



Hochschule für  
Wirtschaft und Recht Berlin  
Berlin School of Economics and Law



# **Social and Economic Upgrading in the Garment Supply Chain in Vietnam**

*DO Quynh Chi, Director of the Research Center for Employment Relations, Hanoi Vietnam*

## **Abstract**

The textile and garment industry in Vietnam has achieved fast expansion in terms of production capacity and export value in all three areas of fibre, textile and clothing manufacturing since the early 2000s. However, the growth of the industry has been mainly attributed to the increase of labour and capital rather than economic upgrading. Most of the garment companies in Vietnam are still participating at the lowest value-added sections of global value chains. This report finds little progress in product, functional and sectoral upgrading at the production level. The reasons for the stagnation in economic upgrading originate both in the international buyers' policy to limit technology transfer to protect their business advantage and the lack of an effective industrial policy by the Vietnamese government. Social upgrading has been achieved mostly in the larger, export-oriented firms that are under the scrutiny of international buyers, while the SMEs and household businesses have been plagued with forced overtime, wildcat strikes, and low wages.

**JEL Classification Codes:** F16, F23, L16

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**Contacts:** [doquynhchi@quanhelaodong.com](mailto:doquynhchi@quanhelaodong.com); [chi.labourstudy@gmail.com](mailto:chi.labourstudy@gmail.com)

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## Abbreviations

CBA	Collective Bargaining Agreement
CLS PLUS	Core Labour Standards Plus
CMT	Cut-Make-Trim
CSR	Corporate Social Responsibility
DOLISA	Department of Labour, Invalids and Social Affairs (provincial level)
EICC	Electronics Industry Code of Conduct
ERC	Research Centre for Employment Relations
EVFTA	Europe-Vietnam Free Trade Agreement
EZ	Economic zone
FDI	Foreign direct investment
FES	Friedrich Ebert Stiftung
FIE	Foreign Invested Enterprises
FOB	Freight on Board (or Free on Board)
FOL	Federation of Labour
GDP	Gross Domestic Production
GSC	Global supply Chain
GSO	General Statistics Office
HR	Human resources
ILO	International Labour Organisation
ITUC	International Trade Union Confederation
IZ	Industrial zone
MNC	Multi-national corporation
MOLISA	Ministry of Labour, Invalids and Social Affairs
MW	Minimum wage
OBM	Original brand manufacturing
ODM	Original design manufacturing
OEM	Original Equipment Manufacturer
OSH	Occupational Safety and Health
POE	Privately-owned Enterprises
RMG	Ready-Made Garment
SAT	Standard Allowed Time

SME	Small and Medium-sized Enterprises
SOE	State-owned Enterprises
TPP	Trans-Pacific Partnership
UNIDO	United Nations Industrial Development Organisation
USDOL	Department of Labour of the United States
VCCI	Vietnam Chamber of Commerce and Industry
VGCL	Vietnam General Confederation of Labour
VITAS	Vietnam Textile and RMG Association
VN	Vietnam
VNUTG	Vietnam National Union of Textile and Garment Workers
WB	World Bank

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## Chapter 1: Introduction

This paper was developed within the context of an international research project studying the economic and social upgrading in various supply chains in the developing countries. The project is led by Berlin School of Economics and Law at the international level and country level, and the national research team develops the national case study for each industry. For the purpose of this study, economic upgrading is defined as productivity increases based on better technology and/or better organisation of the production process. It also implies the increase of innovation in a country. On a more concrete level, it should also be reported whether economic upgrading in one of the following four areas took place (following Humphrey and Schmitz 2002):

- *Process upgrading*: transforming inputs into outputs more efficiently by reorganising the production system or introducing superior technology.
- *Product upgrading*: moving into more sophisticated product lines (which can be defined in terms of increased unit values).
- *Functional upgrading*: acquiring new functions (or abandoning existing functions) to increase the overall skill content of activities.
- *Sectoral upgrading*: clusters of firms move into new productive activities.

Social upgrading is measured by the five key aspects in the ILO's Decent Work Agenda (ILO 2008; ILO 2016b):

- quality of employment.
- social security/risks.
- labour rights(including freedom of association, patterns of resistance including the capability to organise official or wild cat strikes and their frequency, unionisation level, character of trade unions [yellow trade unions, independent interest representation, politically disunited trade unions, proximity to state parties], employment protection through labour law and its enforcement, forms of participation).



- social dialogue (including level of collective bargaining: individual, plant, company, industry, national, transnational level; existence and role of minimum wage; wage level [in relation to other industries and to national average wages]).
- gender equity including differences among women and reproductive work.

Since the lifting of the trade embargo in 1995, the garment industry has been one of the pioneering export sectors of Vietnam. The industry has been significantly expanded both in terms of production, number of enterprises, labour force, and export value, making Vietnam the 5<sup>th</sup> biggest garment exporter in the world (FWF 2015). However, as previous studies indicated, the extension of production which is mainly attributed to increase of capital and labour does not necessarily guarantee economic upgrading and social upgrading (CNV 2016; Do 2017).

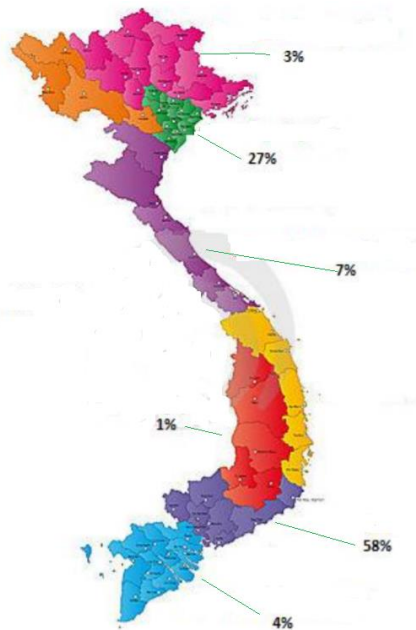
This study, therefore, analyses the secondary data to measure the economic and social upgrading, if any, of the garment industry of Vietnam during a period of 15 years (2002-2017). The data used in this study mainly comes from the Enterprise Survey and the Household Living Standards Survey of the General Statistics Office<sup>1</sup>. The research also benefits from the various empirical studies conducted on the garment industry of Vietnam. The main weakness of the study is the fact that the GSO data rarely separates the garment industry from other manufacturing industries. Also, the data collected, especially those about economic upgrading at workplace level and social upgrading are patchy and sometimes inconsistent.

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<sup>1</sup> GSO Website: [www.gso.gov.vn](http://www.gso.gov.vn)

## Chapter 2: Overview of Vietnam's Garment Industry

**Picture 1: Distribution of Textile and Garment Enterprises**



*Source: Do (2019:18)*

The textile and garment industry has a long tradition in Vietnam, beginning in 1889 with the establishment of the Nam Dinh textile complex (Hill 1998). After the country's reunification in 1975, the state-owned garment companies mainly produced for the domestic market and exported a small proportion to the socialist countries in Eastern Europe. By 1995, exports accounted for only 10.4% of garment and 29.5% of textile production of the industry and the total garment export value was USD 1.02bn (UNIDO 1998). After the collapse of the Soviet bloc, the garment industry plunged into crisis. The remaining companies started to find new markets for export thanks to the lifting of the US trade embargo in 1995 and the first arrival of foreign direct investment. However, the growth of the garment industry was mainly accelerated by the 2002 U.S.-Vietnam Bilateral Trade Agreement and later Vietnam's accession to the WTO in 2006. Between 2002 and 2008, Vietnam's garment export value increased at an annual rate of 22%. After 2008, the global economic recession and internal economic difficulties slowed down the growth of Vietnam's garment sector, but the industry has still maintained an average export growth rate of 12% (GSO 2016b). In 2001, there were only 1,031 textile and garment companies (FPTS 2017), but by the end of 2016, this number had grown to 8,770, among which nearly 6,000 were garment manufacturers and the rest producers of fibres and

textile (see Table 1). The textile and garment industry has maintained a relatively high level of productivity: in the period of 2011-2015, the annual productivity of the industry was 76 million dong per person, which was 11.6% higher than the national figure. However, the productivity growth rate in the industry was only 0.4%/year, much lower than the national growth rate of 4.33%/year (see Table 1).

The centre of the industry is Ho Chi Minh City and the neighbouring region with 58% of garment and textile companies (see Picture 1). The second biggest hub is Hanoi and a few Northern provinces such as Nam Dinh, Thai Binh, Hung Yen, accounting for 27% of the total number of garment and textile companies.

