FDI Inflows and Domestic Firms: Adjustments to New Export Opportunities

Brian McCaig
Wilfrid Laurier University

Nina Pavcnik
Dartmouth College  BREAD, CEPR, IZA, NBER

Woan Foong Wong
University of Oregon

Preliminary
Geneva Trade and Development Workshop
Developing countries have become increasingly integrated into global markets

- Remarkable growth in FDI (primarily greenfield): received majority of global inflows (UNCTAD 2014), with potential implications for technology transfer, productivity, jobs creation.
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Developing countries typically feature greater misallocation of resources

- Politically connected firms, such as state-owned enterprises (SOEs), may receive cheaper credit, easier access to land, face softer budget constraints, etc.
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More evidence needed on how trade policy interacts directly with FDI or other firm types

- In the presence of misallocation, there is no consensus how trade reforms affect allocation of employment/market share and productivity (Atkin & Khandelwal, 2019; Bai, Jin, & Lu, 2019)
- There is ongoing debate on responsiveness of value added trade/fragmented production/FDI to trade agreements (Yi, 2003; Feinberg & Keane, 2006; Johnson & Nouguera, 2017)
We investigate the effects of lower tariffs on exports (due to 2001 US-Vietnam Bilateral Trade Agreement) on firm performance in a low-income country, Vietnam.
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The BTA induced a large, positive export demand shock for Vietnamese firms.

- Main policy change: decline in US tariffs on VN exports.
First Contribution

- Examine the role of competition from FIEs (vs private domestic firms)
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  - Particularly important in low-income countries with a large state sector, where politically unconnected firms might be credit constrained
  - We observe all firm-types, regardless of their size—if we focused on just exporters, we would only be capturing up to 70% of revenue and employment

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  - Important due to potentially delayed adjustment of capital (Dix-Carneiro & Kovak (2017))
  - Government subsidizes SOEs which may increase survival rates (Storesletten, Song, & Zilibotti (2010), Hsieh & Song (2015))
Third Contribution

- Study cumulative effect on incumbents, entry, and exit by firm-type
  - Our period of analysis features large FIE entry and sizeable SOE decline

Revenue

Emp Share

Rev Share

Emp by Initial Type

Pop census

6
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Related Literature

- Impacts of FDI on developing countries
  - Large literature on the effects of FDI on spillovers (Harrison and Rodriguez Clare (2009), Alfaro-Urena, Manelici, and Vasquez (2019))
  - Emerging literature on the effects on reallocation and competition (Aitken, Harrison, and Lipsey (1996), Alfaro and Chen (2018), Atkin et. al. (2019))

- FDI entry/acquisition decision is endogenous
  - Role of selection (Arnold and Javorcik (2009), Guadalupe, Kozmina, and Thomas (2012))
  - Financial constraints factors (Alfaro and Chen (2018))

- FDI entry and (trade) policy
  - Bilateral tax treaties (Blonigen, Oldenski, Sly (2014))
  - FDI entry and tariffs/trade agreement (Feinberg and Keane 2005, 2006)
  - Endogeneity of trade policy to FDI/global supply chains (Blanchard (2007), Blanchard and Matschke (2015), Blanchard, Bown, Johnson (2016))

Also related to literature on firm performance and trade in the presence of politically connected firms, trade and misallocation, and SOE restructuring and reform
Overview

Background on BTA

Conceptual Framework

Data and Data Patterns

Empirical Approach and Results

Conclusion
US-Vietnam Bilateral Trade Agreement


- After embargo is lifted, Vietnamese exports to US still faced high levels of protection as it was subject to the Column 2 US tariff schedule.

- BTA reclassified Vietnamese exports to Most Favored-Nation (MFN) or Normal Trade Relations tariff schedule.

- Tariff cuts resulted from switching from one pre-existing tariff schedule to another.

