ECONOMICS

THE ECONOMICS OF MEASURING FISCAL DECENTRALISATION

PART IV: FISCAL DECENTRALISATION IN VIETNAM, CHINA, AND SELECTED ASEAN NATIONS

By

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The University of Western Australia

DISCUSSION PAPER 08.16
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1 This paper comprises Chapters 7, 8 and 9 of my PhD thesis, The Economics of Measuring Fiscal Decentralisation, The University of Western Australia, 2008. The full thesis is available as Discussion Papers 08.13 to 08.16.
CHAPTER 7
VIETNAM’S FISCAL HISTORY AND DECENTRALISATION
FROM 1976 TO 2007

7.1 Introduction

Vietnam is a developing country in the South-East Asian region with per capita income of US$ 750 in 2007 and a public sector that represents about one quarter of the national economy. The country has faced many challenges in the process of economic growth as a fully independent nation since liberation on 30 April 1975 and the proclamation of the Socialist Republic of Vietnam on 25 April 1976. The Vietnamese economy was thoroughly run down after 30 years of war with two completely different economic systems: the North with the highly centralised and planned regime and the South with the market regime. In the years since unification, Vietnam has attempted to integrate itself further with the world economy.

This chapter aims to explore the fiscal history and fiscal decentralisation in Vietnam since the national unification in 1975 using concepts derived from the fundamental index of fiscal decentralisation developed in Chapter 3. This analysis, together with the investigation of fiscal decentralisation in China and selected ASEAN countries in Chapter 8, provides the context from which future policy on fiscal reforms are drawn for Vietnam in Chapter 9 of this study.

Following this introduction, the history of Vietnam is briefly discussed in Section 7.2. The current structure of the Vietnamese government is discussed in Section 7.3, and raises some concerns for fiscal decentralisation in Vietnam in the future. Changes in the fiscal environment since 1976 are discussed in Section 7.4, which also outlines significant changes in the allocations of revenue sources between the national government and subnational governments (“SNGs”) in Vietnam after the 1990 fiscal reform. Section 7.5 comments on the current general state of fiscal decentralisation in Vietnam with the focus on the analyses of fiscal autonomy and fiscal importance of
SNGs in Vietnam. The fiscal decentralisation index is also measured. Concluding remarks are in Section 7.6.

7.2 Brief overview of the history of Vietnam

Some recent archaeological excavations have proved that the presence of human beings in Vietnam lasted for a long period in the Old Stone Age (300,000–500,000 years) (Ministry of Foreign Affairs of Vietnam, 2003, p.18). Vietnam’s history has reflected many political, social and economic transformations. However, until the mid-nineteenth century, the single defining historical feature was the successive sequence of feudal dynasties. Some of the most important ones are the Ly Dynasty (11th and 12th centuries), the Tran Dynasty (13th and 14th centuries), and the Le Dynasty (15th, 16th and 17th centuries). And, in all the feudal dynasties, highly centralised administrative structures were prominent. However, this long historical tradition was fundamentally changed in 1858 when France colonised Vietnam following the first attack on Danang (the present-day central part of Vietnam). Nguyen Ai Quoc, later known as President Ho Chi Minh, travelled abroad in 1911 to find ways of opposing French colonisation.

On 2 September 1945, Democratic Republic of Vietnam was established. In the same year, the French colonialists invaded the country again. The nine years of war between 1945 and 1954 ended with the defeat of the French in the battle of Dien Bien Phu. The resulting Geneva Agreement on Vietnam was signed between France and Vietnam in 1954. Under this agreement, the country was temporarily partitioned into two parts (North Vietnam and South Vietnam) at the seventeenth parallel with the intention of reunifying these parts within two years (in 1956) by means of a general election held all over Vietnam. However, this did not eventuate and the country remained divided. North Vietnam (the Democratic Republic of Vietnam) with its capital Hanoi came under the control of Vietnam’s Worker Party. The Southern part of Vietnam (The Republic of Vietnam) came under the control of a pro-French administration, and later, a pro-American administration with its capital in Saigon. National reunification and independence were realised on 30 April 1975. The Socialist Republic of Vietnam was
subsequently formed on 25 April 1976, with the remainder of the 20th century being largely devoted to developing the economy.

7.3 Current structure of the government in Vietnam

The current structure of the government (including both national and subnational governments) is summarised in Figure 7.1 below.

FIGURE 7.1
THE CURRENT STRUCTURE OF THE VIETNAMESE STATE


Today, Vietnam is governed by the Vietnamese Communist Party. The present structure of the government system in Vietnam is defined by the 1992 Vietnam Constitution as well as a range of non-constitutional statutes (Appendix A7.1). Unless
otherwise stated, in the discussion that follows, all references to “articles” are to specific articles in the 1992 Constitution of Vietnam.

Federal nations like Australia and The United States typically have three distinct levels of government (namely, federal, state and local governments) while unitary countries often have just two broad levels: national and subnational governments. Vietnam is a unitary country, and, as such, has two main separate levels of government. At the subnational government level, also generally termed “local government” (1992 Vietnam Constitution), there are three distinct strata of government: the province strata, district strata and commune strata. All these strata are constitutionally regulated. The structure within the two levels of government in Vietnam is quite similar in some senses.

7.3.1 The national government

The National Assembly is defined in the 1992 Constitution of Vietnam as “the highest representative organ of the people, the highest organ of the nation’s power of the Socialist Republic of Vietnam” (Article 83). In addition, the National Assembly is the only political entity which has the authority to alter the Constitution and set legislative laws (Article 84). It determines basic domestic and foreign policies, social security, and national defence and security. It also sets the major principles that govern the nation’s machinery, the social relations and activities of the citizens. The term of the National Assembly is five years and it has two meetings annually. However, in special circumstances, the President, the Prime Minister or at least one-third of all members of the Assembly can petition the Standing Committee of the National Assembly to convene an extraordinary session (Article 86). The Standing Committee is the permanent and ongoing administrative body that operates between the two sessions of the National Assembly, with a number of members of the Committee decided by the National Assembly. Members of the Standing Committee cannot be members of the government (Article 90). Its typical rights are the supervision and control over the implementation of constitution, laws, resolutions of the National Assembly; Resolutions and Ordinances of the Standing Committee; supervision over the activities of the government, the Supreme
People’s Court and the Supreme People’s Procuracy; and supervision and provision of guidelines to activities of People’s Councils.

The President of Vietnam is the nation’s Head of State. He or she (though no woman has yet been President) represents the nation at internal functions and in matters of foreign affairs. The President is elected by the members of the National Assembly (Articles 101 and 102). The typical rights of this position include: (i) promulgating the Constitution, laws and resolutions; (ii) submitting proposals to the National Assembly to elect or dismiss the Vice-president of Vietnam, the Prime Minister, the Tribunal President of the Supreme People’s Court, the Head of the Supreme People’s Procuracy; and to appoint, or to sack: the Deputy Prime Ministers, and Ministers and other members of the Government based on the Resolution of the National Assembly or its Standing Committee (Article 103). In addition, the President has the right to attend meetings held by the Standing Committee of the National Assembly and, if needed, attend meetings held by the government (Article 105).

The government is referred to in 1992 Vietnam’s Constitution as the “executive organ of the National Assembly, the highest organ of nation’s administration” of the country (Article 109). It controls the implementation of political, economic, cultural and social duties, defence, security and foreign affairs of the nation (Article 109). In addition, the government is accountable to the National Assembly and is required to report to the National Assembly, the Standing Committee of National Assembly and the President. Other than the Prime Minister, members of the government are not necessarily members of the National Assembly (Article 110). The Prime Minister is proposed by the President and elected and dismissed by the National Assembly with a five-year term. In addition, laws pertaining to the organisation of political activities regulate the organisational structure of the government which consists of ministries and organs at ministerial level. The National Assembly decides whether to establish ministries and public institutions based on recommendations from the Prime Minister. Vietnam currently has many ministries and public bodies that function at ministerial level. Some of them are the Ministry of Finance, the Ministry of Planning and Investment, and the State Bank.
The Supreme People’s Court is the highest judicial body in Vietnam with its members having five-year terms of office as the National Assembly (Articles 128 and 134). The Tribunal President of the Court, proposed by the President and elected or dismissed by the National Assembly, is responsible for reporting to the National Assembly, or its Standing Committee, and the President when the National Assembly is not in session. The Vice-tribunal President and judges are proposed by the Tribunal President and appointed or sacked by the President (Article 103).

The Supreme People’s Procuracy supervises compliance with the law, as established by ministries, ministerial bodies, local administrative bodies, economic organisations, social organisations, and the people’s armed forces. The Supreme People’s Procuracy exercises the right of prosecution, ensures the strict and united implementation of the law (Article 137). The Head, with the five-year tenure, is responsible for reporting to the National Assembly or to the Standing Committee of National Assembly and the President when the National Assembly is not in session (Articles 138 and 139). The Head of the Procuracy is proposed by the President and elected or sacked by the National Assembly. The Deputy Heads, procurators and investigators are proposed by the Head and appointed or sacked by the President (Article 103).

7.3.2 Subnational governments

As a populous country of more than 83 million people in 2007, subnational governments have played a very important role in the economic, social and cultural development of the nation. The administrative structure of the country at subnational authority level is organised into three different sub-levels: province, district and commune. There are currently 64 provinces, in which five large cities are granted a provincial status: Ha Noi, Ho Chi Minh City, Hai Phong, Da Nang and Can Tho. These provinces are divided into 611 districts which are, in turn, subdivided into 10,602 communes (Martinez-Vazquez, 2004). At every level of SNGs, the legislative authority of the government resides in the People’s Council and executive authority resides in the
People’s Committee, whose members are appointed by the People’s Council for the same level of government. Although the People’s Council and the People’s Committee are set up as two distinct bodies under the law, in practice, their membership is usually overlapping (i.e. some members at People’s Council are also members at People’s Committee, except for some positions).

The People’s Council represents “the will, aspiration and right of the local citizens” and is elected by the people (Article 119). The People’s Council is accountable to the local inhabitants and higher bodies of the government. The structure of the People’s Council at SNGs’ level is also divided into three different levels – provinces, districts, and communes. Representatives of the People’s Committee are elected by the People’s Council for the corresponding level of government. The structure of the Committee is in accordance with the Council. It means that there are Committees at province, district and commune level. Furthermore, the structure of the local People’s Court includes: the People’s Court of Provinces; and the People’s Court of Districts. The same principle of the local People’s Court, the structure of the local People’s Procuracy is set up in two different tiers: provinces and districts. There is no local People’s Court and People’s Procuracy at the lowest administrative level of SNGs - the commune level.

7.3.3 The structure of governments: current issues

The discussions in Sections 7.3.1 and 7.3.2 reveal a significant and fundamental issue with the vertical structure of government in Vietnam. Current practices in Vietnam show that each stratum of SNGs is closely supervised by many higher administrative levels. As such, local budgets need to get approval from both the local People’s Council at the same level, and then from the People’s Committee at the next higher level. Furthermore, the consolidated budget of the entire SNGs (or provinces) must be approved by the national government (Ministry of Finance) and then by the highest legislative body, the National Assembly. This long process seriously constrains the fiscal autonomy of SNGs in Vietnam. Discussions of fiscal decentralisation in Vietnam in the previous studies, which point to an improvement in fiscal decentralisation due to the greater fiscal
role of SNGs, such as Martinez-Vazquez (2004), focus mainly on the fiscal importance of SNGs. Fiscal autonomy of SNGs in Vietnam is not, typically, presented as a reason for increased fiscal decentralisation.

7.4 Changes in economic plans since 1976

Changes in economic progress and fiscal arrangements in Vietnam can be reviewed as a sequence of five-year (and later, ten-year) periods. In part, this is because the Government of Vietnam initially prepared and implemented successive “Five-Year Socio-economic Development Plans” from 1976 to 1990 and then “Ten-Year Plans” from 1990. The economic plans and outcomes relative to each five-year plan are briefly discussed to provide the economic planning context within which fiscal arrangements in Vietnam were established.

Period from 1976 to 1980

Immediately after the war, much of Vietnam was in ruins. Reunification commenced with the introduction of the Five-Year Plan from 1976 to 1980. The broad objectives of this plan were: (i) to transform the economy from small-scale to large-scale production; and (ii) to develop heavy industry (such as engineering, energy, metallurgy and chemistry) and agriculture (Vo, 1990). National income, agriculture, and industrial production were planned to increase by 14, 10, and 18 per cent per annum, respectively (De Vylder and Fforde, 1988, p.167).

However, many of the targets of this plan were not realised. GDP increased by only 0.4 percent per annum, whereas the population rate increased to around 2.3 percent annually, and in conjunction with a 20 percent annual increase in the price level (Ministry of Finance of Vietnam, 2003). Food shortages were common, and placing demand for publicly supplied services. Also, agricultural and industrial productions increased by 1.9 and 3.3 percent per year (De Vylder and Fforde, 1988, p.167). Table 7.1 provides planned and actual outcomes for this period, as well as for the subsequent five-year period.
TABLE 7.1
AVERAGE ECONOMIC GROWTH RATES

<table>
<thead>
<tr>
<th></th>
<th>Percentage rates of growth</th>
<th>GDP</th>
<th>Agriculture</th>
<th>Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>Five-Year Plan 1976-1980</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Plan</td>
<td>13-14</td>
<td>8-10</td>
<td>16-18</td>
<td></td>
</tr>
<tr>
<td>Actual</td>
<td>0.4</td>
<td>1.9</td>
<td>3.3</td>
<td></td>
</tr>
<tr>
<td>Five-Year Plan 1980-1985</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Plan</td>
<td>4.5-5.0</td>
<td>6.0-7.0</td>
<td>4.0-5.0</td>
<td></td>
</tr>
<tr>
<td>Actual</td>
<td>6.4</td>
<td>5.3</td>
<td>9.3</td>
<td></td>
</tr>
</tbody>
</table>


Period from 1981 to 1985

Under the Five-Year Plan from 1981 to 1985, priority was given to: (i) stabilise and improve living standards; (ii) reorganise and develop productive capacity; (iii) improve the circulation and distribution of goods; and (iv) apply science to production (Vo, 1990). Economic growth rate was planned to be 5 per cent per annum. Also, agricultural and industrial production rates were expected to increase by 7 and 5 per cent per year, respectively. Initial results were encouraging. Industrial output and agricultural production increased by 9.3 and 5.3 per cent per year (De Vylder and Fforde, 1988, p.167). However, the annual inflation rate rose drastically – to as high as 50 per cent in the early 1980s, and then to a peak of 587.2 per cent in 1985 (Ministry of Foreign Affairs of Vietnam, 2003, p.3).

Period from 1986 to 1990

In December 1986, comprehensive programs of economic reform were initiated in Vietnam in an attempt to characterise society as a multi-sector economy following market-based operations (Vo, 1990). The average real growth rate for this five-year period was 3.9 per cent per year. A priority was also to curb and control inflation. The inflation rate was 774.7 per cent in 1986, but decreased to 223.1 per cent, and then to 34.7 per cent in 1987 and 1988 (Ministry of Foreign Affairs, 2003, p.5). In addition, the first law on foreign direct investment came into effect in 1987 to attract foreign capital into Vietnam’s economy.
Period from 1991 to 2000

A Ten-Year Plan was implemented from 1991 to 2000 with the following specific macroeconomic targets: (i) annual growth rate of 7.5 per cent; (ii) real growth rates for agriculture and industrial production of 4.0 per cent and 12.5 per cent; and (iii) the per capita income to be double the 1990’s level in 2000 (Ministry of Planning and Investment, 2002). Two distinct Five-Year Plans (1991–1995 and 1996–2000) were implemented within this Ten-Year Plan. Economic growth rate, on average, was at 8.2 and 7.0 per cent per annum, respectively\(^2\). Table 7.2 presents a summary of key economic indicators in Vietnam for five Five-Year Plans, starting from 1976.

