

The Vietnamese Garment Industry in the Post MFA Era:
Upgrading, Relocating, or Moving Out?

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Abstract

This paper investigates how key export oriented garment suppliers of Vietnam are coping with emerging challenges in the post MFA era. The garment industry is Vietnam's largest manufacturing based export sector, and is registering significant growth despite increased international competitiveness. The performance of those garment suppliers, however, is not even. While some were able to increase productivity and expand operations, others lagged behind in upgrading and stagnated in terms of competitiveness.

This diversity of individual firm performance seems to stem from, as well as result in, differences in their relationships to international production and distribution networks, and in responses to changes due to the abolition of the MFA. Moreover, as the economy of Vietnam is growing fast, domestic economic conditions have been changing rapidly with new jobs emerging and wages increasing. This is posing additional challenges to Vietnamese garment suppliers in terms of retaining and hiring workers. In response, many are relocating their production facilities to rural areas to overcome labor shortages and wage increases. Further development of the Vietnamese garment industry, however, cannot be sustained by reducing costs as untapped frontiers of cheap labor will eventually be exhausted. Instead, firms must be able to continuously upgrade in terms of process, product or function.

Where upgrading has not been successful, some suppliers are considering moving out from the garment industry and shift into other sectors. Such sectors are typically real estate related industries where profits are based primarily on the rising rental rates of land. Despite being rich with relatively high quality but cheap labor, the industry seems to be already peaking off at the weaker end before having maximized their competitiveness to the fullest extent.

Introduction¹

This paper investigates how the Vietnamese export oriented garment suppliers are coping with challenges from international integration. Garments are the largest manufactured export item of Vietnam, and the abolition of the Multi-Fibre Arrangement (MFA) has resulted in increased international competition.

International trade of textiles and garments have been under strict control since 1974 through an elaborate quota system known as the MFA. Under this, the largest garment markets in the world including the US and EU were restricting its imports to protect their own domestic suppliers. Such restrictions were levied according to items and export origin. In 1994, during the Uruguay Round of negotiations of the GATT, it was decided that this quota system was to be abolished gradually over a 10 years transition period until December 31, 2004. Thus after 2005, trade of textiles and garments were to be integrated into normal WTO rules (Thoburn, 2007; Yamagata, 2007).

The abolishment of the MFA led to increased international competitiveness in garment trade, and provided opportunities for competitive suppliers such as China and India to further expand their exports. At the same time, it also meant that the less competitive exporters would be facing threats as previous exports “guaranteed” under the quota system could now be substituted by supply from more competitive ones (Nordas, 2004). The easiest way to counter such shift is to reduce costs on factors of production. As the garment industry is very labor intensive, much of this would translate into lowering wages when productivity levels remain stable. However, reducing costs has its limitations, and to realize sustainable development of the industry, continuous upgrading will become inevitable.

In this context, this paper attempts to look at what kinds of qualitative changes the abolishment of the MFA has brought to the Vietnamese garment industry, what strategies have been applied by key suppliers in the industry in response to such changes, and what this implies to its development trajectory. In order to do this, this paper will analyze the industry by positioning Vietnam’s major garment suppliers within the international production and distribution networks. It uses the Global Value Chain (GVC) framework to illustrate how individual firm level strategies have resulted in

¹ This paper is an English translated and revised version of Goto, Kenta [2008], “Enterprise Strategies of Vietnamese Garment Manufacturing Companies in the Post MFA Era (Posuto MFA ni okeru Betonamu Housei Kigyo no Keiei Senryaku)” in Shozo Sakata eds. “The Changing Vietnamese Economy and its Economic Entities (Henyo Suru Betonamu Keizai to Keizai Shutai)”, Research Report (Chosa Kenkyu Houkoku Sho) 2007-IV-12, Institute for Developing Economies, Chiba.

process, product, or functional upgrading.

Firm level data and information used in this paper are mainly primary data collected through field work conducted in July and August of 2001, August 2002, and August 2007 in Hanoi and Ho Chi Minh City.

1. The growth of the Vietnamese economy and the garment industry

Vietnam has been growing fast since the implementation of the Doi Moi policy in 1986. Table 1 gives an overview of this growth trend.

Table 1 Growth of the Vietnamese Economy

	1986	1991	1996	2001	2002	2003	2004	2005	2006
GDP (Million US\$, 2000)	12,221	15,913	24,357	33,322	35,681	38,300	41,284	44,765	48,421
Real GDP Growth Rate (Annual, %)	2.79	5.96	9.34	6.89	7.08	7.34	7.79	8.43	8.17
Average GDP Growth Rate (5 Years Moving Average)*	3.24	6.15	7.40	6.24	6.49	6.87	7.14	6.61	5.76
GDP per capita (US\$, 2000)	203	235	328	423	448	473	503	539	576

Note : The figure for 2005 is the average between 2003–2006, and for 2006 it is the average between 2004–2006.
Source: World Development Indicators (Online).

Real GDP quadrupled between 1986 and 2006, and per capita GDP tripled during the same period. Economic growth has particularly been strong since it started establishing trade relations with the Western economies in the 90s, and while it slowed somewhat after the Asian financial crisis in 1997, overall it has still been robust until today.

Table 2 provides an overview of the Vietnamese garment industry. The numbers of firms and workers in the garment industry has been constantly increasing in both absolute terms as well as in shares in the overall economy, and the accumulation of capital in this sector has also been significant. Output grew more than five times between 1995 and 2005, and the share of output has also increased.

Table 2. Outline of the Garment Industry

	1995	2000	2001	2002	2003	2004	2005
Number of Enterprises	n.a.	579	763	996	1,211	1,567	1,745
Share in Manufacturing (%)	n.a.	5.6%	6.2%	6.7%	7.2%	7.6%	7.3%
Number of Workers	n.a.	231,948	253,613	356,395	436,342	498,226	511,275
Share in Manufacturing (%)	n.a.	14.5%	14.1%	16.2%	17.1%	17.2%	16.5%
Capital (Billion VND)	n.a.	9,666	10,852	13,727	18,964	23,546	25,399
Share in Manufacturing (%)	n.a.	4.4%	4.1%	4.3%	4.9%	4.8%	4.3%
Output (1994, Billion VND)	2,950	6,042	6,862	8,181	10,466	12,792	15,304
Share in Manufacturing (%)	3.5%	3.0%	3.0%	3.1%	3.4%	3.6%	3.7%

Source: National Statistical Yearbook 2001 and 2006, NSO.