**Table 1: Overview of Vietnam's garment industry, 2016**

	<b>Fibre and fabric</b>	<b>Clothing</b>	<b>Whole industry</b>	<b>Nation wide</b>
<b>Total output</b>	Fibre: 2.050 tons Fabric: 2,85bn m2	3.903 mil. products		
<b>No. of enterprises</b>	2.789	5.981	8.770	442.485
<b>Total turnover (bn. VND)</b>	204.996	227.779	432.775	13.516.042
<b>Total profit after tax (bn. VND)</b>	5.700	4.696	10.396	556.695
<b>Total capital (bn. VND)</b>	194.195	149.028	343.223	19.677.247
<b>Average productivity (2011-2015)</b>	N/A	N/A	VND 76 million/person/year	VND 68,1 million/person/year
<b>Average productivity growth rate (2011-2015)</b>	N/A	N/A	0,4%/year	4,33%/year

*Source: compiled by the author based on information from General Statistics Office ( 2016a); Vietnam Productivity Institute (2017)*

The average size of textile and garment companies is small, at only 180 workers per firm. There are only 30 companies with more than 5,000 workers. Still, the industry is the biggest employer in the formal private sector with total (formal) employment at nearly 2.0 million, which accounts for 12.3% of the waged employment of the country (GSO 2016a).

According to the 2016 National Statistic Yearbook, the profit margin (per cent of revenue) of the textile and garment companies is much lower than the average of the whole economy. The profitability of textile and garment companies (after tax) is slightly over 2% while the average after-tax profit margin of the economy is 4.1%. According to FPTTS (2017), the after-tax profit for companies producing on Cut-Make-Trim (CMT)<sup>2</sup> contract ranges from 1-3% of turnover, on Freight-On-Board (FOB)<sup>3</sup> contract from 3-5%, and on Original Design Manufacturing (ODM)<sup>4</sup> from 6-7%. Since 65% of garment companies in Vietnam are producing on CMT and only 35% on FOB and 5% on ODM, the profitability of the garment industry remains low.

With 95% of garment export from Vietnam being facilitated by international buyers, the brands (lead firms) have been playing a crucial role in the shaping of the garment industry of Vietnam. The biggest fashion brands sourcing from Vietnam include Nike, Adidas, Levis, and Inditex (Zara), among others (FES Vietnam 2015).

The brands normally enter into FOB contracts with either vendors or first tier suppliers (direct suppliers). In some cases, vendors such as Li & Fung do not manufacture themselves, but instead sub-contract to material suppliers and manufacturing firms. For the latter case, the contract is usually a CMT one with the materials being selected and prices negotiated by the vendor in advance.

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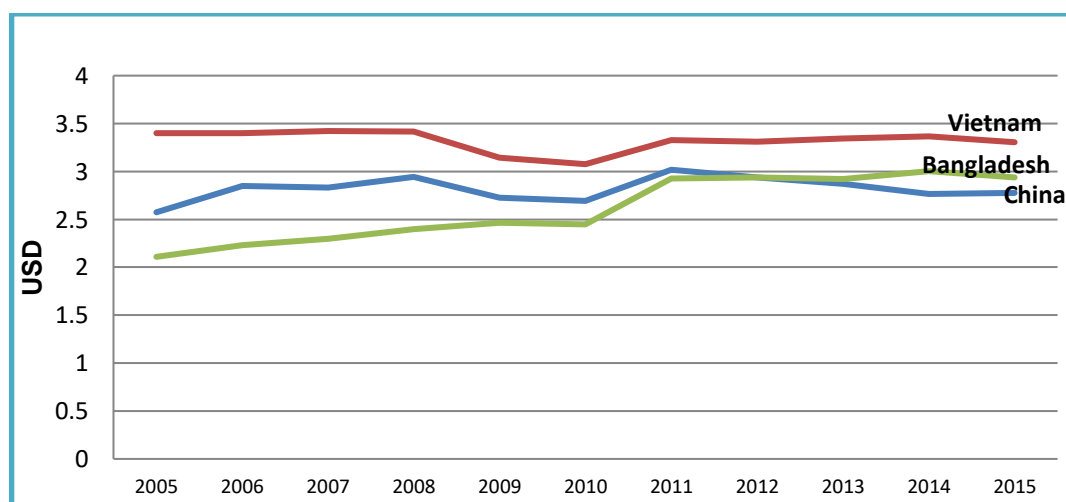
<sup>2</sup>In CMT manufacturing, the apparel buyer pays the manufacturers for the cut (cutting fabric), make (stitching) and trim (trimming of uncut threads tails, finishing and packaging) process. Pre-production process like the order processing, product development, pattern making and pattern grading, and post-production process such as shipping of goods are handled by the buyer.

<sup>3</sup> FOB means “free on board” or “freight on board”. In this case, the exporter quotes the garment buyer a price that includes all costs up to and including delivery of goods aboard an overseas vessel. Here, the exporter quote the price by adding fabric cost, accessories cost, CM (cost of making), overhead cost, commission, C&F (commission and transportation cost from factory to port). For more details see Figure 11.

<sup>4</sup> ODM means Original Design Manufacturing. In this case, the garment producer is responsible for product design, material sourcing, and making of the final products. The products, however, are sold under the brands of the buyers.

The bargaining power of the CMT supplier in the garment supply chain is the lowest. Without the ability to negotiate the fabric price, the CMT supplier can only negotiate on the basis of unit labour cost. Traditionally, both the fashion brand and the supplier have their own technical departments that calculate the Standard Allowed Time (SAT) for each type of product and for each factory, based on which the two parties negotiate the CMT costs. However, this practice rarely exists now as the procurement team of a fashion brand often applies a regional standard time for assembling each type of product or bases it on the historic production data with little research (Miller 2013). According to a 2016 survey of the garment supply chains in Vietnam, the CMT prices have not increased since 2012. In some cases, the CMT prices have even decreased by 5-10 percent/year over the past few years (Do 2017). The nominal price in US dollar of ready-made garment (RMG) imports by square metre to the U.S., the biggest garment market for Vietnam, has declined by 0.02% over the past 10 years (Figure 1).

**Figure 1: Nominal price RMG imports USD from Vietnam, China & Bangladesh to US**



*Source: calculated by the author based on the database of US Department of Commerce*

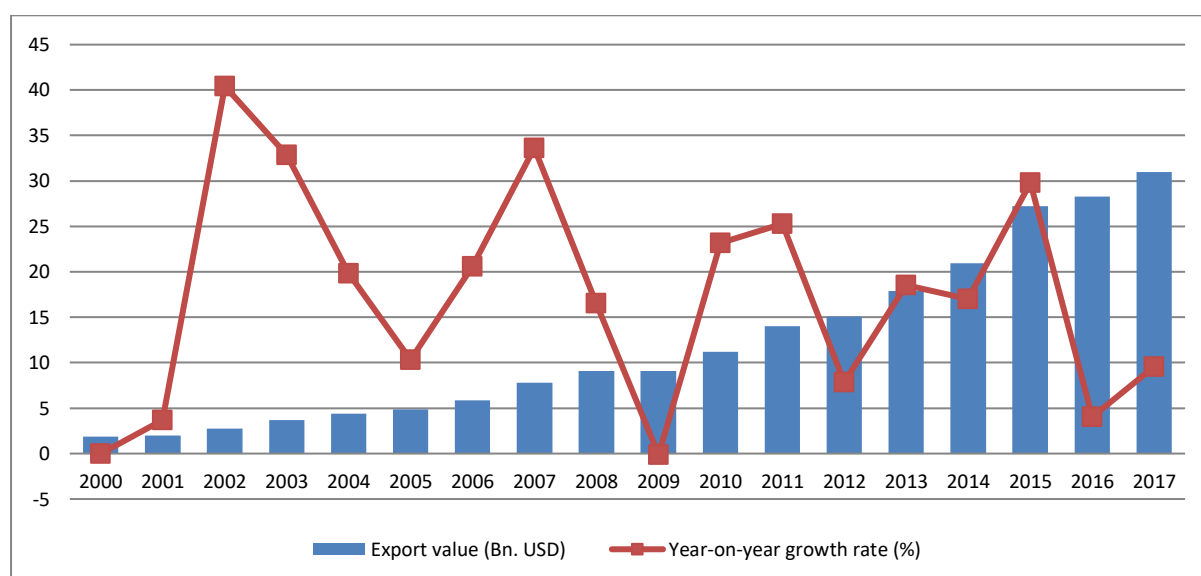
## Chapter 3: Economic Upgrading in the Textile and Garment Industry

### 3.1. Economic upgrading at the industry level

In terms of production, Vietnam has recorded fast growth in the fibre, textile and garment sectors. Fibre production grew at the rate of 29.4% per year in the period of 2012-2016, while that figure for textile is 9.4% per year and 16.4% per year for clothing (FPTS 2017).

