



Asian Regional Seminar on Public Financial Management

PFM Reforms: The lessons learnt -promises and tears

Session 6: Managing Fiscal Decentralization
FISCAL DECENTRALIZATION IN VIETNAM:
OUTCOMES AND THE WAY FORWARD

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26th November



FISCAL DECENTRALIZATION IN VIETNAM: OUTCOMES AND THE WAY FORWARD*

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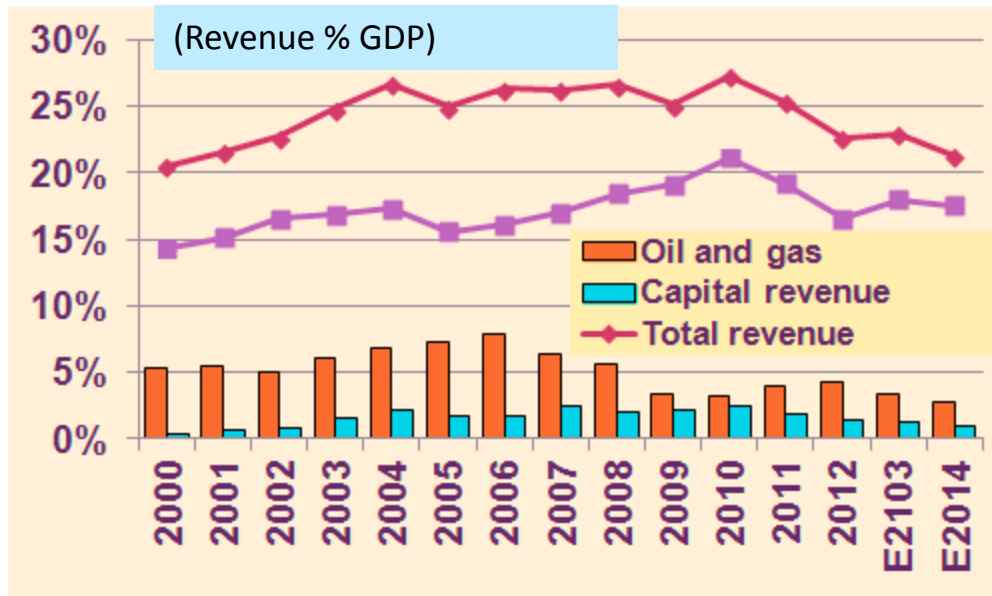
Phnom Penh, 25 -26 November 2014

Outline of the presentation

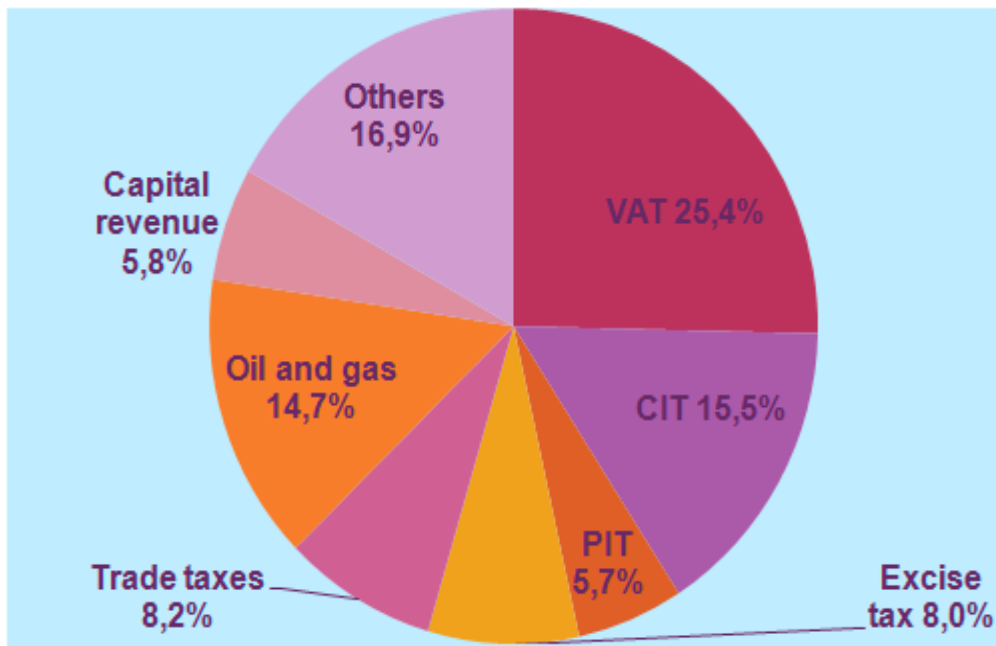
1. Overview of Vietnam's recent fiscal performance
2. Structure of Vietnam's budget system and its impacts on fiscal decentralization
3. Managing fiscal decentralization in Vietnam: the 4 pillars
 - Revenue sharing;
 - Expenditure responsibilities;
 - Inter-governmental fiscal transfer; and
 - Local government borrowing
4. Reforming fiscal decentralization in Vietnam: the way forward

Overview of Vietnam's recent fiscal performance: Revenue

- Tax reform in Vietnam has yielded remarkable successes in term of revenue revenue collection
- Currently, Vietnam relies heavily on consumption taxes:
 - In 2013, revenue from VAT and excise tax accounted for 33.4% of total revenue
- As for revenue from income tax, CIT also plays an important role with a share of 15.5% in 2013 while role of PIT is still relatively small (5.7% of total).
- Share of revenue from oil and gas reached a peak of 29.82% in 2006, but in 2013 reduced to 14.7%. Similarly, share of revenue from trade tax decreased from 15.5% in 2001 to 8.2% in 2013
- Government revenue as % of GDP has decreased since 2010 due to economic slowdown and tax cuts (CIT, PIT...)



