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INTERGOVERNMENTAL FISCAL ARRANGEMENTS IN A TRANSITIONAL ECONOMY : A LOOK AT VIETNAM

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Abstract

Transition from a centrally planned to a market economy calls for accommodating changes in policies and institutions in the provision of public services to meet the needs and requirements of different regions in Vietnam. The analysis here is on the latest developments in fiscal decentralisation in Vietnam and whether and to what extent the implementation of the New Budget Law has improved efficiency in the delivery of public services.

The analysis of the recent developments shows that there are significant improvements in fiscal arrangements. The implementation of the new Budget Law provides a legal framework for the fiscal arrangements. It also clarifies the roles of different agencies and levels of government in the provision of public services. The stable system of arrangements is expected to bring a measure of certainty. On the flip side, however, the local governments do not have powers to raise revenues and therefore, cannot take decisions on level and composition of expenditures. It is also necessary to introduce a simple and transparent formula-based system of transfers to offset revenue and cost disabilities while preserving the incentives. Thus, much needs to be done to address satisfactorily the issues of incentives and accountability as well as those of autonomy and flexibility in the provision of public services at local levels.

Inter-Governmental Fiscal Arrangements In a Transitional Economy: A Look at Vietnam*

M. Govinda Rao

I. Introduction:

Economic liberalisation or *Doi Moi* initiated in Vietnam since 1989 has helped to significantly accelerate growth and reduce poverty. The per capita GDP in the country grew by about 6–7 per cent per year during the period 1990–97 which resulted in significant improvement in the living standards of the people. Since economic restructuring was initiated, the proportion of the poor declined significantly from about 70 per cent to 35 per cent. In spite of this, Vietnam continues to be one of the low-income countries with per capita GDP averaging to about $280. More significantly, since 1997 the regional economic crisis has cast a serious shadow and caused harsh reduction in the growth rate, i.e., 2 per cent in 1998. In addition, the infrastructure bottleneck poses a binding constraint on the ability of the economy to generate and sustain high growth rates.

The inability of the government to provide adequate physical infrastructure and accommodating policies and institutions necessary for the provision of public services according to the diversified requirements of different regions

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is a major constraint in sustaining a high rate and creating a shared basis of economic growth in Vietnam. In order to ensure efficient delivery of public services, market decentralisation implicit in the transition from a planned to a market economy has to be supported by accommodating fiscal, administrative and political decentralisation

Provision of public services in Vietnam, however, is done within the unitary system of government in which, centralised state authority is extended to local administrations in provinces, districts and communes. In this 'de-concentrated' system, local governments do not have decision-making authority. They merely execute central directives. The principle of 'democratic centralism' assigns a strong role to the central government to direct the pattern of development. Local participation is relied upon to ensure that the developments respond to local needs. In this 'double subordination' system, the local executive is accountable both to the higher level government as well as to the elected bodies at the same level. In the formal sense, the system is inflexible. However, the local administrators find different ways to bypass it which in turn can be an additional inefficiency and inequity. While economic liberalisation has helped to establish the role of incentives in av market economy, the centralised and inflexible arrangements constrain accommodating provision of public services required in a market-oriented economy with diverse preferences and needs.

This article attempts to analyse the present system of inter-governmental fiscal arrangements in Vietnam by providing a brief account of the fiscal system and arrangements that existed until 1997 when the New Budget

Law was implemented; the changes due to the implementation of the New Budget Law; efficiency and equity implications of the fiscal arrangements; and a summation of the conclusions.

II. Fiscal Arrangements Until 1996:

Fiscal arrangements in Vietnam is based on a November 1989 resolution of the Council of Ministers unifying the budgetary arrangements of the central and local governments and the subsequent amendments. These arrangements may be characterised as a de-concentrated system. In this system, the centre assigns the responsibility of providing certain public services and of implementing policies and programmes to subordinate local levels under its supervision and control. The local governments consist of provinces (and provincial cities), Districts and Communes. The State budget approved by the National Assembly includes revenues and expenditures of both central and local governments.

Before the implementation of the Budget Law in 1997, fiscal arrangement between different levels of government in Vietnam were carried out on the basis of orders and decrees issued by the Prime Minister from time to time. The fiscal system was rigid and centralised with little room for local initiatives to provide public services. Yet, the centre could not direct the delivery of public services to poorer districts and communes. This is because the provinces determined the allocation to districts and communes and there were no guidelines to make sub-provincial allocations. Often, delivery of services in poorer communes was sustained by contributions, which in effect were regressive. There was considerable ambiguity in the functions assigned to different levels of government. Revenues were assigned afresh every year. This unstable system not only had adverse effects on incentives but also posed difficulties in adopting a medium term strategy and planning and implementation of expenditure decisions. There was no institutional and legal framework for implementation, monitoring and control of budgetary decisions as well.