<table>
<thead>
<tr>
<th>Period</th>
<th>Inflation (CPI)</th>
<th>GDP</th>
<th>Agriculture</th>
<th>Services</th>
<th>Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>1976-1980</td>
<td>21.2</td>
<td>0.4</td>
<td>1.9</td>
<td>-0.1</td>
<td>3.3</td>
</tr>
<tr>
<td>1981-1985</td>
<td>74.2</td>
<td>6.4</td>
<td>5.3</td>
<td>4.7</td>
<td>9.3</td>
</tr>
<tr>
<td>1986-1990</td>
<td>298.7</td>
<td>3.9</td>
<td>3.7</td>
<td>8.7</td>
<td>4.7</td>
</tr>
<tr>
<td>1991-1995</td>
<td>23.5</td>
<td>8.2</td>
<td>4.3</td>
<td>9.5</td>
<td>12.6</td>
</tr>
<tr>
<td>1996-2000</td>
<td>3.4</td>
<td>7.0</td>
<td>3.9</td>
<td>7.3</td>
<td>12.2</td>
</tr>
</tbody>
</table>

Source: Arkadie and Mallon, (2003, p. 28).

The plan for the future (from 2001 and beyond)

The National Assembly’s Resolution on a Five-Year Plan for 2001–2005 and the Strategy for Socio-economic Development for 2001-2010 were drafted with the intention of enabling Vietnam to become an industrialised country by 2020. The overall objectives are: (i) to achieve a high and stable economic growth rate; (ii) to stabilise and improve the standard of living; (iii) to advance economic and labour restructuring towards intensified modernisation and industrialisation; (iv) to improve the market economy's effectiveness and competitiveness; (v) to extend external economic activities; and (vi) to reform education and training, science and technology (IMF, 2004). Total value of GDP in 2010 is targeted to double the level in 2000, with a strong transformation of the structure of the national economy, particularly focusing on industry, construction and

\(^2\) The most significant problem years for the economy over this period were 1997 and 1998 following the Asian financial crisis.
services. Agriculture, industry, and services are expected to account for 16-17 per cent, 

7.5 Fiscal arrangements in Vietnam since 1976

From national reunification in 1975 until 1989, Vietnam effectively remained a 
centralised fiscal and economic system. Unfortunately, fiscal data are not available to 
properly assess this period, which seriously constrains any discussion of fiscal 
decentralisation in Vietnam. Nevertheless, some useful and contextual observation 
pertaining to the period can be made.

From 1976 to 1989 – a general overview

The allocation of spending and taxing activities between the national government 
and SNGs in this period was loosely provided for by government’s Resolution No. 
108/CP of 1978. Under this Resolution, subnational own-sourced revenues were mainly 
raised from fees, charges and assets’ depreciation. Revenue collection shared between the 
national government and SNGs included revenue from the profit of national and public 
enterprises operating at local jurisdiction, tax on agriculture, and tax on industrial 
activities. The sharing rate was determined by the national government. Under this 
Resolution, revenue for SNGs increased by 43.5 per cent in 1980 compared with 1976, 
whereas spending increased 1.5 per cent in 1980 (Ministry of Finance, 2003). However, 
the Ministry of Finance of Vietnam statistics do not differentiate between local revenue 
collected by SNGs and fully retained, and tax revenue that SNGs must share with the 
national government. From the perspective of fiscal decentralisation theory, the key point 
is that Resolution 108 did not devolve authority to set tax rates and bases from the 
national government to SNGs.

In 1983, the government then issued Resolution 138-HDBT, which clarified 
responsibility for the budget allocations of SNGs, with a clear distinction between local 
own-sourced revenue and revenue shared by local governments with the national 
government. For example, locally-sourced revenue included 100 per cent collection on
depreciations, 100 per cent fees and charges, 100 per cent on lottery. Shared revenue included 80 per cent profit from locally public enterprises, 10 per cent profit from national public enterprises operating at local jurisdiction, 40 per cent revenue from tax on agriculture. Also, tax revenue shared between the national government and SNGs included revenue from the taxation of industrial activities; agriculture; as well as profits from local public enterprises (except portions retained at local budget). Sharing rates were also determined by the national government. A subsidy (or transfer) was for provinces which were unable to cover their local expenditure with own-sourced and shared revenues.

However, tax bases fully controlled by the national government were also extended to cover a wide range of services, such as taxes on transportation, and port services. Government revenue still reflected a combination of domestic revenue (revenue collected) and foreign sources (non-refundable aid and commercial loans). This was the period with almost hyperinflation in Vietnam during which government expenditure could not be covered by taxes and charges. Between 1981 and 1986, total government revenue averaged only 48 per cent of total expenditure (Ministry of Finance, 2003). Debt became a major issue in the management of Vietnam’s public finances during this period.

Period from 1986 to 1990

The Government issued and implemented Resolution 186/HDBT in 1989, which was the first regulation on fiscal issues since the economic reforms associated with the Five-Year Plan commencing in 1986. Under this Resolution, only spending responsibilities and revenue sources for SNGs were regulated. SNGs’ revenue came from three different sources: (i) 100 per cent locally collected revenue (revenue collections to cover depreciation, taxes on the slaughter of livestock, and fees and charges); (ii) shared tax revenue with the national government (revenue from profits of national public enterprises, local public enterprises, and taxes on industrial activities); and (iii) conditional transfers to balance SNGs' budget, if needed.
However, under this new arrangement, revenue sharing became subject to a constraint that prevented shared revenue being retained by SNGs. Of the 44 provinces, 14 actually returned additional revenue to the national government budget from their shared revenue because they had balanced their local budgets. Examples included Hai Hung, Dong Nai and Ho Chi Minh City. However, as an overall picture, the aggregate public sector budget was in deficit, as presented in Table 7.3.

**TABLE 7.3**  
THE OPERATIONS OF THE AGGREGATE PUBLIC SECTOR BUDGET  
(Percentage of GDP)

<table>
<thead>
<tr>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Revenue</td>
<td>13.2</td>
<td>12.2</td>
<td>11.3</td>
<td>11.9</td>
<td>13.1</td>
</tr>
<tr>
<td>2</td>
<td>Current expenditures</td>
<td>13.4</td>
<td>12.8</td>
<td>14.1</td>
<td>12.3</td>
<td>15.1</td>
</tr>
<tr>
<td>3</td>
<td>Government savings [(1) - (2)]</td>
<td>-0.2</td>
<td>-0.6</td>
<td>-2.8</td>
<td>-0.4</td>
<td>-2.0</td>
</tr>
<tr>
<td>4</td>
<td>Capital expenditures</td>
<td>5.6</td>
<td>3.9</td>
<td>4.4</td>
<td>6.4</td>
<td>4.5</td>
</tr>
<tr>
<td>5</td>
<td>Overall budget deficit [(3) - (4)]*</td>
<td>-5.8</td>
<td>-4.4</td>
<td>-7.1</td>
<td>-6.8</td>
<td>-6.5</td>
</tr>
</tbody>
</table>

**Financing:**

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>6</td>
<td>Foreign loans and grants</td>
<td>2.2</td>
<td>1.4</td>
<td>2.4</td>
<td>1.5</td>
<td>4.0</td>
</tr>
<tr>
<td>7</td>
<td>Credit from State bank (net)</td>
<td>3.6</td>
<td>2.9</td>
<td>2.9</td>
<td>6.0</td>
<td>2.5</td>
</tr>
</tbody>
</table>

Note: Figures do not add exactly due to rounding.  
Source: Table 8.2 (Fforde and De Vylder, 1996, p.301).

**From 1990 onwards – a move towards a more systematic fiscal decentralisation**

In 1990, a national tax system was introduced including nine different taxes: (i) Tax on agriculture; (ii) Turnover tax; (iii) Special sales tax (Excises tax); (iv) Profit tax; (v) Export and import duties; (vi) Tax on natural resources; (vii) Personal income tax; (viii) Tax on houses and land; and (ix) Tax on capital users. Also, within the tax system, fees and charges were also provided for. In 1997, the Value added tax and Corporate income tax were introduced to replace the turnover tax and profit tax. In addition, Export and import duties, Special sales tax, and Personal income tax have been substantially revised.

Vietnam’s first “Budget Law” was issued in 1996, coming into effect in 1997. This is a statute of the national government – the National Assembly. The law outlined
the spending responsibility and revenue allocations\textsuperscript{3} for national and subnational
governments and regulated subnational borrowing and intergovernmental fiscal transfers.
The 1997 Budget Law was revised in 1998, with changes coming into effect from 1999.
In regard to fiscal decentralisation, the significant change to the 1999 revised Budget Law
resulted in lower tiers of SNGs (district and commune levels) being assured of greater
revenue and greater expenditure responsibilities. Also, the 1997 Budget Law provided for
commune level government (the lowest tier of SNGs) to secure at least 70 per cent their
revenue from taxes on the right of land transfer; land and housing tax; licence tax from
small businesses and agricultural tax.

The “new” Budget Law of 2004 also attempted to facilitate even greater levels of
fiscal activities by SNGs. Specifically, it ensured that the excise tax was no longer to
remain an exclusively national government taxation instrument. Instead, excise tax was
divided into two portions: (i) an excise tax on imports, which became a national
government revenue and (ii) an excise tax on domestic goods and services, which became
a subnational government revenue. A summary of key regulations on these issues from
the 1997, 1999 and 2004 Budget Laws is presented in Table 7.4\textsuperscript{4}.

The process of fiscal decentralisation also gained further momentum with the
issuance of Decree No. 93/2001/ND-CP by the national government in 2001. This decree
provided for increasingly decentralised public administration in Ho Chi Minh City, with
the emphasis on: (i) management of investment and socio-economic development; (ii)
management of land, housing and local infrastructure; (iii) fiscal decentralisation; and
(iv) organising and monitoring its local officials\textsuperscript{5}. The program was subsequently
extended to Hanoi and Haiphong in 2004.

\textsuperscript{3}Tax assignment is an assignment of authority which national governments cannot unilaterally impose or
revoke. In Vietnam, the national government has the power to do just that. As such, the term “tax
allocation” is used.

\textsuperscript{4} A summary of full details can be found in Appendix A7.3.

\textsuperscript{5} Of course, it is significant that this Decree is issued by the national government – an indication of the
underlying legal authority of the national government over fiscal matters.
### TABLE 7.4
A SUMMARY OF KEY REGULATIONS OVER FISCAL ISSUES

1. **Expenditure responsibilities**

<table>
<thead>
<tr>
<th>National government</th>
<th>Subnational governments</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Spending on economic activities, education, training, medicine, technology and environment under <strong>national</strong> control.</td>
<td>a. Spending on economic activities, education, training, medicine, technology and environment under <strong>provincial</strong> control.</td>
</tr>
<tr>
<td>b. Economic operations under the control of <strong>central</strong> organs.</td>
<td>b. Defence, security and social order <strong>assigned from the national government.</strong></td>
</tr>
<tr>
<td>c. Defence, security and social order under <strong>national</strong> control.</td>
<td>c. Operations of central organs and socio-political organisations at <strong>provincial</strong> level.</td>
</tr>
<tr>
<td>d. Operations of <strong>central</strong> organs of the Communist Party of Vietnam, the national and socio-political organisations.</td>
<td>d. Support for social and career organisations under <strong>provincial</strong> control.</td>
</tr>
<tr>
<td>e. Price subsidy under <strong>national</strong> policy.</td>
<td>e. Spending on social policies under their control.</td>
</tr>
<tr>
<td>f. National programs under <strong>central</strong> control, etc.</td>
<td>f. National programs under <strong>provincial</strong> control as assigned by the national government, etc.</td>
</tr>
</tbody>
</table>

2. **Sources of revenue**

<table>
<thead>
<tr>
<th>National government</th>
<th>Subnational governments</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Export and import duties.</td>
<td>a. Rental of land.</td>
</tr>
<tr>
<td>b. Excises tax on import.</td>
<td>b. Income from selling and renting national properties under provincial management.</td>
</tr>
<tr>
<td>c. Profit tax from nation-wide businesses.</td>
<td>c. Registration tax.</td>
</tr>
<tr>
<td>d. Taxes and other revenues from oil and gas.</td>
<td>d. Revenues from lotteries.</td>
</tr>
<tr>
<td>e. Capital withdrawing and profit sharing from joint-venture, joint-stock companies with the contribution of national capital, etc.</td>
<td>e. Non-refundable aids directly to provincial governments, etc.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Shared tax revenue</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Value added tax.</td>
</tr>
<tr>
<td>b. Profit tax, except profit tax from nation-wide businesses.</td>
</tr>
<tr>
<td>c. Personal income tax.</td>
</tr>
<tr>
<td>d. Natural resources tax.</td>
</tr>
<tr>
<td>e. Capital user charges.</td>
</tr>
</tbody>
</table>

3. **Intergovernmental fiscal transfers**

Criteria used in defining the amount of fiscal transfers are population, natural conditions, economic-social conditions of specific areas; particularly focusing on rural areas, remote areas, minority ethnic areas, areas with difficulties. Fiscal transfer amounts are kept constant for the period from 3 to 5 years and are inflation-indexed.

4. **Subnational borrowing**

Provincial governments are allowed to arrange domestic borrowing to meet the needs of investing in infrastructure and they must balance their budget to repay debt in due course. The balance from the debt must not exceed 30 per cent of total capital on basic infrastructure yearly within the provincial budget.

In summary, policy measures to increase fiscal decentralisation in Vietnam were being set in place from the mid-1990s, especially through the introduction of the Budget Laws of 1997, 1999 and 2004. The specific changes in the tax assignment and tax allocation across the national government and SNGs that have increased fiscal decentralisation since 1990 are summarised in Table 7.5.

### Table 7.5

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Value added tax</td>
<td>S</td>
<td>S</td>
<td>S</td>
<td>S</td>
<td>S</td>
<td>S</td>
<td>S</td>
</tr>
<tr>
<td>2</td>
<td>Corporate income tax</td>
<td>S</td>
<td>S</td>
<td>S</td>
<td>S</td>
<td>S</td>
<td>S</td>
<td>S</td>
</tr>
<tr>
<td>3</td>
<td>Excise tax</td>
<td>C</td>
<td>C</td>
<td>C</td>
<td>C</td>
<td>C</td>
<td>S</td>
<td>S</td>
</tr>
<tr>
<td>4</td>
<td>Export-import duties</td>
<td>C</td>
<td>S</td>
<td>C</td>
<td>C</td>
<td>C</td>
<td>C</td>
<td>C</td>
</tr>
<tr>
<td>5</td>
<td>Personal income tax</td>
<td>*</td>
<td>*</td>
<td>L</td>
<td>L</td>
<td>S</td>
<td>S</td>
<td>S</td>
</tr>
<tr>
<td>6</td>
<td>Tax on natural resources</td>
<td>*</td>
<td>S</td>
<td>S</td>
<td>S</td>
<td>S</td>
<td>L</td>
<td>S</td>
</tr>
<tr>
<td>7</td>
<td>Profit remittance tax</td>
<td>*</td>
<td>*</td>
<td>*</td>
<td>*</td>
<td>S</td>
<td>S</td>
<td>S</td>
</tr>
<tr>
<td>8</td>
<td>Agricultural tax</td>
<td>S</td>
<td>S</td>
<td>L</td>
<td>L</td>
<td>L</td>
<td>L</td>
<td>L</td>
</tr>
<tr>
<td>9</td>
<td>Land and housing tax</td>
<td>*</td>
<td>L</td>
<td>L</td>
<td>L</td>
<td>L</td>
<td>L</td>
<td>L</td>
</tr>
<tr>
<td>10</td>
<td>Tax on land use rights</td>
<td>*</td>
<td>*</td>
<td>*</td>
<td>L</td>
<td>L</td>
<td>L</td>
<td>L</td>
</tr>
<tr>
<td>11</td>
<td>License tax</td>
<td>*</td>
<td>L</td>
<td>L</td>
<td>L</td>
<td>L</td>
<td>L</td>
<td>L</td>
</tr>
<tr>
<td>12</td>
<td>Registration tax</td>
<td>*</td>
<td>L</td>
<td>L</td>
<td>L</td>
<td>L</td>
<td>L</td>
<td>L</td>
</tr>
<tr>
<td>13</td>
<td>Slaughter tax</td>
<td>*</td>
<td>L</td>
<td>L</td>
<td>L</td>
<td>L</td>
<td>L</td>
<td>*</td>
</tr>
</tbody>
</table>

Notes:  
- **C** - Central; **L** - Local  
- **S** represents Shared by central and local levels, but the sovereignty over tax bases and rates remains with the central government.  
- a/ Turnover tax before 1999; b/ Profit tax before 1999; and c/ Abolished in 2004.  
- * No information available.  

