TAX REFORMS IN VIET NAM: A SELECTIVE ANALYSIS

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Foreword

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Contents

Abstract

In this paper a framework of tax reform requirements for Viet Nam is developed based on theories of taxation, particularly Optimal Tax Theory, and international tax reform experience in market and transitional economies. The framework is then used to analyze the structure and system of taxation in Viet Nam at the present stage of reform. The paper concludes that the achievements of Viet Nam's tax reforms have been mixed. The rise in the tax:GDP ratio is impressive compared to most developing countries. There has also been a welcome shift away from production taxes to taxes on income and consumption. However, the revenue share of distortionary trade taxes have risen and income taxes are still largely collected from a few state enterprises and joint ventures. A sound base of tax administration for a modern market economy is yet to be established despite initiatives in this direction. The enactment of the new Budget Law notwithstanding, lack of transparency in tax assignment to different levels of government, a large element of discretion and negotiation in setting rates and targets for shared taxes, and inappropriate tax assignment are undermining the tax effort and contributing to inefficiency. These are the key issues that will need to be addressed in the next phase of tax reform.

I. Introduction

Two of the most important pieces of legislation enacted by the Ninth National Assembly in its final session during April-May 1997 included the Law on Value-Added Tax and the Corporate Income Tax Law. Tax reform is one of the key components of a comprehensive program of structural adjustment that the government has been pursuing with assistance from the International Monetary Fund and other donors. The passage of these two new tax laws underlines the resolve of the government to press forward with tax reforms even while there is a slowdown on other aspects of structural adjustment such as financial sector reform and reform of state-owned enterprises. This paper attempts to take stock of what has been achieved, along with the challenges that lie ahead, in the field of tax reforms.

The paper has been organized as follows. This introduction is followed by a brief review of the guidelines offered by tax theory for the direction and design of tax reform. The review is necessarily selective. It focuses especially on the main direction of tax structure reform suggested by the Optimal Tax Theory, supported by theories where the Optimal Tax Theory falls short as a guide to practical action. This is followed in Section III by a discussion of some key lessons from international tax reform experience, which draws on tax reforms in both transitional and market economies. Section IV reviews Viet Nam's tax reform to date against the background of theoretical and empirical insights discussed in preceding sections. Finally, Section V concludes the paper with an account of the tasks ahead in tax reforms.

II. Tax Theory and Tax Reform

The justification for taxation derives from the fact that governments need to carry out certain public functions or provide some public services. These activities are resource-using, hence the government must mobilize resources to finance its activities. However, taxation or other forms of resource mobilization are not costless. They can adversely affect social welfare (Ballard et al. 1985). Hence the benefits of public spending, or the provision of public services, need to be traded off against the welfare costs of taxation in order to arrive at a socially optimal profile of public activities. Politically, governments find it easier to reform taxes rather than expenditure (Shome 1995). Hence, governments have been particularly active in reforming tax systems since the 1980s, which McLure (1990) describes as "the decade of tax reforms." While there are differences across countries in their reforms, there is also remarkable similarity in the broad agenda of tax reforms. Arguably, this shared worldwide agenda of tax reforms is attributable to the emergence of a unifying theory, usually described as Optimal Tax Theory. However, actual applications of the conclusions of this theory have naturally had to come to terms with different policy objectives and different practical issues of tax administration in different countries.

Tax reforms have been driven by the need to mobilize tax revenue through means consistent with the objectives of efficiency, equity, administrative simplicity and, more recently, fiscal decentralization. The essence of the Optimal Tax Theory is the attempt to integrate the first two of these objectives, i.e., efficiency and equity. One of most important results of this theory is the Production Efficiency Theorem (Diamond and Mirrlees 1971). The theorem implies that, under certain simplifying conditions, there should be no taxes on intermediate goods production and foreign trade. This is because production and trade taxes lead to large distortions in relative prices, and consequent welfare losses through resource misallocation, without any special equity benefits. The equity goals can also be met through income or consumption taxes without generating such large allocative inefficiencies. The second major insight of Optimal Tax Theory is the result that, unless the tax (subsidy) enforcement powers of Government are restricted, the optimal tax policy for welfare maximization is lump sum taxes and transfers related to the ability to pay, i.e., that income taxes are better than indirect taxes (Atkinson and Stiglitz 1976, Stern 1976). When the simplifying assumptions of the Optimal Tax Theory are relaxed to approach real world conditions, these simple results have to be modified in several ways (Cremer and Gahvari 1995). The results are further blurred with the relaxation of assumptions regarding perfectly competitive markets, absence of externalities or learning effects, information costs, and uncertainty. What survives as a guide for tax reforms is a broad welfare ranking of tax sources that should be followed to the extent feasible subject to administrative constraints. Thus, from the standpoint of efficiency, combined with equity, the preferred source of tax revenue is income, followed by taxes on consumption, then by taxes on production (intermediate goods) and trade. Assuming that administrative and informational constraints are eased with development, we might then expect tax structures to evolve from an initial situation of high reliance on production and trade taxes, to greater reliance on taxes on consumption, and finally taxes on income as development proceeds. As we shall see later, this theoretical scheme accords quite well with observed international variations in tax structure and can therefore serve as a useful guide for the design of tax reforms.