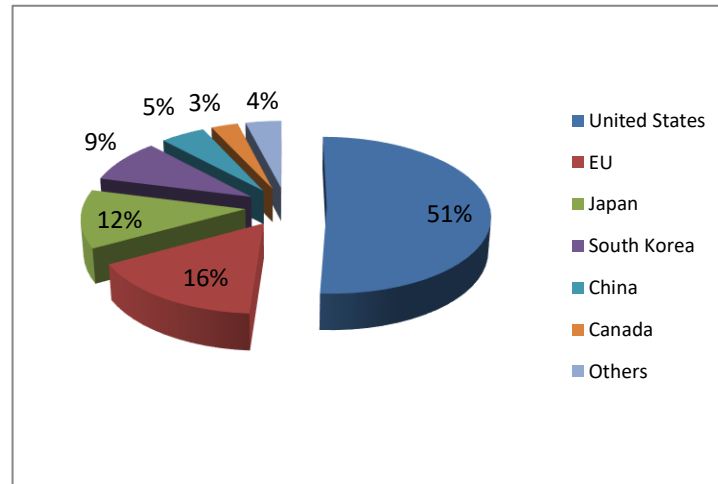
Together with fast growth of production, the export value of the textile and garment industry has increased steadily from USD1.89bn in 2001 to USD31bn in 2017, with an average year-on-year growth rate of 18.4% (see Figure 2). The only year where the industry experienced negative export growth was 2009 due to the impacts of the financial crisis in 2008. The year 2016 was also a difficult year for garment export from Vietnam due to the withdrawal of the US from the Trans-Pacific Partnership (TPP) which seriously affected Vietnam's biggest garment market (see Figure 3 for main export markets). However, the industry recovered in 2017 by increasing exports to China, a new market.

**Figure 2: Garment and textile export value (bn USD) and annual growth rate**



*Source: compiled by the author based on Vietnam Customs Office (2018)*

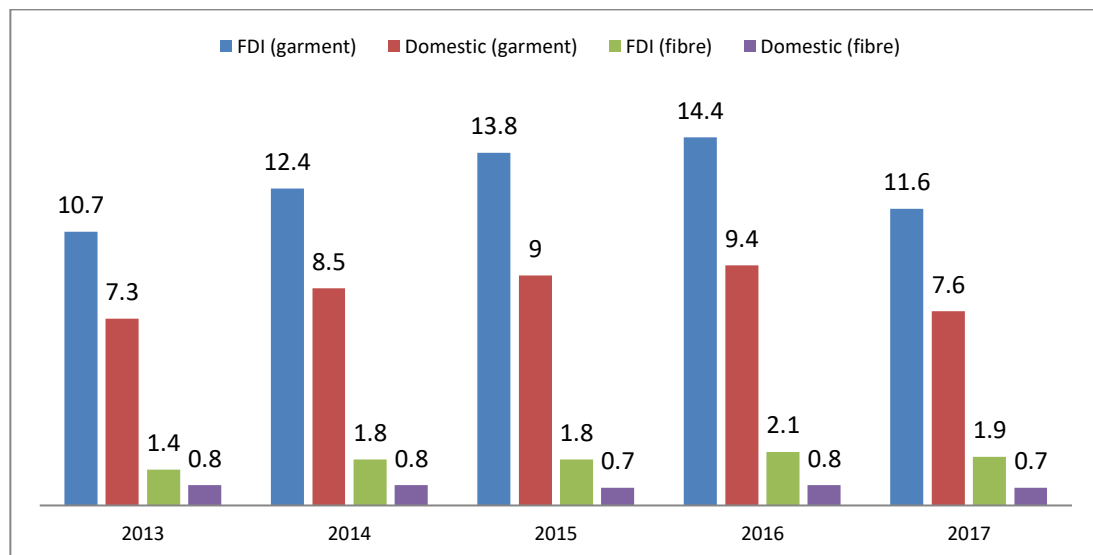
**Figure 3: Garment export markets 2015**



*Source: compiled by the author based on Vietnam Customs Office (2018)*

Although the garment industry has grown significantly over the past 15 years, mostly thanks to fast expansion of the export markets, it should be noted that foreign-owned companies contributed more than 70% to the overall export value of the sector (Do 2017). The textile and garment industry is the second biggest FDI-receiving industry in Vietnam, attracting USD 5bn of foreign direct investment between 2011 and 2016 (FPTS 2017). As shown in Figure 4, the FDI sector accounted for 60% of the garment export and over 70% of fibre export in the period of 2013-2016, while the fibre export by domestic companies stagnated and the garment export of domestic companies grew at a much slower rate.

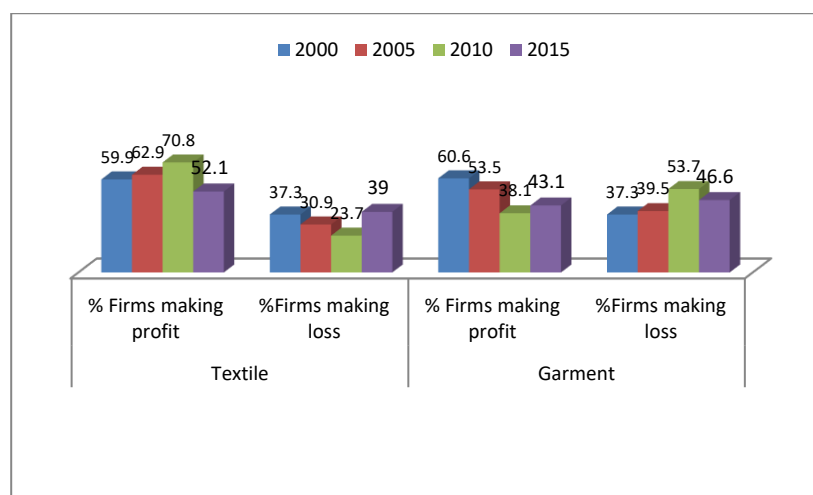
**Figure 4: Export of garment and fibre by FDI vs. domestic companies (bn USD)**



*Source: FPTS (2017:33)*

At the same time, although the number of enterprises in the textile and garment sector have increased steadily over the past 15 years, the proportion of profit-making companies has observed a downward trend, especially in the garment industry (GSO 2016a). The percentage of profit-making textile firms dropped from 70.8% in 2010 to 52.1% in 2015 and that figure for the garment industry also decreased from 60.6% in 2000 to 43.1% in 2015 (see Figure 5). Figure 6, however, illustrates a sharp increase of profit over the past 15 years, especially in the case of the textile industry. The trends show that there has been a strong growth of new firms joining the industry over the past 15 years, but the industry has become much more competitive, with the good performers making higher profits and an increasing proportion of firms losing out (as shown in Figure 5&6). The distribution of profit according to the size of companies is only available for the manufacturing sector as a whole. In the manufacturing sector big companies including FDI companies tend to make much more profit than the small- and medium-sized companies (SMEs). On average, a big company tends to make 82 times more profit per year than an SME (VCCI 2016).

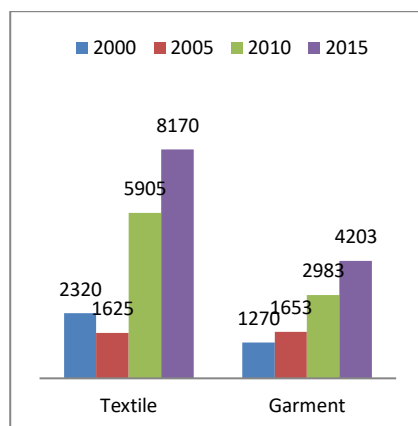
**Figure 5: Percentage of profit- and loss-making companies in textile & garment, 2000-2015**



*Source: compiled by the author based on GSO (2015)*



**Figure 6: Average profit made by textile and garment firms (mil. dong), 2000-2015**



*Source: compiled by the author based on GSO (2015)*

In terms of net value creation, the statistics from the Vietnam customs office show that the garment industry has been able to increase the net value from USD 0.4bn in 2005 to USD 12bn in 2017. In other words, the value added by the Vietnam garment industry increased from 8.3% to 38.7% of the total export value between 2005 and 2017 (see Table 2).

