provides regression analysis to examine the impact of FOEs on domestic wages through backward and forward linkages. Section IV discusses the wage/value-added ratio. Section V highlights the employment characteristics of FOEs. Section VI concludes the paper and provides policy implications.

2. Literature Review

The theoretical literature suggests that FOEs can affect domestic firms' wages through two main channels: productivity spillovers and competition effects. Productivity spillovers occur when domestic firms learn from or imitate advanced technologies and management practices and thus improve their efficiency and profitability. Competition effects arise when FOEs increase the demand for or reduce the supply of skilled labor in the host country and thus bid up the wages of skilled workers relative to unskilled workers. The net effect of FOEs on domestic firms' wages depends on the relative strength of these two channels, as well as on the characteristics of FOEs, domestic firms, and host country absorptive capacity. The empirical literature provides mixed evidence on FOEs' spillover effect on domestic wages. Some studies find positive spillovers, especially for skilled workers or high-tech sectors; some find negative spillovers, especially for unskilled workers or low-tech sectors; and some find no significant spillovers at all.

Many studies show a positive impact of FDI on the employment and wages of the host country. Chang (2007), using a vector autoregressive (VAR) model for Taiwan,

found that shocks in FDI inflows have a negative effect on unemployment. Balcerzak & Zurek (2011), using a VAR model for Poland, found that in the short run, FDI has a negative effect on the unemployment rate, implying a positive effect on employment. Chaudhuri & Mukhopadhyay (2014) found that FDI has the potential to alleviate unemployment among both skilled and unskilled workers in the context of developing countries. Karlsson et al. (2009) found a positive effect of FDI on employment growth in foreign-owned manufacturing firms in China and also found evidence of a positive spillover effect in the form of employment growth in Chinese private manufacturing firms. Nunnenkamp et al. (2009), using Mexican manufacturing data, found a positive employment effect of FDI for both skilled and unskilled workers, and the impact was stronger for export-oriented industries. Broniatowska & Strawiński (2021) employed a cross-sectional dataset and found that foreign-owned firms pay 5 percent more than domestic-owned firms, due to a positive selection effect that reflects the higher skills and productivity of workers in foreign-owned firms.

However, there are also studies that do not find a significant impact of FDI on employment and wages. Aitken et al. (1996) find that FDI inflows tend to only increase wages for workers in foreign firms and have no spillover effects on wages in domestic firms. Chen et al. (2011), using firm-level panel data, showed that in China, investment in the form of FDI has a significant positive effect on the wages and employment of acquired firms but a negligible impact on national employment growth and wage growth.

Te Velde (2003) argued that FDI can affect wages, thereby creating income inequality through education and training opportunities. FDI can affect the supply of skilled labor through training and has a certain contribution to the improvement of the knowledge and skills of workers. FOEs also pay great attention to human resource training, motivating employees to participate in training and self-training to improve professional qualifications and skills. This opportunity has divided employees into two parts: the trained and re-trained workers have higher productivity and work efficiency and receive better job opportunities and a higher income than the workers who have little opportunity or do not have access to vocational training. Te Velde (2003) also explained more reasons why FDI enterprises pay higher wages to employees. Firstly, FOEs classify and recruit workers based on their education level; due to limited knowledge of the quality of labor in localities, they have to pay higher wages than domestic enterprises. Second, foreign firms may be more profitable than domestic firms. Blanchflower et al. (1996) suggested that wages can be positively correlated with profitability, which was supported by empirical evidence in Ghana. Third, foreign enterprises are often large-scale and distributed in developed regions within a country. If there is a large and stable difference in wages between regions, FOEs operating in high-wage regions tend to pay a higher salary. Hence, the wage level in these regions will be higher, and the regional income gap will be widened.

In addition, FOEs can also affect wages in developing countries through competition and technology. According to Chen (2016), in addition to capital, FOEs also bring technology, production know-how, and competition into developing countries. Competition can overwhelm and destroy domestic enterprises in the same industry, and the fact that FOEs bring technology and machines to replace humans can reduce the demand for labor in that industry, leading to unemployment and increasing income inequality in the host country (Mihaylova, 2015). This competition can also cause domestic enterprises to intensify R&D activities, innovation, and technological change (Chen, 2016). If these new technologies require more skilled workers than unskilled workers, the relative wages of skilled workers would rise as FDI inflow increases.