- Vietnam already applied MFN tariffs on US exports prior to BTA.
BTA tariff cuts were large and varied across industries

- 29 pp average reduction (32% to 3%) in manufacturing, sd 16 pp
- Varying cuts across industries with high and low employment levels

2-digit manufacturing industries are sorted by total employment in year 2000 (largest on the left and smallest on the right)
BTA tariff cuts: switching from one pre-existing tariff schedule to another

- Less likely to suffer from conventional concerns about tariff reductions being endogenous to industry lobby, either in US or Vietnam
  - Column 2 tariff schedule (Tariff Act of 1930) applies to countries without normal trade relations status with US
  - MFN tariff schedule was negotiated among WTO members in 1995

- Tariff cuts are uncorrelated with contemporaneous export demand, supply shocks, or pre-existing trends (McCaig & Pavcnik, 2018) and initial ownership employment shares

- The BTA does not have industry-specific policies for FDI
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Conclusion
In typical Melitz framework, reduction in variable export costs due to BTA leads to:

▶ Expansion of the most productive firms
▶ Contraction and/or exit of the least productive firms
▶ A rise in industry productivity due to selection and reallocation

Vietnamese SOEs receive preferential access to inputs (Pincus, 2015). Same export costs reduction now depend on productivity and distortions:

▶ Lower productivity firms can continue to produce or expand with sufficiently high subsidy
▶ Higher productivity firms may not expand or could even exit without subsidy
▶ The overall impact on productivity could be negative (Bai, Jin, and Lu, 2019)
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- Using three World Bank Enterprise Surveys, we find that foreign firms are more likely to:
  - Report international markets as their main market (56% vs 24% for state, 21% for private)
  - Report access to finance is not an obstacle (65% vs 29% for state, 39% for private)

The differing barriers that firm-types face might affect how (re)allocation works and we can shed light on this empirically.
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Data: Annual Enterprise Survey 2000-2017

- All VN businesses registered as an enterprise (General Statistics Office)
  - All state and foreign firms must register to legally operate, private firms only if they employ more than 10 workers (but we observe many register below this cutoff)
- Panel with unique firm id: entrants, exits, and continuing firms
- Ownership data: state-owned (SOEs), foreign-invested (FIEs), or private domestic (PRIs)
- 185,189 firms across 127 4-digit industries
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- Panel with unique firm id: entrants, exits, and continuing firms

- Ownership data: state-owned (SOEs), foreign-invested (FIEs), or private domestic (PRIs) ⇒ Papers typically focus on at most two firm-types

- 185,189 firms across 127 4-digit industries
TFP across Firm-Types

Foreign firms are more productive than state and private firms.
Entry and Exit of Firms

- Between 2000 and 2017, there are high exit and entry rates
  - 75% of firms that were operating in 2000 exited by 2017
  - These exiters made up 39% of revenue & 46% of employment in 2000
  - 97% of firms that were operating in 2017 were not in 2000
  - These entrants made up 83% of revenue & 84% of employment in 2017

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Distortion vs Entry/Exit Costs

- Typical heterogeneous firm models predict similar entry and exit rates across different firm types since all firms face similar entry barriers.

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- However, we see big differences across VN firm types: 49% vs 46% exit rates for SOEs vs FIEs, 27% vs 93% entry rates.

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- However, we see big differences across VN firm types: 49% vs 46% exit rates for SOEs vs FIEs, 27% vs 93% entry rates.

- Suggests firm-type-level barriers that affect entry and exit choices.

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Empirical Approach

- Objective: estimate BTA impact on firms and firm-types in VN manufacturing sector
- Rely on variation of BTA tariff cuts across industries
- Examine evolution of outcomes over time
Industry Level Analysis

- Estimate the evolution of industries as a result of BTA:

\[ Y_{jt} = \sum_{t'=2000}^{2017} \beta_{t'} \Delta BTA_j 1_{t'} + \lambda_j + \theta_t + \alpha_{jt} C_{jt} + \varepsilon_{jt} \]

where \( Y_{jt} \) is the outcome for industry \( j \) at year \( t \), \( \Delta BTA_j \) is change in log US tariff applied to VN imports in industry \( j \) before and after the BTA, indicator \( 1_{t'} \) equals one for year \( t' \), \( \lambda_j \) is industry-level fixed effects, \( \theta_t \) is year fixed effects, and \( C_{jt} \) are controls for VN and CH MFA quotas as well as VN MFN tariffs.