An aspect of tax reform, which has unfortunately not been prominent in the theoretical literature, though it is of enormous importance for tax reform, is administrative simplicity (Mundle 1997).[1] This consideration is important in all countries, especially developing countries where the capacity of tax departments to implement and enforce taxes are typically quite limited. However, it is particularly important in transitional economies where the traditional role of the tax administrator under the erstwhile command system was quite different. The earlier and relatively simple task of verifying that the correct revenue transfers had been made from one government account to another, has to be replaced by a whole new structure of personnel dealing with registration, returns processing, tax collection, auditing, penalties, appeals, etc. An entire new structure of tax administration has to be built virtually from scratch. The establishment of this structure, training of staff, computerization of tax administration, etc. are all key elements of the basic foundation on which the rest of tax reform must rest (Tanzi 1992).

The question of fiscal decentralization has received increasing attention in discussions on tax reform in recent years. The Fiscal Decentralization Theorem (Oates 1977) states

[1]See, however, among others Dasgupta and Mukherjee (1997).

that in the absence of scale economies, subnational governments have comparative advantage in providing public services because the preferences of residents are heterogeneous across jurisdictions and the information cost of revealing their preferences can be quite high. There are also several other advantages to fiscal decentralization as will be intuitively obvious. By locating fiscal decision making close to those affected by the decision, the response to feedback is likely to be more effective. Furthermore, if either capital or labor, or both, are mobile, decentralization enhances the efficiency of public resource use through greater competition between different fiscal jurisdictions. Finally, by making the link between tax collection and the services financed by it more transparent for taxpayers, who are also the beneficiaries, it enhances the tax effort at lower levels of government.

In summary, the main conclusions of tax theory, filtered through the practical experience of tax reforms in both transitional and market economies, lead to a three-tier package of desired tax reform:

i) A gradual shift of the tax structure from initial reliance on production and trade taxes, to increasing reliance on consumption taxes at uniform rates, and eventually taxes on income. For the latter, conventional wisdom suggests a broad-based and low, uniform rate across sources, with minimal exemptions.

ii) Development of tax administration and training of staff in the various practical tasks of tax administration, from registration and returns processing (with computerization) to collection, auditing, and enforcement.

iii) Transparent revenue assignment to different levels of government as part of the process of fiscal decentralization.

III. Tax Reform Experience: Stylized Facts

Tax Structure Reforms

Actual tax reform efforts conform to the insights of theory. However, achievements have been mixed and the degree of success has varied across countries. Though tax-reforming countries have persisted with a multiplicity of taxes, the general direction of tax structure reform has tended to reduce reliance on trade or production taxes, while raising the share of tax revenue from consumption and income taxes.

Income Tax

In the domain of income taxes, reforms have tended to widen the base by lowering exemption limits, bringing hard-to-tax groups within the tax net, and minimizing allowable deductions or exemptions. The income tax is no longer considered an effective instrument for promoting equity, hence the progressivity of personal income tax rates has been reduced. In the transitional economies, a corporate income tax has tended to replace the earlier profit tax and remains a major source of revenue. However, the personal income tax is yet to emerge as a major source of revenue. Meanwhile, schedular personal income tax rates are in place for those who are liable to pay the personal income tax and the rates remain high (Muten 1992).