Source: Author’s review of laws listed in Appendix A7.2.

Exclusively national government taxes include export–import duties and excise tax. The shared taxes between the national government and SNGs consist of the value added tax; corporate income tax; and personal income tax. Many minor taxes are allocated as SNGs’ own-sourced taxes such as tax on transfers of properties, licence tax,

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6 Examples of regulations and laws that shaped the allocations include: 1990 as a result of Resolution 186; 1992 (Decision 168); 1994 (Decision 60); 1996 (Decision 861); 1997 (Budget Law 1997); 1999 (revised Budget Law 1998) and 2004 (Budget Law 2004).
agricultural tax, land and housing tax, and tax on land use rights. Importantly though, regardless of whether a tax is a national tax or shared tax, the tax bases and rates are centrally determined. In view of this, it is evident that the assignment and allocation of taxes in Vietnam since 1990, has dealt primarily with the issue of the “fiscal importance” of SNGs – that is, with the share of total public sector expenditure undertaken by SNGs.

Personal income tax - a shared tax after the introduction of the 1997 Budget Law is something of a special case in Vietnam. International experience has shown that personal income tax usually generates a significant share of total taxation revenue in many countries. However, this is not the case in Vietnam. Maintaining the personal income tax as a shared tax may well be seen by the national government as prudent, particularly if Vietnam needs to implement any requirements imposed by the World Bank on debt management and from the World Trade Organisation.

<table>
<thead>
<tr>
<th>TABLE 7.6</th>
<th>APPROXIMATE TAX ALLOCATION IN VIETNAM IN 2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Item</td>
<td>Per cent of total tax revenue</td>
</tr>
<tr>
<td>A. National taxes</td>
<td></td>
</tr>
<tr>
<td>Export-import duties</td>
<td>24</td>
</tr>
<tr>
<td>Excise tax</td>
<td>9</td>
</tr>
<tr>
<td>Subtotal</td>
<td>33</td>
</tr>
<tr>
<td>B. Shared taxes</td>
<td></td>
</tr>
<tr>
<td>Value added tax</td>
<td>30</td>
</tr>
<tr>
<td>Corporate income tax</td>
<td>31</td>
</tr>
<tr>
<td>Personal income tax</td>
<td>3</td>
</tr>
<tr>
<td>Subtotal</td>
<td>64</td>
</tr>
<tr>
<td>C. Subnational taxes</td>
<td></td>
</tr>
<tr>
<td>Licence tax, etc.</td>
<td>2</td>
</tr>
<tr>
<td>Tax on transfers of properties</td>
<td>1</td>
</tr>
<tr>
<td>Subtotal</td>
<td>3</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: IMF (2003) and author's calculations.
Tax assignment and allocation in Vietnam for 2003 reveal that almost two-thirds of total tax revenue is generated by shared taxes, as shown in Table 7.6. As noted earlier, shared tax revenues are not SNGs’ own-sourced revenue because responsibilities for these taxes are derived from the national government’s power. The sharing rate applied for shared taxes is also predetermined by the national government. As national taxes account for one-third of the total revenue, it can be seen that responsibility for fiscal arrangements in Vietnam remains significantly centralised. SNGs’ own-sourced revenue accounts for only 3 per cent total tax revenue. Taken as a whole, this provides *prima facie* evidence of a still substantial degree of “centralised” fiscal arrangements in Vietnam, even after the important fiscal changes introduced in 1990 which have increased the level of fiscal activity by SNGs.

*Returning revenue to the national government*

Shared taxes between the national government and SNGs provide an interesting example of the mechanism by which the fiscal importance of SNGs increases over time. With a well-endowed region with expected revenue that is greater than its minimum expenditure need, revenue from shared taxes must be transferred to the national budget at a rate to be centrally determined, whereas less well-endowed provinces receive all 100 per cent of shared tax revenue. For example, in 2002, the allocations of shared tax revenue to SNGs vary with Ho Chi Minh City (the economic centre) and Hanoi (the capital city) receiving just 24 per cent and 30 per cent shared tax revenue. Also, Ba Ria – Vung Tau, Binh Duong, and Dong Nai - three of the largest provinces – received 48 per cent, 52 per cent, and 53 per cent. In contrast, the majority of provinces received 100 per cent revenue from shared taxes.

Figure 7.2 reveals that, for the nine biggest provinces and cities (in terms of subnational revenue and expenditure), only Ho Chi Minh City and Dong Nai could “more than” fund their total spending from the sum of own-sourced revenue and their revenue shared with the national government. All other provinces in this sample run a deficit or a balanced budget.
Implicit equalisation

Like other developing countries, Vietnam suffers from the fiscal imbalance in both vertical and horizontal dimensions. The country has an implicit system of equalisation grants, although it is very partial in character. A partial and unsystematic form of fiscal equalisation applies in Vietnam on the basis of the difference between the expected revenue and the minimum expenditure needs of SNGs. Expected revenues are determined by: (i) the subnational branch of tax administration, on the basis of the actual revenue collections of the previous years, taking into account changes in tax policies in the year and (ii) expected economic growth rate during the year. The minimum expenditure needs of SNGs are calculated on the basis of the expenditure norms determined by the national government (Martinez-Vazquez, 2004, p.26). The difference between expected revenue and minimum expected expenditure needs has laid the foundation for the national government to decide the tax sharing rates which are applied to revenue from the shared taxes between national government and SNGs. If the expected

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7 In addition, Vietnam does not have an explicit separate system of capital transfers. Funds for capital investment are tailored in the equalisation transfer and are basically very limited (Martinez-Vazquez, 2004). Table 7.8 of Section 7.6 decomposes the components in the SNGs’ revenue, together with fiscal transfers from the national government, in relation to their expenditure responsibilities for the selected above-mentioned nine provinces in 2002.
revenue (from both own-sourced and shared taxes) is less than its minimum expenditure need, then all proceeds from shared taxes are kept at the subnational budget level.

Under this arrangement, fiscal transfers are partially achieved through shared tax revenue arrangements. The major proportion of any remaining intergovernmental fiscal transfers in Vietnam is in the form of conditional transfers in which SNGs have to follow national requirements on how these funds are expended. As a result, fiscal autonomy of SNGs on fiscal transfers is also very limited. This conclusion is also accurate on SNGs borrowings because SNGs are not generally allowed to arrange borrowings at their own discretion.

7.6 Vietnam and fiscal decentralisation – a critical assessment

Since national reunification in 1976, the fiscal environment in Vietnam has changed significantly. This change can be confirmed in different legal documents governing fiscal arrangements issued in the period. It is generally agreed that Vietnam is pursuing a deliberate policy of process of fiscal decentralisation (Martinez-Vazquez, 2004, p.10) but, as we have seen, it has been subject to serious limitations. In relation to SNGs’ expenditure and revenue shared in the total public finance sector, Vietnam can be considered moderately decentralised (Martinez-Vazquez, 2004, p.13). However, without considering the issue of fiscal autonomy of SNGs, a well considered conclusion on the level of fiscal decentralisation in Vietnam cannot be reached.8

7.6.1 The fiscal importance of subnational governments in Vietnam

For the purpose of this study, the fiscal importance of SNGs is defined in Chapter 3 as the extent to which public sector expenditure is undertaken by SNGs. On that basis, a clear and significant conclusion can be reached on the fiscal importance of SNGs in

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8 We should again state that, due to significant data and information limitations, this section only explores the two important issues of fiscal decentralisation - fiscal autonomy and the fiscal importance of SNGs, for the period from 1997 (the introduction of the First Budget Law) to 2004 (the Budget Law of 2004).
Vietnam. SNGs shared a significant portion of total public sector revenue and expenditure. The outcomes of the government budget revenue and expenditure decentralisation in Vietnam are shown in Table 7.7.

**TABLE 7.7**

**REVENUE AND EXPENDITURE DECENTRALISATION IN VIETNAM**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue (VND billions)</td>
<td>65,352</td>
<td>70,612</td>
<td>78,489</td>
<td>90,749</td>
<td>103,773</td>
<td>121,716</td>
<td>141,930</td>
<td>149,320</td>
</tr>
<tr>
<td>Of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SNGs’ budget revenue (a)</td>
<td>19,264</td>
<td>20,280</td>
<td>19,571</td>
<td>22,269</td>
<td>25,463</td>
<td>30,545</td>
<td>38,683</td>
<td>44,743</td>
</tr>
<tr>
<td>Share of total budget revenue</td>
<td>29.5%</td>
<td>28.7%</td>
<td>24.9%</td>
<td>24.5%</td>
<td>24.5%</td>
<td>25.1%</td>
<td>27.3%</td>
<td>30.0%</td>
</tr>
<tr>
<td>% growth rate (previous year = 100%)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total budget revenue</td>
<td>4.8%</td>
<td>8.0%</td>
<td>11.2%</td>
<td>15.6%</td>
<td>14.4%</td>
<td>17.3%</td>
<td>16.6%</td>
<td>5.2%</td>
</tr>
<tr>
<td>SNGs’ budget revenue</td>
<td>8.5%</td>
<td>5.3%</td>
<td>-3.5%</td>
<td>13.8%</td>
<td>14.3%</td>
<td>20.0%</td>
<td>26.6%</td>
<td>15.7%</td>
</tr>
<tr>
<td>Expenditure (VND billions)</td>
<td>78,057</td>
<td>81,995</td>
<td>95,972</td>
<td>108,961</td>
<td>129,773</td>
<td>148,208</td>
<td>177,150</td>
<td>187,670</td>
</tr>
<tr>
<td>Of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SNGs’ expenditure</td>
<td>28,039</td>
<td>31,808</td>
<td>39,040</td>
<td>45,082</td>
<td>56,043</td>
<td>64,573</td>
<td>66,254</td>
<td>67,184</td>
</tr>
<tr>
<td>Share of total expenditure</td>
<td>35.9%</td>
<td>38.8%</td>
<td>40.7%</td>
<td>41.4%</td>
<td>43.2%</td>
<td>43.6%</td>
<td>37.4%</td>
<td>35.8%</td>
</tr>
<tr>
<td>% growth rate (previous year = 100%)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total budget expenditure</td>
<td>10.7%</td>
<td>5.0%</td>
<td>17.0%</td>
<td>13.5%</td>
<td>19.1%</td>
<td>14.2%</td>
<td>19.5%</td>
<td>5.9%</td>
</tr>
<tr>
<td>SNGs’ budget expenditure</td>
<td>19.1%</td>
<td>13.4%</td>
<td>22.7%</td>
<td>15.5%</td>
<td>24.3%</td>
<td>15.2%</td>
<td>2.6%</td>
<td>1.5%</td>
</tr>
<tr>
<td>Fiscal transfers (VND billions)</td>
<td>9,964</td>
<td>12,290</td>
<td>20,510</td>
<td>26,601</td>
<td>23,553</td>
<td>35,278</td>
<td>38,040</td>
<td>35,048</td>
</tr>
<tr>
<td>% growth rate (previous year = 100%)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share of total SNGs’ expenditure</td>
<td>35.5%</td>
<td>38.6%</td>
<td>52.5%</td>
<td>59.0%</td>
<td>42.0%</td>
<td>54.6%</td>
<td>57.4%</td>
<td>52.2%</td>
</tr>
</tbody>
</table>

(a) SNGs’ budget revenue comprises own-sourced revenue, and revenues from taxes shared with the national government.


In terms of expenditure undertaken by SNGs, for the period considered, total SNGs’ expenditure is around 40 per cent of total government spending. Consequently, in regard to the aspect of fiscal importance, Vietnam may be regarded as a moderately decentralised country. This view is backed up by the fact that fiscal activities undertaken by SNGs account for more than one-third of aggregate public sector expenditure. The Budget Law of 2004 stipulated the service provision responsibilities of the national government include spending on defence, national security, economic activities,
education and training, and the environment. The scope of SNGs’ service provision responsibilities includes economic activities, education and training and others under the subnational control. However, spending on higher education tends to fall within the scope of the national government, whereas the system of elementary, secondary and high schools is administered by the subnational budget\(^9\). Nevertheless, there is some overlap between the national government and SNGs over responsibility for service provisions, such as on economic activities, education and training.

Table 7.7 also indicates that SNGs’ share of total public sector revenue is around 30 per cent. This is significant, being slightly below SNGs’ expenditure shares. When considered in relation to SNGs’ revenue, it may look like the vertical fiscal imbalance is low. However, many SNGs’ revenues in Table 7.7 are not own-sourced revenues. They include revenue from taxes shared with the national government. As the base and the rate of these taxes are controlled by the national government, SNGs’ autonomy is restricted, as discussed in Section 7.6.2.

7.6.2 The fiscal autonomy of subnational governments in Vietnam

The current Budget Law (2004) outlines the responsibilities for service provision of the national government and the SNGs, but the actual allocation is unclear because some service responsibilities overlap. The more fundamental issue though is that, in Vietnam, the national government unilaterally allocates the service obligations across the various levels of government. There is no clear assignment – no constitutional allocation – of responsibilities for the provision of specific services. As a result, the autonomy of SNGs in Vietnam over their spending programs is weak. The result is the national government directs both co-sharing of expenditures on related services and revenue.

Under current practice in Vietnam, provincial governments are allowed to borrow from domestic sources by issuing bonds to fund capital investment such as investment on basic infrastructure. However, provincial governments must run balanced recurrent

\(^9\) Details can be found in Appendix A7.3.
budgets. Also, debt must not exceed 30 per cent of total capital from investment in basic infrastructure within provincial budgets. The only exclusion for international borrowing applies to Ho Chi Minh City, Hanoi and Haiphong – the three largest cities in Vietnam. However, even for these largest cities, direct overseas borrowing is not permitted. The city’s government looks for a source of funding, negotiates terms and conditions and then requests the national government to undertake the borrowings and on lending to the city.

In regards to revenue assignment, the autonomy of SNGs is similarly restricted. Even though SNGs share 30 per cent of total public sector revenues, fiscal autonomy of SNGs is much less than this implies. Three restricting factors are of fundamental importance to fiscal decentralisation in Vietnam. First, the national government sets tax bases and rates for all shared tax revenue. Second, SNGs only autonomously set rates for fees and charges, which comprise an insignificant share of their budget. Third, subnational tax authorities often collect revenues arising within their administrative regions on the national government’s behalf. As Table 7.8 reveals, shared national and subnational taxes play a very important portion in subnational budget revenues. SNGs have very limited discretion to change these bases and rates. SNGs have very limited capacity to adjust their revenue yield. Also, the types of taxes to be shared and the proportion in which the taxes are shared are set by the national government and purely local taxes are extremely limited in Vietnam.