**Table 3: Imports of apparel materials vs. exports (million USD)**

Year	Imports	Exports	Net value creation
2005	4400	4800	0.4
2006	5000	5900	0.9
2007	6356	7800	1.4
2008	7064	9100	2.0
2009	6422	9100	2.6
2010	8911	11200	2.2
2011	11209	14000	2.7
2012	11363	15100	3.7
2013	13547	17900	4.3
2014	15800	20950	5.1
2015	15160	22810	7.6
2016	17200	23800	6.6
2017	19000	31000	12.0

*Source: compiled by the author based on Vietnam Customs Office (2017)*

Despite the overall growth of net value creation, the garment industry of Vietnam relies heavily on imports of materials, especially fabric, mostly from China (FPTS 2017). Ironically, while importing a lot of fabric and materials, Vietnam has been exporting two thirds of its own fibre and fabric (FPTS 2017). There are three main reasons for this shortage of locally-made materials:

First, the production of fibre and fabric requires a much larger investment than garment. The average investment per job in garment in Vietnam is USD 3,000 while that in fibre and textile is USD 200,000 (FPTS 2017). The average textile and dyeing factory requires an investment of USD 2-5 million to install the water processing and disposal system that meets the national standards (FPTS 2017). That is not to say that a number of provinces such as Vinh Phuc, Bac Giang, Phu Tho, Ho Chi Minh city have rejected all investments into dyeing and textile in fear of the adverse environmental impacts.

Second, Vietnam has not developed apparel industrial clusters in which the fibre, textile and garment factories are located closely enough to save transportation time. As a consequence, the transportation of materials from China to Vietnam is faster and less costly than transportation within Vietnam (see Table 3 for an example).

**Table 3: Average transportation time and cost of fibre from China vs. within Vietnam**

	<b>Importing fibre from China</b>	<b>Transporting fibre within Vietnam</b>
<b>Time</b>	4-5 days	10-20 days
<b>Cost</b>	3-3.5 cent/kg	6 cent/kg

*Source: FPTS (2017:42)*

Third, as most garment companies are producing on CMT contracts, the buyers either purchase the materials beforehand or specify on the sources of materials for the products. The local companies, therefore, will often not have a choice in the sourcing of fabric and materials in these cases. On average, the productivity (measured as real GDP per person) of the manufacturing industry is lower than the productivity on the national level(see Figure 7). The average productivity of the manufacturing industry in the period of 2011-2015 was 64 mil

dong/person/year, maintaining an average growth rate of 5.6% per year, while the national figures were 68 mil dong and 8.7% per year correspondingly (VNPI 2017).

Looking more closely at the three main productivity-contributing factors (capital, labour and total factor productivity (TFP)), the statistics from GSO (2016a) indicate that the increase of capital remains the most important leverage for productivity growth for Vietnam, contributing 45.82% in 2015. However, Vietnam made a significant progress in 2013 with TFP growing to become the second biggest contributor to productivity growth at 30.27%, while labour (increasing the number of workers) contributing only 16.9%. As explained by the Vietnam National Productivity Institute, the TFP's contribution has grown thanks to such improvements as market growth, better business environment, economic restructuring, technological renovation, and the quality of labour (VNPI 2017).

However, as 65% of the enterprises in the textile and garment industry are still working under CMT contracts, where value added depends only on low-skilled labour, productivity growth relies first and foremost on the increase of capital and labour rather than the TFP factors.

The indicators discussed so far in this Chapter show that the textile and garment industry of Vietnam has achieved a certain level of economic upgrading. However, a large part of such upgrading can be attributed to the foreign-owned enterprises which now dominate the export of garment and fabric from Vietnam. Despite the fast growth in output and export, the wages of rank-and-file workers in US dollars in the textile and garment industry have seen much slower growth. According Werner International, the labour cost per hour of Vietnam in 1994 was somewhat close to those of China, Indonesia, and India, but is lagging far behind 10 years later (see Table 4).

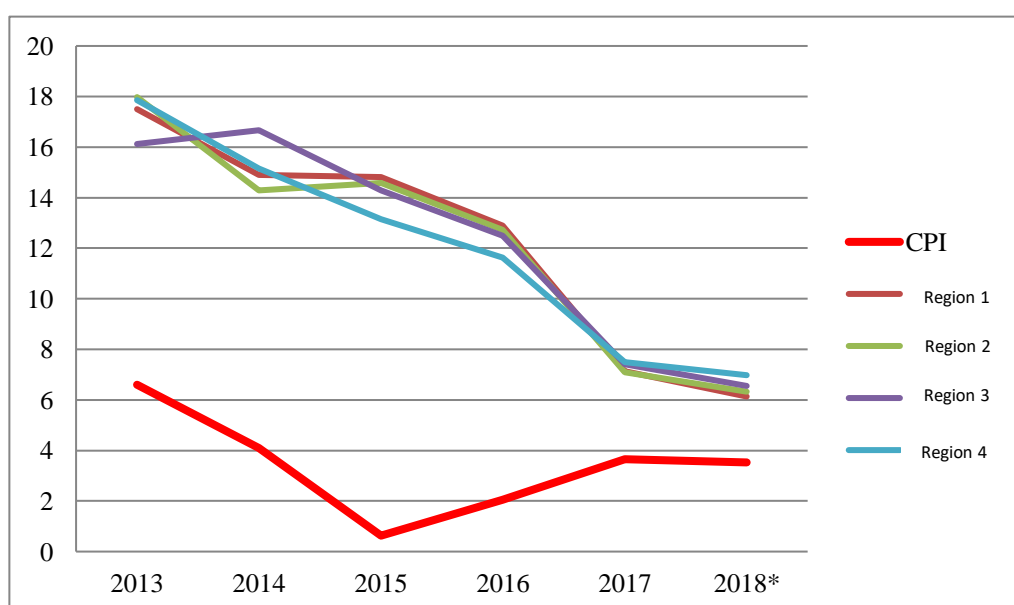
**Table 4: Labour cost per hour in the apparel sector (USD)**

	<b>1994</b>	<b>2014</b>
<b>Vietnam</b>	0.4	0.74
<b>China</b>	0.5	2.65
<b>Indonesia</b>	0.5	0.95
<b>India</b>	0.6	1.12

*Source: Werner International (2015)*

Most of the rank-and-file workers in the textile and garment industry in Vietnam are paid at the minimum wage level for their regular working hours. For instance, when the minimum wage for Region 1 in 2016 was 3,500,000 VND, the garment factories in Ho Chi Minh City paid their rank-and-file workers (entry level) at the minimum wage level plus 7% (compulsory training allowance), or 3,745,000 VND/month. As a result, when minimum wages are adjusted, these companies have to adjust their wage scales accordingly. There are four regional minimum wages in Vietnam: Region 1, which has the highest minimum wage, consists of Hanoi, Ho Chi Minh City and the most developed provinces while Region 4 – the region with the lowest minimum wage- covers the rural areas. The regional minimum wages are adjusted by the tripartite National Wage Council every year. The Council was established in 2013, consisting of fifteen members with equal representation from Ministry of Labour, Invalids and Social Affairs (MOLISA), the Vietnam General Confederation of Labour (VGCL) and the Vietnam Chamber of Commerce and Industry (VCCI). The regional minimum wages have been increased at a diminishing rate since 2013 (see Figure 7). In fact, the growth rate of minimum wages has been increasingly closer to the consumer price index (CPI). For instance, in 2018, while the CPI was 3.54%, the regional minimum wages increased by 5.3% on average.

**Figure 7: Growth rate of regional minimum wages vs. consumer price index (CPI), 2013-2018**



Source: ILO-ILSSA (2018:11)

This means that real wage growth, at least in the low-wage sector, which for most employees stayed close to the minimum wage, did not show any acceleration, which would have signalled a specific upgrading.

### **3.2. Economic upgrading at enterprise level**

To measure the economic upgrading at workplace level, the research will use the classification by Humphrey and Schmitz (2002) laid out in the introduction to this paper. The following section will examine the achievement of the textile and garment industry of Vietnam in each type of upgrading as well as the prospects, if any, for future upgrading.

#### **Process upgrading**

Since 2009, the Vietnamese garment firms try to adopt lean manufacturing<sup>5</sup> to improve their productivity and reduce waste. According to VITAS, by 2017 only 5-7% of garment firms in Vietnam had attempted to adopt lean manufacturing, but the success rate of this adoption was only 10% (or 40-50 companies) while the rest failed to achieve any improvement in productivity (Agtek Da nang 2017). The companies that have successfully adopted lean manufacturing reported productivity increases of 20-52% (such as the companies Garment 10 and Nha Be) and reduction of fault rates from 20% to 8% (such as Hoa Tho and Hung Yen) (Bao Moi 2018).

