



**Research into the Role of the Private Sector in Rural Transport**  
**South East Asia Community Access Programme (SEACAP)**  
**SEACAP 014/001**

**FINAL REPORT**  
**Volume 1**  
**Executive Summary & Main Report**  
**18 May 2005**

**Mekong Economics**  
24 Tran Vu, Hanoi, Vietnam  
Tel/ Fax: 84 4 7162177  
Email: [mekongconomics@hn.vnn.vn](mailto:mekongconomics@hn.vnn.vn)  
Website: [www.mekongconomics.com](http://www.mekongconomics.com)

## EXECUTIVE SUMMARY

This study assesses the capacity and constraints to private sector participation in rural transport infrastructure, consulting and services in Vietnam. It will inform design of the third rural transport project (RT3), and more generally, Ministry of Transport (MoT) policy directions.

The study concludes that private enterprises are ready, and the legal environment adequate, to see an increased role for the private sector in rural transport. There remain problems of legal compliance, which are symptomatic of local cartel arrangements (“managed markets”), and unclear delineation of state management and commercial roles.

The RT market is small, typically around 20 billion VND per province. About half of all contracts are arranged through limited bidding or appointments, with favouritism to SOEs and ex-SOEs. Local collusive practices sustain inefficient enterprises and hinder expansion to other areas.

PS enterprises are also constrained by low margins, illegal payments (“leakage” is reportedly around 30% of contract value), late payments and financing costs.

Nevertheless, PS enterprises are growing in the relatively more favorable regulatory environment, and as high levels of growth and investment is sustained. There is generally adequate capacity, diversity and mobility of PS contractors and consultants, and PS expertise is developing faster than government capacity. The fundamental challenge for PS agents, including service operators, is how to break into managed markets.

The Government of Vietnam (GoV) must “make markets work” and, in particular, address the moral hazard problem of being both regulator and enterprise owner. Immediate measures can include a clearer separation of functions, quotas for non-SOE contracts in projects, and further equitisation of SOEs. Accountability and transparency can be strengthened by a campaign to ensure compliance with existing laws and regulations, including punishment for breaches such as avoiding competitive bidding. More *public* information dissemination is necessary. As are capacity building and professionalisation activities (e.g. certification of consultants). Detailed recommendations are explained in the main report.

### Private Sector in Rural Transport – key Recommendations

#### Recommendations for GOV

- Reserve work for non-SOEs in all donor programs.
- Enforcing compliance and transparency are the most effective ways to enable PS participation and development.
- Restrict provinces in contracting unfunded projects and in the proportion of shopping and limited bidding contracts.

#### Recommendations for Provinces

- Cartels: reduction of influence:
  - a) favour commune-based service operators.
  - b) improve participation and liaison with general business associations
- Delete capital requirements of bidders.
- Strengthen the role of consultants and community supervisors.

#### Implications for RT3

- Require community representatives to (i) approve workplans; (ii) participate in bid evaluations; and (iii) conduct and assist consultants in supervision.
- General demand for bigger packages, higher design standards, more sealing and concreting of village roads.
- Provide a special fund for site/spot improvements for local teams.

At the provincial level, awareness must grow into consensus that managed markets do not serve the public interest. One second-best approach is to set quotas while strengthening public information systems (including more participation by local people and business associations). A proportion of contracts may be allocated to new competitors, and a percentage of jobs for non-local supervision consultants. Provinces should also simplify and expose poor practices in work certification and payments, penalize slow approval processes, and remove capital requirement criteria for bids.

RT3 can also take actions to encourage PS involvement and undermine management of markets. Generally, RT3 should focus on fewer process elements and interventions, so as to make deeper and sustainable changes. The procedures in the Operations Manual should be simplified, and “percentage of unfunded budget in last AWP” be included as criteria for RT3 support. Community representation should be increased in approving workplans, bid evaluation committees, site supervision, and in approving bus licenses.

In programme design, RT3 should develop a consistent approach to enable bigger packages and higher design standards. A special fund should be established for site/spot improvements by local teams, and more attention given to capacity needs by benchmarking specific tasks and competencies. RT3 should also increase training to increase understanding of RT3 documents and procedures, and make an explicit sub-component to disseminate and ensure feedback from projects.

RT3 should, on the one hand, better understand the present incentive structures faced by leaders, staff and contractors in project participation and implementation. On the other hand, it should better articulate where it wants to be heading (by setting benchmarks and performance criteria). That “vision” would include an enhanced role for competitive and efficient large-scale private sector operators. This report presents a set of recommendations which, in part, will assist the transition to a more efficient rural transport sector based on competitive markets<sup>1</sup>.

---

<sup>1</sup> This report references a large volume of supporting documentation collected and drafted as part of this research effort (Volume 2 of this Report). Copies of the supporting documentation may be obtained by contacting [mekongeconomics@hn.vnn.vn](mailto:mekongeconomics@hn.vnn.vn)

**TABLE OF CONTENTS**

<i>List of Figures</i>	<i>II</i>
<i>Abbreviations and Terms</i>	<i>III</i>
<b>1. Objectives of the Study</b>	<b>1</b>
<b>2. Private Sector Context</b>	<b>1</b>
<b>3. Infrastructure Services</b>	<b>2</b>
3.1 Demand and supply	2
3.2 Market Efficiency Issues	4
3.3 Private Sector concerns	5
3.4 Service Quality	6
3.5 Consultants	7
3.6 Equity and Targeting Concerns	7
<b>4. Rural Transport Services</b>	<b>8</b>
4.1 Rural Transport Services and Operators	8
4.2 Rural Transport Services Demand and Supply	8
4.3. Constraints in operations	9
4.3 Consumer welfare, fares and the poor	10
<b>Recommendations for GOV</b>	<b>12</b>
<b>Recommendations for Provinces</b>	<b>13</b>
<b>Implications for RT3</b>	<b>14</b>
<b>Implications for Donors</b>	<b>15</b>

