How deep was the impact of the economic crisis in Vietnam?

A focus on the informal sector in Hanoi and Ho Chi Minh City

Policy brief

This policy brief has been written by Jean-Pierre Cling, Nguyễn Hữu Chí, Mireille Razafindrakoto and François Roubaud.

Contact: Mireille Razafindrakoto (razafindrakoto@dial.prd.fr)
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Vietnam is one of the only South East Asian emerging economies not to have gone into recession in 2009 in the wake of the world crisis. Nonetheless, it has been affected deeply by the crisis, as shown by all macro-economic indicators. The yearly growth rate of GDP has been slowing down from 8.5% in 2007 to 6.3% in 2008 then 5.3% in 2009, before recovering to 6.5% in 2010. The slowdown is especially marked between the first quarters of 2008 and 2009: during this period, the yearly growth rate of quarterly GDP was halved, from 8% to 4% and the export growth to the European Union (which is the first market with the USA) was reduced from +60% to -30% (IMF, 2010). Inflation was also alarming: the yearly increase of the consumer price index reached 28% in September 2008 and even 65% for food (rice and grains).

Overall, because of productivity gains and rapid growth of the labour force due to the “demographic dividend” which is currently peaking, an average economic growth of 7.5% such as attained during 2000-2008 is hardly sufficient to absorb new entrants on the labour market (Cling, Razafindrakoto & Roubaud, 2010a). Even with such a high growth rate, around one fourth of new entrants (whose total number amounts to nearly 1 million per year) end up in the informal sector. The latter thus absorbs the labour surplus which agriculture and the formal sector are unable to employ.

One could therefore have expected a strong impact of the economic downturn in 2008-2009 on employment and the labour market in Vietnam, especially on the informal sector because of its key role as an adjustment variable on the labour market. It should be underlined that this kind of adjustment mechanism differentiates between developing countries such as Vietnam and developed countries where most of the impact of the economic crisis on employment was through a rapid increase of unemployment.

Several quick qualitative assessments of the impact of the crisis have been conducted in Asia and especially in Vietnam, based on a small number of
interviews in some selected industries (construction, clothing, etc.). They indeed put in evidence the impact of the crisis on the informal sector in terms of employment, number of hours worked and wages (Turk & Mason, 2010; Horn, 2010). But, due to the lack of data, no quantitative study of the impact of the crisis on the informal sector had been conducted until now. This is precisely the objective of this policy brief, based on the results of two rounds of Household Business & Informal Sector (HB&IS) surveys conducted on a statistically representative sample in Hanoi and HCMC in 2007 and 2009 within an international research project between Vietnam’s General Statistics Office (GSO) and the French Institut de Recherche pour le Développement (IRD). This brief can be usefully complemented by two companion papers: the first one presents the adjustment of the labour market and the informal economy nationwide, based on the LFS2007 & 2009 (Nguyen et al., 2010); the second one provides detailed results on the dynamics of the informal sector in the two main cities between 2007 and 2009 (Demenet et al., 2010).

It should be stressed that the interpretation of the results of these surveys for evaluating the impact of the crisis is not an easy task for at least the three following reasons:
- First, given the limited knowledge up to now of the dynamics of the informal sector, it is difficult to identify the changes resulting from the natural trend of this sector in the absence of crisis and those due to the impact of the crisis;
- Second, the last round of surveys was conducted during the fourth quarter of 2009 when the economy was already recovering; this tends to underestimate the impact of the crisis which – according to macro-economic data – hit the hardest at the beginning of 2009;
- Third, it is difficult to make comparisons over time for Hanoi province, since the administrative boundaries changed in August 2008. The absorption of the neighbouring province (Ha Tay) and some other

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1 The first round of surveys interviewed 1,305 households businesses in Hanoi and 1,333 in HCMC in 2007, based on a representative sample drawn from the Labour Force Survey. The respective figures for 2009 were 767 in Hanoi and 1,254 in HCMC. A panel survey was added in 2009, with 1,011 and 1,020 HBs drawn from the 2007 HB&IS survey sample interviewed a second time. The HB&IS surveys have been funded by the World Bank and the Institut de Recherche pour le Développement. A qualitative survey (60 semi-directive interviews in Hanoi and HCMC) funded by the World Bank was also conducted at the end of 2009.
districts, whose characteristics are not the same as in the “old Hanoi”, have entailed some structural changes.

