



# Asian Public Governance Forum on Local Finance

*Achieving Fiscal Sustainability of Local Governments*



**13-14 July 2016**

Oakwood Premier Incheon Hotel  
Incheon, Korea





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## WELCOME NOTE

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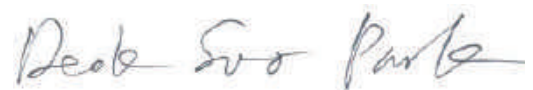
It is my great pleasure to welcome you to the Asian Public Governance (APG) Forum on Local Finance: Achieving Fiscal Sustainability of Local Governments, co-organized by OECD Korea Policy Centre and Incheon Metropolitan City, Korea.

Since its establishment in 2005, the Public Governance Programme of the Centre has been striving to disseminate relevant policy experiences of OECD countries to the Asia-Pacific region. Pursuing this mission, the Programme has hosted numerous international meetings and seminars as well as capacity building programs for more than 1600 public officials and experts from over 30 countries. Our work and contribution to improving public governance for the past 10 years have been well received, and the Programme will continue to strive to act as a regional hub in creating opportunities to strengthen cross-border networks.



In line with our endeavor, the Forum will follow up on its successful launch last year in Lombok, Indonesia. This year's forum aims to provide a valuable opportunity to highlight recent relevant researches on local finance as well as shared experiences from economies with sound fiscal management across levels of government to those who are seeking to achieve fiscal consolidation while tackling political resistance to reforming intergovernmental fiscal relations.

I'd like to express my sincere gratitude for taking part of the forum. I sincerely hope that you'd feel comfortable to contribute your thoughts and exchange new ideas and initiatives. I encourage you to actively participate in all the dialogues and discussions and take numerous benefits back with you. May you find the occasion informative, thought-provoking and act as a catalyst in spurring dialogues for strong collaborations in the future.



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**Park, Deok Soo**  
Director General  
Public Governance Programme  
OECD Korea Policy Centre

## SPONSORSHIP

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The Public Governance Programme (PGP) of OECD Korea Policy Centre, in collaboration with the Incheon Metropolitan City of Korea, is organizing the Asian Public Governance (APG) Forum on Local Finance: Achieving Fiscal Sustainability of Local Governments, which will be held in Incheon, Korea on 13-14 July 2016.

## OBJECTIVES

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The meeting brings together practitioners, policy makers and researchers with expertise in the field of local finance and enable in-depth discussions in a closer setting; serving as a platform for opportunity to strengthen cross-border networks among the experts and public officials.

The objective of the event is to provide an open and participatory platform for the Asia-Pacific countries to stimulate discussions on recent developments and reforms in fiscal relations across levels of government in the region for economic growth. More specifically, participants will be able to (a) exchange experiences and discuss public governance issues of local financial autonomy in their respective countries for mutual learning among policy makers, (b) deepen understanding of current efforts in local finance management, and (c) develop and strengthen areas for collaboration.

## BACKGROUND

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In the aftermath of the global financial crisis, local governments become even more important in bringing about an inclusive, well-balanced and sustainable development. The budgetary constraints at the central level has trickled down to local/sub-national level, where local governments are increasingly finding themselves with smaller grants. This has called for anew interest in checks and balances for soundness of sub-national budgeting while further increased the acknowledgement of the relationship between good governance and sound local finance management.

Recognizing efficient and effective fiscal relations across levels of government are key ingredients for sound fiscal management, the PGP has launched APG Forum on Local Finance to be held on a regular basis for in-depth policy discussions to deepen understanding of local financial autonomy challenges and opportunities, issues and practices, experiences and lessons learned in achieving economic development through sound fiscal management.

The Forum will follow up on its successful launch last year in Lombok, Indonesia, where it provided a platform to present relevant experiences from different countries and discuss current efforts in enhancing the management of local finance for efficient policy-making and service delivery. This year's forum aims to carry on the aforementioned objectives by promoting recent relevant researches on local finance in democratic local governance throughout the region, and facilitating interaction and exchange of experiences in achieving fiscal consolidation while tackling political resistance to reforming intergovernmental fiscal relations.

## EXPECTED RESULTS

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Taking advantage of the presentations and floor discussions, the meeting is expected to achieve the following outputs:

- Increased understanding of current status and trend of local finance in member and non-member countries in Asia and the Pacific and its development direction;
- Enhanced knowledge on local financial autonomy challenges and opportunities, issues and practices, explored experiences and lessons learned in achieving economic development through sound fiscal management;
- Suggestions and recommendations to PGP in the area of local finance to take into consideration for future activities

## PARTICIPANTS

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The APG Forum will bring together practitioners, policy makers and researchers with expertise in the field of local finance from member and non-member countries at the top decision-making levels or those who hold equivalent within national governments. Distinguished experts from various relevant organizations and associations will also take part in this event for in-depth discussions in a closer setting and strengthened cross-border network.

## MEETING STRUCTURE

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The APG Forum will be held for two days and will be articulated into speaker's presentations and study visits. In the opening session, a keynote address will be delivered on the topic of Economic Development and Local Decentralization. After the presentations by invited speakers, the participants are invited to contribute to the discussion drawn from their own country experience and questions to speakers.

For detailed session information, please refer to the Programme.

The official languages of the APG Forum will be English and Korean.

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- Mr. Deok Soo Park, Director General, Public Governance Programme, OECD Korea Policy Centre

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## Day 2 – Thursday, 14 July 2016

**09:30 Meet in the Hotel Lobby**

**10:00 – 15:20 Visits to Incheon’s Key Project Sites**

**10:00 – 10:30 Incheon Free Economic Zone**

Incheon Free Economic Zone (IFEZ) is the first free economic zone ever designated in Korea. The designation was made in Aug, 2003, and the construction of the IFEZ is scheduled to be completed by 2022. The zone is divided into three areas: Songdo, Yeongjong, and Cheongra. The Zone is as big as 123.8 km<sup>2</sup>, 1.4 times the size of Manhattan and 4.2 times Yeouido, Korea. When completed, the Zone will be capable of accommodating 536,000 people and 204,000 households.

**10:35 – 11:00 ifez U-City Operation Centre**

Ifez U-City Operation Centre systematically and comprehensively manages the ifez’s transportation, crime and disaster prevention, environment, and facilities management based on a ubiquitous system. The center takes advantage of IT technologies to receive public governance information from relevant institutions, thereby better responding to public governance matters and providing necessary information to citizens.

**11:10 – 11:50 Incheon Global Campus**

Incheon Global Campus is a national project established together by the Korean government and Incheon metropolitan city, aiming to innovate education system and nurture next generation of global leaders. The campus houses not one but ten global prestigious universities, including the State University of New York, the George Mason University Korea, Ghent University Global Campus, etc.

**12:20 – 13:20 Welcome Lunch / China Town**

Incheon's Chinatown is Korea's only official Chinatown. It claims to be the largest Chinatown in Korea, It is famous for the various Chinese cuisines and attractions, and is known to be the home of jajang-myeon, Koreans' favorite Chinese food.

**13:50 – 14:30 Incheon Transit Corporation**

The construction of Incheon subway line no. 2 was 98.23% complete as of March, 2016. When completed, the subway will connect 27 stations, running 29.2 km. The subway is expected to accommodate 260,115 passengers per day, with 3 minute interval during rush hours and 6 minute during normal hours. Currently 368 people under 6 teams are working for the construction of the subway. The subway is under test operation and expected to open on July 30, 2016.

**14:40 – 15:20 Incheon Asiad Main Stadium**

Completed in Feb. 2015, the Incheon Asiad Main Stadium is was the main venue of the 2014 Asian Games and 2014 Asian Para Incheon. The stadium is designed with a capacity of roughly 30,000 spectators and has a main stadium, a supplementary stadium and a cricket ground.

**16:00 Arrival to Hotel**

## SPEAKER PROFILES

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**Mr. Anwar Shah**

*Advisor to World Bank*

*International Consultant in Public Economics and Governance*

Anwar Shah (Ph.D. economics) is Senior Non-resident Fellow Brookings Institution, USA, Advisor/Consultant, World Bank and Director of the Centre for Public Economics, SWUFE, Wenjiang, Chengdu, China. He has previously served the World Bank, Asian Development Bank, Canadian Ministry of Finance, the Government of Alberta and the UN Intergovernmental Panel on Climate Change. He was responsible for federal fiscal transfers to provinces for health, education and equalization at the Ministry of Finance. With the Government of Alberta, he was responsible for provincial fiscal transfers to local governments. He has published more than two dozen books and numerous articles in leading journals. His recent books include *Fiscal Federalism* (with Robin Boadway), *The Practice of Fiscal Federalism: Comparative Perspectives*, *Intergovernmental Fiscal Transfers*, *Local Governance in Developing Countries* and *Performance Accountability and Combating Corruption* and *Fiscal Incentives for Investment and Innovation*.



**Mr. Cecep Effendi**

*Director General*

*Centre on Integrated Rural Development for Asia and the Pacific (CIRDAP)*

Cecep Effendi is an expert in South East Asia in the areas of good governance, decentralization and local governance. He is Director General of the Centre on Integrated Rural Development for Asia and the Pacific (CIRDAP), a regional intergovernmental organization which provides services in poverty alleviation, rural development and decentralization policies to its 15 member countries in the region. Prior to his engagement at CIRDAP, he served Ministry of Home Affairs of Indonesia as a Member of the Advisory Expert Team to the Minister, and to the Association of Provincial Government in dealing with the Ministry and the Parliament for the new decentralization bills (Local Government Bill, Direct Election Bill and Fiscal Balance Bill). He has Ph.D. in International Studies from Jawaharlal Nehru University, India.



**Mr. Ahn Young-Hoon**

*Senior Research Fellow, Local Administration Office*

*Korea Research Institute for Local Administration (KRILA)*

Young-hoon Ahn, Korean national and Senior Researcher Fellow in Korea Research Institute for Local Administration (KRILA) attached to the Ministry of Interior, has been working closely with the Presidential committee on Local Autonomy Development as one of experts since 2004. He participated in the National Risk Assessment Project of the OECD's High-Level Risk Forum on Disaster Management and Resilience Policy since 2012. He has taught at Ritsumeikan Univ. in Japan and in Rutgers Univ. in US, he taught Political Devolution and Fiscal Decentralisation and Regional Development Policy. He has authored a series of publications and comparative research on Advanced Countries Local Government System and International Public Administration. He holds a Ph.D. and Master's degrees of Paris II Univ. of France in Public Law and Paris IV in Sociology.



**Ms. Bouangeun Ounnalath**

*Director General, Fiscal Policy Development  
Ministry of Finance, Lao PDR*

Bouangeun Ounnalath is Acting Director General of the Fiscal Policy Department of the Ministry of Finance LAO PDR. She has been in the field of public finance for more than 16 years in the Fiscal Policy Department and Budget Department, many of which involved macroeconomic surveillance and fiscal policies. She was involved in the formulation process of the National Socio-Economic Development Plan and the assessment the impact of revenue collection from foreign trade under participating the AFTA. In 2006 joined Policy Research Institute (PRI) of Ministry of Finance of Japan and wrote research paper on Comparison on Salary System for Government between Lao PDR and Japan. She now leads the drafting of Vision 2030 and Fiscal Strategy for Public Finance Development 2025, Five Year Budget Plan 2016-2020, and the legal framework on taxes, royalties and benefits from hydro power and mining sectors.



**Ms. Nguyen Thi Thuy**

*Senior Researcher, National Institute for Finance  
Ministry of Finance of Vietnam*

Nguyen Thi Thuy is a senior researcher in the National Institute for Finance attached to the Ministry of Finance of Vietnam. She works for the Public Finance Policy Department, specializes in the state budget and public debt management. She is responsible for conducting research, analyzing economic issues, providing advices and contributing to the Government's policies. Her current research interests include public finance, economic development, fiscal and monetary policies. She holds a master degree in Economics of Money, Banking and Finance from the University of Sheffield, U.K.



**Mr. Withee Pharnichwong**

*Senior Economist, Local Fiscal Policy sub division  
Fiscal Policy Bureau, Fiscal Policy Office, Ministry of Finance, Thailand*

Withee Pharnichwong has worked in the Fiscal Policy Bureau, Fiscal Policy Office more than a decade, mainly focus in government expenditure policy such as budget formulation, budget monitoring, also making fiscal policy to respond with the changed economic situation. Currently, He has worked in the Local Fiscal policy sub division, which responsible for the calculation of overall revenue of the local authorities, determine the criteria for allocation of revenue to the local authorities, also engage in the development of local policy and regulatory.



**Mr. Lee Yong-Chul**

*Assistant Mayor for Planning and Coordination  
Incheon Metropolitan City, Korea*

Lee Yong-Chul is Assistant Mayor for Planning and Coordination of the Incheon Metropolitan City, Korea. Prior to assuming the position in 2015, he was Head of Daejeon Government Buildings Management Service; Director of Local Finance Policy Division, Local Subsidy Division, and Local Tax Analysis Division. He also served as Senior Secretary to the President for Political Affairs, and for Non-Governmental Organizations. He received B.A in Anthropology and M.A. in Political Science from Seoul National University.



**Mr. Yanfeng Bai**

*Professor, Dean of the School of Public Finance and Tax  
Central University of Finance and Economics (CUFE), Beijing, China*

Yanfeng Bai got his PHD in economics in 2005 from Renmin University of China, then he began to do teaching and research in CUFE. His research interest is focused on fiscal and tax policy, especially in energy and environment. He has good research cooperation with the Ministry of Finance, China and Development Research Center, State Council of China. His projects includes some sponsored by National and Beijing Fund of Philosophy and Social Science.



**Mr. Hoy Vicheth**

*Chief Office of Budget Control and Monitor for District and Municipality,  
General Department of Finance for Sub-national Administration,  
Ministry of Economy and Finance, Cambodia*

Hoy Vicheth, a Cambodian national and received a bachelor degree in economics from Northern Illinois University and earned a master degree in economics from Western Illinois University in United State of America. He has been working in the Ministry of Economy and Finance of Cambodia since 2012. He is active in both policy and budget affair for sub national administrations. He engages in strengthening efficiency in sub national government budget implementation and supports the ministry of economy and finance on producing a budget strategy plan for sub national administrations which is a part of the national public financial management reform program.



**Ms. Kim Su-Kyung**

*Local Finance Team Manager, Local Finance Policy Division  
Ministry of Interior, Korea*

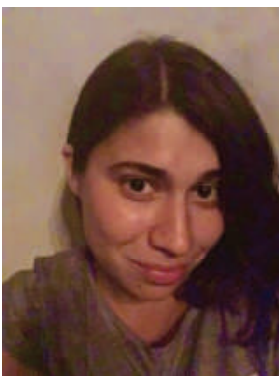
Kim Su-Kyung is Team Manager of Local Finance Policy Division of the Ministry of Interior, Korea. As a senior Deputy Director, she is currently responsible for Korea's 'Local Finance Reform' to enhance local fiscal soundness and coordinates basic plans and major policies in response to environmental changes in administration. She has been working in the field of local government fiscal affairs including local tax for more than 12 years. In her previous positions, she worked at the Civil Service Commission as Deputy Director of the Performance Management Division, and as Deputy Director of Local Tax Policy Division.



**Mr. Niño Alvina**

*Director of Local Government Units Operations Service  
Bureau of Local Government Finance, Department of Finance, Philippines*

Niño Raymond B. Alvina is the Director of Local Government Units Operations Service of the Bureau of Local Government Finance, an attached agency of the Department of Finance. Prior to formally joining the Government in 2015, he has worked on property valuation and taxation reforms, and other projects on local finance in various capacities from 2005 to 2014. In his current role, he supports policy development and is in-charge of the Bureau's oversight functions on local treasury and assessment services, capacity building, and project management. His recent initiative is on benchmarking performance standards and setting up the fiscal sustainability scorecards of all local governments in the Philippines.



**Ms. Antonina Levashenko**

*Director of Russia-OECD Centre, Russian Presidential Academy of National Economy and Public Administration (RANEPA)*

Antonina Levashenko has a master degree in international law. She has worked as a researcher in Ye.T. Gaidar Institute for Economic Policy, as a lawyer and senior researcher in The Russian Presidential Academy of National Economy and Public Administration (RANEPA), as a senior researcher in Russian Foreign Trade Academy of the Ministry for the Economic Development of the Russian Federation (in Russia-OECD Club of Academy). Now she is a Chief of Russia-OECD Centre RANEPA. Her area of interest includes tax, investment, trade, corporate governance, financial markets, and support for exports. Environmental policy, investment (green investments), government procurement, responsible business conduct, corporate governance, taxes, offshore, exchange controls and OECD standards in these areas are the main issues studied. As an expert, she has closed cooperation with government authorities; mainly Ministry of economic development, Ministry of construction, Ministry of industry and trade, Audit Chamber, Ministry of Finance.



**Ms. Alexandra Koval**

*Director of Russia-OECD Club*

*Russian Foreign Trade Academy (RFTA)*

Alexandra Koval has a master degree in law of international trade. She has worked as a researcher in Russian Foreign Trade Academy (RFTA) under Ministry of economic development of Russian Federation and specialised in export support measures. Alexandra is now leading "Russia-OECD Club" and works as the researcher in Russia-OECD Centre. As an expert, she has closed cooperation with government authorities like Ministry of Economic Development, Ministry of Industry and Trade, Audit Chamber. Export support, regulatory policy, public governance and regional development OECD tools are the main areas of interests.







Commemorative Photograph



# Opening Session

## Opening Remarks

- Mr. Park Deok-Soo, Director General, Public Governance Programme, OECD Korea Policy Centre

## Welcome Remarks

- Mr. Jeon Sung-Soo, Deputy Mayor, Incheon Metropolitan City, Korea

## Keynote Address

### ***Empowering Local Governments for Improving Economic and Social Outcomes: Progress to-date and the Unfinished Agenda***

- Mr. Anwar Shah, Advisor to World Bank, International Consultant in Public Economics and Governance



**Opening Remarks**

Mr. Park Deok-Soo

Director General, Public Governance Programme, OECD Korea Policy Centre



**Welcome Remarks**

Mr. Jeon Sung-Soo

Deputy Mayor, Incheon Metropolitan City, Korea



**Keynote Address**

Mr. Anwar Shah

Advisor to World Bank, International Consultant in Public Economics and Governance



## Keynote Address



**Mr. Anwar Shah**

*Advisor to World Bank*

*International Consultant in Public Economics and Governance*

Anwar Shah (Ph.D. economics) is Senior Non-resident Fellow Brookings Institution, USA, Advisor/Consultant, World Bank and Director of the Centre for Public Economics, SWUFE, Wenjiang, Chengdu, China. He has previously served the World Bank, Asian Development Bank, Canadian Ministry of Finance, the Government of Alberta and the UN Intergovernmental Panel on Climate Change. He was responsible for federal fiscal transfers to provinces for health, education and equalization at the Ministry of Finance. With the Government of Alberta, he was responsible for provincial fiscal transfers to local governments. He has published more than two dozen books and numerous articles in leading journals. His recent books include *Fiscal Federalism* (with Robin Boadway), *The Practice of Fiscal Federalism: Comparative Perspectives*, *Intergovernmental Fiscal Transfers*, *Local Governance in Developing Countries* and *Performance Accountability and Combating Corruption* and *Fiscal Incentives for Investment and Innovation*.





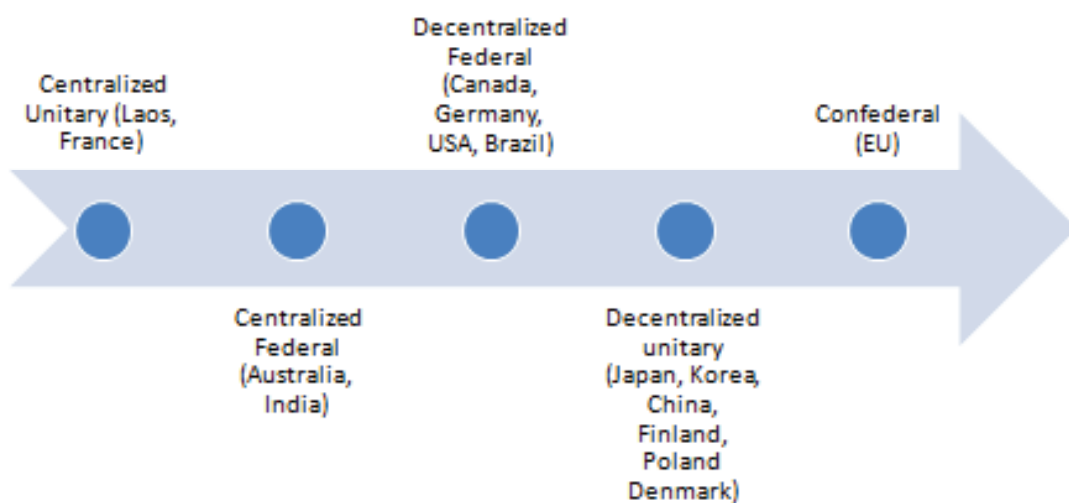
# Empowering local governments for improving economic and social outcomes: Progress to-date and the unfinished agenda

Anwar Shah ([shah.anwar@gmail.com](mailto:shah.anwar@gmail.com))  
Brookings Institution, USA, Southwestern University of Finance and  
Economics, Chengdu, China and World Bank

## Asian Public Governance Forum on Local Finance: Achieving Fiscal Sustainability of Local Governments

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## Centralization – Decentralization Spectrum



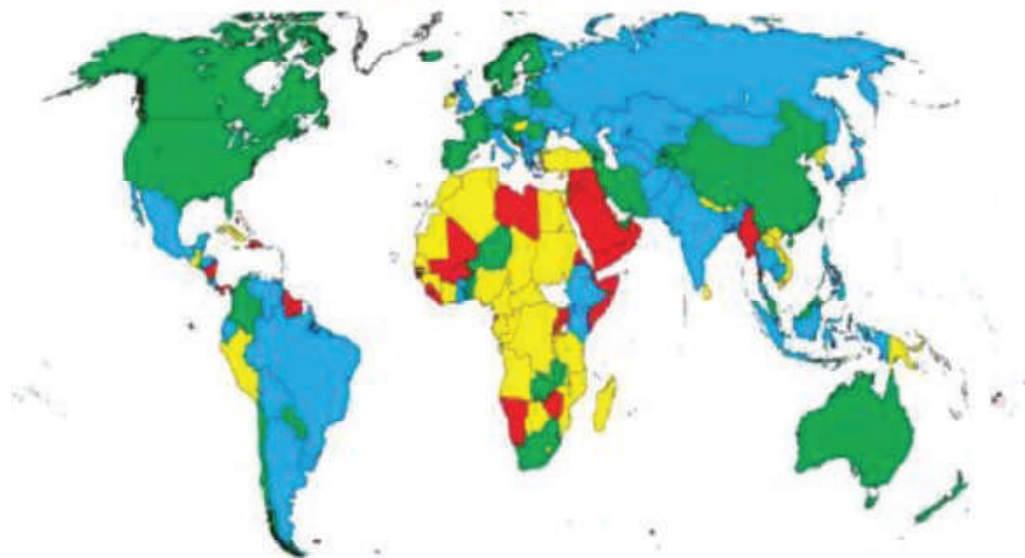
Anwar Shah

A silent revolution has swept the world during the last three decades.