**LIST OF FIGURES**

Figure 1: Percentage of Contractors' Revenue from Rural Transport	3
Figure 2: Winners and Losers in Transport Sector: SOEs or non-SOEs?	6
Figure 3: Diversity of Services in RT	9
Figure 4: Fare per Km, by Bus and by Motorcycle	11

**ABBREVIATIONS AND TERMS**

ADB	Asian Development Bank
BAR	Basic Access Road to commune centre
Bn	Billion VND
DAF	Department of Administration and Finance
DFID	Department for International Development (UK)
DPC	District People Committee
DPI	Department of Planning and Investment in line ministry
GOV	Government of the Socialist Republic of Vietnam
LBT	Labour-based Technology
MOT	Ministry of Transport
Mn	Million VND
ODA	Official Development Assistance
PDOT	Provincial Department of Transport
PER	Public Expenditure Review
PPC	Province Peoples Committee
PMU	Project Management Unit
PPMU	Provincial Project Management Unit
PRIP	Provincial Road Improvement Project
PS	Private sector
RT2, RT3	World Bank Rural Transport Project 2, 3
RTU	Rural Transport Unit, MOT
SEACAP	South East Asia Community Access Programme
SOE	State-Owned Enterprise
TOR	Terms of Reference
VND	Vietnam Dong Currency
VOC	Vehicle Operating Costs

## 1. Objectives and Approach of the Study [see Note 1; and WB (3) in Attachment 2]

Vietnam is committed to developing a multi-sector economy, and that includes active support for developing a strong and competitive private corporate sector. In that context, SEACAP commissioned Mekong Economics Ltd. to undertake this study to assess the capacity and constraints to private sector [PS] (see Note 1b, Attachment 1) participation in rural transport [RT] services, consulting, construction and maintenance works. That assessment has led to a wide range of recommendations for consideration by the Ministry of Transport [MoT] and the 3<sup>rd</sup> Rural Transport Programme [RT3].

This research for this report was conducted over three months and included extensive fieldtrips to Phu Tho, Lao Cai, Quang Nam and Vinh Long provinces. These provinces represent the geographic diversity of Vietnam (and Phu Tho and Lao Cai are pilot provinces for RT3). Preparation for the fieldtrips involved reviews of previous and current survey work. We would like to thank the PDOTs for their assistance in logistical arrangements. In the provinces, twenty-two transport service operators were interviewed, and focus groups involved around 200 participants [see Attachments 4, 7.14]. Traffic count records were reviewed, some moving counts were recorded, and transport users were interviewed at market centers [Attachment 7.13].

In this report we firstly introduce the general context of private sector development in Vietnam and in the RT sector. Section 3 then reviews the demand and supply situation for infrastructure services (3.1), followed by analysis of market efficiency issues (3.2), review of concerns specific to developing the PS (3.3) and service quality issues (3.4). Discussion of consultancy work for RT projects, and equity and targeting concerns, conclude the infrastructure discussion. In Section 4 we look at rural transport services. The overview of demand and supply for RT services (4.2) is followed by a discussion of constraints for developing the sector (4.3) and concerns about consumer welfare, fares, and the poor (4.4).

## 2. Private Sector Context

Recent changes to the Constitution, to taxation legislation, to the land law, and to legislation on commercial arbitration represent important steps in developing the foundations for a more competitive business sector. The 5<sup>th</sup> Party Plenum on private sector development also called for action to reduce discriminatory treatment of the private sector, and to reduce administrative discretion in implementing regulations. The recent announcement of the Unified Enterprise Law is another step towards a “level playing field” for market competition. In this more supportive legal environment, the numbers of registered private companies have increased dramatically in recent years.

An initial conclusion is, therefore, that in 2005 the framework of laws and regulations is suitable for PS participation, and that formal policy reforms are not a priority concern compared to the need to effectively enforce the recently promulgated legislation. In RT, and elsewhere, there is a general need to move from informal to formal ways of doing business.

In RT, PS enterprises are responding positively to new conditions and opportunities [Coplestone p.18; and Attachment 8] as regulations are reduced [MPDF, p.iii]. The constraint on their growth and market efficiency, however, is the persistence of informal and non-transparent business practices. Resistance to change is strong in local situations, where there is a preference for maintaining order and avoiding the ‘noise’ (or contest) of open

markets [Note 4], and personal relationships weaken the legal framework, especially in contract law [WB (3) PER p. 22].

The move to “rule by law” is constantly undermined by the contradictions of having the government as both owner and regulator of economic activity (“moral hazard”). Consequently, GOV staff and enterprises often cooperate to manage markets. Managing includes flexibility in procurement rules, limited number of bidders, rotation of work for enterprises, subcontracting, sharing of equipment and key staff, and allocating some opportunities for SOEs which are in transition to equitised businesses or are heavily indebted.

Managed markets (see Note 8b, Attachment 1) discriminate against new entrants, which in Vietnam mean the private sector. SOEs therefore have better access to information, land, capital and equipment, and have fewer problems with job management, dispute resolutions and variations in contracts. These managed markets bring some benefit in terms of short-run stability or work and employment, but at the much higher cost of inefficiency and corruption. The job of government is to make markets work better and equally for all, and not to favour of team of players over another.

