

**Diversification, risk management and risk coping strategies:  
Evidence from rural households in three provinces in Vietnam**

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**Abstract**

The paper analyzes the relationship between the allocation of labor and land, the number of crops grown and income sources of rural households in Vietnam and different types of shocks and risks. It uses the data from the first phase of the household survey in three provinces of Central of Vietnam, conducted within the scope of the DFG research project “Impact of shocks on the vulnerability to poverty: consequences for development of emerging Southeast Asian economies”. The results suggest that the households diversify their portfolio (labor and land) into different income generating activities in order to cope with shocks. Among the different types of shocks and risks, agriculture and economic shocks and risks are the main factors to explain the (ex-post) risk-coping strategies and the (ex-ante) risk management of the households. The number of crops grown and the number of income sources from the households experienced with shocks are higher than others. In addition, the high-risk expectation households diversify their labor and land more than the low risk expectation households. The access to credit and market, the number of household labor, the education of the household head, and the wealth of the household are also very important factors that impact on the diversification level of the households.

*Keywords: Diversification, risk management, risk coping strategies, Vietnam*

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## 1. Introduction

Poor households in developing countries generally face many uncertainties stemming from extreme weather conditions, market imperfection, and misguided policy regulations, in addition to the recent rapid liberalization and globalization process. Hence, income risk is generally high in developing countries making rural households particularly vulnerable to covariate and idiosyncratic shocks (Dercon; 1999). The complete absence or only partial existence of formal insurance and credit markets (Besley 1994) prompts households to adopt self insurance mechanism. In fact, as shown by Dercon (1999) households living in high risk environments have developed rather sophisticated (ex-ante) risk management and (ex-post) risk-coping strategies.

Numerous studies have investigated diversification in developing countries. For example, Menon (2006) examined the effect of rainfall uncertainty on occupational selection in rural Nepal and found that occupational choice is mainly determined by the uncertainty associated with historical rainfall patterns but this negative effect is less obvious in households that have access to credit. He suggested that improving access to credit markets for poor households may help reduce their vulnerability to rain shocks. When examined the vulnerability and responses to covariate flood shocks and idiosyncratic health shocks among peasant households in the Amazonian tropical forests, Takasaki (2002) found that households have four typical coping strategies, including alternative activities (gathering, fishing, and upland cropping), precautionary savings (food stock and asset disposition), labor adjustment, and informal insurance mechanisms (e.g., mutual insurance). Karugia (2006) evaluated the role of land on income diversification and poverty reduction in rural Kenya and found that poorer households tend to depend more heavily on food-crop production and seasonal wage labor activities for their incomes and are therefore likely to be vulnerable in face of personal (such as illness) and covariate shocks such as droughts.

In Vietnam, Minot et al.(2006) used the three Vietnam Living Standard Surveys (1993, 1998 and 2002) data to examine the trend of income diversification and poverty in Northern Upland of Vietnam. They found that income diversification including crop diversification, has increased in this region over time. Poorer households are more diversified in crop production than richer ones, and rural households are more diversified than urban. On the national level, crop diversification contributed about 12% of the growth of crop income with large variation among income groups. Non-farm income is becoming an important source of income of the household although it has grown only slowly during 1998-2002 period. Using the same data of the Vietnam Living Standard Survey (1993 and 1998), Van de Valle et al.(2004) examined the role of the participation in the rural non-farm market economy on the poverty and found that it will be the route out of poverty for some, but not all poor households. In addition, education, ethnic minority and commune characteristics are influencing on the consumption growth and level of diversification in the same way but some other factors have opposite effects such as household size is positive for diversification but negative for welfare, land size has positive impact on the welfare but negative on diversification.

Most current papers have analyzed income diversification in the context of economic growth and poverty. However, these analyses did not always adequately capture the dynamic nature of poverty. For example, the role of past environmental and economic shocks can play in explaining diversification has often been ignored in the literature as this requires time series

data of shock events. This paper explores this aspect for the case rural households in three provinces in Central Vietnam, namely Ha Tinh, Hue and Dak Lak. The data used for this analysis come from the first phase of a panel household survey carried out under the auspices of the DFG research project “Impact of shocks on the vulnerability to poverty: consequences for development of emerging Southeast Asian economies”. A total of some 2200 households were interviewed on their socio- economic status, health, education, income, consumption, assets, borrowing and the shocks that they experienced during the past five years. A simple model is developed that uses different diversification parameters to investigate the effect of household characteristics as well as those of past shocks and anticipated risks on the diversification of labor and land resources of rural households.

The paper is organized as follows. In the next section a brief assessment of the type of risks that occurred in Vietnam in the recent past is presented. This can help to set the frame for specifying the role of shocks that were observed from the survey. Section 3 provides the methodology for measuring diversification. Section 4 presents the data and the model specification and section 5 presents the empirical results. The last section is summary and conclusion.

## **2. Agricultural Risks in Vietnam**

To a large extent, rural households in Vietnam depend on agriculture as the main source of income. However, income from agriculture tends to be become less stable for two major reasons. First, the increasing environmental risks and second the economic risks incurred with Vietnam’s rapid development. Natural disasters such as typhoons, storm surges, flash floods, drought, and saline water intrusion are increasing. In 2007, more than 400 people were killed by natural disasters, 6936 houses and 975 schools were destroyed. The total economic value of losses was estimated at USD 704 million (XHMT- GSO 2007). Natural disasters affect particularly the center coastal region where typhoons, storm surges, flash floods, drought, saline water intrusion often happened during the year. Drought is often recorded in Central Highland while floods, typhoons and storms are very frequent in North Central Coast (Chaudhry and Ruyschaert 2007). Vietnam in recent years is also increasingly being affected by livestock diseases such as Avian Flu and Foot and Mouse Disease. Rural households are mostly affected by these risks with strong implications for the economy considering that the agricultural sector accounts for almost half of total household income and absorbs 64% of the labor force in Vietnam (VHLSS 2006). The likelihood of disasters is also increasing as a result of global warming. A recent study by Dasgupta et al.(2007) on the potential impacts of sea level rise in 84 coastal developing countries showed that a 1-metre rise in sea level would have an effect on approximately 5 percent of Viet Nam’s land area, affect 11 percent of the population, impact on 7 percent of agricultural land, and could reduce GDP by 10 percent.