Apart from lean manufacturing, the textile and garment companies have invested in the upgrading of technological factors of production, such as automation (especially in cutting, buttoning, and simple sewing) and CAD (computer-aided design). The 2016 ILO survey of over 4,076 enterprises in the ASEAN region, including 446 companies in manufacturing and services from Vietnam, indicated that Vietnamese enterprises have outperformed other ASEAN companies in terms of investment in R&D but have been slower in upgrading technology (see Figure 9). In terms of barriers to enterprises being able to upgrade technology, around one in four firms surveyed in Vietnam cited high fixed capital costs as the leading

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<sup>5</sup>Lean manufacturing or lean production, often simply "lean", is a systematic method for waste minimisation ("Muda") within a manufacturing system without sacrificing productivity. Lean also takes into account waste created through overburden ("Muri") and waste created through unevenness in works loads ("Mura"). This management philosophy is derived mostly from the Toyota Production System and identified as "lean" in the 1990s.

obstacle, though this is somewhat lower than results for ASEAN as a whole (see Figure 10). Clearly, the pioneers in upgrading technology will be the large firms rather than the SMEs. Additionally, the ‘lack of government incentives’ appears to be a bigger problem for Vietnamese enterprises than for ASEAN as a whole.

A study by the ILO on technology innovations in the textile, clothing and footwear industry found that innovation in these sectors has largely been driven by major brands and transnational manufacturers investing targeted proportions of their returns into R&D (ILO 2016a). For example, in 2015 Adidas invested around 0.8 per cent of net sales in R&D (around 139 million euros). Transnational apparel manufacturers such as Esquel are also known for investing millions in R&D, recruiting top-level engineers and making technology key to competitiveness. However, although these industry leaders are sourcing from thousands of factories in Vietnam and ASEAN region, the adoption of global innovation appears to be somewhat limited in the supply chains, partly due to constraints in skills and financial resources, and partly because the region largely trades on basis of low-cost labour (Do 2017). Still, it is argued that global brands and transnational manufacturers that source or produce in the region are making attempts to integrate incremental technological processes to improve efficiency and increase compliance by their suppliers to meet product quality and environmental sustainability standards (ILO 2016a).

In the case of Vietnam, the buyers that target middle and high-end markets tend to build a longer-term relationship with their suppliers to ensure both quality and contract security. To do so, the buyers, especially the Japanese companies, have tried to transfer particular types of technology and knowledge to Vietnamese suppliers that would upgrade their production capacity on both the process and product fronts (Ohno 2015; Do 2017). In CMT arrangements, for instance, it is quite common for buyer firms to send their technicians to suppliers to help them upgrade their production processes in order to ensure delivery of quality products, which is considered by Vietnamese firms as the main source of technological transfer from buyers (Do 2017). It is also common, however, that buyers carefully select the types of technology and knowledge they transfer to suppliers (Goto 2007). Technology that is transferred tends to be confined to production techniques and product information which are helpful in process and product upgrading. The more knowledge intensive skills that would lead to functional upgrading are, however, rarely transferred to suppliers. This is largely because such knowledge

intensive functions are the core competence areas for buyers themselves, enabling them to maintain rents in the value chain to reap a higher proportion of value-added (Do 2017). Such core business functions are related to the capacity of enterprises to acquire and transform market information into real production and distribution network arrangements. These types of enterprise capacity are key in order to realize upgrading from simple assembly operations (CMT) to higher level functions (Goto 2007). As found in a survey of Korean garment companies in Vietnam, the Korean firms tend to limit the engagement in technological innovation to the Korean engineers while the Vietnamese employees are not involved (Cho 2017).

### **Product upgrading**

There has not been a clear trend of product upgrading in the textile and garment industry of Vietnam. The evidence from recent empirical data proves that the industry is still focusing on lower to middle-end products (FPTS 2017). According to the VITAS (Vietnam Textile and Apparel Association) member companies, although they prefer higher-end products usually from Japan and South Korea, these contracts are often too small to sustain production for the whole year. As a result, they accept fast-fashion, low-cost orders which require simple technology and low skills but they are large enough to sustain production (Do 2017).

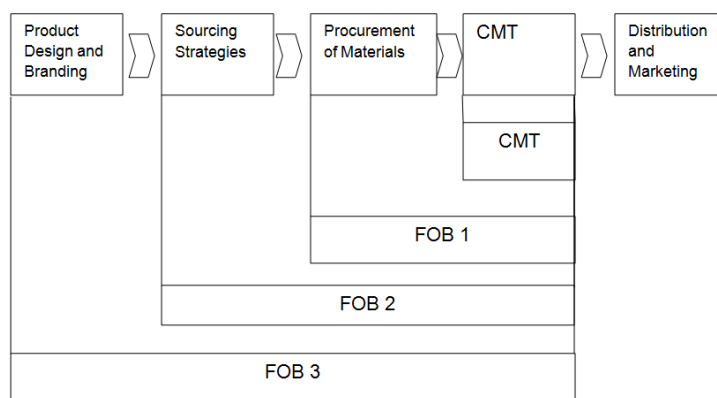
### **Functional upgrading**

The domestic market provides a modest share of revenues for Vietnamese garment companies. In 2018, the sale of garment products in the domestic market accounted for only 2% of the garment export value (Nhan Dan 2019). Vietnam has 158 domestic garment brands which play a minor role in the domestic market. In recent years, the domestic market has been dominated by international fast-fashion brands such as Zara, H&M, Mango, among others (Kinhhte Viet Nam 2019).

In terms of export, for the past 15 years of development, the garment industry of Vietnam remains at the lowest value-added section in the global value chain: Cut-Make-Trim and FOB level 1 (see Figure 8 for a classification of FOB) (Ohno 2015). According to Vietnam Textile and RMG Association (VITAS2014), 65% of garment export from Vietnam has been on CMT contracts, 30% on FOB levels 1&2 and only 5% on ODM (original design manufacturing) or FOB level 3. According a recent study by FPTS (2017), only 10-15 companies in Vietnam can

perform FOB 2 and only the company Garment 10 has been able to perform FOB 3 in which it develops new designs to offer to international brands.

**Figure 8: Classification of FOB according to functional processes**



*Source: adapted from Goto (2007)*

There are three main challenges for the Vietnamese firms to move up into FOB 3 (or ODM). First, they lack access to market information. Most Vietnamese suppliers, regardless of the production modality, have only limited information on the retail end of production, in terms of where the exported products were going, what kind of markets they were targeting, and at what price the garments were sold (Goto 2007). Second, even when they have the information, they do not have the capacity to transform it into actual product design. No Vietnamese company has been able to set up their own supply chain connecting consumer markets to material production – the section is currently dominated by Korean and Hong Kong companies (FPTS 2017; Do 2017). Without such information, experience and knowledge of the supply chain, it is practically impossible for Vietnamese suppliers to correctly position themselves in the value chain, identify viable functional upgrading possibilities and design, brand and market their own products overseas. Third, Vietnamese firms have limited access to low-cost credit to perform higher-functional tasks in global value chains (Do 2017; Goto 2007). To implement FOB 2&3 orders, Vietnamese firms must have enough capital to cover the costs for materials, machinery, labour, transportation and taxes months before they receive payment from their buyers. In the meantime, the bank interest rates for domestic currency in Vietnam range from 6-8%, and export firms also have to deal with volatile exchange rate fluctuations which tends to drive credit costs even higher (Do 2017). With these factors combined, bank credit may become too expensive for Vietnamese firms, most of which are SMEs.



## Sectoral Upgrading

Looking at sectoral upgrading, cotton fibre production proves to be a very promising area. Vietnam's fibre industry with 96 companies accounts for 2.5% of the global capacity (FPTS 2017). As seen in Figure 4 and 5, proportionately more textile firms are making profit than garment firms and the average profit made by a textile factory is twice as much as that of a garment one. Also, in Vietnam the cost to produce fibre is much lower than those of the top fibre-producing countries thanks to the (even) lower minimum wages, the actual wage level in general and cheap electricity tariff (see Table 5). The cotton fibre locally produced could be used for domestic production instead of importing fabric and fibre from other countries, which could give Vietnam an advantage in terms of production time and costs.