### Table 7.8

<table>
<thead>
<tr>
<th>No.</th>
<th>Province</th>
<th>Total Expenditure for Province</th>
<th>Own-sourced revenue (%)</th>
<th>Shared taxes (%)</th>
<th>Transfers (%)</th>
<th>Total (%)</th>
<th>Total Revenue for Province (VND billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Ha Noi</td>
<td>3,188</td>
<td>23</td>
<td>42</td>
<td>35</td>
<td>100</td>
<td>4,299</td>
</tr>
<tr>
<td>2.</td>
<td>Hai Phong</td>
<td>1,316</td>
<td>21</td>
<td>41</td>
<td>38</td>
<td>100</td>
<td>1,628</td>
</tr>
<tr>
<td>3.</td>
<td>Da Nang</td>
<td>752</td>
<td>33</td>
<td>37</td>
<td>30</td>
<td>100</td>
<td>1,131</td>
</tr>
<tr>
<td>4.</td>
<td>Khanh Hoa</td>
<td>774</td>
<td>30</td>
<td>29</td>
<td>41</td>
<td>100</td>
<td>1,035</td>
</tr>
<tr>
<td>5.</td>
<td>Ho Chi Minh City</td>
<td>5,137</td>
<td>60</td>
<td>31</td>
<td>9</td>
<td>100</td>
<td>6,925</td>
</tr>
<tr>
<td>6.</td>
<td>Dong Nai</td>
<td>1,207</td>
<td>32</td>
<td>47</td>
<td>21</td>
<td>100</td>
<td>1,533</td>
</tr>
<tr>
<td>7.</td>
<td>Binh Duong</td>
<td>692</td>
<td>34</td>
<td>41</td>
<td>25</td>
<td>100</td>
<td>972</td>
</tr>
<tr>
<td>8.</td>
<td>Ba Ria Vung Tau</td>
<td>1,111</td>
<td>19</td>
<td>65</td>
<td>16</td>
<td>100</td>
<td>1,849</td>
</tr>
<tr>
<td>9.</td>
<td>Can Tho</td>
<td>948</td>
<td>31</td>
<td>33</td>
<td>37</td>
<td>100</td>
<td>1,127</td>
</tr>
</tbody>
</table>

Source: Derived from Martinez-Vazquez (2004, p. 29).
Figure 7.3 shows the relationship between SNGs’ expenditures by several large SNGs relative to their “own-sourced” taxation revenue given they have autonomy in setting tax rates and tax bases. Significantly, all 64 provinces and cities in Vietnam rely on the national government for support, either through revenues from tax sharing and/or from direct conditional grants because the selected localities are the biggest provinces in the country.

![Figure 7.3 OWN-SOURCED REVENUE AND EXPENDITURE, 2002](VND thousand billions)

Source: Ministry of Finance, Vietnam.


Using the FDI developed under the “fiscal autonomy and fiscal importance” approach outlined in Chapter 3, the degree of fiscal decentralisation in Vietnam can be estimated over the period 1997 to 2007. It is noted that SNGs’ shared revenue accounts for about 64 per cent of total public sector revenue as shown in Table 7.6 of this chapter, based on data from the IMF. Also, SNGs’ own-sourced revenue is equal to 36 per cent of total SNGs’ revenue, based on data from Vietnam’s Ministry of Finance.

To distinguish between the difference in fiscal autonomy and fiscal importance of SNGs in Vietnam, the FDI is presented in its component parts.

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10 While SNGs’ own-sourced revenue accounts for 36 per cent of subnational revenues, it accounts for only 3 per cent of total public sector revenue in Vietnam.
Figure 7.4 shows the indices of fiscal decentralisation for Vietnam as well as indices of its two components: “fiscal autonomy” and “fiscal importance”. It is strikingly clear that the degree of fiscal decentralisation evident in Vietnam has not trended upwards, but between 1997 and 2002, there has been a successful policy of shifting fiscal activities down from the national government to SNGs (i.e. fiscal importance of SNGs). There has been no corresponding decentralisation of responsibility for expenditure and revenue decisions to SNGs (i.e. fiscal autonomy of SNGs).

7.7 Concluding remarks

This chapter has reviewed the recent history and current state of fiscal decentralisation in Vietnam. On balance, it is concluded that the current state of fiscal arrangement in Vietnam is still relatively centralised. SNGs are allocated significant shares of revenue raising and spending activities by the national government, but the responsibility for such decisions has not been devolved. Prima facie, Vietnam is
moderately decentralised when fiscal importance of SNGs is considered in isolation. However, this view in isolation is misleading - fiscal autonomy of SNGs must also be considered. Moderate fiscal decentralisation can only be completely realised when SNGs are given more autonomy in their spending programs and by assigning real, constitutionally protected, tax-raising powers to SNGs. As such, genuine reforms to advance fiscal decentralisation in Vietnam still have some way to go.
Non-constitutional statutes that define the structure of the Vietnamese State:

- Law 05/2003/QH11 dated 17 June 2003 on the supervisions of the National Assembly.
- Law 33/2002/QH10 dated 02 April 2002 on the Organisation of The Supreme People’s Court.


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11 Under the current legislation of Vietnam, the Constitution is the highest legal document of the nation and the National Assembly is the only organ to promulgate or revise the Constitution. Since 1945, Vietnam has had four Constitutions in 1946, 1959, 1980 and 1992.
Appendix A7.2

LEGAL DOCUMENTS FOR THE INVESTIGATION OF TAX ALLOCATION IN VIETNAM: FROM 1990 TO 2004

1. Resolution No. 108/CP dated 13 May 1978 and came into effect on 01/01/1979.
2. Resolution 138-HDBT dated 19 November 1983 and came into effect on 01/01/1984.
3. Resolution 186-HDBT in 1989 and came into effect on 01/01/1990.
5. Decision 60-TTg dated 08/02/1994 and came into effect in the financial year 1994.
6. Decision 861/TTg dated 30/12/1995 and came into effect in 1996.
8. The Law on the Government budget in 1998 (revised for Law in 1996) and came into effect on 01/01/1999.
12. Decision 54/2004/QD-TTg dated 05 April 2004 on “The Preferential Fiscal Regime” for Haiphong and came into effect after 15 days of its publication.

Appendix A7.3
A SUMMARY OF KEY REGULATIONS OVER FISCAL ISSUES SINCE 1997

Appendix A7.3.1
EXPENDITURE RESPONSIBILITIES

I. BUDGET LAW 1997

A. NATIONAL GOVERNMENT

The spending responsibilities for the national government could be summarised as follows:

1. Current expenditure:
   g. Spending on economic activities, education, training, medicine, social and cultural events, informatics, science, technology and environment under national control.
   h. Economic operations under the control of national organs.
   i. Defence, security and social order except those assigned to subnational governments.
   j. Operations of central organs of the Communist Party of Vietnam, the national and socio-political organisations.
   k. Price subsidy under national policy.
   l. National programs under national control.
   m. Support to social contribution funds in accordance with the government’s regulations.
   n. Subsidy to people in the targeted programs.
   o. Subsidy to social and career organisations.
   p. Interest payments for government’s loans.
   q. Aids.
   r. Other spending.

2. Capital expenditure:
   a. Investments on subsidised infrastructure projects under national control;
   b. Investment and supports for State-Owned Enterprises (SOEs); capital contributions for joint-stock, joint-venture companies in the field that required the presence of national contribution of capital.
   c. Subsidy for national-supported funds and development-assisted funds to projects and programs for economic development.
   d. National reserves.

3. Repayment of government’s loans.

4. Spending for supplement financial reserves.

5. Fiscal transfer to subnational governments.

B. PROVINCIAL GOVERNMENT

1. Current expenditure:
   g. Spending on economic activities, education, training, medicine, social and cultural events, science, technology and environment under provincial control.
   h. Defence, security and social order assigned to provincial governments.
   i. Operations of central organs of the country, Communist Party of Vietnam and socio-political organisations at provincial level.
   j. Supports for social and career organisations under provincial control.
   k. Spending on social policies under provincial control.
l. National programs under provincial control as assigned by the national government.
m. Price subsidy under the provincial policy.
n. Interest payments for provincial loans.
o. Other spending.

2. Capital expenditure:
a. Investments on infrastructure projects under provincial control.
b. Investment and support for State-Owned Enterprises.

3. Repayment of provincial loans.

4. Spending for supplementary financial reserves.

5. Fiscal transfer to lower tiers of governments.

C. SUBNATIONAL GOVERNMENT AT DISTRICT LEVEL

1. Current expenditure:
a. Spending on economic activities, education, social and cultural events, and others under district control.
b. Defence, security and social order assigned to district governments.
c. Operations of central organs of the state, Communist Party of Vietnam and socio-political organisations at district level.
d. Support for social and career organisations under district control.
e. Other spending.
f. Besides the above, cities under a direct provincial control are required to allocate spending on management and maintenance of public projects.

2. Capital expenditure:
a. Investments on infrastructure projects under district control as assigned by the provincial government.
b. With cities under a direct provincial control, they are required to allocate spending on investment to build public elementary, secondary and high schools and public welfare programs, lighting, electricity, water supply, internal traffic, traffic safety and local hygiene.

3. Fiscal transfer to lower tiers of governments.

D. SUBNATIONAL GOVERNMENT AT COMMUNE LEVEL

1. Current expenditure:
a. Spending on social and cultural events under commune control.
b. Support for educationally-supplemented programs, kindergartens under commune control.
c. Operations of medicine at commune level.
d. Management, repair and maintenance of architecturally important buildings, welfare programs and local public transportation under commune control.
e. Operations of central organs of the nation, Communist Party of Vietnam and socio-political organisations at commune level.
f. Social orders at commune level.
g. Other spending.

2. Capital expenditure:
Investments on infrastructure projects as assigned by the provincial government.
II. Revised Law 1999

No changes for expenditure responsibilities of national and provincial governments. However, there was a change for expenditure responsibilities for governments at district level. Spending on education, training and medicine, which were previously assigned to the provincial government, is now the scope of subnational spending at district level.

III. Law 2004

There are no changes in this 2004 Law in comparison with the first two laws. However, there was an important insertion in the section of responsibilities for the national government. Spending of loan funds is now the scope of national spending.

Appendix A7.3.2

SOURCES OF REVENUE

I. **Budget Law 1997**

A. **NATIONAL GOVERNMENT**

The following sources are the national government’s revenue:

1. **Sources for 100 per cent revenue for the national government:**

Revenue from:

- f. Export tax and import duties.
- g. Excises tax.
- h. Profit tax from nationwide businesses.
- i. Taxes and other revenues from oil and gas.
- j. Capital withdrawing and profit-sharing from joint-venture, joint-stock companies with the presence of the national capital; revenue from the national reserves.
- k. Government’s loans, non-refundable aids from overseas nations and international organisations.
- l. Fees and other revenue paid to the national government.
- m. Revenue from the accrued balance of the national budget.
- n. Other non-tax revenues.

2. **Shared revenue between national and provincial governments:**

Revenue from the following sources are subject to be shared between national and provincial governments. Sharing rates are predetermined by the national government:

- f. Turnover tax.
- g. Profit tax, except profit tax from nationwide businesses.
- h. Income tax for high-income earners.
- i. Profit remittance tax.
- j. Natural resources tax.
- k. Capital user charges.

B. **PROVINCIAL GOVERNMENT**

1. **Sources for 100 per cent revenue for provincial government:**

Revenue from:

- f. Rental of land.
- g. Income from selling and renting national properties given to provinces to be managed and utilised.
- h. Registration tax.
- i. Revenues from lotteries.
- j. Non-refundable aids directly to provincial governments.
- k. Other fees and charges determined by the national government to be paid to provincial budget.
- l. Mobilisation from individuals, organisations to invest in infrastructure.
- m. Voluntary contributions from domestic and overseas organisations and individuals directly to subnational government budget.
- n. Revenue from the accrued balance of the provincial budget.
- o. Fiscal transfers from the national government.
- p. Other collections.
2. **Shared tax between national and provincial governments:**
   
   As in Section A.2

3. **Shared tax between provincial, district and commune governments:**

   Revenue from the following sources is subject to be shared between provincial and district governments. Sharing rates are predetermined by the central government:
   
   a. Agricultural tax.
   
   b. Tax on the rights transfer of agricultural land.
   
   c. Land and housing tax.
   
   d. Fees on land usages.

C. **SUBNATIONAL GOVERNMENT AT DISTRICT LEVEL**

1. **Sources for 100 per cent revenue for the government at district level:**

   Revenue from:
   
   a. Licence tax; except licence tax from small businesses at wards.
   
   b. Slaughter tax.
   
   c. Fees and charges from activities implemented and managed by organisations at district levels.
   
   d. Administrative receipts from units managed by district levels.
   
   e. Non-refundable aids directly to district governments.
   
   f. Fees to provincial government as regulated by the national government.
   
   g. Mobilisation from individuals, organisations to invest in infrastructure.
   
   h. Voluntary contributions from domestic and overseas sources directly to subnational budget at district level.
   
   i. Revenue from the accrued balance of the district budget.
   
   j. Fiscal transfers from the provincial government.
   
   k. Other revenue.

2. **Shared tax between provincial, district and commune governments:**

   As in Section B.3

3. Except the above revenue, the local budget of cities under the direct control of the province will also be allocated sharing revenue of turnover tax, profit tax and licence tax which are collected within the respective administrative region with a predetermined sharing rate. In addition, investment funds can be set up in accordance with regulations from the national government.

D. **LOCAL GOVERNMENT AT COMMUNE LEVEL**

1. **Sources for 100 per cent revenue for the government at commune level:**

   Revenue from:
   
   a. Licence tax from small businesses at commune.
   
   b. Slaughter tax.
   
   c. Fees from operations under commune control.
   
   d. Revenue from usage of public land.
   
   e. Revenue from operations of non-productive activities.
   
   f. Non-refundable aids directly to commune governments.
   
   g. Revenue from the accrued balance of the commune budget.
   
   h. Fiscal transfers from higher-tier governments.
2. **Shared tax between province, district and ward governments:**
   As in Section B.3

II. **Revised Law 1999**
- There were two main changes in the tax system of Vietnam in 1997. The Value added tax replaced Turnover tax and the Corporate income tax replaced Profit tax.
- With these changes, in terms of the allocations of revenue, there were some changes as follows:
  - *Regarding Corporate Income Tax*: no changes (i.e. only the name of the tax changed).
  - *Regarding VAT*: changes are as follows:
    - VAT on import: revenue for the national government.
    - Other VAT: revenue for subnational governments at provincial level.
- The sharing rates of taxes between the provincial government to subnational governments at district and commune levels are determined by the Provincial People’s Committees.
- It is required that revenue from agricultural tax for the local budget at commune levels should not be less than 20 per cent total revenue from this type of tax.

III. **Budget Law 2004**
- Revenue from the Excise tax is no longer the national government’s revenue. Revenue from this tax is divided into two portions:
  - Excise tax on imports is national government’s revenue.
  - Excise tax on domestic goods and services is subnational governments’ revenue.
- The sharing rates of taxes between the provincial government to governments at district and commune levels are determined by the Provincial People’s Councils.
- The local budget of cities under a direct control of the province is allocated at least 50 per cent revenue from the licence tax from the provincial government.
- Local budget of the governments at commune level is allocated at least 70 per cent revenue from tax on the rights transfer of land; land and housing tax; licence tax from small businesses and agricultural tax.

Appendix A7.3.3
SUBNATIONAL BORROWINGS

I. **Budget Law 1997**

The provincial government is allowed to make domestic borrowing to meet the needs of investing in basic infrastructures with decisions from the Prime Minister, and the provincial government itself must balance its budget to repay debt in due course.

II. **Budget Law 2004**

The provincial government is allowed to make domestic borrowing to meet the needs of investing in basic infrastructures and the provincial government itself must balance its budget to repay debt in due course. The balance from the debt must not exceed 30 per cent of total capital investment in basic infrastructure yearly within the provincial budget.

**Source:** The Ministry of Finance of Vietnam, at [www.mof.gov.vn](http://www.mof.gov.vn)
Appendix A7.3.4
INTERGOVERNMENTAL FISCAL TRANSFERS

I. **Budget Law 1996**

- Fiscal transfer from the national government to subnational governments to ensure that the subnational governments are capable of implementing the socio-economic responsibilities assigned by the national government.
- Criteria used in defining the amount of fiscal transfers are population, natural conditions, socio-economic conditions of specific area; particularly focusing on rural areas, remote areas, minority ethnic areas, areas with other difficulties.
- Fiscal transfer amounts are kept constant for the period from 3 to 5 years.
- Inflation-indexed fiscal transfer amount.