Revenue structure in 2013 (% of total)

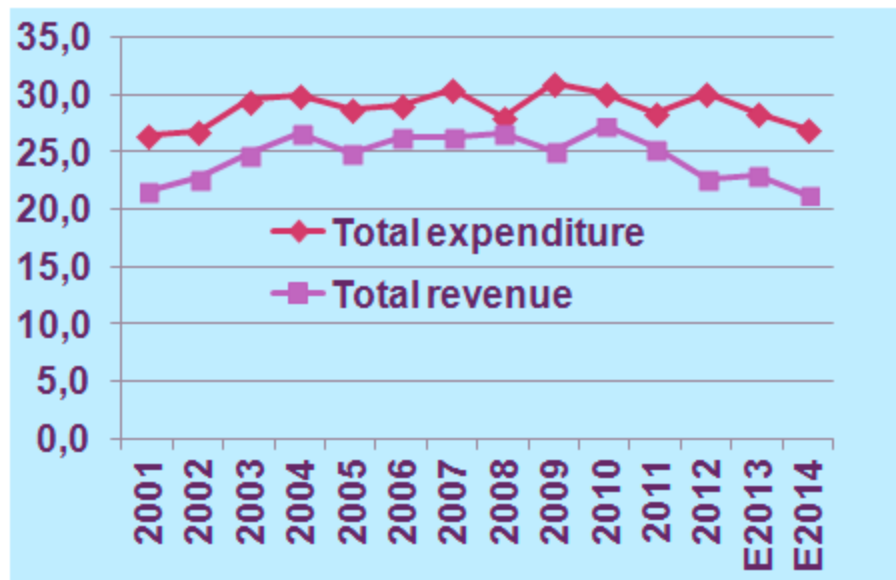


Source: Calculated from MOF data

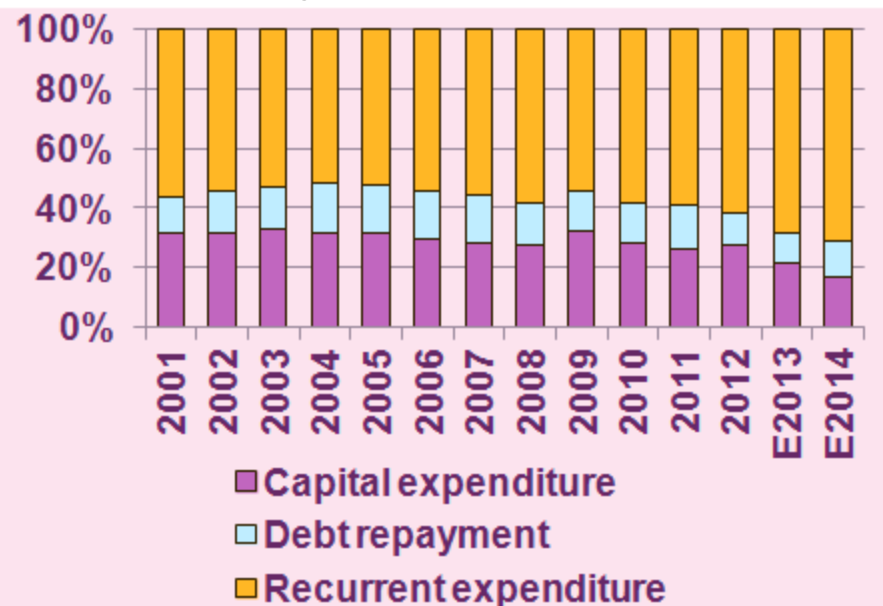
Overview of Vietnam's recent fiscal performance: Expenditure

- Rapid expansion in the size of government expenditure, reaching 28.4% GDP in 2013:
 - Relatively high in compared with other countries in the regions
 - Recurrent expenditure takes the largest share: 68% of the budget in 2013.
- Expenditure priorities have been are given to social security and poverty reduction and infrastructure development:
 - Moving toward promoting social and human development:
 - E.g. expenditure for education account for around 20% of the total budget
 - Implementing 16 National Target Programs focusing on a wide range of objectives: poverty; education, health, rural development...

Budget expenditure and revenue (% GDP)



Structure of budget expenditure (% total)