Introduction of VAT

In most countries of the European Community and in Latin America and Asia that have undertaken tax reforms, introduction of a value-added tax on consumption has emerged as probably the single most important item of tax reform. The elimination of cascading, by rebating taxes paid on inputs, and the ease of enforcement arising from cross reporting has made this a popular tax. Countries that have introduced the VAT have usually abolished sales taxes and reduced the lists of excise taxes. Typically, uniform rates of around 10 percent or less are being applied. However, there are countries like Bangladesh where the rate is 15 percent (United Nations 1995). In the transitional economies, the lack of a pre-existing tax administration of the kind appropriate for market economies makes the introduction of VAT a major challenge. It requires several measures from legislation to registration and implementation. Each of these measures will in turn require several steps. Tait (1992) estimates that proper preparation for introducing the VAT would typically require a period of about 18 months as shown below in Table 1.

Trade Taxes

Though exports are occasionally taxed, the main trade tax is usually the import tariff. Reduction of the rates and spread of import tariffs, greater uniformity of rates across commodities, and replacement of specific rates by ad valorem rates have been the main features of tariff reform. In the transition economies, unlike most developing countries, trade taxes have not usually been an important source of revenue in the past and therefore did not require major reforms.

Reform of Tax Administration

The mobilization of tax revenue, as well as realization of the efficiency and equity goals of taxation, depend on effective tax enforcement and compliance with tax provisions by the public. Reform of tax administration has in fact been an important component of tax reform in many countries. The main objective is to ensure transparency and simplicity of the tax system along with effective and efficient enforcement. This aspect of tax reform has been particularly important in the case of transitional economies. A cadre of tax administrators have therefore had to be built virtually from scratch to deal with a multiplicity of new functions in tax administration.

Fiscal Decentralization

This was not a major feature of tax reform in the early 1980s. However, by the 1990s decentralization had emerged as a major goal of fiscal reforms. This has happened mainly because of growing awareness of the welfare gains of fiscal decentralization in terms of efficiency, closer communication between lower-level fiscal authorities and beneficiaries, and competition between jurisdictions. Thus, assignment of taxes to subnational authorities is

TABLE 1
Timetable for VAT Introduction

	Months to Introduction of VAT																	Post-VAT			
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21
1. Policy and Legislation																					
Allocate development budget								X													
Establish VAT Development Unit								X													
Appoint staff to Development Unit								X	X												
Resolve outstanding policy issues									X	X	X										
Consult other organizations on law									X	X											
Revise current draft of VAT law									X	X	X										
Finalize draft VAT law											X										
Draft law to Council of Ministers											X										
Present law to Parliament											X	X									
Pass law												X	X								
2. Publicity and Education																					
General sectoral discussions										X	X	X	X	X	X	X	X	X	X		
Hold seminars for business											X	X	X	X	X	X	X	X	X		
Draft and print VAT Guide													X	X	X	X					
Draft and print Registration Guide													X	X	X	X	X				
Draft and print standard account books																X	X	X	X		
Prepare VAT material for consumers													X	X	X	X	X	X	X		
Prepare trader-specific pamphlets													X	X	X	X					
Advertise registration period																X	X	X	X		
Advertise implementation date																					X
Advertise first payment date																					X
3. Organizational																					
Decide organizational structure									X	X											
Estimate number of taxpayers									X	X											
Calculate staff needed for VAT										X	X	X									
Appoint senior territorial staff													X	X							
Allocate staff to audit positions														X	X	X	X				
Allocate initial processing staff														X	X	X	X				
Allocate remaining staff																	X	X	X		
4. Operational Issues																					
Decide broad operational issues																					
Design registration system																					
Design return/payment process sytem																					
Design audit system																					
5. Computer Development																					
Complete user specifications-registration												X	X	X							
Develop registration system														X	X						
Test registration system															X	X					
Load registration database																X	X				
Complete user specifications full system														X	X	X	X				
Develop full system																	X	X	X	X	X
Test and revise full system																					XXX
6. Forms																					
Design and print registration form												X	X	X	X	X					
Design and print return form														X	X	X	X	X	X		
7. Manuals (Staff instructions)																					
Allocate staff to write manuals														X	X						
Prepare technical manual											X	X	X	X	X						
Processing and procedures manual														X	X	X	X	X	X		
Advisory activity manual														X	X	X					
Audit manual																		X	X		
8. Training Development and Delivery																					
Technical training															X	X	X	X	X		
Return processing training																				X	
Advisory training																X	X	X	X		
Audit training																					X
9. Registration and Implementation																					
Issue registration forms																		X	X		
Conduct advisory visits																				X	
Issue first return forms																					XX
Receive first payments																					XX
Identify defaulters																					XX
Pursue defaulters																					X

Source: Tait (1992).

now an important feature of ongoing tax reforms in People's Republic of China (Wong et al. 1995), India (Rao 1997), and elsewhere. However, decentralization has to be combined with central coordination across regions and an effective federal transfer mechanism to offset the fiscal disadvantage of poorer jurisdictions.