The economic risks for agriculture and rural areas are a result of Vietnam’s open economy policy. The process of liberalization and rapid integration into the world economy with reducing trade protection and subsidies makes the domestic markets become more exposed to fluctuations of the international markets. A good example is coffee in the Central Highlands, where, as a result of coffee price collapse, farm labor is moving to both wage and self employment despite low compensation. The rapidity of shifts in the sources of income for the Central Highlands observed during 1998-2002 (World Bank 2002) demonstrated the impact of external market on the rural economy.

### 3. Methodology to measure diversification

In developing countries rural households often depend on a few sources of income (Reardon 1997; Toulmin et al. 2000). Ersado (2006) summarizes key factors that can explain the income diversification strategy which a household can choose. These include: (a) self- insurance against risk in the context of missing insurance and credit markets, (b) an ex-post coping strategy, (c) an inability to specialize due to incomplete input markets, (d) a way of diversifying consumption in areas with incomplete output markets, (e) to exploit strategic complementarities and positive interactions between activities, and (f) simple aggregation effects where the returns to assets vary by individual or across time and space. In the absence of good formal insurance and credit markets, agricultural households in Vietnam have basically two options to reduce income variability. The first option refers to land allocation decisions and the second refers to the reallocation of labor.

On land, households may select an agricultural enterprise where the correlation between price and yield is low or by adjusting the crop portfolio to the specific characteristics of their land, i.e. growing different crops or different parcels on land in order to minimize the effect of biotic or abiotic stresses. The second option is that households reallocate their labor into non-farm activities as wage income is largely uncorrelated with agricultural income. In addition non farm income can help to accumulate assets in a good agricultural year which increases the household's capacity to smooth consumption in the years with shocks affecting agriculture.

The actual degree of diversification chosen by a household depends on several factors. First is the initial conditions, i.e. how strongly his income varies and what their capacity to smooth consumption is. Second is the household's preferences towards risk and third is the cost of diversification, i.e. the amount of income reduction for reducing risk. Risk averse household will tend to diversify more and will accept higher risk premiums. For example, Morduch (1990) found that credit-constrained households are more willing to sacrifice income in order to reduce risk. In order to better understand income diversification strategies actual portfolio diversification needs to be analyzed as the share of each income source in total income depends on the allocation of household resources for each income generating activity, including liquid capital, assets and labor allocation (e.g. Barrett 2000; Minot 2006).

There are different methods that can be applied to measure diversification as discussed by Culas et al. (2005) and Minot et al.(2006). Culas et al.used four indices to measure diversification. The first index is called *Index of maximum proportion (MI)* and it is defined as the ratio (proportion) of the farm's primary activity to its total activities. It is measured as the maximum proportion of the crop acreage in activity  $i$  in total farm acreage cropped so the diversification increases when  $MI$  decreases. This index has the limitations as it does not take into account the balance in planting area among the other crops as well as the total number of crops grown. With the same value of  $MI$ , the households having more crops grown or more balancing in term of the share of planting area among the rest of crops (excluding the biggest proportion of planting area crop) could have more diversification than other households. The second index is the number of activities ( $M2$ ) that the farm operates and as pointed out by the author, the weakness of this index is that it gives no weight to the distribution of the farm's employment over the activities. The third index is the *Herfindahl index (M3)* that is measured by taking the square of the shares of a farm's activities, gives a particular weight to the farm's principal activities. As it gives limited weight to minor activities, this index is insensitive to

minor activities. The fourth index is *Entropy index (M4)*, this index gives less weight to the larger activities by multiplying the share of activity  $i$  by a log term of the inverse of the respective shares. However, both  $M3$  and  $M4$  cannot be applied for cases where household incur negative income from their income generating activities. Therefore, these indices could not be used for estimating income diversification. Minot et al. used  $M2$ , *Share of income from non-farm in total income* and the SID index to measure income diversification.

In this study we use the Simpson index of diversity to measure the portfolio diversification of the household:

$$SID = 1 - \sum_i P_i^2$$

where  $P_i$  is the proportion of household portfolio that is allocated to income generating activity  $i$ . The index takes into account the number of income generating activities, the share of household resources allocated to each activity and gives more weight to the activity with a higher share of household portfolio allocation. The index ranges from 0 to 1 with 0 if a household devotes all resources to one income generating activity and approaching 1 if the number of income generating activities is very high.

In this paper the SID index is applied taking into account the resource capacity of the household. The SID index for labor allocation was based on the main occupation of the household member aged from 10 to 60. Household labor was classified into three types, namely agriculture, wage employment and non-farm self-employment. The SID index for land area was based on the area that households allocated to each crop during the crop year 2006/07. Income sources were specified by major sources, namely income from crops and forestry, income from livestock and aquaculture including hunting, income from non-farm self-employment, income from wage employment, income from public transfer, income from dividend and capital gain, income from remittances, and other income such as income from indemnity. About 30 different crops were included in the crop diversification index.

Like the *Herfindahl and Entropy indexes*, the SID index in principle can also be used for measuring income diversification. The problem is the occurrence of negative net income. Therefore, in addition to income shares, the total number of income sources and the number of crops grown were used as additional measures of diversity ( $M2$ ).