- Without controls

- \( \beta_{t'} \) is the cumulative BTA impact on the outcome by each year

- BTA implementation year 2001 is the base year for outcome changes
Industry Level Analysis

- Estimate the evolution of industries as a result of BTA:

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- \(\beta_{t'}\) is the cumulative BTA impact on the outcome by each year

- BTA implementation year 2001 is the base year for outcome changes

- Short pre-BTA period due to data limitation
We can establish a longer pre-BTA period with US imports from VN (UN Comtrade data)

\[ IM_{jt} = \sum_{t'=1996 \backslash 2001}^{2018} \beta_{t'} \Delta BTA_j \mathbb{1}_{t'} + \lambda_j + \theta_t + \alpha_{jt} C_{jt} + \varepsilon_{jt} \]
Summary of Industry Results

▶ Vietnamese industries subject to larger US tariff reductions expand relative to the industries with lower tariff cuts

▶ Employment, firm counts, and revenue (noisy)

▶ Cumulative effects grow for 5-6 years after the BTA, after which they accumulate more slowly but continue to rise (firm count and employment) or begin to level off (revenue)

▶ Consistent with typical predictions, as resources and revenue allocate toward industries experiencing greater declines in variable export costs
Industry and Firm-type Analysis

Next, focus on each firm type $o \in \{FIE, SOE, PRI\}$ respectively:

$$Y_{jot} = \sum_{t' = 2000 \backslash 2001}^{2017} \beta_{ot'} \Delta BTA_j 1_{t'} + \lambda_{jo} + \theta_{ot} + \alpha_{jt} C_{jt} + \varepsilon_{jot}$$

where $Y_{jot}$ is the outcome for firm type $o$ in industry $j$ at year $t$, $\Delta BTA_j$ is the change in US tariff applied to VN imports in industry $j$ before and after the BTA, indicator $1_{t'}$ equals one for year $t'$, $\lambda_{jo}$ is industry-ownership-level fixed effects, $\theta_{ot}$ is ownership-year fixed effects, and $C_{jt}$ are controls for VN and CH MFA quotas as well as VN MFN tariffs.

$\beta_{ot'}$ is the cumulative BTA impact on the outcome on ownership $o$ by each year.

Longer pre-BTA period
Employment by Ownership

- Industries with larger tariff cuts experience expansion of foreign and private firms, smaller contraction of state firms (relative expansion given overall decline).

BTA was implemented in Dec 2001 (base year 2001). Dashed lines show 95 percent Confidence Intervals. 4-digit industry and year FE are included with standard errors clustered at the 4-digit industry level. MFA VN and CN quota controls as well as VN MFN tariffs are included. Weighted by year 2000 industry employment.

Related Party
Summary

- Industry-level results are generally in line with traditional trade theory.

- Industry and firm-type: industry-level expansion is predominantly driven by foreign firms (over private and state firms), and is sustained over time.
  - Important to control for firm-type-year trends, especially for state firms.
  - State firms are declining less in industries with higher cuts.

- Next Question: How is employment share/market share reallocating across firm-types within industries?
  - Split firms into continuers, entrants, and exits (status).
Effects of BTA Tariff Cuts on Employment Shares by Firm Status

- Tariff cuts result in expansion of entrants, declines in continuing and exiting firms
  - Entry response is particularly pronounced; Counter to typical predictions, continuers contract in response to lower tariffs
Effects of BTA Tariff Cuts on Employment Shares by Firm Status
Tariff cuts result in increased employment share of foreign firms, reduced private share, and no change for the state firms.
Effects of BTA Tariff Cuts on Employment Shares by Firm-Type