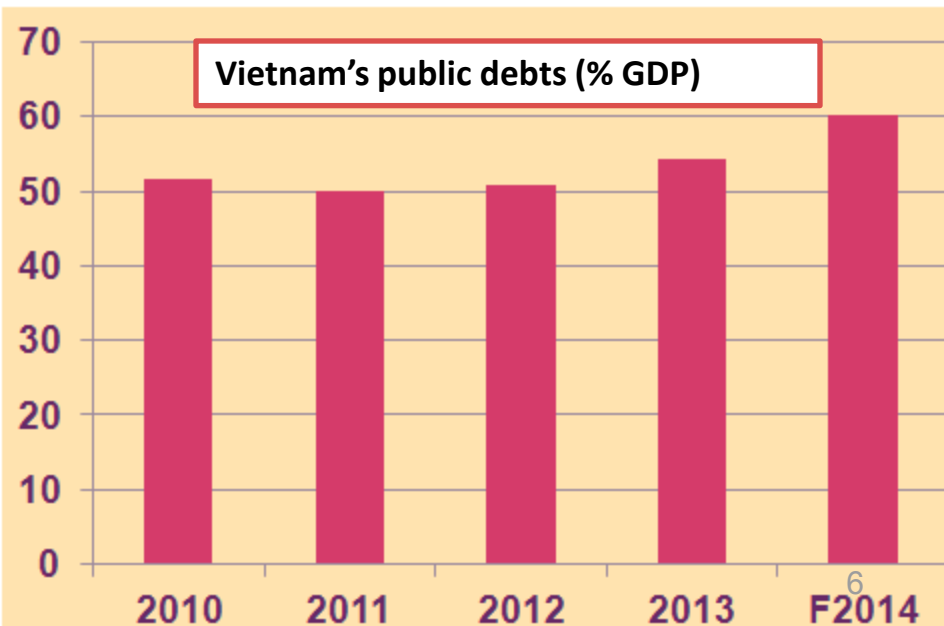
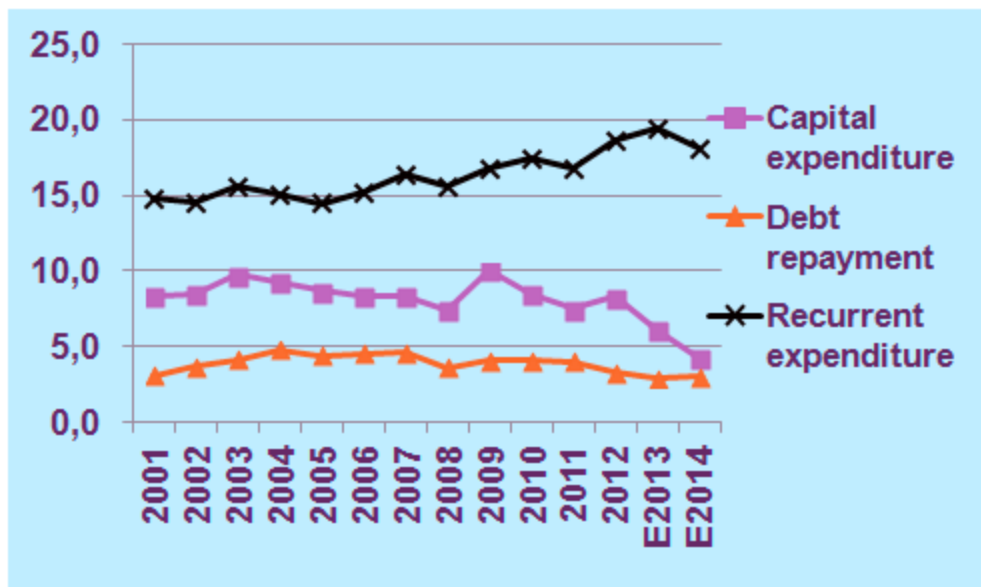


Source: Calculated from MOF data (2014)

Overview of Vietnam's recent fiscal performance: Issues

- Fall in revenue collection as % GDP: in 2013, revenue collection reduced to 22.9% GDP (average 2006-10 was 26.3% GDP)
- Rapid expansion in the size of recurrent expenditure while there is a fall in that of capital expenditure:
 - Risk of violating the “Golden rule” on fiscal balance?
- High and persistent budget deficit: 5.3% GDP in 2013 and 2014 (in 2015 is expected at 5% GDP)
- Rapid increase in the level of public debt in recent years: 54.2% GDP in 2013 and expected to increase to 60.3% in 2014 (the threshold is set at 65% GDP).

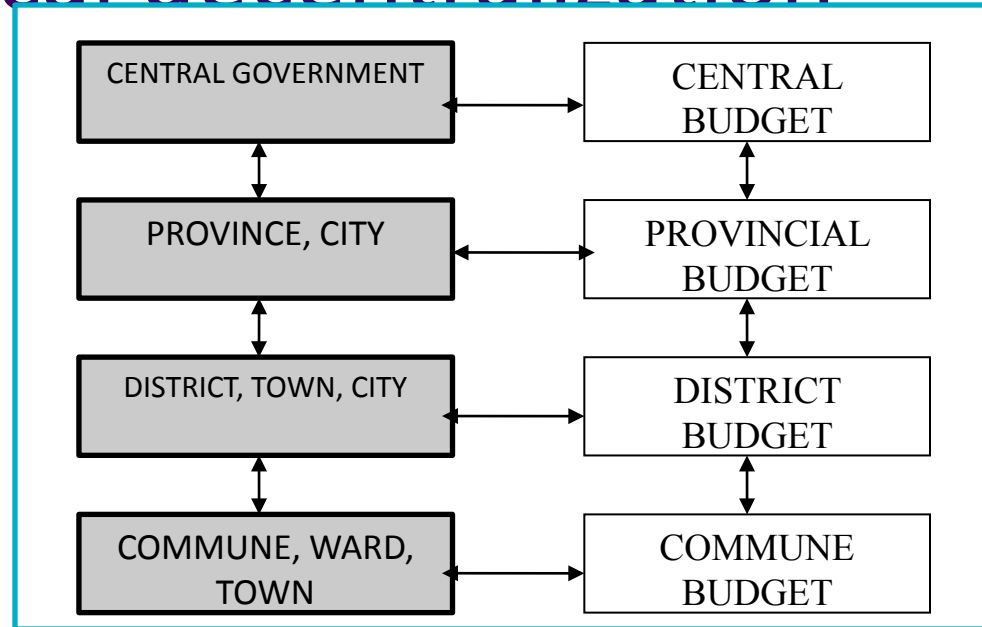
Government expenditure by category (% GDP)



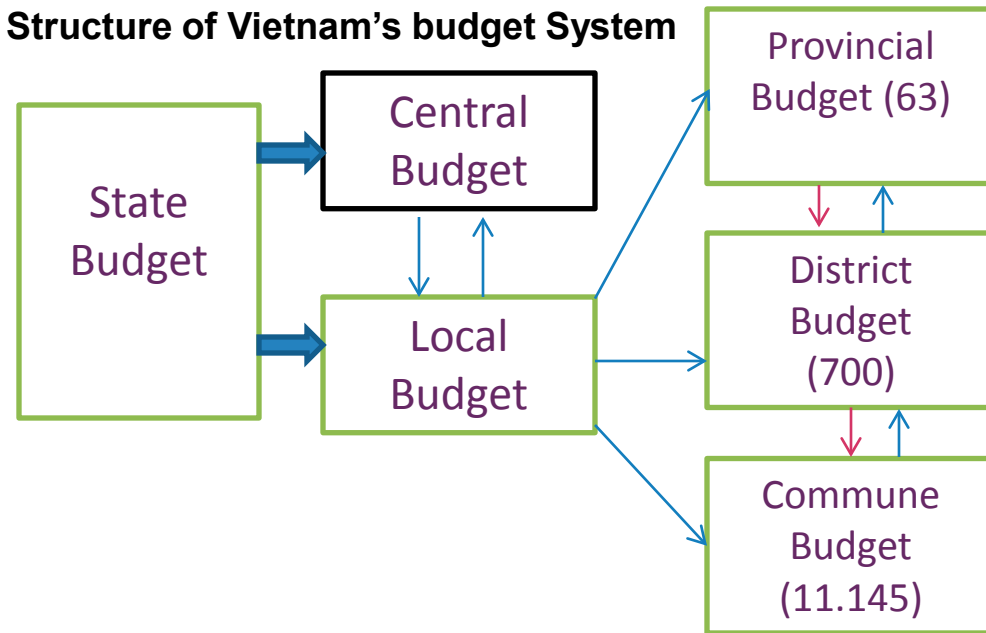
Source: Calculated from MOF data (2014)