Moreover, the presence of FOEs can increase demand for skilled labor (Murnane & Levy, 1992; Gottschalk & Smeeding, 1997). Feenstra & Hanson (2001) suggested that trade in intermediate inputs and deepening the global production chain are important explanations for the widening income gap between skilled and unskilled workers.

Foreign-owned enterprises (FOEs) are often considered a source of positive spillovers for domestic firms, especially in developing countries. However, the empirical evidence on the effects of FOEs on the wages of local workers is mixed and inconclusive. Given this ambiguity and the increasing importance of FOEs in Vietnam's economy, this paper aims to provide empirical evidence of the wage spillovers from FOEs to domestic firms in Vietnam.

3. Regression Analysis on the Impact of FOEs on Wages

To examine the impact of FOEs on domestic wages, the following equation is estimated:

$$\begin{aligned} LnWage_{ijt} = \alpha + \beta_1 Presence\ of\ FOE_{ijt} + \beta_2 Backward\ linkage_{jt} \\ + \beta_3 Forward\ linkage_{jt} + \beta_4 Average\ wage\ of\ FOE_{ijt} \\ + \beta_5 TFP_{it} + \beta_6 Capital\_Labor\ ratio_{it} + \gamma_t + \gamma_j + \varepsilon_{ijt} \end{aligned} \quad (1)$$

$Presence\ of\ FOE_{ijt}$ indicates the ratio of capital of foreign-owned firm i to the total capital of firm in industry j at time t.

The horizontal linkage is calculated as follows:

$$Horizontal_{jt} = \left[\sum_{i\ for\ all\ i \in j} Presence\ of\ FOE_{it} * Y_{it} \right] / \sum_{i\ for\ all\ i \in j} Y_{it} \quad (2)$$

where Y_{it} is the output (measured as revenue) produced by firm i in industry j at time t. Thus the $Horizontal_{jt}$ captures the extent of foreign presence in industry j at time t.

The backward linkage of FOEs is defined as:

$$Backward\ linkage_{jt} = \sum_{k\ if\ k \neq j} \gamma_{jkt} * Horizontal_{kt} \quad (3)$$

where γ_{jkt} is the technical coefficient obtained from Input-Output tables 2012, which indicates the share of the output of industry j supplied to industry k.

The forward linkage of FOEs is computed as:

$$Forward\ linkage_{jt} = \sum_{n\ if\ n \neq j} \delta_{jnt} * Horizontal_{nt} \quad (4)$$

where δ_{jnt} is the share of total inputs sourced from industry n to industry j, obtained from Input-Output tables.

Variables TFP_{it} and $Capital\_Labor\ ratio_{it}$ are used to control for the technological and capital intensity at firm level. We follow Levisohn & Petrin (2003) to estimate TFP as follows:

$$TFP_{it} = y_{it} - \beta_l l_{it} - \beta_m m_{it} - \beta_k k_{it} \quad (5)$$

The data used in this study come from the annual enterprise survey conducted by the General Statistics Office of Vietnam for the period 2010-2018.

The estimation results using the translog function show that FOEs have a positive impact on the wages of domestic enterprises through backward linkages and negative effects on the wages of domestic enterprises through forward linkages (Table 1). Accordingly, the opportunity to provide inputs for FOEs has helped domestic enterprises improve technology and labor productivity, thereby increasing wages for workers. In contrast, the impact of the forward linkage of FDI on the wages of domestic firms is negative. This can be explained by the fact that FOEs' participation in the supply of input would limit the motivation for technological innovation in domestic enterprises, thereby negatively impacting productivity and wages in domestic enterprises. The negative impact of FOEs on domestic wage in Vietnam is also revealed by Nguyen et al. (2019), in which the authors analyze the service industry, but the variable of interest-presence of FOEs is measured by the employment share of FOEs in an industry.

In addition, the estimated results also show that the variables of average wage of FOEs in the industry, total factor productivity, and capital/labor ratio have a positive impact on the wages of domestic enterprises. The increase in average wages at FOEs has led to an increase in wage levels in the same industry, reflecting the impact of competition between FOEs and domestic enterprises on the demand for skilled labor.