3

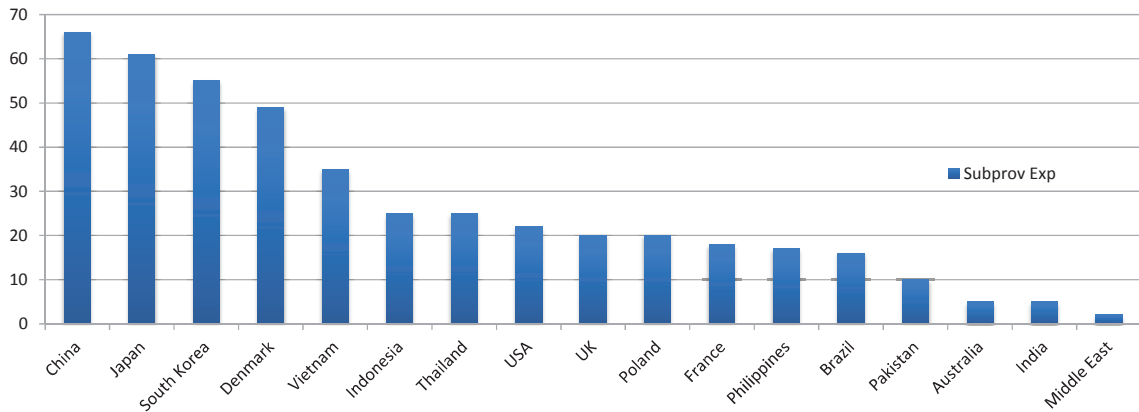
And local governments are assuming a more expansive role in public spending in some regions

LG Relative Importance

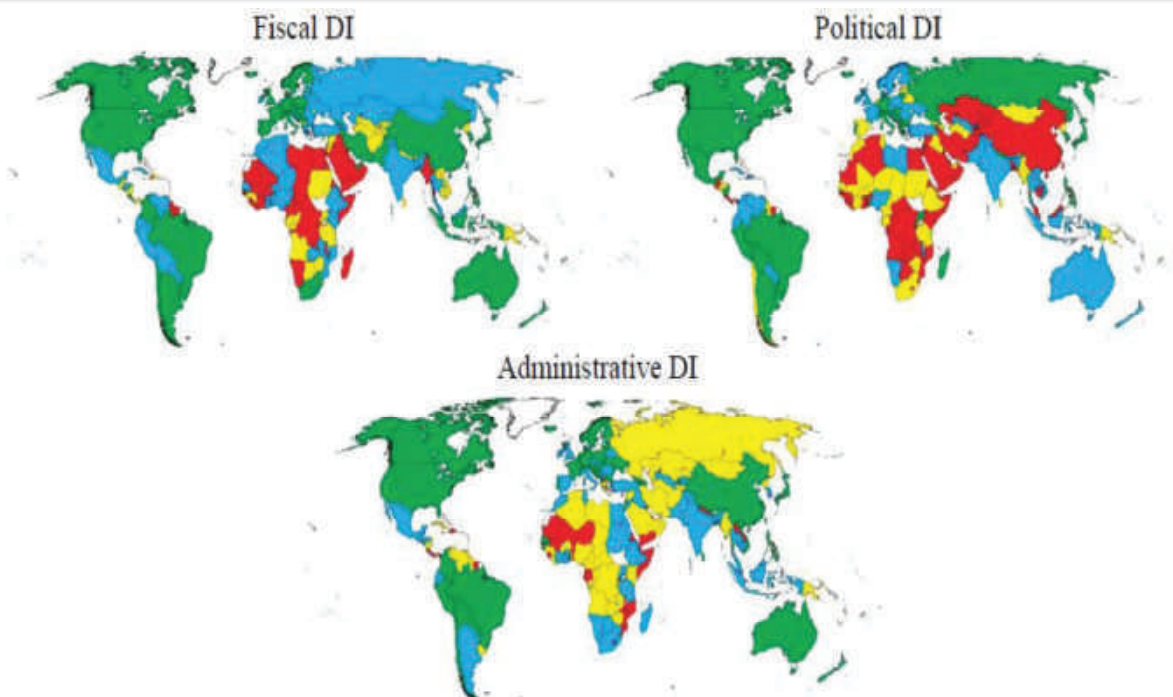


## Countries with empowered local governments offer greater potential for improving economic and social outcomes

Sub-provincial expenditures as a share of total expenditures

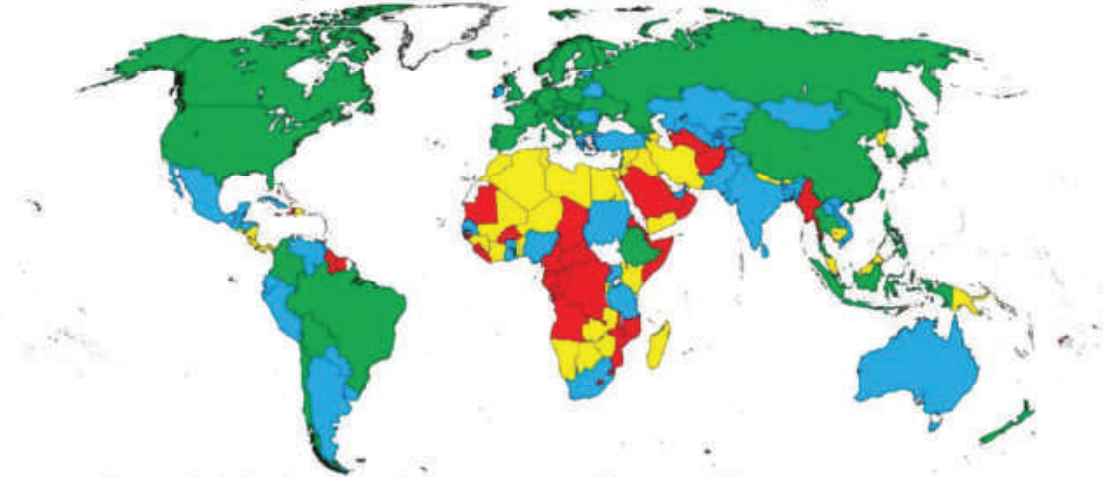


## There has been uneven fiscal, political and administrative decentralization across the globe



# Overall decentralization reforms have also varied across countries

Figure 9: Index of Decentralization - World Map

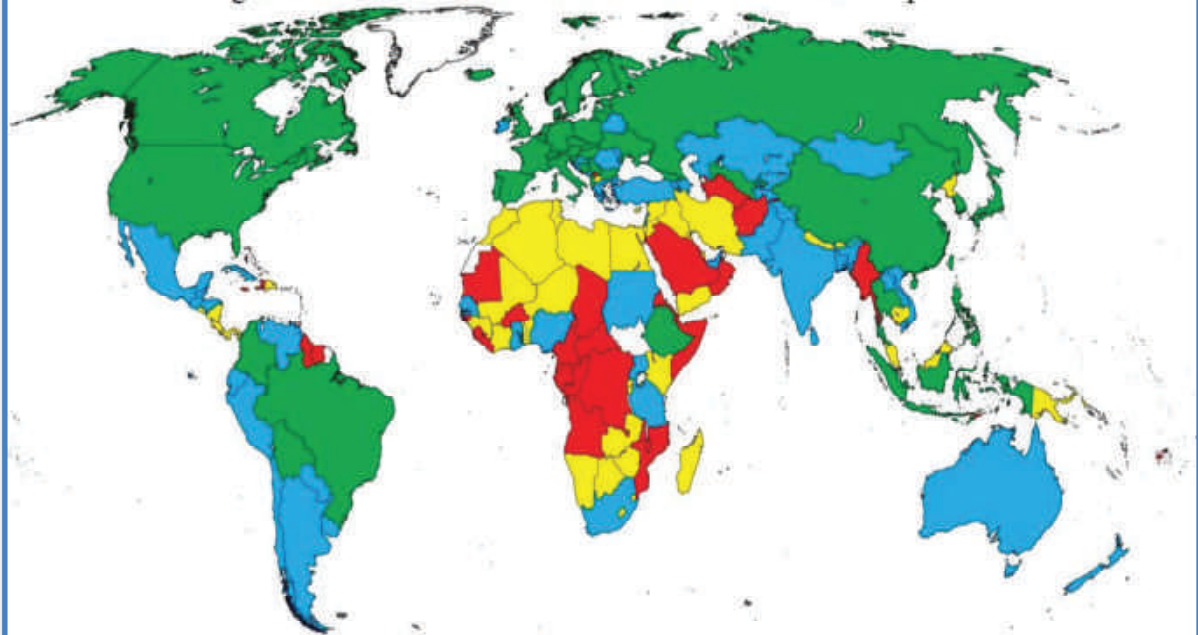


Source: Authors' calculations based upon data sources reported in Annex Table A1.

Note: Color of a country corresponds to its percentile in the world's distribution: red – 0-25<sup>th</sup>, yellow – 25-50<sup>th</sup>, blue – 50-75<sup>th</sup>, green – 75-100<sup>th</sup>.

# But public decision making has moved closer to the people in some regions more than others

Figure 10: Government Closeness Index - World Map



## Evidence on Government Closeness to Its People

Governance Model	Sample size	Government closeness index (median values)
Centralized unitary	92	0.1
Decentralized unitary	42	3.35
Dual federalism	19	2.06
Federation of civic republics	1	32

Source: Basic data from Ivanyna and Shah (2014)

### **Cross country evidence on the impact of fiscal decentralization**

## Conclusions on Regional Equity

- Empirical evidence shows that that centralization leads to greater regional disparities
- Regional disparity more pronounced in countries with interventionist regional policies
- Subnational political autonomy creates political pressures against inequitable development
- However, regional convergence largely attributable to removing distortions (barriers to trade and impediments to factors and goods mobility) in the economy.

## Fiscal Decentralization and Fiscal Performance – Some Conclusions

- Fiscal federalism – deeper thinking on institutional design and development
- Greater clarity in roles and responsibilities
- Greater emphasis on rules of the game and fair play
- Greater emphasis on bottom-up accountability through citizen empowerment.
- Decentralized fiscal systems better record of fiscal management than centralized fiscal systems.

# Fiscal Decentralization and fiscal management – empirical evidence

<i>Fiscal performance</i>	<i>Impact of Fiscal Dec</i>
Quality of debt management	Positive but insignificant
Quality of fiscal policy and Inst.	Positive significant
Efficiency in revenue collection	Mixed but insignificant
Prudent use of taxes	Positive significant
Growth of public exp.	Negative but insignificant
Control of deficit	Negative but insignificant
Growth of public debt	Positive but insignificant
Public sector management	Positive and significant
Service delivery performance	Positive and significant
GDP growth	Positive but insignificant.

Localization works as an antidote to corruption in all countries but more so in developing countries

Table 6: Results of the main estimation - alternative inference

	paid bribe		bribe burden		informal gift		bribe%sales	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
est. method	lpm	dl	lpm	dl	lpm	dl	lpm	dl
dec. index, main	-0.13*** (0.04)	-0.09 (0.31)	-6.01*** (1.48)	-13.10** (5.17)	-0.68*** (0.07)	-1.50** (0.70)	-4.55*** (1.07)	-7.50 (9.50)
exp. decentralization	-0.04* (0.02)	-0.02 (0.16)	-2.37*** (0.65)	-4.66 (2.84)	-0.25*** (0.03)	-0.61** (0.24)	-3.11*** (0.46)	-3.94 (3.33)
dec. index, aux.	-0.02 (0.02)	-0.02 (0.19)	-3.08*** (0.81)	-6.51* (3.39)	-0.29*** (0.03)	-0.83*** (0.27)	-2.83*** (0.49)	-3.17 (3.94)
standard errors	robust	stand.	robust	stand.	robust	stand.	robust	stand.
dataset	GCB	GCB	GCB	GCB	WBES	WBES	WBES	WBES
		av.		av.		av.		av.

*Note* \* - significant at 10% level, \*\* - significant at 5% level, \*\*\* - significant at 1% level. Dependent variable: columns (1)-(2) - *paid bribe*; columns (3)-(4) - *paid bribe*; columns (5)-(6) - *informal gift*; columns (7)-(8) - *bribe%sales* (see definitions in Table 2). Estimation methods: columns (1), (3), (5), (7) - OLS on the whole sample (lpm); columns (2), (4), (6), (8) - OLS on the averaged data from the corresponding sample (see Wooldridge (2006)). Standard errors are reported in brackets: columns (1), (3), (5), (7) - heteroscedasticity robust; columns (2), (4), (6), (8) - standard. Other controls included in the regressions are identical to that of in Table 5.

## Evidence: Government being closer to people helpful in combating corruption, improving social outcomes and economic growth

**Table 14: Decentralization Indexes and Human Development, Corruption and Growth**

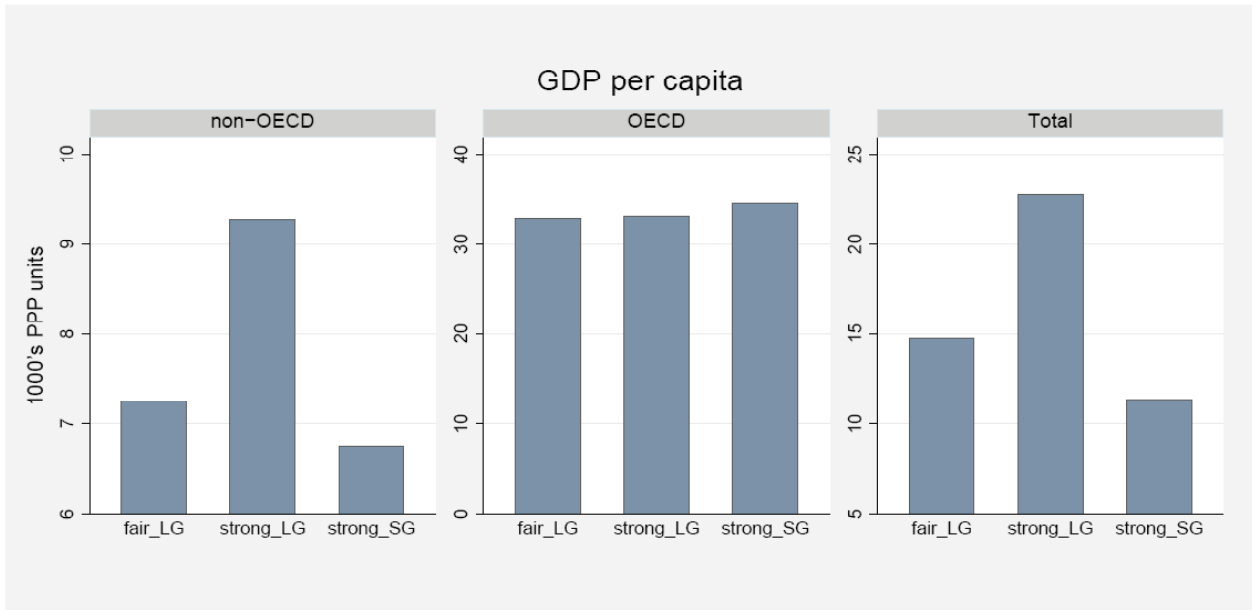
All vars as of 2005	Human Development Index			Corruption Perception Index			Real GDP per Capita Growth, 2000-10		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
log GCI	0.00475** (0.00217)			0.230*** (0.0532)			0.122 (0.129)		
log DI		0.00453** (0.00217)			0.241*** (0.0528)			0.104 (0.129)	
log LG expenditures			0.00511 (0.00371)			0.198** (0.0960)			0.117 (0.218)
log population							0.0546	0.0592	0.102
log GDP per capita	0.00379 (0.00260)	0.00393 (0.00267)	0.00205 (0.00242)	0.269*** (0.0648)	0.290*** (0.0658)	0.181*** (0.0637)	(0.155)	(0.158)	(0.143)
openness	0.0550*** (0.00380)	0.0549*** (0.00382)	0.0558*** (0.00381)	0.804*** (0.0951)	0.794*** (0.0946)	0.856*** (0.0990)	-0.0784 (0.226)	-0.0759 (0.227)	-0.0557 (0.225)
literacy rate	-8.87e-05 (7.23e-05)	-9.05e-05 (7.25e-05)	-8.06e-05 (7.29e-05)	0.00123 (0.00180)	0.00107 (0.00178)	0.00153 (0.00189)	0.000320 (0.00430)	0.000307 (0.00431)	0.000535 (0.00430)
1 if in OECD	0.00263*** (0.000271)	0.00264*** (0.000271)	0.00270*** (0.000272)	-0.00699 (0.00666)	-	-	-0.0172 (0.0161)	-0.0166 (0.0161)	-0.0154 (0.0160)
constant	0.00272 (0.0135)	0.00312 (0.0135)	0.00674 (0.0136)	1.821*** (0.337)	1.826*** (0.334)	1.983*** (0.353)	-	-	-
R-squared	0.118** (0.0465)	0.120** (0.0469)	0.111** (0.0480)	-1.075 (1.136)	-0.861 (1.137)	-1.644 (1.223)	3.170*** (0.805)	3.152*** (0.805)	3.069*** (0.804)
observations	143	143	143	141	141	141	143	143	143

Note: \* – significant at 10% level, \*\* – significant at 5% level, \*\*\* – significant at 1% level. Standard errors in parentheses. All regressions include regional dummies. Abbreviation: *GCI* – Government Closeness Index, *DI* – Decentralization Index.

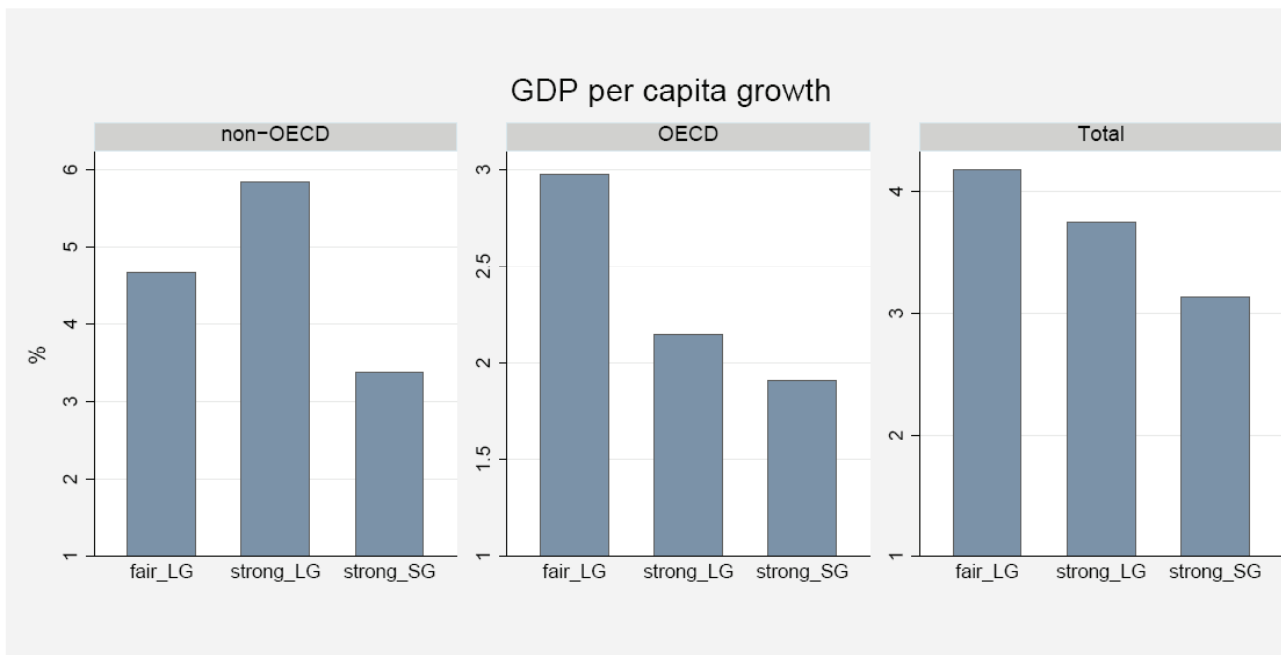
Positive payoffs of having leaner provinces and home rule for local governments: cross country evidence from the most recent decade (2000-2010)