IV. Tax Reform in Viet Nam: An Assessment

The main dimensions of tax reform outlined above, based on tax theory and the collective experience of tax reform in different parts of the world over the past two decades, presents a convenient frame of reference for assessing Viet Nam's record of tax reforms during the past few years. At the outset it must be noted that the track record in fiscal legislation, particularly tax legislation, has been impressive. Enactment of the new Budget Law in early 1996 has been followed within a year by enactment of the Value-Added Tax Law and the Corporate Income Tax Law. Starting from scratch, the basic legal framework is being rapidly put in place for administering a modern tax system in a market economy. However, legislation is only the first step in tax reform. The ultimate test of effective reform is how implementation of the laws translates into a tax system that generates adequate revenues with minimal distortionary effects. The 1990s have been a remarkable period for revenue mobilization in Viet Nam, as indeed for many other dimensions of the economy. The tax:GDP rose from about 11 percent of GDP in 1991 to over 20 percent in 1996. This compares quite favorably with other developing countries, many of which have much higher per capita incomes than Viet Nam. Thus, in terms of revenue mobilization, tax reforms in Viet Nam have been very successful. However, the key question is, what impact has this effort had on resource allocation in the economy? In other words, how has the tax structure evolved over time?

It was pointed out earlier that as development proceeds, the main sources of tax revenue should ideally shift from production and trade taxes, which are the most distortionary, to consumption taxes and taxes on income, which are less distortionary. In Viet Nam trade taxes used to account for only about 15 percent of tax revenue at the beginning of the 1990s. Though this was not as low as the 2-3 percent observed in OECD countries, it was still much lower than the shares of 25-35 percent observed in other developing countries of Asia, Africa, and Latin America (Table 2). This is presumably because trade taxes were not very important in the erstwhile command economies, as is also evident for the countries of East Europe and the former Soviet Union. Unfortunately, that share has now risen to almost 30 percent and is actually even higher than the average shares observed in the non-OECD countries of Asia, Latin America, and the Middle East.

This adverse movement in the share of trade taxes has occurred despite a lowering of the marginal tariff rates from 300 percent to only 60 percent in 1996. It reflects the fact that the trade sector has grown much faster than the rest of the economy. This in itself is quite desirable since it has accelerated Viet Nam's integration with the international economy. However, it also means that Viet Nam's dependence on distortionary trade taxes is much greater today than at the beginning of tax reforms.

[2]The classification of various taxes as taxes on consumption or production is not unambiguous, especially in Viet Nam. The following discussion of tax structure is therefore subject to possible misclassification of some taxes.

TABLE 2
Tax Structure of Viet Nam and Selected Country Groups

Country Groups[a]	Taxes on Profits, Income, and Capital Gains			Domestic Taxes on Goods and Services			International Trade Taxes			Others (Social Security, Payroll Taxes, Property Tax, etc.)
	Total	Individual	Corporate	Total	Consumption Taxes[c]	Production Taxes[d]	Total	Exports	Imports	
(0)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
OECD Countries (1986-1992)	36.5	27.6	8.1	31.4	19.2	9.3	2.5	2.5	0.0	29.6
African Countries (1986-1992)	30.2	11.4	17.1	27.5	14.5	11.7	36.6	26.5	9.7	5.7
Middle Eastern Countries (1986-1992)	33.4	6.1	25.2	19.4	5.8	9.1	28.5	26.6	0.2	18.7
Non-OECD Western Countries (1986-1992)	23.0	6.4	14.0	33.3	15.5	13.0	24.9	21.5	2.5	18.8
Non-OECD Asian Countries (1986-1992)	31.7	14.7	16.9	36.6	14.4	16.4	26.6	23.5	2.9	5.1
Eastern Europe and Former Soviet Union Countries (1986-1992)	35.3	9.4	25.6	42.3	34.8	6.5	9.3	2.8	0.3	13.1
Viet Nam (1992)	17.2	1.0	16.2[b]	48.3	27.0[c]	21.3[c]	14.5	—	—	20.0
(1996)	25.7	2.0	23.7[b]	34.3	24.8[c]	9.5[c]	28.9	—	—	11.1