By ownership form, the magnitude of the impact of FOEs on wages of state-owned enterprises (SOEs) through forward linkage is greater than that of domestic private firms. This may be a result of stronger backward linkages of FOEs with SOEs than with domestic private firms. The negative impact from the forward linkage of FOEs with SOEs is also smaller, possibly because SOEs use fewer inputs from FOEs than domestic private enterprises. The impact of the average wage of FOEs on SOEs is also greater than that on domestic private enterprises, which may reflect that the level of competition for skilled labor between FOEs and SOEs is larger than that of domestic private enterprises.

Table 1: Estimation Results of the Impact of FOEs on Wages of Domestic Enterprises by Type of Ownership

Variables	(1) Overall	(2) State-owned enterprise	(3) Domestic private enterprise
Presence of FOEs	-0.294***	-0.971***	-0.278***
	(0.0198)	(0.165)	(0.0202)
Backward linkage	0.483***	1.081***	0.470***
	(0.0187)	(0.148)	(0.0190)
Forward linkage	-0.324***	-0.203***	-0.329***
	(0.00380)	(0.0344)	(0.00392)
Average wage of FOEs	0.235***	0.319***	0.238***
	(0.00451)	(0.0260)	(0.00473)
Total factor productivity (TFP)	0.403***	0.379***	0.399***
	(0.000618)	(0.00608)	(0.000629)
Capital/Labor ratio	0.0525***	0.0812***	0.0508***
	(0.000421)	(0.00447)	(0.000430)
Constant	0.435***	0.446***	0.434***
	(0.0177)	(0.109)	(0.0187)
Number of observations	1,725,310	15,902	1,656,016

Variables	(1) Overall	(2) State-owned enterprise	(3) Domestic private enterprise
R-squared	0.316	0.290	0.313
Number of id	531,225	3,773	513,752
Standard errors in parentheses *** p<0.01, ** p<0.05, * p<0.1			

Source: Authors' calculation.

The results of the impact analysis by region also show the positive impact of the backward linkage and the negative impact of the forward linkage of FOEs on the wages of domestic firms, but with different degrees of impact between regions (Table 2). The biggest impact can be found in the Red River Delta, which has the largest concentration of FOEs in the country, especially high-tech FOEs such as Samsung and LG. Next are the Southeast, North Central, and Central Coast regions, the Northern Midlands and Mountains, and the Mekong Delta. For the Central Highlands region, where FOEs are the least concentrated, the impact of FOEs on workers' wages is positive but not statistically significant.

For the forward linkage, the impact of FOEs on the wages of workers working for domestic enterprises is also negative for all regions. However, the degree of impact is different, in which the largest impact is on the Southeast region, followed by the Mekong Delta, the Red River Delta, the Northern Midlands and Mountains, the North Central Coast, and the Central Coast, and the lowest impact is for the Central Highlands region.

The average wage of FOEs in the industry has a positive impact on the wage of domestic enterprises in most regions, the largest of which is in the Southeast region, but has a negative impact in the Red River Delta region, where most FOEs are concentrated . The average wage of FOE in the Red River Delta region is much higher than that of domestic enterprises (1.89 times in 2018). Therefore, competition in the labor market can cause the FOEs to attract skilled workers and the domestic enterprises to only attract unskilled human resources. However, it is worth noting that the Southeast region also has a high wage gap between the FOEs and domestic enterprises, but the wages of FOEs have a positive impact on the wages of domestic enterprises in the region with a significant magnitude.

Table 2: Estimation Results of the Impact FOE on Wages of Domestic Enterprises by Econom