Table 3 summarizes the trends in the compositional change of firm ownership of the garment industry according to the share of output, in terms of value. Firms in the state sector, or state owned enterprises (SOEs), have been constantly increasing outputs, while their share in total output has been steadily declining. On average, garment manufacturing SOEs in Vietnam have been better equipped in terms of capital and access to foreign markets compared to private suppliers, and were playing dominant roles in the export oriented industry (Goto, 2003). The decline in their output share seems to suggest that the importance of such SOEs is diminishing. It should, however, be noted that most of the former SOEs are going through an equitization process within the ongoing SOE reform program (World Bank et al., 2005). It may be the case that the same firms are still playing key roles in the export oriented garment industry, albeit under different ownership categories.

Table 3 Output by Type of Ownership

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Output of the Garment Industry	2,950	3,400	4,325	4,667	5,218	6,042	6,862	8,181	10,466	12,792	15,304	18,463
State Sector	1,025	1,180	1,491	1,524	1,735	1,926	1,942	2,156	2,656	3,235	3,823	4,534
	34.8%	34.7%	34.5%	32.7%	33.3%	31.9%	28.3%	26.4%	25.4%	25.3%	25.0%	24.6%
Non-State Sector	1,389	1,710	1,949	2,084	2,267	2,616	3,109	3,609	4,020	4,954	5,823	6,928
	47.1%	50.3%	45.1%	44.7%	43.4%	43.3%	45.3%	44.1%	38.4%	38.7%	38.0%	37.5%
Collective	9	20	20	33	46	45	56	32	38	61	69	n.a.
(kinh te tap the)	0.3%	0.6%	0.5%	0.7%	0.9%	0.7%	0.8%	0.4%	0.4%	0.5%	0.4%	n.a.
Private**	327	n.a.	721	727	810	1,056	1,433	1,733	1,946	2,758	3,348	n.a.
(kinh te tu nhan)	11.1%	n.a.	16.7%	15.6%	15.5%	17.5%	20.9%	21.2%	18.6%	21.6%	21.9%	n.a.
Household	1,053	n.a.	1,208	1,324	1,411	1,516	1,620	1,843	2,035	2,136	2,406	n.a.
(kinh te ca the)	35.7%	n.a.	27.9%	28.4%	27.0%	25.1%	23.6%	22.5%	19.4%	16.7%	15.7%	n.a.
Foreign Invested Sector	536	510	886	1,058	1,215	1,500	1,811	2,417	3,791	4,602	5,658	7,000
	18.2%	15.0%	20.5%	22.7%	23.3%	24.8%	26.4%	29.5%	36.2%	36.0%	37.0%	37.9%

Note:

* Upper Row: Value (Billion VND, 1994), Lower Row: Share in the Garment Industry (%).

** Output for the Private Sector for 1997, 1998 and 1999 are based on author's calculations.

Source: National Statistical Yearbook 1999, 2000, 2001, 2003 and 2006, NSO.

For the “non state sector”, which includes different types of private enterprises, the number of firms has been increasing while the trends in output share is decreasing. Within this category, firms classified as “private (kinh te tu nhan)” are the ones that has been growing both in terms of the number of firms and output share. On the other hand, the “collective (kinh te tap the)” and “household (kinh te ca te)” firms, which are mostly micro enterprises that cater primarily for the domestic market, are declining in terms of output share². The output level of firms in the “foreign invested sector” has increased most significantly, which in 2006 occupied the largest share in the industry of 37.9%.

Table 4 describes changes of shares in real output (quantity) according to ownership. As an overall trend, with the exception of 1998, the production of garments has been increasing. The rate of increase has been particularly high in the periods before the Asian financial crisis in 1997 and after the bilateral trade agreement with the US (USFTA) coming into effect in December 2001. The share of real output of foreign sector firms is recording stable growth in contrast to the declining shares of state sector firms, while that for private firms has been quite stable.

Table 4 Garment Output by Firm Ownership										Unit: Million Pieces		
	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Total Output	172	207	302	275	302	337	376	489	727	923	1011	1212
Annual Increase		20.3%	45.9%	-8.9%	9.8%	11.6%	11.6%	30.1%	48.7%	27.0%	9.5%	19.9%
State	72	71	83	90	109	123	139	183	204	219	219	142
Share	41.9%	36.5%	36.5%	36.5%	36.5%	36.5%	37.0%	37.4%	28.1%	23.7%	21.7%	11.7%
Non-State	73	114	110	127	135	149	160	184	319	414	482	573
Share	42.4%	44.2%	44.2%	44.2%	44.2%	44.2%	42.6%	37.6%	43.9%	44.9%	47.7%	47.3%
Foreign	27	22	109	58	58	65	76	122	204	290	310	497
Share	15.7%	19.3%	19.3%	19.3%	19.3%	19.3%	20.2%	24.9%	28.1%	31.4%	30.7%	41.0%

Source: National Statistical Yearbook 1999, 2000, 2001, 2003 and 2006, NSO.

2. Overview of the export oriented garment industry

1. The importance of the garment industry as an export oriented industry

Figure 1 summarizes the main export items of Vietnam based on the HS2002 classification. Oil and related products (mainly crude oil) has been the largest export commodity of Vietnam, occupying more than one-fourth of Vietnam’s total exports in

² The domestic garment market has been primarily catered by “household” firms which are predominantly micro enterprises, often under informal subcontracting arrangements for larger private firms such as the ones classified as “private” firms. There is a significant agglomeration of this type of industry in Ho Chi Minh City, particularly in the Tan Binh District and Districts 5 and 6 (“Cho Lon”, or the “China Town”). For details, see Goto (2005).

2005. The second largest export item was garments, with 14% of its total exports. Out of all garment exports, almost two-thirds were woven fabric based garments (such as shirts, trousers, and jackets), and about one-thirds were knitted garments (including t-shirts, polo-shirts, sweat-shirts, and underwear). This has been followed by footwear and seafood.