Structure of Vietnam budget system and its impacts on fiscal decentralization

- Vietnam has 4 tiers of government: central; 63 provinces (cities); 700 districts (cities, towns) and 11.145 communes (wards)
- Vietnam's budget system consist of central budget and local budget, in which local budget consists of budgets of local authorities having People's Council and People's Committee:
 - Local budget includes provincial budget (including provincial and district budget); district budget (including district and commune budget) and commune budget
 - The State budget law (2002) covers all levels of government:
 - Ensuring the uniformity of the budget system.

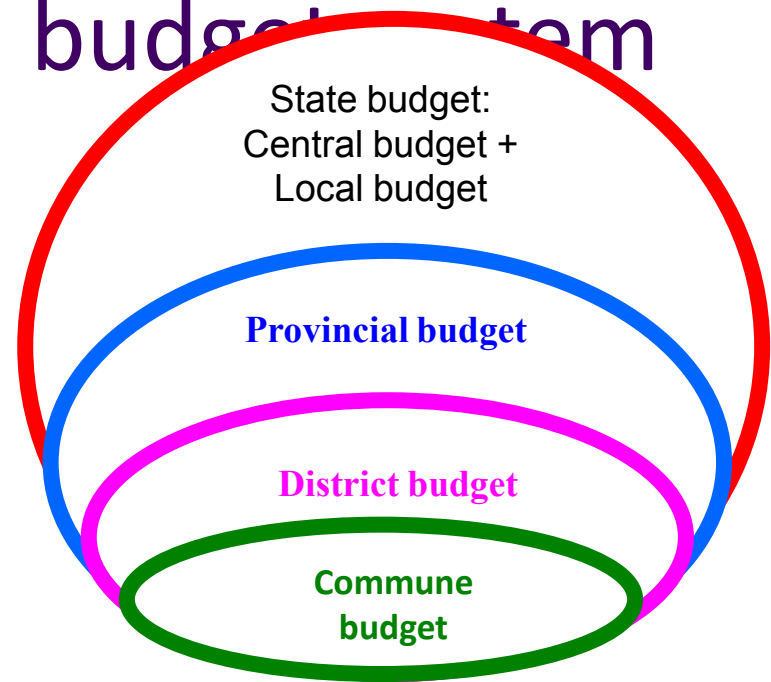


Structure of Vietnam's budget System



Overview of Vietnam budget system

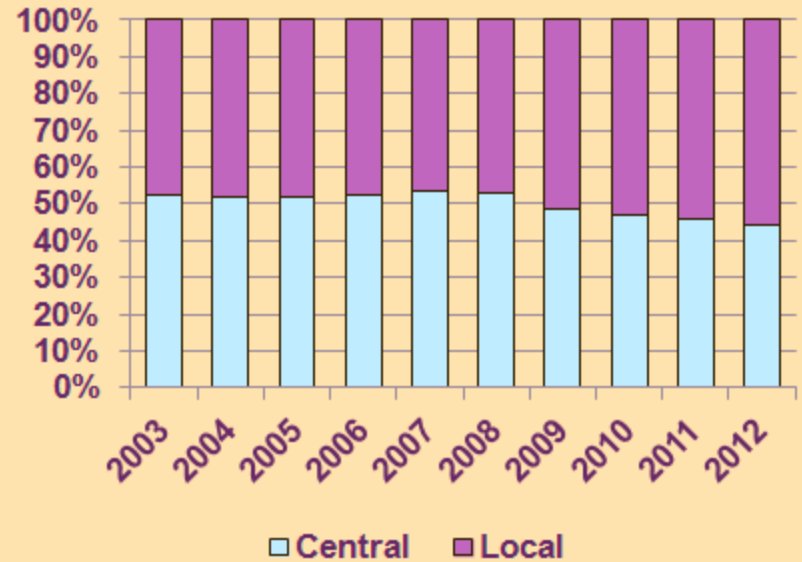
- Vietnam is one among the few countries that have a unique nested budget system (“Matrioska”):
 - ❑ Lower budgetary level is a component of the upper budgetary level
 - Budget of higher level of administration ensure the balance for the budget of the lower: Local budgets are not allowed in deficits.
- Impacts of the “nested” budget system:
 - Assuring uniformity of the budget but reducing fiscal autonomy of local governments
 - Complicating budget process and monitoring:
 - Budgets of local governments are prepared through a bottom-up process
 - Does not facilitate fiscal accountability of the lower levels of government.
- The 2013 Constitution does not make any change on the structure of budget system, but there is a distinction between rural and urban administration.