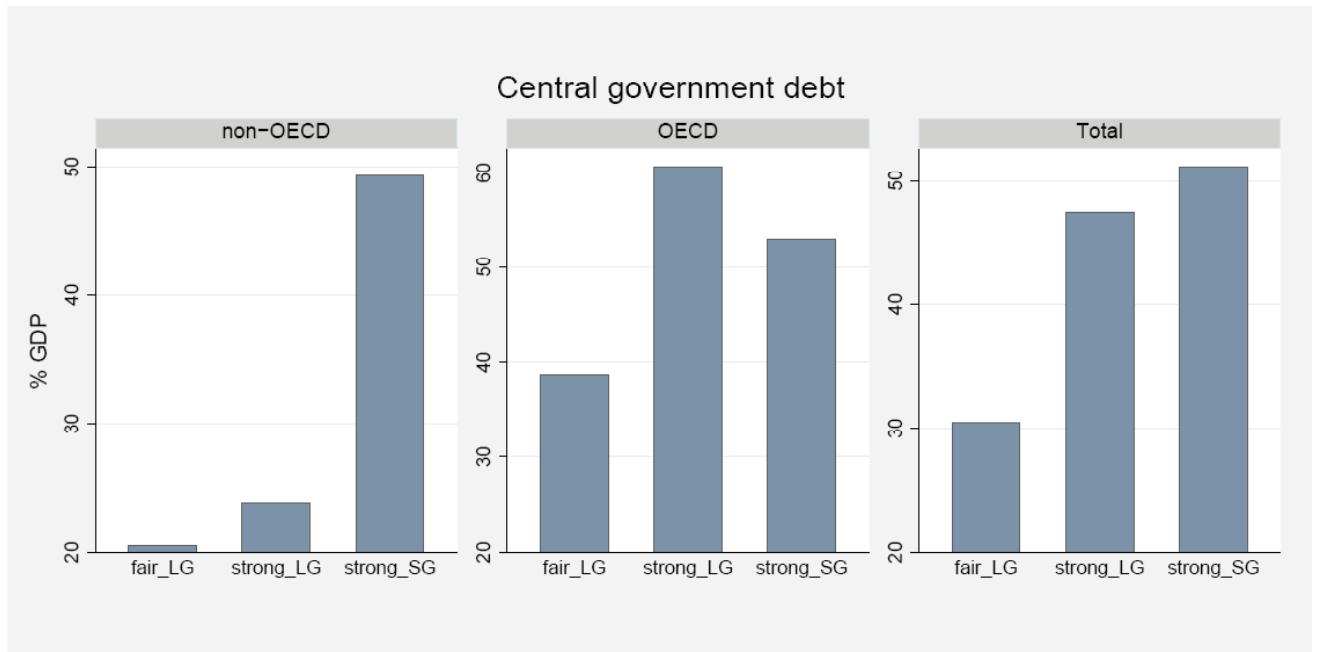
# Higher GDP Per Capita



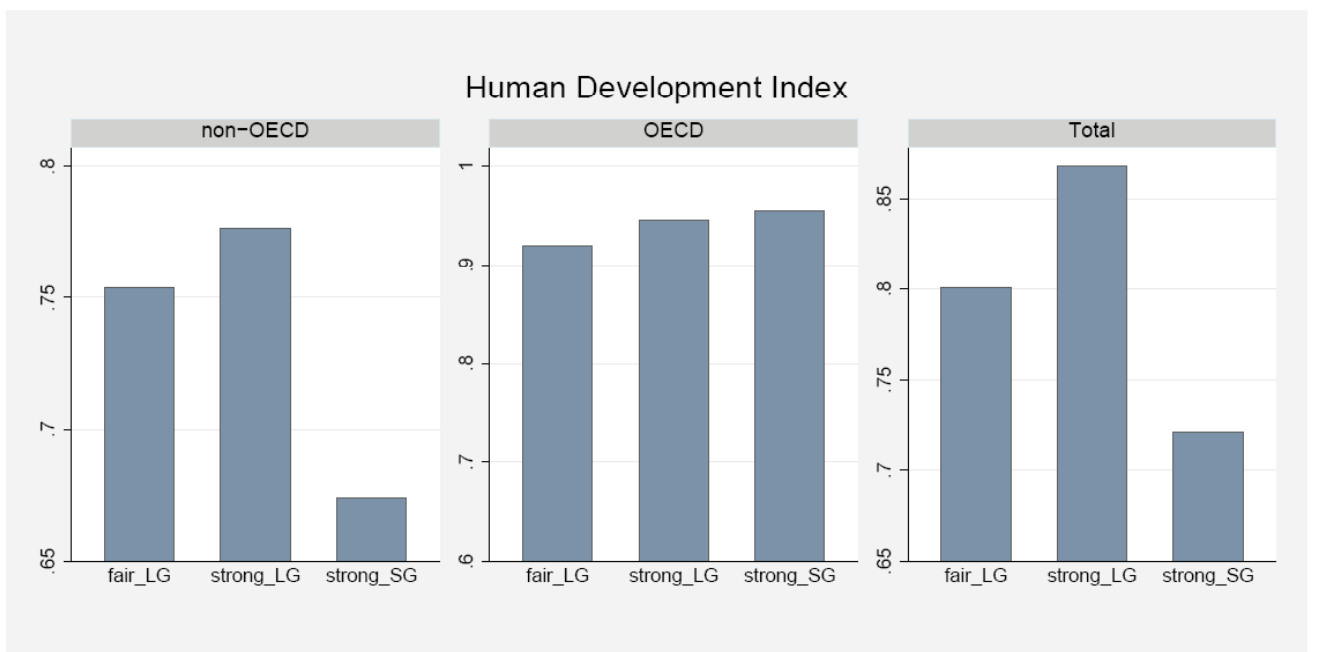
# Higher GDP per capita growth rate



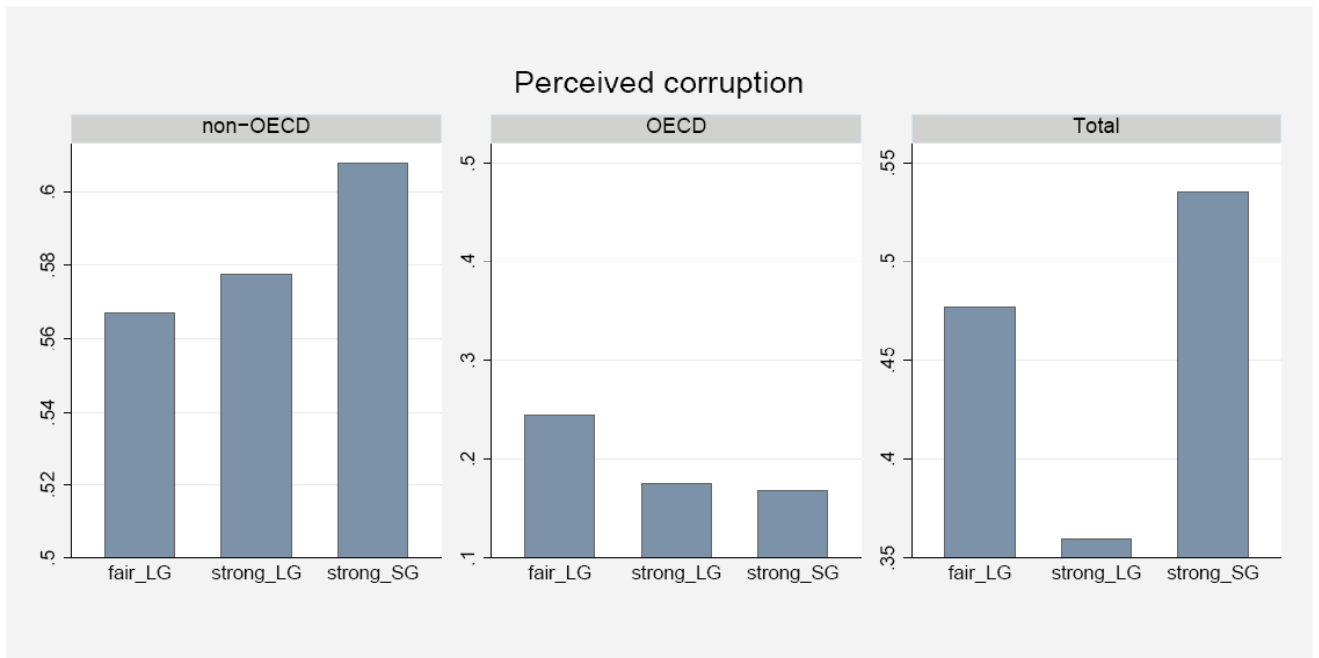
# Lower debt



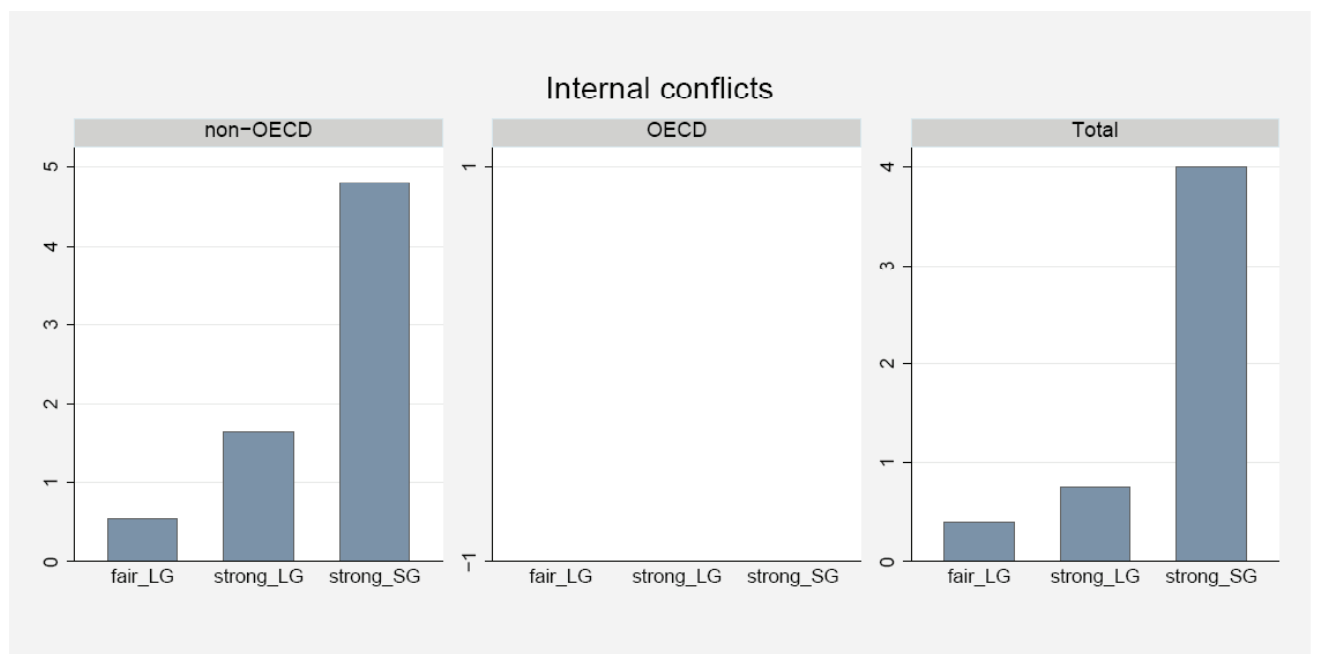
# Higher HDI



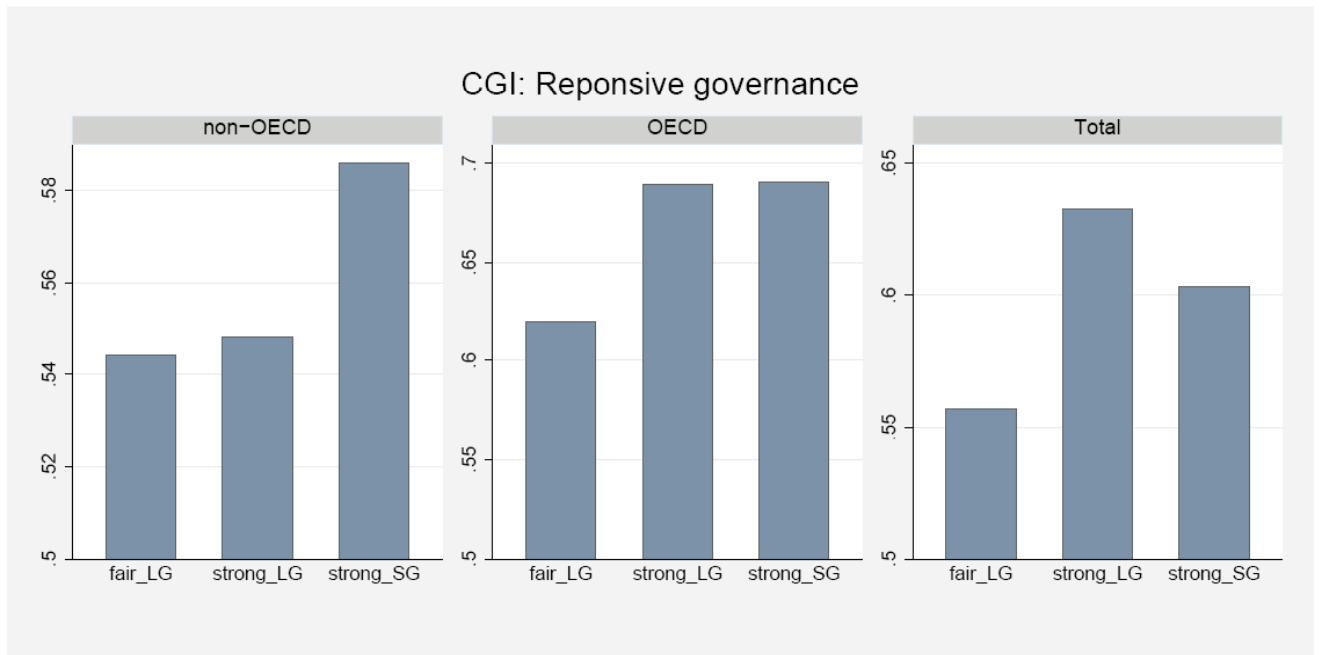
# Lower Corruption



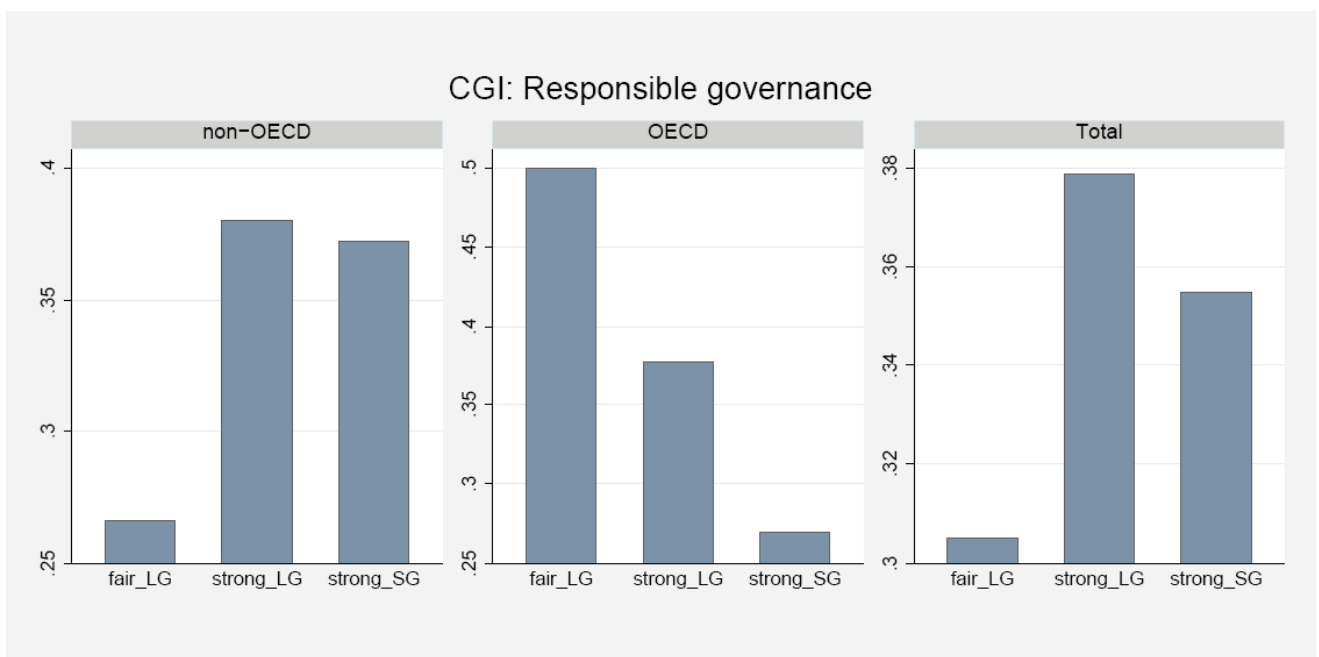
# Lower internal conflicts



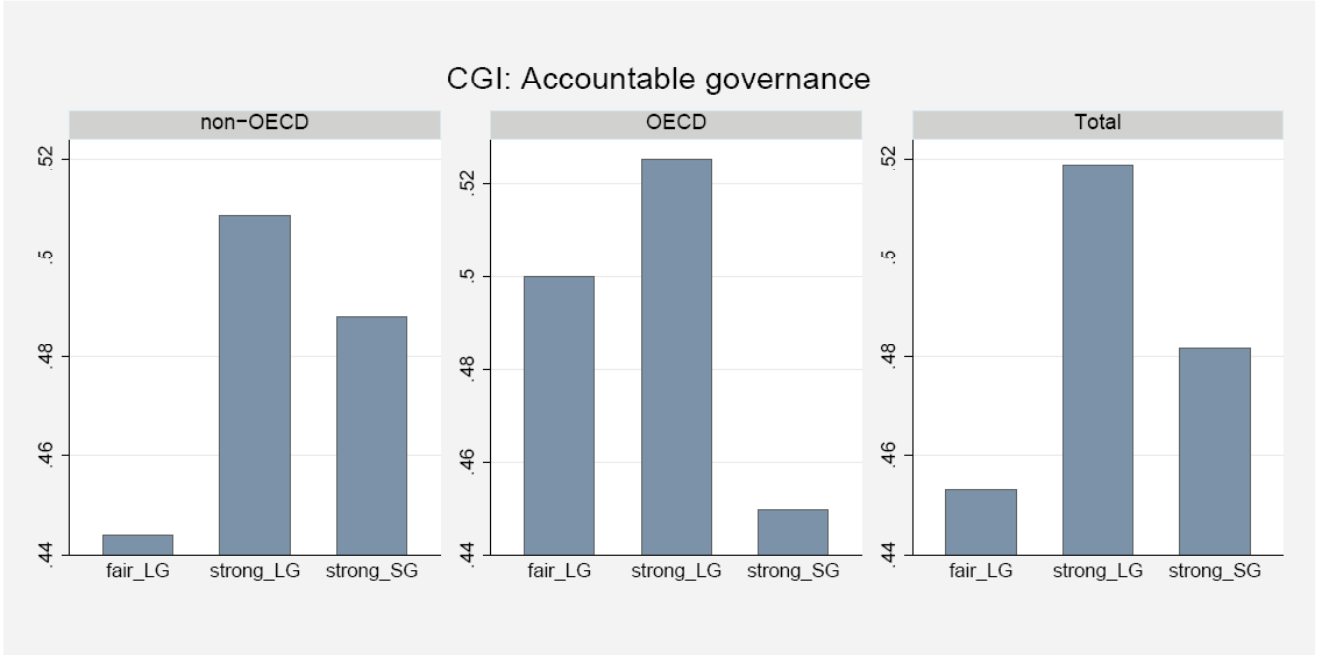
# More responsive governance



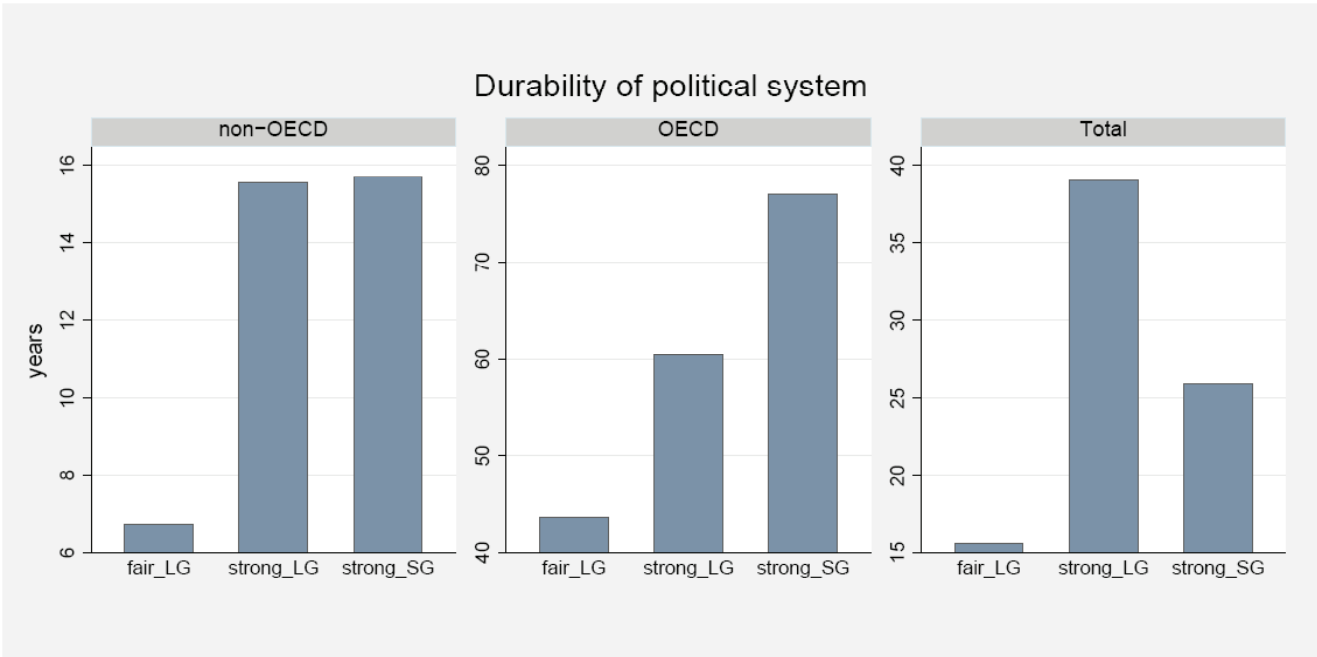
# More responsible governance



# More accountable governance



# More durable political system



# Impact of Decentralization on Governance Outcomes

Model	Sample size	Fair Gov	Acc. Gov	Incorr. Gov	Resp. Gov	Overall
Centralized unitary	20	0.55	0.51	0.29	0.56	0.51
Dual Federalism	11	0.60	0.50	0.37	0.62	0.56
Dec. unitary	18	0.59	0.58	0.37	0.65	0.59
Fed of civic republics	1	0.74	0.52	0.50	0.74	0.67

Source: Ivanyna and Shah (2011)

## Qualitative Evaluation of Multi-order Governance Models

**Table 1. An Impressionistic Evaluation of Multiorder Governance Models**

Criterion	One republic (centralized)	One republic (decentralized)	Federation of provinces	Federation of civic republics
	Unitary	Unitary	Dual Federalism	Federation of local governments
<b>Number of countries (2014)</b>	146	24	25*	1
<b>(a) Transactions Costs</b>				
Citizen participation	High	Low	Medium	Low
Citizen monitoring and oversight	High	Low	High	Low
Legislative oversight	Medium	Medium	Medium	Medium
Agency costs	High	Low	High	Low
Uncertainty costs	Low	Low	High	Low
Executive decision making costs	Low	Low	High	Low
Intergovernmental coordination	Low	Medium	High	Low
<b>OVERALL COSTS</b>	<b>HIGH</b>	<b>LOW/MEDIUM</b>	<b>HIGH</b>	<b>LOW</b>

# .....evaluation

Criterion	One republic (centralized)	One republic (decentralized)	Federation of provinces	Federation of civic republics
<b>(c) Enabling environment, people empowerment and for better public service delivery and growth</b>				
Local Public Services	No	Yes	May be	Yes
Local economic development	No	Yes	May be	Yes
Poverty alleviation	May be	Yes	Yes/May be	Yes
International competitiveness	No	Yes	May be	Yes
Growth	May be	Yes	May be	Yes
People empowerment	No	May be	May be	Yes
Government closeness to the people	No	Yes	No	Yes
Adapting to a changing world	No	Yes	No	Yes
<b>Overall governance outcomes</b>	<b>Uncertain</b>	<b>Better</b>	<b>Fair to good</b>	<b>Best</b>

## **EMPOWERING LOCAL GOVERNMENTS : NEXT STEPS**

Anwar Shah

# Imperatives of a changing world

- Information revolution empowers people
- Role of citizens as governors and principals as opposed to subjects and clients but political finance undermines democratic accountability
- Social dumping by the private sector to enhance competitiveness
- Enhanced role of supranational regimes with democratic deficit
- International competitiveness delinked from resource base
- Enhanced role of central governments in education and skills enhancement and social welfare
- Diminishing economic relevance of intermediate orders of governments but stronger political clout
- Internationalization of cities
- Enhanced role of local governments to deal with both market and government failures but local governments are shackled in most countries

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## Emerging Vision of Local Government: 20<sup>th</sup> versus 21<sup>st</sup> century

- |                                            |                                                                                              |
|--------------------------------------------|----------------------------------------------------------------------------------------------|
| • Residuality principle                    | • Subsidiarity and home rule principle                                                       |
| • Ultra vires                              | • Community governance                                                                       |
| • Focus on government                      | • Focus on governance                                                                        |
| • Agent of central/provincial governments  | • Primary agent for citizens and gatekeeper for shared rule                                  |
| • Accountable to higher governments only   | • Accountable to voters                                                                      |
| • Direct provider                          | • Network facilitator                                                                        |
| • Dependent on central directives          | • Autonomous                                                                                 |
| • Rules driven, bureaucratic, technocratic | • Managerial flexibility and accountability for results, strengthens voice, choice and exit. |
| • Exclusive with elite capture             | • Inclusive and participatory                                                                |
| • Overcomes market failures                | • Overcomes market and government failures                                                   |
| • Boxed in a centralized system            | • Global and local connectivity                                                              |

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## The Role of local governments for the information age

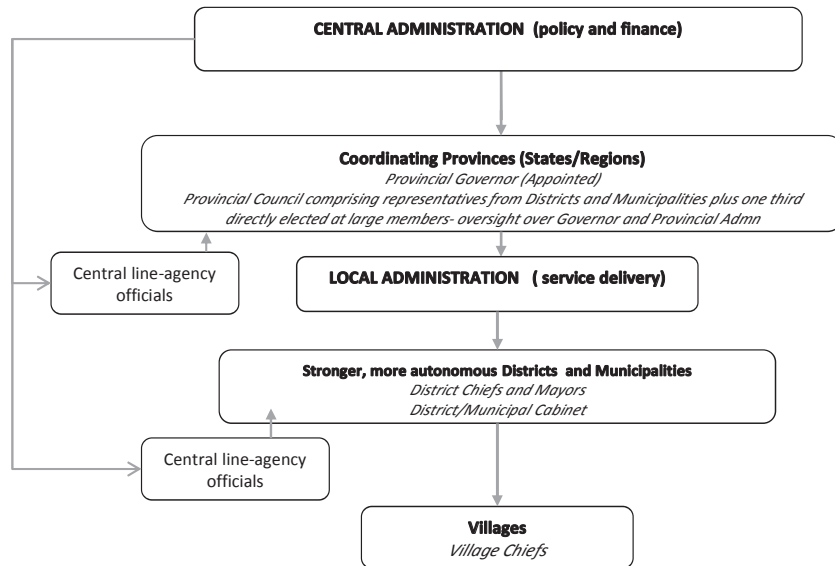
- Local government as the primary agent to reduce transactions costs and deal with the commitment problem
- Facilitator of network form of local governance
- Oversight of shared rule
- LG as a catalyst to enhance national competitiveness in a globalized world.

Anwar Shah

## A New Vision of Multi-order Governance

- Local government enjoy home rule and serve as the primary agent providing oversight on shared rule in local area. Facilitator of network governance. Catalyst to enhance international competitiveness.
- Provinces (States/Regions) having inter-local functions, coordination and local government oversight roles.
- Provincial legislature comprising ex-officio elected heads of local governments plus one-third directly elected on a province-wide basis at large members providing oversight on the centrally appointed chief executive and serving as a network of inter-local coordination
- Centre leads rather than commands. Centre also entrusted with financing of social and economic union tasks.

# A NEW VISION of Decentralized Unitary Government for the Information Age



## Changing Paradigm of Multi-order Governance

### 20th century

Unitary or federal

Centralized or provincialized  
Center that manages or coerces  
Citizens as agents, subjects, clients and consumers  
Focus on government

Focus on division of the fiscal pie

Competitive edge for resource based economies

Federalism as a tool for coming together or holding together  
Residuality principle, ultra vires, "Dillon's rule"

Limited but expanding role of global regimes with democracy deficits  
Emerging federal prominence in shared rule

Strong state (province) role

Diminishing role of local government

Tax and expenditure centralization with revenue sharing and input based conditional grants to finance sub-national expenditures

Sources: Adapted from Boadway and Shah (2009)

### 21st century

Decentralized unitary or compound federal republic of local governments  
Globalized and localized  
Center that leads  
Citizens as governors and principals

Focus on governance with interactive direct democracy

Focus on responsive, responsible, fair and accountable governance

Competitive edge for human capital based economies

Global collaborative federalism with a focus on network governance and reaching out

Community governance principle, subsidiarity principle, home- or self-rule and shared rule

Wider role of global regimes and networks with improved governance and accountability

Leaner but caring federal government with an enhanced role in education, training, and social protection

Ever-diminishing economic relevance of states (provinces) and tugs-of-war to retain relevance

Pivotal role of local government as the engine of economic growth, primary agent of citizens, gatekeeper of shared rule, facilitator of network governance; wider role of "beyond government" entities

Tax and expenditure decentralization with fiscal capacity equalization and output-based national minimum standards grants for merit services

## In closing

- **Leaner but important coordination role for provinces in large countries and expansive role with home rule for local governments critical to peace, order, good government and growth.**
- **Path dependency make these reforms infeasible in countries with centralized governance or dual federalism and state capture by elites.**
- **But we owe it to billions of disempowered citizens of this world to keep trying.**

Anwar Shah

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# Session 1

## Central-Local Financial System in Asia-Pacific Countries

### Speakers

#### ***Fifteen Years after the Implementation of Decentralization Policy in Indonesia: Two Contending Approaches***

- Mr. Cecep Effendi, Director General, Centre on Integrated Rural Development for Asia and the Pacific

#### ***Current Trend of the Intergovernmental Transfer in Korea***

- Mr. Ahn Young-Hoon, Senior Research Fellow, Local Administration Office, Korea Research Institute for Local Administration

#### ***Central-Local Finance System in LAO PDR***

- Ms. Bouangeun Ounnalath, Director General, Fiscal Policy Development, Ministry of Finance, Lao PDR

#### ***Fiscal Decentralization in Vietnam: Recent developments and reforms***

- Ms. Nguyen Thi Thuy, Senior Researcher, National Institute for Finance, Ministry of Finance, Viet Nam

### Discussion



## Session 1

### Central-Local Financial System in Asia-Pacific Countries



**Mr. Cecep Effendi**

*Director General*

*Centre on Integrated Rural Development for Asia and the Pacific (CIRDAP)*

Cecep Effendi is an expert in South East Asia in the areas of good governance, decentralization and local governance. He is Director General of the Centre on Integrated Rural Development for Asia and the Pacific (CIRDAP), a regional intergovernmental organization which provides services in poverty alleviation, rural development and decentralization policies to its 15 member countries in the region. Prior to his engagement at CIRDAP, he served Ministry of Home Affairs of Indonesia as a Member of the Advisory Expert Team to the Minister, and to the Association of Provincial Government in dealing with the Ministry and the Parliament for the new decentralization bills (Local Government Bill, Direct Election Bill and Fiscal Balance Bill). He has Ph.D. in International Studies from Jawaharlal Nehru University, India.





# DECENTRALIZATION POLICY IN INDONESIA AFTER FIFTEEN YEARS Two Contending Approaches

**Dr. Cecep Effendi**  
**Director General, Centre on Integrated Rural  
Development for Asia and the Pacific (CIRDAP)**

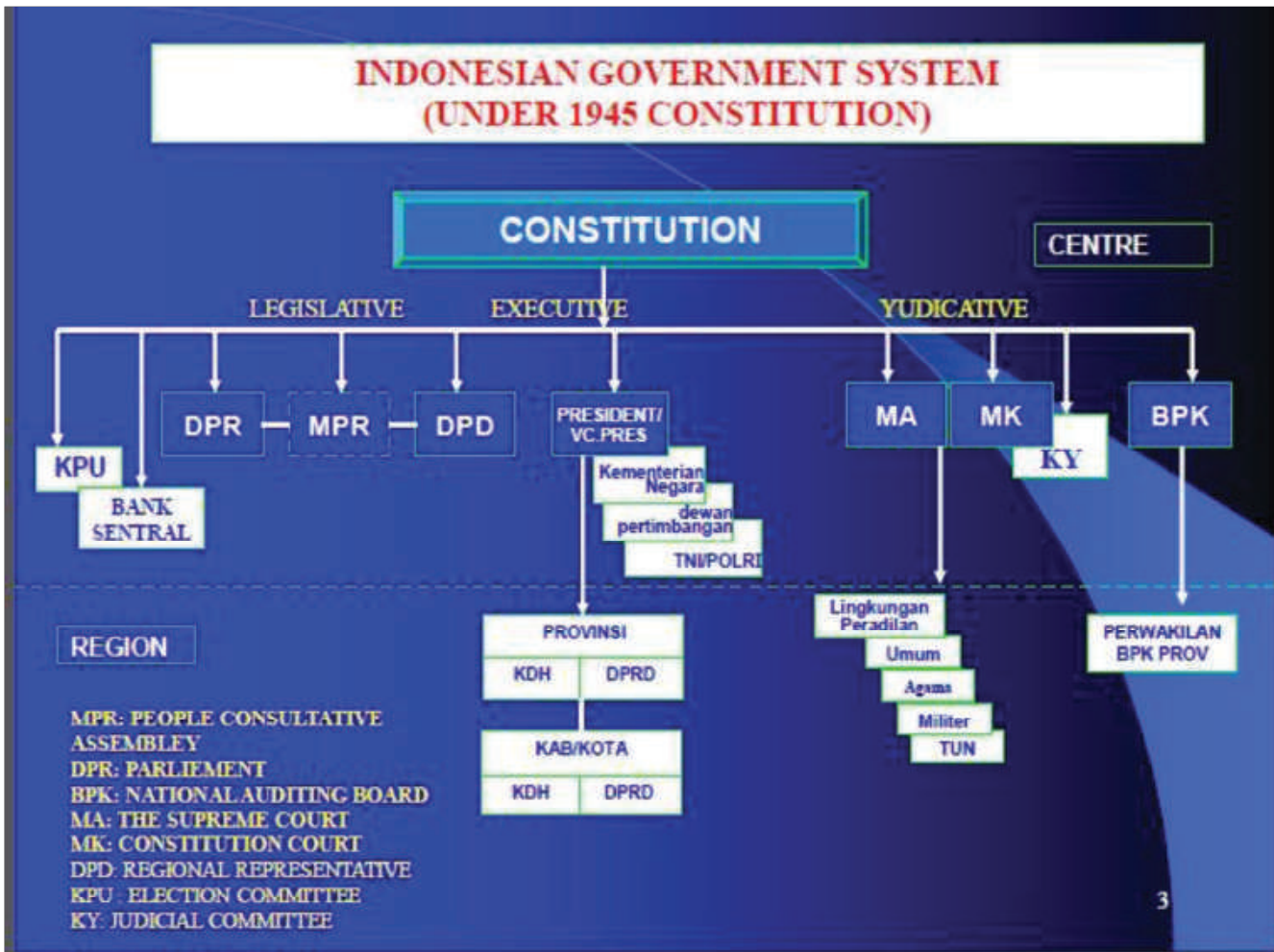


# Presentation consists of a number of issues

- 1. Introduction
- 2. The Undeclared Agenda : Maintaining Unity and Integrity of Indonesia
- 3. Local Direct Election
- 4. Intergovernmental Fiscal Transfer
  - 4.1. General Allocation Fund
  - 4.2 Specific/Special Allocation Fund
- 5. Own Source of Revenues (PAD)
- 6. Brief Observation

## **BRIEF INFORMATION OF INDONESIA**

1. UNITARY COUNTRY IN THE FORM OF REPUBLIC
2. POPULATION : 240 MILLION
3. NATURE OF COUNTRY: ARCHEPELAGIC ( 17.000 ISLANDS)
4. PROVINCE: 34 PROVINCES (AUTONOMOUS)
5. DISTRICT/CITY: 491 UNITS (AUTONOMOUS)
  1. DISTRICT : 411 DISTRICTS
  2. CITY : 98 CITIES
6. SUB DISTRICT : 6694 UNITS (ADMINISTRATIVE)
7. VILLAGE : 69.429 UNITS:
  1. RURAL VILLAGE (IN CHARGE WITH TRADITION AND CUSTOMARY)
  2. URBAN VILLAGE (ADMINISTRATIVE UNDER SUB DISTRICT)



- **Introduction**
- The collapse of the centralized New Order regime in 1998 brought about dramatic change in Indonesia's Centre-Regional relations.
- The weakening of the State provided the opportunity for regions like Aceh, Papua and smaller scale in Riau to demand separation from Indonesia or at least less control from the central government.