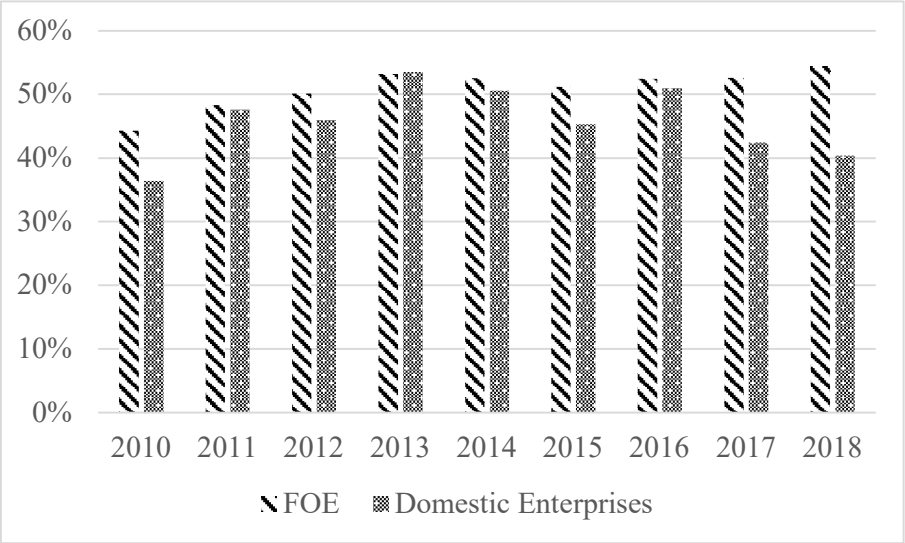
Variables	(1) Overall	(2) Red River Delta	(3) Northern Midlands and Mountains	(4) North Central and Central Coast	(5) Central Highla
Presence of FOEs	-0.294***	-0.697***	-0.0729	-0.144**	-0.0126
	(0.0198)	(0.0443)	(0.0851)	(0.0591)	(0.153)
Backward linkage	0.483***	0.648***	0.376***	0.387***	0.209
	(0.0187)	(0.0421)	(0.0813)	(0.0561)	(0.143)
Forward linkage	-0.324***	-0.287***	-0.281***	-0.226***	-0.108***
	(0.00380)	(0.00774)	(0.0171)	(0.0101)	(0.0288)
Average wage of FOEs	0.235***	-0.195***	0.378***	0.395***	0.411***
	(0.00451)	(0.00927)	(0.0170)	(0.00982)	(0.0293)
Total factor productivity (TFP)	0.403***	0.556***	0.490***	0.378***	0.325***
	(0.000618)	(0.00119)	(0.00266)	(0.00150)	(0.00364)
Capital/Labor ratio	0.0525***	0.0397***	0.0860***	0.0734***	0.0835***
	(0.000421)	(0.000869)	(0.00204)	(0.00102)	(0.00281)
Constant	0.435***	0.911***	0.147**	0.302***	0.652***
	(0.0177)	(0.0366)	(0.0643)	(0.0379)	(0.112)
Number of observations	1,725,310	567,052	92,961	265,013	49,090
R-squared	0.316	0.433	0.374	0.294	0.220
Number of id	531,225	170,042	25,815	77,231	15,253
Standard errors in parentheses					
*** p<0.01, ** p<0.05, * p<0.1					

Source: Authors' calculation.

4. Wage and Value-Added in FOEs

The results of the analysis of enterprise survey data show that the FOEs have a higher wage/value-added ratio than domestic enterprises. Besides, while the wage/value added ratio of domestic enterprises tended to decrease sharply in the period 2016-2018 (51% to 40.4%), the ratio of wages/value added of FOEs maintained the tendency to increase (from 52.5% to 54.4%) (Figure 3). This can be explained by the fact that FOEs still focus mainly on the labor-intensive industries of the manufacturing sector.

Figure 3: Ratio of Wages/Value- added of Enterprises in Vietnam by Type of Ownership (%)



Source: Authors' calculation from Vietnam Enterprise Surveys data.

By region, the Southeast region, the North Central and Central Coast, the Northern Midlands and Mountains, and the Red River Delta have the largest overall wage/value added ratio, but the difference is not large (Table 3). The Mekong Delta and the Central Highlands have a significantly lower wage/value-added ratio than the above regions. However, FOEs in the Mekong Delta region have the largest wage/value- added ratio in the country (60.9% in 2018). The Mekong Delta is also the region with the second highest accumulated foreign direct investment in the country, behind the Red River Delta.

Table 3: Wage/Value-added Ratio of Enterprises by Region and Type of Ownership in 2018 (%)

	Overall	**FOEs**	**Domestic Enterprises**
Red River Delta	42.5%	51.1%	40.6%
Northern Midlands and Mountains	44.2%	57.5%	41.1%
North Central and Central Coast	44.4%	56.0%	43.3%

	Overall	FOEs	Domestic Enterprises
Central Highlands	37.7%	56.7%	36.9%
Southeast	44.7%	55.1%	40.2%
Mekong River Delta	39.5%	60.9%	35.7%

Source: Authors' calculation from Vietnam Enterprise Surveys data.