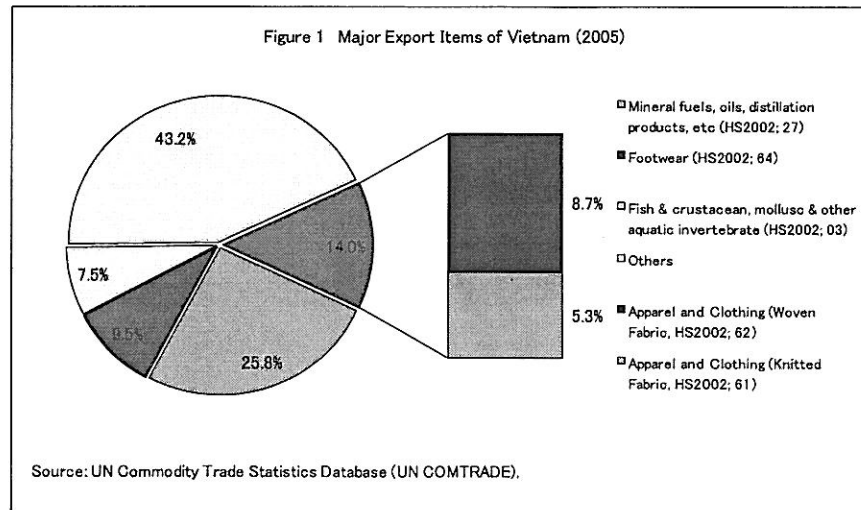
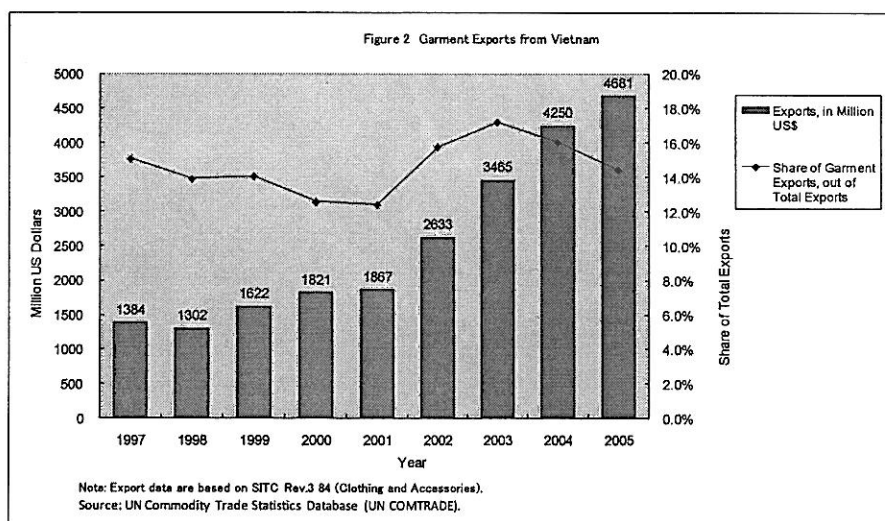


Figure 2 depicts the trends of garment exports between 1997 and 2005 in terms of value and share. The figure shows that the export volume has, except for 1998, increased rapidly, while the share of garments in total exports remained more or less the same.



2. Changes in the value chain orientation³

Table 5 tracks changes in the export destinations of Vietnamese garments. Most notable is the rapid increase of garment exports to the US market. Japan has been the largest foreign market for Vietnam until 2001, occupying more than a quarter of its total garment exports. This position, however, has been taken over by the US in 2002. This increase of exports to the US is primarily due to the USBTA that came into effect in 2001, and since 2003 it has been absorbing more than half of Vietnam's garment exports.

Table 5 Major Importers of Vietnamese Garments

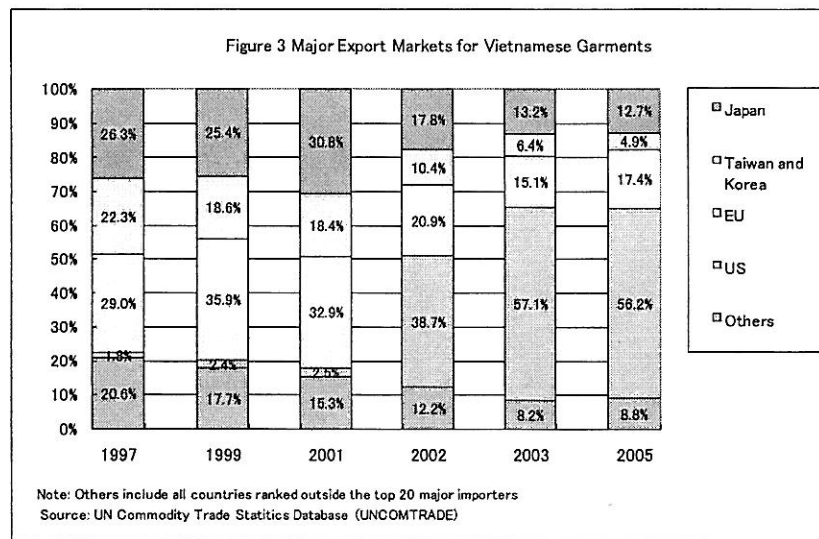
	1997	1999	2001	合計	2002	2003	2005
Rank	\$1,383,858,048	\$1,622,055,936	\$1,866,505,570		\$2,632,680,786	\$3,464,674,959	\$4,680,633,515
1	Japan \$363,919,008	Japan \$412,318,016	Japan \$574,743,020		US \$1,018,534,169	US \$1,978,332,295	US \$2,629,917,811
2	Taiwan (2) \$240,338,000	Taiwan \$247,420,000	Taiwan \$266,574,267		Japan \$467,539,227	Japan \$456,209,663	Japan \$596,084,177
3	Germany \$175,506,000	Germany \$237,396,000	Germany \$217,543,740		Taiwan \$206,801,189	Germany \$179,492,138	Germany \$231,710,766
4	Korea \$68,310,000	France \$84,657,000	France \$100,995,211		Germany \$203,758,149	Taiwan \$170,748,954	Taiwan \$183,846,840
5	Singapore \$63,811,000	Russia \$70,760,000	Korea \$77,359,756		UK \$71,734,008	UK \$73,594,848	UK \$152,961,631
6	France \$51,455,000	UK \$54,670,000	UK \$77,087,121		France \$70,723,667	France \$65,009,624	France \$106,956,175
7	The Netherlands \$50,388,000	Korea \$54,602,000	The Netherlands \$52,476,667		Korea \$68,151,221	Korea \$52,165,554	Canada \$83,580,268
8	Russia \$43,435,000	The Netherlands \$50,278,000	Spain \$50,117,050		Russia \$51,797,267	The Netherlands \$48,657,538	Spain \$82,173,308
9	UK \$34,128,000	Singapore \$49,017,000	Russia \$47,709,593		Spain \$46,864,172	Spain \$41,137,464	The Netherlands \$78,836,049
10	Switzerland \$32,101,000	Belgium \$39,584,000	US \$47,561,105		The Netherlands \$46,001,215	Russia \$36,895,339	Belgium \$54,270,016
11	Hong Kong \$28,158,000	US \$39,446,000	Italy \$35,785,186		Canada \$38,909,811	Italy \$36,700,162	Russia \$48,253,305
12	Italy \$25,959,000	Italy \$29,464,000	Poland \$32,428,418		Poland \$35,113,164	Canada \$34,535,574	Korea \$44,733,245
13	US \$25,241,000	Spain \$29,428,000	Canada \$29,119,679		Poland \$28,478,968	Belgium \$33,142,390	Italy \$39,310,772
14	Canada \$23,627,000	Switzerland \$25,337,000	Belgium \$26,810,568		Belgium \$26,734,958	Hong Kong \$31,976,788	Mexico \$30,455,140
15	Spain \$22,749,000	Czech \$24,405,000	Malaysia \$24,235,447		Malaysia \$26,523,311	Malaysia \$23,832,126	Czech \$30,117,049
16	Australia \$15,401,000	Canada \$23,098,000	Czech \$21,682,488		Australia \$23,055,346	Czech \$23,568,666	Malaysia \$28,432,908
17	Belgium \$15,220,000	Poland \$20,347,000	Australia \$20,626,758		Czech \$22,024,562	Poland \$20,585,672	Australia \$24,186,088
18	Czech \$14,379,000	Australia \$20,075,000	Singapore \$16,162,707		Singapore \$16,558,920	Australia \$19,428,377	Sweden \$19,941,709
19	Poland \$11,498,000	Sweden \$11,158,000	Mexico \$12,615,447		Mexico \$18,191,639	Mexico \$17,985,094	Poland \$18,266,021