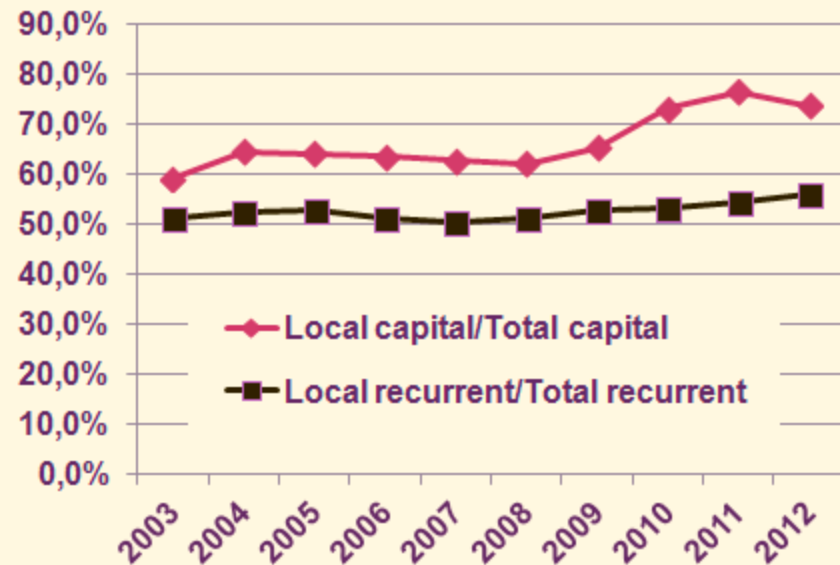
Fiscal decentralization in Vietnam: Expenditure composition (% of total)

Expenditure resp

- Local spending accounts for more than half of total government spending in Vietnam:
 - Local governments play a key role in public service delivery
- Share of local government spending increased from 47.5% in 2003 to 55.6% in 2012, which is relatively high share compared to other countries
- In 2012, 73.9% of overall capital expenditure and 56.1% of recurrent expenditure are devoted to local governments:
 - More spending are given to local governments in education; health care and social security.
 - Provincial authorities have the autonomy in determine fiscal relationship (expenditure assignments and revenue sharing) with districts and communes within their jurisdiction.



Local share of expenditure (%)



Source: Computed from MOF data (2014)

Fiscal decentralization in Vietnam

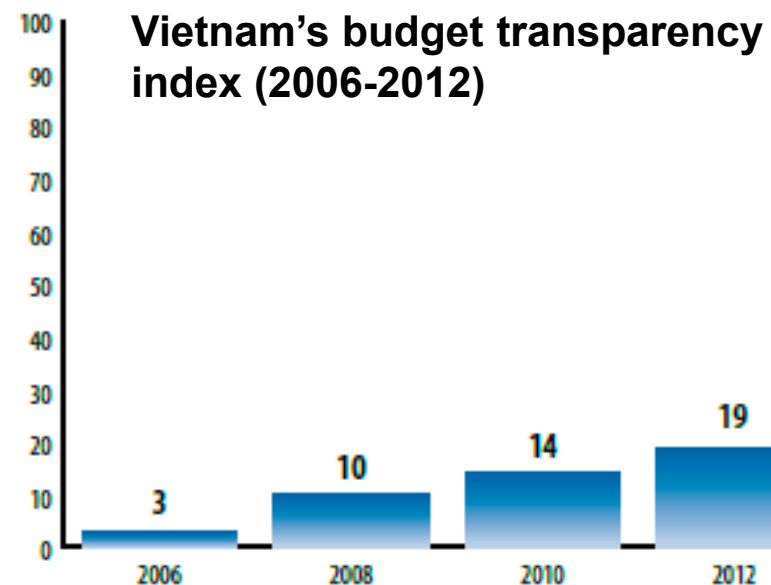
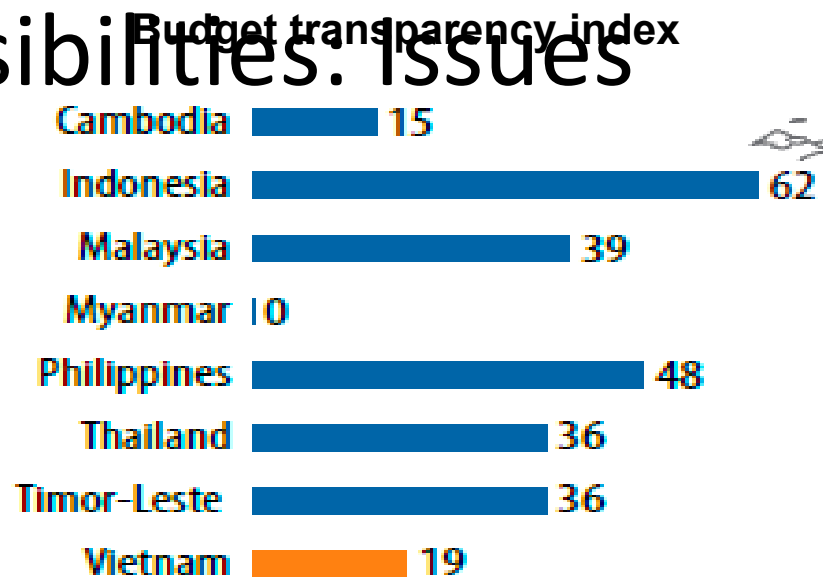
Expenditure responsibilities: Issues

- High level of local expenditure does not necessarily mean high degree of decentralization:
 - ❑ In Vietnam, standards and norms are set and monitored by the central authorities
- Most expenditure assignments in Vietnam are concurrent: Extent of overlap and loss of accountability:
 - ❑ Some functions should be assigned exclusively to one level of government: Law on local government organization is under discussion (under the 2013 Constitution)
- Local fiscal autonomy is impacted by central rules on minimum allocation to certain areas (e.g., not less than 20% of total spending has to be allocated to education);
 - Should not be such rule to ensure the flexibility for the local governments and fund should be allocated in accordance with actual need and capacity to absorb.
- Rapid expansion in the share of local capital spending has also posed concerns over efficiency and consistency with the nation-wide objectives (local capacities in absorbing large amount of resources):
 - Need to strengthen monitoring mechanism
 - Adopting medium- term fiscal framework
- Accountability of local authorities is reduced by the nested feature of the budget system:
 - Ensuring clarity on expenditure assignments is very important for ensuring the accountability of governments at all level in performing their functions

Fiscal decentralization in Vietnam

Expenditure responsibilities: Issues

- Fiscal transparency is improved but still limited and creating difficulty in monitoring the outcomes of decentralization:
 - Only approved budget and final account are disclosed: Vietnam does not disclose the draft budget (limit the opportunities for people to effectively take part in budget process)
 - Disclosed information is mainly in aggregate format
- Enhancing transparency is a very important requirement for effective decentralization:
 - Improving public access to budget information
 - Reviewing budget classification to make it consistent with GFS and ensure functional and economic breakdowns of expenditure are available
 - Links budget transparency and accountability.