- Aceh, Papua and Riau contributed immensely to the national budget, but felt they got very little in return from the exploration of their natural resources. Western observers began talking Indonesia to be next Yugoslavia in late 1990s.
- Finding itself being pushed between two conflicting demands, maintaining the national unity of the country on the one hand, and giving more power to the regions on the other, the Habibie Administration put forward a new legal framework in managing centre-regional relations in Indonesia.

- Ministry of Home Affairs (led by Army General) preoccupied with the issue of maintaining national unity and integrity when Indonesia as a nation state was threatened by the demand of separation by the insurgent groups in Aceh and Papua.
- This became the undeclared agenda of the Habibie Administration and its successors.
- The government declared that the purpose of introducing local autonomy was to give more, wider and proportional power to the local government in the form of regulating, distributing and managing national resources as well as sharing revenues and expenditures between centre and local government.



## • **The Undeclared Agenda**

- The Habibie Administration issued Law No. 22/1999 on Local Governance and Law 25/1999 on fiscal balance between Centre and Regional Government. Law No. 22/1999 devolved a number of powers in managing local government to the regions allowing the regions to manage their own affairs. Law No 25/1999 paved the way for more autonomy to the region by providing with fiscal resources to the regional government.

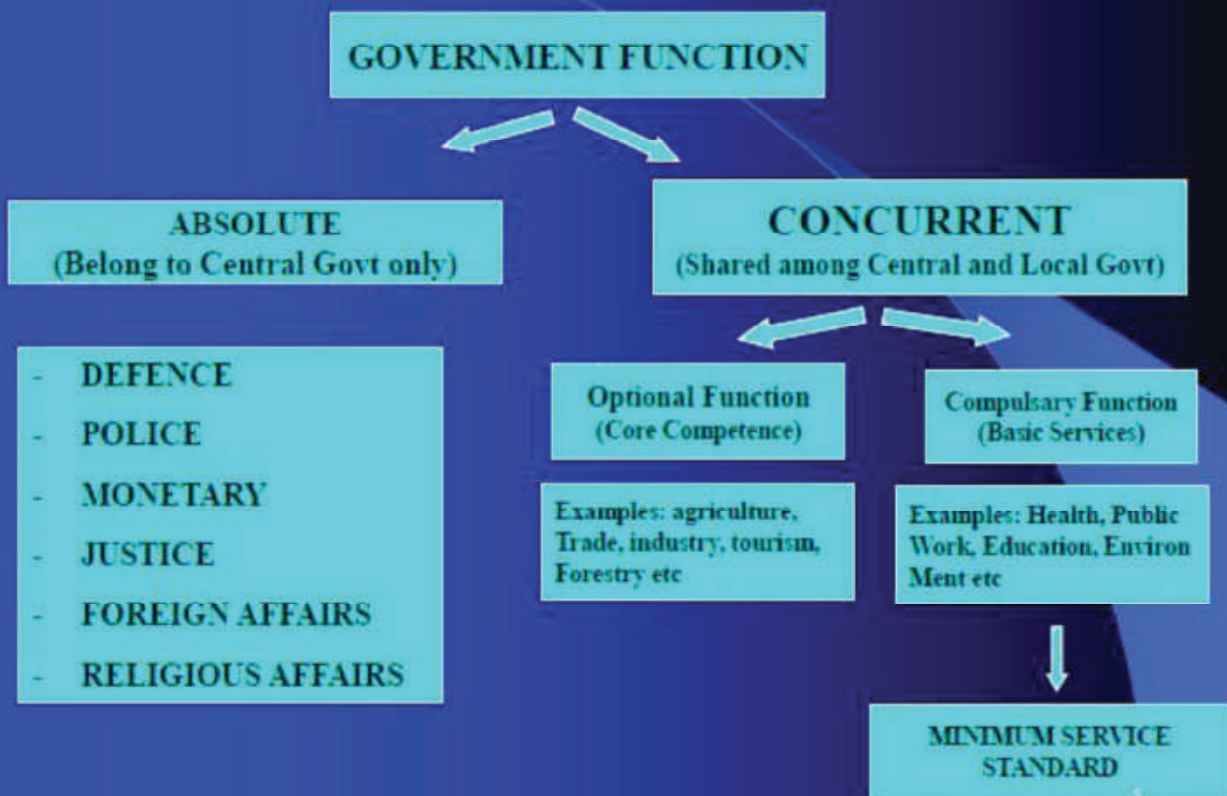


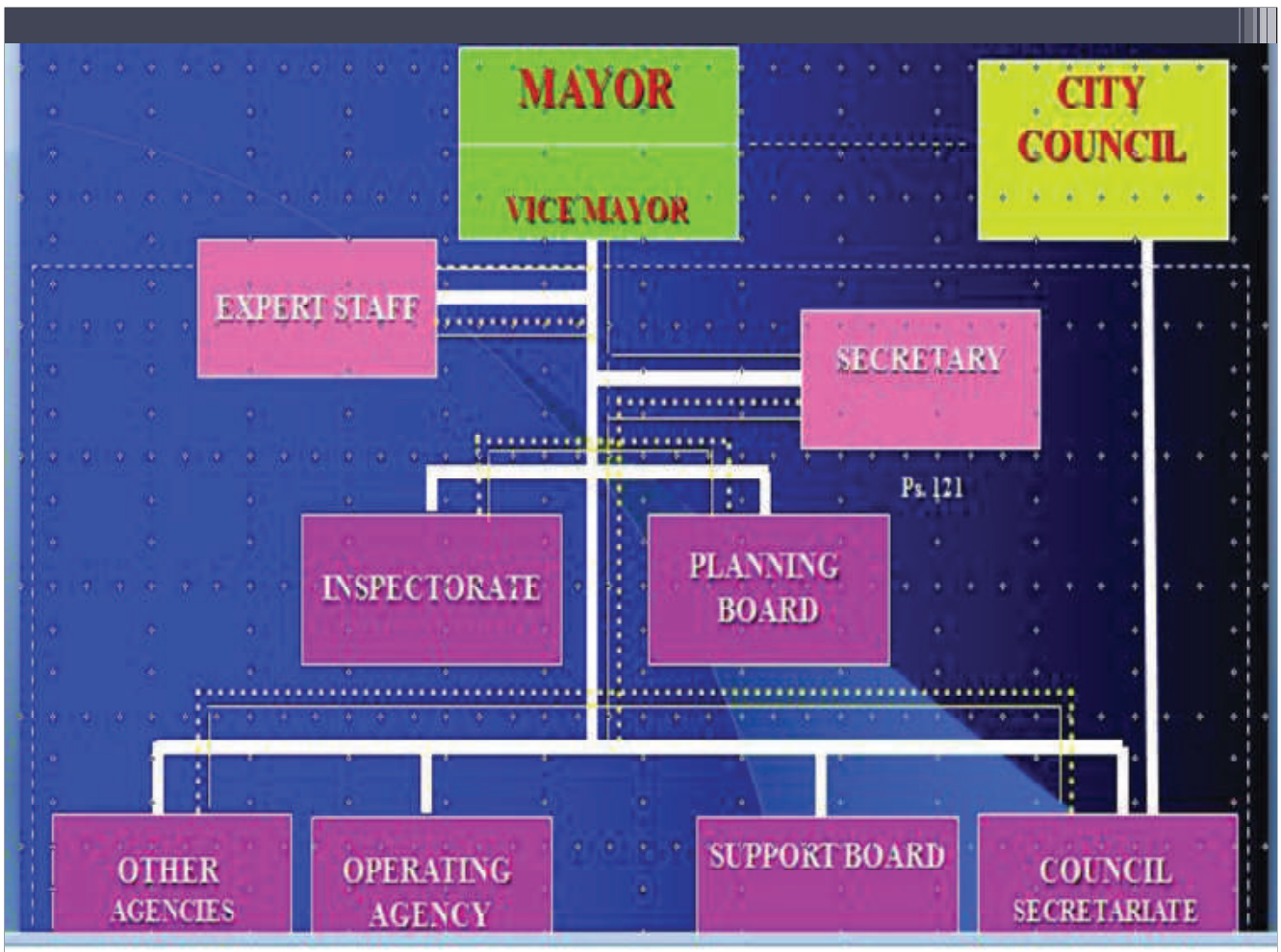
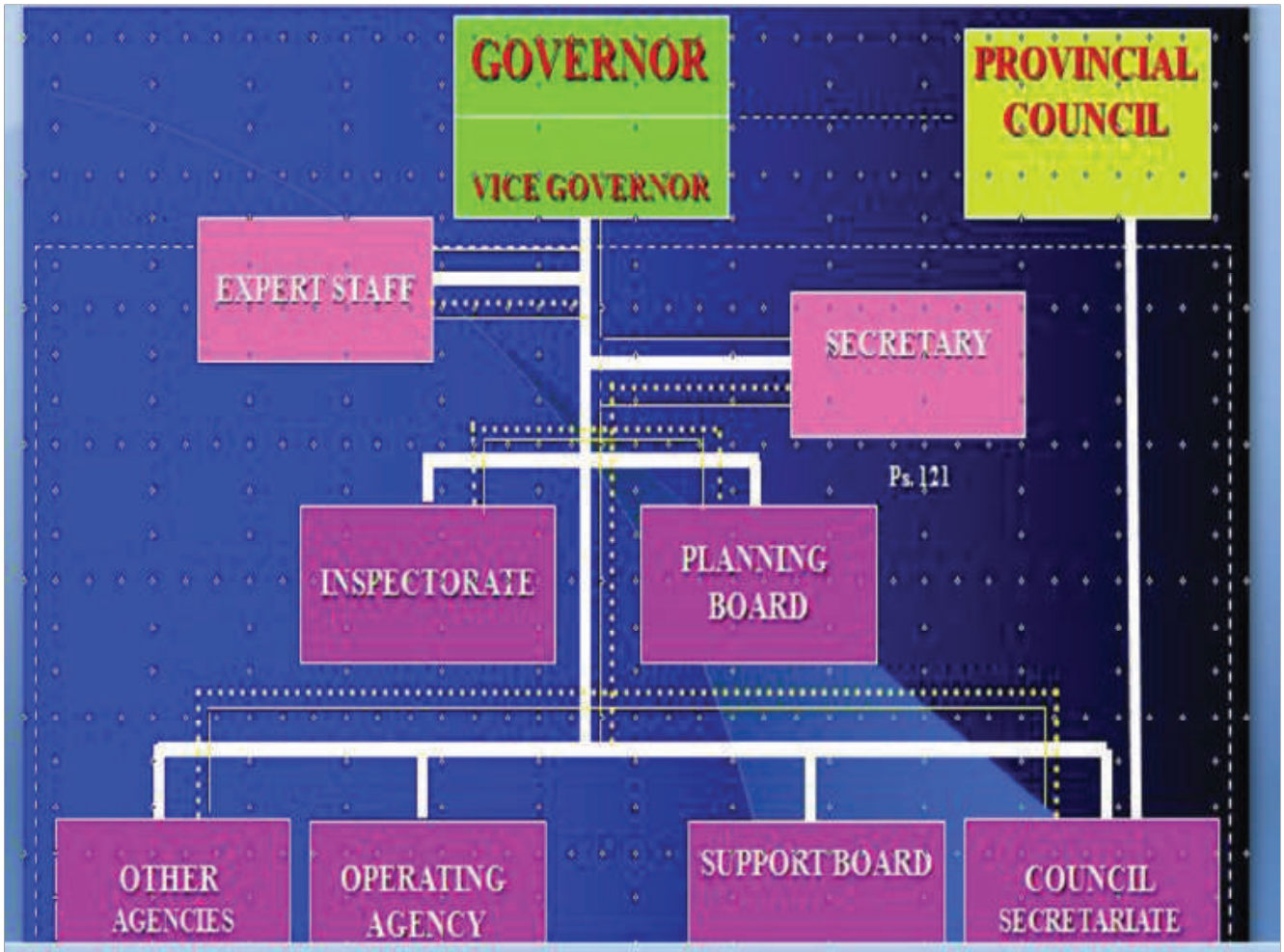
- Law No. 22/1999 which later revised two times (Law No. 32/2004 and Law 23/2014) had some characteristic which became the hallmark of Indonesia's decentralization policy until today.
- The locus of autonomy is in the district/municipal level not in the province. The government argued that district/municipality could ensure better public services delivery to the people. However the political reason was that the government was determined to prevent the concentration of power at the provincial level, taking into consideration the history of regional separatism in Indonesia in the 1950s.

- Except six absolute functions which continues to be in the hands of Central Government, most of the functions in managing local governments, in relation to public service delivery are in the hand of district and municipal government. Governor have to play a dual role, as head of the autonomous province, and representative of the central government in his/her province acting on behalf of the President in conducting monitoring and evaluating the performance of the district/municipality in the province.



## THE TRANSFER OF POWER TO LOCAL GOVERNMENT



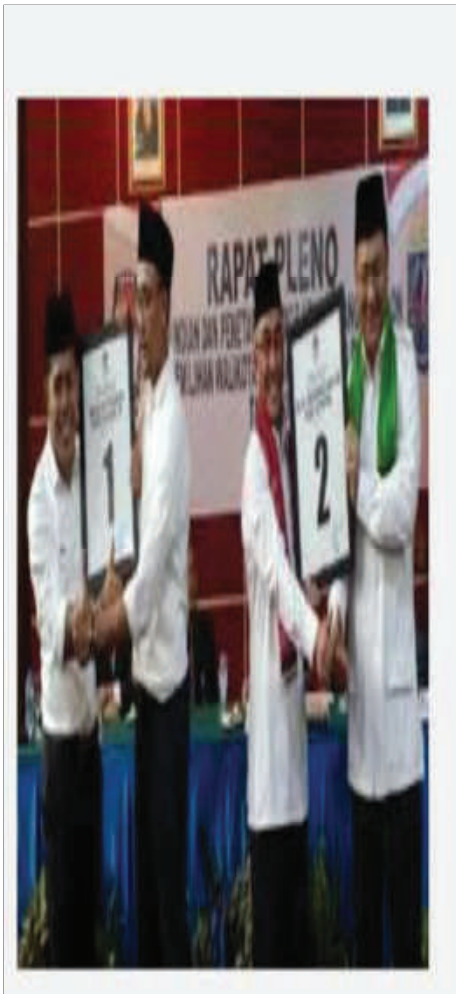


## **Devolved Functions to the Region**

1. Social Affairs
2. Environment
3. Trade
4. Sea and Fishery
5. Forestry
6. Education
7. Health
8. Small and Medium Enterprises
9. Labour and Transmigration
10. Agriculture and Plantation
11. Labor and Transmigration
12. Mines
13. Transportation
14. Investment
15. Tourism and Culture

16. Women Empowerment
17. Family Planning
18. Industry
19. Public Works
20. Spatial Planning
21. Youth and Sports
22. Telecommunication
23. Housing
24. Archives
25. Land Administration
26. Politics and National Unity
27. Statistics
28. General Affairs
29. Village Empowerment
30. Personnel
31. Library





## Local Direct Election (PILKADA)

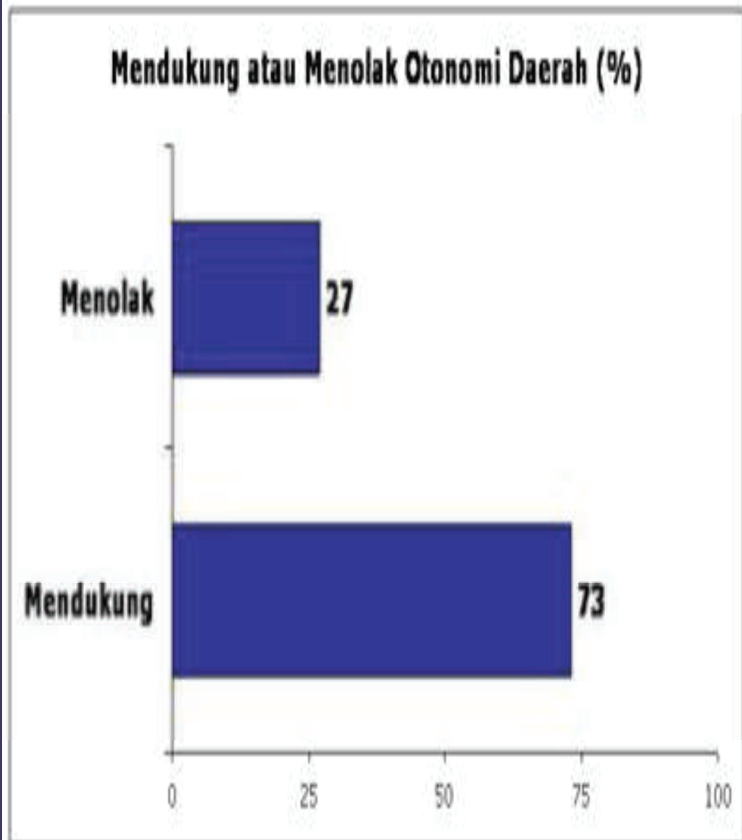
- The revision of Law No. 22/1999 on Local Government (Law No. 32/2004) introduced a direct local election for all of head of local government (regent/mayor/governor).
- Prior to the revision, all the post was chosen by the local councils, but rampant corruption taking place during the election; disappointment with the choice of the Council and lack of people's participation were common.
- The Government changed the election for local government heads making it similar to the Presidential election.



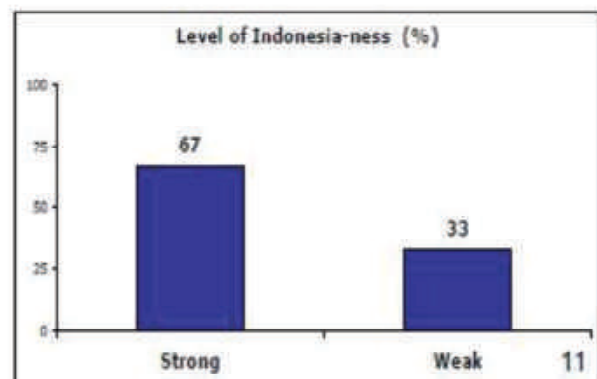
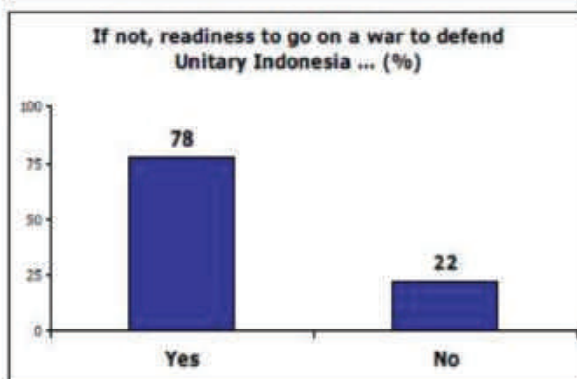
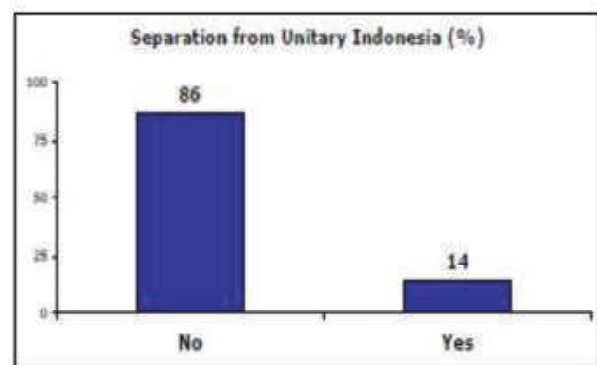
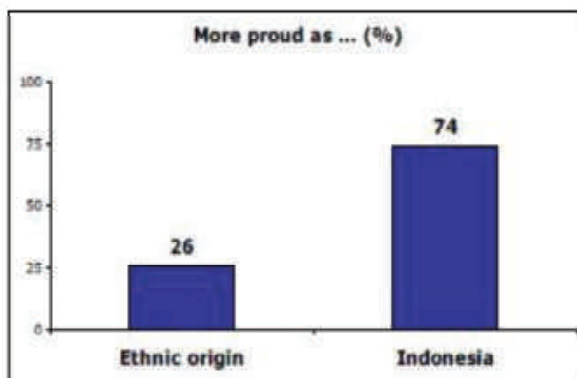
Local Direct Election demanded that the candidate has to be supported by 20 percent out of the total number of seats in the local legislative council or 25 percent out of the total votes received during the legislative election.

The demand forces most of the candidate to look for coalition partners in order to meet the demand of the Local Direct Election Law. Candidate goes even further by choosing his/her deputy from minority background in order to win enough votes during the election.

Six years after the implementation of Local Autonomy Law (2007), respected Indonesian Institute of Survey conducted a survey to 1300 respondents in various part of Indonesia. The survey came with conclusion 73 % Indonesians supported the implementation of local autonomy. Only 27 % rejected the implementation of local autonomy.

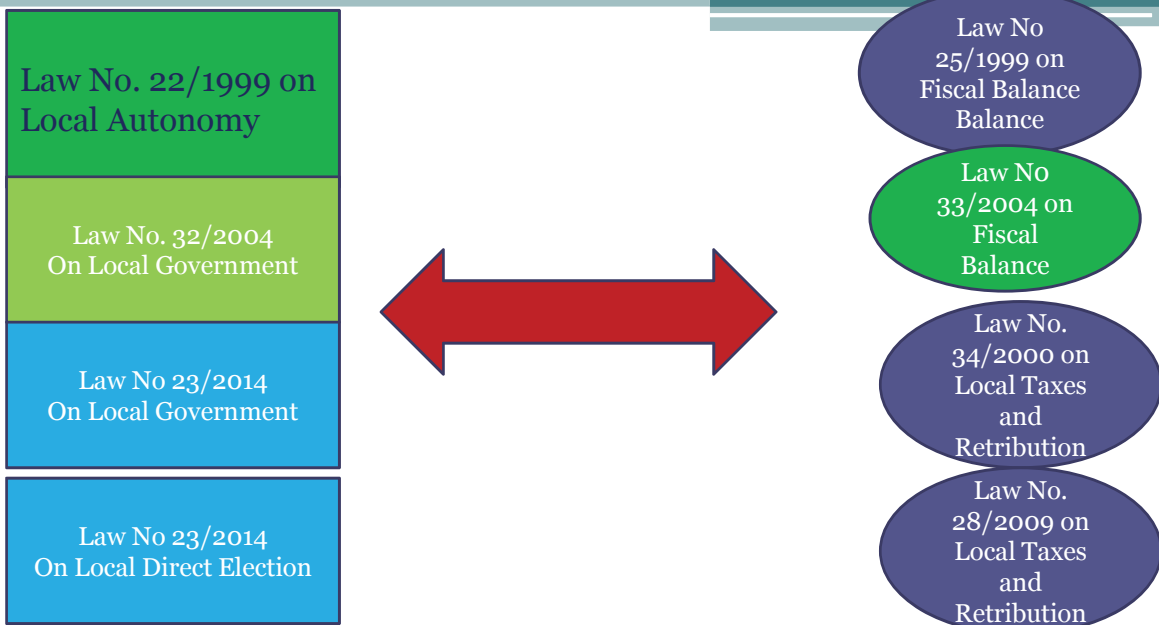


### Commitment to Nationhood (Indonesia-ness)





- **Fiscal Transfer and Limited Local Fiscal Capacity**
- **The Habibie Administration introduced Law No. 25/1999 on Fiscal Balance Between Central and Local Government. The imposition of a new law aimed at promoting decentralization by providing the region with sharing revenue resources to implement local autonomy.**
- **The implementation of the Law 25/1999 like Law No. 22/1999 on Local Government became the hallmark of fiscal relations between Centre and Local Government and continues to be followed to large extent by new Laws that followed**



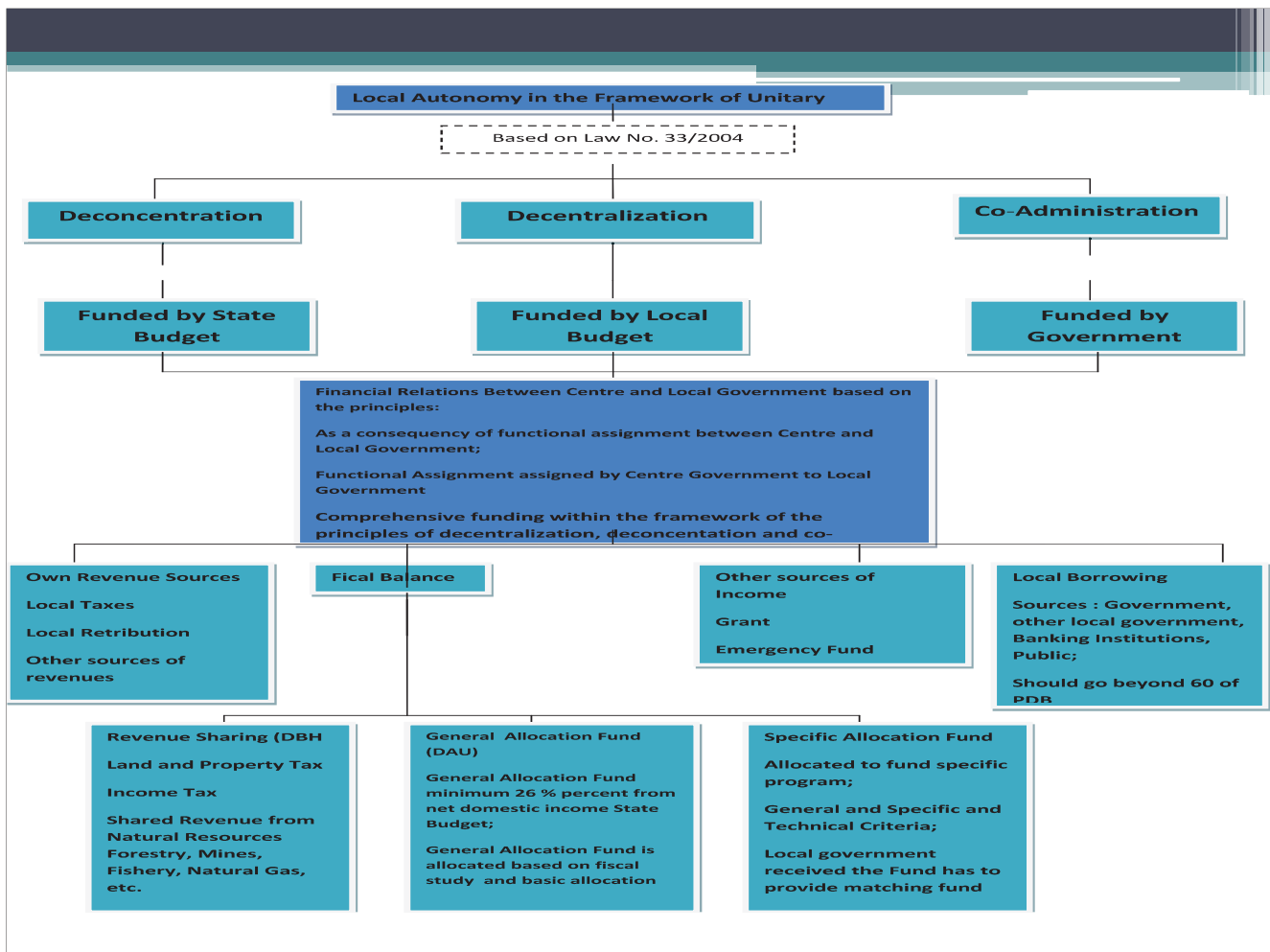
Local government has to have the capacity to manage their own government affairs for the betterment of local public services delivery as well as has the capacity to manage and develop its own sources of revenues and developing its own economic potential (Law No.22/1999).

