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A Model of Municipal Budget for Big Cities in Vietnam

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The WB (2004) remarked that the infrastructure in big cities in Vietnam was poor and affected badly the quality of life and sustainable development. Proactive growth of big cities as economic dynamics poses challenges to municipal governments in controlling the economic growth, pollution, technological replacement, and diversification of production, etc. These problems constitute high pressure on improvement and enhancement of quality of public services, which requires bigger municipal expenditure. Increases in the municipal expenditure, in their turn, require reforms in mechanism for defining sources of income of the municipal budget. The municipal government needs greater autonomy in making and controlling budgetary plan in order to make optimal use of resources and improve social benefits. At present, the municipal government and budget in their correct senses haven't come into being and only a budgetary level for cities responsible to the central or provincial governments. There is no dif-

ference in management and delegation of rights and duties between municipal and rural governments. It's about time Vietnam built municipal governments, especially for big cities, and municipal budget in order to cope with urban development and improve the quality of life in cities.

I. AN OVERVIEW OF MUNICIPAL GOVERNMENT AND BUDGET

Accessing the municipal finance or budget, all economists start with basic characteristics of municipal government and governance. Regarding from the aspect of delegation of administrative duties, municipal government is a kind of local government. The municipal government is a level of government in the system of national administration, assigned by law certain rights and duties to employ existing resources to provide urban residents with public services. Municipal governance is different from rural governance. With diverse changes in its socioeconomic life, the municipal governance requires consideration of

different relations between relevant parties, especially between the municipal government and residents. A good municipal government, as Anwar Shah put it, not only provides a series of public services but also ensures the living and rights for urban residents, creates a democratic environment, supports the market, develops the city in a sustainable manner, and provides conditions for outputs with a view to enhancing the quality of life for residents in the city and neighboring rural areas. From this aspect, we can see that the municipal governance has its own characteristics: (i) Municipal governance must be based on a consistent development plan; (ii) Municipal governance must be in a decentralizing framework (the municipal government is assigned more rights to determine policies and supply public services); (iii) Municipal governance must be based on a law system and instruments with priorities, technological advances, and knowledge-based economy. The characteristics burden the municipal government with all assigned functions. Many theories point out rationality of the process of making decisions on public policies in an effort to enhance the active role of the municipal government based on: efficiency, responsibility, controllability and autonomy, such as:

- Foot voting model (Tiebout, 1956): Individuals take tax rates and public services into consideration when deciding where they live. Thus, the foot voting reflects appraisal by community of ability of local government and size of market for public services.

- Stigler's model (1957): the representative government works better the closer the government is to its constituency.

- Regional decentralization (Oates, 1972): Each public service should be supplied by a level of government who controls some minimum region where benefit and cost can be localized.

Theories of municipal governance have their own scientific values because they all establish a framework for improving efficiency of the municipal government. The framework, according to many authors such as Baiey (1999), and Dollery and Willis (2001), comprises right actions (supplying public services appropriate to citizens' demand), non-autocracy (acting in the best way with the lowest cost and highest

standard), and responsibility (acting according to the approach based on public interests). The role of the municipal government in such a combination contrasts to the traditional one (Groos, 2001).

To fulfill specific tasks of the municipal governance, the precondition is that the municipal government should have enough resources beside the human one. This issue highlights the role of municipal budget in the local fiscal policy. The municipal governance and budget control are closely interrelated: when this one is lacking the other can't operate effectively. Principal relations lie in structure and delegation of rights to subordinate authorities: determining the need for public services and functional responsibility taken by these authorities. Functional responsibility and size of the region determine volume of expenditure. It also constitutes a basis for effective distribution of revenues, including the fiscal transfer. With characteristics of size and population density, and socioeconomic ununiformity of urban residents, cities attract neighboring communities to consumption of public services, therefore the municipal budget must be different from budget of rural districts in the following aspects: (i) Fiscal size and power of the municipal budget are bigger than that of the rural budget; (ii) Municipal government enjoys greater autonomy than rural ones; (iii) Supply of public services in big cities is more abundant and complicated; (iv) Municipal government is assigned more rights to decisions on budget revenues; (v) Budget control must ensure transparency, responsibility and efficiency.

II. BUDGET CONTROL IN HCMC

This section analyses the municipal budget in Vietnam and the convenient sample is HCMC because it really is a big city and assigned special statute. Moreover, it government is building a plan on municipal government. Thus, the HCMC budget control may reflect the control over municipal budget in Vietnam today.