According toeconomic activities, firms in manufacturing and service industries have the highest wages/value-added ratios (Table 4). Health services and education and training services have a very high wage-to-value-added ratio because the input from these industries is mainly high-quality human resources. For the manufacturing industry, the wage/value-added ratio of FOEs is significantly higher than that of domestic enterprises (57.18% compared to 47.7% in 2018), showing that the FOEs in the manufacturing and processing industry in Vietnam focus mainly on labor-intensive activities.

Table 4: Wage/Value-added Ratio of Enterprises in Selected Economic Activities in 2018 (%)

	Overall	FOEs	Domestic Enterprises
Agriculture, forestry and fishing	43.1%	40.1%	43.6%
Mining and quarrying	27.5%	30.8%	27.4%
Manufacturing	51.7%	57.2%	47.7%
Construction	49.3%	46.5%	49.4%
Transportation and storage	35.1%	45.6%	33.8%
Accommodation and food service activities	47.4%	54.7%	46.4%
Information and communication	52.9%	65.7%	44.3%
Financial, banking and insurance activities	49.5%	58.2%	43.8%
Real estate activities	18.6%	25.5%	17.5%
Education and training	65.9%	69.3%	65.4%
Health and social work activities	78.2%	67.5%	79.3%

Source: Authors' calculation from Vietnam Enterprise Surveys data.

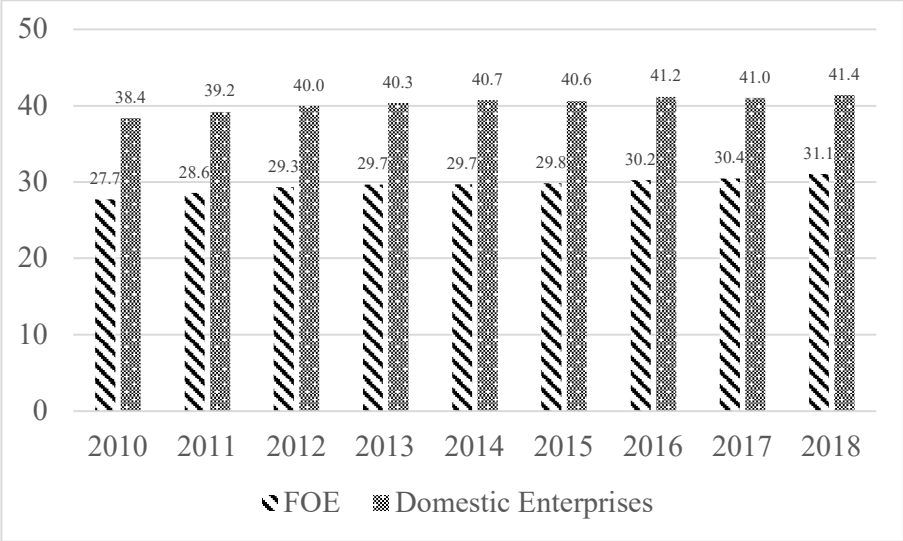
5. Employment Characteristics in FOEs

5.1. Workers' age

The average age of workers in FOEs is always significantly lower than in domestic enterprises, although it tends to increase year by year (Figure 4). Specifically, the average age of employees in FOEs in 2010 was 27.7 years old, then gradually increased to 31.1 years old in 2018. Meanwhile, the average age of employees working for domestic enterprises is much higher and gradually increased from 38.4 in 2010 to 41.4 in 2018. This may reflect the fact that most FOEs enter Vietnam to take advantage of unskilled workers, especially FOEs in the textile, leather, and footwear industries. Therefore, many FOEs tend to recruit young workers and find ways to dismiss employees when they pass a certain age (usually over 35 years old) due to concerns about having to

pay high salaries and high social insurance contributions when employees have seniority or fear that they are not healthy enough to work.