## 4. Data and Model Specification

### 4.1. Data

We use the data from the first phase of the survey in three provinces in Central of Vietnam of the project “Impact of shocks on the vulnerability to poverty: consequences for development emerging Southeast Asian economies”. This survey was conducted in Dak Lak, Hue and Ha Tinh provinces from June to August 2007. There were 2200 households that were randomly selected for interview from 220 villages in 110 communes in all districts of these provinces. The sample was distributed proportionately to the population size of each district with some adjustments to over-sampling in the remote areas where the population is small and thus the

number of households would have been insufficient for the estimation<sup>3</sup>. Hence a weighting procedure was used to adjust for over-sampling in remote areas. Two questionnaires were used in this survey, one for the household and the other for the village. The household questionnaire collects information about various aspects of socio-economic conditions of the household. It includes demographic conditions, migration, education, health, agriculture, off-farm and non-farm employment, borrowing and lending, remittance, insurance, consumption and assets. In addition, there is a special section that collects information about the different types of shocks that the household has experienced since 2002 and the different types of future risks that the household perceived. It includes the common (flood, drought, storm, avian flu,) and the idiosyncratic (sick, death, accident, lost of job, bankruptcy) shocks and risks. For each type of shock and risk, the respondent was asked to evaluate the impacts on the household as well as the coping strategies that household used to cope with the shock. The village questionnaire is used to interview village leader with the purpose to collect information about infrastructure and basic public goods such as access to the market, road, irrigation system that could affect the livelihood of the households (Questionnaires are posted in <http://www.vulnerability-asia.uni-hannover.de/390.html>).

#### 4.2. Model Specification

A simple linear regression model was used to measure the effect of shock and risk on the portfolio and income diversification of the household.

$$(1) \quad Y_{ij} = \beta_0 + \beta_k X_{ijk} + \gamma_n S_n + \varphi_m R_m + \varepsilon_{ij}$$

Where:

$Y_{ij}$  are the SID indexes of labor, land of the household  $i$  in village  $j$ , the number of income sources, the number of crops grown of the household  $i$  in village  $j$ .

$X_{ijk}$  are control variables for factors, which are believed to influence the diversification decision of a household. These include household and village characteristics. Furthermore, the total asset lost due to the shock, which could reduce the chance of household to recover production with a possible negative impact on the diversification of the household. Access to credit, however, could help the household to expand its production and facilitate the change in crop patterns as well as to move labor working in agriculture into other sectors. Therefore, it could have a positive effect on the diversification of the household. We expect the same sign for total assets for production on the diversification. Households with more assets for production could have a higher chance to diversify its labor and land. Labor is an important input of the production so the household with more labor (measured as the number of people aged from 10 to 60) could have more chance to diversify in agriculture production as well as in non-farm activities thus this variable could have positive impacts on the dependent variable. In Vietnam, there is a big difference between Kinh & Chinese ethnic group with the ethnic minority group in terms of economic status and in culture. Therefore, an ethnic minority variable is added in the model. The age of the household head is a proxy of the indicator reflecting the working experience that is also added on the model to control the

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<sup>3</sup> Detail information about sample design of this survey is discussed in “Sampling for vulnerability to poverty: Cost effectiveness versus precision”. Bernd Hardeweg, Suwanna Praneetvatakul, Tung Phung Duc and Hermann Waibel

impact of this variable on the diversification. Education could have positive impacts on the diversification of both labor and land of the household as higher education gives better opportunities to work in the non-farm sector that requires skilled labor. In addition, household heads with higher education are expected to manage and allocate their resources better than the household head with lower education. The sex of the household head might also effect on diversification so this variable is included in the model. In order to grow more crops, the household needs more land. Hence, the total owned land area could have positive effect on land diversification and the number of crops grown by household but it could have an opposite effect on labor diversification as it absorbs more labor to work in agriculture. The Land Use Certificate (LUC) reflects the ownership status of the household on the land so the household could invest more on the LUC plots. In addition, the irrigated land could allow the household to specialize on high value crops. Therefore, these factors could favor specialization. People living in the mountainous area or far away from the urban area generally have a lower chance to work on the non-farm activities due to lack of information and high transaction costs, such as transportation. Thus we expect a negative effect on labor diversification. On the other hand, this could have positive effect on the land and crop diversification due to high transaction costs for buying and selling the products. The dummy variables to control the difference in diversification among three provinces are added on the model. The descriptive statistics of the dependent and independent variables are shown in the table 3 in section 5.

The effect of shocks on diversification was measured in different ways. First, we define  $S_n$  as a dummy variable in order to investigate the difference between households who, during the past five years, suffered from one or more shocks and those who did not. In the second step, shocks were defined as a continuous variable, i.e. taking the number of shocks that household has been experienced from 2002 to 2006. In the third step, different types of shocks were defined as dependent variables<sup>4</sup>. Hereby, shocks were divided into four groups. These groups are demographic and health shocks, including the illness and death of a household member, social shocks such as conflicts with the neighbor in the village, agricultural shocks such as natural disasters (flood, drought, or pests), and diseases and economic shocks, such as job loss or the collapse of a business. The variable  $S_n$  that represents for each group of shocks is measured as the number of shocks that household experienced in the past 5 years for each group.

$R_m$  is defined as a risk variable. In the household survey, respondents were asked to assess the likelihood of different types of events that they expected would take place in the next 5 years and the impacts of these events on the household. The definition of events on this subsection is the same as in the shock section. Therefore, the  $R_m$  variable has the same variable labels as the  $S_n$  variable except that  $R_m$  reflects the risk management strategy of the household while  $S_n$  refers to the risk coping strategy.

It is reasonable to assume that village characteristics might simultaneously correlate with both diversification and shock. Households living in the same village are often affected by common shocks such as natural disasters, crop and livestock diseases and they also have the same production pattern, especially in agriculture production. Therefore, this interdependence could impair the identification of the estimation of (1). To control these factors and the

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<sup>4</sup> We use the same shock classification as in the household questionnaire of the survey

unobserved external variables, a village- fixed model was formulated where and these factors and unobserved external variables are captured by fixed- effects  $V_j$  :

$$(2) \quad Y_{ij} = \beta_0 + \beta_k X_{ijk} + \gamma_n S_n + \varphi_m R_m + V_j + \varepsilon_{ij}$$

## 5. Results

Table 1 in the appendix shows the distribution of different shocks among three provinces during the past 5 years. Illness of the household, drought, floods, livestock diseases and unusual heavy rainfall are the major shocks that happened in these provinces. However, drought is most popular in Dak Lak while floods usually occur in Ha Tinh and Hue. Hue has a much higher percentage of households affected by unusual heavy rainfall while Ha Tinh has a higher percentage of households affected by livestock diseases. Table 2 shows some key indicators of the three provinces. Ha Tinh is the poorest province measured by the percentage of poor households and the income per capita while Dak Lak is the richest province. In addition, households living in Dak Lak have about 43% of income from crops while households in Hue and Ha Tinh are less dependent on the income from crops.