Note: Data are for SITC Rev.3.84 (Clothing and Accessories). UNCOMTRADE (SITC) does not officially register data for Taiwan, but most of it is recorded under "other asia, nes".
Source: UN Commodity Trade Statistics Database (UNCOMTRADE).

Table 5 shows Vietnam's increasing exports to the EU as well. Asian importers including Japan, Korea and Taiwan were major export destinations until 2002, but since then exports to those countries have dropped in terms of output share, particularly for Korea.

³ Value chains in this paper are defined as micro-economic organizational networks of international production and distribution, which links could be established through foreign direct investment, but more importantly through different types of non-equity based inter-firm relationships.

Figure 3 summarizes how Vietnamese garments have changed its composition in terms of export destination according to major groups of importers. In 1997, the three major buyer groups including “Japan”, “Korea/Taiwan” and “EU” were each responsible for roughly a quarter of Vietnamese garment exports. Rapid growth of exports to the US is also remarkable in this figure. This change in export destination would, however, impact the Vietnamese garment industry in terms of its development trajectory because different export destinations are coordinated through different value chains with different governance structures.



3. Differences of market positions according to export destinations

The international production and distribution network of garments is a typical “buyer driven chain” where key coordination and governance functions are undertaken by buyers (Gereffi, 1999). In this, product specification is determined by buyers based on demands and conditions from the markets they serve. While general consumer preferences and requirements for garments are likely to be different between markets in Japan, the US, and the EU, what is more important for the purpose of this paper is the differences in the types of garments that is produced by Vietnamese suppliers according to export destination⁴. Figure 4 attempts to classify the Vietnamese products with respect to the level of value added and production volume per order for the Japanese,

⁴ Market characteristics in the EU are different for each of the countries within the EU as well, but based on interviews with Vietnamese suppliers, this paper assumes that they are more homogeneous in contrast to the Japanese and US markets.

US and EU markets respectively. Note that this classification is in relative terms based on perspectives of Vietnamese suppliers and some of the international buyers who cater for multiple export destinations.

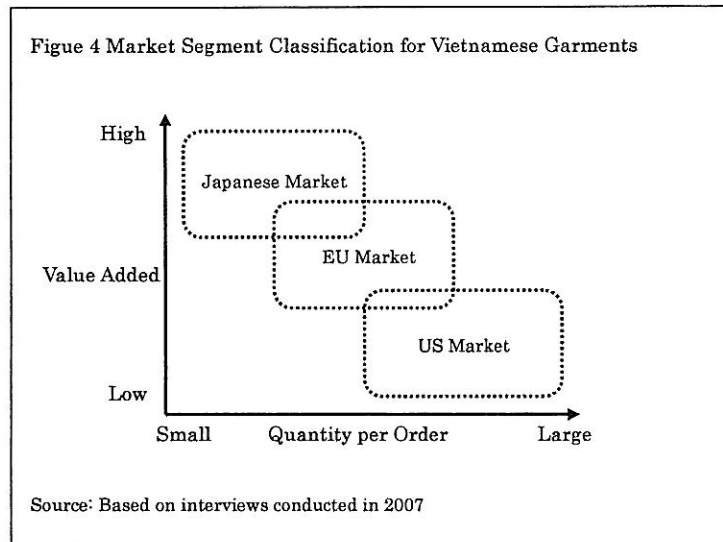
Most of the Vietnamese garments that are produced for the Japanese market are on the higher value added end, with relatively complex design and product specification compared to garments for the EU and US markets. The size for such an order is typically small, with wide variation in size and color. While cost pressures are increasing from Japanese market oriented value chains, quality is still regarded as most important. Buyers that coordinate production and distribution for this market see the key sources of competitiveness of Vietnamese suppliers in their capacity to produce products with complex specifications subject to its stringent quality requirements. This, according to them, is what differentiates Vietnam from other exporters such as India and China, which are perceived as better suited for markets segments in the relatively cheaper “volume zone” categories⁵.

In contrast, garments for the US market are mostly supplied to segments in the lower price range, where competition in prices is extremely fierce. Reducing costs becomes most important, and this is done by producing garments with very simple design specifications allowing suppliers to minimize operational losses during the CMT processes⁶. Most orders for the US market are also large in terms of quantity, which allows Vietnamese suppliers to gain productivity from being on the same learning curve for a longer period⁷. The EU market is positioned between the Japanese and US markets in terms of both the levels of value added and order quantity.

⁵ According to Japanese buyers, however, the garment industry of China is much wider in scope and thus is able to produce “everything”, including items that range from low value added, price competitive products to high value added men’s and women’s suits. They are therefore also able to supply similar items where Vietnam has competitiveness in. However, it has been perceived that Vietnam has comparative advantages in catering for smaller and more complex “niche market” orders, relative to China.

⁶ CMT stands for Cut, Make and Trim, and indicates the labor intensive assembly processes that are undertaken by Vietnamese garment suppliers. See Goto (2003), Nadvi and Thoburn (2004), and Goto (2007) for more on CMT.