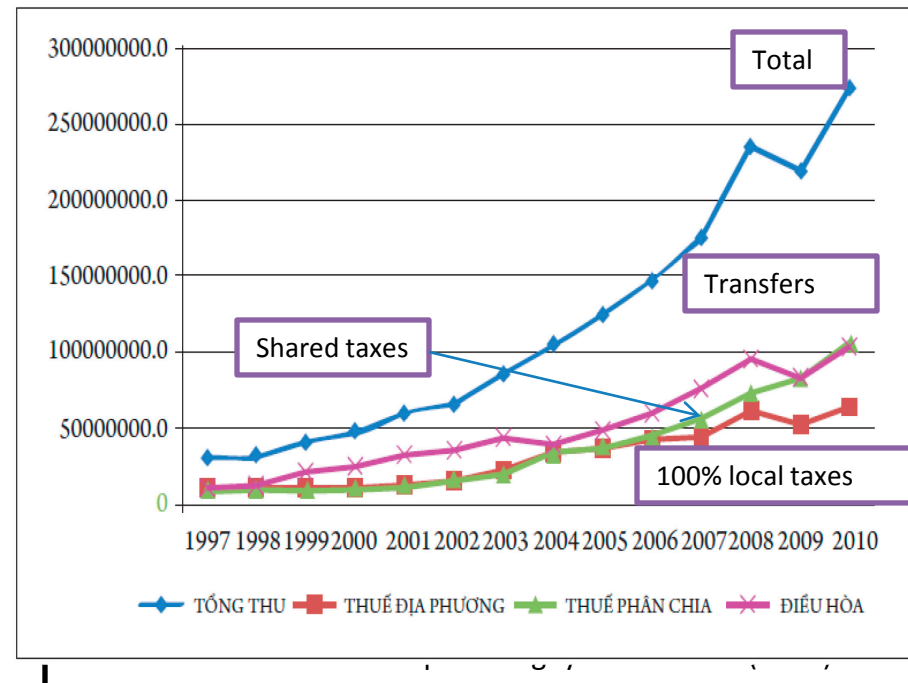
Source: Open Budget Survey 2012
(International Budget Partnership)

Vietnam

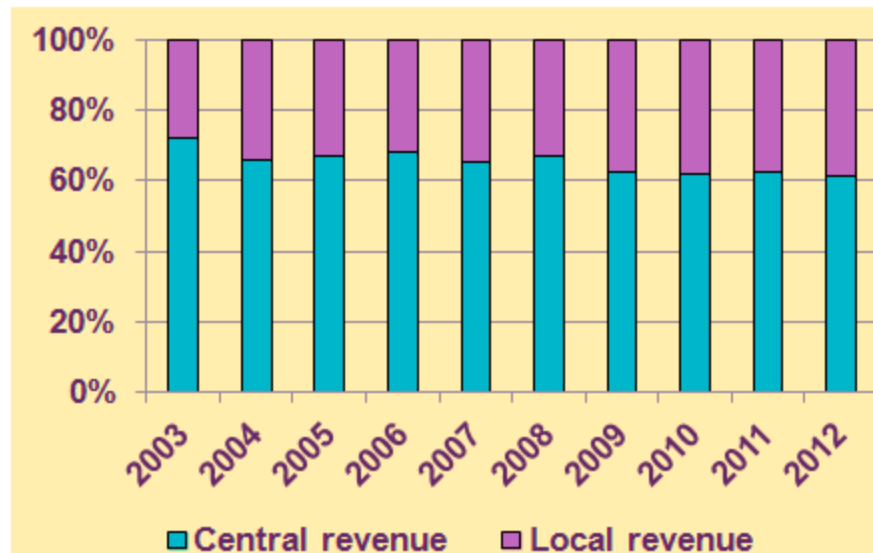
Revenue sharing

- Local governments in Vietnam have 3 main sources of revenue:
 - Revenue retained 100% by local authorities, such as taxes and fees related to lands, local fees and charges...;
 - Revenue shared between local authorities and central government, such as VAT (except on imports), CIT (except on enterprises with uniform accounting) or PIT; excise tax on domestic goods...;
 - Transfers from upper levels of government
- Share of local revenue in total government revenue increased from 28.1% in 2003 to 38.4% in 2012
- Revenue retained 100% by local authorities mainly comes from: Land use levies and lotteries, other items take very small shares.

Local budget revenues by composition (VND bil.)



Budget revenue composition (% of total revenue)



Vietnam

Revenue sharing

- ❑ For shared revenue, Vietnam adopts the “sharing rate” which is kept stable for 3-5 years (known as Stability period):
 - Key fiscal parameter is fixed in the Stability period
- ❑ In the Stability period 2011-15, among 63 provinces:
 - 3 provinces only allowed to keep a portion of the shared taxes (the remaining is transferred to the central budget)
 - 50 provinces retain 100% of shared taxes collected in their jurisdictions.