[a]Data for groups of countries are unweighted averages.
[b]Includes profit tax and tax on joint ventures.
[c]Includes sales tax, turnover tax, VAT and for Viet Nam, special consumption tax.
[d]Includes excise duties, and for Viet Nam, natural resource tax, agricultural tax, and slaughter tax.
Sources: Shome (1995) and Ministry of Finance, Government of Viet Nam.

Fortunately, the rising dependence on trade taxes has been compensated by the declining share of revenue from a variety of distortionary production taxes such as the natural resource tax, agricultural tax, etc. (Table 2, col. 6)[1]. Viet Nam's dependence on production taxes is now lower than in other developing countries of Asia, Africa, and Latin America, and comparable to their shares in the Middle Eastern and OECD countries.

The share of consumption taxes has not changed much, but it is quite high at about a quarter of total tax revenue. This share is higher only in the former command economies of Eastern Europe and the Soviet Union. It must be regarded as a positive feature of Viet Nam's tax structure since consumption taxes are not as distorting as production and trade taxes. The same is true of the high share of profit taxes, plus a new joint venture tax since 1993 (presumably the counterpart of profit tax for joint ventures in Viet Nam). Both these shared features of transitional economies are attributable to the central role of profit taxes and turnover taxes in the erstwhile command economies.

The high and rising share of the profit tax (plus joint venture tax) would normally be seen as a positive feature of Viet Nam's tax structure since these are, in principle, taxes on income and therefore the least distortionary. However, most of these revenues flow from state-owned enterprises (SOEs), which do not yet follow standard international accounting practices in the calculation of profits. Under hard budget constraints and competitive market conditions, a number of the enterprises might turn out to be nonviable. Hence, excessive dependence on a relatively small number of SOEs remains a major source of fiscal fragility in Viet Nam, though the total share of SOEs in revenues from all taxes has declined from over 63 percent in 1992 to about 47 percent in 1996. Hopefully that share will decline further while revenue from the recently imposed corporate tax and personal income tax will rise. At present personal income tax accounts for only 2 percent of total tax revenue.

In addition to revenue mobilization, tax structure, and individual taxes, the development of tax administration is also an important component of tax reforms. The government has taken a number of initiatives to re-engineer Viet Nam's tax administration for a market-based tax system. These range from pilot self-assessment schemes, to taxpayer registration, to computerization. The IMF and a number of other bilateral or multi-lateral donors are actively assisting the government in this task. However, the present period is a gestation period since capacity building and institutional reform both take time. In particular, implementation of the recently legislated VAT will take a great deal of detailed preparation as was pointed out in Section III earlier. And this is one of the most important components of the tax reform program. Hence, it might take another couple of years of sustained effort before we begin to see the results.

Finally, we return to the question of fiscal decentralization. It was mentioned earlier that fiscal decentralization leads to improved efficiency in the use of public resources because of information economies, greater accountability, and responsiveness to local residents and interjurisdictional competition to attract investments and businesses. However, the risk of greater interregional disparities, tax exportation, and other adverse effects require that fiscal devolution be combined with improved federal regulation and coordination. This delicate balancing act calls for transparent and unambiguous assignment of both spending and taxation responsibilities to different levels of government. Viet Nam took a major step in this direction with the enactment of the new Budget Law in early 1996. However, recent reviews by Bird et al. (1995) and McLure and Martinez (1996) indicate that the present structure of intergovernmental fiscal relations does not measure up well to rational criteria for fiscal devolution.