**Table 5: Comparison of fibre production costs between Vietnam and top fibre-producing countries in 2015**

Country	Minimum wage (USD/month)	Electricity tariff (USD/kwh)
Vietnam	114-165	0.07
India	395	0.12
Pakistan	200	0.10
China	151-330	0.11
Turkey	333-433	0.08
Indonesia	248	0.11

*Source: adapted from FPTS (2017)*

However, Vietnam is much weaker in producing polyester fibre (FPTS 2017). Also, at the moment, the dying and textile machinery and technology are old and outdated<sup>6</sup>, resulting in a disconnection of fibre and garment manufacturing in Vietnam (FPTS 2017).

### 3.3. Industrial policy and incentives for the textile and garment industry

The textile and garment industry is regarded as one of the priority industries of Vietnam's industrial masterplan (Ohno 2015). However, the policies and incentives provided for the industry remain too general and sometimes counter-productive. For instance, the masterplan

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<sup>6</sup>According to Ministry of Industry and Trade, 30% of textile machines in Vietnam are outdated while investment into dying is large but not encouraged by local authorities in fear of environmental impacts (FPTS 2017)

for textile and garment industry development until 2030 envisions the development of cotton farming regions in 8 provinces but provides no specific directions about how to develop those regions (see Table 6). To support the domestic fibre industry, the Ministry of Industry and Trade increased the polyester fibre import tariff from 0 to 2%. However, while the local fibre factories are struggling, the garment factories have been affected as they have to import fibre at a higher cost. In another example, the government also requires that the directors of companies importing garment printing machines must have college degree or higher in printing in order to get import license, which has prevented most of the printing companies from purchasing the latest printing machines (FPTS 2017).

**Table 6: Regulations and policies on the development of textile and garment industry of Vietnam**

<b>Regulations and Policies</b>	<b>Details</b>
<b>Decree 111/2015/NĐ-CP on development of supporting industries (textile is one of the 6 priority industries)</b>	<ul style="list-style-type: none"> <li>- State subsidy of up to 50% of R&amp;D costs</li> <li>- State subsidy of 50-70% of technological transfer costs</li> <li>- Tax incentives for firms operating in supporting industries</li> </ul>
<b>Decree 60/2014/NĐ-CP on licensing for imports of garment printing machines</b>	<ul style="list-style-type: none"> <li>- Directors of companies importing garment printing machines must have college degree or higher in printing</li> </ul>
<b>Decision 1966/BCT – XNK by Ministry of Industry and Trade</b>	<ul style="list-style-type: none"> <li>- Increase import tariff of polyester fibre from 0 to 2%</li> </ul>
<b>Decision 3218/QĐ-BTC on planning the textile-garment industry up until 2030</b>	<ul style="list-style-type: none"> <li>- Development of cotton farming regions</li> <li>- Development of fibre, dying and textile companies</li> <li>- Development of 7 clusters of garment production</li> </ul>

*Source: compiled by the author based on Government Office (2019)*

In other words, Vietnam still lacks a clear and comprehensive policy to support the textile and garment industry in further upgrading. Notwithstanding, the industry has managed to achieve

high growth, strong attraction of FDI, and fast market expansion over the past 15 years. Without the government's clear and effective incentives, the economic upgrading of local companies will continue to be hampered by: (i) the asymmetrical power relations in global value chains; (ii) reliance on imports of materials; (iii) lack of market information; and (iv) limited access to low-cost credit.

## **Chapter 4: Social Upgrading in Vietnam's Textile and Garment Industry**

### **4.1 The sources used to report social upgrading**

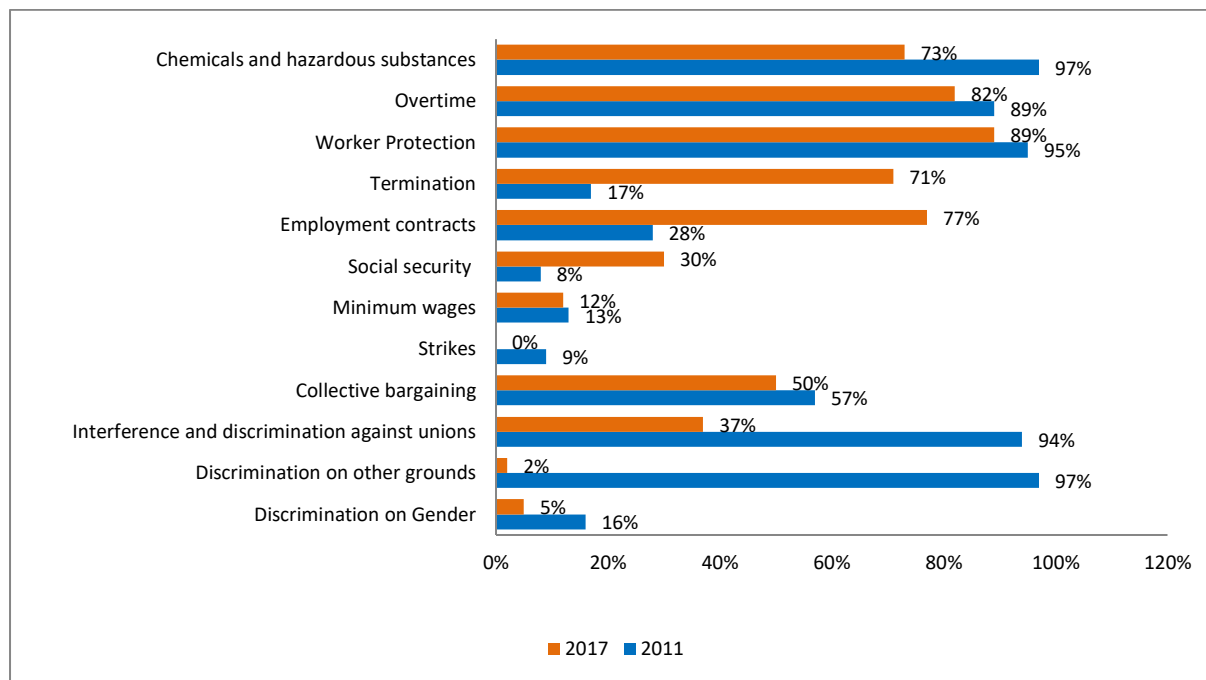
To measure social upgrading in the textile and garment industry of Vietnam, we rely on the information from three sources:

First, the compliance assessment reports of Better Work Vietnam (BWV) in 2011, 2014 and 2017 (Better Work Vietnam 2011, 2014 & 2017). Better Work, a project by ILO and IFC, now reaches over 400 garment firms in Vietnam, most of which are first-tier suppliers of international fashion brands. BWV issues annual compliance assessment reports based on their audits of the member companies covering the key international and national labour standards. Second, the data produced by the General Statistics Office (GSO) via the annual Labour and Employment Survey which covers some selective aspects of labour rights such as wages, working hours, and working ages. The GSO data includes all (formal) textile and garment companies irrespective of their position in the global value chain. Third, reports by NGOs in cases of violations of labour rights in the garment industry.

### **4.2. Quality of employment**

According to BWV's assessment, the working conditions in BWV factories between 2011 and 2017 have improved in many of aspects the measured. The most significant improvements are found in interference in union activities (from 94% non-compliance rate to 37%), discrimination on gender and other grounds, and the incidence of handling chemicals and hazardous substances (see Figure 9).

**Figure 9: Non-compliance rates of Better Work Vietnam (BWV) garment factories of key labour standards in 2011 vs. 2017**



*Source: compiled by the author based on Better Work Vietnam (2011) & (2017)*

However, the non-compliance rate has increased in the cases of other labour standards, including employment contracts, termination and social security. According to the 2014 report, as many as 61.2% of employees are working on short-term, precarious employment contracts or no contracts at all (Better Work Vietnam 2014).

In some other aspects, BWV factories have performed better, but the non-compliance rate remains high in areas such as: violation of overtime limit, worker protection (provision of proper protective equipment for workers), and collective bargaining. Open-ended working contracts are below 40%. Particularly, overtime remains the most difficult area as over 80% of the factories still violate the overtime limit. Furthermore, violation of minimum wage has not been significantly improved, with the non-compliance rate only having been slightly reduced from 13% to 12% in the past 6 years (see Figure 9).

It should be noted that the BWV member factories are first-tier suppliers and mainly larger companies. Despite their size, the violations in some aspects such as employment security, social security, working hours, types of contracts and wages remain persistent.

The working conditions in SMEs, especially those that are in the lower tiers of the supply chains, are worse. According to the 2014 survey by ILO and GSO, there are over 41 thousand child workers in the textile and garment industry, mostly between 15-17 years old and 79% are girls (ILO, MOLISA and GSO 2014). The textile and garment industry is the second biggest absolute employer of child labour in the industrial sector after construction, with 2.35% of workers employed in the sector being children.