In spite of these limitations, this policy brief shows that the economic downturn together with high inflation has had a severe impact on the informal sector. Two key messages come up from the analysis of the survey results: on the one hand, the important growth of employment in the informal sector between 2007 and 2009, as well as of the number of informal household businesses, which has been stimulated by the crisis; on the other hand, the striking difference between Hanoi and HCMC, the informal household businesses in the South being by far the most affected on the whole, especially in terms of incomes. Although this latter result should be checked further, one can hypothesize that Vietnam’s economic hub has suffered more on the whole from the crisis due to its dependency on world markets, and that this greater openness directly impacted on the informal sector.

1. Employment growth in the informal sector has been increased by the economic crisis

Hanoi’s total population was 6.5 million and that of HCMC 7.1 million in 2009. Half of the population was occupied: The LFS2009 counted 3.3 million (main) jobs in Hanoi and 3.7 million in HCMC, among which respectively 1.1 million (32% of total employment) and 1.3 million (34% of total employment) in the informal sector. This makes the informal sector the number one employer in both cities.

Between 2007 and 2009, the number of jobs in the informal sector increased by 56,000 in Hanoi (+6%) and by 206,000 in HCMC (+19%). For HCMC, the informal sector gained 1 percentage point between 2007 and 2009, and contributes for 40% of net jobs creation. As mentioned here above, proper comparisons for Hanoi are made difficult by the change of boundaries of the province, approximately doubling its size. However, we present in table 1 here below some estimates of the evolutions during 2007-2009 based on our own calculations.
As expected, the new province is significantly more “informalized”. The share of the informal sector decreased by a slight 1.5 point in Hanoi whether the comparison is made on “old” or “new” Hanoi. This decrease suggests that the economic crisis has not had a huge impact in Hanoi, especially compared to HCMC; results from the HB&IS survey commented hereafter confirm this observation. Furthermore, if we restrict to the jobs created in 2009, the contribution of the informal sector is at the front line with around 30% in both cities, hand in hand with domestic enterprises.

Table 1: Evolution of structure of main jobs by institutional sectors (%)

<table>
<thead>
<tr>
<th>Institutional Sector</th>
<th>“New” Hanoi</th>
<th>“Old” Hanoi</th>
<th>Contribution</th>
<th>Ho Chi Minh City</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Public</td>
<td>19.1</td>
<td>17.8</td>
<td>28.5</td>
<td>28.0</td>
<td>15.3</td>
</tr>
<tr>
<td>Foreign Enterprise</td>
<td>2.6</td>
<td>4.0</td>
<td>4.5</td>
<td>7.2</td>
<td>10.6</td>
</tr>
<tr>
<td>Domestic Enterprise</td>
<td>9.2</td>
<td>12.6</td>
<td>13.7</td>
<td>18.4</td>
<td>27.8</td>
</tr>
<tr>
<td>Formal Household Business</td>
<td>7.3</td>
<td>7.8</td>
<td>8.8</td>
<td>8.4</td>
<td>11.6</td>
</tr>
<tr>
<td>Informal Household Business</td>
<td>33.3</td>
<td>31.8</td>
<td>29.7</td>
<td>28.2</td>
<td>27.4</td>
</tr>
<tr>
<td>Agriculture</td>
<td>27.7</td>
<td>26.0</td>
<td>13.5</td>
<td>9.8</td>
<td>7.3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: LFS2007 & 2009, GSO; authors’ calculations.

Total employment is not exactly the sum of employment in all sectors, because nearly 1% of jobs cannot be affected to a determined sector of activity. The data from 2007 survey has been adjusted to fit with the 2009 Population census. Contribution corresponds to the share of jobs created in 2009.