### **3. INFRASTRUCTURE SERVICES**

#### **3.1 Demand and Supply**

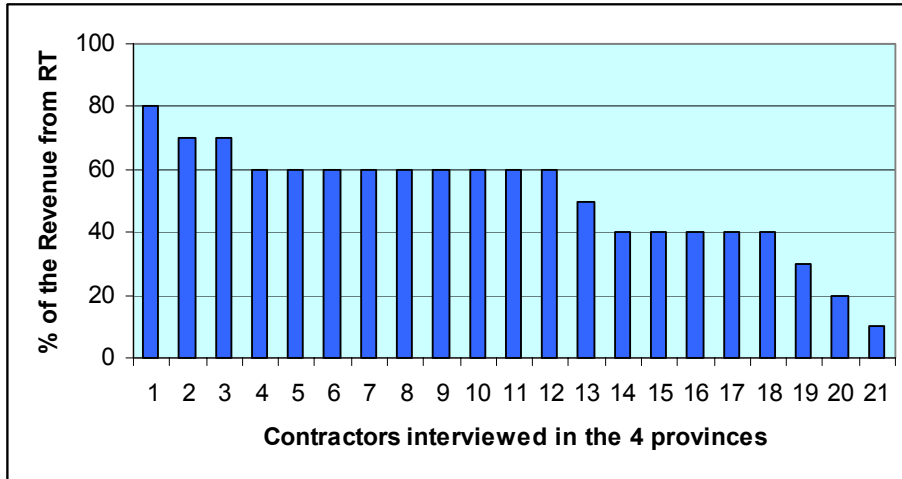
The RT market seems to be characterized by a situation of over-supply, despite the increased volume of ODA lending for RT development. The market is also small, typically around 20 billion VND per province, and with negligible maintenance budgets. All transport sector work is around 10% of state budget in a typical province, indicating a share of around 5% in all civil works. Such broad estimates would place typical RT demand at 1% of total works in a province [see also Mick Foster, Annex 4]. Non-RT civil works demand will grow faster than RT works (as constrained by state budget) [see CIEM p.10-14].

Consequently, companies do not specialize in RT work and diversify into construction; irrigation; electricity construction and distribution; industrial construction; materials production; equipment leasing; fuel supply. Figure 1 shows that, of 21 RT contractors interviewed, RT work accounted for 30-70 percent of their total revenues. The figure is ranked by total revenue in 2003 (i.e. the contractor with the largest revenue is “1” and the lowest “21”), and we can see that RT work was generally a higher share of total revenue for the smaller contractors, which also tended to be private.

Almost all new road work comes from special programmes and donors. For a typical district involved in some donor programmes [see ADB in progress, 2004; and Attachment 7.3], the PPMU processes about 10 – 15 Bn per year; while the public mobilizes about 4 - 5 Bn each year, plus 1 Bn from the DPC. The latter fund is mostly allocated to the maintenance and small repairs team of the state-owned Road Management Units. Typically there are 10-20 enterprises and work groups competing for that work, plus another 5-10 from province level who might be attracted by larger packages [Attachment 7.2, 7.4].



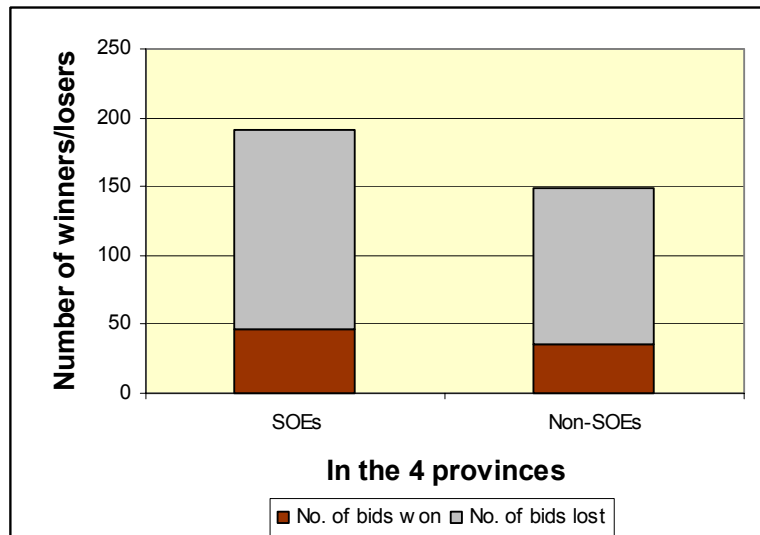
**Figure 1: Percentage of Contractor Revenues from Rural Transport jobs**



Source: Attachment 7.3

Figure 2 shows that the share of PS contractors in terms of numbers of bids (sum up of number of bids won and number of bids lost) and the number of bids won is not much less than for the SOEs. This is partly because donor projects, with their tougher conditions, transparency and competitive bidding have resulted in more contracts going to PS contractors. The larger contracts, however, are mostly from the state budget and go to SOEs (and recently equitised SOEs). About half of the contracts are arranged through limited bidding or appointments, and many of these smaller jobs go to PS enterprises [Attachment 7.2]. SOEs and favoured ex-SOEs therefore end up taking a large share of the thin market.

**Figure 2: Winners and Losers in Transport Sector: SOEs or non-SOEs?**



Source: Attachment 7.2

The increased supply of PS contractors is due to rapid economic growth and investment, focused donor programmes, equitisation, and changes in regulations [Attachment 8]. The PS is active and increasing its market shares across all forms of civil works [see Concetti p.7; Copplestone p.29; CIEM p.14; MPDF p.4]. Competitive forces being introduced in other sectors are impacting on the RT sector.

Most significantly, contractors are increasingly seeking work in other provinces and districts. This has been helped by improvements in transport and communications, but it also suggests better regulations and more open competition. If this trend continues, consolidation of contractors may occur as the more efficient ones grow.

At present, however, there is generally adequate (and maybe excess) capacity, as well as diversity and mobility of RT contractors and consultants. There are many recent entrants, many failing enterprises, and competition is intense for even small contracts. Within this generally dynamic market environment there remain, nevertheless, a small but important number of protected state enterprises.