1. Concept of municipal government in Vietnam:

City as an administrative unit has been established but the true municipal government hasn't come into being. In the existing system of law, the

city is perceived as a local unit of administrative machinery. The Law of Organization of People's Council and Committee 1994 only provides details of rights and duties of each level of government and local governments simply comprising three levels with similar rights and duties for each level, that is, the municipal government is not different from the rural one of the same level. Laws don't mention the concept of municipal government, there is therefore no separate legal mechanism for the municipal governments.

The concept of municipal government has just been mentioned recently when the HCMC government started building a plan on the municipal government in 2006. Urban and rural administrative units have different characteristics. So it's unreasonable to design the same administrative machinery for both urban and rural areas because it prevents the city from develop up to its assigned purposes and potentials. In the municipal governance, all levels of authorities of cities have to deal with such difficulties as unruly construction, water supply and sewerage, shortage of greenery, slums, traffic jam, overloaded grid, pollution, unemployment, poverty, social evils, and increases in population, etc.

This situation comes from the following causes: (i) The system of laws is not perfect enough to control the market economy, which produces dishonest practices; (ii) Laws relating to urban management are lacking, inconsistent and less strict; (iii) Infrastructure in most cities is very poor and badly damaged; (iv) Municipal governance and organization are not rational; (v) Town and urbanization planning is carried out too slowly and inconsistently; and (vi) Management of rural and urban areas is not discriminated.

In such a situation, the municipal governance requires a centralization approach in which all officials from municipal managers to civil servants of all levels should master characteristics of big city in order to work out appropriate and effective policies and practices, otherwise the municipal governance can be done according to a short-term strategy or some small-scale viewpoint.

2. HCMC budget control:

Basically, big cities in Vietnam still operate according to principles set by the National Budget Law and its bulk of subordinate legislation. This means that the HCMC budget control is still modified by the National Budget Law and there is no difference in this control between municipal and rural authorities of the same level.

a. Budget income:

As allowed by the National Budget Law, the HCMC budget income comes from three sources: (i) 100% controlled revenue; (ii) revenues shared with budget of the central government and subordinate levels of authorities; and (iii) revenues contributed by the public. Distribution of sources of revenues to the municipal government is not equal to its assigned expenditures. The HCMC budget relies too much on the budget policy of the central government. According to theories of delegation and municipal governance, the supply of public services by HCMC government doesn't meet the social demand, which is shown in the following facts:

- Local budget income: Total tax take in HCMC (comprising inland revenues and export-import duties) usually accounts for some 30% of the national tax take. According to regulations, the local budget income comprises:

+ 100% controlled revenue: This source is divided into two categories by the National Budget Law: 100% controlled revenue and shared revenue (regular income). In the past few years, this source of revenue was not stable. The 100% controlled revenue covered some 30% of the budget expenditure (2006), and the HCMC expenditure had to depend on shared revenue and other sources. From 2004 till now, the 100% controlled revenue reduced drastically. This means that the HCMC budget income depend a lot on negotiation with the central government on the share revenue and transferring/supporting revenue.

In the structure of the 100% controlled revenue, the best part comes from sale of state-owned houses and taxes on transfer of land use right, which covers 51% of the regular expenditure. It's worth noting that this income is not stable in future when this resource "exhausts." Similarly, income from registration fees and license tax covers 17.1% of the budget expenditure; and some

80% of this income is from the real estate registration fee, which will reduce over time. Thus, some two-third of the 100% controlled revenue for the HCMC budget income is related to real estate. Fees and charges relating to transport means will become potentials for increases in the budget income. At present, fees and charges on transport means and parking fees represent only a small proportion of the budget income.

+ Shared revenue: In the years 1996-99, over 80% of the HCMC budget income was sent to the central budget, and the HCMC government controlled only 18% (1998). In 2000-06, however, the HCMC government was allowed to retain 36% or 37% of the total income. Facing unsolved problems with the infrastructure, the central government increased the share of the HCMC government from 15.5% in 1996 to 29% in 2004-06. In the period from 2007 – 2010, however, the central government decides to reduce this percentage from 29% to 26% because of national budget deficit, which makes it much difficult for the HCMC government to improve the quality of public services and social benefits.