![Graph showing the effects of BTA tariff cuts on employment shares by firm-type.](image-url)
Foreign firm entry is driving (1) overall employment growth in entrants and (2) overall growth in foreign firms, while foreign incumbents and exiters decline in employment shares.
Effects of BTA Tariff Cuts on Employment Shares by Firm Status: Foreign
Effects of BTA Tariff Cuts on Employment Shares by Firm Status: State

- Tariff cuts lower state entrant employment shares but increase exit shares
  - Entrants enter at lower rates in high cut industries relative to lower one, exit rates are lower
  - Counter to benchmark model predictions: If everything is allocated efficiently before, we would expect the opposite result (entry contributing to and exit taking away from emp share)
Effects of BTA Tariff Cuts on Employment Shares by Firm Status: State
Effects of BTA Tariff Cuts on Employment Shares by Firm Status: Private

Tariff cuts increase entrant and decrease exit shares initially, but diminishes over time.
Effects of BTA Tariff Cuts on Employment Shares by Firm Status: Private
Effects of BTA Tariff Cuts on Employment Shares by Firm Status & Type

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2017 coefficient. Bolded term indicates statistical significance. Controls: initial employment shares interacted with year fixed effects and Chinese exports to the US.
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- Focus on entry: how much of this is initial entrant size vs subsequent growth?
Growth after entry: Foreign firms that enter in 2001

- Foreign entrants are larger than average private entrant, and grow by a factor of > 4 by 2017

The figure tracks surviving firms within the 2001 entry cohort. Initial employment is the mean of entry employment (in 2001) among surviving firms in each year. Contemporary employment is the mean of contemporary employment among surviving firms in each year.
Growth after entry: Private Firms that enter in 2001

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Growth after entry: Private Firms that enter in 2001

- Private entrants are smaller, and grow by less—factor of $< 2$ by 2017—Difference not driven by smaller private firm size (50 or more)

The figure tracks surviving firms within the 2001 entry cohort. Initial employment is the mean of entry employment (in 2001) among surviving firms in each year. Contemporary employment is the mean of contemporary employment among surviving firms in each year.

PRI 2010 entry
Growth after entry: State Firms that enter in 2001

- State entrants are larger than average foreign entrant, but contract over time

The figure tracks surviving firms within the 2001 entry cohort. Initial employment is the mean of entry employment (in 2001) among surviving firms in each year. Contemporary employment is the mean of contemporary employment among surviving firms in each year.
Growth after entry: Foreign, State, and Private Firms that enter in 2001

- Large differences in employment growth after entry across firm-types relative to initial employment—important to examine longer term adjustments

The figure shows the ratio of contemporary employment to initial employment among surviving firms within the 2001 entry cohort. Initial employment is the mean of entry employment (in 2001) among surviving firms in each year. Contemporary employment is the mean of contemporary employment among surviving firms in each year.
Decomposition of Tariff Effects on Emp Share through Foreign Entry

- Tariff effects initially driven by entry size, while contribution from subsequent growth increases over time
- By 2017: half is due to initial entry size and half is subsequent growth

The left figure analyzes the emp share based on entrant’s initial employment. The right figure analyze emp share based on entrant’s post entry change in employment.
Conclusion

- This paper assesses the longer-term impact of a one-time trade policy reform on firms.
- We find important differences in the effects of trade policy on foreign and private domestic firms in a low income country with a large state sector.
  - Expansion is predominantly driven by foreign firms over private domestic and state firms.
  - Private domestic firms have not seen employment growth in response to export opportunities.
- Results highlight the importance of studying the cumulative effect of trade shocks on incumbents, entry, and exit by firm-type over a 16-year period.
  - Foreign entry drives overall reallocation, while state firms stall it through low exit rates.
  - Employment growth effects in foreign entrants take time to materialize in response to tariffs.
Conclusion