Many stakeholders, including some GOV officials, want a period of consolidation and limitations on new entrants to the RT market. They worry about the apparent cruelty of an “unmanaged market”. Their main concerns focus on stability and quality, and they argue that there are already enough contractors and service operators available, and that quality will be threatened by more small competitors. They suggest a “strategic pause” to allow for a process of consolidation of the existing enterprises [see also Concetti p.23]. These concerns are misplaced. The RT market is undergoing fundamental changes that are making it more efficient, which means cost-effective. In general that process will probably involve a reduction in the total number of contractors and an increased share for the PS. Slowing that process of change only imposes unnecessary costs.

### **3.2 Market efficiency issues**

The RT market is far from perfect, but it is also functioning and competitive. Market efficiency can be increased in a number of areas. In this section we explore those that apply to all contractors, and in the next we look at those that are the particular concern of PS contractors.

**Size matters.** RT works averaged over five years appear to contribute around 40-50% of the revenue of a typical small, district-based contractor, and around 20-30 % of a typical, larger, province-based contractor. The general opinion is that the small contractors cannot grow from the typical demand and packages in the RT sector [Note 9; see also Mick Foster, Annex 3].

Small contractors in RT get almost all of their work through Appointed Contracts. The skills and personnel and resources to prosper in this appointments market are generally not expandable into the competitive bidding market of larger contracts.

It seems likely that most locally-grown district-based contractors will be squeezed out of wider markets by more central enterprises with broader, diverse revenues and business networks, including better access to various donor projects. This is not necessarily a bad thing if it means greater cost-effectiveness. Further, clearer and more transparent processes may evolve as enterprises and individual contracts become larger [ILO p.7; Concetti p.24].

**Leakage** is reportedly around 30% of contract value [Note 8b, Attachment 1]. The public interest concern is to identify where the contractor is saving funds between the real cost of the work done and the certified, as-built cost, and then to propose remedies. Opinions from the fieldwork suggested checking if the engineer's cost estimate was too high, if contract variations were properly verified, and if actual wages paid according to the cost estimates. Provisions that ensure mandatory public disclosure of all information related to contracting would go a long way to reduce leakage.

**Business uncertainty** is much greater in an environment characterized by leakage and collusion, which is exacerbated by the tendering of projects which are un-funded or under-funded in budgets. Uncertainty also increases due to excessively complex **project administration and co-ordination**, which is reportedly "a constraint on planning and implementing the works, and a cause of corrupt payments". The multiple links between involved agencies [sub-systems] weakens information flows and delays decision-making [Note 14; Attachment 5.2]. Knowledge and information are not flowing well from and within the GOV. There is a justifiable demand for fewer agencies and steps in all processes.

**Late payments** due to multi-step procedures, personal interests in bureaucracy, and errors in information impose further costs upon enterprises [Note 12; ILO p.14, Note 11; WSP (2) p.7]. One of the most frustrating delays appear to be in obtaining the "sign off" document after a satisfactory quality audit [see also RT2 (2) p.1, 6]. Processes in RT2 and ADB PRIP (using Imprest/Advance Account) [Attachment 5.2B], were praised as they provided few excuses for late payments. The consensus was that work on delayed payment contracts is not below required standards, although sometimes work is slowed, or even stopped, because of overdue payments.

Given strong competition and the above problems, it is not surprising that reported profit margins are low. For open-bidding packages (more than 1 Bn), contractors reported that they expect around 5% net profit, and their bids are typically 8 to 12 percent lower than Engineer's estimate [see also Copplestone p.19]. Where bids are invited on 'competitive price offer' (from 0.5 to 1 Bn) and appointed contracts (under 0.5 Bn), they still only expect 5% profit, although the contracted price is typically 0 - 8% lower than Engineer's estimate. In reality, the real profit margin on larger packages is probably higher, but also low by international standards.

RT contracts entail unjustifiably high levels of uncertainty and business risk, not to mention leakages. These are costs that any company needs to accommodate. In the context of over-supply, companies tend to underestimate such risks to obtain jobs and then suffer the consequences. It is not the responsibility of government to help such companies, but rather to reduce the uncertainties and risks faced by all companies in the RT market, both private and state.

### **3.3 Private Sector concerns**

PS contractors are smaller than SOEs, and tend to do a large share of the smaller projects. As noted above, this presents the problem of how to grow into larger companies and win larger tenders. They also face systematic discrimination.

Most financing of PS contracts comes from owner or family savings, cash from other projects or activities, or (for 'hot cases') from the local moneylenders with personal guarantees and

short terms [Attachment 10; CIEM ch.5]. PS contractors typically cannot access bank loans. Banks impose complicated procedures (especially for new companies), and require much time and cost to process transactions. Generally, banks still see PS companies as too small and find it hard to monitor their business activity. There is potential for small enterprises to use the Bank of Social Policy (VBSP) – but only with state approval, which has its own costs and delays. Further, banks have a strong preference for SOEs as they come with explicit or implicit GOV guarantees, have borrowing histories, and have easier access to land as collateral. Access to capital is the most serious and possibly the binding constraint stopping PS contractors growing into larger companies.

While information transparency could improve in many areas, it is a particular problem for the less-connected PS contractors. Most officials and entrepreneurs in the RT market suffer from poverty-of-information. Hoarding of information and dependence on a few sources were common practices. There is a need to impose public information disclosure requirements, using public spaces, newspapers and the internet. Without such policies, PS contractors will continue to suffer due to weaker personal links to those GOV officials with information.

Registration of Contractors and Consultants (with profiles, capacity, works done, etc) appears to be an incomplete, informal process. However, it seems that GOV agencies know exactly the capacity of local enterprises, but need to have more formal advice about non-local enterprises. A proper registration system will support the growth of the larger and most efficient firms to grow and to obtain jobs outside of their local areas.

Most contractors had no strong concerns about prequalification requirements for tendering because their capacity was sufficient for RT requirements. Some criteria, however, seemed not to be relevant and to discriminate against new PS firms, such as equipment requirements (when they can be hired or borrowed) and the age of the firm since establishment.

