TO DEVELOP THE MARKET FOR MUNICIPAL BONDS

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I. FINANCIAL DELEGATION IN VIETNAM

1. Financial delegation

Since 1990, the government has kept on reforming its financial policy, especially its budget control to cope the economic reform and industrialization. The 1997 National Budget Law is really a milestone in the reform in the mechanism for delegating financial decisions to local governments.

The National Budget Law determines what taxes, along with certain fees and charges, are collected by each level of government. Provincial governments are allowed to borrow from domestic sources and run supply services but all borrowings re to be controlled by the central government.

The financial delegation helps enhance the autonomy of local governments making them feel freer to work out the expenditure plans and more responsible and transparent in public finance management. According to WB experts, the Vietnamese financial delegation is of the decentralized system. From 1992 up till now, expenditures assigned to local governments rose from 26% to 43% of the total public expenditure.

However, the financial delegation during the industrialization period reveals many shortcomings that produce bad effects on the supply of public services by local governments:

- Local receipts including certain fees and charges usually exceed the planned targets while voluntary contributions from local residents fall short of expectations.

- Rights to generate new sources of receipt of local government are limited. All decisions on tax rates and categories are made by the central government.

- Limited receipts prevent local governments from adjusting their expenditure and way of distributing expenditures among economic items.

2. Debts by local governments

The legal infrastructure for local governments' borrowings has been developed in recent years:

- Article 8, section 3 of the National Budget Law says: "...in cases where provincial governments want to carry out infrastructure projects as allowed by law that are beyond reach of the provincial budget, they are allowed to mobilize local investments according to specific decision of the PM and must use the provincial budget income to repay debts."

- Circular 09 TC/NSNN by the Ministry of Finance providing guidelines on delegation, formation, implementation and settlement of budget income and expenditure says: "Provincial budgetary authority can mobilized local investments needed for infrastructure projects as allowed by the Article 8, section 3 of the National Budget Law. These investments couldn't exceed 30% of the annual provincial budget for capital investment."

- The Government allowed the formation of Fund for Development Investment in HCMC in June 1997 and in many other provinces (Đồng Nai, Bình Dương, Hải Phòng, Bình Định and Đồng Tháp) since then. However, these funds attract only limited resources (up to the end of 2000, legal capital of these funds in six above-mentioned provinces amounted to VND600 billion only). The best part of their capital came from budgetary income while investment from the private sector was very limited.

The cause of the situation is the lack of a long-term strategy to develop the market for municipal bonds. At present, the legal basis for the issue of municipal bonds is Decree 01/2000 dated Jan. 13, 2000. The Decree allows provincial governments to issue municipal bonds in order to (1) add more capital to the fund for development investment; and (2) invest in infrastructure projects that couldn't be financed by the national budget, state credits, ODA and FDI sources.

The procedures for issuing municipal bonds, however, are all decided by the central government. Provincial governments have to make borrowing plans and submit them to the central government for approval. When the plan is approved, the National Treasury and Ministry of Finance and SBV arrange an issue by tender on behalf of the provincial government, and then transfer the sum to the provincial government as a borrower. This mechanism leaves no role to the local government.

II. MEASURES TO DEVELOP THE MARKET FOR MUNICIPAL BONDS

1. Perfecting policies on financial delegation and provincial debts

Provincial could enjoy more autonomy in mobilizing capital for development projects. When setting limits on the provincial debts, local socioeconomic conditions and effects of investment projects must be taken into consideration. When the national economy is more open and investment in urbanization increases, it's necessary to give provincial governments more autonomy it their financial management.

Provincial governments need borrowings to complete their development projects on time but a legal framework for the provincial debts is much needed in order to prevent abuse of authority of all kinds.

The legal framework must suggest measures to facilitate and control borrowings by local governments, such as: standardized accounting principles, regular financial disclosure, regular inspections from the central government, clear statement of responsibility of the provincial government, etc. These measures, however, couldn't prevent "ethical risks" which take place when the central government supports local ones by providing them with guarantee against insolvency. This guarantee will soon encourage local governments to run into debt with the result that they become defaulters.

The measure to prevent financial insolvency is to set limit on provincial debts. The reasons behind this measure are:

- Firstly, possibility of abuse of authority will be high if there is no limit on the borrowings. If there is no inspection or a mechanism for issuing municipal bonds, provincial governments will develop a tendency to let their regular expenditure rise and exceed their ability to pay and use borrowings to cover their shortage.

- Secondly, limits on borrowings by provincial governments are necessary to obtain stability and sustainable development. What the central government must do is to introduce policies to ensure stable development, including the control over debts generated by either central or local governments.

2. Establishing necessary frameworks for the development of municipal bonds

a. Legal infrastructure:

- There must be regulations about issues of bonds, and municipal bonds in particular.

- There must be a mechanism for delegating more rights to provincial governments to issue municipal bonds. Under this mechanism, provincial governments are responsible for organizing the issue, deciding the quantity of bonds to issue, guaranteeing the issues of bonds for projects carried out by local companies, and ensuring efficiency of investment and financial solvency.

- A committee controlling bonds issued locally is also needed. The committee will act as an advisor for the provincial government on problems relating to the issue of bonds.

b. Instruments of the market for municipal bonds:

A wide range of bonds could be issued in order to provide the market with diverse commodities and help provincial governments improve their ability to mobilize dead money from the public. In current conditions in Vietnam, provincial governments, to get loans from the public, could issue discount bonds, optional bonds, installment bonds, continued bonds and escalator bonds. In addition, they could encourage subordinate bodies supplying public utility services to issue bonds to raise funds for infrastructure projects (for building apartment houses, hospital, water supply and sewer systems, sewage works, etc.) or guarantee the bonds issued.

c. Mechanism for issuing bonds:

Foreign experience shows that provincial government should make issue by tender instead of offering public issue in order to reduce cost and raise funds quicker. Generally, the issue by tender is applied to common money bonds while issue of projects bonds is based on agreements with underwriters.

d. Issue interest:

The issue interest must be based on the supply-demand relation and potential changes in the interest rates on the money and capital markets.

e. Municipal bond fund:

When the personal income is rather low and the public are still new to the stock market, the issue of bonds will meet with difficulties and be considered as risky, the municipal bond funds can make it less risky and help improve the profitability of investment. Moreover, these funds can help develop local market for bonds.

Generally, to organize a market for municipal bonds isn't a difficult task, the problem is how to make it helpful and active enough to play well its role in raising funds needed for development projects. To achieve this objective, the central government should adopt new and more open policies, especially ones to allow provincial government more autonomy in financial management as presented above.■