The total number of informal household businesses (IHBs) comes to 725,000 in Hanoi in 2009, and the corresponding figure in HCMC is 967,000. Their average size (1.5 worker in Hanoi, 1.3 in old Hanoi, and 1.4 worker in HCMC) slightly decreased since 2007. The growth of the number of informal HBs is

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2 For the LFS only, we can make an estimate of the evolution of employment both in “new” and “old” Hanoi. For the HB&IS survey, we can only make a comparison for “old” Hanoi, as the 2007 HB&IS survey was only conducted on this restricted area. Overall, caution is required on the interpretation of the results on “old” Hanoi from the 2009 LFS and HB&IS survey, given the small sample size.
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estimated at 23% in Hanoi and 29% in HCMC within the two-year period. With this quite rapid growth pace, the persistence and dynamism of this sector cannot be denied. However, without any comparable figures from another time period or from other similar countries, the diagnosis which can be made is limited. On the one hand, this evolution could just result from the usual rhythm of expansion of the informal sector given the demographic growth of the population in the cities. It even could have been slowed down by the lower growth of the economy in general and the contraction of demand. On the other hand, the informal sector could evolve in a countercyclical way compared to the rest of the economy. The increase in the multi-activity rate from 2007 to 2009 which is observed from the LFS (Nguyen et al., 2010), which might have induced a multiplication of the number of HBs, constitutes an evidence in favour of the latter scheme. All in all, the economic crisis has probably increased the size of the informal sector.

This hypothesis is confirmed by the diminution of the rate of formalization: in 2009, formal HBs represent 15.2% of HBs in Hanoi (it is even lower in old Hanoi: 14.3% compared to 19.5% in 2007) and 17.6% in HCMC (25.4% in 2007). The economic crisis in 2008-2009 has induced a phenomenon of informalization which has affected the two cities and almost all industries.

Panel data analysis based on a survey sub-sample confirms this informalization process: a huge 31% of FHBs in Hanoi and 15% in HCMC entered the informal sector, while on the reverse only around one IHB out of ten got formalized, in both cities. The HBs which became informal were smaller (value added, number of jobs), less productive and more precarious (no professional premises). Disaggregating by industries, the informalization rate is at its highest for services, especially in Hanoi where almost one FHB out of two (47.3%) quitted for the informal sector. Without any benchmark, it is difficult to assess these figures. However, one may reasonably assume that part of this striking informalization process (especially in Hanoi) is due to the crisis. Surprisingly, it is more pronounced in the capital city where the impact of the crisis has been less severe.
Table 2: Formalization and informalization rates between 2007-2009 (%)

<table>
<thead>
<tr>
<th>Economic activity (2007)</th>
<th>Formalization rate</th>
<th>Informalization rate</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Hanoi</td>
<td>HCMC</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>4.5</td>
<td>9.5</td>
</tr>
<tr>
<td>Trade</td>
<td>0.9</td>
<td>2.9</td>
</tr>
<tr>
<td>Services</td>
<td>7.7</td>
<td>8.5</td>
</tr>
<tr>
<td>Total HB</td>
<td>8.3</td>
<td>10.2</td>
</tr>
</tbody>
</table>


“Formalization” means that the HB was informal in 2007 and became formal in 2009.
“Informalization” means that the HB was formal in 2007 and became informal in 2009.

Panel data also provides estimates of the mortality rate of IHBs between 2007 and 2009. For each city, we compute two rates using different hypotheses related to the sources of the attrition process.\(^3\) Whatever the methodology adopted, the mortality rate appears very high: it ranges between 15-21% in Hanoi and 21-31% in HCMC. As this kind of survey was not conducted before in Vietnam, we cannot measure whether this mortality rate is normal in this country, or has been increased by the economic crisis. However, from the average age of IHBs in 2007 (7 years in Hanoi and 8 years in HCMC), we can induce that over two years nearly 30% of IHBs should have disappeared in Hanoi and around 25% in HCMC, which reflects the great precariousness of informal sector activities (making the hypothesis that their total number remains constant over the period, which is approximately the case). The rate we obtain is much inferior to this in Hanoi and in the middle of the estimate range in HCMC. We can conclude that the crisis has not provoked a massive closure of HBs and that is might even be the opposite: in a normal growth period, there might have been more alternative job opportunities and more HBs might have closed.