PS firms would, understandably, prefer to reserve some or all RT3 works for non-SOEs and to extend this condition through all donor programmes [see Note 15]. This positive discrimination, however, would segment the market and could trap PS firms into dependence on donor projects, which are only a small part of contracting market [Mick Foster, Annex 3]. Certainly it is unfair that ongoing biases are one reason that SOEs continue to take a large share of state budget contracts, but protected a small part of the market just for PS firms is a “second best” choice relative to leveling the playing field for all firms irrespective of firm ownership. A temporary PS quota could, however, be justified to counteract the ongoing, and hopefully temporary discrimination in favour of state enterprises, but that should go hand-in-hand with addressing the general problems raised in Section 3.2 above.

### 3.4 Service Quality

The **quality of contractors** varied, but was generally quite good. All contractors consulted were able to show that they have good technical staff to implement RT contracts. Management skills seemed adequate. Most directors have long experience and a formal diploma in the transport and construction business [Note 13]. In the context of over-supply, the reported low margins in tenders might be depressing quality on smaller jobs typical of RT, if only because duty of care and supervision might be less practised on the smaller, remoter jobs. On the other hand, if leakage is really around 30 percent, there would be scope to both reduce contracted prices and increase the quality and (real) margin on jobs simply by reducing illegal practices.

Because of over-supply, low requirements per job [Note 16] and cooperation among associates, there is no demand for a business dedicated to leasing equipment [refer Attachment 9; ILO p.15].

Many stakeholders reported that RT2 road standards are too low, and that roads degrade after only 2-3 years. Gravel appears not to be appropriate for some rural roads. Some commentators expect that RT3 will focus on upgrading RT2 BAR gravel roads to bitumen sealing, instead of constructing more gravel road.

### **3.5 Consultants**

Due to GOV policy reforms and private investor demand, the number and capacity of consulting firms is adequate for current RT workloads and probable demand [Note 18]. The RT context allows consultants to obtain regular work, but ongoing development of their professional skills suffers from an underdeveloped technical and vocational education system.

Local agencies have a strong preference to employ ex-SOE staff in design work, because of their reputations, knowledge of local situations and access to information. They also have advantages in logistics; support services, costs and availability [see also Concetti p.6]. Only time can allow the building of similar “human capital” in the newly emerging private consulting sector.

For most RT projects, locally-based Consultants are appointed through consideration of their dossiers and checking their statements of capability [Note 19]. Surveys show that PPMUs and Consultants still prefer this method and it is recommended for RT3.

Consultants are requested to get a *Supervising Consultant Certification* awarded by MOT after brief training [see Note 19]. There is a need to strengthen support for supervision consultants, as they are on the front-line of imposing quality control upon the managed market cartels. Support to consultants supervising small works can be provided by local residents. Appropriate people, especially women, can be trained and authorised to supervise and report upon locally contracted jobs and on community work.

### **3.6 Equity and Targeting Concerns**

Contracting, consulting, engineering and RT works are overwhelmingly “male domains”. In local work, men and women are equally involved in labouring. Women make up a larger proportion of the lowest paid work [Note 22]. Actual wages paid fluctuate with the season, and the local livelihood activities, and are about 40-50% of the billing rate.

Contractors and RMU’s prefer to employ people who have more experience in roadworks to reduce supervision costs and for quality reasons. More remote, poor and vulnerable people are less in demand and, if selected, their wages are much lower. Subsidising employment of the poor is inadvisable as it is unsustainable, difficult to monitor, and there are more appropriate options for direct targeting expenditures.

Vietnam is well experienced in deploying local labour, and studies show that there are potential gains in productivity and quality by using labour-based technologies [ILO; Mick

Foster, TDSI; LBT] in peripheral, basic access conditions with smaller packages [Note 21]. This suggests a need (in RT3 and state budget works) to develop and support promotion of “appropriate technologies” by managers and technicians at district and commune levels.

#### **4. RURAL TRANSPORT SERVICES**

##### **4.1 RT Services and Operators [see also ADB (2)]**

RT services are competitive within an otherwise highly regulated environment. State management determines the registration of businesses and approval of routes. Fares are stipulated by PPC. State management operates through cooperatives, usually organized around an SOE or equitised SOE. Their main functions appear to be coordination of operators and advice to GOV agencies concerning supply and prices, and to mediate with police and other authorities. SOE operators, however, do not dominant the RT services market and there seem few particular policy biases in favour of SOEs.

Capital and expertise requirements are low for RT service firms, and non-transport enterprises can often provide their own vehicles. Over 75% of operators feel that entry is ‘too easy’, that competition is ‘big ‘or ‘very big’, and ‘is increasing’ [Attachment 7.10].

Nevertheless, cartels exist with varying degrees of formality and effectiveness as the search for profit and protection of market share requires operators to find ways around operating agreements, such as in moving into ‘protected’ routes or serving passengers outside of agreed terminals and bus stops. It seems likely that such PS pressures will erode the influence of cartels and cooperatives and lead to a gradual phasing out of direct state management.

RT service operators operate independently and none interviewed thought that forming a representative Association would be useful.

##### **4.2 RT Services Demand and Supply**

RT services demand is growing at 8-10 percent per annum on inter-urban and long distance routes, despite the rapidly increasing private ownership of vehicles. Most RT service firms are operating in multi-point markets, with numerous small clients whose demand depends on seasonal production; trade and the business cycle [see DFID p.14]. Where road surfaces remain poor, travel is restricted to walking, animals, bicycles, motorcycles, and tractors. These forms of transport account for 90 percent of travel. Motorcycle traffic has doubled in four years, and income trends suggest another doubling in the next 4-5 years [Notes 28, 32; and DFID p.9]. As Figure 3 shows, RT services are diverse. Passenger services dominate revenues (of the firms visited for this study), with inter-provincial passenger services accounting for 30 percent of revenues.