- Law No. 25/1999 on Fiscal Balance Between Centre and Local Government (later revised as Law No. 33/2004) became the basis for the Government to implement centre-local financial relations based on three principles: deconcentration, decentralization and co-administration.
- Management of centre-local financial relations is based on four principles, namely:
- (1) for functions based on the responsibility of the central government in the region within the framework of deconcentration is funded through the State Budget.

- (2) for functions which are the responsibility of local government within the framework of decentralization are funded by the Local Government Budget (APBD)
- (3) for functions which are the responsibility of the central government or government higher level within the framework of co-administration is funded by central government budget (APBN) or APBD of government of higher level as the responsible government.
- (4) So long as there is insufficiency in financial resources of local government, central government will provide financial support.

- To enable local government in the regions to implement the decentralization policy, Central Government provides financial allocation to the region. The transfer fund to the region can be classified into two categories, namely Fiscal Balance (Dana Perimbangan) and Special Autonomy Fund (Dana Otonomi Khusus).
- Fiscal Balance consists of three parts
- (1) Sharing Revenues (Dana Bagi Hasil)
- (2) General Allocation Fund (Dana Alokasi Umum)
- (3) Special Allocation Fund (Dana Alokasi Khusus)

- **Transfer of fund to the region has some purposes :**
- (1) to minimize the fiscal gap between the centre and the region; and between region and region;
- (2) to facilitate national development priority which becomes the responsibility of local government;
- (3) to improve the quality of public service delivery;
- (4) to increase local government's source of income;
- (5) to expand the development coverage.



## Fiscal Balance Fund (Dana Perimbangan)

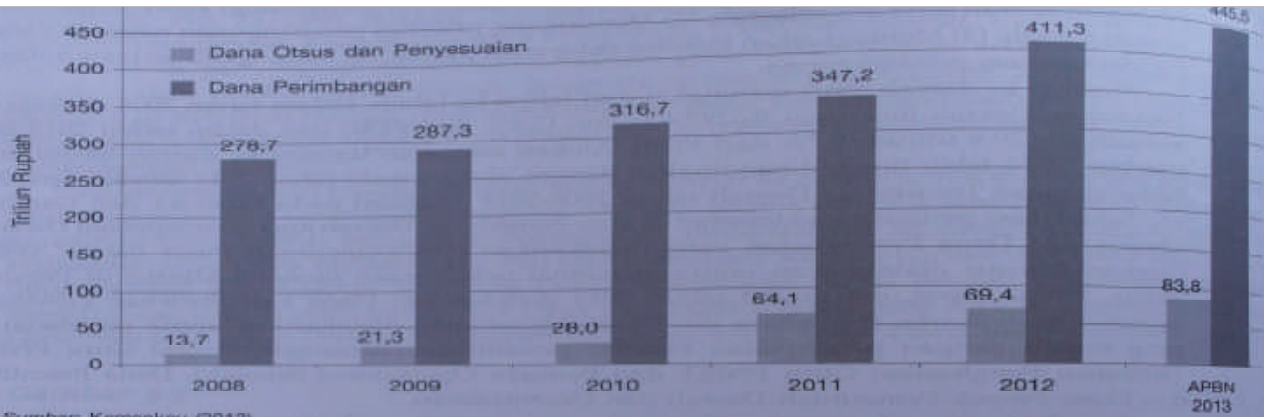
- Law No 25/1999 and Law No. 33/2004 defines Fiscal Balance Fund as source of fund from the State Budget which is allocated to the local government to finance their needs within the framework of decentralization.
- The laws also categorised that Fiscal Balance Fund consist of three components (1) Sharing Revenue Fund.

**Sharing Revenue Fund (Dana Bagi Hasil)** has two components:

- (1) Tax based Income sources consist of :
  - Land and Property Tax (PBB);
  - Retribution on the ownership of land and Property (BPHTB);
  - Income Tax (Pph orang pribadi)

- (2) Non-Tax Based Income Sources/Natural Resources Income consists of :
  - Forestry sector;
  - General Mining Sector;
  - Fishery;
  - Oil Mining;
  - Natural Gas Mining;
  - Law No. 33/2004 defines that the sharing revenues for the centre, province and district. Percentage of sharing revenues from Sharing Revenue Fund is that District may get 64.8 percent, province 16,2 percent and central government may get 10 percent, while 10 percent is allocated for the cost of collecting process.

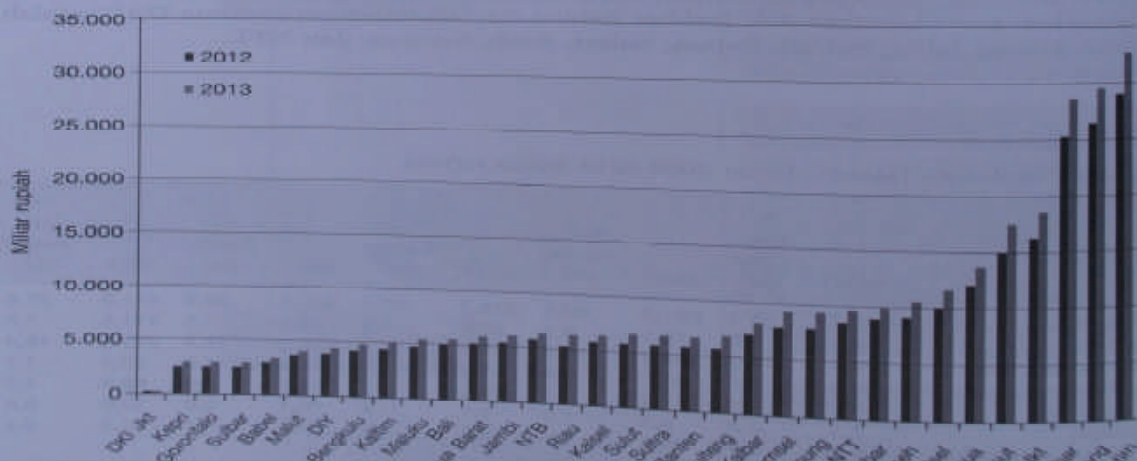
- **General Allocation Fund/Specific Allocation Fund (DAU/DAK)**
  - General Allocation Fund (DAU) and Specific Allocation Fund (DAK) are two important component regulated by Law No 25/1999 and Law No.33/2004 as an integral part of transfer fund from central government to district/city.
  - General Allocation Fund is a block grant allocated to the district and city with the purpose of filling the gap between their capacities and financial needs and it is distributed with a formula based on certain principles which indicating that poorer and underdeveloped regions need to get bigger shares than the rich and developed regions.
  - The main purpose of General Allocation Fund is to achieve certain degree of equality in providing public services delivery by the district/city governments. Law No. 22/1999 stipulated that the central government has to allocate 25 % of its national budget to be transferred to the region as General Allocation Fund.



Sumber: Kemenkeu (2013)

**Gambar 3.7**

Dana Alokasi Umum Per Provinsi di Indonesia, 2012-2013\*



## Special Allocation Fund (DAK)

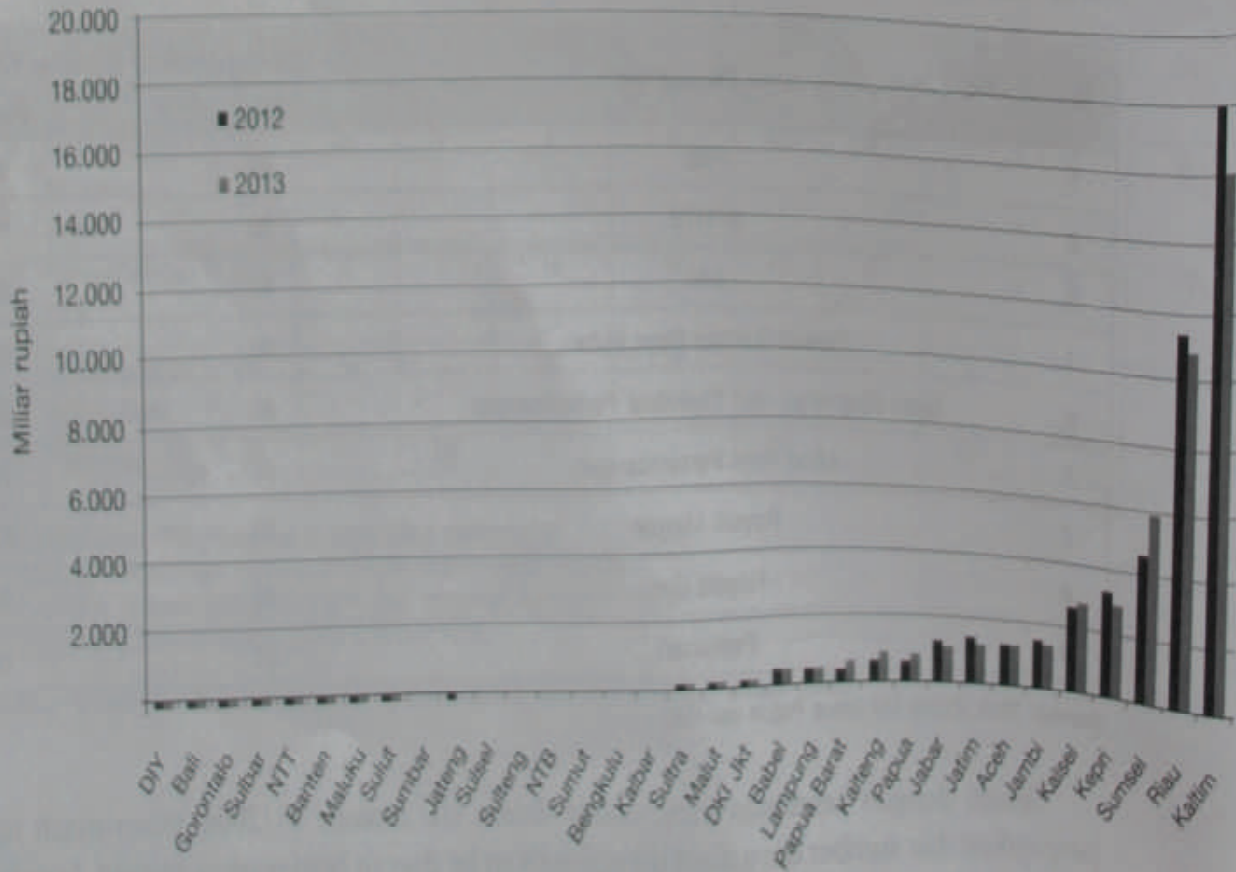
- Special Allocation Fund is directed to certain region with special purpose. The source of budget allocation is the responsibility of central government to be distributed to certain region for specific national purpose.

### Specific purposes in the Special Allocation Fund consist of :

- (1) need for physical structure and infrastructure in remote region;
- (2) need for physical structure and infracture for transmigration region;
- (3) need for physical structure and infrastructure in coastal region/remote islands;
- (4) need for physical structure and infrastructure in the region damaged by environmental disaster.

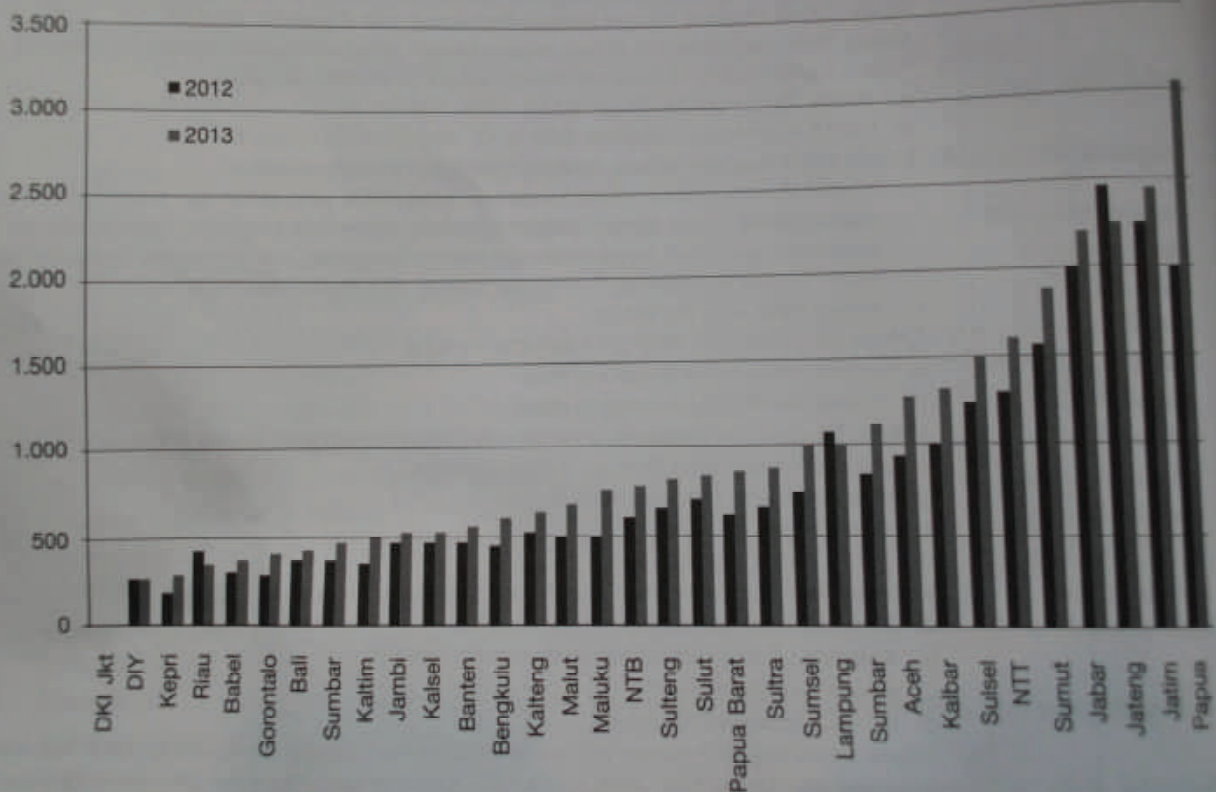


DBH Sumber Daya Alam Per Provinsi di Indonesia, 2012-2013



Gambar 3.14

DAK per Provinsi di Indonesia, 2012-2013



Sumber: Kemenkeu (2013)

## Own Sources of Revenues (PDRD)

- According to Law No. 33/2004 on Fiscal Balance Between Centre and Regional Government, local government has two major sources of revenues to finance their expenditures.
- **First**, own sources revenues are revenues raised by local government from its own local sources, consists of taxes, levies and other sources of revenues.
- **Second**, Intergovernmental transfer consists of Revenue Sharing (DBH), General Allocation Funds (DAU), Special Allocation Fund (DAK).

- Own Source Revenues as source of revenues, the Government tries its best to push the local government to increase its revenue from Local Taxes and Local Retribution (PDRD). To achieve this, the Government introduced and reintroduced regulatory framework to be able to adapt to the new developments (Law No. 34/2000 and Law No. 28/2008)
- To fully support the implementation of decentralization policy, the policy of local taxes and local retribution are aimed at strengthening the taxing powers to the region was introduced. By giving taxing powers to the region, the Government expected the local government would have the capacity to generate enough revenues to be the source of fund for the local services.

**COMPOSITION OF LOCAL REVENUES IN LOCAL BUDGET 2010**

Source of revenues	Total Budget (In Million Rupiah)		
	Total Provinces and District and City	33 Provinces	499 Districts and Cities
<b>Own Sources of Revenues</b>			
<b>Local Sources of Revenues</b>	71.799	47,331	24,468
• Local Taxes	47,674	39,575	8.099
• Local Retribution	8,010	1,429	6,580
• Local Separated Properties	3,636	1,748	1,887
• Other Own Sources Revenues	12,479	4,577	7,901
<b>Fiscal Balance Fund</b>	291,277	45,024	246,253
• General Allocation Fund	192,408	19,299	173,110
• Special Allocation Fund	21,261	774	20
• Sharing Revenues	77,606	24,950	52,656
<b>Others Legal Sources Revenues</b>	38.817	9,964	28,853
• Grant	4,247	469	28,853
• Emergency Fund	371	0	371
• Provincial Taxes	11,947	103	11,844
• Adjustment Fund and Special Autonomy	15,437	8,413	7,023
• Financial Assistant from Provinces	4,942	110	4,831
• Other Legal Revenues Sources	1,870	866	1,003
<b>Total Revenues</b>	<b>401,893</b>	<b>102,318</b>	<b>299,575</b>

- The table above shows total revenues for the aggregate local budget in 2010 nationally was Rp. 401, 9 trillion out of which Rp. 102, 3 trillion (25,5%) was provincial revenues and Rp. 299, 6 (74, 5%) trillion was combined revenues districts and cities.
- Judging from the composition source of revenues, it is clear that local revenues (province and district/city) nationally is dominated by Fiscal Balance Fund which came from the central government, that is Rp. 291,3 (72%), consisting of Rp 192,4 trillion from General Allocation Fund (DAU), Rp. 21, 2 trillion from Specific Allocation Fund (DAK) and Rp. 77, 6 trillion is from Sharing Revenues Taxes/Non-Taxes.
- Revenues coming from local own revenues sources (PAD) Rp. 71,8 trillion (18 %) and other sources of income Rp. 38,8 trillion (10%).

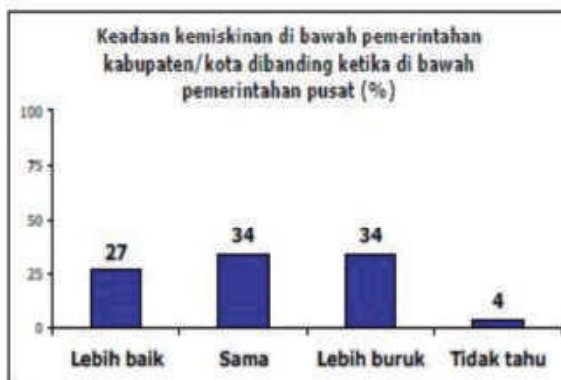
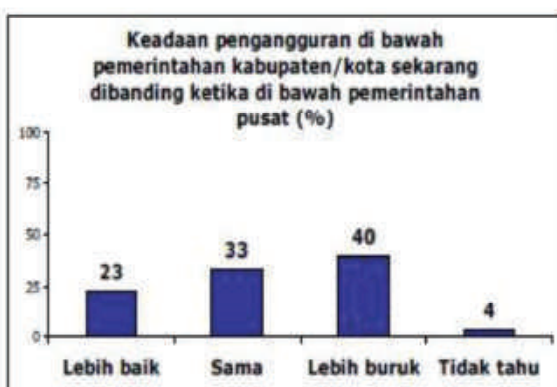
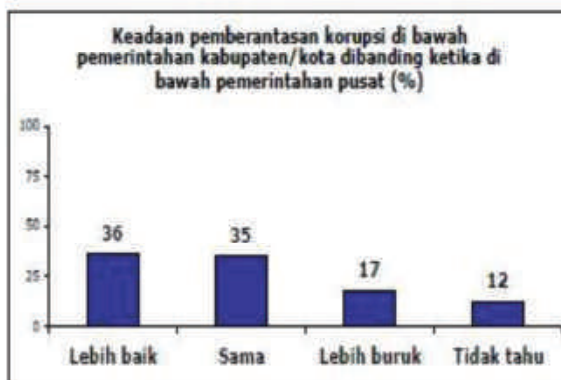
- If the total revenues from provinces and district/city is separated, one will find from the total provincial budget Rp. 102,3 trillion, own revenue sources (PAD) contributes Rp. 47,3 trillion (46%), Fiscal Balance Fund contributes Rp. 45 trillion (44%), other sources of revenues Rp. 9,96 trillion (10%).
- Judging from the revenues side, the role of own sources of revenues and fiscal balance fund at the provincial level are relatively balanced which make the province is less dependent with the central government.

- On the contrary, the situation at the district/city level is different. The total amount of aggregate local budget Rp. 299,6 trillion, the biggest contribution comes from Fiscal Balance Fund Rp. 246,3 trillion (82%), while own source revenues is very small Rp. 24,5 trillion (8%) even far smaller than other sources revenue amounted to Rp. 28,9 trillion (10%).
- Limited capacity of the district/city government to maximize its taxing power granted by the decentralization has been responsible for the performance of district/city government to deliver high quality of public services delivery. As a result, while people supports the implementation of decentralization in Indonesia, people expresses their dissatisfaction with the dismal performance of district/city government.

## Ratio Own Sources of Revenue (PAD) In Total Local Government Budget District/City 2011-2012 (BAPPENAS, 2012)

Ratio PAD In Total PAD Spending	Total Province (%) in 1999	Total District/City (%) in 1999	Total Province (%) in 2012	Total District/City (%) in 2012
- 10 %	3 (11,1%)	156 (51,1 %)	4 (12.1%)	381 % (80%)
10-20%	4 (14.8%)	86 (29.2 %)	3 (12.1 %)	65 % (13,7%)
20-30 %	11 (40,7 %)	0	3 (9.1 %)	22 % (4.6 %)
30-40 %	1 (3,7 %)	8 (2.6 %)	5 (15.2 %)	1 (0.2 %)
+ 50 %	2 (7.4 %)	2 (0.7 %)	8 (24.2%)	1 (0.2%)
Total	27 (100%)	305 (100%)	33 (100%)	476 (100%)

### Evaluasi terhadap kondisi daerah sebelum dan setelah otonomi daerah



## Some Observations

- Politically, Indonesia's decentralization policy has succeeded in achieving its undeclared agenda, maintaining Indonesia's unity and integrity. Even after sixteen years of implementation of decentralization policy, Indonesia's sense of nationhood has become much stronger than before.
- Indonesia has not been so successful to achieve the second goal of decentralization policy in establishing local economic base at the district/city level to enable district/city government to be less dependent on fiscal transfer from the central government. Fiscal transfer continues to be the dominant factor in financing local government.

- The weak local economic base in district/city in Eastern Indonesia has been the legacy of Java oriented development model adopted by the New Order government in for three decades . This contributes greatly to over dependend on fiscal transfer of district/city from the central government.
- Central government has been reluctant to impose stronger measures to reduce the dependency on fiscal transfer to the district/city in Eastern Indonesia due to the political sensitivity of West-East divide.
- Heavy dependend on fiscal transfer from central government is a factor of lack of accountability of the head of district/city to their peoples despite of the implementation of local direct election. Eventually it is also responsible for dismal performance of district/city government in providing better public services delivery.



**THANK YOU VERY MUCH**





## Session 1

### Central-Local Financial System in Asia-Pacific Countries



**Mr. Ahn Young-Hoon**

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Korea Research Institute for Local Administration (KRILA)*

Young-hoon Ahn, Korean national and Senior Researcher Fellow in Korea Research Institute for Local Administration (KRILA) attached to the Ministry of Interior, has been working closely with the Presidential committee on Local Autonomy Development as one of experts since 2004. He participated in the National Risk Assessment Project of the OECD's High-Level Risk Forum on Disaster Management and Resilience Policy since 2012. He has taught at Ritsumeikan Univ. in Japan and in Rutgers Univ. in US, he taught Political Devolution and Fiscal Decentralisation and Regional Development Policy. He has authored a series of publications and comparative research on Advanced Countries Local Government System and International Public Administration. He holds a Ph.D. and Master's degrees of Paris II Univ. of France in Public Law and Paris IV in Sociology.