II. **Revised Budget Law 1999**

The amounts of fiscal transfers are annually indexed with inflation rates and economic growth rates.

III. **Budget Law 2004**

The higher level of government will decide the amount of fiscal transfers on the basis of particular goals that the lower tiers of government cannot manage after using its allowance budget and reserve budget.

CHAPTER 8
FISCAL DECENTRALISATION IN CHINA AND SELECTED ASEAN NATIONS

8.1 Introduction

China has become one of the largest economies in the world in the ten years since its economic reform in 1990. The size of the economy, as represented by GDP, was around 43 per cent GDP of the United States (“US”) in 1997. However, its income per capita, at around 9 per cent of the US level, is still well below that of rich developed countries (Department of Foreign Affairs and Trade of Australia, 1997, p.11). Since 1990, China has experienced a yearly average rate of economic growth of more than 10 per cent. This significant achievement has laid the strong and steady foundation for China to advance and become one of the leading economies in the world in the future.

China has set up a close relationship with The Association of South-East Asian Nations (“ASEAN”) concerning economic development and cooperation and regional peace and security. ASEAN was established on 8 August 1967 in Bangkok by the five original member countries: Indonesia, Malaysia, the Philippines, Singapore, and Thailand. Five new members have joined the Association since then, including Brunei Darussalam on 8 January 1984, Vietnam on 28 July 1995, Laos and Myanmar on 23 July 1997 and Cambodia on 30 April 1999. The ASEAN region has a population of 500 million, a total area of 4.5 million square kilometres, a combined gross domestic product of almost US$ 700 billion and a total trade of about US$ 850 billion (Asian Development Bank, 2007).

This chapter analyses fiscal decentralisation in China using the conceptual elements associated with the emphasis on fiscal autonomy and fiscal importance of subnational governments (“SNGs”). Consideration is also given to the fiscal arrangements in the above-mentioned ASEAN countries. The motivation for this derives from the fact that these countries, together with Vietnam, are: (i) from the same region; (ii) all popular developing countries; and (iii) have relatively high economic growth rates
(at least in comparison with other countries at a similar level of development in different regions). The contribution of the chapter is the provision of a solid foundation for a comparison between the pattern of fiscal decentralisation in these countries and Vietnam. Some implications are drawn from the fiscal experience in these countries for the future progress of fiscal decentralisation in Vietnam.

In this chapter, following this introduction, Section 8.2 discusses China’s long march towards fiscal decentralisation since 1949. In these discussions, the process towards fiscal decentralisation is examined from the core analytical perspective adopted in this thesis – that is, in terms of the distinction between fiscal autonomy and fiscal importance of SNGs in China, particularly since 1994 when a new tax sharing system was introduced. Also, the degree of fiscal decentralisation in China is estimated for the years when data are available. A general synthetic comparison of Vietnam and China is presented in Section 8.3 with the intention of identifying similarities and differences between these two countries’ fiscal systems and identifying potential lessons from China’s experience for fiscal decentralisation in Vietnam. The paths to fiscal decentralisation in Indonesia, the Philippines, and Thailand are also examined in Section 8.4. Fiscal arrangements in these countries are considered here because they are members of the ASEAN and have some important similarities to Vietnam, in terms of fiscal arrangement (unitary countries), level of economic growth (all developing countries), population, and data availability. As such, these countries may, like China, provide insights which are useful to consider when reflecting on reform of fiscal decentralisation in Vietnam. The degrees of fiscal decentralisation across these five countries, for the years when data are available, are also measured in Section 8.5. The purpose of Sections 8.4 and 8.5 is to identify potential lessons for Vietnam from the experience of these three ASEAN countries with fiscal decentralisation. Conclusions are drawn in Section 8.6.

8.2 China’s long march to fiscal decentralisation

The Chinese Communist Party came into power after the civil war in 1949. With the expectation to make China become “a socialist, modernised and industrialised,
China is the most populous country in the world with population of more than 1.3 billion in 2007. The SNGs’ structure consists of 31 provinces, in which there are 4 cities under direct administrative control of the national government (Beijing, Tianjin, Shanghai, and Chongqing), 5 autonomous regions (Inner Mongolia, Guangxi, Tibet, Ningxia, and Xinjiang), and 22 other provinces. Consistent with convention in China studies, all provinces, cities, and autonomous regions are referred consistently to as “provinces” in this chapter. Government below the provincial level comprises three administrative levels: 479 prefectures, 1,894 counties and more than 60,000 townships (IMF, 2004, p.647). Due to the vast and populous areas, policy coordination among different levels of government, particularly from national to provincial levels, is very important and indispensable (Ma and Norregaard, 1998). As a result, some degree of fiscal decentralisation became an important tool for the national government to manage its economic, social and fiscal policies.
8.2.1 Fiscal environments in China prior to 1979

Prior to 1979, China’s achievements during the three decades since 1949 were significant. The achievements were partly contributed by the fiscal system which was centralised in nature (DFAT, 1997, p.14). The centralised nature of the fiscal system presented two important characteristics: (i) national budget control and (ii) an expenditure-oriented fiscal approach (Tong, 1997) which are discussed in turn. First, the national government controlled the budgets of all levels of government. All subnational budgets required approval from the national government, which also determined the structure and line-items in subnational budgets. Second, under the expenditure-oriented approach to fiscal affairs, revenue collected by SNGs was remitted to the national government. Then, the national government effectively arranged transfers among subnational regions in accordance with spending responsibilities assigned to them. For the period 1949 to 1979, for example, Shanghai had to remit up to 90 per cent of its locally-collected revenue to the national government whereas Tibet retained all 100 per cent of its locally-collected revenue (Tong, 1997). In aggregate, 85 per cent of all government revenue was collected by SNGs that were remitted to the national government, which, in turn, funded SNGs’ expenditure which accounted for 50 per cent of all public sector revenue.

Two main concerns had been raised. First, SNGs had a diminished incentive to increase their revenue yield, as it was shared with the national government. Second, there was a concern about the capacity of the national government to plan all SNGs’ spending at the budget line-item level and to determine the structure of subnational budgets in a way that meets local needs. As such, by 1978, these perverse incentives brought China to the threshold of implementing reform in both the economic and fiscal fields.

8.2.2 Reforms and fiscal decentralisation in China in 1979-1994

In 1979, China initiated an extensive fiscal reform program, with the beginning of a process of fiscal decentralisation where the fiscal relationships among different levels
of government were altered. The ratio between subnational spending and total government spending averaged 50 per cent before and after the reform (i.e. the period from 1975 to 1979 and from 1980 to 1990) (Qian, 2002). However, under the 1979 reform, SNGs were assigned the authority to decide the structure of their local spending, although within broad guidelines from the national government. Also, SNGs at provincial level were given the authority to determine the assignment of expenditure responsibility and sources of revenue with their lower tiers of SNGs at prefecture, county and township levels (Qian, 2002). These two changes reveal the fact that, in addition to a significant level of fiscal importance of SNGs which was represented by a ratio of subnational expenditure in total government spending, the relevance of provincial fiscal autonomy on spending programs had finally gained some official recognition.

Between 1980 and 1984, the national government introduced further devolution of responsibility for revenue and expenditure to separate national and subnational fiscal decisions. This became known at the outset as the “eating in separate kitchens” arrangement (Qian, 2002). In this period, own-sourced local revenue; own-sourced national revenue; and revenue sharing were introduced. Regarding the revenue shared, the uniform rate was applied across regions with more than 80 per cent of revenue collected by SNGs being remitted to the national government. The national government did not have any representative offices to collect its own-sourced revenue, except for the case of import duties which were collected by the Custom offices (Ma, 1995). These arrangements had some important social implications. First, it restored some (albeit modest) incentive to SNGs to ensure compliance with tax laws, because SNGs retained a share of the revenue collected. Second, it resulted in more unequal regional distribution of public resources: wealthy provinces became relatively richer and the poor regions became relatively poorer.

This problem was recognised by the national government and changes were introduced. Revenue sharing rates were no longer uniform across regions (Ma, 1995). In 1985, the national government set different revenue sharing rates to different regions with reference to their respective budget conditions (surplus or deficit). The sharing rates were
more favourable to poor regions than to rich regions. For example, rich regions such as Shanghai, Beijing, Tianjin, and Liaoning were required to remit larger portions of their collected revenue to the national government. This adjustment solved imbalances among regions. As such, fiscal disparities among regions were reduced. However, fiscal incentives to rich provinces deteriorated relative to poor provinces. Rich regions were no longer enthusiastic about increasing tax revenue which was shared with the national government, in contrast to poor regions. This required further adjustment which is capable of compromising all possible regional and national interests.

In 1988, a new fiscal contracting system was implemented. The significant changes in this new system involved the introduction of a set of six different sharing rates which were then applied to different regions. The contracted revenue sharing specified:

(i) fixed yearly growth rate of revenue; (ii) fixed share in total revenue; (iii) fixed share in total revenue plus incremental fixed sharing rate; (iv) remittance with fixed amount growth rate; (v) fixed remittance; and (vi) fixed grants (Zhang and Martinez-Vazquez, 2003). The new system provided a compromise balance in serving the interests of the national government, and poor regions as well as rich areas. However, this system still resulted in difficult problems emerging for both national and subnational governments because of many different types of contracts, with divergent rates adopted for different provinces, and the potential for inconsistency between some of the six specified sharing arrangements.

By way of caveat, it should be noted that the preceding discussions have focused on the “budget” sector only – i.e. the fiscal arrangements for the general activities of government. It is also relevant that development in the “extra-budget” (or public trading enterprises) sector impacts on the relative fiscal positions of national and subnational governments. For the period from 1979 to 1994, there was a significant increase in extra-budgetary fund generation and outlays, almost 100 per cent for revenue and 80 per cent for expenditure (Arora and Norregaard, 1997). However, these funds also open the possibility for SNGs to transfer some resources from budgetary (i.e. the amounts need to be shared with the national government) to extra-budgetary funds which can be used for
SNGs’ own use. For example, SNGs have the capability to provide tax concessions, tax holidays, and exemptions to enterprises operating in their region and still arrange for revenue raised from public utility charges, surcharges and fees to be returned to the “budget” as dividends or other payments from the extra-budgetary sector. Consequently, while reforms that commenced in 1979 were intended to improve efficiency of the fiscal system, by 1994, many substantial fiscal problems remained and needed to be corrected.

8.2.3 1994 onwards

Background for the 1994 reform

Prior to 1994, the national government was concerned about its low level of fiscal autonomy over national fiscal matters on two grounds. First, total government revenue substantially decreased from 1978 and accounted for only 17 per cent Gross National Product (“GNP”) in 1993, whereas it was usually over 30 per cent GNP in capitalist economies. It should be recalled that the “eating in separate kitchens” policy had the effect of reducing the already modest incentive for provinces to ensure tax compliance, and that much of the decline in tax revenue vis-à-vis tax capacity was attributable to this policy. Second, and related to the first point, the national budget deficit started increasing from 0 per cent GNP in 1978 to 4.7 per cent GNP in 1992. Figure 8.2 presents the continuing decline of the ratio between total government revenue to GNP and an increased budget deficit in China for the period 1978-1992.

Furthermore, the system of fiscal arrangements, for the period 1979-1993, provided limited benefits to the national government, while provinces enjoyed the benefits of extra-budgetary funds and greater incentives to ensure tax compliance. As a result, two main goals of the national government were: (1) to raise the ratio of total government revenue-to-GDP; and (2) to raise the ratio of national government-to-total public sector revenue (Wang, 1997), or the so-called “two ratios”. A new “tax sharing system” introduced in 1994 was the main mechanism for realising these two goals.
Evaluation of the 1994 reform

In order to attain the goals of the two ratios, fundamental changes in intergovernmental fiscal transfers were made via the promulgation and implementation of China’s first “Budget Law”. Under this law, fiscal relations were based on the tax sharing system. The most significant aspects of this system were that:

- Revenue from enterprise profits was replaced by a new tax system including personal income tax, corporate income tax and value added tax. These three new shared taxes generated significant revenue for the national budget. Also, tax bases and tax rates were nationally determined. As such, the national government retained a significant share of revenue sharing.

- A national tax authority set up its representative offices in each province. Shared revenues and exclusively national taxes were collected by the national government. As a result, SNGs were no longer responsible for collecting these sources of revenue on behalf of the national government as they did prior to 1994.

These two new measures helped the national government achieve its fiscal goals, but left SNGs in disadvantaged circumstances, which are discussed in the following sections. Figure 8.3 shows that the ratio between national revenue and total revenue...
increased substantially from 1993 to 1994, from 20 per cent to 55.7 per cent whereas the ratio of total revenue and GDP slightly decreased from 12.6 per cent in 1993 to 11.2 per cent in 1994. From 1994 onwards, while the ratio between total revenue and GDP continuously increased, the other ratio was largely unchanged at around 50 per cent.

**FIGURE 8.3**
THE PERFORMANCES OF THE "TWO RATIOS"
CHINA, 1994-2000

![Graph showing the performances of the two ratios in China from 1994 to 2000.](image)


**Fiscal importance of subnational governments in China after the 1994 reform**

Fiscal importance of SNGs in China has been high since 1980 with SNGs’ outlays accounting for around 70 per cent of government expenditure. In short, as Table 8.1 shows, while SNGs’ revenue share decreased sharply, subnational share of expenditure remained still high even after the 1994 reform.

**TABLE 8.1**
SUBNATIONAL SHARES OF REVENUE AND EXPENDITURE IN CHINA
PRE- AND POST-1994 REFORM

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</thead>
<tbody>
<tr>
<td>Revenue (100 millions yuan)</td>
<td>1,132</td>
<td>1,160</td>
<td>2,005</td>
<td>2,937</td>
<td>3,149</td>
<td>3,483</td>
<td>4,349</td>
<td>5,210</td>
<td>6,242</td>
<td>13,395</td>
<td>16,386</td>
<td>18,904</td>
<td>21,715</td>
</tr>
<tr>
<td>Of which: Subnational budget revenue</td>
<td>956</td>
<td>875</td>
<td>1,235</td>
<td>1,945</td>
<td>2,211</td>
<td>2,504</td>
<td>3,391</td>
<td>2,312</td>
<td>2,986</td>
<td>6,406</td>
<td>7,803</td>
<td>8,515</td>
<td>9,850</td>
</tr>
<tr>
<td>Subnational share of total revenue (%)</td>
<td>84.5</td>
<td>75.5</td>
<td>61.6</td>
<td>66.2</td>
<td>70.2</td>
<td>71.9</td>
<td>78.0</td>
<td>44.4</td>
<td>47.8</td>
<td>47.8</td>
<td>47.6</td>
<td>45.0</td>
<td>45.4</td>
</tr>
<tr>
<td>Expenditure (100 millions yuan)</td>
<td>1,122</td>
<td>1,229</td>
<td>2,824</td>
<td>3,084</td>
<td>3,387</td>
<td>3,742</td>
<td>4,642</td>
<td>5,793</td>
<td>6,824</td>
<td>15,887</td>
<td>18,903</td>
<td>22,053</td>
<td>24,650</td>
</tr>
<tr>
<td>Of which: Subnational expenditure</td>
<td>590</td>
<td>562</td>
<td>1,935</td>
<td>2,079</td>
<td>2,296</td>
<td>2,572</td>
<td>3,330</td>
<td>4,038</td>
<td>4,828</td>
<td>10,367</td>
<td>13,135</td>
<td>15,281</td>
<td>17,230</td>
</tr>
<tr>
<td>Subnational share of total expenditure (%)</td>
<td>52.6</td>
<td>45.7</td>
<td>68.5</td>
<td>67.4</td>
<td>67.8</td>
<td>68.7</td>
<td>71.7</td>
<td>69.7</td>
<td>70.8</td>
<td>65.3</td>
<td>69.5</td>
<td>69.3</td>
<td>69.9</td>
</tr>
</tbody>
</table>

In addition, fiscal relations across different levels of government significantly changed after the 1994 reform. China has developed a complex system of intergovernmental fiscal transfers based on four main types (Su and Zhao, 2004). 