⁷ For woven shirts, for instance, a typical order for the Japanese market would be around a couple hundred pieces, per style, rarely exceeding thousand. For American orders, on the other hand, one order normally has at least a few thousand pieces, which often exceeds ten thousand pieces.



Such differences based on market destinations have important implications to the Vietnamese garment industry since it defines its expectations from buyers and its key international competitors. These also define to a certain extent the main areas in which competitiveness will be built up over time.

Value chains that cater for Japanese markets are normally coordinated by Japanese trading companies or brand apparel firms. In Vietnam, it is widely acknowledged that the quality requirements are much more stringent for the Japanese market compared to others. In addition, since even a small divergence from the specification will most likely end up being rejected by the retailers, Japanese buyers place the highest priority in maintaining quality and uniformity of the products. Therefore in order to minimize these types of business risks, Japanese buyers have strong incentives to commit themselves to raising the technical capacity of Vietnamese suppliers to meet the required specifications. The most common method for this is to dispatch their own technical staff to those suppliers on a relatively long term base, at the buyers' expense. Another is to train Vietnamese production line managers at Japanese garment manufacturing firms in Japan. Through such arrangements, relatively advanced knowledge and technology, particularly on configurations of production lines and management methods, are transferred to Vietnamese suppliers. As such arrangements are costly to Japanese buyers and are de-facto context specific investments, they also tend to prefer to establish a long term relationship with selected suppliers. Value chains that are oriented towards Japanese markets are thus typical "quasi-hierarchical" in terms

of its governance structure⁸. Transfer of knowledge and technology through such interfirm relationships have contributed to increasing productivity of Vietnamese suppliers (Goto, 2003).

Garments for the US and EU markets, on the other hand, are coordinated in value chains typically governed by buyers from Hong Kong, Taiwan and Korea. Those buyers function as agents for American and European retailers and apparel firms. Transfer of technology through production arrangements under these buyers are much more limited compared to production arrangements by Japanese buyers, primarily because the level of quality requirement is relatively lower. As price competitiveness is most important for the majority of exports to these markets, orders are placed more competitively which may result in less stable business relationships with value chain coordinators in comparison with Japanese market oriented value chains. Such differences in value chain orientation based on export destination have different requirements and implications, and it is common that one particular supplier is connected to several value chains with different orientation.

4. The possibility of different development trajectories according to value chain orientation

This section attempts to see how the differences in export destinations and value chain orientation could play out in terms of potential upgrading. The GVC literature classifies upgrading into three major types, namely process upgrading, product upgrading and functional upgrading⁹. Process upgrading refers to enhancing production efficiency by applying new technology or by rearranging existing production systems; product upgrading refers to moving into higher value added product lines; and functional upgrading refers to moving into more complex and knowledge intensive functions in the particular value chain (Humphrey and Schmitz, 2000). For some types of upgrading, particularly on processes and products, transfer of technology through linkages with production and distribution networks coordinated by international buyers becomes important (Schmitz and Knorringa, 2000). Functional upgrading, however, is about shifting towards more knowledge and skill intensive functions in the value chain. In the garment industry, such functions include product design, material sourcing, branding, and marketing, which is more difficult and requires more time for upgrading

⁸ Other types of governance structures pertinent to value chains include “arm’s length market relations”, “network” and “hierarchy”. See Humphrey and Schmitz (2000) for more details.

⁹ There is also another form of upgrading called “inter-sectoral upgrading”, which suggest a switch from one industry to another using knowledge acquired in a particular value chain. See Humphrey and Schmitz (2000), Schmitz (2004) for more details.

to happen (Humphrey and Schmitz, 2000; Bazan et al., 2004; Giuliani et al., 2004; Goto, 2007).

Upgrading is critical because it would enable firms to secure economic rents by creating entry barriers to potential new entrants. Entry barriers become higher when more difficult types of upgrading is realized. Therefore, unless firms are able to secure such economic rents, competitive pressures in the market may compel firms to compete by cutting production costs, and in worse cases, it could lead to the phenomena often referred to as the “race to the bottom” (Kaplinski, 1998)¹⁰. In such a context, firms that are connected to value chains coordinated by Japanese buyers may have a larger chance for process and product upgrading through transfer of new and advanced technology. In contrast, exports to the US market are competing primarily on costs, and technological transfer from buyers to Vietnamese suppliers is much more limited. As garments for the US market have relatively lower value added contents, they may eventually end up competing directly on costs with other garment exporting countries such as Bangladesh and India, where wages are lower. When this happens, adding new technological contents would become crucial.

5. The US Vietnam Textile and Apparel Import Monitoring Program

Aside from the abolition of the MFA, the Vietnamese garment industry faced another major change in the international trading environment of garments. In January 2007, when Vietnam became a member of the WTO, the US imposed in turn the Vietnam Textile and Apparel Import Monitoring Program. The aim of this program is to protect its own domestic textile and garment producers by monitoring imports from Vietnam on dumping practices. Five product categories including trousers, shirts, sweaters, underwear and swimwear are being monitored under this program, and the program will continue until January 2009¹¹.

From interviews conducted in August 2007, this program was perceived as one of the major risks by both Vietnamese suppliers and international buyers, because of the uncertainties related to possible future export restrictions to the US. This led to some of the Vietnamese suppliers to adopt a new strategy, which is to reduce export shares to the

¹⁰ The term “race to the bottom” is often referred to describe a situation in which firms have no choice but to compete for survival at the expense of social standards, particularly labor conditions.

¹¹ For details, see “Commerce Completes First Review of Vietnam Import Data: Commerce Finds Insufficient Evidence of Dumping” Commerce News, October 26, US Department of Commerce. (<http://ia.ita.doc.gov/download/vietnam-textile-monitoring/press-release-VTM-10-26-07.pdf>, accessed on January 21, 2008).

US and in turn increase exports to other major markets, particularly the EU and Japan. Several key exporters emphasized this as their new strategy, and the most competitive and productive suppliers were even starting to “select” buyers by rejecting some of the new incoming orders from the US, in an attempt to diversify and balance exports between the three major destinations. This new strategy seems to imply that some shift in power balance between suppliers and buyers is happening within a chain that is fundamentally buyer driven. It should be noted, however, that not all Vietnamese suppliers have been able to take such measures. The new strategy is mainly adopted by the more competitive suppliers, whose demand is typically larger than their supply capacity. Suppliers that were less competitive have become more dependent on the growing export businesses to the US markets in conditions where they were not able to negotiate terms and/or reject orders¹².