Sharing rate of the shared taxes in selected provinces in 3 stability period (%)

Provinces	2004-06	2007-10	2011-15
HÀ GIANG	100	100	100
PHÚ THỌ	100	100	100
HÀ NỘI	32	31	42
HẢI PHÒNG	95	90	88
VĨNH PHÚC	86	67	60
HẢI DƯƠNG	100	100	100
BẮC NINH	100	100	93
NINH BÌNH	100	100	100
NGHỆ AN	100	100	100
ĐÀ NẴNG	95	90	85
KHÁNH HÒA	52	53	77
QUẢNG NAM	100	100	100
QUẢNG NGÃI	100	100	61

Fiscal decentralization in Vietnam:

Revenue sharing

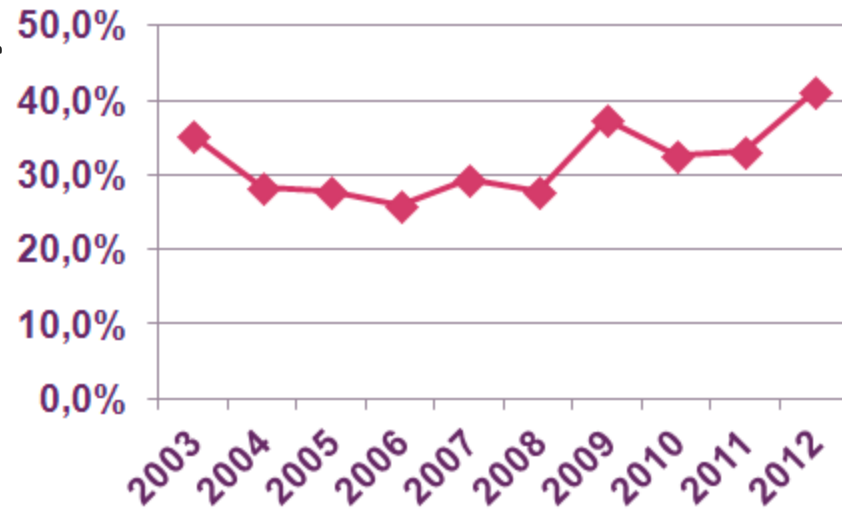
- Autonomy of local authorities in revenue raising is limited.
 - Revenue types 100% retained by local authorities are small taxes or fees
 - Tax bases and tax rates are set by the central government (National Assembly)
 - Local authorities have limited powers in setting fees and charges within the ceiling set by the central authorities
 - Law on fees and charges in under discussion and it is expected that more power will be given to local authorities
- Shared revenues (especially VAT and CIT) are currently shared between central and local governments based on where the revenues are actually collected rather than where they are incurred:
 - CIT of enterprises adopted unified accounting regime are credited to the jurisdictions where their headquarter are located (mainly large cities, such as Hanoi or Hochiminh city):
 - Causing some equity concerns as being likely to favor more socio-economic developed localities (regions)
 - Revenue collected on enterprises produced goods subject to excise tax is shared between central and local authorities where the enterprises are located:
 - Should be 100% assigned to the central budget?

Fiscal decentralization in Vietnam

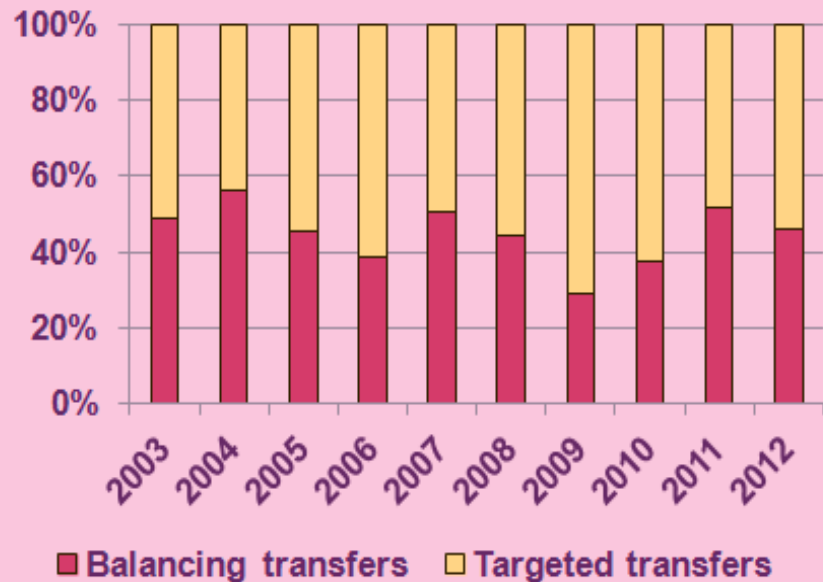
Intergovernmental f

- A rule-based system (allocation norms) of intergovernmental fiscal transfers has been developed to narrow horizontal and vertical imbalances:
 - Balancing transfers and targeted transfers (including 16 National targeted programs)
- Balancing transfers and shared revenue are used by provincial authority to deal with horizontal and vertical imbalances across districts