This cut forces the HCMC government to try its best to attract foreign and domestic investment needed for development projects and it is allowed a special fiscal mechanism: If the income is higher than the planned target, the HCMC government can retain 30% but it must not exceed the extra income compared with the sum realized in the previous year. The central government agrees to save 70% of the remainder 70% of the extra income for HCMC development projects. Thus, the HCMC budget gets 79% (30% of the extra income at its disposal and 39% for planned expenditures). The HCMC government has the full right to use proceeds of land auction for development projects and mobilize necessary funds through BOT and BT contracts when allowed by authorized bodies. Considering the need for development of the infrastructure, the central government could allow the HCMC government to raise fund by issuing municipal bonds but their total value must not be higher than the total public investment for the year.

b. Budget expenditure:

At present, the HCMC is allowed to cover expenditures needed for implementation of tasks

of an administrative unit, and perform functions of a municipal government. The National Budget Law allows the same expenditures for the HCMC government as any local government of the same level. This means that allocation of expenditures to the HCMC budget is not based on characteristic of a big city. In other words, the expenditures in the HCMC budget are not different from the ones in any provincial budget. Expenditures specific to big cities are not reflected in the structure of expenditures. Municipal expenditures and obligations are separate, as shown in the following facts:

HCMC budget expenditure accounts for 28.3% of its total income and 8.6% of total expenditure from the central budget, while the HCMC budget income accounts for 30% of the central budget income. According to classification of expenditures by the National Budget Law, HCMC budget expenditure comprises investment and regular expenditure. Because the infrastructure is the foundation of HCMC economic development, the HCMC government has tried to mobilize possible resources to invest in infrastructure projects in recent years. At present, the infrastructure in certain areas in HCMC is good enough to build a centralized financial- economic center. As for investment, expenditure on transportation consumed the biggest share (43%) in 2006 followed by public services (19%) and education (7%). As for regular expenditure, over 50% was spent on education and health care services. It's worth noting that expenditure on health care has reduced recently while the one on the administrative machinery has risen, from 8.5% in 2001 to 14% in 2006.

c. Other sources of investment beside the HCMC budget:

Some 80% of public investment in development projects in HCMC comes from non-budget sources. This shows the importance of the infrastructure: Good governance creates a favorable environment for private investment in the infrastructure projects (roads, electricity, and telecommunications, etc.). Many forms of cooperation between the public and private sectors have come into being and operated well. Many main roads have been built according to BOT and BT contracts; or infrastructure-for-land contracts.

3. Estimate of municipal budget control in Vietnam

The municipal budget control in Vietnam is just in a pilot scheme and it is still included in the local fiscal policy. Share in existing sources of income and 100% controlled revenue assigned to the HCMC government are still very small and don't match the potentials for new revenues in HCMC. This mechanism limits the autonomy of the HCMC budget. Expenditures assigned to the HCMC government, and the Hà Nội one as well, are numerous and it can't cover all of these expenditures because of lack of autonomy in control over municipal budget income. One of consequences of this situation is the fact that investment projects financed by the central government are widespread in HCMC and sometimes they are found in fields that could be realized by the HCMC budget. This affects greatly the urban development strategy.

There is no difference between HCMC and provincial governments because both of them have to depend on financial support from the central government. HCMC, as one of two big cities provided with a special statute, applied the new statute for one year and only realized some 50% of tasks assigned. The HCMC government has to admit that the main cause is the fact that district governments are reluctant to change their way of management and look for and suggest measures to deal with obstacles to local governments instead of relying on "cooperation" from the central government. The budget control and municipal governance are not linked with evaluation of efficiency of costs of outputs and results of policies over time. This leads to the fact that the government is not loyal to public interests and acts irresponsibly and improperly.

These limitations lead to the need to perfect the municipal financial policy in terms of concept and action in order to develop the city in a sustainable manner and produce positive effects on economic development of other provinces and the whole region.

III. A MODEL OF MUNICIPAL BUDGET FOR BIG CITIES

1. Bases for the model

With an objective of developing into an indus-

trial country by 2020, the socioeconomic development strategy up to 2020 stresses on the role as administrative, economic and cultural centers of big cities. They must pioneer in industrialization, modernization and development of knowledge-based economy and act as levers for a region and the whole country as well. To achieve this aim, big cities must be provided with suitable mechanism for their public finance and the model of municipal budget control must be based on moder urban governance. Because Vietnamese cities have to play the role of economic and financial centers, full attention must be paid to interrelations of three parties of the urban development: the public, municipal government and organizations (the main factor of the urban economy). Interactions of the three parties allow the big cities to ensure: (i) high quality of life – what the public are most interested in; (ii) good business climate where market access and high-quality services are available – what the organizations are interested in; and (iii) good governance with resources and political support needed for more improvements in the quality of life and supply of better services – what the municipal government pays full attention to.

For this reason, full attention must be paid to increases in the need for public service. In beefing up advantages of the city, the important factor is to improve the state control and policies on the infrastructure and public services that aim at creating a good business climate for organizations. In the trend of globalization, big cities as locations with well-defined borders also integrate into the world. For example, flows of direct investment are determined by companies situated in cities and flows of laborers and goods also come to and go out of big cities. A big city in the globalization, therefore, benefits from its local characteristics. Besides economic issues, social ones of a city should also be handled properly. Improving the living standard of a city is related to many problems: unemployment, accommodation for low-income earners, and migration of laborers from rural areas to informal and uncontrollable sectors in the city, etc. These problems, along with common challenges to all big cities in their development in a changeable period, require new ways of management of city

needed for a sustainable development.