#### **4.2. Labour rights**

The historical background of the Vietnam General Confederation of Labour (VGCL) and its long-lasting alliance with the ruling party granted the VGCL a special position in the political regime. It is one of the socio-political organisations subordinate to the Party-controlled 'Fatherland's Front'<sup>7</sup>. In addition, the special role and status of the Vietnamese trade unions as the sole representative of all workers in Vietnam was underlined in Article 10 of the revised State Constitution of 2012. The VGCL chairman has a seat in the powerful Central Party Committee and each of the key union officials at national and local level is given a Party position. The national union reports directly to the Central Party Secretariat (*Ban Bi thu*) and submits its major plans and strategies to the Party leaders for approval before they are publicised (Clarke et al. 2007).

Despite the legal changes in the early 1990s which laid the regulatory foundation for labour-management negotiation in the workplace, the labour relations practices of state-owned enterprises (SOEs) remain largely unchanged. Collective bargaining, handling of grievances and settlement of labour disputes have been adopted by SOEs merely as formalities, without having any practical impact on the labour-management relationship (Do2011). Particularly, the company unions in SOEs have not changed their traditional socialist approach and have become even more dependent on the Party management. In other words, the labour relations processes in the SOEs are not substantially different from the practices in the socialist

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<sup>7</sup>Vietnam Fatherland's Front is an umbrella group of pro-government "mass movements" in Vietnam, and has close links to the Communist Party of Vietnam and the Vietnamese government. It is an amalgamation of many organisations, including the VGCL, Youth's League, Women's Union, Peasants' Union, and Veterans' Union, among others.

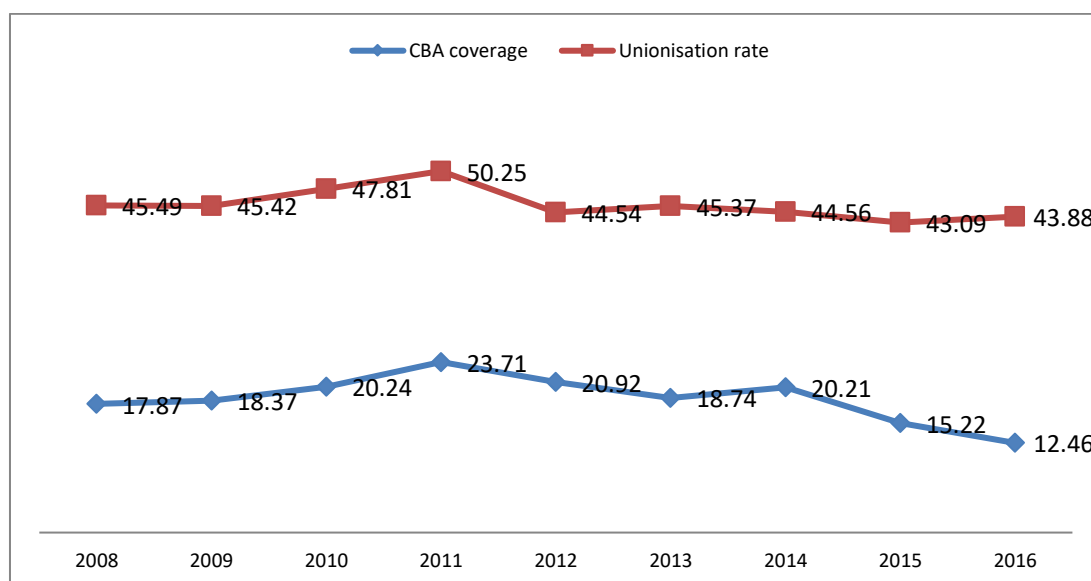
command economy, despite a different labour-management relationship which has been officially promoted by the state.

The model of enterprise unions in the SOEs has been largely transferred to the non-state sector. It is common to find enterprise union leadership dominated by high-ranking managers (Trinh 2014). These enterprise unions often operate as an ‘extended arm’ of the personnel department of the company and provide the stamp of legitimacy for management’s decisions (Do 2011). In the meantime, the labour legislation grants the right to collective bargaining to the unions (either the enterprise unions or the upper unions). Consequently, the lack of proper worker representation by the union becomes a major obstacle to the practice of workers’ right to negotiate with management on employment terms and conditions. Workers are not consulted about the collective agreements, which mainly replicated the minimum requirements of the legislation. Wages of the rank-and-file workers are arbitrarily set by management, mostly at the minimum wage level so as to minimise their labour costs (Do and van den Broek 2015; Do and Torm 2015).

### **Unionisation rate**

Union membership increased from 6.7 million in 2008 to 9.6 million in 2016 (VGCL 2017). The unionisation rate decreased slightly from the peak of 50.25% in 2011 to 43.8% in 2016 (see Figure 10). However, the proportion of female union members has increased from 48% in 2008 to 54% in 2016. Although women dominate the union membership now, the proportion of female union leaders at both local and national level remained in 2016 under 30% (Interview with the Organising Department of VGCL, 2016). Unionisation rate in the private and foreign-owned sector was only 33% in 2014, much lower than the union density of 76% in state-owned enterprises (World Bank 2015). The unionisation rate among the formal textile and garment industry is 5.78% (VGCL 2017).

**Figure 10: Unionisation rate vs. collective bargaining agreement (CBA) coverage, 2008-2016**



*Source: compiled by the author based on VGCL (2017)*

### **Collective bargaining**

The 1995 Labour Code and the 1990 Law on Trade Unions confine the practice of collective bargaining to workers in unionised workplaces, as only the workplace unions are entitled to represent workers in bargaining with the employer and to sign collective bargaining agreements (CBAs). The unorganised workers are not allowed to practise the right to collective bargaining and if they do so, the collective agreement is regarded as invalid. The revised Labour Code in 2002 extends the right to collective bargaining to unions of cooperatives that employ workers. However, unions in public services, armed forces and public security and occupation-based unions like unions for teachers or medical workers do not have the mandate of collective bargaining on behalf of their members.

Temporary workers are also excluded from collective agreements because they do not have labour contracts with the employer. According to the VGCL, the percentage of employees who have signed labour contracts with employers is 96 percent among SOEs, 65 percent in the foreign-invested sector and only 45 percent in the domestic private sector (VGCL 2017).

While the unionisation rate seems to plateau in the past 5 years, the collective bargaining coverage dropped from 23.7% in 2011 to 12.46% in 2016. According to a study by FES and VGCL in 2015, most of the CBAs were initiated by employers rather than by the enterprise

unions, due to the former's need to comply with corporate social responsibility requirements. In fact, the workers covered by CBAs were often not aware of the existence of such agreements (FES-VGCL 2015). In other words, the CBAs were concluded not on the basis of genuine labour-management negotiations but more as a legal formality. The employers, on the other hand, were not willing to include higher-than-minimum provisions in the CBAs, as the CBAs must be registered at the local labour administration and can become an obstacle to the companies if they wish to lower the standards (FWF 2015).

Ministry of Labour Invalids and Social Affairs(MOLISA) estimated that 50% of the unionised companies in the garment industry have signed CBAs (MOLISA 2012). However, there are no official statistics on CBA coverage in the garment industry. The Vietnam Textile and RMG Association(VITAS) and the national garment union signed a sectoral CBA in 2014, which covered 70 VITAS member companies and over 140,000 workers (Interview with VITAS representative, August 2019).

### **Sectoral Collective Bargaining Agreement in Textile and Garment Industry**

The textile and garment industry was chosen by the Vietnamese government as the pilot for sectoral bargaining. The first term of the sectoral CBA ran for one year from April 2010 and the second phase for two years from June 2011. The third phase covering 3 years ran until 2017. Over 100 enterprises that are members of VITAS with 140,000 workers have participated in the pilot programme, comprising about 6% of the total garment and textile workforce. The latest phase of the CBA is from 2017 to 2020, covering 80 companies and 130,000 workers. The coverage was reduced because, as explained by VITAS officials, some companies had been faced with business difficulties and thus withdrew from the agreement (Interview with VITAS representative, August 2019).

The latest completed CBA from 2013 to 2017 is composed of 16 articles including eight articles related (directly and indirectly) to wages and incomes. Table 7 shows the wage rates set by the third sectoral CBA for the year 2017. The differences between the CBA wage rates and the regional MWs range from 13.8 to 14.6%. It should be noted that the CBA rates include all wage components such as basic salary, allowances, and cash-based benefits.