3. Vietnamese Garment Suppliers – Did Upgrading Happen?

1. The situation of garment suppliers in 2007 – in comparison to 2001

This section attempts to analyze whether key garment suppliers were able to upgrade in the post MFA era, with special reference to the changing domestic economic environment. Table 6 provides a summary overview of the firms that were interviewed in 2001 and 2007. 10 firms were interviewed in both years, of which five were located in Hanoi, and five were located in Ho Chi Minh City.

¹² For example, one supplier in Hanoi, whose main export destination used to be Japan, is now producing almost exclusively for the US market. This supplier was one of the less successful firms in terms of increasing competitiveness, and was facing reducing orders from Japan and other markets most notably from the EU. Its operation has been shrinking, with fewer workers. The firm, however, is still able to operate, as the overall level of orders from the US to Vietnam is increasing. The firm is receiving some of the orders that were not able to secure production capacities in more competitive ones, on less attractive terms.

Table 6 Outline of Key Suppliers (in comparison to the situation in 2001)

Supplier	Change in Outputs	Share of Exports	Share of CMT	Number of Workers	Average Wages	Labor Shortage	Expanding and/or Relocation
A	About the same	About the same	—	— —	+	Major Problem	Thai Nguyen, Bac Ninh
B	+	About the same	—	++	+	Major Problem	Hai Phong, Thai Binh, Quang Binh
C	+	No Change	—	+	n.a.	Major Problem	Vinh Phuc
D	n.a.	No Change	+	—	+	Problematic	Nam Dinh, Thai Binh
E	—	+	—	—	+	Major Problem	Nam Dinh, Ha Nam
F	++	—	—	++	+	Not a Problem	Ben Tre, Vinh Long, Tien Giang, Ninh Thuan, Binh Thuan
G	About the same	+	—	+	+	Major Problem	Long An, Dong Thap
H	+	No Change	—	++	+	Problematic	An Giang, Tien Giang, Da Lat, Gia Lai, Binh Duong
I	+	About the same	No Change	+	+	Not a Problem	Long An, Laos, Cambodia
J	About the same	No Change	n.a.	No Change	+	Problematic	Currently planning

Note:

* “++” means that the annual increase since 2001 was more than 10%, and “+” is an annual increase less than 10%. Likewise, “— —” means a an average annual decrease of 10% or more, and “—” is a decrease less than 10% a year.

** On labor shortage, answers are categorized into either “Major Problem”, “Problematic”, or “Not a Problem”.

*** “n.a.” means that data was not available at the time of interview.

Source: From interviews in 2001 and 2007.

While most of the firms have expanded in terms of output since 2001, three suppliers (A, G and J) experienced almost no change, and for one (E) output actually decreased. In terms of export ratio, most of the firms were already primarily focusing on the export market in 2001, and this has basically not changed in 2007. It is very common to see suppliers such as D and G that produce garments solely for the export market. F was the only one which reduced its export share (and thus increased production for the domestic garment market), but the shares has only fallen from 90% in 2001 to 88% in 2007¹³.

Most of the garments produced in value chains coordinated by international buyers are under a contractual modality referred to as the CMT. CMT stands for “Cut, Make and Trim” where only the labor intensive assembly functions are carried out by Vietnamese suppliers, which functions are of low knowledge intensity. Under the CMT arrangement, buyers supply Vietnamese firms most of the input materials such as fabrics and accessories, free of charge. Vietnamese suppliers produce garments based on specifications from buyers, and export all products under buyers’ arrangement in exchange for processing fees. Vietnamese producers carry no responsibilities in knowledge intensive functions such as product design, distribution arrangement and marketing. This is, however, also the functional area where most of the business risks

¹³ The Vietnamese garment industry has a “dual” structure depending on whether the garments are for exports or for the domestic market. For instance, suppliers that produce for export markets rarely channel their products to domestic markets, while the domestic market is primarily catered by suppliers specializing in the domestic markets. See Goto (2003) for more details.

are concentrated and the level of value added is the highest (Goto, 2003; Nadvi and Thoburn, 2004, Goto, 2007).

The share of CMT arrangements have decreased for most suppliers except for D and I. Instead, such firms have increased shares in “FOB” type of orders, meaning that Vietnamese suppliers procure fabrics and accessories using their own financial account¹⁴. However, such “FOB” modalities could include a wide range of functions, and most types of FOB operations in Vietnam are arrangements where Vietnamese suppliers only purchase input materials as instructed from buyers, which in essence is equivalent to the CMT modality in terms of functional contents¹⁵. There were also no suppliers that were using Vietnamese inputs, except for some minor accessories including carton boxes, name tags and plastic bags.

In terms of numbers of workers, which has direct implications on changes in operational scale and output, the outcome has been quite diverse with six suppliers increasing, three decreasing, and one being roughly the same. On wages, however, all suppliers reported an increase.

Table 7 is a summary of average wages comparing it for the garment industry against the average for all manufacturing based industries, and the overall economy for 2002, 2003 and 2004. According to this, wages in all industries including the garment sector have increased, however its increase for the garment industry has been relatively modest. The average wage levels for the garment industry is also significantly lower in comparison to both the manufacturing sector and national averages.

¹⁴ FOB types of contractual arrangements are more common for exports to the US and EU, compared to exports to Japan.

¹⁵ The case of supplier D is, however, very unique. As the table shows, it has increased the share of CMT types of contracts since 2001. D used to be an SOE that was fully owned by the Hanoi People’s Committee (equivalent to the local government unit of the city of Hanoi), primarily producing garments for export to former east European countries under FOB contracts. In 2005, however, a company from Hong Kong acquired 30% of D’s share, and started reorienting its exports to the US, Japan and the EU. It shifted its production modality from FOB to CMT, and brought in technical staff from Hong Kong to upgrade in terms of process. At the same time, as a longer term strategy it created a planning and designing department within the company, and started in-house training of its own human resources in such knowledge intensive functions.

Table 7 Wage Comparison (per month)			Unit: 1000VND
	2002	2003	2004
Garment Industry *	994	1080	1133
<i>Annual increase</i>	—	8.7%	4.9%
Manufacturing Sector Average	1145	1243	1327
<i>Annual increase</i>	—	8.6%	6.8%
All Industries	1249	1422	1476
<i>Annual increase</i>	—	13.9%	3.8%
State Sector	1309	1617	1693
<i>Annual Increase</i>	—	23.5%	4.7%
Non-State Sector	916	1046	1135
<i>Annual Increase</i>	—	14.2%	8.5%
Foreign Sector	1897	1774	1780
<i>Annual Increase</i>	—	-6.5%	0.3%

Note: These are wage data for "Manufacture of wearing apparel; dressing and dyeing of fur" in the Enterprise Survey.
Source: Enterprise Survey, GSO 2005.

