



Improving Vietnam's Sustainability

Key priorities for 2013 and beyond

Taming Unpredictability as Source of Growth: What More Competitive Freight Logistics Can Do in Vietnam

This note summarizes the findings of Blancas et al. (2013), a World Bank report on Vietnam's logistics sector performance, challenges, and opportunities.

Key messages

- While Vietnam has attained a strong track record of economic growth over the past 20 years, the drivers that fueled that growth are rapidly depleting, making it critical to develop new drivers of growth going forward.
- More competitive transport and trade logistics can become a new driver of sustained growth through their positive impact on productivity and their direct influence on business competitiveness.
- Logistics operations in Vietnam are costly relative to key regional peers like China, Malaysia, and Thailand primarily because of the prevalence of unpredictability in supply chains.
- The key root causes for supply chain unpredictability are: cumbersome and inconsistently applied government regulations; lack of automation in key trade-related processes such as trade clearance; fragmented modal planning in transportation; a belief among shippers and logistics service providers that facilitation payments are necessary to avoid delays in supply chains; low barriers to entry in trucking; and major supply-demand imbalances in infrastructure provision, particularly in deep-water port facilities at the Southern gateway of Cai Mep-Thi Vai.

Key actions*

- Minimize paper-based processes in the customs and technical clearance of imports and exports.
- Define and manage “multimodal logistics corridors” where containerized flows on trucks or barges can move on adequate infrastructure and with minimal regulatory delays.
- Improve hinterland connections to deep-water ports at the Northern and Southern gateways.
- Facilitate the entrance of international players to the freight forwarding and third-party logistics service provider market and encourage collaboration between foreign and domestic players in this market.
- Promote a more sustainable supply-demand balance in the trucking industry by introducing a safety- and overloading compliance-rating system for carriers and by providing better access to credit for fleet expansion and modernization; truck emissions regulation should be gradually phased in over the medium term.

* List is not exhaustive.

The Challenge of Finding New Sources of Growth

Vietnam has achieved sustained economic growth over the past 20 years. This solid track record of growth was primarily driven by a rapidly-expanding labor force and a shift in economic activity away from agriculture and towards the higher-productivity manufacturing and services sectors. In particular, Vietnam has benefited from the “demographic dividend” afforded by a young, vibrant labor force combined with a declining dependency ratio. While over the past 10 years wages in China have grown at double-digit rates, labor costs in Vietnam have remained attractive relative to peers in both East and South Asia. This has allowed Vietnam to continue to attract foreign direct investment and in particular multinational companies looking to set up manufacturing operations.

Vietnam’s key challenge is that both of the above drivers of growth are being depleted and need to be replaced by within-sector productivity improvements. The next 20 years will see the working age population grow at a mere fraction of the rate at which it grew over the previous 20 years. And the room for further sectoral restructuring of the economy is now more limited than in the past.

Better transport and trade logistics—the chain of operations involved in moving raw materials and finished products from origin to destination, both domestically and internationally—can play a significant role in increasing productivity going forward. In particular, better performing logistics can provide international and domestic investors with an environment where they can source products for export at a lower total landed cost than what they incur in other countries. While certainly not the only factor going into this determination, minimizing total landed costs is the single most important element going into shippers’ sourcing location decisions.

A stronger logistics sector is also consistent with Vietnam’s long-term vision of spurring export-led growth. Export operations necessarily interact with the various elements of the national logistics system—basic infrastructure provision, availability of facilities and equipment, service delivery, and the institutional and regulatory environment—and depends on it for survival.

And Vietnam’s exports sector is particularly logistics-intensive, given the high incidence of import content of Vietnam’s export products. For example, it is estimated

that 70 to 80 percent of the value of Vietnam’s garment exports is made up of imported raw materials and components. The corresponding figure for footwear exports is estimated at 50 percent. Facilitating exports therefore requires that attention be paid to improving the performance of import supply chains as well.

Finally, there is a perception—on the part of freight stakeholders and analysts alike—that Vietnam’s logistics costs as a share of national output are high compared to peer countries like China, Malaysia, and Thailand. While validating these macro level estimates is difficult, an aggregation of data sources does suggest that Vietnam’s logistics costs are likely higher than some of the more globally-integrated developing Asian countries, even as they appear to be either at par or more competitive than those of some peers like Cambodia, Indonesia, and the Philippines.

The Voice of the Market

Testimonies by logistics stakeholders in Vietnam (including domestic and multinational shippers, transportation carriers, container terminal operators, logistics service providers, trade associations, and government authorities), supplemented by market research and international benchmarking, overwhelmingly corroborate that logistics costs in Vietnam are indeed costly. Most importantly, they reveal that the root cause for costly logistics is the incidence of unpredictability that permeates supply chains. This unpredictability requires manufacturers to self-insure against uncertain freight itineraries by carrying higher levels of inventory than they would otherwise need to manage their daily operations, or face the even costlier risk of lost sales, interrupted manufacturing production runs, or a proliferation of pricey, avoidable emergency shipments. It is estimated that Vietnam’s shippers spend approximately US\$100 million annually in extra inventory carrying costs incurred due to import-export clearance delays; and this amount, which excludes all other sources of unpredictability in supply chains that in practice increase inventory costs even further, is projected to reach US\$180 million by 2020.