Earlier studies on fiscal arrangements in Vietnam have brought out the shortcomings in the working of inter-governmental fiscal arrangements (Rao, Litvack and Bird, 1999; World Bank, 1996). A high degree of centralisation has constrained the capacity of local governments to deliver the services efficiently. This in turn has provided the rationale for centralising policies and their implementation. The mechanism of determining assignments and transfers was negotiated but remained non-transparent, leaving considerable room for bureaucratic and political discretion and subjectivity. As expenditure estimates were critical to determining tax assignments, the system provided incentives to the provinces to exaggerate and distort their expenditure requirements. Further, the provinces could appropriate revenue collections in excess of budgeted targets for spending on developmental heads, investments or for contributing to the financial reserve fund. The General Taxation Department (GTD) which makes revenue projections, tended to underestimate revenues in order to show better performance and, this served the interest of the provinces as well. Changes in assignments every year not only made it difficult to plan the provision of public services but also had adverse incentives for mobilising revenues at local levels. At district and commune levels, there was no standard system of assignment and each province followed its own system.

The studies by the World Bank (1996) have also brought out the problems in local budget planning and implementation. Multiple administrative norms laid down by the line ministries were not always in harmony with one another. The Ministry of Education and Training (MOET) for example, requires the provinces to spend 60 per cent of their budgets on salaries and, the remaining on materials (20 per cent), maintenance (10 per cent), and other activities (10 per cent). At the same time, it also stipulates that there should be 1.15 teachers per class in primary schools. This implies a wage bill which leaves hardly any money for non-salary expenditures (World Bank, 1996a). In addition, there were norms for determining provincial expenditure estimates for different departments. These did not necessarily conform to the administrative norms. In any case, the budgetary norms did not have much relevance. They were used only for the first round negotiations and the final expenditure plan had no relationship with the expenditures determined according to norms. Thus, Vietnam had an over-determined system of budgetary and administrative norms with little room for local government manoeuvrability and initiative.

To provide a legal framework to conduct fiscal arrangements between the central and local governments and to place the formulation, implementation, monitoring and control of budgetary decision on a systematic footing, the government in Vietnam initiated budgetary reforms and promulgated the new budget law in 1997. The Law was amended and supplemented in May 1998 to deal with some of the identified problems and to take into account the new developments (link the decision to implement the Value Added Tax). In what follows the important features of inter-governmental fiscal arrangement in Vietnam after the implementation of the New Budget Law are discussed.

III. Fiscal Arrangements Under The New Budget Law:

a. Role and Responsibilities of Different Governmental Agencies

The Budget law defines the roles and responsibilities of different agencies involved in budget preparation and implementation. The Ministry of Finance (MOF) has the responsibility to consolidate the recurrent expenditure estimates of all levels of government and to make revenue forecasts for the budget year. It is also required to undertake financial inspection and audit of all organisations and units, which receive government funds or contribute to it. The Ministry of Planning and Investment (MPI) has to consolidate the investment budget of central ministries, and local governments. The State Bank of Vietnam has to help the MOF to prepare the estimates of government borrowing in order to meet budgetary spending requirements and advance money to the government to cover temporary deficits in the state budget fund as decided by the Prime Minister. The line ministries are required to cooperate with the MOF to prepare the budget under their jurisdiction and allocate it to different branches and areas under their jurisdiction and in monitoring and implementing the budgets of the branches under their charge. The Peoples' Councils at local levels have to decide the draft budget of local governments and ratify the budget accounts. They are also required to decide the policies and budget implementation measures at their respective levels.

b. Assignment of Revenues and Expenditures

The Law defines responsibilities and sources of revenue of different levels of government. Most public services are assigned concurrently to different administrative levels, but the assignment follows the principle of geographical spread of benefits, size of the projects and volume of spending. The centre undertakes operation and maintenance of large projects; the local governments implement projects to benefiting the respective jurisdictions. Each local unit is responsible for its administration and internal security and they have some functions pertaining to national defence as well. Education and health are concurrent subjects with a functional division of responsibility. School education is a local responsibility and the centre has to look after training (higher education). Large hospitals are in the central domain, the provinces administer provincial hospitals, the districts administer district hospitals, and communes look after the health centres.

In the case of revenues, the law specifies the taxes that can be retained entirely at central and local levels as well as the taxes shareable between them and among local governments themselves. The policy of determining the base and the rate structure of taxes vests with the centre. The general taxation department (GTD) – which is a central government agency – does the tax collection through its branches in provinces and districts. However, the local governments can retain the collections in excess of the targets and therefore, the local governments have an interest in assisting and facilitating the collection of taxes by the GTD. They also provide incentives to the tax officials in provinces located in their jurisdictions to collect revenues in excess of the targets.