On a related issue, all suppliers except F and I were facing labor shortages. Most of the suppliers interviewed had their factories in Hanoi or Ho Chi Minh City, except for a few, whose factories were nevertheless located in the vicinity not far from the city centers. Wage rates in those large city areas were increasing rapidly, making wages at Vietnamese garment suppliers relatively unattractive. The labor turnover rate has been high in general, and retaining or hiring workers has become increasingly difficult. Some of the workers who left those firms went to other garment suppliers that offered higher wages, but many were also moving to better paid jobs outside the garment industry, which tended to be service sector jobs.

All companies that were interviewed had plans to either build additional production capacity in rural areas, or relocate all production facilities to rural areas where labor was more abundant and cheaper. There is an important difference, however, between companies that established plants based on the first reason and the second. Suppliers that became more competitive and thus were able to increase outputs, such as I and F, basically had no serious problems in either securing workers or hiring new ones. However, expanding operations were restricted by the amount of land they had, so they had to move outside the city center to build additional manufacturing capacities. The weaker ones, on the other hand, had not only problems in retaining and hiring workers, but they were also struggling to just keep their businesses running. For such companies, the opportunity cost of land was simply too high, and thus decided to relocate everything from the city centers to rural areas. With the land that would be made available due to relocation, most were planning to establish hotels, office buildings or shopping centers, with a clear strategic vision of moving out from the garment industry.

2. Value chain orientation and upgrading at the factory level

Table 8 summarizes changes in export destinations for the firms interviewed. Compared to 2001, most have increased exports to the US quite drastically with an annual increase in shares of 10% or more, except for F and H. In contrast, the export share to Japan has been decreasing, except for D and E. Changes in the export share to the EU market is more mixed.

Table 8 Export Orientation and Buyers' Profile

	US		EU		Japan **		Buyer Profile
	Change *	Share (%), 2007	Change	Share (%), 2007	Change	Share (%), 2007	
A	++	60	++	35	--	5	Mostly Korean trading companies.
B	++	40	+	40	--	20	For the US and EU: Trading companies from Hong Kong, Taiwan and Korea. For Japan: Japanese trading companies.
C	++	55	No change	20	--	7	For the US and EU: Trading companies from Hong Kong, Taiwan and Korea. For Japan: Japanese trading companies.
D	++	50	—	20	Almost no change	30 (Japan, Canada, Taiwan)	90% of the buyers are trading companies from Korea and Hong Kong. However, there are also some direct relationships with American and European wholesalers, trading firms, and retailers.
E	++	40	—	20	Almost no change	40	For the US and EU: Trading companies from Hong Kong, Taiwan and Korea. For Japan: Japanese trading companies.
F	+	30	Almost no change	20	—	30	For the US and EU: Trading companies from Hong Kong and Korea. For Japan: Japanese trading companies.
G	++	60	—	20	--	10	Most are trading companies from Hong Kong, Korea, and Taiwan. Orders for one of the largest US retailers, however, goes directly through the retailer's branch office in HCMC.
H	+	20	+	50	--	30	For the US and EU: Trading companies from Hong Kong, Taiwan and Korea. For Japan: Japanese trading companies.
I	++	70	—	A few	--	23~26	For the US : Trading companies from Hong Kong and Korea.
J	++	50	—	30	—	A few	Trading Companies from Korea and Hong Kong.

Note:

* "++" means that the annual increase since 2001 was more than 10%, and "+" is an annual increase less than 10%. Likewise, "--" means an average annual decrease of 10% or more, and "—" is a decrease less than 10% a year.

** Export share for supplier D includes shares for Canada and Taiwan.

Source: Interviews during field work.

F and H are interesting cases where changes in export destinations were pursued as part of their enterprise strategies. Both firms were producing around 50% of garments for the US markets prior to 2007, but since the announcement of the US anti dumping monitoring program, they have reduced their export shares to the US rapidly and instead increased it for the EU and Japan. B is taking a similar strategy, and those three are among the most competitive garment suppliers in Vietnam with very stable increases in orders. All three firms have become more selective in what type of orders to accept, and in some instances they reject new orders particularly from the US and shift production capacity for orders to the EU and Japan. Most of the buyers for the US and EU markets

are trading companies from Hong Kong, Korea and Taiwan, while for the Japanese market they are predominantly Japanese buyers.

Table 9 attempts to examine how much upgrading has happened for the suppliers interviewed since 2001 in terms of process, product and function. For process upgrading, it compares output per worker in terms of quantity, as consistent and comparable information and data on value, particularly value-added has not been available¹⁶. Roughly half of the firms have experienced upgrading in their processes, with some increasing productivity levels by 30% to 50% since 2001. However, some firms, such as A, C, E and G, were not able to realize significant productivity gains during the same period. Most of the suppliers who were successful in process upgrading either received in the past, or were receiving at the time of interview, technological assistance from Japanese buyers, and some even had very advanced machineries from such buyers in their production line on a long-term lease base. This group of suppliers expanded their production capacity significantly and hired more workers, while on the other hand those that were not successful faced much more difficulties in retaining and hiring workers, and as a result, shrunk in terms of production capacity. These would suggest that the suppliers' degree of success in process upgrading has strong implications on its ability to cope with retaining and hiring workers, which should be particularly critical in the context of rising wages and labor shortages. Suppliers that were not successful in process upgrading had high turnover rates, resulting in lower average years of experience of their workers. They were especially not able to retain skilled workers which had detrimental effects on labor productivity¹⁷. Wage gaps were also significant among suppliers, where successful suppliers were able to pay around two million Vietnamese Dong (VND) per month for skilled workers, while unsuccessful ones only were paying around half of that wage level¹⁸. Productivity increase through process upgrading and retaining workers had cumulative and causal relationships that were transmitted through wage levels – higher productivity suppliers were able to attract more orders from buyers, and were able to higher wages, and thus were able to attract better workers, while in the opposite case it caused a vicious circle.

Most of the suppliers interviewed did not experience significant upgrading in either product or functions during 2001 and 2007, with the only exception of D which

¹⁶ All firms, except I, were mainly producing woven fabric based garments, particularly men's shirts. The benchmark for comparison has been the number of long-sleeved, regular collar, one pocket shirts per worker. The numbers ranged in the range of 7 and 24, where the Japanese standard is usually somewhere between 28 and 32.