**First**, the contact system operated prior to the 1994 reform and was still in use. Well-endowed SNGs remitted locally collected tax revenue, after retaining the assigned amount for expenditure responsibility, to the national government budget whereas less-endowed provinces received transfers from the national government. Of the 31 provinces, sixteen provinces were on the recipient side and fourteen provinces were on the remitting side (Wang, 2004). This effectively represents a partial fiscal equalisation system.

**Second**, the tax rebating system (or revenue returned system) was developed with the goal of compensating less-endowed provinces so that they would not be worse off after the introduction of the 1994 reform.

**Third**, the system of transitional transfer payments was introduced in 1995 to reduce fiscal disparities among different provinces in China. The value of this type of grants is determined with reference to regional domestic product, population, and regional wage differentials.

**Fourth**, conditional grants were also introduced under two main forms of: (i) payments to SNGs for the adjustment of income distribution (i.e. funds earmarked for uses which increase the income levels of low and middle class) and (ii) payments to minority areas.

In regards to expenditure arrangements, China does not have an explicit assignment of expenditure between the national government and SNGs and among tiers.
of SNGs. This results in a lack of a formal assignment in terms of government expenditure (Martinez-Vazquez, 2001). The current budget law presents a very broad definition of the assignment of expenditure responsibility between the national government and SNGs and decisions on spending programs are still left at the discretion of the national government. As a result, the 1994 reform did not improve the fiscal autonomy of SNGs across their spending issues. A brief summary of these expenditure assignments is presented in Table 8.2.

**TABLE 8.2**

THE CURRENT ASSIGNMENT OF EXPENDITURE RESPONSIBILITIES IN CHINA

<table>
<thead>
<tr>
<th>1</th>
<th>The national government</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Defence; foreign affairs; operations of the national government; operational expenses for cultural, educational, science, and public health undertaking at the national level.</td>
</tr>
<tr>
<td></td>
<td>Key capital construction; agriculture; subsidies; and social security; and etc.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>2</th>
<th>The subnational governments</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Operations of SNGs; operational expenses for culture, education, science, and public health undertaking at the subnational level.</td>
</tr>
<tr>
<td></td>
<td>Subnational capital construction; agricultures; subsidies; and social security; and etc.</td>
</tr>
</tbody>
</table>


The fiscal autonomy of subnational governments after the 1994 reform in China

The 1994 reform did not improve the autonomy of SNGs in generating their own-sourced revenue. By setting up the representative office of the national tax authority in every province, the national government was able to collect all national taxes as well as shared taxes. After the 1994 reform, the national government collects main taxes with significant revenue – Import duties, Excises taxes, Value added tax. Subnational taxes include local company profits, stamp taxes, and a wide range of other minor taxes. Some taxes are shared between the national government and SNGs, including the Value added tax (except VAT on imports) with the ratio of 75:25 to national and subnational governments; and stamp taxes on stock exchange transactions with a ratio of 50:50 (Su and Zhao, 2004). The significant decrease in SNGs’ tax collection, which was not treated as subnational revenue, in China after the 1994 reform is clearly illustrated by Figure 8.5. As a result, in terms of SNGs’ share of revenue collection, for the period 1980 to 1993,
the average SNGs’ share was around 70 per cent total public sector revenue collections. This share fell to 44.4 per cent in 1994 and has remained at around that share since then.

![Figure 8.5](image)

**FIGURE 8.5**

**REVENUE COLLECTION, CHINA:**

1980–1995

Yuan (thousand billions)

(a) Subnational revenue collection includes revenue collected by SNGs on behalf of the national government.

**Source:** Statistical Yearbook of China, 1996.

Significantly, the reform of 1994 did not achieve a notable increase in the fiscal autonomy of SNGs. Prior to 1994, SNGs had some autonomy over the “off-budget” tax treatment of public enterprises. However, that SNGs’ power was officially abolished after the 1994 reform (Bahl, 1995). This abolition weakened the fiscal autonomy of SNGs. Also, the centralisation of tax collection and administration contributed to a decreased level of fiscal autonomy of SNGs. SNGs were only allowed to collect personal income taxes and some smaller taxes without getting involved with the assessment, collection and audit of the value added tax (Bahl, 1995).

In conclusion, *prima facie*, China appears to have recentralised its fiscal arrangements through the introduction of the new tax sharing system from 1994. The background for this view is that the SNGs’ collection in total revenue collection decreased sharply since 1994. In addition, since 1994, the national government changed the arrangement of shared revenue so that it could account for the lion’s share of national fiscal resources to increase two ratios as previously discussed.

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8.2.4 China’s fiscal decentralisation index: 1995–2003.

The fundamental index of fiscal decentralisation in China is measured, using the approach developed in Chapter 3, with its two component indices for the fiscal autonomy and fiscal importance of SNGs. To analyse the contribution of each component in the index, Table 8.3 presents SNGs’ fiscal autonomy and fiscal importance, and the FDI after the 1994 reform. From 1995 to 2003, even though the fluctuations are small, the general trend is that SNGs’ fiscal autonomy, fiscal importance and the FDI for China have slightly fallen.

<table>
<thead>
<tr>
<th>Variables</th>
<th>Own-sourced revenue (100 mil. of yuan)</th>
<th>Expenditure (100 mil. of yuan)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiscal autonomy (%)</td>
<td>31 32 33 32 31 31 30 28 29</td>
<td>71 73 73 71 69 65 69 69 70</td>
</tr>
<tr>
<td>Fiscal importance (%)</td>
<td>71 73 73 71 69 65 69 69 70</td>
<td>47 49 49 48 46 45 45 44 45</td>
</tr>
<tr>
<td>FDI (%)</td>
<td>47 49 49 48 46 45 45 44 45</td>
<td>47 49 49 48 46 45 45 44 45</td>
</tr>
</tbody>
</table>

Source: Author's calculations and Statistical Yearbook of China (2004).

Figure 8.6 shows the general trend of SNGs’ fiscal autonomy, fiscal importance, and the FDI in China for a longer period, from 1989 to 2003. By and large, the reduction in fiscal importance is offset by an increase in fiscal autonomy (although there has been a slight decline in fiscal autonomy from 1997). It is important to note that there was no radical change in the degree of fiscal decentralisation in China after the 1994 reform, even though there was a substantial reduction in subnational revenue collection from 1994, as shown in Figure 8.5. This is because, prior to 1994, national revenues, which were collected by SNGs on the national behalf, are not treated as subnational revenues. As such, the clear conclusion is that, for the entire period, fiscal importance of SNGs in China has consistently contributed more to the overall level of fiscal decentralisation compared with the level of SNGs’ fiscal autonomy.
8.3 China and Vietnam – a fiscal comparison

China and Vietnam are both developing countries in the Asia region with real per capita income in 2007 of around US$ 2,000 and US$ 750, respectively. Since 1990, both China and Vietnam have achieved high and stable rates of economic growth – among the highest rates in the world, around 10 per cent per year. Economic reform started in China in the late 1970s and 10 years later, in 1986, an extensive economic reform program was also launched in Vietnam. Both China and Vietnam have attempted to integrate themselves further with the world economy. Changes in fiscal decentralisation have been an element of broader economic reform in both countries.

8.3.1 Similarities between China and Vietnam

China and Vietnam share many similarities in the pattern of their economic growth. China commenced its extensive pro-market oriented economic reform in 1979 while Vietnam marked its historic move towards market-oriented economic reform in 1986. The basic similarities between China and Vietnam are presented in Table 8.4.
TABLE 8.4
COMMON PRACTICES FOR ECONOMIC GROWTH, CHINA AND VIETNAM

<table>
<thead>
<tr>
<th>Event</th>
<th>China</th>
<th>Vietnam</th>
</tr>
</thead>
<tbody>
<tr>
<td>War finished</td>
<td>1949 The Communist Party came into power.</td>
<td>1975 The nation was reunified.</td>
</tr>
<tr>
<td>Extensive economic reform programs</td>
<td>1979 Adopted the market-oriented economy.</td>
<td>1986 Adopted the market-oriented economy.</td>
</tr>
</tbody>
</table>


China and Vietnam have also shown a strong relationship both from the perspectives of politics and historical facts. The presence of Chinese in Vietnam for a thousand years in feudal regimes highlights the similarities of these two countries in terms of culture and society. Table 8.5 presents the similarities between China and Vietnam to which some implications from Chinese experience of fiscal decentralisation can be drawn for Vietnam.

TABLE 8.5
SIMILARITIES BETWEEN CHINA AND VIETNAM

<table>
<thead>
<tr>
<th>Similarity</th>
<th>China</th>
<th>Vietnam</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Political and government structure:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government structure</td>
<td>National People’s Congress; President and Prime Minister.</td>
<td>National Assembly; President and Prime Minister.</td>
</tr>
<tr>
<td>Local governments</td>
<td>Three levels: 31 provinces; more than 1,800 counties and more than 60,000 townships.</td>
<td>Three levels: 64 provinces; more than 600 districts and more than 10,000 communes.</td>
</tr>
<tr>
<td>Population.</td>
<td>Ranks number 1 in the world in 2007 with more than 1.3 billion people.</td>
<td>Ranks number 13 in the world in 2007 with more than 83 million.</td>
</tr>
<tr>
<td>2. Economic aspects:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Before economic reform</td>
<td>The centrally planned economy.</td>
<td>The centrally planned economy.</td>
</tr>
<tr>
<td>Extensive economic reform</td>
<td>1979 In 1994 with the introduction of tax sharing system – the first Budget Law.</td>
<td>1986 In 1997 with the introduction of the Budget Law.</td>
</tr>
<tr>
<td>Significant fiscal changes.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Clearly then, the similar history of these countries, in which communism was followed, reveals some common patterns in the process of economic growth in China and Vietnam. The issue of relevance is whether there are lessons for Vietnam from fiscal reform in China, especially with respect to the degree of fiscal decentralisation.

8.3.2 Significant fiscal differences between China and Vietnam

In regards to fiscal decentralisation, the main weakness in the assignment of expenditure responsibilities concerns lack of transparency and clarity in that both countries reveal overlapping spending responsibilities between national and subnational governments, particularly in relation to economic activities. The national government still accounts for a significant role, it is, however, clear that spending on the essential services is significant from the side of SNGs.

<table>
<thead>
<tr>
<th>TABLE 8.6</th>
<th>CURRENT ARRANGEMENTS IN MAIN SPENDING RESPONSIBILITIES AMONG LEVELS OF GOVERNMENT IN CHINA AND VIETNAM</th>
</tr>
</thead>
<tbody>
<tr>
<td>Level</td>
<td>China</td>
</tr>
<tr>
<td>The national government</td>
<td>Defence; foreign affairs; operations of the national government.</td>
</tr>
<tr>
<td></td>
<td>Operational expenses for culture, education, science and public health undertaking at the national level.</td>
</tr>
<tr>
<td></td>
<td>Key capital construction.</td>
</tr>
<tr>
<td></td>
<td>Social securities.</td>
</tr>
<tr>
<td></td>
<td>Agriculture; subsidies; debts.</td>
</tr>
<tr>
<td>Subnational governments</td>
<td>Operations of subnational governments.</td>
</tr>
<tr>
<td></td>
<td>Operational expenses for culture, education, science and public health undertaking at the subnational levels.</td>
</tr>
<tr>
<td></td>
<td>Local capital construction.</td>
</tr>
<tr>
<td></td>
<td>Social security.</td>
</tr>
<tr>
<td></td>
<td>Agriculture; subsidies.</td>
</tr>
</tbody>
</table>

Current arrangements on the allocation of sources of revenue

In China and Vietnam, both levels of government (national and subnational) are allocated taxing power to a different extent. Table 8.7 presents tax allocation among levels of government in these two countries. Among some differences, taxes for shared revenue deserve special attention because the sharing rate of revenue is not predetermined in the case of Vietnam. This means that the national government has its own privilege to change the sharing ratio without notice to SNGs. This also explains why lobbying and negotiating may be possible for SNGs. On the other hand, for China, these sharing ratios are clearly predetermined for each type of shared tax. SNGs will have more incentive to increase tax revenue so that their portion will increase accordingly.

TABLE 8.7
CURRENT ALLOCATION OF SOURCES OF REVENUE
CHINA AND VIETNAM

<table>
<thead>
<tr>
<th>Level</th>
<th>China</th>
<th>Vietnam</th>
</tr>
</thead>
<tbody>
<tr>
<td>The national government</td>
<td>• Customs duties; VAT on imports; Excise tax.</td>
<td>• Custom duties; VAT on imports.</td>
</tr>
<tr>
<td></td>
<td>• Enterprise income tax (from rail transportation, state post,</td>
<td>• Excise tax from imports.</td>
</tr>
<tr>
<td></td>
<td>4 state-owned commercial banks, 3 state-owned policy banks, and</td>
<td>• Enterprise income tax (from nationwide businesses such as airlines,</td>
</tr>
<tr>
<td></td>
<td>offshore oil and gas).</td>
<td>rail, water, electricity corporations, etc.).</td>
</tr>
<tr>
<td></td>
<td>• Business tax from headquarters of banks, insurance corporations</td>
<td>• Personal income tax.</td>
</tr>
<tr>
<td></td>
<td>and ministry of railroad.</td>
<td>• Corporate income tax, excluding from those for national budget.</td>
</tr>
<tr>
<td></td>
<td>• Profit remittances by all centrally owned enterprises.</td>
<td>• Natural resources tax.</td>
</tr>
<tr>
<td></td>
<td>• Export rebates of enterprises engaged in foreign trade.</td>
<td></td>
</tr>
<tr>
<td>Shared taxes between national and subnational governments</td>
<td>• Domestic VAT (75:25).</td>
<td>• Domestic VAT.</td>
</tr>
<tr>
<td></td>
<td>• Stamp tax on security transaction (97:3).</td>
<td>• Domestic excise tax.</td>
</tr>
<tr>
<td></td>
<td>• Personal income tax (60:40).</td>
<td>• Personal income tax.</td>
</tr>
<tr>
<td></td>
<td>• Enterprise income tax, excluding from those for central budget</td>
<td>• Corporate income tax, excluding from those for national budget.</td>
</tr>
<tr>
<td></td>
<td>(60:40).</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Resources tax (offshore: 100 per cent for central budget and</td>
<td>• Natural resources tax.</td>
</tr>
<tr>
<td></td>
<td>onshore: 100 per cent for local budget).</td>
<td></td>
</tr>
<tr>
<td>Subnational governments</td>
<td>• Business tax, excluding those for shared revenue.</td>
<td>• Agriculture tax.</td>
</tr>
<tr>
<td></td>
<td>• Property tax; Stamp tax; Contract tax.</td>
<td>• Tax on land use right.</td>
</tr>
<tr>
<td></td>
<td>• All other minor taxes.</td>
<td>• Slaughter tax; and some minor taxes.</td>
</tr>
</tbody>
</table>


For the overall comment, Figure 8.7 presents: (i) both shares of subnational revenue and expenditure in total government revenue and expenditure in Vietnam are lower than those of China and (ii) subnational expenditure is always greater than subnational revenue in these two countries.

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**FIGURE 8.7**
**SUBNATIONAL REVENUE AND EXPENDITURE**
**CHINA VS. VIETNAM: 1997-2003**

Note: Subnational revenue includes own-sourced revenue and revenue from shared taxes.


8.4 Fiscal decentralisation in selected ASEAN nations

Some developing countries within the Association of South-East Asian Nations (“ASEAN”), such as Indonesia, the Philippines, and Thailand are also similar to Vietnam in that they are all developing countries in the same region of the world. As these countries have also confronted the issue of fiscal reforms they may have the potential to provide lessons for Vietnam.