# **Current Trend of the Intergovernmental Transfer in Korea**

July, 2016

By Dr. Ahn Young-hoon

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Korea Research Institute for Local Administration (Kрила)

## Contents

- 1. Korea Situation at a Glance**
- 2. Local Government Structure and System**
- 3. Local Finance and Intergovernmental Transfer Trend**
- 4. Some Possible Way Forward to Solution**

# Korea Situation at a Glance

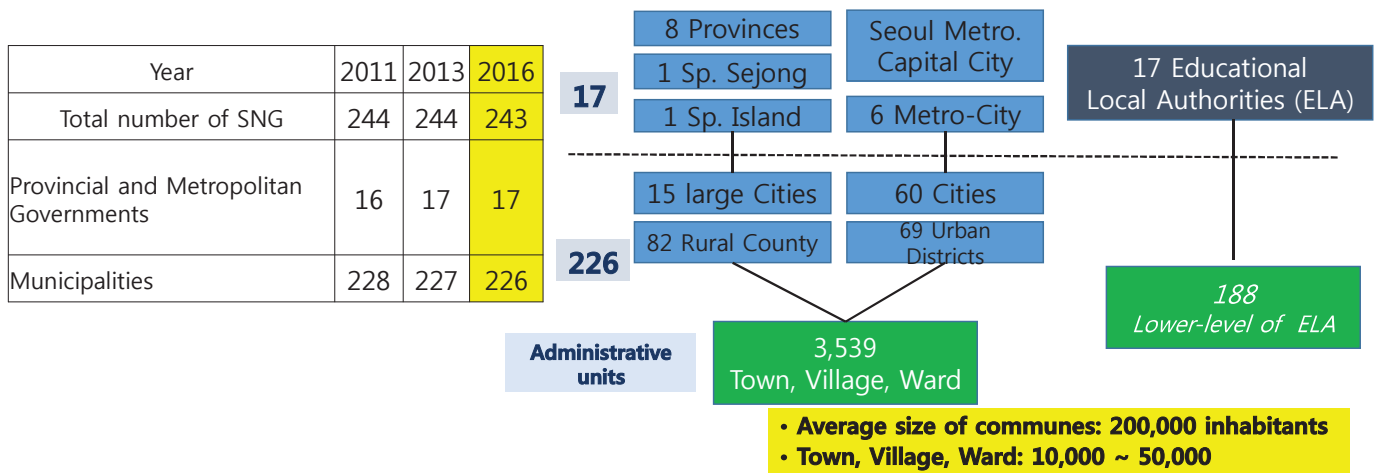
- Korea shows more and more dwindling birth rate
  - The fertility rate, or the average number of babies that a woman is projected to have during her lifetime, stood at 1.24 in 2014 (At least 1.8 level is needed)
  - Labor population (aged between 15 and 64) drops to 37.02 million from 37.04 million in 2016
- The fast-aging society
  - The elderly aged 65 years or older make up 14 percent or more of the population
  - According to the Ministry of the Interior's(MOI) population statistical data,
  - 14.35 million residents in their 20s and 30s
  - 9.7 million people are over 60s
  - 8.37 million in their 50s
  - 8.87 million in their 40s
- Unemployment rates continue to raise
  - The employment rate of people aged 15-29 stood at 41.5% in 2015, whereas the youth jobless rate has been on a continuous rise and reached a record high of 12.5% in February, 2016

# Korea Situation at a Glance

- National debt soaring
  - Since the last decade, Korean government debt grew 12.3 percent per annum on an average
  - It has now exceeded that of some EU countries:
    - **Before, the ratio of government debt to GDP, which stayed below 20 percent in the early 2000s, shot up to 38 percent in 2015**
    - **The government fiscal policy does not include yet raising corporate taxes for conglomerates**
  - The financial ministry lowered its 2016 economic growth outlook by 0.3 percentage point to 2.8 percent decelerating from the previous year's 3.3 percent on-year growth
- However, National Tax Revenue Increased
  - The Ministry of Strategy and Finance (MOSF) announced that it had collected KRW96.9 trillion in taxes in the first four months of the year,
  - A 23% increase from the same period a year earlier and already 43% of the government's targeted tax revenues achieved for 2016
  - Personal income tax revenues grew 22.8% and Value-added tax (VAT) receipts also increased by 22.4%
- But, Political opposition parties pushes to burden more corporate taxes on big companies (e.g., 25% hikes from the current 22%)

## Local Government Structure in Korea

- Two-tiered sub-national governments (SNG)
  - ✓ Upper-level of Local Governments (LG): Provincial/Metropolitan
  - ✓ Lower-level of Local Governments (LG): Municipalities
- Uniformed Organization: Strong-Mayor vs. Weak-Council

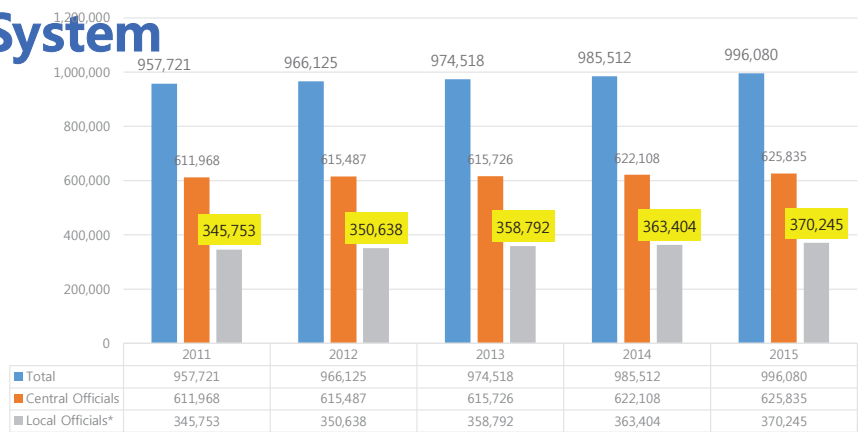


## Elected Local Officials and Politicians

Over 3,687 elected local officials since June 2014 (last local election)

- ✓ 9 provincial governors and 8 metropolitan mayors
- ✓ 226 city mayors (limitation to the consecutive 3-term of office)
- ✓ 789 local councilors in upper-level (84 proportional seats)
- ✓ 2,898 in lower-level (375 proportional seats)
- ✓ 16+1 elected Superintendents of educational local authority (ELA)
- ✓ 82 Educational local councilmembers position abolished

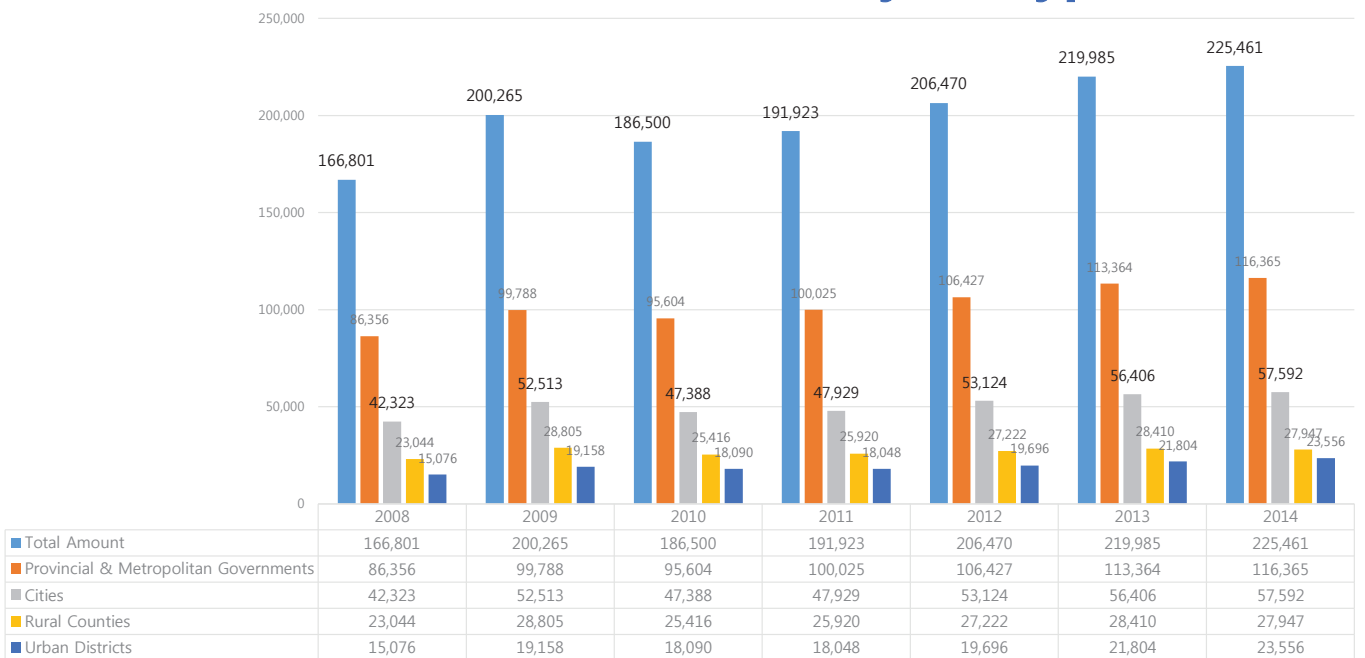
# Local Civil Service System



\* Including Local Officials in Educational Local Authorities

- Dual system of central and local employees in 9 grades, on the basis of on the central and local Civil Service Acts (625,800 vs. 370,000 staff)
- **Local public officials Act** regulates appointment, recruiting, examination, wages, guaranty of status, discipline and sanction, educational training, etc.
- Total number in local workforce is regulated by the Presidential Decree and the ceiling rate of staff number limited within national block grant pursuant to each local government
- Local public officials are recruited on the basis of and conducted by the upper-level local governments

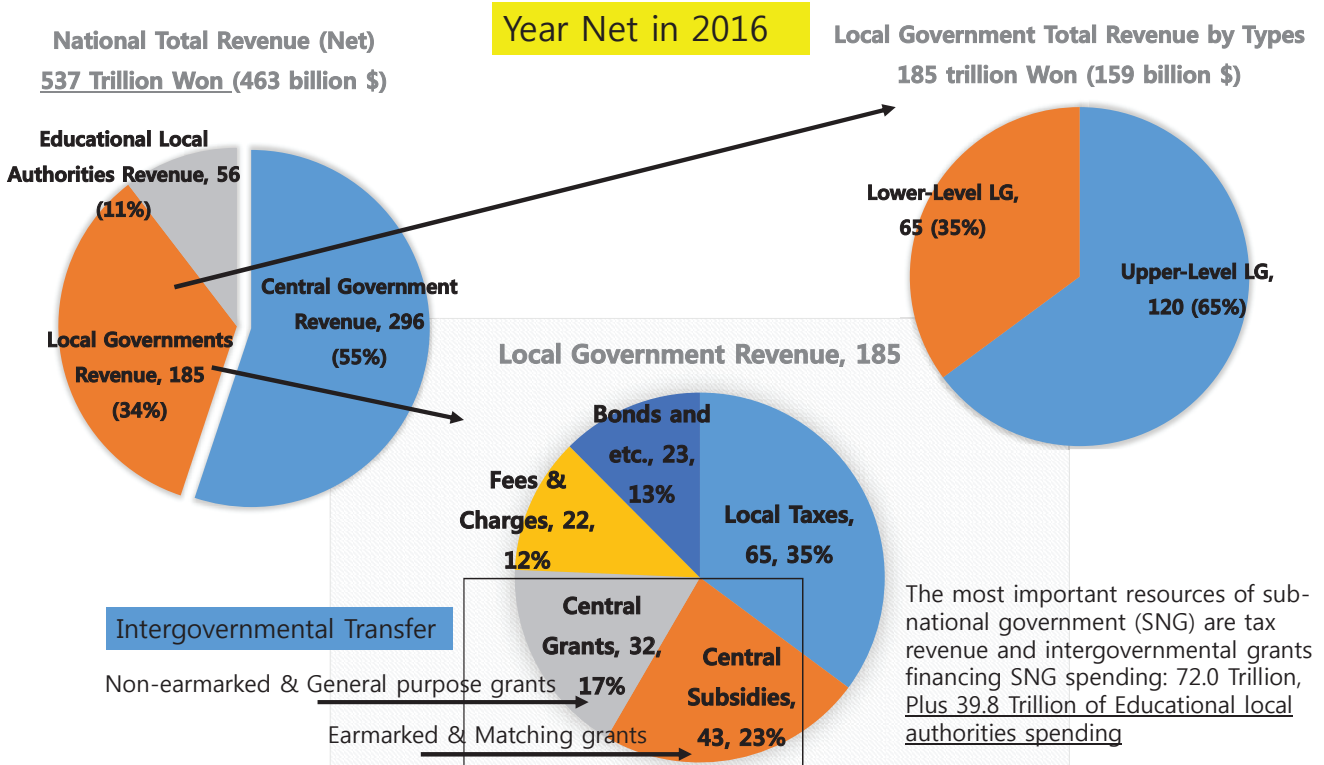
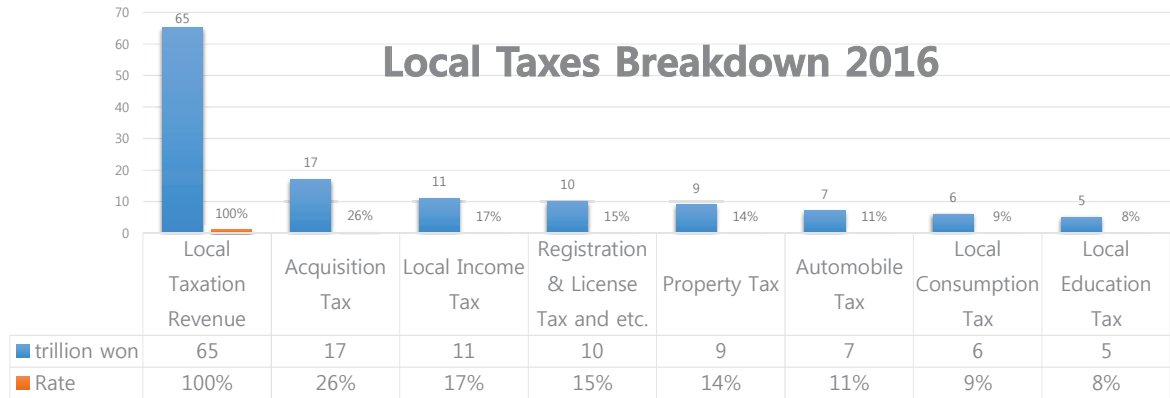
# Total Amount of Local Finance by LG Types

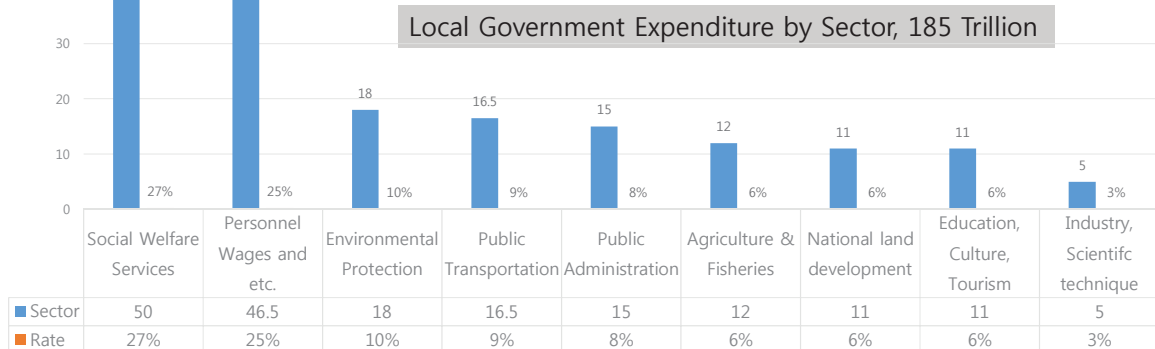
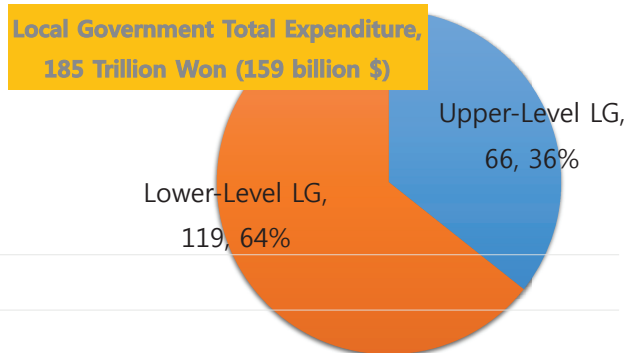
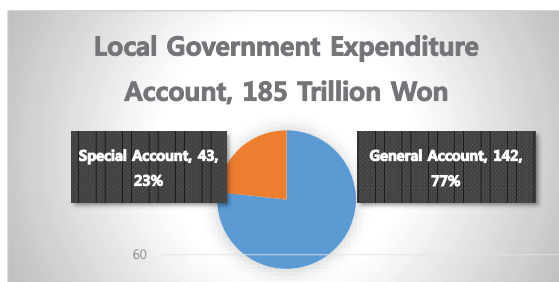


Source: MOI(2016) Summary of Local Budget for FY2016 (Unit: 1 Billion Won)

# Structure and Total Revenue of Local Taxation

- 9 Ordinary taxes
  - Property tax, Local Consumption tax, Local Income tax
  - Acquisition Tax, Registration & License Tax, Resident Tax, Automobile Tax
  - Leisure Tax, Tobacco Consumption Tax
- 2 Earmarked (Special) taxes
  - Regional Resource & Facilities tax, Local Education tax





## The 2016 Intergovernmental Transfer

- Grants from Central Government : 72.0 Trillion
  - **Vertical Transfer, Non-earmarked Central Grants (General purpose grant as local shared tax): 32.0 Trillion**
  - **Earmarked Central Grants (Subsidies): 43.0 Trillion**
- Upper level of local governments transfer also 2 types of grants to municipalities:
  - **Regional government's Adjusted Grant (regional revenue sharing) to Municipalities: 8.2 Trillion**
  - **Regional government's Earmarked Grant (Subsidies) to Municipalities 10.4 Trillion**
- Educational Grants for Sub-national Educational Authorities
  - **Central Government's Grant: 39.8 Trillion**
  - **Local Government's Grants: 8.7 Trillion**
  - **Local Government's Subsidies: 2.0 Trillion**

Source: The Ministry of the Interior's [Local Government Finances 365 \(lofin.moi.go.kr\)](http://lofin.moi.go.kr)  
 Source: Local Finance Reform Website <http://www.moi.go.kr/lfi/>

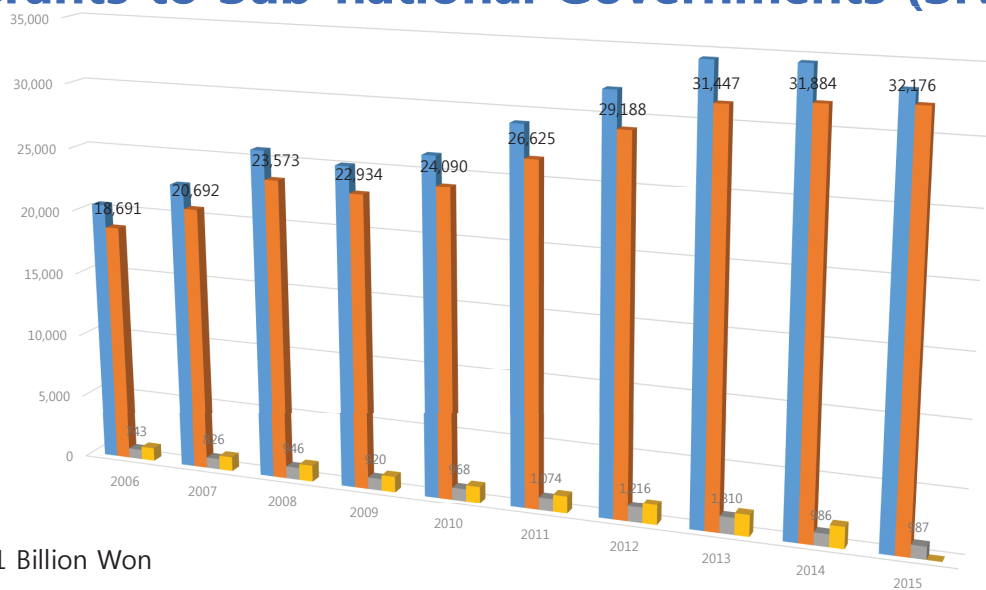


## General Purpose Grant to Subnational Governments

- Central Grants are distributed from Central government to Local governments by issuing part of tax income as financial resources, composed of 3 Taxes composed of
- **1) General Grant** provides general financial resources to maintain basic standards of administration of local governments and takes up 97% of total general grants excluding Decentralization tax
- **2) Special Grant** is to aim at meeting unpredictable financial demands not reflected in calculation of the General Grant (Ordinary Local Shared Tax such as disasters, installation of public welfare facilities, or national projects : 3% of total central grants less Decentralization Tax)
- **3) Decentralization Tax** (0.94% of domestic tax revenue, 2005~2014) was introduced to preserve financial resources necessary for the project to transition part of National Subsidies Projects to local governments
- Legally fixed proportion of 19.24% of total domestic tax: 34.5 Trillion Won in 2014

## Central Grants to Sub-national Governments (SNG)

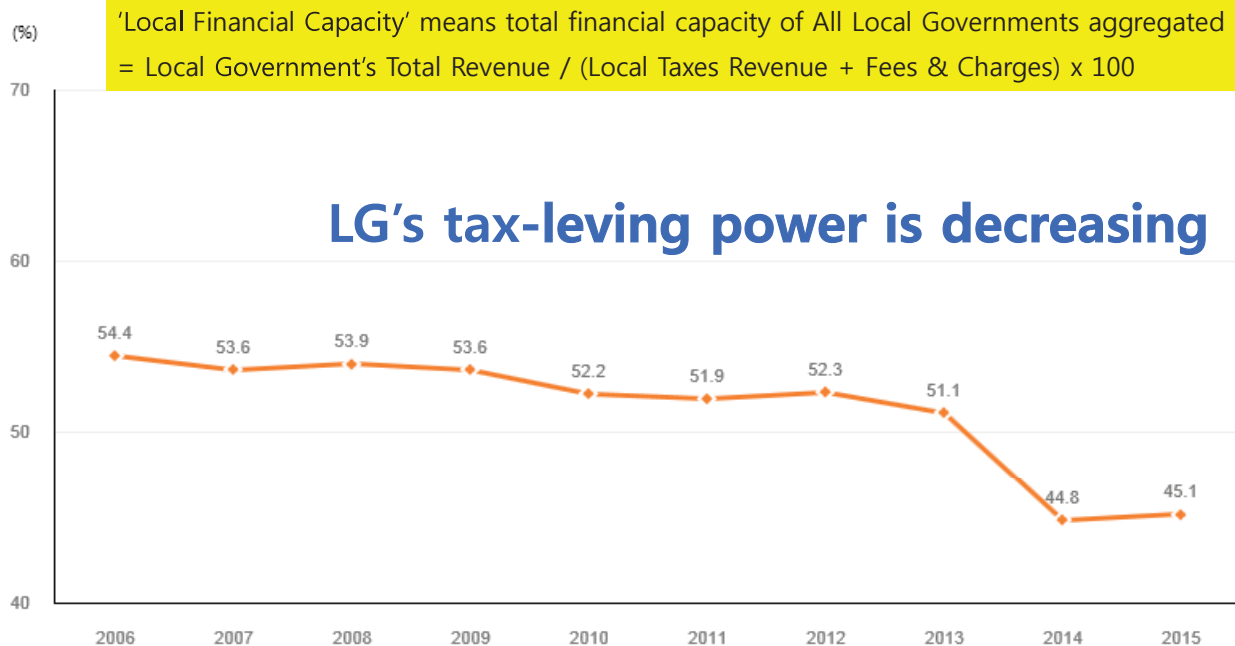
LG's  
Financial  
dependence  
on Central  
government  
is increasing



Unit: 1 Billion Won

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Total Amount	20,441	22,624	25,779	25,080	26,345	29,122	31,966	34,440	34,559	33,163
General Grant	18,691	20,692	23,573	22,934	24,090	26,625	29,188	31,447	31,884	32,176
Special Grant	743	826	946	920	968	1,074	1,216	1,310	986	987
Decentralization Tax	1,006	1,105	1,259	1,225	1,287	1,422	1,561	1,682	1,688	0

## LG's Yearly Local Financial Capacity: Average Rate (%)



## Current Situation in Local Government

- Among the 226 local governments, 75 of them could not afford to pay the local public servants' payroll costs with their own earnings
- Many local government's festivals turned out to have dark sides:
  - ✓ Some festivals and events incurred major deficits as much as 11 billion won
  - ✓ According to the website sources, 361 local festivals that cost more than 300 million won (\$260,000) were held in 2014, and only one that did not lose money was the Hwacheon Sancheoneo Ice Festival in Gangwon
- A controversial plan to adjust local government subsidies:
  - ✓ Government's adjustment plan on Intergovernmental subsidies between municipalities reveals that less-wealthy local governments would receive more grants from central government while wealthier ones would receive less
  - ✓ One of wealthiest municipality, *Seongnam* City, protests that the adjusted plan make them lose their autonomy by eventually making them financially dependent on the central government; City mayor supports its welfare programs financially supporting youth amid high unemployment, offering free school uniforms to students and helping mothers with postnatal care

## Current Situation in Local Government

- Intergovernmental transfers appear to have become the main policy instrument in Korea decentralization
- But, the critical question is therefore how and to what extent the current balance between taxes(local financial autonomy) and grants:
  - It means that decentralization is more asymmetric than a decade ago
  - The gap between SNG expenditure and SNG own tax revenue has widened
  - And the share of intergovernmental grants in total government expenditure covering this gap has become larger

## Better Situation in Local Government

- Good Example: Jeju Island attracts more than 12 million people every year
  - Commemorating 10<sup>th</sup> anniversary of the Jeju Special self-governing Provincial Government, Jeju Island has for years been enticing tourists and investors from around the globe
  - To boost the island's global competitiveness and better cater to overseas demands, the government has taken various legislative and administrative steps since 2006 the Special Act on the Jeju Special Self-governing Province and the Development of Free International City
    - In 2010, it amended the immigration law, granting permanent residency to foreign nationals who invest in property worth \$500,000 or more and live there for at least five years
    - For those, Jeju self-governing authority offer visa-free entry, lower taxes and hassle-free business licensing
  - Foreign nationals now possess some 20.78 square kilometers, or 1.12 percent of the total, with the Chinese being the largest stakeholder with 0.47 percent, followed by the U.S. with 0.22 percent and Japan with 0.13 percent.
  - As of June 2015, at least 14 Chinese investment projects, each worth 5 billion won and totaling nearly 3.8 trillion won

## Recent Efforts to Change in Local Finance

- Performance-based budgeting in LG on the basis of accrual accounting system (2016)
- Newly reframed Program Budget System
- Financial Program Performance Evaluation
- Budget-costing System for measuring exactly daily operational administrative costs and assets depreciation, etc.

## Some Keys to Solution

- Local Taxation Reform
- Establish National Finance Committee on Transfers to Subnational Governments
- Fiscal decentralization Result Evaluation System
- Adopt a real equalization Fund System for Balanced Regional Development

**Thank you so much!**

## Session 1

### Central-Local Financial System in Asia-Pacific Countries



**Ms. Bouangeun Ounnalath**

*Director General, Fiscal Policy Development  
Ministry of Finance, Lao PDR*

Bouangeun Ounnalath is Acting Director General of the Fiscal Policy Department of the Ministry of Finance LAO PDR. She has been in the field of public finance for more than 16 years in the Fiscal Policy Department and Budget Department, many of which involved macroeconomic surveillance and fiscal policies. She was involved in the formulation process of the National Socio-Economic Development Plan and the assessment the impact of revenue collection from foreign trade under the participation at the AFTA. In 2006 joined Policy Research Institute (PRI) of Ministry of Finance of Japan and wrote research paper on Comparison on Salary System for Government between Lao PDR and Japan. She now leads the drafting of Vision 2030 and Fiscal Strategy for Public Finance Development 2025, Five Year Budget Plan 2016-2020, and the legal framework on taxes, royalties and benefits from hydro power and mining sectors.