Particularly with regard to the assignment of revenues, the position is as follows. Revenues from trade taxes and excise duties are assigned to the central government along with profit receipts from enterprises with nationwide operations, revenues from oil industry (including income tax from oil firm employees), returns on capital investment, and a number of other nontax revenue receipts. Receipts from the turnover tax, income tax, natural resource tax, and land revenue are shared between the central government and provincial governments. The provincial governments receive revenues from the housing tax, license tax, registration tax, and various fees and charges for properties owned or services provided by provincial authorities. The district and commune governments receive revenues from properties owned or services provided at the district and commune level. Revenues from the agricultural land use tax, and the tax on use or transfer of land use rights are shared between the provincial and commune-level government. Finally, there are subventions from the central government to some provinces and from the provinces to some districts. Further details of this structure of tax assignment is provided in the Appendix. Changes in the assignments in recent years are shown in Table 3.

There are a number of features of the system of tax assignment that can impair the tax effort and lead to other negative consequences. First, there is a system of dual control

TABLE 3
Tax Assignment in Viet Nam

	1990	1992	1994	1995	1996	Budget Law
Turnover tax	R	R	R	R	R	R:C/P
Excises	C	C	C	C	C	C
Profits tax[a]	R	S	**	R[1]	R[1]	R:C/P
Individual, income tax[b]	*	*	*	S[2]	R[2]	R:C/P[2]
Foreign trade taxes[c]	S[3]	**	**	R	C	C
Land use rights						
Grant	*	*	50S/50C	30S/70C	S	
Transfer	*	*	C	50S/50C	S	R:P/Com
Agriculture tax	R	R				R:P/Com

Key: C - central, S - subnational, P - provincial, Com - commune, R - regulating (shared)
* No information.
** No information, presumably as before.
[a]Profits tax on nationwide enterprise taxed as a unit accrue to the Central Government.
[b]Individual income tax of individuals employed in the oil and gas sector accrues to the Central Government.
[c]Only taxes on minor amounts of foreign trade may have accrued to subnational governments.
Source: McLure and Martinez (1996).

where provincial offices of the General Tax Department (GTD) report to their headquarters as well as local authorities. There is also a prevailing practice of setting up rates and targets by negotiation for shared taxes like the turnover tax or profit tax. These two features lead to lack of transparency, poor incentives for tax effort at the provincial level, and disadvantages for the poorer or politically weaker provinces.

Provincial authorities and local GTD officials have the incentive to overstate revenue needs, while understating revenue potential. Setting low revenue targets will then enable the concerned jurisdiction to retain a large part of the excess collection and also argue the case for larger subventions. The system also encourages tax exportation for the turnover tax since receipts are assigned where the turnover originates. Ideally, the rates should be set uniformly for all provinces at arms-length by the federal tax authorities, while allowing the provinces to levy surcharges, within limits, to meet provincial revenue requirements.

Trade and excise tax receipts have appropriately been assigned to the Central Government. Otherwise it could lead to a high incidence of tax exportation through high rates being set at the originating province for production or importation. The new value-added tax should also be assigned to the central government for similar reasons. Otherwise there could be serious problems of tax exportations and interjurisdictional coordination. Direct taxes like the personal income tax or the profit tax are appropriate candidates for tax sharing. However the main constraint here is the lack of standard international accounting practices and a proper system of returns filing and assessment. This leaves much room for incorrect tax assessment and assignment between different levels of government.

V. Conclusion: The Road Ahead in Tax Reforms

Comparing the structure and system of taxation in Viet Nam at the present stage of reform with the framework developed earlier on the basis of taxation theory and international tax reform experiences, the achievements of tax reform in Viet Nam have been mixed. The rise in the revenue share of taxes on consumption and income are to be welcomed. These are less distorting than production taxes, which have declining shares in tax revenue. However, these gains are offset by the sharp increase in the share of trade taxes, which are also highly distortionary. Moreover, the share of personal income tax has remained marginal, the rise in the share of income taxes coming entirely from the rise in revenues from the profit tax, mostly collected from SOEs, and the joint venture tax. This makes the direct tax base fragile since it is not clear how many of these enterprises would survive under hard budget constraints in a competitive market environment.

The development of a sound system of tax administration and cadre of tax officials suited to a modern market economy is an urgent necessity since efficient revenue performance, and hence macroeconomic performance, rests on the base of tax administration. The government has taken a number of initiatives in this matter with strong donor support. However, it will take some time before this capacity building effort begins to bear fruit.