This section explores paths to fiscal decentralisation from three countries, all of which are foundation members of the ASEAN: Indonesia, the Philippines, and Thailand. The other founding members, Malaysia and Singapore, are not considered in this study because these countries are significantly different to Vietnam. In that regard, Singapore is an advanced country in terms of economic growth and Malaysia is a federal country. Also, Singapore and Malaysia have small populations (Singapore with 4.5 million and Malaysia with around 20 million) compared with Vietnam and the selected ASEAN countries examined in this section.
8.4.1 Contextual information

Like Vietnam, Indonesia, the Philippines and Thailand are all populous and developing countries in Asia, each with a low GDP per capita by international standards. Economic growth rates, per capita GDP, inflation and fiscal imbalance in these selected countries, together with Vietnam, are presented in Figure 8.8. Data are from the Asian Development Bank (2007).

FIGURE 8.8
MAIN ECONOMIC INDICATORS, 2001–2006
VIETNAM AND SELECTED ASEAN NATIONS

Also, a current structure of these five countries is presented in Table 8.8. These countries share many similarities with Vietnam. Most importantly, all are: (i) unitary
countries with a low level of income; (ii) populous nations with around 230 million for Indonesia, 80 million for the Philippines, 65 million for Thailand, and 82 million for Vietnam; and (iii) have three levels of subnational governments. For benchmarking and comparative purposes, China and Vietnam have also been included in Table 8.8.

<table>
<thead>
<tr>
<th>No.</th>
<th>Country</th>
<th>Population (Million)</th>
<th>Subnational governments</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Indonesia</td>
<td>230</td>
<td>32 autonomous provinces</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>368 districts</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>3625 subdistricts</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>66,979 villages.</td>
</tr>
<tr>
<td>2</td>
<td>The Philippines</td>
<td>80</td>
<td>80 provinces</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>115 cities and 1,495 municipalities</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>41,945 barangays.</td>
</tr>
<tr>
<td>3</td>
<td>Thailand</td>
<td>65</td>
<td>76 provinces</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>75 changwads</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>6,745 districts and</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>1,129 municipalities</td>
</tr>
<tr>
<td>4</td>
<td>Vietnam</td>
<td>82</td>
<td>64 provinces</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>611 districts</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>10,602 communes.</td>
</tr>
<tr>
<td>5</td>
<td>China</td>
<td>1,300</td>
<td>31 provinces</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>479 cities and 1,894 counties</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>60,000 townships; and</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>804,153 villages.</td>
</tr>
</tbody>
</table>


8.4.2 Fiscal importance of subnational governments

The three ASEAN nations considered in this study plus China and Vietnam reveal a very insignificant ratio of subnational own-sourced revenue as a percentage of total SNGs’ revenue. Based on largely unpublished estimates obtained directly from Ministries of Finance, Taliercio (2005) and Mountfield and Wong (2005) estimate that Indonesia’s own-sourced revenue accounts for 15 per cent of total SNGs’ revenue – the highest level in all five countries in the sample. China and Vietnam have a very low level of own-sourced revenue, around 5 per cent total SNGs’ revenue. Table 8.9 suggests that all five countries have been assigned very limited taxing powers to generate subnational revenue. In regards to expenditure responsibility, fiscal activities undertaken by SNGs are significant in these five countries, except for Thailand with the lowest ratio of SNGs’ expenditure in total government expenditure of 10 per cent. As such, it is clear that subnational expenditures in these five countries are funded by shared revenue with the national government and/or intergovernmental fiscal transfers from the national
government, not by their own-sourced revenue – the revenue generated with their own revenue-raising powers assigned from the national government.

### TABLE 8.9
**ESTIMATES OF OWN-SOURCED REVENUE**\(^{12}\) **AND EXPENDITURE OF SUBNATIONAL GOVERNMENTS**

<table>
<thead>
<tr>
<th>Country</th>
<th>Own-sourced revenue (% of total SNGs’ revenue)</th>
<th>Tax administration</th>
<th>Subnational expenditure (% of total expenditure)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia (2002)</td>
<td>15.4</td>
<td>Multilevel administration with tax sharing</td>
<td>32</td>
</tr>
<tr>
<td>The Philippines (2002)</td>
<td>13.1</td>
<td>Self-administration by each level of government</td>
<td>26</td>
</tr>
<tr>
<td>Thailand (2002)</td>
<td>&gt; 5</td>
<td>Multilevel administration with tax sharing</td>
<td>10</td>
</tr>
<tr>
<td>Vietnam (2003)</td>
<td>&lt; 5</td>
<td>Central administration with tax sharing</td>
<td>48</td>
</tr>
<tr>
<td>China (2003)</td>
<td>&lt; 5</td>
<td>Multilevel administration with tax sharing</td>
<td>69</td>
</tr>
</tbody>
</table>


#### 8.4.3 Fiscal autonomy of subnational governments

Taxing-power assignment to SNGs is central to the issue of fiscal autonomy of SNGs. In view of this, it is appropriate to consider the specific assignment of taxation categories in selected ASEAN countries under consideration. For benchmarking and comparative purpose, the cases of Vietnam and China will again be considered.

The initial review revealed that property taxes are not applied by SNGs across all of the five countries. Vietnam, for example, does not have a property tax in the modern sense of the term because there is no formal market for land transaction and land is

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\(^{12}\) The subnational own-sourced revenues reported in this table reflect estimates provided directly from: the Ministries of Finance for Indonesia and the Philippines; the World Bank’s staff estimates for China and Vietnam; and the internal World Bank’s draft document for Thailand. These data are not publicly available and are different from data derived from the publicly available Government Finance Statistics yearbooks published by the IMF, which are used for the fiscal decentralisation index reported in Section 8.4.5 of this chapter (except for Vietnam, in which case detailed disaggregated data were required from the Ministry of Finance, Vietnam). In brief, the IMF data assign revenue collected from shared taxes to levels of government in accordance with the share of revenue collections they retain (even when the authority to set the base, rate and revenue share resides with the national government). Moreover, the data are not published at a disaggregated level, so revenue from shared taxes cannot be netted off SNGs’ own-sourced revenue. This data limitation was acknowledged in Section 3.4.2 of Chapter 3.
collectively owned. However, Vietnam does levy taxes on land rights (i.e. the right to use land) and housing, land rent and transfers of land use right. However, fiscal autonomy of SNGs over these taxes is limited since the national government sets all tax bases and tax rates. In Thailand, land taxes account for only 5 per cent of SNGs’ revenue but the national government controls all property tax rates and bases (Taliercio, 2005, p.112). On the other hand, China has many taxes on property which are levied on the same tax base which are not market-valued through direct transactions, such as tax on real estate holding (i.e. unrealised asset value), tax on the use of urban land, and land value added tax (Statistical Yearbook of China, 2006, p.290). However, to a certain extent, SNGs in China have more autonomy over these property taxes compared to SNGs in Vietnam because they are able to set these tax rates within the band determined by the national government. Large cities may set relatively higher property tax rates. Indonesia provides very limited SNGs’ autonomy over property tax because the national government controls policy and administration and shares 80 per cent of the revenue from this tax. In the Philippines, the property tax is a significant source of revenue for SNGs which can set tax bases and tax rates within the limit set by the national government. For example, the property tax rates are set at 2 per cent for provinces and 3 per cent on the market value for cities and municipalities. Specifically, the property tax brings more than 35 per cent total subnational revenue in the Philippines (Taliercio, 2005, p.112).

The second important tax for SNGs’ revenue is business tax. Table 8.10 reveals that, among 5 countries, only China and the Philippines administer formal business tax systems. Business tax in the Philippines is imposed on the value of gross sales and it accounts for almost 30 per cent total subnational revenue while, in China, this type of tax is levied on transportation, communication and construction which are not subject to the value added tax. Revenue from the business tax accounts for around 22 per cent total subnational revenue in China (Taliercio, 2005, p.114). Most importantly, SNGs in these two countries have full autonomy to set the rates for this tax. This assignment is really an autonomy enhancing tool for SNGs.
### TABLE 8.10
THE ASSIGNMENT OF SUBNATIONAL OWN-SOURCED REVENUE

<table>
<thead>
<tr>
<th>Tax/Charges</th>
<th>Vietnam</th>
<th>China</th>
<th>Indonesia</th>
<th>The Philippines</th>
<th>Thailand</th>
</tr>
</thead>
<tbody>
<tr>
<td>User charges</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>on roads, education and other services.</td>
<td>But extra-budgetary fees on SNGs’ services</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property taxes</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td></td>
<td>SNGs tax land and housing rent, and transfer of land use rights, but have no autonomy to set tax bases and tax rates.</td>
<td>On urban land use taxes and SNGs have autonomy to set tax rates to a limit set by the national government.</td>
<td>But revenue is shared between SNGs and the national government.</td>
<td>Rates set by SNGs to a limit and SNGs have full autonomy to administer this tax.</td>
<td>The national government sets tax rates and bases for taxes on land development and house and land tax.</td>
</tr>
<tr>
<td>Business taxes</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>But the national government and SNGs share revenue from corporate income tax.</td>
<td>On gross receipts and other surcharges (e.g. urban maintenance and construction tax).</td>
<td>Though officially limited to a few sectors.</td>
<td>It is a relatively large revenue source.</td>
<td>Though limited to a small number of sector-specific business type taxes.</td>
</tr>
<tr>
<td>Excise taxes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td></td>
<td>But taxes on vehicle and vessel use.</td>
<td>On motor vehicles, fuels and minerals.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Personal income tax</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td></td>
<td>But revenue is shared between the national government and SNGs.</td>
<td>This tax is assigned to SNGs who have no autonomy to set rates and bases.</td>
<td>But revenue is shared and SNGs have no autonomy on tax policy.</td>
<td>Though the tax is in the form of a poll tax.</td>
<td></td>
</tr>
<tr>
<td>Payroll taxes</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Though base of national personal income tax includes payroll.</td>
</tr>
<tr>
<td>General sales taxes</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td></td>
<td>But the national government and SNGs share revenue from value added tax.</td>
<td>But the national government and SNGs share revenue from value added tax.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Adapted from Taliercio (2005, p.113).

The last significant generator of own-sourced revenue for SNGs is users’ fees and charges. Users’ fees and charges are widely available as in Table 8.10. The Philippines
has more than 33 different types of users’ charges such as civil registration, electrical light and power fees, hospital fees, building permit fees (Taliercio, 2005, p.115). In Thailand, SNGs levy users’ charges on garbage collection, public utilities, and medical services. In Indonesia, significant revenue comes from charges for health services which account for around 33 per cent of local revenue and 46 per cent of provincial revenue (Taliercio, 2005, p.116). Vietnam’s SNGs also levy various types of service charges, from health services to garbage collection, public utilities, road toll and many others.

There are significant similarities between these five countries in terms of the assignment of responsibilities for services provision by SNGs. A summary of key assignments is presented in Table 8.11. There are three significant issues regarding the assignment of expenditure responsibility across the national government and SNGs: (i) unclear assignment of expenditure responsibility; (ii) non-matching of fiscal resources to the assigned expenditure responsibility to SNGs from the national government; and (iii) non-matching of SNGs’ authority over their spending decisions to their responsibilities.

<table>
<thead>
<tr>
<th>Area</th>
<th>Vietnam</th>
<th>China</th>
<th>Indonesia</th>
<th>The Philippines</th>
<th>Thailand</th>
</tr>
</thead>
<tbody>
<tr>
<td>Defence</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
</tr>
<tr>
<td>Foreign affairs</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
</tr>
<tr>
<td>Environment and natural resources</td>
<td>N, P, L</td>
<td>N, P, L</td>
<td>...</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>Unemployment insurance</td>
<td>...</td>
<td>L</td>
<td>...</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>Industry and agriculture</td>
<td>N, P, L</td>
<td>N, P, L</td>
<td>L</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>Education</td>
<td>N, P, L</td>
<td>L</td>
<td>L</td>
<td>N, P, L</td>
<td>L</td>
</tr>
<tr>
<td>Health</td>
<td>N, P, L</td>
<td>L</td>
<td>L</td>
<td>N, P, L</td>
<td>L</td>
</tr>
<tr>
<td>Social welfare</td>
<td>N, P, L</td>
<td>L</td>
<td>L</td>
<td>P, L</td>
<td>...</td>
</tr>
<tr>
<td>Police</td>
<td>N</td>
<td>L</td>
<td>L</td>
<td>P, L</td>
<td>L</td>
</tr>
<tr>
<td>Highway</td>
<td>N, P, L</td>
<td>N, P, L</td>
<td>N, P, L</td>
<td>...</td>
<td>L</td>
</tr>
</tbody>
</table>

Notes: N = National; P = Provincial; L = Local government; and (…) = not identified.

Source: Adapted from Mountfield and Wong (2005, p.88).

It is clear from Table 8.11 that overlapping assignment of responsibility for provision of services between the national government and SNGs is most pronounced in Vietnam, significant in China and the Philippines, and insignificant in Indonesia and
Thailand. National and subnational governments deal concurrently with most of the spending items. The overlapping of responsibilities is usually an indicator of “unclear” expenditure assignment. For Indonesia, Decentralisation Law No. 20 of 1999 allocated all “residual” areas of spending, which are not under the national government’s scope, to SNGs. This is as a result of the so-called “Big Bang” approach in fiscal decentralisation in this country introduced in 1999 (Mountfield and Wong, 2005, p.90). It is also the case in Thailand. In contrast, China and Vietnam reveal significant overlapping in the assignment of responsibility for service provision. The national governments in these two countries attempt to assign a greater extent of spending responsibility to SNGs but as they were unwilling to assign matching levels of authority over SNGs’ tax bases, such attempts met with limited success. In addition, the national governments set the norms for SNGs to follow in their expenditure assignment. However, the experience of all five countries reveals a general similarity that is truly fundamental to the issue of fiscal autonomy - responsibilities of SNGs for service provision far exceeds SNGs’ own-sourced revenue to finance the services provided.

In short, all five countries face the issue of non-matching of fiscal resources to the assigned expenditure responsibilities of SNGs. Fiscal resources in this discussion are SNGs’ own-sourced revenue and do not include shared revenue to SNGs from the national government when the national government controls the tax rates and bases and the share of the revenue yield allocated to SNGs. In terms of SNGs’ fiscal autonomy, it is clear that SNGs in Indonesia, the Philippines and Thailand are more autonomous in comparison with Vietnam and China. SNGs in China and Vietnam rely heavily on revenue shared with the national government as well as the intergovernmental fiscal transfers from the national government in comparison with SNGs in Indonesia, the Philippines, and Thailand in the analysis.

Finally, there is a significant mismatch between authority and responsibility of SNGs over their spending programs. In these five countries, SNGs as the service providers are assigned responsibility to provide public services to their region without the ability to decide the level at which services are provided or manage their own expenditure
programs. In Vietnam, the provincial government must strictly follow the expenditure norms for particular functions set by the national government through the national budget process. For example, the provincial government must spend 15 per cent of their budget on education by 2000, 18 per cent by 2005 and 20 per cent by 2010. Similarly, in Indonesia, the national government sets an expenditure ceiling for each region (or province) (Mountfield and Wong, 2005, p.99).

8.4.4 Constitutional aspects of fiscal autonomy

Of the five unitary countries considered in this analysis, only the Philippines and Thailand provide some legal guarantees for the revenue-raising powers of SNGs in their Constitution. However, even in these two countries, the constitutional guarantee of SNGs’ autonomy over revenue power is “conditional”. The provisions in each country are:

**The Philippines:**

- **Section 5.** Each local government unit shall have the power to create its own sources of revenues and to levy taxes, fees and charges subject to such guidelines and limitations as the Congress may provide, consistent with the basic policy of local autonomy. Such taxes, fees, and charges shall accrue exclusively to the local governments.

- **Section 6.** Local government units shall have a just share, as determined by law, in the national taxes which shall be automatically released to them.