c. The Process of Budget Formulation

Based on the Prime Minister's decisions for the socio-economic plan for the forthcoming year and forecast of revenues and expenditures, the MOF, in the budget circular, provides guidelines for preparing the budgets to each of the spending departments and provinces (and cities directly under the centre). It also provides indicative targets of recurrent expenditure to each of the Central Ministries and Provinces. The provinces then prepare the indicative targets for the districts which in turn prepares them for the communes. At each level, the spending departments prepare their draft budgets and submit them to the finance department at that level which, after consolidation, submits it to the People's Committee. The latter finalises the draft budget and submits it to the People's Council for approval and simultaneously communicates the draft budget to the finance department at the higher level. The process of preparing the budget extends all the way down to the commune level. The finance department at each level consolidates the draft budgets of spending agencies at that particular level as well as those below it. At the centre, the MOF consolidates the estimates received from the line ministries and provinces. The centre also keeps some extra cushion to negotiate. It discusses the estimates with the provinces and supplements the expenditures in some cases, if necessary.

The ministries and provinces have to prioritise from among the approved projects to match the indicative targets. The eligibility for approving the projects is specified to the relevant authority in the special Decrees 42 and 92 issued by the Government in July 1996 and August 1997. In the past, all investment expenditures were allocated by the MPI. However, according to the new procedure, the investment projects are classified into A, B and C groups depending on the nature and strategic importance of the projects and volume of investment. Group A consists of large and strategic projects which have to be approved by the Prime Minister. For Group B and C projects the Ministers, heads of agencies in the ministries and, Peoples Committees of provinces and provincial cities can make the investment decisions. The provinces can also delegate the decision-making power for investments of less than a certain value to the Chairmen of the People's Committees in districts, particularly in Ha Noi and Ho Chi Minh cities.

Investment outlay to central and local governments is determined in a manner similar to that of recurrent expenditures. The resources available for investment after providing for recurrent expenditures are allocated among the provinces through negotiations and based on socio-economic conditions, level of development of the province, its population size, number of centrally-managed projects in the province, and counterpart funding required for the overseas donors. The provinces and ministries include the approved projects to match investment ceilings. The provinces consolidate investment budgets of various provincial departments as well as those of governmental units below them and communicate them to the MPI. Similarly, the MPI consolidates the investment budgets of the provinces and central government ministries. In 1996, when the provinces were first authorised to match investment targets with projects, the local pressures led to choosing a large number of projects for implementation. This resulted in under-funding and a thin spread of resources. Consequently, a heavy cost and time overruns. Subsequently, the Central government brought in additional conditions, such as that the province should be able to complete 70 per cent of the project within the first year and complete the entire project within two years.

The recurrent expenditure, investment and revenue estimates consolidated by the MOF are presented to the National Assembly for approval before 30 November. The process of allocating central and local budgets, bringing about budget balance at each of the levels is required to be completed before 31 December so as to enable the budget implementation from the financial year beginning 1 January.

After it is approved, the MOF communicates the budget to the spending ministries and provinces, as well as the treasury, to facilitate implementation. The finance departments at different levels have the powers to supervise and control the implementation of the budget at the same level as well as the levels below them. The finance department ensures that the expenditures are incurred strictly according to the approved budget. The spending units prepare the spending plan and based thereon, the finance department prepares the quarterly spending plans for each spending unit. The treasury ensures the disbursements are made according to the plan.

The Law lays down procedures for finalising budget accounts as well. Based on the guidance received from the MOF, the budgetary units have to prepare their accounts and submit them to the higher managerial body. The State Treasury at the relevant level certifies the accounts. The finance department at each level examines and approves the accounts of various departments at that level as well as those below. It submits the accounts to the People's Committees of that level for consideration and People's Councils for ratification. The accounts are also sent to the finance department at the next higher level. The MOF shall consider and approve revenues and expenditures of central agencies; examine the local budgets and consolidate them for submission to the National Assembly for ratification. The state audit agency has the responsibility of auditing accounts to ensure its correctness and legality.

d. Salient Features of the New Budget Law Summarised

The new budget law has brought about a number of important changes in the budgetary process. The salient features are summarised here:

i) it provides the legal framework for the budgetary process and defines the roles of different governmental agencies. It lays down the procedures to formulate, implement and monitor the budgets of different governmental units. It provides an institutional mechanism for the purpose and defines the lines of authority and precedence of different agencies.

ii) the law demarcates functions of different levels of government. In the case of revenues, the sources accruing to each level of local governments in entirety and those shareable with higher level government have been identified. In the case of expenditures, however, there is a large area of concurrency and functional separation based on the convention. Thus, in spite of defining the roles, there is room for ambiguity. Higher level governments can push the expenditure responsibility to lower levels particularly when revenues are stagnant.

iii) the budgetary process integrates revenues and expenditures at all levels of government. In the past, the state budget included the expenditures of the communes only to the extent that they were financed from revenues devolved by the provinces or districts. According to the new law, it is necessary to include all expenditures, including those financed from revenues from voluntary contributions by the communities. This provides a wholistic picture of the operation of the public sector in the country.