# Central-Local Finance system in LAO PDR

Asian Public Governance Forum on Local Finance:  
Economic Growth through Local Decentralization

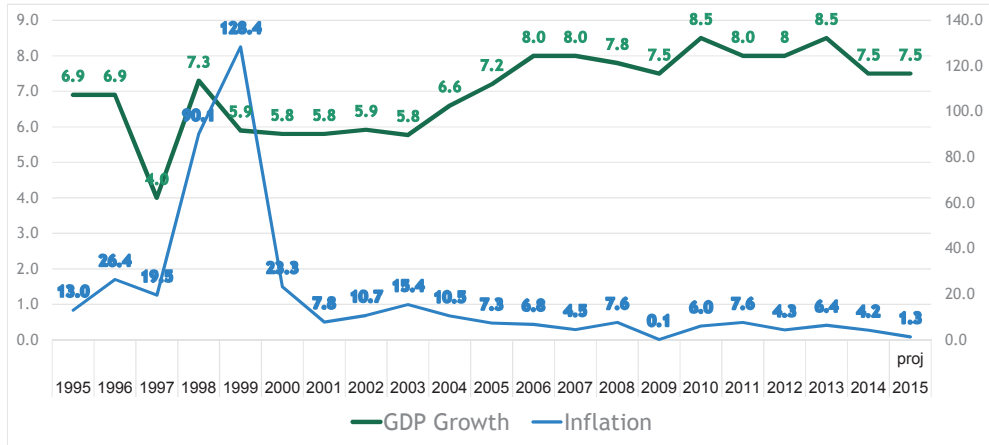
13-14 July 2016/South Korea

Prepared by  
Bouangeun Ounnalath  
Acting Director General  
Fiscal policy Department, Ministry of Finance

## Outlines

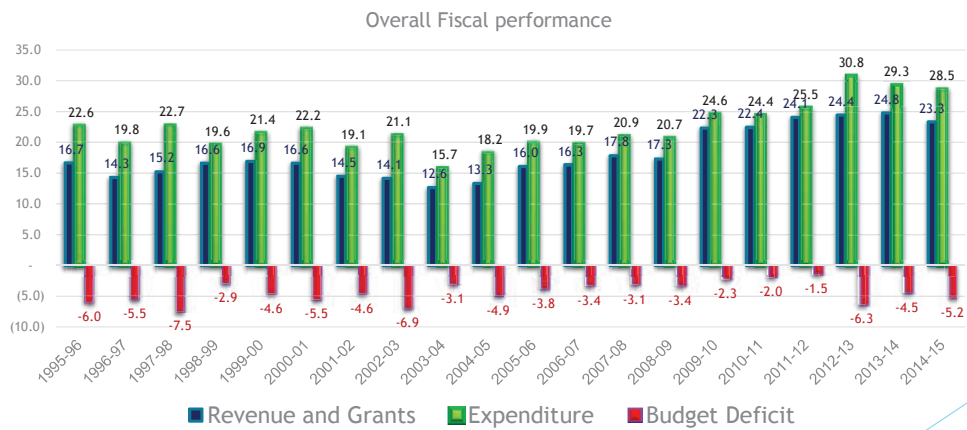
- ▶ Recent Economic Developments
- ▶ Central-Local Fiscal Decentralization
- ▶ Further developments

## GDP Growth (percent)



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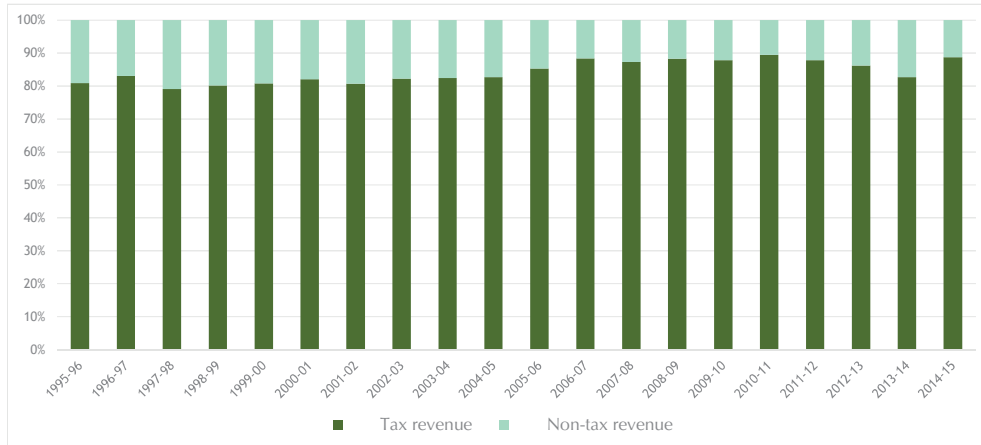
## Fiscal Performance



4



## Revenue Performance



## Government Revenue by sectors



## Recent Economic Developments in Brief

- ▶ The economy of LAO PDR continued to grow at 7.5% in 2014; slightly below the 8% average over 2011-2013 due to slow down in some real sectors and fiscal tightening.
- ▶ GDP per capita increased from 1,100 USD in 2011 to 1,570 USD in 2014.
- ▶ Average annual inflation in 2014 decrease to 4.2 percent from 6.4 percent in 2013 driven primarily by slower growth in food prices and decline in fuel prices and is estimated to be 1.3 percent in 2015.
- ▶ The fiscal deficit for 2014-2015 is estimated to be 5.0% of GDP as a result of fiscal consolidation measures.

## Central-Local Fiscal System

Legal framework to support:

- *The State Budget Law - No 071/NA, dated December 16 2015.*

## State Budget System in LAO PDR

▶ State budget is unified manner throughout the country including central and local budget:

- **Central budget** - *budget of Ministries, ministries-equivalent organizations, the Lao Front for National Construction and mass organizations at the central level.*
- **Provincial/Local budget** - *budget of local administrations and sectors at provincial and district level.*

## Central-Local Fiscal Decentralization

▶ The division of responsibilities between central and local levels of rights in

- guiding
- managing
- and making decision

in budgeting, implementing, consolidate, audit and evaluation the state budget.

## Division of Central-Local in revenue collection

### Division in revenue collection:

- ✓ The state revenue collecting by central level
- ✓ The state revenue collecting by local levels:
  - The state revenue collecting by provinces
  - The state revenue collecting by districts

## Division of Central-Local state expenditure

### State budget expenditures

- ✓ Central budget expenditures
- ✓ Local budget expenditures
  - Expenditures provincial level
  - Expenditures district level

## Central-Local budget transfer

- ▶ Central budget will provide support to the local budget in the event the state revenue collecting by provinces are insufficient to cover local budget expenditures approved by the national assembly.
- ▶ In the event the state revenue collecting by local levels exceeds the plan, the local budgets shall transfer the surplus to the central budget.

## Province-District budget transfer

- ▶ Provincial budget will provide support to the district budget in the event the revenue collecting by the districts are insufficient to cover district budget expenditures approved by the national assembly.
- ▶ In the event the state revenue collecting by districts exceeds the plan, the district budget shall transfer the surplus to the provincial budget.

## Targeted budget transfer

- ▶ The central budget shall provide support to the local budgets for specific investment programmes and national level projects that implementing in the localities.

## Policy to promote revenue collection

- ▶ In the event provincial budget can collect revenue exceed the plan, provinces are allowed to use the proportion of the excess revenue for development purposes by including the programmes or projects in next fiscal year budget.
- ▶ In the event district budget can collect revenue exceed the plan, districts are allowed to use the proportion of the excess revenue for development purposes by including the programmes or projects in the next fiscal year budget.

## Further Developments

- ▶ MoF will continue to draft the guideline for implementing the new budget law.
- ▶ Disseminate the new state budget law to each ministries and provinces.

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Thank you for your kind  
attention

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## Session 1

### Central-Local Financial System in Asia-Pacific Countries



**Ms. Nguyen Thi Thuy**

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Ministry of Finance of Vietnam*

Nguyen Thi Thuy is a senior researcher in the National Institute for Finance attached to the Ministry of Finance of Vietnam. She works for the Public Finance Policy Department, specializes in the state budget and public debt management. She is responsible for conducting research, analyzing economic issues, providing advices and contributing to the Government's policies. Her current research interests include public finance, economic development, fiscal and monetary policies. She holds a master degree in Economics of Money, Banking and Finance from the University of Sheffield, U.K.



**ASIAN PUBLIC GOVERNANCE FORUM ON LOCAL GOVERNANCE:  
Achieving Fiscal Sustainability of Local Governments**

**FISCAL DECENTRALIZATION IN VIETNAM:  
Recent developments and reforms**



**Incheon, July 2016**

**Nguyen Thi Thuy  
National Institute for Finance  
Ministry of Finance of Vietnam**

*The information and view expressed herein does not necessarily represent the opinions of any organization*



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  - Local government borrowing**
- 4. Recent developments and reforms**

## Section 1

### Vietnam's recent fiscal performance



## Recent Economic Developments: An Overview

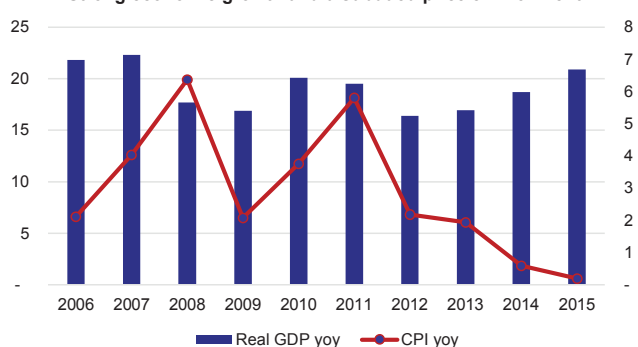
- **Growth continues on a sustainable path**

- ❑ Vietnam is amongst the fastest growing economies in emerging Asia, sustaining an average GDP growth rate of above 6% over the past decade. Growth exceeded the government's own target in 2015, and is expected to accelerate to 6.7% in 2016

- ❑ Growth has been sustainably helped by investments and robust exports, with consumption remaining a key stimulant.

- ❑ Continued macroeconomic stability in Vietnam defies a challenging external environment

Strong economic growth and a subdued price environment



Source: MoF and GSO (2016)

- **Commitment to macroeconomic stability a long-term priority**

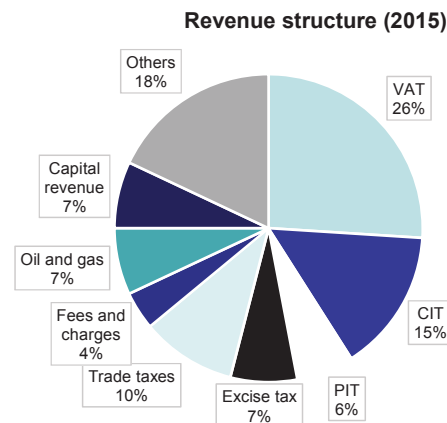
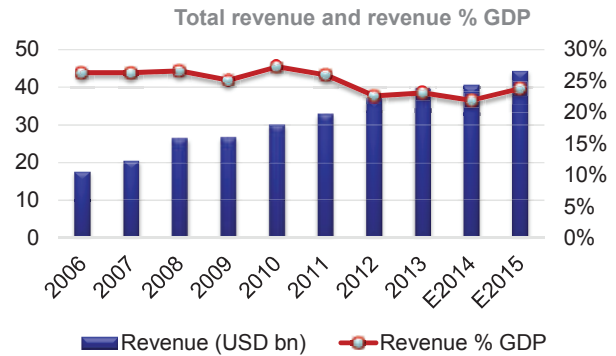
- ❑ A long-term strategy for government finance signals commitment to sustainable fiscal prudence

- ❑ The government stands resolutely committed to driving critical reforms to position Vietnam for future prosperity



## Vietnam's recent fiscal performance: Revenue

- The Government's revenue continued to increase despite the after-effects of the global financial crisis and falling oil prices as a result of the Government's various tax reforms
- Total State budget revenues for 2011-2015 increased 2 times compared to the period of 2006-2010
- Share of domestic revenues increased from 59% for 2006-2010 to 68% for 2011-2015, meanwhile revenue from import and export taxes reduced from 21% to 18% and revenue from oil and gas decreased from 18% to 13%.
- Vietnam relies heavily on consumption taxes with revenue from VAT and excise tax accounted for 26% and 7% respectively of total revenue



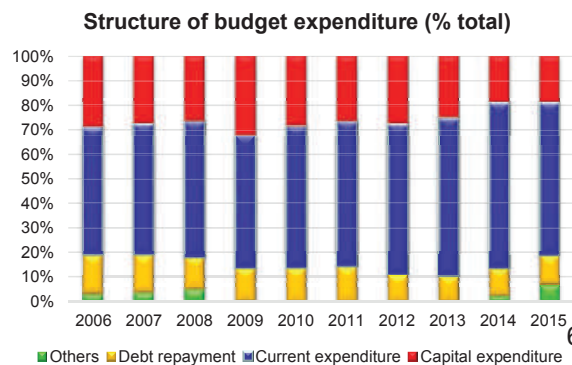
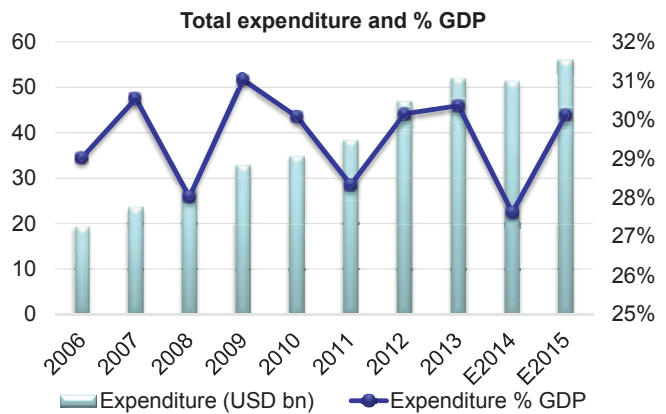
Source: Calculated from MoF (2016)

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## Vietnam's recent fiscal performance: Expenditure

- It meets social security targets, poverty reduction and infrastructure development
- Moving toward promoting social and human development
- The National Target Programs focusing on a wide range of objectives: poverty, education, health, rural development...
- State budget expenditures have been increasing rapidly.
- Current expenditure increased significantly and took the largest share of 63% of the total expenditure as of 2015.



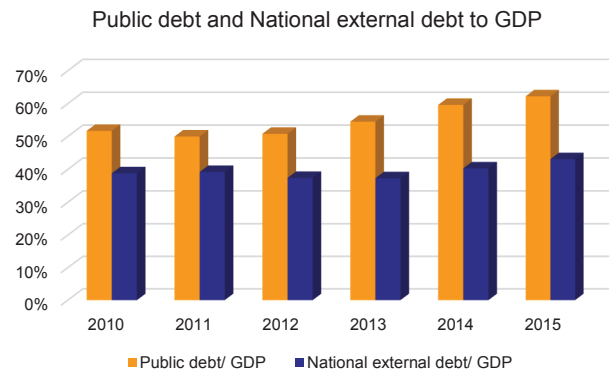
Source: Calculated from MoF (2016)

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## Vietnam's recent fiscal performance: Challenges

- An unstable expenditure structure: rapid expansion of current expenditure meanwhile a significant fall in share of capital expenditure in total expenditure
- High and persistent budget deficit
  - ❑ the average of budget deficit in the period of 2011-2015 was 5.63% GDP
  - ❑ Relatively high compared with other countries in the regions
- Rapid rise in the level of public debt to GDP:
  - ❑ As of 2015, public debt reached a record high 62.2% GDP (the threshold is set at 65% GDP)



Source: MoF (2016)

## Section 2

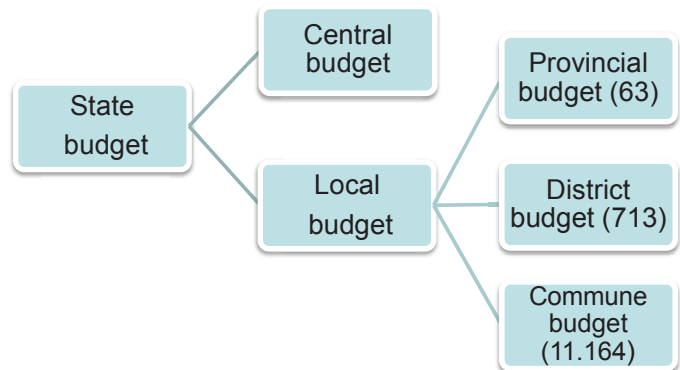
### Central – local fiscal system in Vietnam



## Central – local fiscal system in Vietnam

- Vietnam has 4 tiers of governments: central; 63 provinces (cities); 713 districts (cities, towns); 11.164 communes (wards)
- Vietnam’s budget system consists of central budget and local budget
- Local budget includes:
  - Provincial budget (including provincial and district budget)
  - District budget (including district and commune budget)
  - Commune budget
- The SBL 2002 and revised in 2015 is the key legislation underpinning budget management and covers all levels of government to ensure uniformity of the budget system

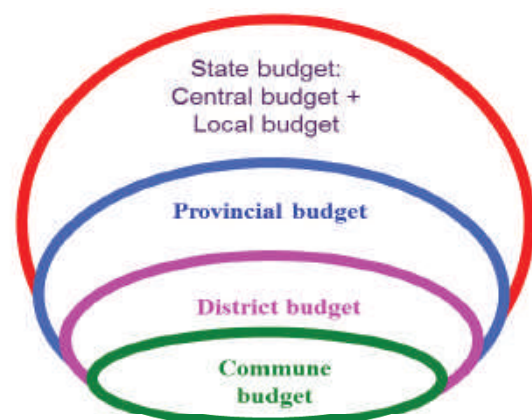
Structure of Vietnam’s budget system



## Central – local fiscal system in Vietnam

- **A nested budget system means:**
  - Lower budgetary level is a component of the upper budgetary level
- Budget of higher level of administration ensure the balance for the budget of the lower → **local budgets are not allowed in deficits.**
- **Consequences of the nested budget system:**
  - Assuring uniformity of the budget but reducing fiscal autonomy of local governments
  - Complicating budget process and monitoring (bottom-up budgeting and top-down decision-making)

Vietnam’s nested budget system



## Section 3

### Fiscal decentralization

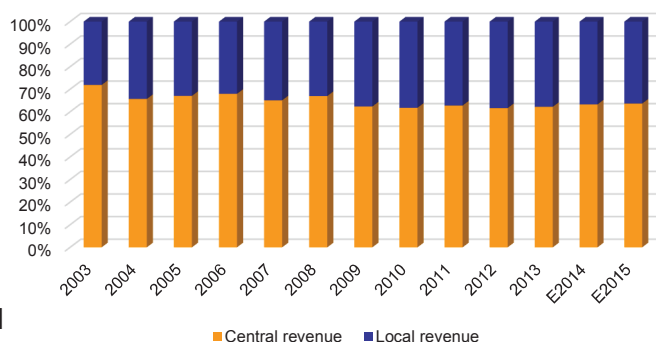


### Revenue sharing

- **A breakdown of the 3 revenue categories**

- ❑ Central revenues: VAT on imports, Import and Export tax, taxes and revenue from petroleum...
- ❑ Revenue retained 100% by local authorities: local fees and charges, land and housing tax, natural resource taxes, registration fees...
- ❑ Revenue shared between central and local governments: VAT (exl. VAT on imports), CIT, PIT...
- Share of local revenue in total government revenue increased from 28.1% in 2003 to 36,4% in 2015
- For central – local shared revenue, Vietnam adopts the “sharing rate” which is kept stable for 3-5 years (known as the Stability period). In principle, provinces with “sharing rate” less than 100% will transfer to the central budget.

Budget revenue composition (% of total revenue)



- In the Stability period 2011-2015, among 63 provinces:
  - ❑ 13 provinces only allowed to keep a portion of shared taxes (the remaining is transferred to the central budget)
  - ❑ 50 provinces retain 100% of shared taxes collected in their jurisdictions.

Source: Calculated from MoF (2016)





## Revenue sharing: Shortcomings

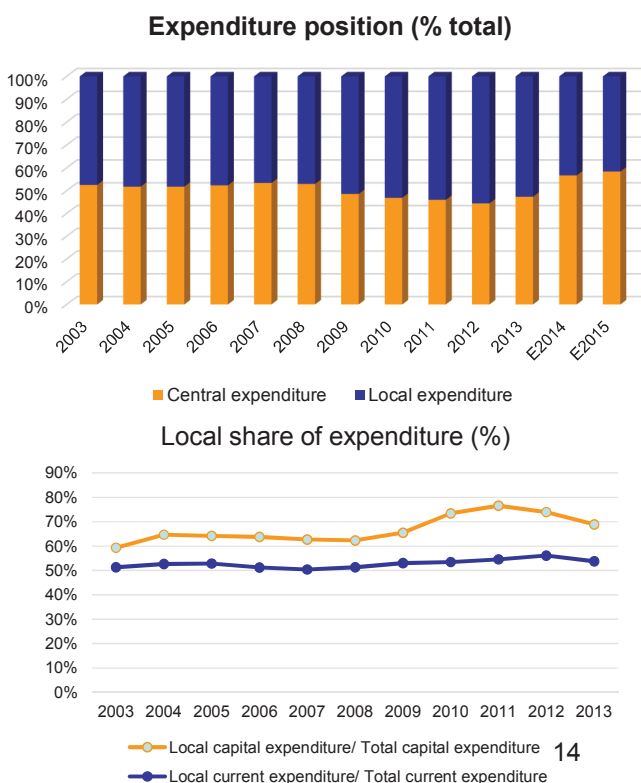
- **Limited revenue autonomy**
  - ❑ Revenues retained 100% by local authorities are small and unstable taxes and fees with relatively low tax collection efficiency
  - ❑ Local authorities have limited powers in setting fees and charges within the ceiling set by the central authorities (local authorities are unable to issue local taxes but able to issue some local fees and charges that present only 10% of total local budget)
  
- **An inappropriate classification of revenue sources for some taxes**
  
- Shared revenues (especially VAT and CIT) are currently shared between central and local governments **based on where revenues are actually collected rather than where they are incurred**
  - Cause of inequality as being likely favor more socio-economic developed local governments

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## Expenditure responsibilities

- **Local governments play a particularly important role in public service delivery**
  - ❑ Local governments are responsible for over half of total government spending, account for 69% of overall capital expenditure and 54% of current expenditure (2013)
  - ❑ More spending are given to local governments in education, health care and social assistance
  
- Provincial authorities have the autonomy in determine fiscal relationship (expenditure assignments and revenue sharing) with districts and communes within their jurisdiction.



Source: Calculated from MoF (2016)



## Expenditure responsibilities: shortcomings

- ❖ Most expenditure assignments are **shared/ concurrent** that may cause ambiguity over expenditure assignments
- ❖ **Lack of explicit assignments** for different tiers of government
  - In many cases, both province and district authorities are also assigned the same service delivery responsibilities that may lead to overlap and unduly complicates planning and budgeting
- ❖ **Central fiscal rules and norms on minimum allocations impact adversely on local autonomy**
  - There are minimum allocations set for education and science and technology without due consideration of actual needs, the level of service provision and capacity to absorb
  - A minimum allocation to an area such as science and technology without consideration of capacity can lead to waste and the inefficient use of resources
- ❖ Expenditure assignments are based on **standards and norms** without consideration of public service provision

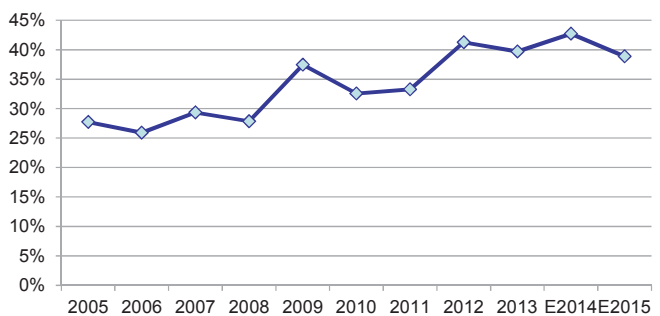
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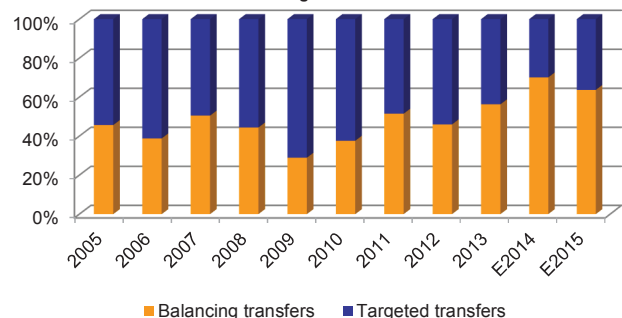
## Intergovernmental fiscal transfer

- Vietnam has developed a relative transparent rule-based system of intergovernmental fiscal transfer to narrow horizontal and vertical imbalances
  - Balancing transfer (unconditional transfer)
  - Target transfer (conditional transfer) includes 16 National targeted programs
- Balancing transfers and shared revenues are used by provincial authorities to deal with horizontal and vertical imbalances across districts
- **Challenges**
  - The current system has promoted more equality across and within provinces but there is wide variation in per capita expenditure across provinces and regions
  - 'Negotiation mechanism'
  - Lack of predictability in targeted transfers...

Total transfers as % of central revenue



Share of balance and targeted transfers in total transfers



Source: Calculated from MoF (2016) 16



## Local government borrowing

- According to the SBL 2002, local governments are allowed to borrow domestically (issue local government bonds and other legal borrowing) to finance local infrastructure projects
- The local borrowing limits help to maintain local debt at prudent levels.
- ❑ For local governments, Vietnam's provinces are only allowed to borrow up to 30% of their capital budget (except Hanoi and HCMC)
- Currently, share of borrowing by local authorities in Vietnam's total public debt remains small (the average of 3% during 2003-2015)
- **Shortcomings:**
  - ❑ Some provinces have breached their borrowing limits
  - ❑ It needs to look closely at indirect liabilities and contingent liabilities (e.g. Local Development Funds, local SOEs...)
  - ❑ A ceiling based on annual capital budget is not based on economic rationale
    - The annual capital budget is unstable and heavily relies on the local revenue
    - The ceiling of local government borrowing should monitor both debt service and debt stock that reflect debt sustainability, solvency and repayment capacity

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## Section 4

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### Recent developments and reforms



## Recent developments and reforms

- *The revised SBL 2015, with effect from budget year 2017, ensures the uniformity of the state budget, increases fiscal decentralization and promotes the autonomy of the local governments. It also addresses the shortcomings of the fiscal decentralization in the SBL 2002 through major changes as follows:*
- **Revenue sharing: It aims to maximize revenue retained at local budget either through 100% local retained or central-local shared revenue.**
  - **More accurate** classification revenue sources  
E.g. CIT of enterprises with uniform accounting shall be shared between central and local governments (instead of central revenue according to the SBL 2002)
  - **More comprehensive:** e.g. Revenue from fines for administrative violations and other fines is specified in the SBL 2015 (not clearly specified in the SBL 2002)...

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## Recent developments and reforms

- **Intergovernmental fiscal transfers**
  - **More flexible:** In the Stability period, the competent authorities are able to decide an increase in balancing transfers from the higher level budget to lower level budget compared to the first year of the Stability period (as in the SBL 2002, balancing transfers keep unchanged in absolute values during the Stability period, thus difficulties may arise for provinces with limited fiscal capacity)
  - **More specific:** Targeted transfer shall be used in these cases:
    - (i) To implement new policies enacted by higher level authorities that are not allocated in the budget estimate of the beginning year of the Stability period
    - (ii) To implement National target programs and programs/ projects assigned by the higher level authorities
    - (iii) To support for recovery from natural disasters, epidemics and disasters beyond the fiscal capacity of the lower level budget
    - (iv) To support for several major and particularly important programs/projects that have a tremendous impact on local socio-economic development. The total capital investment of central budget transferring to local budget shall be capped at 30% of total capital expenditure of central budget
  - **Strengthening the legal basis in special cases** such as local revenue is lower than the estimate due to objective reasons or excessive revenue...

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## Recent developments and reforms

- Local deficit**
  - Local budgets are allowed in deficit
  - The state budget deficit includes deficits of both central and local budgets
- Local government borrowing:** Based on the debt servicing capacity of local governments. E.g.
  - The SBL 2015 caps outstanding loans of Hanoi and HCMC at 60% of the revenue retained
  - Provinces which have their total retained revenue higher than local current expenditure are required to maintain outstanding loans below 30% of the revenue retained
  - Provinces which have their total retained revenue not exceeding local current expenditure must maintain outstanding loans below 20% of the revenue retained
- Set budget institutional framework for policy making** (e.g. medium-term fiscal framework)
- Establish a legal basis to set ground for performance-based budgeting**
- Improve fiscal transparency and accountability**

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## ...and prospects for further changes

- ***Through significant changes have been achieved regarding fiscal decentralization, in order to improve the efficiency of using national financial resources, there is clearly a critical need for further reform would focus on following aspects:***
  - Completion of set of expenditure norms and criteria would provide a better ground for strict control over state financial resources utilization (issued Decision on promulgating a set of quantitative norms for state budget allocation for investment expenditures in the period of 2016-2020)
  - Strengthening transparency and disclosure of the state budget (The OBI of Vietnam for the year 2015 is 18/100, considerably lower than the global average (45/100) and many other Southeast Asian countries)
  - Although the SBL 2015 mentions performance-based budgeting, it needs further steps to strengthen the system from input driven approach to more performance-based one
  - ...