- We find that FDI and exports are complementary
  - Main industry-specific policy change is a tariff reduction in exports destination
  - VN already open to FDI, then subsequent opening of export opportunities
- Exports positively respond to tariff cuts, with the effects increasing over time
  - Main effects is to the US initially, with expanding effects to other countries
- FDI responses to tariff cuts follow similar cumulative pattern as exports
- Takeaway: entry and firm-types are two important factors to take into account when trying to understand the short- and long-term impact of trade liberalization episodes
### Manufacturing Sector in Vietnam: Employment Share

- Substantial increase of foreign-invested firms: 22% of employment in 2000, 58% by 2017
- Large decline of state-owned firms (45% to 3%), while private domestic firms grow (33% to 39%)

![Manufacturing Employment Share](chart)

<table>
<thead>
<tr>
<th>Year</th>
<th>Foreign</th>
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<td>2001</td>
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<td>2009</td>
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<td>2017</td>
<td>0.58</td>
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Manufacturing Sector in Vietnam: Employment by Initial Ownership

- Large initial state sector: 46% of employment in 2000, 9% by 2017 (vs 2017 current type 3%)
- Large employment increase of initial private domestic firms (32% to 34%, vs current type 39%) and foreign-invested firms (22% to 57%, vs current type 58%)
Manufacturing Sector in Vietnam: Revenue Share

- Large state-owned sector: 38% of revenue in 2000, < 5% by 2017
- Foreign-invested firms started with 41% of revenue with increase to 60% in 2017, increase in private domestic firms (20% to 35%)
We do not find any strong correlation between the initial within industry employment shares for each ownership type and their corresponding industry-level BTA tariff cuts.

The employment shares are in 2000. The tariff reduction is $\ln(1+\text{Column2}) - \ln(1+\text{MFN})$. Each observation is weighted by total industry employment in 2000.
FDI policy in the BTA

- Includes commitment that VN would open market access for US FDI, focusing on services
  - VN was already relatively open to FDI in manufacturing by the BTA
    - No manufacturing industries required special approval for an investment entry license under the 1996 Foreign Investment Law
    - Very few restricted sectors (tobacco, sugar and alcohol, chemicals, pharmaceuticals)

- BTA was viewed as a stepping stone to WTO
  - Commitment to eliminate gov screening of FDI, removal of all trade-related investment measures inconsistent with the WTO
  - Accomplished by the 2006 Unified Investment Law (covers all enterprises)
    - Freedom in terms of entry mode of foreign firms (full ownership vs joint venture)
    - Abolished local content requirements and export performance requirements

- 77% of manufacturing foreign employment were wholly owned in 2000, 95% by 2017
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<td>Year 2010</td>
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<td>FIEs</td>
<td>PRIs</td>
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<td>Revenue</td>
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<td>Employment</td>
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<td>44,958</td>
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Revenue and Assets are measured in millions of Vietnamese Dong.
Entry and Exit of Firms between 2000 and 2010

- Between 2000 and 2010, there are high exit and entry rates
  - 65% of firms that were operating in 2000 exited by 2010
  - These exiters made up 36% of revenue & 42% of employment in 2000
  - 92% of firms that were operating in 2010 were not in 2000
  - These entrants made up 68% of revenue & 73% of employment in 2010

<table>
<thead>
<tr>
<th>Share of</th>
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<th>Revenue</th>
<th>Employment</th>
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<tr>
<td>All ownership types</td>
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<td>Entrants</td>
<td>0.92</td>
<td>0.68</td>
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Manufacturing Sector in Vietnam: Revenue
Ownership Distribution across Industries

2-digit manufacturing industries are sorted by tariff change (largest tariff cut on the left and smallest on the right).
TFP across Firm-Types: Incumbents

- 2010 TFP convergence driven by SOE incumbents
Comparison without and with controls

- The impact of BTA is large even in the absence of controls

- MFA expiry in 2005: VN exports were constrained before while CH exports would compete with subsequent VN exports

- VN joined WTO in 2007: reduction in VN MFN import tariffs

BTA was implemented in Dec 2001. 3-digit industry and year FEs are included.
Base year is 2001. Dashed lines show 95 percent confidence intervals.
Standard errors clustered at the 3-digit industry level. Weighted by year 1997 world imports from VN.
We can establish a longer pre-BTA period using the 1998 Industrial Complete Survey for foreign vs state and private firms.