iv) the system of assignments and transfers will remain unchanged for 3 to 5 years. While the revenue from tax assignments will automatically adjust to changes in prices and GDP, adjustments will be made in cash transfers to take account of changes in prices and GDP every year. The stability in assignment is expected to enhance local initiatives in planning the provision of public services. To take care of unforeseen contingencies, however, the centre can give extra assistance to the local governments. The law also provides for readjustment of the assignments if national defence and security are in danger or if major changes in budget revenues and expenditures are expected.

v) each level of government and individual units of government are made to carry out their expenditure responsibilities. This linking of revenues and expenditures at the margin is expected to provide greater incentive to the local governments to mobilise revenues. Although the local governments cannot determine tax policies, they play an important role in administering the tax collections and thus, influence revenue collections.

vi) the law formalises and sanctifies the levy of charges, fees and surcharges by the local governments, hitherto informally. It also authorises collection of voluntary contributions from individuals and organisations at local levels, including the communes.

IV. Intergovernmental Fiscal Arrangements: An Evaluation:

Although the budget law was formally implemented in 1997, attempts to put formulation and implementation of the budget on a systematic footing were under way during the last few years. Thus, although the new system has been in operation only during the last couple of years, the analysis should bring out equity and efficiency implications and identify the areas of improvement.

(a) Trends in Fiscal Decentralisation

The expenditure shares of local governments do not show any clear trend. It is seen that expenditure share of local governments declined from 35 per cent in 1992 to 33 per cent in 1994, but later increased to 38 per cent in 1996 (Table 1). This increase, however, cannot be inferred to mean increase in expenditure decentralisation. This is because (i) this is at best an imperfect measure of fiscal decentralisation and at worst is misleading; (ii) to a large extent the measure merely reflects better coverage of the commune expenditures in the State budget. It would be interesting to see the relative roles of the centre and local government after the implementation of budget law. Unfortunately, estimates of expenditure after the law has been implemented are not available.

The new budget law has helped to provide a legal framework and has clarified the roles of different agencies in budget formulation, implementation, monitoring and control. These new developments have also imparted a measure of stability to the fiscal arrangements. Nevertheless, the process of negotiating expenditures remains critical to determining the assignment of various taxes and cash transfers, though once negotiated, the arrangement remains stable for three years. The budgeting exercise by local governments is confined to determining the allocations to various sectors and units below them. They hardly have independent revenue powers; all the tax powers are vested with the centre. They can raise revenues only from some minor fees or user charges which constitute less than 5 per cent of total revenues.

The budget law stipulates that certain taxes must be shared between different levels of local government, but the higher levels decide the shares of lower levels. In general, there is a reluctance to devolve revenues to lower level governments and therefore, in the amendment to the Law, it was stipulated that at least 20 per cent of the proceeds from agricultural tax should be assigned to each of the communes. As regards assignment to different units, each province follows its own system in making assignments to the districts. Similarly, there are wide variations in the assignments made to the communes by the districts.

(b) The Assignment System and Incentives

As mentioned earlier, the tax policy decisions are taken by the central government and tax collections are done by the GTD, a central government department. But the local governments can influence tax collections by providing incentives in cash and kind to the tax officials. Local governments have an incentive to collect more tax revenues –they can retain the revenues in excess of targets. At the same time, this arrangement could lead to the tax officials concentrating on the collection of mainly the taxes assigned entirely or partially to the local governments. This could cause distortions in the tax system.

(c) Flexibility to Local Governments in Budget Implementation

The lack of flexibility and autonomy in determining inter-sectoral allocations presents problems in efficient delivery of public services. According to the budget law, the local governments can include an additional 3 to 5 per cent of total expenditures while budgeting in order to meet any unforeseen requirements during the course of the year (Article 9). However, ultimately the indicative targets set up by the MOF and the negotiating skills of the provinces decide their expenditure allocation.

Once the National Assembly approves the budget, altering sectoral allocations requires prior approval of the MOF. Thus, flexibility in budgeting decisions to local governments depends upon their ability to collect independent revenues. As mentioned earlier, own revenues of local governments from fees and charges constitute less than 5 per cent of their total revenues. The only other source of flexibility for the local governments is to collect revenues in excess of the budget targets. Not surprisingly, besides facilitating revenue collections, local governments have introduced incentives to the tax officials located, within their jurisdictions, to collect more tax revenues. This has also provided an additional reason for the tax officials to underestimate revenue targets.

In the case of communes, however, the community contributions are an important source of revenue. This gives them greater flexibility in budget implementation. At the same time, this can result in wide variations in the standards of services. The richer communes can collect more contributions than the poorer ones. If the latter decide to have the same levels of services, the system results in regressive contributions.