Size, scope, position and upward tendency of municipal expenditure affect directly changes in the municipal budget control. At the same time, demand for expenditures and sources of finance require changes in the design of fiscal transfer and regulations on access to sources of credit. At present, the municipal budget control is facing the following difficulties:

- The fiscal demand of big cities is hard to calculate exactly: It's difficult to calculate exactly the size and speed of urbanization in Vietnam because it is based only on the household registration system. Legal standards of town planning are set at higher levels in foreign countries, and in the model of urbanization in the past two decades, rural areas after industrialization were added to big cities as suburbs or as near extension of urban areas. It's easy to see that both central and municipal governments admit that difference between actual urban increase and nominal urban increase is from two reasons: lack of social welfare with its full functions in rural areas; and different standards of education and health care services. This means that they allow a big number of households registered in rural areas to be added to the official urban system. This leads to more burdens on the municipal expenditure and the city has to cover extra expenditures caused unexpectedly by unemployed residents because of economic recession.

Moreover, big cities absorb neighboring areas beyond their administrative borders. Changes in their borders also increase expenditures on public services while farming land contracts and is turned into industrial parks or sites of housing development. To deal with changes in urban borders, municipal governments in Vietnam are facing difficult tasks, such as reducing inequality; improving their financial capacity; and inefficiency in supply of public services.

- Size of public investment in the supply of public services in cities is limited: If cities supply enough public services to their residents, they should increase remarkably the capital and regular expenditures in order to ensure a series of social services and infrastructure. Present investment in public-financed projects is not enough. Most projects are designed and realized

at a scale that is smaller than actual demand. Result of this situation is either standard of public services may be lower if all residents are supplied as they require or part of residents can't get access to public services.

The above-mentioned changes imply that the task of building a model of municipal budget must focus on three strategies:

- Rationalizing the municipal expenditures in order to optimize burdens of spending; and improve efficiency of the supply of public service and efficiency of investment.

- Increasing stable sources of revenues in order to maximize resources for cities and defining clearly shares transferred to municipal governments.

- Creating conditions favorable for the cities to get access to sources of credits needed for reaffirming the municipal credit policies, making instrument of municipal credit into laws, and beefing up the legal infrastructure of municipal credit market.

2. Model of municipal budget in big cities

a. Delegation of expenditures to municipal governments:

Big size and diversity of urban society of big cities as centers attracting economic forces force municipal governments to supply more public services than their rural counterparts. Classification of expenditures introduced by the National Budget Law 2002 fails to reflect functions assigned to municipal governments. In Our opinion, expenditures from the municipal budget should focus on infrastructure, transportation, communications, high-quality human resource, cultural facilities, electricity, effluent treatment, trash collection; police and SWAT forces, fire prevention, housing and health care, etc. High demand for such public services forces municipal governments to design a reasonable policy on public expenditure. In big cities that house a lot of companies, more investments must be put in infrastructure, human resource, communications and telecommunications. Cities have also to supply public services needed for improvements in the quality of life, which can help attract the human resource from other localities. Expenditures on cultural facilities, communications, power and water supply, protection for the

environment, etc., therefore, should be increased. High degrees of specific needs in big cities also require more expenditures on social services, housing conditions, health care and reduction of poverty. High population density also means that the police force, along with its fire department, must be bigger.

To optimize the burden of expenditure, functional responsibility of the municipal government must be redefined along with new burdens caused by the urbanization and market reforms.

- Reform in municipal administrative governance: The most basic decision relating to municipal governance and budget control is on barriers that prevents residents from accessing public services. Demand for labor in big cities and industrial estates is very high and administrative barriers include transfer of pension and right to education between districts, and they could hinder labor mobility. Removal of the household registration system may stimulate flows of migrant workers to big cities and increase the demand for public services. However, the flow of peasants to big cities may be limited because (i) price of land and cost of living are high; and (ii) accommodation for low-income earners in cities is costly when the supply of rooms and houses for rent at reasonable prices is limited. Generally, migration of rural residents to big cities doesn't take place at a big scale; and the stimulus to urbanization is the fast increase in residents in suburbs and neighboring rural provinces who get jobs in inner cities.