\(^3\) The interviewers asked the household whether the IHB interviewed in 2007 was still operating in 2009 or not. The percentage of “stop activity” answers provides one estimate of the mortality rate of IHBs. However, the previous estimate might underestimate the mortality rate because a significant number of existing IHBs in 2007 were not found in 2009 (7% in Hanoi and 11% in HCMC), and part of them has probably disappeared. This is why a second higher estimate is presented here, which adds to the “stop activity” answers all the IHBs which could not be tracked.
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Last of all, the analysis of the industry breakdown shows that structural changes have occurred in favour of tertiary activities. The predominant share of trade and services activities already observed in 2007 is not only confirmed but is even higher in 2009. Services become more predominant in HCMC (representing 55% of IHBs in 2009 compared to 46% in 2007). This is also the case for Hanoi if we look only at the evolution within the old boundaries of the city (52% vs. 45%). But the inclusion of the neighbouring areas has changed the global structure in Hanoi given the weight of manufacturing activities and the predominance of trade in these areas (whereas services are less developed). Therefore, trade sector ranks first with 40% of IHBs in Hanoi, services account for 35% and last, manufacturing activities (including construction) play a not-inconsiderable role, with 25% of IHBs and 37% of total informal sector jobs in the city.

2. The impact of the crisis on incomes and labour conditions in the informal sector: a mixed picture

Overall, income in the informal sector is the lowest of all sectors except from agriculture. The monthly average income amounts to 3.7 million VND in Hanoi whereas the median income is 1.9 million VND in 2009. The corresponding figures are respectively 2.7 million VND and 2 million VND in HCMC. These figures reflect the disparities inside the informal sector, in particular between workers of different status. The average income fails to represent the real situation of the majority of informal sector workers. This was already the case in 2007 and the income distribution pattern did not change much during the period.

One would expect the economic crisis in 2008 and 2009 to have impacted negatively on the earnings in the informal sector given the increased competition induced by the higher number of HBs and the restriction of demand. Survey results are however very different in this regard: the growth of average income in Hanoi contrasts with its reduction in HCMC. In each town, the important (inverted) gap between the average and median variation

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4 This may be due to the existence of many "craft villages" in the former province of Ha Tay which undertake manufacturing activities.
of income is an indicator of the strong heterogeneity of the individual evolution of IHBs.

*In Hanoi*, an impressive growth of the average level of income can be observed (+22% in real terms for old Hanoi). The slight decrease of the median income is due to a structural effect with the addition of HBs with lower income from Ha Tay and the neighbouring areas. The evolution of the median income is also positive, even if the pace is less important, if the analysis is restricted to the “old Hanoi” (+3.3%). The employers and the own account workers are those who have benefited the most from this improvement. The remuneration of wage workers has also increased but this is mainly due to the better situation of these categories in the new areas of Hanoi (a decrease of -4% of the average earnings of the wage-workers and of -14% of the median is observed in the “old Hanoi”).

*In Ho Chi Minh City*, if we look at the evolution of the average income, the situation seems to have worsened in the informal sector from 2007 to 2009 (-3.5% in real terms). But the median income has clearly increased (+10.9%). Contrarily to Hanoi, the units with higher level of income (the bigger or the most efficient ones) tend to pull down the average income. It appears that since they are more connected to the formal economy, they are the main victims of the crisis. In this city, the employers and, to a lower extent, the own account workers, are the categories which have suffered the most from the crisis (with the paid apprentices which represent a minor part of the workers), whereas the income of wage-workers has slightly improved (+2.8% for the average income and +1.3% for the median). As wage workers in the informal sector are paid at subsistence level, there is no margin for downward adjustment in time of crisis.

The fact that the informal sector met more serious difficulties in HCMC is confirmed by qualitative answers to the survey. Almost one half (46%) of IHBs in HCMC declared that they have suffered from a decrease in income between 2008/2009. This proportion is also important but much inferior in Hanoi, where one quarter (23%) of Hanoi’s IHBs suffered from such a decrease. Even if some distance has to be kept considering the imprecision of qualitative (subjective) data to measure changes in income, these results tend
to prove the reality of the crisis, particularly hard in HCMC. The contrast between the two cities is consistent with previous findings. However, one can perceive, thanks to the qualitative information, the degree of severity with which the crisis has been felt.