The flexibility in implementing budgets varies widely across different local government units. When the economy is fast growing, revenues are buoyant and it is easy to exceed the revenue targets. In contrast, in a stagnant economy, given that expenditure functions overlap between different levels of government, the tendency for each level of government is to push the responsibility downwards to the extent it can. The line ministries transferring the responsibility of financing some national programmes to the provinces, is a case in point. There are also cases where the line ministries ask the provinces to make matching contributions to finance some of the national programmes. As expenditure responsibility is pushed downwards, communes, being the lowest level, have to absorb the vagaries of economic fluctuations. If revenues are stagnant, either they have to reduce expenditures or community contributions will have to increase. In poorer communes and districts in particular, the adverse effect of economic downturn on the service level could be severe. Thus, the system of voluntary contributions could turn out to be a regressive tax.

(d) Stable Assignment System

According to the New Budget Law the system of assignments and the cash transfers will remain unchanged for 3-5 years. Consistency in the shares of assigned taxes to provinces, districts and communes is expected to provide a measure of certainty in revenue flows and enable them to plan the provision of public services better. The system however, discriminates against poorer provinces receiving cash transfers. Although the law provides for the adjustment of the amount of cash transfers to increases in incomes and prices, based on the recommendations of the National Assembly Standing committee, the extent of indexation is less than complete. This year for example, the cash transfers are being adjusted by about 6 per cent when the increase in real GDP alone is estimated to be of that order which means there is virtually no adjustment for increase in prices.

The provinces do not have the power to raise revenues because policies relating to the tax base and rates are determined by the central government. However, they have been assigned the power to levy and collect user charges and fees. The absence of proper guidelines for levying user charges has resulted in high rates and wide and unsystematic variations across provinces. It may therefore, be desirable to specify the principles for levying these charges. The provinces may be required to levy user charges based on the long run marginal cost unless it is explicitly desired that the service should be subsidised for social considerations. In the case of fees, it may be necessary to lay down a band of rates for various services within which the provinces could levy.

(e) Negotiated System of Assignments

A major shortcoming of the fiscal arrangements in Vietnam is the continuation of the negotiated system of determining transfers. As mentioned earlier, determining expenditure levels of provinces is critical to determining tax assignments and cash transfers from the central government to provinces. In such a system, prevailing levels of expenditures on different services and the bargaining skills of the provinces are the key determinants of transfers, not considerations of equity and efficiency. Besides, the negotiated system of transfers is non-transparent and even when it is equalising, it may not appear to be so. Targeting the transfers to offset fiscal disability of poorer provinces is better achieved when the transfer system is formula-based and is designed to achieve the objective.

(f) Equity in Inter-governmental Transfers

Foregoing discussion shows that since the implementation of the new budget law, local government incentives to raise resources have improved. However, the more affluent provinces, districts and communes seem to have been able to avail the opportunities better than their poorer counterparts. The richer local government units have been able to collect larger revenues from the stable assignment system.

Analysis shows that the assignment system, like in the past, results in a significant redistribution of revenues from richer to poorer provinces. The distribution of revenue collections shows close positive relationship with GDP (Figure 1). Thus, while the provinces with higher levels of development show a disproportionately higher rate of revenue increases, the rate of increase in expenditures was much lower. The cross-section elasticity of revenues with respect to GDP is 1.87, whereas the value for per capita expenditures is significantly lower at 0.27 (Table 2). Thus, in fact, the revenue elasticity in 1996 is higher than in 1994 (1.44), which indicates that the richer provinces are able to take better advantage of the incentives offered by the stable system of assignments.

In spite of the significant redistribution noted above, the distribution of per capita expenditure has a significant positive association with per capita GDP. It is also seen that the cross-section elasticity of expenditures with respect to GDP has increased, albeit marginally from 0.20 in 1994 to 0.27 in 1996 (Figure 2). The distribution of capital expenditures is more unequal, and the income elasticity with respect to GDP is higher at 0.57. Thus, the richer provinces are in a better position to take advantage of the incentives in the assignment system. As they can generate larger surpluses over targeted revenues, they can spend disproportionately higher amounts on capital expenditures, which in the long term may accentuate inter-regional disparities. Among social services, inter-provincial distribution of education expenditures shows a better targeting; per capita education expenditures are higher in provinces with higher rate of illiteracy. However, health expenditures have no relationship with the health indicator like infant mortality rate.

V. Concluding Remarks:

Sustaining economic growth in Vietnam in the medium and longer term context will depend upon, to a great extent, the ability of the government to evolve a conducive institutional framework including fiscal and administrative structures for delivering equitable and efficient levels of public services. Further, as the economy makes a transition to the market economy, demand for evolving a rational system of inter-governmental relationships to provide accommodating levels of public services to varied preferences and requirements of different regions will increase. The recent reform measures introduced by the government reflect the importance it attaches to the issue of providing a proper institutional framework for delivering public services. However, as the foregoing discussion shows, there are still some serious shortcomings and potential perverse incentives requiring reform.