**Table 2. Summary statistics of key indicators of the three provinces**

	<i>Ha Tinh</i>	<i>Hue</i>	<i>Dak Lak</i>
Poor households (%)	48.0	30.7	28.9
Income from crop production (thousand VND)	3155.7	3361.4	14077.1
Total income of the household (thousand VND)	19136.5	23862.2	32990.3
Income per capita per month (thousand VND)	443.9	488.5	678.8
Share of income from crop (%)	16.5	14.1	42.7

Table 3 shows the summary statistics of all variables. Over three-fourth of the households reported at least one shock in the past five years. The main types of shocks are agriculture and demographics shocks. In terms of shocks expected in the future an even higher proportion of the respondents (94%) expected at least one event to take place in the next 5 years.

Table 3 also shows the variables for diversification. On average, each household has about 4 income sources and 2 crops grown. It reflects the specialization in agriculture production in these provinces, especially in Dak Lak where coffee production is dominant. The results of SID land and labor indices (0.22 and 0.23, respectively) also show the low level of diversification of the rural households in these provinces.

**Table 3. Summary statistics of variables**

<i>Variables</i>	<i>Obs</i>	<i>Mean</i>	<i>Std. Err.</i>	<i>Min</i>	<i>Max</i>
<i>Dependent variables</i>					
Number of income sources	2152	3.91	0.04	1.00	8.00
Number of crops grown	2152	1.87	0.07	0.00	8.00
SID land index	2152	0.22	0.01	0.00	1.00
SID labor index	2152	0.33	0.01	0.00	0.72
<i>Independent variables</i>					
<i>Household characteristics</i>					
Household has experienced at least one shock in the past 5 years (1=yes, 0=no)	2152	0.78	0.01	0.00	1.00
Number of shocks that HH experienced from 2002 to 2006	2152	1.35	0.03	0.00	4.00
Number of Demographic shocks from 2002 to 2006	2152	0.44	0.02	0.00	4.00
Number of Social shocks from 2002 to 2006	2152	0.03	0.00	0.00	2.00
Number of Agriculture shocks from 2002 to 2006	2152	0.73	0.03	0.00	4.00
Number of Economics shocks from 2002 to 2006	2152	0.08	0.01	0.00	3.00
Household expected at least one risk in the next 5 years (1=yes, 0=no)	2152	0.94	0.01	0.00	1.00
Number of risk that HH expected in the next 5 years	2152	4.47	0.09	0.00	9.00
Number of Demographic risks	2152	1.56	0.06	0.00	5.00
Number of Social risks	2152	0.57	0.03	0.00	4.00
Number of Agriculture risks	2152	2.52	0.08	0.00	8.00
Number of Economics risks	2152	1.64	0.08	0.00	7.00
Total asset lost due to shocks in the past 5 years (VND million)	2152	4.10	0.33	0.00	220.00
Household is currently borrowing (1=yes, 0=no)	2152	0.74	0.01	0.00	1.00
Total asset value for production of the household (VND million)	2152	7.84	0.56	0.00	518.41
Total asset value for crop production of the household (VND million)	2152	7.25	0.50	0.00	518.41
Total household member aged from 10 to 60	2152	3.66	0.05	0.00	11.00
Ethnicity of the household (1= Kinh & Hoa, 0=other)	2152	0.84	0.02	0.00	1.00
Age of the household head	2152	48.27	0.38	17.00	99.00
Square age of the household head	2152	2519.12	39.99	289.00	9801.00
Number of years in school of the household head	2152	6.78	0.15	0.00	20.00
Sex of the household head (1=male, 0=female)	2152	0.84	0.01	0.00	1.00
Total land area owned by household (hecta)	2152	0.73	0.05	0.00	40.76
Share of the household land area having Land Use Certificate (LUC)	2117	0.66	0.02	0.00	1.00
Share of the irrigated land of the household	2152	0.39	0.40	0.00	1.00
<i>Village characteristics</i>					
Distance from village to District town (km)	2152	13.75	1.05	0.20	75.00
Village is located in the mountain (1=yes, 0=no)	2152	0.42	0.04	0.00	1.00
Ha Tinh province (1=yes, 0=no)	2152	0.38	0.00	0.00	1.00
Hue province (1=yes, 0=no)	2152	0.22	0.00	0.00	1.00
Dak Lak province (1=yes, 0=no)	2152	0.39	0.01	0.00	1.00

### *5.1. Diversification of labor allocation*

To investigate the effects of shocks, six different variants of the model were tested, i.e. with the three different ways of including shocks as well with and without fixed effects. The shock variables were included as dummy variables (model 1 and 2), as count variables for all shocks (model 3 and 4) and by type of shocks (model 4 and 6). Results of all models are shown in table 4. Model 1 & 2 illustrate that households who experienced shocks during the past five years were significantly more diversified in labor allocation for both cases with and without the fixed village effects. When counting the number of shocks (model 3 & 4) only the fixed effects model is significant. Specifying shock variables by type shows that only in the fixed effects model, agricultural shocks are significant. This indicates that households used labor diversification as one of the (ex-post) risk-coping strategies.

The risks which households expect seem to also have significant influence on diversification (model 3 & 5). This is reasonable as current portfolio decisions are made to increase and stabilize future incomes. The result also shows that the high risk averse household diversify his labor more than the low risk averse household. Among the different types of risks, agriculture and economic risks are the main factors to explain the (ex-ante) risk management of the household, measured by labor diversification.