Supply is growing in line with demand for RT services. Sector growth is fundamentally determined by growth in demand because the incomes, savings and credit of entrepreneurs, especially in provincial and district centers, are rising faster than the production and incomes of rural residents. Generally, a positive supply response is swift when vehical operating costs [VOCs] fall or consumer demand rises.

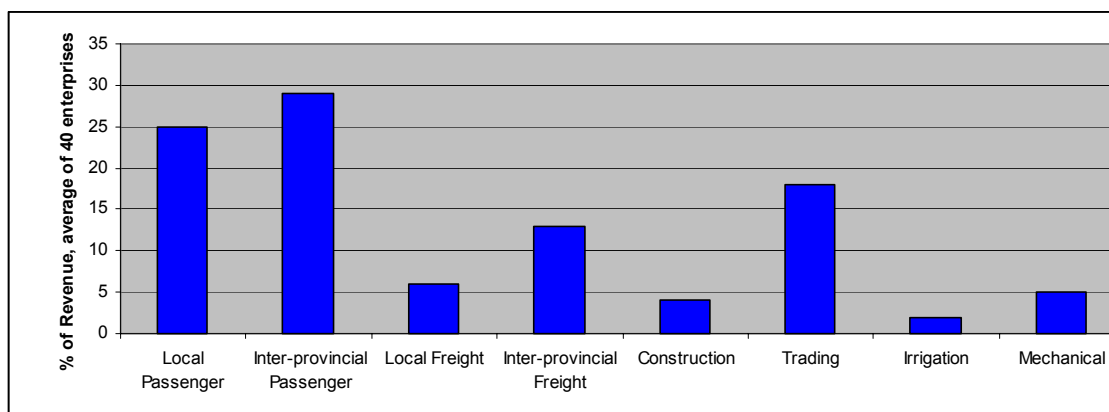
All informants were satisfied with the availability of mechanical and electrical repairs services for RT vehicles and boats, but with some concerns about the quality of services. In some areas, there was interest in setting up well-equipped workshops and providing training and certification for mechanics.

The poor living in remote areas face less choice and higher per kilometer transportation costs. Most do not have reasonable access to bus services, and instead rely on motorbike taxis (xe om). Buses may reach other areas, but their availability and frequency are restricted by VOCs, especially during the wet season. Poor roads and low population densities make cost-effective PS delivery of transport services difficult. Nevertheless, even low quality seasonal roads have had an important impact in improving the access of agricultural wholesalers to villages, which has increased the net price paid to farmers and promoted crop diversification.

### 4.3 Constraints on operations

The numbers of passengers carried per vehicle per day are reported to be falling. To stay competitive, operators believe [Attachment 7.10] that they must buy modern vehicles and equipment, improve their service, and seek new routes. Some admit that they ‘secretly’ offer lower fares, contrary to cooperative arrangements [see Note 27 on pricing]. Profits were reported to be 4-5 percent of turnover in RT services [Attachment 7.9]. Fares have risen recently because of oil prices, but are regarded as not sufficient to cover rising VOC and business costs [including traffic fines].

**Figure 3: Diversity of Services in Rural Transport**



Source: Attachment 7.8

Nevertheless, operators generally reported 8-10% growth in revenues in recent years, although they expect slower growth next year, and it is evident that many operators are borrowing, and paying off debts for new vehicles. The overall impression is therefore one of a competitive market with ease of entry and exit, but also with excessive regulations and the costs and corruption associated with these.

Congestion on inter-provincial routes and deteriorating surfaces, both of which slow travel speeds, are further problems. Inter-urban traffic is growing faster than RT traffic, so operators prefer to invest and operate at that level, with lower VOC. All operators reported that corrupt

payments (sometimes to limit competition and sometimes for no specific return) are a major cost and distraction in their business.

Police are active in enforcing safety regulations, loading limits, and checking the condition of vehicles. RT operators frequently reported that policing is “too zealous” and “costly” in money and delays. Although a sensitive issue, this is something the GOV should investigate. If enforcement of regulations imposes excessive costs upon RT service operators, then that means unnecessarily higher costs of transporting goods to domestic and international markets. It becomes an international competitiveness concern.

On the other hand, claims by operators that they “must overload” [Note 25] make little sense if they are being regularly penalized for doing just that. There are clearly two sides to the story, but the story should be understood and the full costs and benefits of particular regulations, and their enforcement, evaluated.

Operators reported their most serious constraints in RT [Attachment 7.10] as low and variable demand in peripheral areas; difficulty accessing financing and therefore new equipment; inconsistent or ‘unreasonable’ policing. Infrastructure-related concerns included poor road conditions, safety risks, load limits, VOCs, traffic congestion; and for boats, silting of channels and the poor condition of some landings and wharves.

Operators prefer to run bigger vehicles across all networks, but are constrained by load limits and dimensions. These constraints, however, may be justified as there are good safety and road maintenance reasons for such regulations. All countries have them. The issue is whether the detail of the regulations is reasonable, and whether enforcement is fair and transparent. The users’ interests are best served by reasonable regulations focused on protecting public safety and public goods, but generally not by managing markets and limiting competition.

Some waterways services, mostly for construction materials, are impeded by the silting of channels, usually in the dry season (which is also the construction season). This problem, and expanding demand for civil works, is seeing some loads shifting to road networks. This is not necessarily more efficient as the private transportation costs do not reflect the high public expenditures on roads (user fees as small). There is a need to research the costs and benefits of these alternatives, and there might be a need for a cost-sharing programme of dredging in some districts. Similarly, for other cargo and passenger services by water, actual and perceived costs could be reduced by improved landings and wharves [see Note 33].