### Table 3: Evolution of the household income and savings & households having to cut expenditures (% of IHBs’ heads)

<table>
<thead>
<tr>
<th></th>
<th>Hanoi</th>
<th>HCMC</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Increased</td>
<td>Decreased</td>
</tr>
<tr>
<td>Evolution of income</td>
<td>34.5</td>
<td>23.3</td>
</tr>
<tr>
<td>Evolution of savings</td>
<td>10.5</td>
<td>36.0</td>
</tr>
<tr>
<td>Households having to cut expenditures</td>
<td>Food: 9.5, Health: 7.5, Education: 5.8</td>
<td>Food: 36.8, Health: 16.7, Education: 6.7</td>
</tr>
</tbody>
</table>

Source: HB&IS survey, Hanoi and HCMC, 2009, GSO-ISS / IRD-DIAL; authors’ calculations. (1) Increased-Decreased

Consumption measures confirm the previous results and allow us to stress again the specificity of HCMC, where the crisis has been acute (37% of informal households declare they had to reduce their food expenditures). It is interesting to point out that health and education budgets are less elastic when it comes to reducing expenditures; however, the relatively high proportion (17%) of informal households who had to reduce health spending in HCMC is still a strong signal. Another indication comes from the decrease in savings, which affected 36% of informal households in Hanoi and 48% of them in HCMC. Surprisingly, the decrease in savings did not turn into more debt, probably because the possibilities to borrow were very limited.

Strikingly enough, a more negative picture on the evolution of incomes seems to derive from qualitative answers than from quantitative ones. We can put forward various explanations for this relative discrepancy:

- first of all, it has to be reminded that qualitative answers refer to the household income while quantitative ones refer to the IHB’s; household income might be more affected than IHB’s if other sources of incomes out
of the IHB (formal wage work for example; transfers received) decrease;
- second, another reason could be the underestimation of inflation by official
data; between 2007 and 2009, the total consumer price index increased by
28% while the price of staple food products (rice and grain) increased by
54%; as the weight of these products in the consumer price index (around
10%) is much inferior to their weight in the total budget of poor people,
deflating income by the official index probably overestimates incomes of
the informal sector;
- last of all, experience from opinion surveys conducted worldwide suggests
that qualitative answers from households concerning their income often
provide a more negative picture than reality;

<table>
<thead>
<tr>
<th>How did informal household businesses suffered from the crisis</th>
</tr>
</thead>
<tbody>
<tr>
<td>“My turnover in 2008 was equal to one third of 2007, because people had to cut off their expenditures, but in 2009 the situation has improved”. Motor bike workshop, Hanoi.</td>
</tr>
<tr>
<td>“Construction work is at standstill. Construction contracts are less and less...Workers accepted to reduce their salary”. Construction, Hanoi.</td>
</tr>
<tr>
<td>“The economic crisis affected our activity very much. In previous times people used to eat as much as they wanted, but now they have to think how much they take. Before, one rice helping used to cost 20 thousand VND only, now I had to reduce the price to 18 thousand VND...I had to lay off several workers”. Street restaurant, Hanoi.</td>
</tr>
<tr>
<td>“2008 was a very hard year — sales plummeted”. Ice cream seller, HCMC.</td>
</tr>
<tr>
<td>“For the first half of 2009, there were no orders. Also for a period, the price of the input materials rocketed while the payments I received remained unchanged. I and my employees had to take days off and wait for new orders”. Poster maker, HCMC.</td>
</tr>
<tr>
<td>“The turnover decreased, because the incomes of clients are lower and the prices of goods go up”. Clothes seller, HCMC.</td>
</tr>
</tbody>
</table>

Source: Razafindrakoto & Nguyen Huu Chi (2010)

It should be stressed that the evolution of the level of income results at least partly from an extension of already long working hours in Hanoi in 2009 compared to 2007 (from 49.3 to 51.5 hours per week if we restrict the analysis to “old Hanoi”; the working hours remain stable if the analysis is extended to new areas in 2009). In HCMC, if we exclude the services sector which stands
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as an exception with lower working hours per week, a slight increase is also noticeable: +1.1 hours in average in the *manufacturing* IHBs; +1.2 hours in the trade sector.