In order to move labor into other production sectors, especially into non-farm self-employment, a household needs money to invest on the labor skill, initial investment to set up a business. One of the capital channels is to take loans from a bank or other lenders. Access to credit is a strong positive, significant impact on the level of labor diversification of the household and the coefficient is consistent among the models. The level of labor diversification is obviously dependent on the number of labors in the household. The household with more labors will allocate some of them into non- agricultural sectors to maximize the production efficiency. The age of the household head has a negative effect on labor diversification of the household but education measured by number of years in school of the household head has a significant positive sign. The household owning more land and having a higher share of land with Land Use Certificate (LUC), could invest more in agriculture and thus requires more labor. As a result, the land area owned by the household and the share of land with LUC have a negative sign; however, these factors are not statistically significant. It was also found that households living far from the district town and households living in the mountainous areas are significantly less diversified than other households. In addition, households living in Hue province where the degree of urbanization is higher and is the highly concentrated in tourism are much more diversified than the households living in Dak Lak or Ha Tinh. The omission of village variables in the fixed effects model reduced the overall fit of the model suggesting that location factors are an important determinant of labor diversification.

**Table 4. Determinant of SID labor index**

Independent variables	Dependent variable: SID labor index of the household					
	1	2	3	4	5	6
	coef	coef	coef	coef	coef	coef
Household has experienced at least one shock in the past 5 years (1=yes, 0=no)	0.043***	0.055***				
Household expected at least one risk in the next 5 years (1=yes, 0=no)	0.007	-0.000				
Number of shocks that HH experienced from 2002 to 2006			0.007	0.012**		
Number of risks that HH expected in the next 5 years			0.006***	0.003		
Number of Demographic shocks from 2002 to 2006					0.008	0.010
Number of Social shocks from 2002 to 2006					-0.016	-0.010
Number of Agriculture shocks from 2002 to 2006					0.004	0.015*
Number of Economics shocks from 2002 to 2006					-0.015	0.005
Number of Demographic risks					-0.004	0.000
Number of Social risks					-0.005	-0.010
Number of Agriculture risks					0.009***	0.005
Number of Economic risks					0.009**	0.006
Total asset lost due to shocks in the past 5 years (VND million)	-0.001	-0.000	-0.001	-0.000	-0.000	-0.000
Household is currently borrowing (1=yes, 0=no)	0.025*	0.017	0.023*	0.017	0.022*	0.017
Total asset value for production of the household (VND million)	-0.000	0.000	-0.000	0.000	-0.000	-0.000
Total household member aged from 10 to 60	0.028***	0.027***	0.027***	0.026***	0.028***	0.026***
Ethnicity of the household (1= Kinh & Hoa, 0=other)	0.027	0.005	0.028	0.006	0.030	0.003
Age of the household head	0.002***	0.002***	0.002***	0.002***	0.002***	0.002***
Number of years in school of the household head	0.004***	0.005***	0.004***	0.005***	0.004***	0.005***
Sex of the household head (1=male, 0=female)	0.003	-0.006	0.003	-0.007	0.004	-0.007
Total land area owned by household (hecta)	-0.005	-0.003	-0.004	-0.003	-0.005	-0.003
Share of the household land area having Land Use Certificate (LUC)	-0.013	-0.019	-0.013	-0.019	-0.015	-0.020
Share of the irrigated land of the household	-0.000	-0.000	-0.000	-0.000	0.000	-0.000
Distance from village to District town (km)	-0.001**	(dropped)	-0.001*	(dropped)	-0.001**	(dropped)
Village is located in the mountain (1=yes, 0=no)	0.044***	(dropped)	0.042***	(dropped)	-0.036**	(dropped)
Hue province (1=yes, 0=no)	0.055***	(dropped)	0.061***	(dropped)	0.063***	(dropped)
Dak Lak province (1=yes, 0=no)	0.010	(dropped)	0.017	(dropped)	0.013	(dropped)
_cons	0.228***	0.246***	0.229***	0.260***	0.221***	0.260***
Number of observations	2,137	2,137	2,137	2,137	2,137	2,137
Adjusted R2	0.111	0.082	0.112	0.085	0.116	0.086
Village fixed- effect	No	Yes	No	Yes	No	Yes

note: \*\*\* p<0.01, \*\* p<0.05, \* p<0.1

## *5.2 Diversification of land*

Land diversification is mainly related to agriculture and economic shocks. It can be assumed that the correlation in terms of income variability among the crops is imperfect positive. Different types of shocks could impact on the different types of crops. Therefore, households might allocate agricultural land to different crops and balancing of land allocation for each crop to manage the risk in agricultural production. Table 5 shows that shocks have a strong positive significant impact on the land allocation among the crops of the household. Like the impact of the diversification of labor, the more shocks that households experienced in the past 5 years, the more balance we found in terms of land allocation among the crops and higher number of crops grown by the household. As expected, agriculture shocks strongly influence land diversification decisions of farm households (see results of model 5 & 6). Economic shocks have a negative effect on land diversification but it is not significant when we use the village fixed- effect model. A possible explanation is that economic shocks could reduce the price of output (crop products) and increase the price of input of crop products. Therefore, households could switch to producing high yield and high value crops. As a result, the land diversification measured by SID index is reduced. Agricultural risks also have a significant, positive effect on the land diversification but the effect is smaller than for agriculture shocks. Apparently households who expect more agricultural risks in the near future apply a more balanced land allocation and grow more crops grown than the other households (see results of model 5 and 6).

Households with more assets for crop production could concentrate on producing the tradable high value crop products, reducing the number of crops grown as well as the diversification of their land. Asset for crop production had a significant negative sign. The number of laborers has a strong positive significant effect on land diversification, and the age of the household head shows a non-linear correlation with land diversification. A possible reason is that households heads as they gain more experience in their life as a farmer will concentrate on the crops that give high revenues. The irrigated land allows the household to specialize their crop production and then reduce the balancing of land allocation. Households living in a place far from the market might have to grow more crops to satisfy their consumption and food security needs. We found that the households living in the mountainous area and far from the market are more diversified than households living in more urbanization place (for example in Hue province). This finding is consistent with the finding of Minot et al.(2006) and Pandey et al.(2006) for the households in Northern Upland of Vietnam.