PRIs and SOEs could not be separated in 1998 in a way consistent with later years because employment in joint stock companies was not listed as > 50% state or ≤ 50% state as in the enterprise data. Hence, we don’t know how to assign JSC employment to either state or private.
US Related Party Trade with Vietnam

- BTA tariff cuts result in an increase in US non-related party imports from VN

US Related Party imports from VN (Census Bureau): transactions which includes “Any person directly or indirectly owning, controlling, or holding with power to vote, $\geq 5\%$ of the outstanding voting stock or shares of any organization and such organization.”
World Imports from VN: With and Without the US

World Imports from VN without US shows presence of scale-spillovers to other markets

\[ IM_{jt} = \sum_{t'=2000\backslash 2001}^{2017} \beta_{t'} \Delta BTA_j I_{t'} + \lambda_j + \theta_t + \alpha_j C_{jt} + \varepsilon_{jt} \]
BTA was implemented in Dec 2001 (base year 2001). Dashed lines show 95 percent Confidence Intervals. 4-digit industry and year FE s are included with standard errors clustered at the 4-digit industry level. MFA VN and CN quota controls as well as VN MFN tariffs are included. Weighted by year 2000 industry employment.
Revenue by Ownership

BTA was implemented in Dec 2001 (base year 2001). Dashed lines show 95 percent Confidence Intervals. 4-digit industry and year FE{s} are included with standard errors clustered at the 4-digit industry level. MFA VN and CN quota controls as well as VN MFN tariffs are included. Weighted by year 2000 industry employment.
Growth after entry: Foreign Firms 2010 Cohort

The figure tracks surviving firms within the 2010 entry cohort. Initial employment is the mean of entry employment among surviving firms in each year. Contemporary employment is the mean of contemporary employment among surviving firms in each year.
The figure tracks surviving firms within the 2001 entry cohort. Initial employment is the mean of entry employment among surviving firms in each year. Contemporary employment is the mean of contemporary employment among surviving firms in each year.
Growth after entry: SOEs 2010 cohort

The figure tracks surviving firms within the 2010 entry cohort. Initial employment is the mean of entry employment among surviving firms in each year. Contemporary employment is the mean of contemporary employment among surviving firms in each year.
BTA was implemented in Dec 2001 (base year 2001). Dashed lines show 95 percent Confidence Intervals. 4-digit industry and year FE\s are included with standard errors clustered at the 4-digit industry level. MFA VN and CN quota controls as well as VN MFN tariffs are included. Weighted by year 2000 industry employment.
Growth after entry: PRIs 2010 cohort

The figure tracks surviving firms within the 2010 entry cohort. Initial employment is the mean of entry employment among surviving firms in each year. Contemporary employment is the mean of contemporary employment among surviving firms in each year.
The figure tracks surviving firms within the 2010 entry cohort. Initial employment is the mean of entry employment among surviving firms in each year. Contemporary employment is the mean of contemporary employment among surviving firms in each year.
Population Census employment estimates

- In 1999, based on workers age 15 to 64:
  - 35.06 million total workers
  - 3.15 million (9.0 percent) in manufacturing
  - 1.30 million (3.7 percent) in formal manufacturing

- In 2009, based on workers age 15 to 64:
  - 46.12 million total workers
  - 6.46 million (14.0 percent) in manufacturing
  - 3.68 million (8.0 percent) in formal manufacturing
Foreign Employment by Source Country

- In 2000: Taiwan 36%, South Korea 19%, Japan 14%, China .1%, US 1.2%
- In 2015: Taiwan 23%, South Korea 28%, Japan 14%, China 8%, US 1.4%