Although the system of fiscal assignments in the budget law provides incentives to local governments for resource mobilisation, it has two specific problems: (i) the system has the potential of creating serious distortions in the system. In the present system, the tax officials are accountable to both central and local governments. The incentives given to tax officials to collect more revenues from the taxes assigned to them can cause serious distortions in the tax structure. (ii) the assignment is essentially origin-based and the provinces can retain revenues in excess of the intended collections. This tends to place the local governments with smaller revenue bases at a relative disadvantage.

Balancing incentives with equity is one of the difficult challenges in fiscal assignment. One possible way to resolve the issue in Vietnam in the medium term is to assign some tax bases (as against tax revenues) to local governments. The power to determine the base and rate structure of locally-based taxes, in respect of which the local governments have an advantage in collection, could be clearly assigned to local governments, whereas, all broad-based taxes could vest with the centre. The local governments could have their own small tax departments to administer their taxes, independent of the central taxation department. The local governments would also receive a percentage share of total revenues collected by the centre, which can be fixed perhaps for a period of three to five years. The shares to the provinces can be determined not on the basis of origin, but on the basis of a formula representing shortfall in capacity to achieve the required measure of equalisation. The cost disabilities for the mountainous provinces can also be taken into account in the equalisation formula. Assigning tax powers to the local governments would impart flexibility and incentives to their budgetary decisions. At the same time, retaining power to levy broad based taxes at the centre would enable it to undertake stabilisation and regional redistribution measures effectively.

An important shortcoming in the fiscal arrangements is the system of determining expenditure and revenue allocations through negotiations. It is important to move over to a formula-based system in the medium term to allocate resources according to the requirement of different regions and localities and to impart fairness and objectivity to the system. Tax sharing and cash transfers would have to be designed to offset revenue and cost disabilities of poorer localities. At the same time, it is necessary to ensure that the transfer formula is kept simple. Developing a reliable information system and systematic compilation of not only revenue and expenditure data but also of important economic indicators like GDP, its sectoral composition, demographic structure of population at both national and provincial levels, is critical to evolving a formula-based transfer system.

Keeping the tax assignment unchanged for 3 to 5 years in the budget law imparts a degree of certainty and helps the local governments to plan their activities.

However, the arrangement places the poorer provinces getting cash transfers at a disadvantage unless it is indexed fully to neutralise increase in prices.

Assigning the right to levy some charges and fees to the provinces has provided them some flexibility in budget implementation even though the revenue from their own sources is less than 5 per cent. However, in the absence of other independent revenue sources, local governments have had to make intensive use of these instruments and this has resulted in wide inter-provincial variations.

Reforms in inter-governmental fiscal arrangements to enable efficient delivery of public services to accommodate the requirements of a market economy will have to proceed in terms of devolving greater powers to sub-national governments. In particular, it is necessary to empower the local governments with some revenue handles. This will provide them with greater flexibility in expenditure decisions and will also ensure allocative and technical efficiency in the delivery of public services. Such an arrangement will ensure greater accountability and incentives by linking revenue raising and expenditure decisions. This, however, has to be accompanied by a concerted attempt in capacity building of the local governments. In the initial stages, greater decentralisation in revenue decisions could be attempted in respect of provincial cities such as Ha Noi, Ho Chi Minh, Da Nang and Hai Phong, where the capacity to administer the taxes was already high, and later this extended to other provinces as the capacity developed. Another important area where reforms are necessary is in respect of designing an inter-governmental transfer system, which is simple, transparent and equitable. It is necessary to replace the prevailing negotiated system with the formula-based system. The formula should be designed to offset revenue and cost disabilities. This is an important area and Vietnam can well learn from the experience of a number of countries in designing an appropriate transfer system, which will fulfil the objectives of inter-governmental transfers without involving disincentives on fiscal management.

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Table 1: Central and Local Expenditures in Vietnam

	Percentage of Local Expenditure to Total Expenditure (%)				Per Cent of GDP, 1996		Per Capita Expenditure, 1996 (Thousand. VND)	
	1992	1994	1996	1998(Plan)	Total	Local	Total	Local
I. Current Expenditures								
1. General Administration	64.9	45.4	54.20	50.35	2.46	1.33	82.83	44.90
2. Economic Services	20.2	37.6	61.88	68.00	1.62	1.00	54.65	33.82
3. Social Services, of which	37.5	39.0	44.52	43.42	7.86	3.50	264.86	117.93
i) Education	76.3	76.4	86.18	81.69	2.13	1.83	71.70	61.79
ii) Health	61.9	57.1	67.84	57.15	1.07	0.72	35.99	24.42
iii) Pensions and Social Relief	8.2	7.9	6.79	6.87	3.17	0.21	106.78	7.25
4. Interest Payments	0.0	0.0	0.00	0.00	1.04	0.00	35.20	0.00
Total I - Current Expenditures	34.1	28.7	39.95	39.82	26.13	10.44	880.94	351.95
II - Capital Expenditures	37.9	41.1	37.93	38.89	6.04	2.29	203.76	77.29
Total Expenditures	35.4	32.7	37.97	38.18	24.32	9.23	819.84	311.32