- Diversifying suppliers of public services: Foreign experience shows that the municipal government alone, or with cooperation from the central government, could not supply enough public services to residents and develop the infrastructure as expected. If the government can satisfy the demand at a high rate, its effort is not certainly economically effective. That is why participation of the private sector becomes necessary. Municipal government had better adopt policies to encourage the private sector to supply public services if possible. By analyzing cost-effectiveness, the government can decide what services can be assigned to private suppliers. The private sector can supply a lot of

public services at lower costs. The most common way to attract private suppliers is to open competitive bidding for construction of apartment houses or sewerage or sewage works; supply of transport, legal advisory services, etc. Moreover, the public and private sectors can cooperate in supplying such services, or carrying out projects under BT, BOT, and BTO contracts in order to attract the private sector to infrastructure projects.

- Enhancing efficiency of the supply of public services: Output result becomes a criterion for evaluating efficiency of the supply of public services. With increasing demand for urban services, establishing a controlling framework and considering the output result of the control over public expenditure can help enhance the efficiency of public expenditure. Controlling the output result is considered as an instrument for (i) concentrating public resources on fields that bring about the highest benefit for society; (ii) improving public policies by evaluating actual results; and (iii) beefing up efficiency of management by making priorities and purposes transparent.

b. Establishing sustainable sources of revenue for the municipal government:

- Maximizing locally-controlled sources of revenue (100% controlled revenue): City-controlled sources of revenue are the ones at disposal of the municipal government. Determining such sources of revenue is linked with defining the task of supplying urban services: (i) ensuring the supply of public services by local governments regardless of changes in policy on fiscal transfer by superior levels; (ii) ensuring the highest responsibility for quantity and quality of public goods supplied to localities; (iii) ensuring the highest efficiency of the supply of goods and services based on comparison between cost and benefits; and (iv) improving responsibility for financial decision making process of the municipal government.

These locally-controlled sources of revenue may increase or decrease over time because (i) proceeds from sale of state-owned houses or taxes on transfer of the land use right are not stable due to fluctuations in the realty market; (ii) revenues from fines, unrefunded aid, and contributions from individuals and organizations are not stable;

(iii) capital mobilized from various sources and loans may increase but they require presence of many factors; fees and charges are considerable sources of revenue but they contain some unreasonable regulations. Due to characteristics of urban economy, many sources of revenue could be developed but they haven't been fully tapped up till now. To expand sources of revenue, the municipal government should:

- + Re-dividing existing fees between local and central governments in a manner that reflects the role of the municipal government (rates of fees must be based on ability to pay of payers.)

- + Certain specific fees could be introduced to big cities (this practice is common in many countries) and purposes of these fees are made clear beforehand, such as building roads or protecting the environment.

- + Unifying taxes and fees on land and building works and turning them into a tax on durable property.

In principle, fee is an instrument used by the government for supplying urban services effectively. Users know how much they pay for the services and tend to choose and evaluate the services. When paying a beneficiary fee for the service, the user usually give feedback to the government on what residents need. The beneficiary fee includes user fee, license fee, etc. Besides the user fee, big cities in Vietnam can apply a system of specific fees to raise fund needed for dealing with current problems, such as traffic congestion, pollution, road building, etc. Use of specific fees may enhance the urban management ability. The payers accept these fees easily because they know what purpose the fee is used for.

The municipal government has to introduce some other payables too, and they may be called special payables. If this can be applied the revenue will be important because it mobilizes for the local budget part of benefit the payers receive for effort to build the technical infrastructure of the city. When the infrastructure is improved or developed, value of real estate owned by families or organizations will be higher. This increase is the benefit gained by families and organizations but is simply comes from the public investment, so it's reasonable to share part of the increased value with the municipal budget. This revenue

can be used for projects (to build schools, sewerage or street lights) that bring about more benefits for owners of property.

- More autonomy in decisions on sources of revenue by municipal government: Sharing reasonably sources of revenue relating to financial capacity of each level of budget will affect favorably the activeness and dynamic of the municipal government in balancing the budget and supplying the public services. If sources of revenue originating from local economic growth are assigned to the municipal government, this mechanism may encourage local authorities to maintain and develop these sources of income. Vietnam is still in the group of countries where delegation of rights and duties is of the lowest level: governments of big cities have no right to make decisions on taxes. When the economy is in transition, it's necessary to recognize and determine ways to enhance the autonomy of the municipal government in allocation of budget income. Big cities can only balance their budget when municipal governments are allowed to change the rates of certain taxes or impose some taxes based on local conditions and benefits for residents, such as personal income tax, property tax and taxes on businesses carried out in the city. This practice is reasonable because local governments grasp financial ability and needs of tax payers so they can set tax rates appropriate to local conditions ■

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