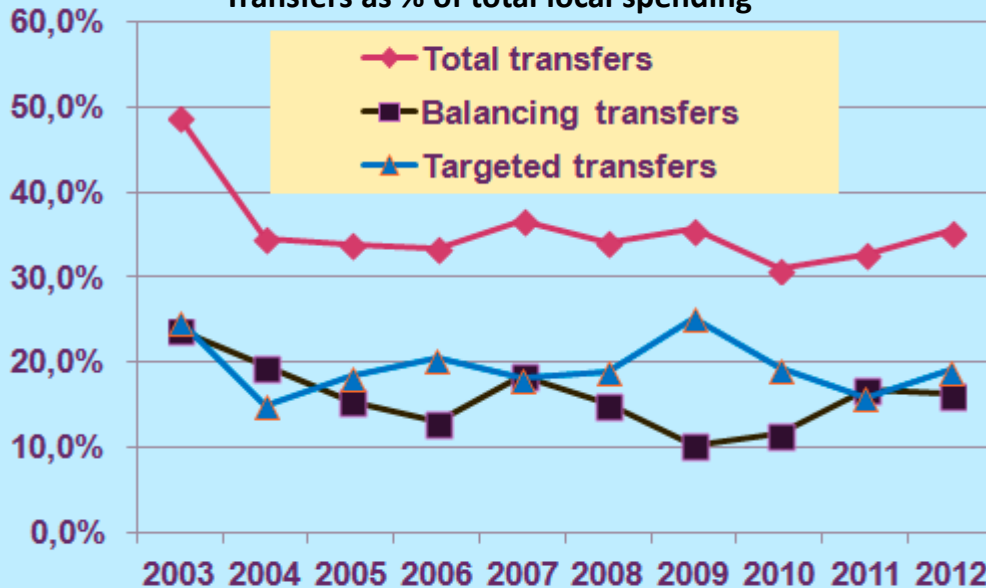
Total transfers as % of central revenue



Share of balance and targeted transfers in total transfers



Transfers as % of total local spending



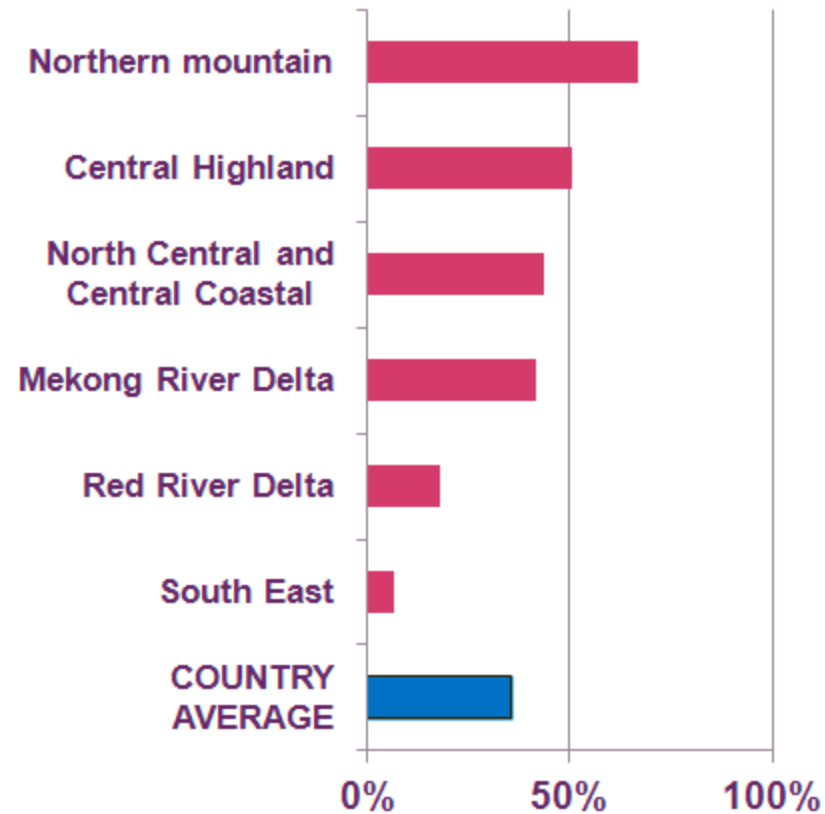
Source: Computed from MOF data (2014)

Fiscal decentralization in Vietnam

Intergovernmental fiscal transfers

Transfers as % of total local spending by region 2012

- Wide variation in the reliance on transfers across regions and provinces
- A typical feature in Vietnam is that balancing transfers is kept constant in absolute amount during the Stability period (currently 5 years):
 - Negatively impacts local governments covering their expenditure needs mostly by the transfers (mainly poor regions)
 - Does not take account of raising costs of service delivery, except cost of new initiatives
- There is a lack of predictability in targeted transfers:
 - Lack of linkage with future funding requirements (e.g. for operation and maintenance)
 - Unfunded assignments are prevalence
- Targeted transfers must be linked with regional and nation-wide development priorities:
 - Linked with the medium-term expenditure framework.



Source: Computed from MOF data (2014)

Fiscal decentralization in Vietnam



Local government borrowing

- In Vietnam, local authorities (provinces) are allowed to borrow domestically to finance local infrastructure projects:
 - Local authorities are required to maintain total local outstanding debts below 30% of their annual capital budget, except Hanoi and Hochiminh city where the limit is increased to 100%
- Currently, share of borrowing by local authorities in Vietnam's total public debt remains small (less than 2%), but there are still issues that need to be addressed:
 - Some provinces have breached their borrowing limits
 - The Draft State budget law (revised) proposes to increase the limits
 - Indirect liabilities of the local governments also need to be monitored (e.g. Local Development Funds...);
 - Setting local borrowing limit based on annual capital budget does not show a clear link with debt servicing capacity of the local government
 - The budget for capital expenditure is not stable and relies substantially on local revenue
 - The limits should be linked with the indicators that measure the capacity to repay the debt by the local authorities (e.g. capacity to raise revenue).

Reforming fiscal decentralization in Vietnam: The way forward



- Reform agenda:
 - The Financial Development Strategy towards 2020 approved by the Prime Minister has pointed out key directions for public financial management reform in Vietnam, including fiscal decentralization:
 - Revising related legal framework on public finance management, such as adopting a new Law on fees and charges (propose in 2015)
 - Modernizing public finance management (e.g. TABMIS; GFMIS...)
 - The revised State budget law is currently under discussion and is expected to be approved by the National Assembly in May 2015):
 - More fiscal autonomy are given to local government (focusing on 4 pillars of decentralization)
 - Enhancing budget institutional framework for policy making (e.g. adopting medium-term fiscal framework):
 - Link budget allocation with strategic development orientations
 - Budget is spent within resource availability and consistent with policy priorities.
 - Gradually shifting from input-based budget to performance -oriented budget
 - Improving budget transparency and accountability
 - Enhancing budget disciplines (fiscal rules).

THANK YOU FOR YOUR ATTENTION!