#### **4.4 Consumer welfare, fares, and the poor**

Bus fares on national and provincial roads are around 200-300 VND per km, varying mainly with the terrain and the degree of competition. Fares are much higher on RT network, to 400-600 VND/km on buses and 800–1000 VND on motorcycles (see Figure 4) [Attachment 7.13; and Note 26; and ADB (2)].

Users are often willing to pay the higher cost of motorcycles, when they have the choice, because motorcycles have no waiting time, are available throughout the day, and they provide direct access to farms and houses. Users change to cheaper bus travel on reliable roads, which link them to larger markets and a stronger relationship with wholesalers.

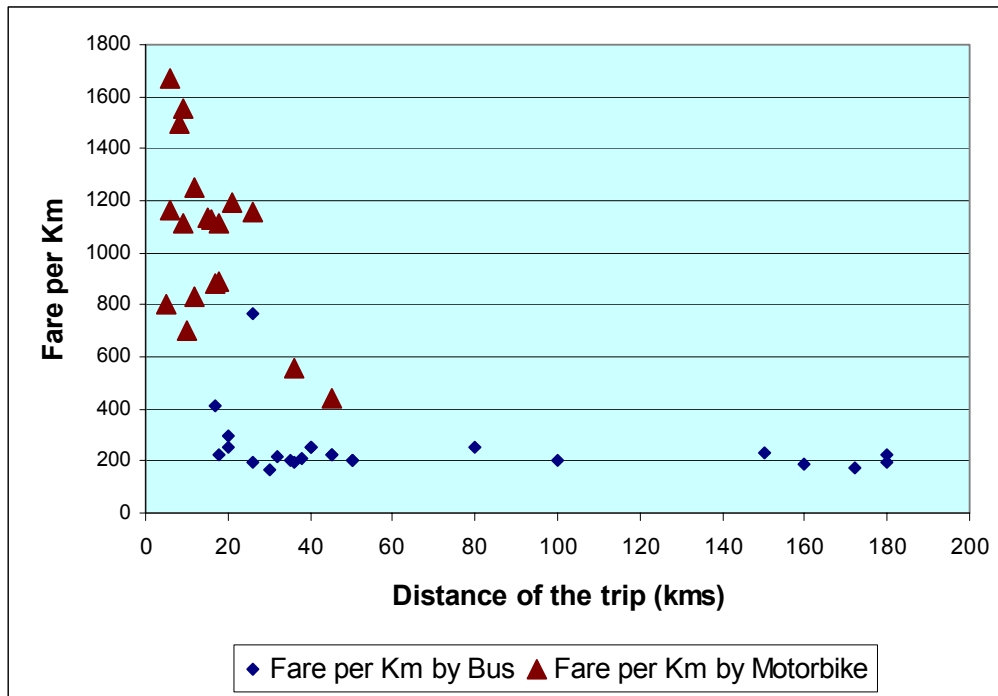


On the more remote and rougher roads, however, users are typically the poorest [DFID p.8-13] and must depend on motorcycles, walking and animals. They are paying more than three times the rate per km (as well as in time per km) than users who live closer to market centres and have access to services by bus. Nevertheless, rough roads that provide motorcycle access have a big impact, as they allow the move from walking and animals to motorcycles (say, from 4 km/h with 50 kgs load; to 20 km/h with 100-200 Kgs) [see also DFID p.8, 14].

Low-standard roads, however, were criticized by the (mostly non-poor) stakeholders interviewed. They reported that RT2 road standards were too low, and that a good level of service is provided for only 2-3 years. Their preference was for fewer kms of sealed roads [Note 29].

Direct subsidies to improving RT services for the poorest areas are not advisable. Subsidies are already implicit in the roads being constructed to reach such areas, and what services emerge to utilize these roads should be left to market forces to determine. Although, given the present regulations, the PPC could improve local supply by approving more commune-based operators, as against center-based applicants.

**Figure 4: Fare per Km, by Bus and by Motorcycle**



Source: Attachment 7.13

RT operators generally reported that safety issues were a minor item in their business [Attachment 7.9], although accident data from PDOTs [Attachment 7.12 and cited in PER (page 22)] confirm the importance of safety as a policy problem. Operators and users reported risks due mainly to rough surfaces on slopes, landslides in hilly country, overloading of vehicles, defective vehicles and, on major roads, vehicle mixture, speed and roadside congestion. Some RT users fear the faster speeds on improved roads, and would prefer traffic calming at corners and intersections.

Some operators believe that fares are set ‘too high’ because they are “influenced by the large overheads of SOEs”, and that there is significant latent demand (‘high price elasticity’) from customers for rides 15-20 percent below the stipulated fares. The policy argument for the GOV setting the precise fare price is weak. Concerns about the quality of the service should be expressed and enforced in safety regulations, not in price controls. There is, however, an argument for setting ceiling prices, as control of particular routes could create local monopoly conditions.

## **Recommendations for GOV**

To strengthen markets and market efficiency the GOV should:

1. Promote the vital role of senior leaders and managers to promote full compliance with existing laws, regulations and procedures.
2. Penalize (through clear conditions in allocations) those PPCs that award contracts in projects that have not been funded, or award a project without bidding if above the minimum value requiring competitive bidding
3. Require (consistent nationwide) Contractor and Consultant registration of capability statements, with public access and independent verification of statements.
4. Increase compliance through community representatives having an active role in prioritizing projects, bid evaluation and works supervision.
5. Challenge ‘leakage’ by reducing the number of steps in licensing and contracting works and services; enforce public disclosure of all bidding information; and conduct inter-agency joint reviews, decisions and approvals, rather than segregated actions among agencies.
6. Accurately monitor delays as an indicator for future allocations to provinces.
7. Provide joint PS-GOV staff training and regular consultations to diffuse oligopoly.
8. Strengthen the contents and standards of training, and the certification process of consultants.
9. Research the real costs and benefits of transporting goods in Vietnam with a view to regulatory changes and more transparent and fair enforcement.