**Source:** Article 10, The 1987 Constitution of the Republic of the Philippines.

**Thailand:**

**Section 284:**

... For the purpose of the continual development of decentralisation to a higher level, there shall be the law determining plans and the process of decentralisation, the substance of which shall at least provide for the following matters.

1. The delineation of powers and duties in the management of public services between the State and a local government organisation and among local government organisations themselves.

2. The allocation of taxes and duties between the State and a local government organisation, having regard to burdens of the State vis-à-vis the local government organisation and those among local government organisations themselves.
3. **The setting up of a committee to perform the duties in (1) and (2) consisting, in an equal number, of representatives of relevant government agencies, representatives of local government organisations and qualified persons possessing the qualifications as provided by law.**

4. **In the case where the delineation of powers and duties and the allocation of taxes and duties under (1) and (2) have been made for any local government organisations, the committee under (3) shall review them every five years as from the date of the delineation of powers and duties or the date of the allocation of taxes and duties, as the case may be, in order to consider the suitability of the delineation of powers and duties and the allocation of taxes and duties previously made, having particular regard to the promotion of decentralisation.**

   **The proceeding under paragraph four shall be effective when the approval of the Council of Ministers has been obtained and the National Assembly has been notified thereof.**

**Source:** Chapter 9, the 1997 Constitution of the Kingdom of Thailand.

In the case of the Philippines, the national Congress may set guidelines and limitations on the devolution of taxing powers. In the case of Thailand, the question of assigning taxing powers is placed in the hands of a Committee which is constituted by the decision of the National Assembly. Nevertheless, the committee does comprise representatives of local governments. Also, no such regulations on fiscal powers of SNGs are found in the Constitutions of the other countries in the sample: Indonesia, Vietnam and China. As such, revenue-raising powers and expenditure responsibilities of SNGs lie in the national budget laws as in the case of Vietnam and China. This reveals a fragile nature of fiscal arrangements between the national government and SNGs in these countries.

8.4.5 Numerical evidence

Based on the measures of fiscal autonomy and fiscal importance of SNGs, and the fundamental index of fiscal decentralisation developed in Chapter 3, it is possible to consider the degree of fiscal decentralisation for Indonesia, the Philippines, and Thailand\(^\text{13}\). Unfortunately, due to data limitations, fiscal arrangements in Indonesia, the

\(^{13}\) For consistency of an international comparison in terms of fiscal autonomy and fiscal importance of subnational governments, as well as the degree of fiscal decentralisation across years, we use fiscal data from the Government Finance Statistics yearbooks published by the IMF – the only systematic source of time series fiscal data.
Philippines, and Thailand can only be explored in different timeframes: 1975-1993, 1978-1992, and 1975-2001, respectively. The results are shown in Figure 8.9.

FIGURE 8.9
FISCAL AUTONOMY, FISCAL IMPORTANCE, AND THE FUNDAMENTAL INDEX OF FISCAL DECENTRALISATION
SELECTED ASEAN NATIONS AND CHINA

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Legend:
- Fiscal importance:
- Fiscal autonomy:
- FDI:
The Philippines and Thailand have fiscally decentralised their fiscal powers and responsibilities to SNGs. Interestingly, fiscal autonomy and fiscal importance of SNGs in Indonesia are of similar orders of magnitude. However, in the Philippines and Thailand, the fiscal autonomy of SNGs is much greater than fiscal importance. It is likely to be linked to the fact that powers to generate revenue for SNGs are regulated in their respective Constitution whereas it is not the case in Indonesia.

The fiscal importance of SNGs in Indonesia\textsuperscript{14}, the Philippines, and Thailand is much lower than for Vietnam but fiscal autonomy of SNGs in these three selected ASEAN countries is significantly higher than that of Vietnam. The lessons of this for fiscal reform in Vietnam will be considered in Chapter 9.

8.5 Concluding remarks

The chapter overviewed fiscal decentralisation in China since its fiscal reform in 1979 and compared the arrangements for fiscal decentralisation between China and Vietnam. Both countries were found to have pursued the objective of fiscal decentralisation by increasing the expenditure activities of SNGs (i.e. increase the fiscal importance of SNGs) but without a corresponding increase in the fiscal autonomy of SNGs over their revenue-raising activities.

Fiscal arrangements in other selected ASEAN nations, namely Indonesia, the Philippines, and Thailand were also considered with reference to the fiscal autonomy and fiscal importance of SNGs. To date, reform has focused more on fiscal importance than fiscal autonomy of SNGs. It was found that the constitutional dimension to reform in the Philippines and Thailand was linked to the realisation of a greater degree of fiscal autonomy for SNGs. This suggests a possible means by which reform in Vietnam and other populous developing nations may increase the degree of fiscal decentralisation.

\textsuperscript{14} The investigation for Indonesia and the Philippines is quite dated as available data discontinued at 1993 for Indonesia and 1992 for the Philippines. This will limit the analysis of the contributions of these two countries to Vietnam’s fiscal decentralisation in Chapter 9.
CHAPTER 9
SUMMARY AND CONCLUSIONS

In his classic study on fiscally decentralised systems, Oates (1972) demonstrated that “it will always be more efficient (or at least as efficient) for local governments to provide the Pareto-efficient levels of output for their respective jurisdictions than for the central government to provide any specified and uniform level of output across all jurisdictions” (Oates, 1972, p.35). While this finding has since been qualified, static economic efficiency benefits arising from decentralised arrangements of fiscal relations between the national and subnational governments remain a key factor in favour of fiscal decentralisation. However, no conclusive view on dynamic efficiency implications of fiscal decentralisation has been established yet, as the empirical results of investigations into the relationship between economic growth and fiscal decentralisation are mixed15.

To date though, measurement of fiscal decentralisation has been largely arbitrary and failed to reflect considerations that are important in the theory of fiscal decentralisation. For example, fiscal decentralisation has been simply defined as: (i) the national share of total government expenditure by subnational governments (SNGs) (Davoodi and Zou, 1998) or (ii) the share of SNGs’ revenue in consolidated government revenue (Thieben, 2003). The degree of fiscal decentralisation for Australia and Germany are 62 per cent and 71 per cent using expenditure shares; and 45 per cent and 43 per cent using the revenue measure16. However, most importantly, these measures are both detached from the theory of fiscal decentralisation in that neither of these measures accounts for the degree of fiscal autonomy that SNGs have over their fiscal activities.

This study makes three contributions to the existing literature on the economics of fiscal decentralisation. First, it develops a new index of fiscal decentralisation in which “fiscal autonomy” plays a significant role. This is then applied to a wide range of

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15 Immi (2005), Thieben (2003), and Yilmaz (1998), to name a few, find a positive relationship between fiscal decentralisation and economic growth, while Davoodi and Zou (1998) and Zhang and Zou (1998) find a negative relationship.

16 Extract from Table 3.3 of Chapter 3.
countries, ranging from federal to unitary nations, and from developed to developing economies. Second, it provides the basis for incorporating the influences of subnational “fiscal inequality” into future development of the index of fiscal decentralisation. Third, it applies the conceptual foundation associated with the indices developed in this study to developing countries, for the purpose of general policy guidelines for the reform of fiscal decentralisation arrangements in Vietnam in particular, and developing countries more generally. This chapter overviews the seven major chapters of the thesis; discusses the significance of the study; and highlights some important lessons for Vietnam’s fiscal decentralisation in the future.

9.1 A summary of the thesis

Chapter 1 discusses the current issues associated with fiscal federalism and the economics of fiscal decentralisation that motivate this study. It also presents summarised numerical examples which illustrate many of the ideas pertaining to measuring fiscal decentralisation.

Chapter 2 discusses the main aspects of the economics of fiscal decentralisation. Subsequent to the pioneering work of Oates, two generations of theory were found in the fiscal decentralisation literature. The first generation theory of fiscal decentralisation is found to be well established and includes two main streams: (i) those that draw on Tiebout’s impure local public good concept, and integrate it with the Musgravian framework on three different branches or categories of public finance and (ii) those that draw on Tiebout’s notion of interjurisdictional mobility and link it with forces that limit the size of the public sector. The second generation theory of fiscal decentralisation also began to emerge by drawing on notions from the theory of the firms; the economics of information; principal-agent problem; and the theory of the contract. Much of the work of the second generation theory concerns the issue of balance between the degree of fiscal centralisation and fiscal decentralisation. However, the presence of the second generation theory of fiscal decentralisation does not remove the main findings of the first generation
theory; rather, it complements these findings by providing new perspective on a trade-off issue in fiscal decentralisation.

Chapters 3, 4, 5 and 6 make significant and important contributions to the thesis as these chapters are devoted to the development of measures of fiscal decentralisation that draw on the economics of fiscal decentralisation. Chapter 3 analyses and develops a new and theoretically sound foundation for the development of the fiscal decentralisation index (“FDI”). The index developed in Chapter 3 mainly concerns first-order issues of fiscal decentralisation, which emphasises fiscal autonomy and fiscal importance of SNGs, and is suitable for international comparisons. Chapter 4 provides a further enhancement to the index by extending the FDI to account for two further issues in fiscal decentralisation – the intergovernmental fiscal transfers and subnational borrowings which form the second-order issues. The other unique contribution of Chapter 4 is that the first-ever index of fiscal decentralisation, developed by an Italian economist Scotto in 1950, has been revised and compared to the newly developed indices in this study to highlight the relative strengths and weaknesses of each approach.

Chapter 5 provides the foundation that, in future, will provide the basis for an even more refined measure of fiscal decentralisation by considering the distributional aspects of revenue and expenditure across subnational units (including both regional (state) and local levels). This was done for two reasons that became evident in the indices developed in Chapters 3 and 4: (i) revenue and expenditure of government within each subnational region are implicitly assumed to be equal (either in absolute, or in per capita terms); and (ii) the hierarchical structure of the implicit fiscal constitution is ignored (i.e. subnational governments are not differentiated by type – the state government level is not distinguished from the local government level). Using information theory developed by Theil (1967), an analytical framework for investigating fiscal inequality was developed that captured differences in the distribution of revenue and expenditure across subnational governments, including both across regions (states or provinces) and local councils in Chapter 5. Fiscal inequality of SNGs includes two components: (i) the between-region inequality and (ii) within-level of government inequality. In addition,
SNGs’ fiscal inequality has been measured in two distinct ways. First, a geographical-region approach was adopted in which subnational regions were geographically allocated into different groups. Second, a governmental-hierarchy approach was adopted in which different levels of government were considered (i.e. state level versus local level).

Chapter 6 involves the specific application of the concept of fiscal inequality to Australia and Denmark – the two countries for which adequate data were available to apply this approach. In Australia, subnational government units include 7 state governments and 700 local governments whereas subnational government units in Denmark consist of 14 counties and 273 local municipalities. Using the framework of fiscal inequality developed in Chapter 5, at the aggregate level, total fiscal inequality was found to be greater in Australia compared with Denmark. This meant that the dispersion of revenue and expenditure shares was different in these two countries. The results revealed that there may be a positive bias in the fundamental index (the FDI in Chapter 3) and the enhanced index of fiscal decentralisation (the eFDI in Chapter 4) in favour of unitary countries, such as Denmark, China, and Vietnam, and against federal nations such as Australia and Switzerland. As such, the degree of fiscal decentralisation for Australia (or federal countries more generally) and Denmark (or unitary countries more generally) will, in future studies, need to be adjusted for the impact of subnational fiscal inequality.

Chapters 7 and 8 are devoted to the historical analysis of the current state of fiscal decentralisation in Vietnam (in Chapter 7) since 1990 and fiscal decentralisation in China since 1979; and in selected ASEAN nations (in Chapter 8). Prima facie, Vietnam appears to be moderately decentralised because its subnational revenue and expenditure account for around one-third of total government revenue and expenditure. However, it was shown that it is a partial and misleading view because it does not account for the fiscal autonomy of SNGs in Vietnam. Subnational governments’ revenue in Vietnam mainly comes from taxes shared with the national government, where tax bases and rates are all centrally determined. Also, decisions on expenditure programs at subnational regions are not at their discretion. As a result, the analysis reveals the centralised nature of fiscal
authority in Vietnam, as SNGs have still not been assigned significant revenue-raising powers and responsibilities for public service delivery.

9.2 Implications for the study

This study has investigated the economics of measuring fiscal decentralisation. It was, in some respects, a response to the inconsistent and partial measures of a degree of fiscal decentralisation presently adopted in current empirical studies. The fiscal decentralisation indices developed have been progressed in stages: a fundamental FDI (Chapter 3) was developed that focused on fiscal autonomy and fiscal importance of SNGs; an enhanced FDI (Chapter 4) was developed which incorporated the influences of intergovernmental transfers and debts on SNGs’ fiscal autonomy. The issue of subnational fiscal inequality (Chapters 5 and 6) was also introduced to the economics of fiscal decentralisation, with a view to this influence being incorporated within future versions of the indices.

Our estimates of the degree of fiscal decentralisation should be particularly useful for international organisations, such as the IMF and World Bank, interested in promoting decentralised fiscal reform; and national and subnational governments that advocate fiscal reforms related to the assignment of fiscal powers, unconditional transfers and others. Companies and residents may also be interested in the background work on subnational fiscal inequality aspects of revenue and expenditure across subnational units. Perhaps, most importantly, academics and economists will find the study to be useful as it provides a comprehensive analysis of the economics of fiscal decentralisation. It should also encourage further research on the relevance of fiscal inequality to further issues of fiscal decentralisation.

9.3 Some lessons for Vietnam

Subnational governments in Vietnam are clearly, as evidenced and discussed in Chapter 7, in a very weak position because: (i) the national government sets tax bases and
tax rates; (ii) tax administration is nationally centralised; and (iii) there is a heavy interference on subnational spending programs from the national government. That is, under current arrangements, the fiscal autonomy of SNGs in Vietnam is very limited, and reform should be aimed at redressing this. A mechanism for devolving more responsibility from the national to subnational governments would be highly desirable.

This thesis has revealed that fiscal autonomy of subnational governments in Vietnam is at the lowest level in comparison to similar ASEAN countries (Indonesia, the Philippines, and Thailand) and to China. As the national government of Vietnam attempts to reform fiscal decentralisation have, to date, shown no signs of devolving responsibility to SNGs, it appears that only the provision of some degree of basic “constitutional” authority for subnational government responsibility over fiscal matters will enhance an enduring increase in fiscal decentralisation through improved fiscal autonomy. Perhaps the constitutional provision for the Philippines and Thailand, as discussed in Chapter 8, may prove instructive in that regard. For Vietnam, and other similar developing countries, the key is for SNGs to become accountable to the public for their fiscal decisions, but this should be achieved without decreasing the capabilities of individual subnational governments to respond innovatively to public demands and to compete with other SNGs. Consequently, any constitutional provision to make SNGs autonomous should not be so prescriptive as to prevent innovative subnational behaviour emerging, either in regard to methods of own-sourced revenue raising or to methods of providing public services.

Other factors that could be complementary to constitutional change in affecting an increase in fiscal decentralisation include: (i) a relatively greater emphasis by SNGs on fees and charges for services compared to “general taxation” (as the former would generally be at the discretion of SNGs, while the latter would generally be largely directed by the national government); (ii) reduced emphasis on “shared” taxes; and (iii) a (constitutionally mandated) reduction in the portion of fiscal transfers from the national government to SNGs made in the form of conditional transfers (i.e. tied grants).
9.4 A final word on fiscal autonomy and fiscal inequality

The curious lack of recognition of the fiscal autonomy of SNGs revealed in this thesis has two dimensions, a “constitutional” dimension (i.e. a tendency within developing nations to decentralise finances to SNGs without a corresponding degree of responsibility and autonomy); and an “applied measured” dimension (i.e. a tendency to measure fiscal decentralisation in applied academic studies without regard to the role of SNGs’ fiscal autonomy). The challenge ahead is to reintroduce fiscal autonomy as a central feature of both “constitutional” and “applied measured” issues in fiscal decentralisation. Ideally, this should be done in a manner that also accounts for the influence of fiscal inequality.
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