The rate of wage-workers in the informal sector has decreased both in Hanoi (from 15.3% in 2007 to 9.4% in 2009 in “old Hanoi”) and in HCMC (from 16.9% to 12.7%). The significant reduction of the percentage of temporary workers for the two cities could be interpreted positively as regards employment security (from 29.4% to 7.7% in Hanoi and from 18.3% to 5.7% in HCMC). At the same time, this could reflect the impact of adverse conditions in the informal sector: given the low level of demand, HBs could not afford to hire temporary workers; consequently, former temporary workers have to create their own business.

Globally, insecure working conditions are still the norm in the informal sector. Social security coverage, profit sharing and paid leaves are quasi-inexistent and a significant proportion of IHBs work without any premises (street vendors, motorbike taxis, etc.).

If we restrict the analysis to the *old boundaries of Hanoi*, no significant changes can be noticed regarding the percentage of workers without contracts (from 61% to 62%). In greater Hanoi, the percentage is only 53%. The percentage of IHBs working without premises has decreased (from 40% to 36%).

But in HCMC, the situation even worsened as regards the lack of protection and of premises: the percentage of dependent workers without any form of contracts (written or verbal ones) has increased from 62% in 2007 to almost three-quarters of the workers in HCMC in 2009; the percentage of IHBs working without premises has increased from 37% to 41%.
3. Conclusion and Policy issues

The informal sector is a huge component of the Vietnamese economy which has even increased with the crisis. Whatever the growth hypothesis for the years to come, the informal economy is here to stay. In spite of its intrinsic flexibility, the informal sector suffered significantly from the difficult economic situation in 2008 and 2009. This is specially the case in HCMC, where clear recessive patterns are observed, with adverse consequences on household well being and poverty, underlining the necessity to take into account heterogeneous local circumstances. The greater vulnerability of the economic capital of Vietnam compared to Hanoi may be explained by the very nature of the shock which affected the more opened megalopolis. Some policy implications can be drawn from these results:

- In spite of a recent higher awareness about informality in Vietnam, the informal sector still remains a non tackled issue from a policy perspective, largely ignored by the authorities. None of the temporary measures considered in the stimulus package to mitigate the negative impact of the global crisis has benefitted the informal sector. It is all the more problematic that poverty is progressively changing face, from its traditional rural and agriculture profile, to a more urban and informal phenomenon;
- No one really knows who should register (business licence) and pay taxes. This fuzzy frontier between formal and informal HBs and lack of transparency create a grey zone prone to informal arrangements and negotiation, including corruption. Enacting clear rules would help reducing discretionary decisions and harassment by public officials, as well as allowing them to enforce legal regulations on a clear-cut basis;
- Formal and informal sectors are no definitive status: the dynamic approach shows that a far from negligible part of IHBs get formalized and vice versa. Given the advantages of formalization (access to credit, lower risks of corruption, better economic performances, etc.), incentive policies should be designed to favour the flow from informal to formal sector;
- Easier access to credit would also help to improve equipment and productivity. It is all the more important as more and more IHBs are
facing credit constraints. Credit constraints (cash flow problems and access to credit) have become especially crucial in HCMC where they ranks first among the sources of difficulties while easier access to credit is also the first need for assistance requested. In particular, micro-finance institutions are quasi absent in both cities and should be put in place at a larger scale, as in other developing countries;

• Contrary to expectations, the informal sector is only marginally integrated into the rest of the economy. Its already tiny links with the formal sector, through subcontracting and access to big orders, have even decreased between 2007 and 2009. Consistently, this point became one of the main demands for assistance expressed by the IHBs: access to big orders ranks first in Hanoi and second in HCMC (after access to credit) among the main needs expressed in 2009. Therefore, there is room for policies to enhance access to market, in particular through market information;

• From a human resource perspective, two kinds of policy may be suggested. On the one hand, training programs with specific curricula adapted to informal sector conditions should be developed to improve returns to skills. Up to now such programs have been marginal (if any) in Vietnam. On the other hand, labour force protection schemes should be put in place to limit the high precariousness and vulnerability of the informal sector workers. An assessment and an adaptation of the voluntary social insurance seem necessary.

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