Unpredictability in Vietnam-based supply chains is caused by a variety of factors, none of which necessarily dominates. But taken together, these factors both undermine trade competitiveness and render the challenge of strengthening logistics performance an eminently multisectoral endeavor. Vietnam’s most critical sources of supply chain unpredictability are (a)

erratic interpretation and enforcement of regulations regarding international trade (e.g., import-export clearance) and domestic transportation (e.g., use of highways by container trucks); (b) a less-than-automated customs and technical clearance system with considerable human intervention; and (c) non-integrated infrastructure, whereby major gateways like marine ports lack adequate landside connections, or cargo handling facilities are not in close proximity to transport arteries and gateways, and major supply-demand imbalances persist throughout the transportation and logistics service provision sectors.

The Essential Nature of Institutions

The most entrenched challenges facing Vietnam logistics are “soft” in nature and not related to the quality of infrastructure. Specifically: (a) freight stakeholders consistently express concerns that, in their view, facilitation payments to customs officials and the police are necessary elements of keeping supply chain delays to a minimum. Their perception is that this not only artificially increases costs, but also sets up an unlevel playing field for those stakeholders who would rather not engage in this practice. (b) Fragmentation in decision making has resulted in transport corridors that are not managed as integrated avenues for trade, but rather on a silo basis. This has also resulted in major supply-demand mismatches throughout the transport and logistics service provision sectors, perhaps most poignantly exemplified by container port over capacity in the Ho Chi Minh City (HCMC) and Cai Mep-Thi Vai areas. (c) Regulatory uncertainty is recurrent, also due in part to fragmentation, as regulations are subject to interpretation at the local level and their implementation in practice is uneven across provinces and even within local agencies. (d) The trucking industry offers poor service with a carrier base largely able to only compete on price. Non-compensatory rates in the trucking industry are thought to be associated

with chronic overloading, high accident rates, high incidence of empty miles, frequent truck breakdowns, and road congestion.

However, opportunities also lie in the hard infrastructure realm. Specifically, the deep water ports at Cai Mep-Thi Vai need better landside and waterway connections to HCMC and surrounding areas. This can be part of a strategy to alleviate the serious underutilization of these ports at present. In the Red River Delta, development of Lach Huyen port is a priority, but it faces key risks due to an uncertain funding structure. Furthermore, it will be critical to better manage supply and demand in the Northern port range to avoid the pitfalls faced in its Southern counterpart. Logistics parks remain a nascent concept in Vietnam and need to be developed significantly further. A more intense use of IT infrastructure in logistics is needed, particularly with regard to the automation of customs clearance, a more extensive use of GPS systems and load boards in the trucking industry, and a more effective control of truck axle loads on highways.

Most of the above challenges and opportunities require stronger inter-agency coordination, and some have behavioral components that demand institutional strengthening: these are concerted actions that go well beyond the provision of isolated assets. As a lower middle income country in transition, Vietnam has reached a point where the quality of institutions—in the particular case of logistics to chiefly include the various modal planning and policy-making agencies of the Ministry of Transport, the General Department of Vietnam Customs, other trade clearing agencies (e.g., those responsible for security and technical clearance), and the police—is now an essential rather than peripheral element of improving competitiveness.

Key Recommendations

The following is a sample of policy recommendations that can contribute to more cost-effective logistics operations in Vietnam, by sector:

Sector	Intervention
Management of customs and technical clearance in international trade	Re-double efforts to fully automate the e-commerce system for customs clearance by 2014 as planned. Extend paperless customs to all shippers. Strengthen meritocracy in public sector agencies responsible for customs and trade clearance.

Sector	Intervention
Intermodal transport	Define strategic “logistics corridors” in Northern and Southern gateways where infrastructure quality and regulatory provisions (e.g., vehicle weight, speed, and dimensions limits) are such that high-cube containers can flow with minimal unnecessary delays.
Deep-water ports	Improve hinterland connections with higher-capacity, well-maintained road and IWT access in the short term (road access should also be extended to Distribution Centers added or relocated to the Cai Mep-Thi Vai and Hai Phong/Lach Huyen areas); based on broad consultations, develop a plan to better manage container terminal handling capacity, especially in the HCMC and Cai Mep-Thi Vai markets; consider the viability of rail links and on-dock rail facilities in the long term, particularly at Hai Phong/Lach Huyen.
Logistics management	Devise ways for the public and private sectors to collaborate in two key aspects of logistics management: (1) the formulation of public policies for the sector and (2) generating better awareness, among private-and state-owned firms alike, of the benefit-cost tradeoffs associated with modal and supply chain design choices. In this respect, an inter-ministerial logistics committee, a public-private logistics forum, a logistics observatory, and expanded offers for logistics training may be considered.
Third-party logistics service providers (e.g., freight forwarders)	Further liberalize the market to facilitate (a) entrance of international players, (b) collaboration and knowledge transfer between international and domestic players, and (c) ease of doing business for existing or prospective providers that want to engage shippers across a wide variety of modes and service types.
Trucking	Promote a more sustainable supply-demand balance by introducing a safety and overloading compliance-rating system for carriers and by providing better access to credit for fleet expansion/modernization; in the medium term, truck emissions regulation should be gradually phased in. Reduce the incidence of empty miles by promoting load exchanges and the development of the truck brokerage industry.

Many of the above recommendations, such as enhancing meritocracy in the public sector, setting up mechanisms and entities such that transport corridors are explicitly managed in an integrated way, strengthening the applicability and enforcement of regulations, and increasing the supply and quality of local managerial talent in logistics, share one thing in common: they all require strong political leadership and a view towards the medium- and long-term.

Reference

Blancas, Luis C., John Isbell, Monica Isbell, HuaJoo Tan, and Wendy Tao. 2013. *Efficient Logistics: A Key to Vietnam’s Competitiveness*. Washington, DC: World Bank.

For Further Discussion

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