**Table 5. Determinant of SID land index**

Independent variables	Dependent variable: SID land index of the household					
	1	2	3	4	5	6
	coef	coef	coef	coef	coef	coef
Household has experienced at least one shock in the past 5 years (1=yes, 0=no)	0.022	0.027**				
Household expected at least one risk in the next 5 years (1=yes, 0=no)	0.008	-0.020				
Number of shocks that HH experienced from 2002 to 2006			0.019***	0.014***		
Number of risk that HH expected in the next 5 years			0.006**	0.003		
Number of Demographic shocks from 2002 to 2006					0.006	0.002
Number of Social shocks from 2002 to 2006					-0.023	0.000
Number of Agriculture shocks from 2002 to 2006					0.044***	0.030***
Number of Economic shocks from 2002 to 2006					-0.058***	-0.005
Number of Demographic risks					-0.004	0.002
Number of Social risks					0.001	-0.003
Number of Agriculture risks					0.014***	0.007**
Number of Economic risks					-0.002	-0.001
Total asset lost due to shocks in the past 5 years (VND million)	-0.000	-0.001	-0.000	-0.001*	-0.000	-0.001
Household is currently borrowing (1=yes, 0=no)	0.020	0.016	0.012	0.012	0.009	0.013
Total asset value for crop production of the household (VND million)	-0.001***	-0.000*	-0.001**	-0.000	-0.000**	-0.000
Total household member aged from 10 to 60	0.010**	0.010***	0.009**	0.009***	0.008*	0.008***
Ethnicity of the household (1= Kinh & Hoa, 0=other)	-0.049	-0.047	-0.048	-0.044	-0.038	-0.044
Age of the household head	0.008**	0.006**	0.008**	0.006**	0.008**	0.006**
Age square of the household head	-0.000**	-0.000**	-0.000**	-0.000**	-0.000**	-0.000**
Number of years in school of the household head	0.000	0.001	0.000	0.001	0.001	0.001
Sex of the household head (1=male, 0=female)	0.001	0.003	0.001	0.003	0.001	0.002
Total land area owned by household (hecta)	0.006	-0.001	0.006	-0.001	0.005	-0.001
Share of the household land area having Land Use Certificate (LUC)	-0.005	-0.004	-0.005	-0.005	-0.004	-0.005
Share of the irrigated land of the household	-0.001***	-0.001	-0.002***	-0.001	-0.002***	-0.001*
Distance from village to District town (km)	-0.002*	(dropped)	-0.001	(dropped)	-0.001	(dropped)
Village is located in the mountain (1=yes, 0=no)	0.110***	(dropped)	0.110***	(dropped)	0.105***	(dropped)
Average travel time to go to market (minutes)	0.002***	(dropped)	0.002***	(dropped)	0.002***	(dropped)
Hue province (1=yes, 0=no)	-0.093***	(dropped)	-0.088***	(dropped)	-0.093***	(dropped)
Dak Lak province (1=yes, 0=no)	-0.018	(dropped)	-0.026	(dropped)	-0.023	(dropped)
_cons	-0.050	0.073	-0.056	0.051	-0.071	0.036
Number of observations	2,117	2,117	2,117	2,117	2,117	2,117
Adjusted R2	0.148	0.054	0.157	0.075	0.182	0.098
Village fixed- effect	No	Yes	No	Yes	No	Yes

note: \*\*\* p<0.01, \*\* p<0.05, \* p<0.1

### *5.3. Diversification in the number of crops grown*

One other way to measure diversification is to use the number of crops grown by the households. Table 6 shows the regression results of different models. It is clear that shocks have a strong significant positive impact on the number of crops grown by households. In addition, agricultural shocks and risks play a very important role to explain the difference in terms of number of crops grown among households. Demographic shocks have a significant, positive effect on the number of crops grown. A possible reason could be that household has to spend their money from saving or selling production assets due to the death or illness of a household member. Therefore, they could not produce high value crops as these crops need higher investment in both labor and capital. In contrast, social risks have a significant negative effect on the number of crops grown. The village fixed- effect models show a statistically significant negative effect total asset lost from shocks on the number of crops grown. Access to credit helps the household to expand agricultural production and therefore increases crop diversification. Irrigated land and mechanization as reflected in the level of assets allow the household to specialize crop production rather than to diversify. Land owned by the household and the household head being a male are the two factors that have statistically positive effect on the crop diversification. As expected, the households living in the mountainous areas and far from the market grow more crops than other households. In addition, the households living in Ha Tinh province, where the land is much more fragmented than other provinces, grow much more crops than other households living in Hue or Dak Lak. The results of this section also provides a clear picture, where the diversification of crop, measured as the number of crops grown, is one of the risk coping strategies and risk management activity to cope with agriculture shocks and risks.