Source: Ministry of Finance, Peoples' Republic of Vietnam

Table 2: Regression Results, 1996						
Dependent Variable	Constant	Per Capita GDP	Illiteracy rate	Infant mortality rate	$\bar{R}^2$	F
Per Capita Revenues	-8.5916 -(10.405)	1.8661* (17.274)	-	-	0.8512	298.40*
Per Capita Current Expenditures	4.5753 (7.1573)	0.1186 (1.4179)	-	-	0.0191	2.0105
Per Capita Exp. on Education	3.5925 (6.9832)	0.0153 (0.2666)	01721* (3.2482)	-	0.1612	5.9956*
Per Capita Exp. on Health	1.3798 (1.4664)	0.158** (2.0317)	-	0.1473 (1.0599)	0.0415	2.1271
Per Capita Capital Expenditures	-0.0245 -(0.0204)	0.5677* (4.2473)	-	-	0.2469	18.040*
Per Capita Total Expenditures	3.7194 (5.4193)	0.2683* (2.9875)	-	-	0.1323	8.9253*

*Note: * denotes significant at 1 per cent level; ** denotes significant at 5 per cent level*

Figure 1

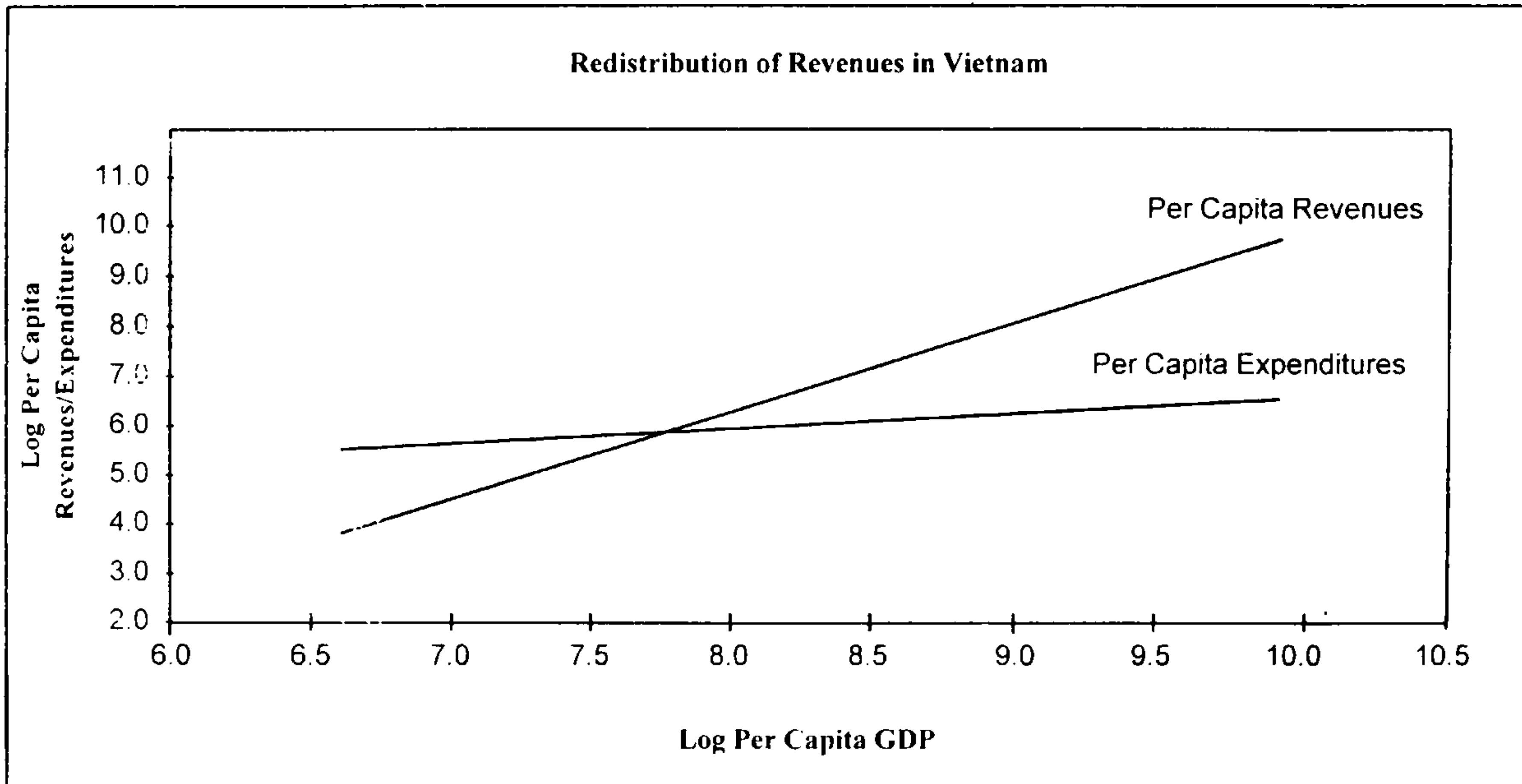
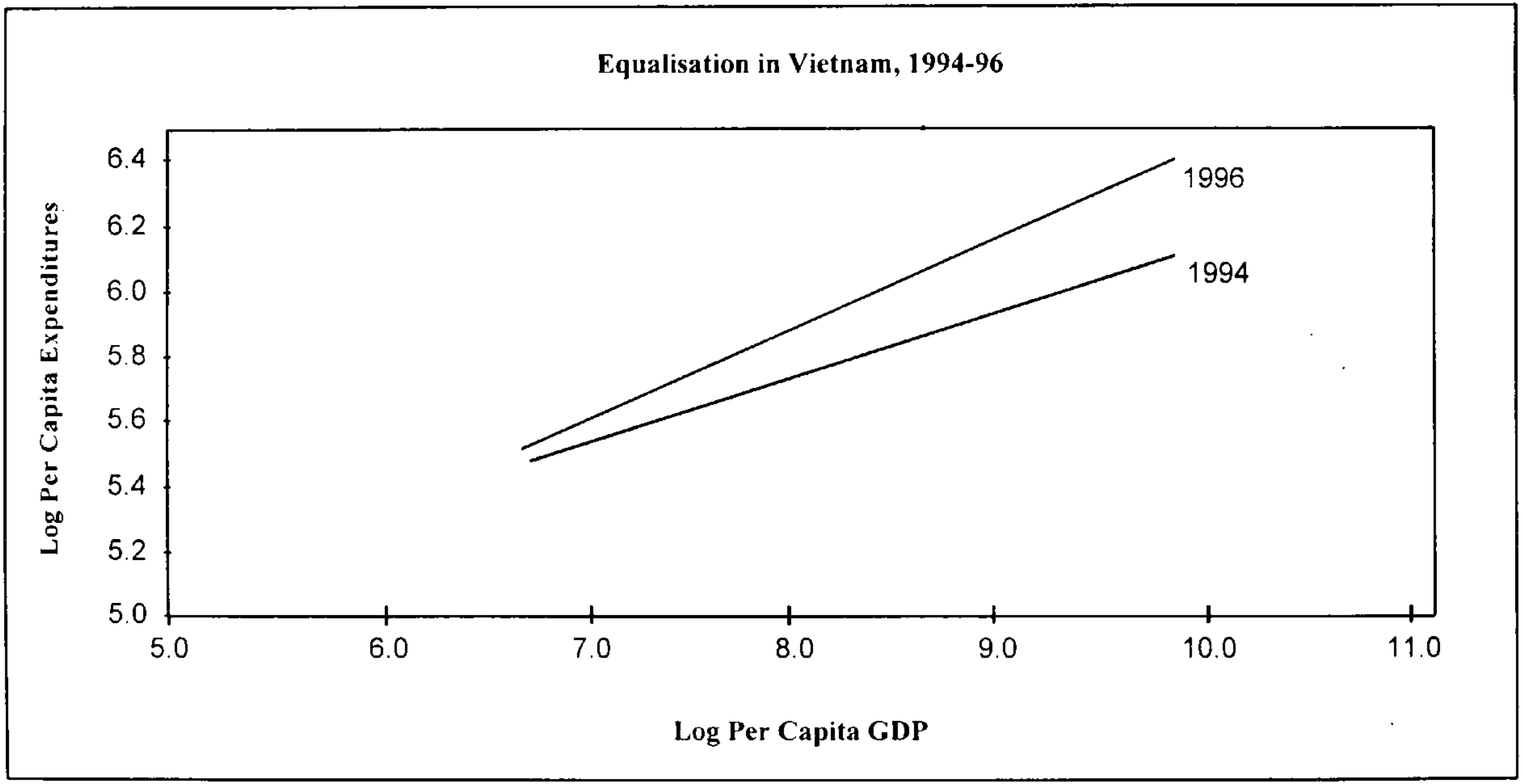

Redistribution of Revenues in Vietnam
Per Capita Revenues
Per Capita Expenditures
Log Per Capita Revenues/Expenditures
Log Per Capita GDP
11.0
10.0
9.0
8.0
7.0
6.0
5.0
4.0
3.0
2.0
6.0
6.5
7.0
7.5
8.0
8.5
9.0
9.5
10.0
10.5

Figure 2


Equalisation in Vietnam, 1994-96
6.4
6.2
6.0
5.8
5.6
5.4
5.2
5.0
Log Per Capita Expenditures
1996
1994
5.0
6.0
7.0
8.0
9.0
10.0
11.0
Log Per Capita GDP

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