To support the move to a “level playing field” for all enterprises, the GOV should:

10. Separate the administration, ownership and implementation functions of the state to enable more transparent and consistent operations.
11. Set targets to reduce the market share of SOEs and ex-SOEs in civil works.
12. Reserve a specific share of work for non-SOEs in all donor programmes.

13. Improve transparency and information to PS through their general business associations.

## **Recommendations for Provinces**

### To strengthen markets and market efficiency the provincial authorities should:

14. Promote awareness that managed markets do not serve best the long term public interest.
15. Favour commune-based RT service operators.
16. Encourage more participation by local people and business associations in state decision-making processes.
17. Maintain a policy (through design and packaging for competitive procurement) of strengthening existing contractors.
18. Support the sub-contracting of new non-local contractors.
19. Set up Contractor and Consultant Registration (including the listing of actual ownership), with public information and independent verification.
20. Reserve a significant percentage of jobs for non-local supervision consultants. It was noted that non-local supervision consultants imposed a greater discipline on the quality of local projects, as local supervision consultants tended to be less able to be objective in evaluations. The use of non-local supervision consultants should therefore be encouraged.
21. Experiment in several provinces with fare price ceilings rather than fixed prices
22. Research the relative costs and benefits of public investments in road and waterways.

### For improved management and supervision of RT work, the provincial authorities should:

23. Simplify and expose improper practices in work certification and payments.
24. Apply ‘sunset’ clauses in approval processes, with explicit penalties on owners and administrators.
25. Delete the capital requirements of bidders’ eligibility.
26. Require “years of experience” of lead staff, not of the company itself.
27. In Performance Specifications, delete the equipment requirements.
28. Give flexibility to plan the size and technology in contract packages according to the local design of the scheme and the market of procurement.

29. Investigate the supply and standard of mechanics and their assistants at vocational centers; and link them to the training by the major vehicle brands.
30. Support consultants and community supervisors in their site supervision.
31. Empower women as supervisors in works, asset protection and services (including the monitoring of wages and passenger fares).
32. Support and enable more bottom-up planning in RT to promote more local responsibility.
33. PDOT to develop capacity and incentives to support districts and communes, especially in selection and execution of maintenance and small contracts.
34. Consider stricter speed controls at corners, bridges, intersections, and where RT vehicles use main roads of higher capacity.

### **Implications for RT3**

35. Criteria for RT3 support to include “percentage of unfunded budget in last AWP”.
36. Simplify procedures in Operations Manual. Apply only one procedure for RT3 bidding, evaluation, approval and contract signing (unlike RT2) [Notes 23, 24]; and promote joint actions and decisions across agencies, with particular attention to supervision and payments.
37. Reduce the number of persons in Bid Evaluation Committees.
38. Require community representatives to participate in approving workplans, bid evaluations (including preparatory assessment by PDOT, conducting site supervision and assist consultants in supervision, and in approving bus licenses.
39. Consider longer term organisations, incentives and disincentives for leaders and staff and contractors in project participation and implementation (to overcome ad hoc commitments in the life of a project).
40. Make a consistent response to the general request for bigger packages, higher design standards, more sealing and concreting of village roads.
41. Provide a special fund for site/spot improvements for local teams, to reduce local hazards and to promote local responsibility for assets and usage.
42. Improve the focus on real capacity and needs by benchmarking specific tasks and competencies, in collaboration with GOV, PS and community stakeholders.
43. Test a system of independent verification of registration documents and work experience of consultants and contractors, initially in Phu Tho and Lao Cai. Professional associations should be involved in the process and maintenance of the database, and there should be penalties for false declarations.

44. Offer packages of around 300 Mn at communes, and around 1000 Mn at districts, to assist small and local enterprises and enable use of more LBT.
45. Increase the training for contractor personnel in RT3 documents and procedures. The main needs are (as in RT2) on implementation management, quality assurance, and procedures, requirements and terms of donors [see also RT2 (2) p.6]. The training and guidance must be sustained – and NOT provided as a single event only; and should fit closely with work cycles of contractors.
46. Make an explicit sub-component to disseminate and mainstream knowledge from projects.
47. Address the skepticism (especially in PS) about the effectiveness of technical assistance and training, including joint workshops with PS, and objective benchmarking and assessment.
48. Strengthening of supervision consultants might include promotion of their professional associations, and training focused on relationships with contractors.
49. Operations Manuals should be disseminated through a training programme for all entities participating in a project, with well-targeted follow up training.
50. Develop and support the managers, technicians and supervisors at districts and communes (in RT3 and state budget works) to raise productivity through labour-based technologies.

## **Implications for Donors**

51. Development effect – the potential is small for a single project to influence the market and its commercial and technical practices. The implication: focus effort on fewer systems/ organisations/stakeholders so as to make more profound and lasting changes; with stronger demonstration effects to other areas and sectors.
52. Stakeholders in donor projects must consider their sustained impact upon non-donor, normal operations under state budgets. The sheer number of changes in business environment, studies, projects and other interventions seems ‘too much’. Fewer and better-focused activities, with direct incentives and disincentives in implementation, seems more suitable to increasing the flow-on impact.
53. Associations: previous studies [ILO, RT2, Copplestone, Concetti, WSP(2)] advocated industry associations and “Cooperative Alliances” in support of PS development and viability. However, there was little interest expressed by consultants, contractors or operators in forming/joining professional associations. Because of diversity of enterprises, the probable evolution will be gradually through general business associations.
54. To enable equal opportunities for women requires a shift in cultural preferences about the division of labour (including access to and control over capital needed to enter the field). It is highly likely that women’s participation will depend primarily on family connections for the foreseeable future.

55. Affordable, safe and reliable services to poor households and poor areas: the long-term solution is in reduced VOC from better roads. The short-term solution is in improving access for motorcycle, ownership of motorcycle and commune-based operators.