**Table 7: Garment Sectoral collective bargaining agreement (CBA) vs. regional minimum wages (MWs) (nominal VND/month) in 2017**

	Garment Sectoral CBA 2017	Government set minimum wage, 2017	Difference (%)
Region 1	4.3 mill	3.75 mill	14.6
Region 2	3.8 mill	3.32 mill	14.4
Region 3	3.3 mill	2.9 mill	13.8
Region 4	2.95 mill	2.58 mill	14.3

*Source: compiled by the author based on statistics from VGCL online (2017)*

So far, the sectoral CBA has not been extended beyond VITAS to include foreign-owned and privately owned domestic companies. Nonetheless, the provisions in the CBA, especially wages, are not significantly higher than the minimum wages.

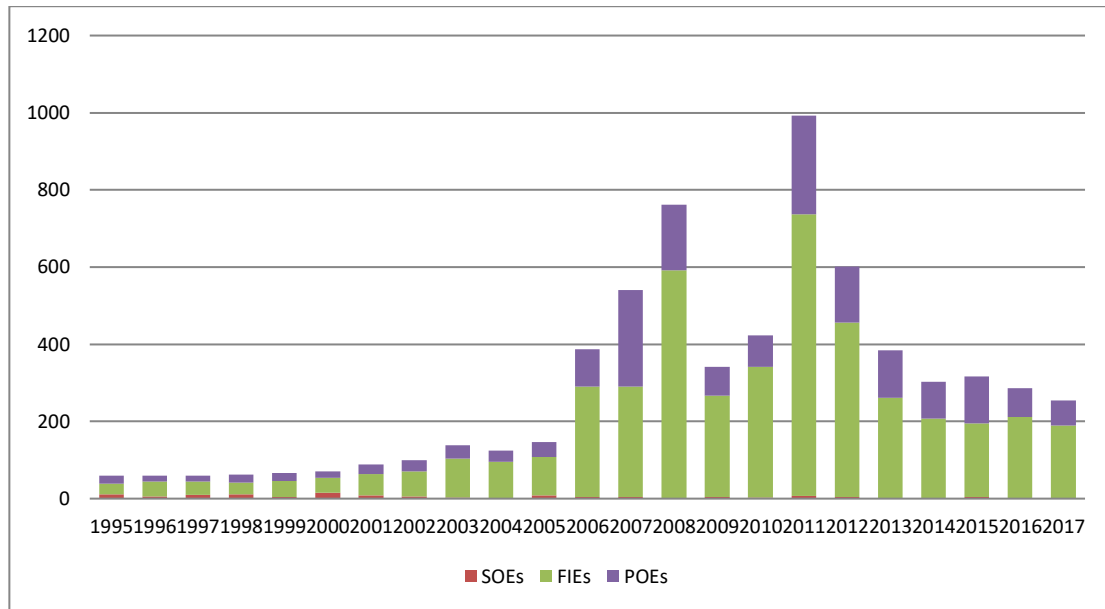
### **Management's interference in unions**

According to BWV's compliance report, 30% of the unions in their member factories are headed by senior managers (Better Work Vietnam 2017). However, it is estimated that around 70% of enterprise unions in Vietnam are headed by managers (Trinh 2014). In the past 3 years, BWV has required their member companies to ensure that the enterprise unions are headed by rank-and-file workers instead of managers. However, their attempt has been vocally criticised by the Vietnam General Confederation of Labour (VGCL) as violating the Trade Union Law which does not prohibit senior managers from joining the union leadership. According to VGCL officials, there is no conflict of interest for a senior manager to lead the union, because the manager is also an employee. Management manipulation of union elections and intervention into the unions' operations remain pervasive (Trinh 2014).

### **Wildcat strikes**

There were over 6,600 strikes in Vietnam between 1995 and 2017 (VGCL 2017). The incidence of strikes was around 100 per year from 1995 until 2004 and only increased sharply since 2005 with the first wave of strikes in the Southern provinces. The number of strikes peaked in 2011 at nearly 1,000, after which it decreased quickly to around 300 per year (see Figure 11).

**Figure 11: Incidence of strikes by enterprise ownerships, 1995-2017**



*\*SOEs: state-owned enterprises; FIEs: foreign-owned enterprises; POEs: Privately owned enterprises Source: compiled by the author based on strike statistics from VGCL (2017)*

In the period from 1995 to 2016 over 70% of strikes occurred in foreign-owned companies, while 24% of strikes were in private ones and the SOEs had almost no strikes. Over 64% of strikes happened in the Southern industrial areas, especially Ho Chi Minh City, Binh Duong and Dong Nai. In terms of industries, garment and textile were the most affected by strikes with 37% of strikes, followed by footwear and wood processing (VGCL 2017).

Another noteworthy feature of wildcat strikes in Vietnam is the fact that between 1995 and 2016, 70% of strikes occurred in unionised companies (VGCL 2017). This fact indicates that enterprise unions have been ineffective in representing workers in negotiations with employers and partially explains the explosion of wildcat strikes that have emerged since 2000.

None of the strikes so far followed the legal procedure and none were led by the trade unions. However, *wildcat strikes have become the most important method for workers to bargain for higher wages and better working conditions*(Clarke et al. 2007; Do and van den Broek 2015). According to the 2011 survey by ILO, employers accepted all workers' demands in 90% of strikes (ILO 2011). One of the important reasons for wildcat strikes having been successful for workers was the approach by local authorities and the VGCL to settle strikes. Strikes were usually settled by a strike taskforce, composed of the local labour administration and upper-

level union representatives, who collected workers' demands and then persuaded employers to accept them (ILO 2011). Strikers were normally not punished and were also often paid for the strike days.

While the enterprise unions played no role in organising wildcat strikes, the upper-level unions have been active in settling disputes via the strike taskforces. However, the upper-level unions usually relied on their political power to pressure the employers to accept workers' demands rather than taking strikes as opportunities to negotiate with employers on behalf of the workers (Do and van den Broek 2015; Clarke et al 2007).

#### **4.3. Gender equity**

Women account for 70% of the rank-and-file labour force in the textile and garment industry. However, women are paid less than men for the same jobs: unskilled female workers are earning 15.6% less than men, while the pay gap for technicians is 16.4% (GSO 2016b). Women make up the majority of union membership in the garment industry; yet, over 70% of union leadership is taken up by men (VGCL 2017).

In the 2014 survey by Better Work Vietnam (2014) covering 2,500 workers in 98 member factories, it was found that gender-based occupational segregation in garment industry is pronounced: 49% of female workers surveyed were sewers and more men than women are found in higher-skilled and better-paid roles such as 'cutter', 'packer', and 'supervisor'. Women were less likely to be promoted and to receive training than men; less than 14% of women have been promoted compared with about 25% of men. This is despite the fact that women, on average, had been employed at the same factory for a longer period of time than men. The proportion of workers who believed barriers to promotion exist was almost 100%. A significant share of workers considered the relationship with their supervisor as the main obstacle to promotion. Women believed so more than men.

The difficulties for migrant women are particularly acute: 60% of women working in industrial zones are rural migrants; yet 90% of the female migrants have difficulties to access basic social services in their destination provinces. For instance, 71% of the female migrant workers do not

have access to public, health services and 21.2% of the children of 6-14 years old, accompanying the migrant workers, cannot go to school (M-Net 2018).

## **Chapter 5: Conclusion**

The study has investigated economic and social upgrading in the textile and garment industry of Vietnam for the past 15 years. Overall, the industry has seen significant quantitative expansion in terms of production and export value in all three areas of fibre, textile and clothing manufacturing. The expansion of the sector, however, is attributed more to the increase of capital and labour rather than technological innovation or economic upgrading at the production level. In fact, the garment industry reported little progress in product, process, functional and sectoral upgrading. One key reason for this can be found in the strategy of international buyers to limit transfer of technology to protect their business advantage. However, more importantly, Vietnam lacks a clear industrial masterplan to provide good incentives to the textile and garment industry to upgrade. The current incentives prove to be counter-productive, as they tend to create more obstacles to the local industry.

The first-tier suppliers or the larger, export-oriented garment firms have observed certain progress in social upgrading in the past 15 years thanks to the strict scrutiny of the international brands and civil society organisations. Still, issues such as union rights, worker protection, and gender discrimination persist. The SMEs and household businesses which account for the majority of firms in the industry, however, face a number of serious labour problems including child labour, forced overtime, and wildcat strikes. Particularly the rural migrant workers face acute difficulties in accessing basic social services in their destination localities, including limited access to clean water and decent accommodation, education for their children and public healthcare.

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