Figure 4: Average Age of Workers in FOEs and Domestic Enterprises

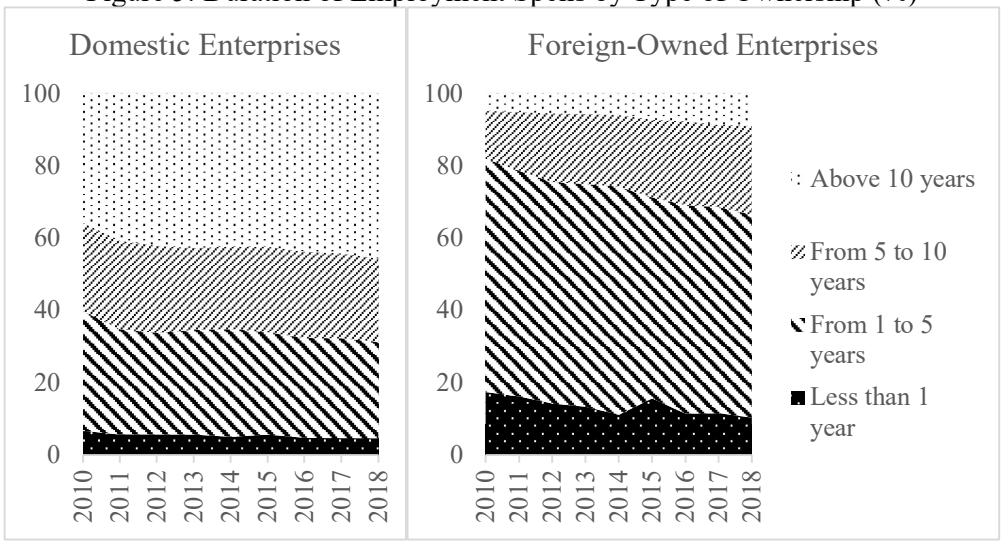


Source: Authors' calculation from Vietnam Enterprise Surveys data.

5.2. Duration of employment spell

The duration of employment spells in FOEs is quite short, mainly 1-5 years, although this proportion has decreased from 64.6% in 2010 to 56.2% in 2018 (Figure 5). The positive trend is that the proportion of employees working for 5-10 years has increased from 13.3% in 2010 to 22.7% in 2018, and the proportion of employees working for more than 10 years, although it accounts for a low percentage, has an increasing trend from 4.7% in 2010 to 8.6% in 2018. Meanwhile, the proportion of employees working less than 1 year also decreased from 17.4% in 2010 to 10.3% in 2018.

Figure 5: Duration of Employment Spells by Type of Ownership (%)



Source: Authors' calculation from Vietnam Enterprise Surveys data.

In contrast, for domestic enterprises, employees working for more than 10 years accounted for the highest proportion and also tended to increase from 35.5% in 2010 to 45.6% in 2018. The proportion of employees working 5-10 years has remained relatively stable at 23.1% in 2018, although slightly down from 24.5% in 2010. Meanwhile, the proportion of short-term workers tends to decrease; specifically, the proportion of employees working for 1-5 years decreased from 33.1% to 26.6%, and the proportion of employees working for less than 1 year decreased from 6.7% to 4.7% in the period 2010-2018.

The low sustainability of employment in FOEs suggests that workers' livelihoods may be jeopardized when these enterprises relocate.

6. Conclusion

The analysis results from the panel data regression model show that FOEs have the effect of increasing wages in domestic enterprises through backward linkage. This means that domestic enterprises, by providing inputs to FOEs, were able to improve their productivity and thus increase their employees' wages. In contrast, the impact of FOEs on wages through the forward linkage is negative, indicating that the participation of FOEs in providing inputs may adversely affect the performance of domestic firms in the same industry.

The wage policy of FOEs also indicates that they use a large portion of their value added to pay for labor input. This pattern is consistent across different regions of Vietnam where FOEs operate. In the manufacturing and processing industry, which attracts most of the FOEs, their ratio of wages to value added is much higher than that of domestic enterprises. Moreover, FOEs tend to favor young workers and offer them short-term employment contracts. This raises concerns about the sustainability of employment in FOEs.

For a developing country like Vietnam, the FOEs have played and will play an important role in promoting growth, creating jobs, and stabilizing the livelihoods of workers. Therefore, we urge policymakers to pay more attention to the stability and sustainability of jobs for workers in FOEs.

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