**Table 6. Determinant of number of crops grown**

Independent variables	Dependent variable: Number of crops grown by household					
	1	2	3	4	5	6
	coef	coef	coef	coef	coef	coef
Household has experienced at least one shock in the past 5 years (1=yes, 0=no)	0.230**	0.296***				
Household expected at least one risk in the next 5 years (1=yes, 0=no)	0.027	-0.186*				
Number of shocks that HH experienced from 2002 to 2006			0.122***	0.152***		
Number of risk that HH expected in the next 5 years			0.049***	0.019**		
Number of Demographic shocks from 2002 to 2006					0.082*	0.101***
Number of Social shocks from 2002 to 2006					-0.138	0.017
Number of Agriculture shocks from 2002 to 2006					0.224***	0.221***
Number of Economic shocks from 2002 to 2006					-	0.031
Number of Demographic risks					-0.013	0.018
Number of Social risks					-0.074*	-0.095**
Number of Agriculture risks					0.108***	0.042**
Number of Economic risks					0.012	0.020
Total asset lost due to shocks in the past 5 years (VND million)	-0.003	-0.005**	-0.004	-0.006***	-0.002	-0.005**
Household is currently borrowing (1=yes, 0=no)	0.105*	0.104*	0.053	0.071	0.041	0.073
Total asset value for crop production of the household (VND million)	-0.003***	-0.003**	0.003***	-0.002*	0.003***	-0.002*
Total household member aged from 10 to 60	0.085***	0.081***	0.076***	0.074***	0.073***	0.066***
Ethnicity of the household (1= Kinh & Hoa, 0=other)	-0.197	-0.207	-0.193	-0.187	-0.148	-0.206
Age of the household head	0.031**	0.033**	0.029**	0.031**	0.029**	0.034***
Age square of the household head	-0.000**	-0.000**	-0.000**	-0.000**	-0.000**	-0.000**
Number of years in school of the household head	0.010	0.008	0.011	0.009	0.015*	0.010
Sex of the household head (1=male, 0=female)	0.148**	0.112*	0.147**	0.107	0.143**	0.105
Total land area owned by household (hecta)	0.072*	0.049***	0.074*	0.049***	0.071*	0.049***
Share of the household land area having Land Use Certificate (LUC)	0.067	0.023	0.067	0.023	0.063	0.019
Share of the irrigated land of the household	-0.004***	-0.001	0.004***	-0.001	0.004***	-0.001
Distance from village to District town (km)	-0.007*	(dropped)	-0.006	(dropped)	-0.006	(dropped)
Village is located in the mountain (1=yes, 0=no)	0.482***	(dropped)	0.489***	(dropped)	0.483***	(dropped)
Average travel time to go to market (minutes)	0.016***	(dropped)	0.015***	(dropped)	0.014***	(dropped)
Hue province (1=yes, 0=no)	-0.420***	(dropped)	-0.373**	(dropped)	0.397***	(dropped)
Dak Lak province (1=yes, 0=no)	-0.449***	(dropped)	0.475***	(dropped)	0.482***	(dropped)
_cons	0.257	0.716**	0.205	0.562*	0.131	0.496
Number of observations	2,117	2,117	2,117	2,117	2,117	2,117
Adjusted R2	0.202	0.071	0.217	0.098	0.243	0.107
Village fixed- effect	No	Yes	No	Yes	No	Yes

note: \*\*\* p<0.01, \*\* p<0.05, \* p<0.1

#### *5.4. Diversification in the number of income sources*

The most frequently used method to measure income diversification is the number of income sources. Table 7 shows the results of the regression models. It is obvious that shocks have a significantly positive effect on the number of income sources of the household. Households which experience at least once shock during the past 5 years have a higher number of income sources than the average household. The more shocks experienced by households, the higher the number of income sources. In addition, agriculture shocks and demographic shocks are two main factors that have a statistically positive significant effect on the number of income sources. Agriculture and demographic shocks make the household to reallocate their investment sources into different income generating activities to minimize the effects of a shock. Household who expect high risks in future behave in a similar way. However, as shown by the coefficient the effect is not strong. In addition, we found that there are only significant impacts of agriculture and economic risks on the number of income sources when we used the model without the village fixed effect (model 5) and these impacts disappeared in the village fixed- effect model (model 6). These results suggest that rural households in the three provinces diversified their resources into different income generating activities as only one of several shock coping strategies and risk management.

The loss of asset due to the shocks could reduce the capacity of the household to maintain all income generating activities. Therefore, we see a negative effect of this variable on the number of income sources. Once again, as the regression results suggest, access to credit plays a very important role for the household to recover production as well as to move into different income generating activities. The household, which is currently borrowing, has about 7% higher number of income sources than the average household. The number of laborers is also a significant determining factor on income diversification but effect is small. An ethnic minority household has much less income sources compared to the Kinh & Chinese household. As expected, education and age of the household head (as a proxy for working experience) have strong significant effects on the number of income sources. It is obvious that experience and education could give people more opportunities to move out of the agriculture sector. Households having more land could keep their laborers working on the agriculture sector and then have a significantly lower income diversification. The location of the household also plays an important role for diversifying income sources. Living far from the urban area is a barrier for household members to migrate and work in non- farm occupation. Therefore, we found that the households living in the village located in the mountainous area have a substantially significant lower number of income sources than other households. Finally, the households living in Dak Lak province have lower number of income sources than two other provinces, which in part can be explained by the high concentration of coffee growing and the lack of industrial development in this province.

**Table 7. Determinant of number of income sources**

Independent variables	Dependent variable: Number of the household income sources					
	1 coef	2 coef	3 coef	4 coef	5 coef	6 coef
Household has experienced at least one shock in the past 5 years (1=yes, 0=no)	0.316***	0.372***				
Household expected at least one risk in the next 5 years (1=yes, 0=no)	-0.057	-0.124				
Number of shocks that HH experienced from 2002 to 2006			0.097***	0.111***		
Number of risk that HH expected in the next 5 years			0.040***	0.012		
Number of Demographic shocks from 2002 to 2006					0.134***	0.107***
Number of Social shocks from 2002 to 2006					-0.135	-0.109
Number of Agriculture shocks from 2002 to 2006					0.078**	0.138***
Number of Economic shocks from 2002 to 2006					-0.076	0.038
Number of Demographic risks					0.014	0.002
Number of Social risks					0.006	-0.047
Number of Agriculture risks					0.050***	0.006
Number of Economic risks					0.048***	0.026
Total asset lost due to shocks in the past 5 years (VND million)	-0.007***	-0.003	-0.007***	-0.003	0.006***	-0.002
Household is currently borrowing (1=yes, 0=no)	0.270***	0.246***	0.240***	0.242***	0.234***	0.239***
Total asset value of the household (VND million)	-0.001	-0.000	-0.001	0.000	-0.000	-0.000
Total household member aged from 10 to 60	0.071***	0.067***	0.064***	0.064***	0.064***	0.063***
Ethnicity of the household (1= Kinh & Hoa, 0=other)	-0.264***	-0.330**	-0.254***	-0.321**	0.225***	-0.332**
Age of the household head	0.005***	0.005***	0.005**	0.005***	0.005**	0.005***
Number of years in school of the household head	0.030***	0.028***	0.030***	0.027***	0.030***	0.027***
Sex of the household head (1=male, 0=female)	-0.032	-0.041	-0.033	-0.047	-0.018	-0.047
Total land area owned by household (hecta)	-0.023**	-0.015	-0.022**	-0.015	-0.022**	-0.015
Share of the household land area having Land Use Certificate (LUC)	0.032	-0.006	0.036	-0.007	0.025	-0.011
Share of the irrigated land of the household	0.000	0.000	-0.000	-0.000	0.000	-0.000
Distance from village to District town (km)	-0.000	(dropped)	0.001	(dropped)	-0.000	(dropped)
Village is located in the mountain (1=yes, 0=no)	-0.321***	(dropped)	-0.311***	(dropped)	0.255***	(dropped)
Hue province (1=yes, 0=no)	0.114	(dropped)	0.151*	(dropped)	0.166**	(dropped)
Dak Lak province (1=yes, 0=no)	-0.220**	(dropped)	-0.197**	(dropped)	0.269***	(dropped)
_cons	3.302***	3.220***	3.204***	3.217***	3.152***	3.256***
Number of observations	2,137	2,137	2,137	2,137	2,137	2,137
Adjusted R2	0.093	0.047	0.101	0.054	0.114	0.051
Village fixed- effect	No	Yes	No	Yes	No	Yes