Finally, fiscal decentralization is critical for establishing an efficient tax system. The new Budget Law of 1996 made a major advance in this direction. However, a review of the existing system reveals a lack of transparency, a large element of discretion and negotiation in the setting of tax rates and targets for shared taxes, and inappropriate tax assignment, all of which adversely effect the tax effort and increase the inefficiency of the tax system. These are some of the issues that have to be seriously addressed during the next phase of tax reforms.

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Appendix:

Revenue Assignment by Levels of Government

All revenues from certain taxes (and other sources) are assigned entirely to a particular unit of government (central, provincial, district, or commune). By comparison, revenues from various other sources ("shared" or "regulating" taxes) are shared between two levels of government. The following lists the assignment of revenues contained in the Law on State Budget adopted in April 1996.

Revenue of the Central Government

The Central Government receives all revenues from the following taxes and other sources:

- Revenues from exploiting and processing oil (including income tax from workers of oil firms)
- Profit tax from business accounted as a single unit*
- Export and import duties
- Excise tax
- Revenues from utilization of budget capital
- Transport fees
- Dividends from state shares in joint ventures
- Incomes from selling and renting state properties managed by central government authority
- State capital returns from state-owned enterprises (depreciation and fees for the use of capital)
- Income from selling goods and services and administrative receipts from organizations under management of central government authority
- Taxes, fees, and charges paid to the central budget (such as fees from registration of natural resources exploitation; charges from airport use; charges for using air space of the territory)
- Returns from state loans (both principal and interest)
- Withdrawals from the state reserve fund
- Grants to the government from foreign governments, nongovernment organizations, and foreign individuals
- Borrowings of the government
- Revenues from state economic activities that the government determines shall be paid into the central budget, such as after-tax profits or income of state-owned enterprises; income from selling and renting properties managed and utilized by the state; capital returns from state-owned enterprises, capital returned from development support funds
- Other nontax revenues as stipulated
- Revenue from the accrued balance of the central budget

Revenues Shared between Central and Provincial Governments

The following are shared between central and provincial governments:

- Turnover tax
- Profit tax or income tax of businesses (excluding tax on profits of businesses that must be accounted as a unit)
- Personal income tax (excluding tax on employees of oil firms)
- Natural resource tax
- Revenues from renting land

*These are nationwide activities in which the profits cannot legitimately be assigned to only one province, such as the post, telecommunications, and electricity enterprises. The economic distinction is not totally clear between these enterprises, for which profits must be accounted as a unit, and others operating in more than one province, where profits are assigned to the province where the enterprise is registered.

Revenue of Provincial Government

In addition to revenues from these shared taxes, provincial governments receive all revenues from these sources:

- Revenues from lotteries
- Housing tax
- License tax (except for license tax imposed on small businesses in communes)
- Registration tax
- Other fees and charges determined by the government to be paid to provincial budgets
- Income from selling and renting state properties given to provinces to be managed and utilized
- Income from selling goods and services and administrative receipts of units under management of provinces
- Voluntary contributions for provinces
- Grants from organizations and foreign individuals sent directly to provinces
- Other revenues as stipulated
- Revenue from accrued balance of provincial budget

Subventions from the Central Government

Some provinces also receive subventions from the Central Government.

Revenue Sources of District Governments

District governments receive all revenues from these sources:

- Fees and charges from activities implemented and managed by organizations at district levels
- Income from selling and renting state properties given to districts to be managed and utilized
- Income from selling goods and administrative receipts from units managed by districts
- Voluntary contributions for districts
- Supplementary allocations from provincial budget
- Other revenues as stipulated
- Revenue from accrued balance of district budget

Besides the revenue items mentioned above, cities and towns having the status of districts (provincial-dependent cities and towns) are assigned part of tax on issue or transfer of land use rights and supplementary revenue from urban activities, as allowed by the government.

Subventions from Provinces

Some districts also receive subventions from provinces.

Revenues of Communes

- License tax from small business
- Slaughter tax
- Fees from activities of units under management of communes
- Revenue from selling and renting state properties that are managed and utilized by communes
- Money collected from using public assets and land for public benefit
- Revenue from selling goods and services and administrative receipts under the management of communes
- Voluntary contributions for communes
- Aid from organizations and foreign individuals sent directly to communes
- Other revenues stipulated

Revenues Shared between Province and Commune Governments

Revenues from the following sources are shared between provincial and commune budgets.

- Tax on using agricultural land
- Tax on transfer of land use right
- Receipts from issue of land use right
- Land and housing tax