¹⁷ According to Glewwe et al. [2004, pp58-59], growth in wage levels was "considerably" faster than output growth even during the 90s.

¹⁸ In August 2007, 1 US\$ was roughly 16,000 VND.

switched from FOB based, low value added production to east European countries to more value added CMT orders to the US and EU, and Japan. Most of the suppliers were also primarily producing under CMT, or under an FOB arrangement which functions were fundamentally the same as the CMT modality¹⁹. However, one of the most significant changes related to potential functional upgrading is that 6 suppliers out of 10 interviewed in 2007 reported that they would put more emphasis on developing products for the domestic market, whereas in 2001 the domestic market was completely neglected for it being “too small”. All 6 suppliers already had, or were in the process of creating, own designed and branded garments specifically for the domestic garment market. Institutions that would support the Vietnamese domestic garment market to function efficiently is still relatively underdeveloped, especially in areas such as domestic distribution systems, trade credit arrangements and protection of intellectual property rights (McMillan and Woodruff, 1999; Goto, 2005). However, major cities such as Hanoi and Ho Chi Minh City are booming with new brand apparel shops, which production and distribution are coordinated by smaller private Vietnamese enterprises who have successfully transformed themselves from garment suppliers into “apparel firms” operating in more knowledge intensive functions (Goto, 2006). There is thus a possibility that a domestic focus would help Vietnamese export oriented garment suppliers in upgrading its functions in marketing, branding and designing.

¹⁹ See Goto (2003) and Goto (2007) for more details.

Table 9 Upgrading since 2001

Supplier	Process (productivity)	Product	Function
A	About the same	No change	No changes of functions in the export business. Tried to promote functions in designing and branding through selling original garments in the domestic market, but have so far not been successful.
B	+	No change	Exports: No significant change in functions. Domestic: Actively strengthening functions in design, marketing, and distribution for the domestic market. Eight new brands will be created specifically for the domestic market.
C	No change	No change	No significant changes in functions in the export business. Some own designed garment production for the domestic market.
D	n.a.	Started producing higher value added products	Refocusing from FOB to CMT, while trying to upgrade skill contents of its workers particularly in areas of designing and planning.
E	About the same	No change	No changes in functions in the export business, but some for the domestic market.
F	+	No change	Exports: No change in functions. Domestic: Actively strengthening functions in design, marketing, and distribution for the domestic market. Eight new brands will be created specifically for the domestic market.
G	No change	No change	No change in functions.
H	++	No change	No change in the export business, but actively for the domestic market particularly in designing, planning and marketing.
I	+	No change	No change in functions in the export business.
J	+	No change	No change in functions in the export business.

Note:

* "++" means that the annual increase since 2001 was more than 10%, and "+" is an annual increase less than 10%. Likewise, "--" means a an average annual decrease of 10% or more, and "-" is a decrease less than 10% a year.

Source: Interviews during field work in 2007.

Conclusion

The Vietnamese garment industry has been recording remarkable growth since it opened up its economy in the early 90s, and particularly since the USBTA came into effect in late 2001. This growth is still continuing even since the abolishment of the MFA at the end of 2004. In line with this, the industry has been shifting its exports more towards the US and EU markets while reducing exports to Asia, notably Japan. This change in export destination, however, could have significant effects to the industry as different export markets are coordinated through different value chains with different requirements and expectations.

For Japanese buyers, Vietnamese suppliers were seen as providers of mid-range items with relatively high value added contents. In order to satisfy the strict market requirements, buyers had strong incentives to commit themselves to help Vietnamese

suppliers to upgrade processes through transferring advanced knowledge and technology. Process upgrading happened, and Japanese buyers started differentiating Vietnamese suppliers from others including China, India or Bangladesh, which to them were seen as suppliers of lower value added products in comparison to Vietnam. In contrast, garments to the US market are typically products with lower value added contents, where product differentiation is less a concern, and where cost pressure is more severe. However, orders are much larger in quantity compared to Japanese ones, which enable suppliers to standardize processes and thereby minimize production losses.

One of the implications of this to Vietnamese suppliers is that value chain orientation matters for upgrading, and would affect its development trajectory. Value chains catering for the Japanese markets would probably be very helpful in achieving process upgrading. In contrast, value chains for the US, and to some extent to the EU, come with substantially larger orders, which would help minimize adjustment costs, losses in production, and would also help expand operations. Firm level data suggest that while productivity levels of Vietnamese suppliers are, on average, still low in comparison to more advanced countries' suppliers, there is significant variation between Vietnamese suppliers. For suppliers who are on the lower end in terms of process, being connected to value chains with Japanese market orientation may be a good strategy. For more advanced suppliers, on the other hand, a mix of different export destinations including bulky orders from the US could be more desirable. Whether Vietnamese garment suppliers are in fact able to select the value chains to be integrated, especially given the fact that such value chains are typically buyer driven, remains one of the main issues of concern in this context.

Against such a background, the anti-dumping monitoring program was imposed by the US for Vietnamese garment imports in January 2007. This was perceived, by both buyers and suppliers, as a major risk factor in the export business to the US. In response, some of the firms started diversifying its export portfolio by reducing dependency on the US market, and instead have been increasing exports to the EU and Japan. Vietnamese suppliers who were able to take such measures were among the most competitive, being in excess demand in relation to their production capacity. Such suppliers gained bargaining power vis-à-vis international buyers, and it was these types of suppliers who were reorienting its export directions.

The division between competitive suppliers and the weaker ones has become more evident, particularly in the context where the domestic economy is booming, with new jobs emerging in other sectors and wage levels increasing. Both competitive and weak

suppliers are moving to suburban or rural areas where labor is more abundant and cheaper, but for the former this is within the context of expanding operations, while for the latter it is part of a survival strategy and a response to acute labor shortage. For the latter ones, not being able to upgrade process has played out in terms of their productivity gains being much lower than increases in overall wage levels. This, with reduced orders from international buyers, induced them to move out from the garment industry and reinvest its resources to particular service sectors where they could simply exploit rising rental rates of land. In absolute terms, labor productivity of the garment industry is still low on average from an international perspective, and its potential increase would have accommodated wage increases. However, before having reached its potential to its fullest extent, the industry seems to be already peaking off at the weaker end.

The abolishment of the MFA is only a recent phenomenon, and China is still restricted by the US and EU. Therefore it is still difficult to provide a conclusive picture on the future of the garment industry of Vietnam. However, individual firm performance in its export oriented garment industry is already diverse. Strategic choices of these suppliers would have more important implications on its future growth, particularly when all restrictions on international trade in garments are removed.

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