note: \*\*\* p<0.01, \*\* p<0.05, \* p<0.1

## 6. Summary and Conclusion

Vietnam is among the countries which could be severely affected by climate change and natural disasters as well as from the effects of globalization and integration into the world market. Using data from the first phase of the household survey in three provinces in Central of Vietnam, conducted within the scope of the DFG research project “Impact of shocks on the vulnerability to poverty: consequences for development of emerging Southeast Asian economies”, it can be concluded that self-insurance mechanisms are applied to cope with shock, which are mainly agricultural shocks. However our analysis generates some evidence that households diversify their portfolio into different income generating activities in order to cope with shocks. Among the different types of risks, agriculture and economic shocks and risks are the main factors to explain the (ex-post) risk-coping strategies and the (ex-ante) risk management of the households. Households diversify their labors to work in different sectors and their land into different crops and balance the share of labor in each sector and land for each crop in order to cope with shocks. As result, we found that the number of crops grown and the number of income sources from the households experienced with shock are higher than others. In addition, the high risk expectation households also diversify their labor and land allocation more than the low risk expectation households. Access to credit and the market, the number of the household labors, education of the household head, and the wealth of the household are also the important factors that drive the level diversification chosen by a household.

The results suggest the experience from the past shocks, the household characteristics and infrastructure are the very important factors to explain the existing farming system as well as the portfolio allocation decision of the household. With the dominant and increasing of the agriculture shocks, the poor infrastructure and lack of agriculture insurance system in rural area in Vietnam, there would raise the question whether increasing public investment (infrastructure, credit) could help the households to diversify their portfolio and then reduce the vulnerability to poverty. In addition, whether the diversification, one of the self- insurance mechanisms, is enough for household to cope with shocks or does it need to have the government insurance system that could protect the household to reduce the vulnerability of the shocks. The comparison with households in Thailand are also useful to have additional concrete findings. These are the suggestions for future analysis using the panel data from the DFG project.

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## 8. Appendix

Table 2. Shock distribution in three provinces

<i>Type of Shock</i>	<i>Ha Tinh</i>	<i>Hue</i>	<i>Dak Lak</i>	<i>Total</i>
Illness of household member	35.0	21.2	43.8	100.0
	28.5	26.8	19.6	23.5
Death of household member	46.5	17.1	36.4	100.0
	6.1	3.5	2.7	3.8
Household member left the house	37.4	11.4	51.3	100.0
	1.8	0.9	1.4	1.4
Person joined the house	15.9	26.3	57.8	100.0
	1.2	3.0	2.3	2.1
Money spent for ceremony	36.9	19.7	43.5	100.0
	1.9	1.5	1.2	1.4
Household Damage	33.2	5.9	60.9	100.0
	1.3	0.4	1.3	1.1
Theft	32.4	23.1	44.5	100.0
	1.4	1.6	1.1	1.3
Conflict with neighbor	13.0	21.9	65.0	100.0
	0.1	0.3	0.4	0.3
Relatives/Friends stop sending the money	0.0	46.5	53.5	100.0
	0.0	0.2	0.1	0.1
Flooding	40.5	27.9	31.6	100.0
	13.1	14.0	5.6	9.3
Drought	6.3	2.8	90.9	100.0
	4.6	3.2	36.6	21.2
Unusually heavy Rainfall	13.0	81.3	5.7	100.0
	2.7	26.3	0.7	6.0
Crop pests	27.4	9.7	62.9	100.0
	6.1	3.4	7.7	6.4
Storage pests	0.0	81.2	18.8	100.0
	0.0	2.7	0.2	0.6
Livestock Disease	50.3	10.4	39.3	100.0
	18.2	5.8	7.8	10.4
Landslide, Erosion	0.0	100.0	0.0	100.0
	0.0	0.1	0.0	0.0
Job Loss	31.61	17.16	51.24	100
	0.4	0.33	0.35	0.36
Collapse of business	40.19	19.19	40.62	100
	1.17	0.87	0.65	0.84
Unable to pay back loan	34.98	15.76	49.26	100
	0.27	0.19	0.21	0.22
Strong increase of interest	0	0	100	100
	0	0	0.5	0.26
Strong decrease of price of output	1.07	0.9	98.02	100
	0.13	0.17	6.55	3.51
Strong increase of price of input	0	0	100	100
	0	0	1	0.52
Be in debt	75.18	24.82	0	100
	0.65	0.33	0	0.25
Be in jail	31.89	3.98	64.13	100
	0.13	0.03	0.14	0.12
Lack of farm land	0	0	100	100
	0	0	0.21	0.11
Was cheated	80.82	0	19.18	100
	1.06	0	0.14	0.38
Work abroad	100	0	0	100
	0.39	0	0	0.11
Traffic accident	69.43	9.18	21.39	100
	6.75	1.39	1.14	2.81
Storm	7.13	92.87	0	100
	0.13	2.54	0	0.51
Built the house	37.56	12.08	50.36	100
	0.38	0.19	0.28	0.29
Other	64.53	9.51	25.97	100
	1.57	0.36	0.35	0.7
Total	28.86	18.59	52.54	100
	100	100	100	100