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Thank you for your attention

## Speakers

Mr. Cecep Effendi

Director General, Centre on Integrated Rural Development for Asia and the Pacific



Mr. Ahn Young-Hoon

Senior Research Fellow, Local Administration Office, Korea Research Institute for Local Administration



Ms. Bouangeun Ounnalath  
Director General, Fiscal Policy Development, Ministry of Finance, Lao PDR



Ms. Nguyen Thi Thuy  
Senior Researcher, National Institute for Finance, Ministry of Finance, Viet Nam





## Discussion





## Session 2

### Strategies to Prevent and Overcome Local Financial Crisis

#### Speakers

##### ***Thai Strategies to Prevent Local Financial Crisis***

- Mr. Withee Pharnichwong, Senior Economist, Fiscal Policy Office, Ministry of Finance, Thailand

##### ***The factors of fiscal crunch and the strategies for financial soundness in local government - with a case of Incheon metropolitan city***

- Mr. Lee Yong-Chul, Assistant Mayor for Planning and Coordination, Incheon Metropolitan City, Republic of Korea

##### ***Move of Huawei from Shenzhen, Local Finance, and Supply-side Reform***

- Mr. Yanfeng Bai, Professor, Dean of the School of Public Finance and Tax, Central University of Finance and Economics, Beijing, China

#### Discussion

- Moderator: Mr. Kim Pilhyun, Research Fellow, Korea Institute of Local Finance



## Session 2

### Strategies to Prevent and Overcome Local Financial Crisis



**Mr. Withee Pharnichwong**

*Senior Economist, Local Fiscal Policy sub division*

*Fiscal Policy Bureau, Fiscal Policy Office, Ministry of Finance, Thailand*

Withee Pharnichwong has worked in the Fiscal Policy Bureau, Fiscal Policy Office more than a decade, mainly focus in government expenditure policy such as budget formulation, budget monitoring, also making fiscal policy to respond with the changed economic situation. Currently, He has worked in the Local Fiscal policy sub division, which responsible for the calculation of overall revenue of the local authorities, determine the criteria for allocation of revenue to the local authorities, also engage in the development of local policy and regulatory.

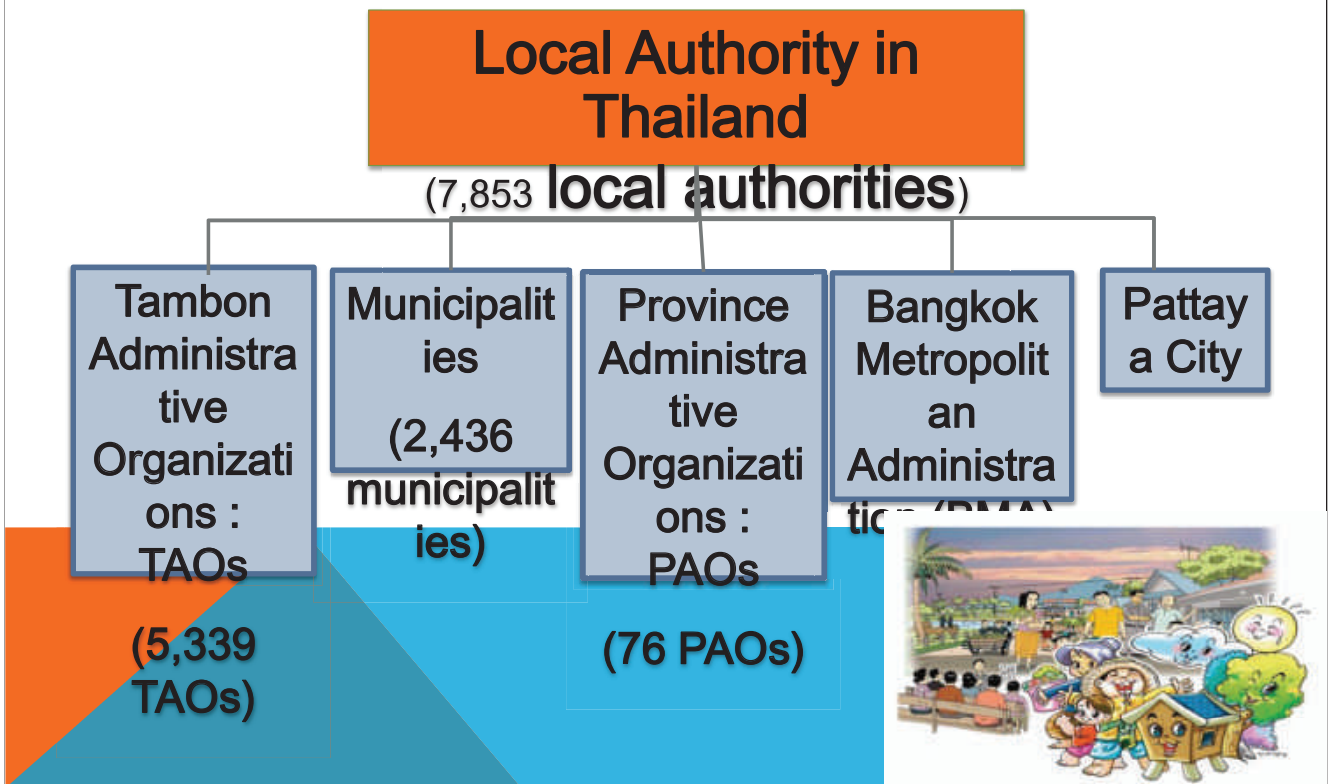


# THAI STRATEGIES TO PREVENT LOCAL FINANCIAL CRISIS

## Thailand Decentralization

- In 1997 the Thai Constitutions had intended to decentralize to the local authorities, aimed at increasing local autonomy, local authority, and local administration to self determine of local affairs, develop local economies, public Utilities.
- In 1999 the Decentralization Acts has become effective. The main purposes of this act is to serve as the backbone of decentralization, including
  - (1) the National Decentralization Committee (NDC)
  - (2) local services responsibilities
  - (3) the allocation of taxes and duties
  - (4) the decentralization plan
  - (5) measures for transitional period.

## Decentralization structure



## HOW LOCAL AUTHORITY FINANCE THEIR ACTIVITIES?



**“Only 10 Percent of Locally self collected”**

**Instability of Financing**







Instability of Financing

Inability to Pay Back Debt

How to Prevent Local Financial Crisis



## HOW TO PREVENT LOCAL FINANCIAL CRISIS

- ✓ Debt Emerging Control
- ✓ Accumulated Reserve



## DEBT EMERGING CONTROL



1. Only Municipalities, PAO, and Pattaya City that can borrow.
2. Have to be investment project that already contained in the 3 year Local Development Plan (approved by communities)
3. Have to do the analysis of revenue and expenditure in the past 3 years, included pay back plan
4. The past debt plus the new debt not more than 35 percent of the investment budget
5. Have to pay back with in 10 years

## ACCUMULATE RESERVES



We established **“The accumulated Reserves”** which collect 25 percent from money left from payment in the annual budget to act as a reserve of Local authority

**“The accumulated Reserves”** is allow to use in

- 1) The case of the income is insufficient and need the money first such as paying salary etc.
- 2) Paying for treatment of suffering from emergency occurrences such as natural disaster

**“The accumulated Reserves”** must approve by local parliament .

**THANK YOU**





## Session 2

### Strategies to Prevent and Overcome Local Financial Crisis

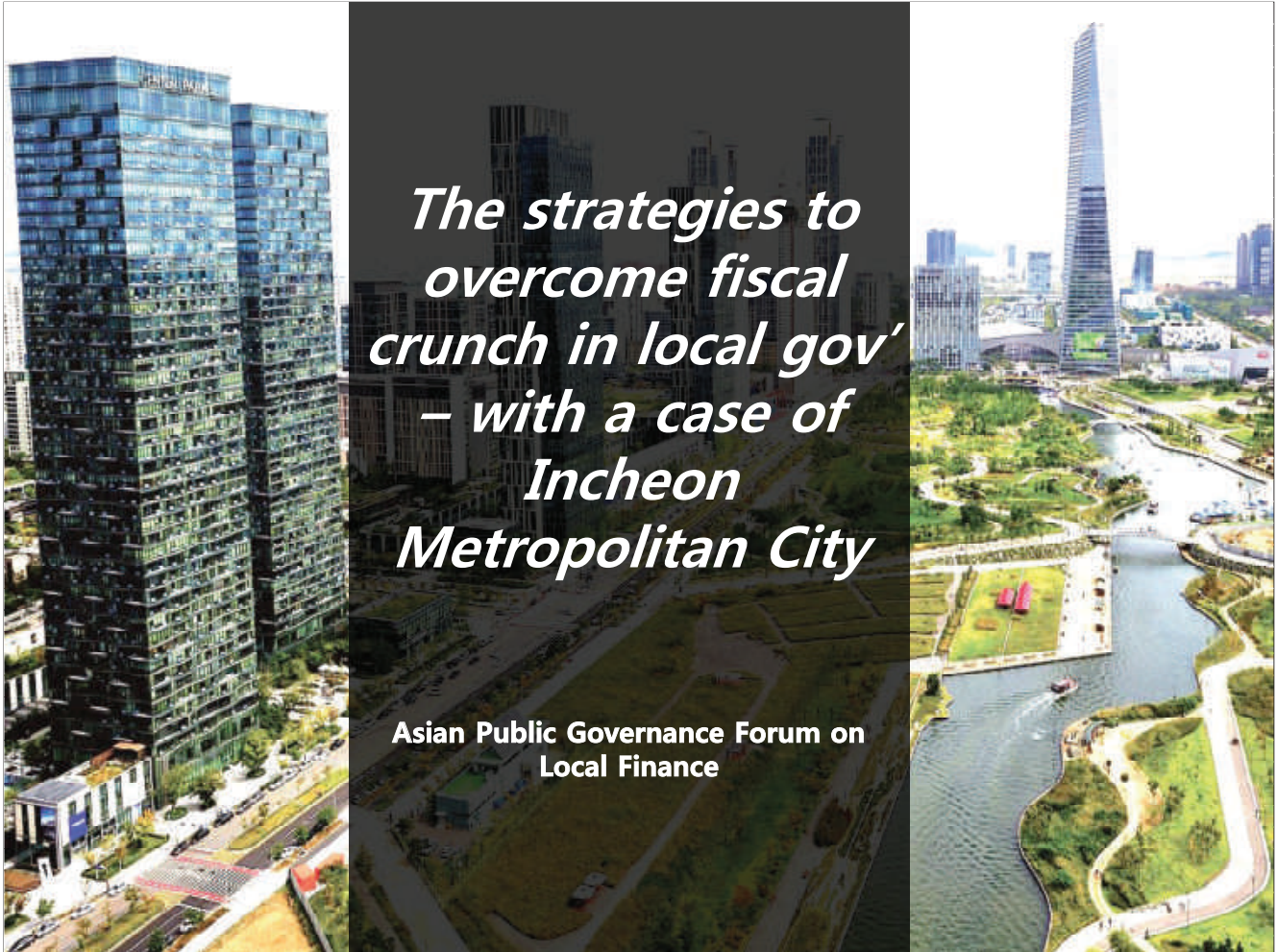


**Mr. Lee Yong-Chul**

*Assistant Mayor for Planning and Coordination  
Incheon Metropolitan City, Republic of Korea*

Lee Yong-Chul is Assistant Mayor for Planning and Coordination of the Incheon Metropolitan City, Korea. Prior to assuming the position in 2015, he was Head of Daejeon Government Buildings Management Service; Director of Local Finance Policy Division, Local Subsidy Division, and Local Tax Analysis Division. He also served as Senior Secretary to the President for Political Affairs, and for Non-Governmental Organizations. He received B.A. in Anthropology and M.A. in Political Science from Seoul National University.

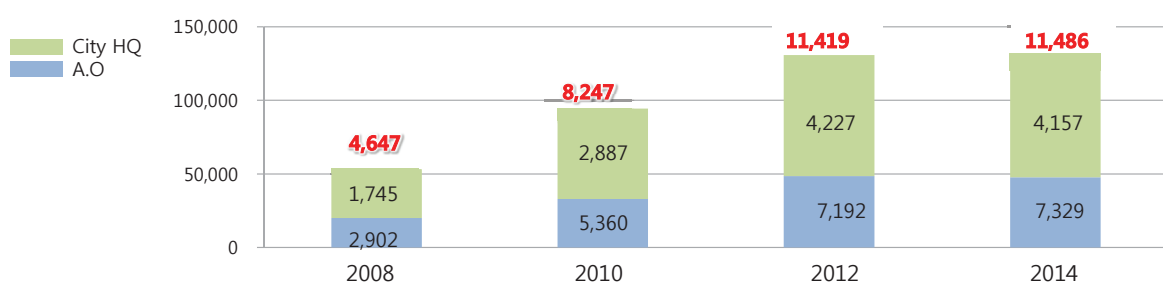




## Our Experience of Fiscal Crunch

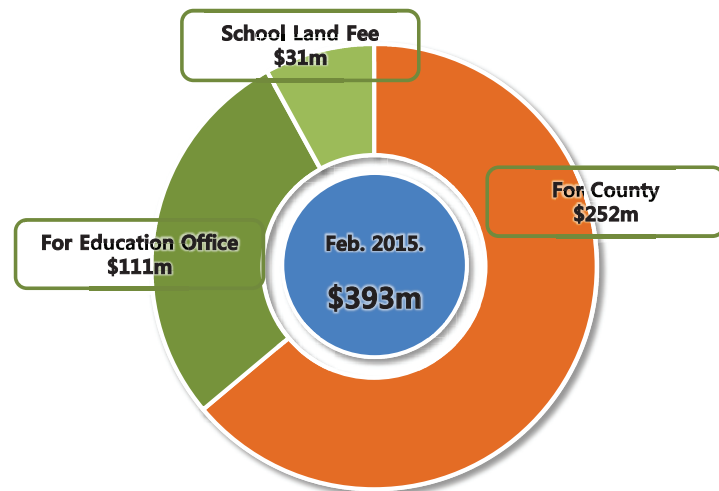
- Total Debt(2014, including Affiliated Organization) – \$ **11,486m**
- '08~'14 Headquarter \$ **1,745m** ⇒ \$ **4,157m** , A.O \$ **2,902m** ⇒ \$ **7,329m**

Year / \$	2008	2010	2012	2014
Total Debt	<b>4,647m</b>	<b>8,247m</b>	<b>11,419m</b>	<b>11,486m</b>
City HQ	1,745m	2,887m	4,227m	4,157m
Financial (Debt-Budget Ratio)	1,346m (25.8%)	2,350m (36.8%)	2,444m (35.1%)	2,842m (37.5%)
Non-Financial	399m	536m	1,782m	1,315m
A.O(including IDC)	2,902m	5,360m	7,192m	7,329m



## Our Experience of Fiscal Crunch

Legal expenditure not covered nor included in the statistics runned to \$ 393m



- Debt-Budget Ratio 30% for 6 years in a row (reached 39.9% in 1<sup>st</sup> QT of 2015)  
⇒ Designated to “management-needed local gov”(2015.7)

## Cause of Crisis

### 2009 fiscal expansion policy

- Radical Expansion to overcome the International Financial Crisis
- The Most Expansion among Local Gov's  
(Issuing Bonds \$ 725m : 3.4 times of ordinary year(\$ 214m))

### Demands for Infrastructure increase – Incheon Metro 2<sup>nd</sup> Line, SMRT 7<sup>th</sup> Line extension

- Incheon Metro : Invest \$ 1,749m (Own \$ 606m / Bonds \$ 175m /Subsidy \$ 968m )
- SMRT extension : Invest \$ 101m

### Developing New City / Revitalisation of Old Downtown

- Big Project of New City(Geomdan Smart City, Youngjong Sky City)
    - Influenced by economic downturn of real estate
  - Big Investment to Revitalise old town(such as Dohwa project)
    - Stalled in for a long time
- ⇒Debt of IDC Increase rapidly



## Cause of Crisis

### Hold Asian Games

- Issuing bonds for construction the stadiums for AG : \$ 948m  
⇒ 32.4% of remained financial debt in late 2014

### City' s own services grown

- Childbirth Grant
- Grant for the Veterans of Vietnam War

⇒ Overlapped by many factors of fiscal crunch

## The 3-Year Plan for Financial Management

### ○ Vision of Macro fiscal policy



## Strategies – Revenue Side

### Strengthen Foundation of Tax

- Enhancing local-tax collection
  - reducing the default, examining new tax exemption
- Legislation of new Tax Items
  - such as Local Resource Facilities Tax)

### Enlarge National Subsidy by project

- Digging Central-Local Matching Projects
- Close relationship between Central-Metropolitan-Primary local government

## Strategies – Revenue Side

### Expand Transfer Revenue(Local Shared Tax)

- Prevention leaking of factors when sharing tax on a legal basis
- Developing Projects which is worth of Central Special Subsidy

### Discover non-tax revenue

- Price Rationalisation of Public Facilities
- Full utilisation of Sport complex (constructed for Asian Games)
- Disposal of Public Property ⇒ Make good use by Private Sector

# Strategies – Expenditure Side

## Enhance Management of Tax Expenditure

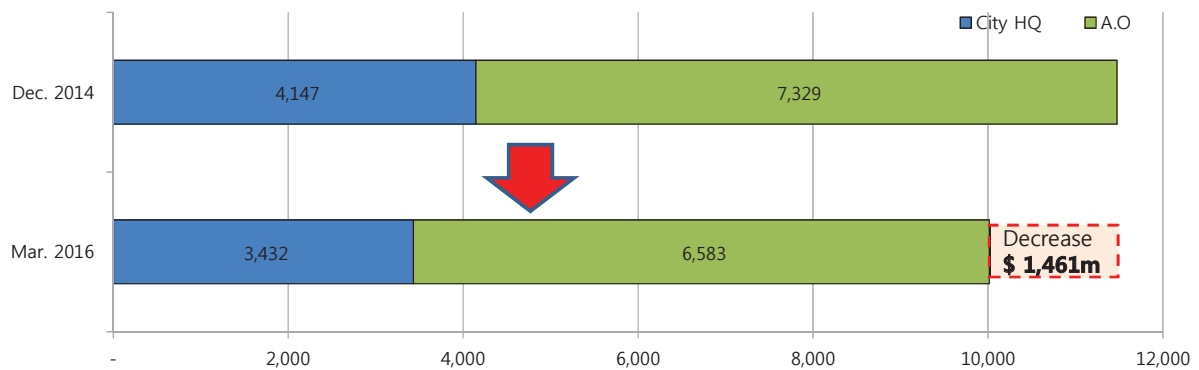
- Recheck the size and expense of big project before beginning
- Improvement of Subsidy System(Differential ratio by Ability-to-pay Principle)
- Welfare Efficiency by merging similar businesses

## Reinforce Fiscal Disciplines

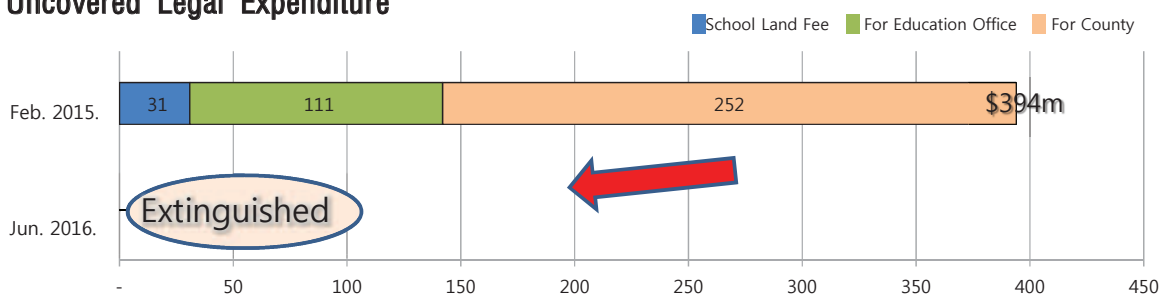
- Making effective Mediumterm Financial Plan
  - Project not included in MFP is rejected for Annual Budget
- Tightening Assessment and Feedback for each project
- Transferring Own Services to Cooperative ones with Central gov'

# Outcome

## ○ Decrease in Total Debt

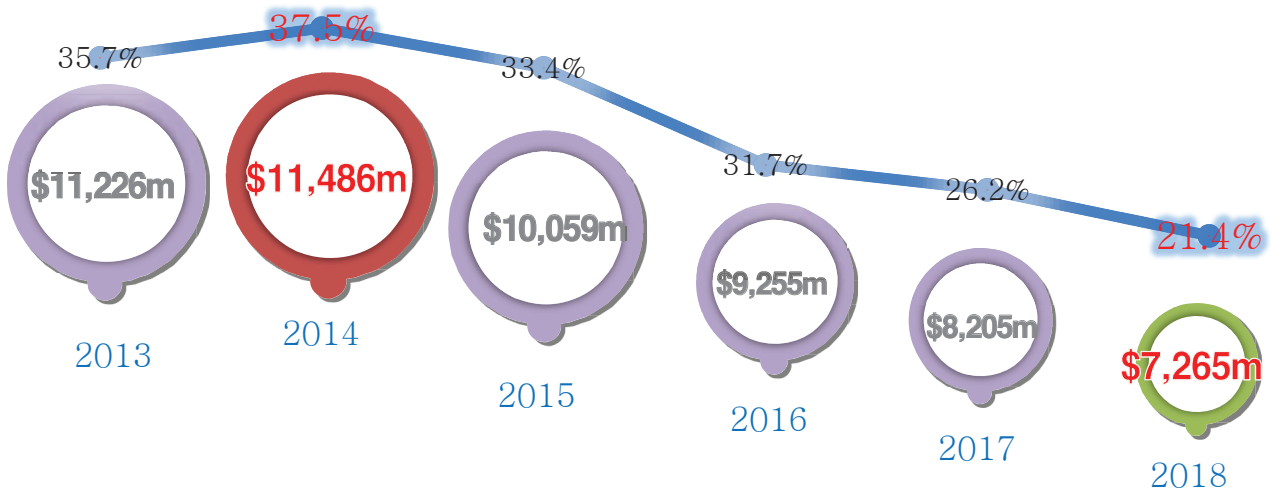


## ※ Uncovered Legal Expenditure



# Prospect

## ○ Prospect of Total Debt



## ※ Prospect of Financial Debt in HQ

Year	2015	2016	2017	2018
City HQ(\$)	2,755m	2,842m	2,008m	1,674m
(Debt-Budget Ratio)	(33.4%)	(31.7%)	(26.2%)	(21.4%)

## Session 2

### Strategies to Prevent and Overcome Local Financial Crisis



**Mr. Yanfeng Bai**

*Professor, Dean of the School of Public Finance and Tax  
Central University of Finance and Economics (CUFE), Beijing, China*

Yanfeng Bai got his PHD in economics in 2005 from Renmin University of China, and he began to do teaching and research in CUFE. His research interest is focused on fiscal and tax policy, especially in energy and environment. He has good research cooperation with the Ministry of Finance, China and Development Research Center, State Council of China. His projects include some sponsored by National and Beijing Fund of Philosophy and Social Science.



# Move of Hoawei from Shenzhen, local finance, and supply-side reform

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Wang jinxian

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School of Public Finance  
and Tax. CUFE

2016/7/20



## Outline

- 1. Why is Huawei trying to move?
- 2. The devil rebukes sin?
- 3. Land finance's two parts
- 4. The overall implementation of VAT and land finance
- 5. Conclusion

# 1. Why is Huawei trying to move?

- "The manufacturing businesses that were closed were not of high quality, they were not competitive in the global market, and they consumed a great deal of energy."
- **Xu Qin**, mayor of Shenzhen, saying more than 17,000 manufacturers have been closed in the past five years in Shenzhen due to local authorities' plan to upgrade industries. It has been reported that Huawei plans to move some of its factory operations to the neighboring city of Dongguan, citing high costs, but Xu says the company has pledged it will not move its headquarters or R&D center.
- China Daily Africa Weekly 06/03/2016 page26



- Dongguan is the center of manufacturing, covering a spectrum ranging from textiles to electronics.
- Dongguan is ranked fourth in China in exports.
- Shahid Yusuf, Metropolitan Cities: Their Rise, Role, and Future. Roy W. Bahl, Johannes F. Linn, and Deborah L. Wetzel, Financing Metropolitan Governments in Developing Countries, Lincoln Institute of Land Policy, Cambridge, Massachusetts, 2013.





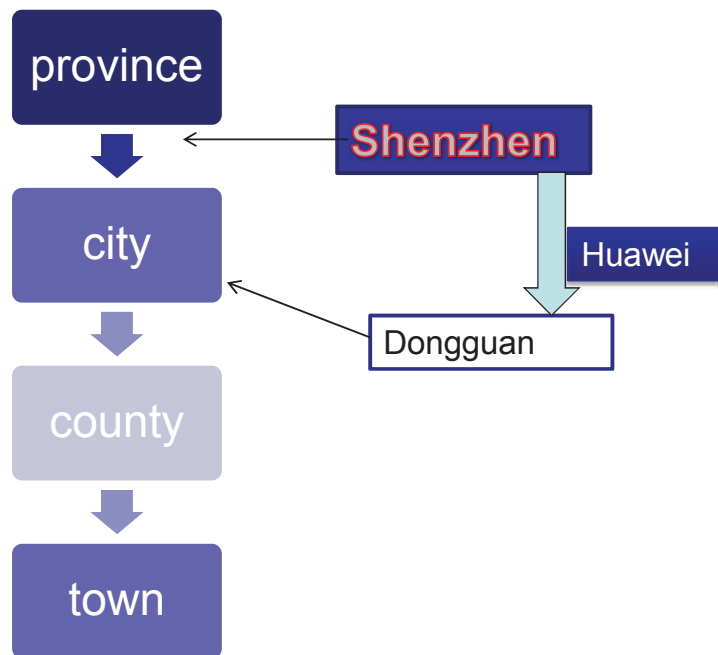
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## Huawei is so important for Shenzhen

- In the first two months 2016, for the Longgang District, Shenzhen City, Huawei accounted 47% of the industry added value, with the 40% increase.
- Without Huawei, the district's industry added value will drop by 14.3%.

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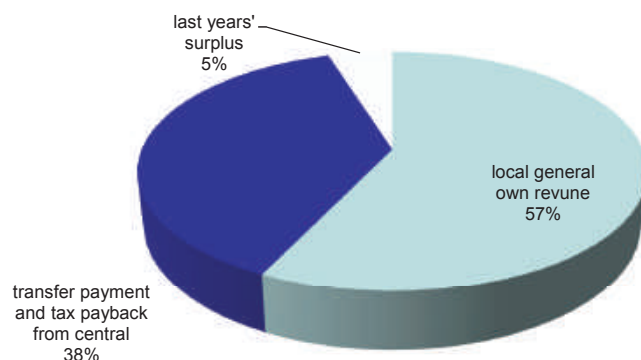
# China's four levels local governments



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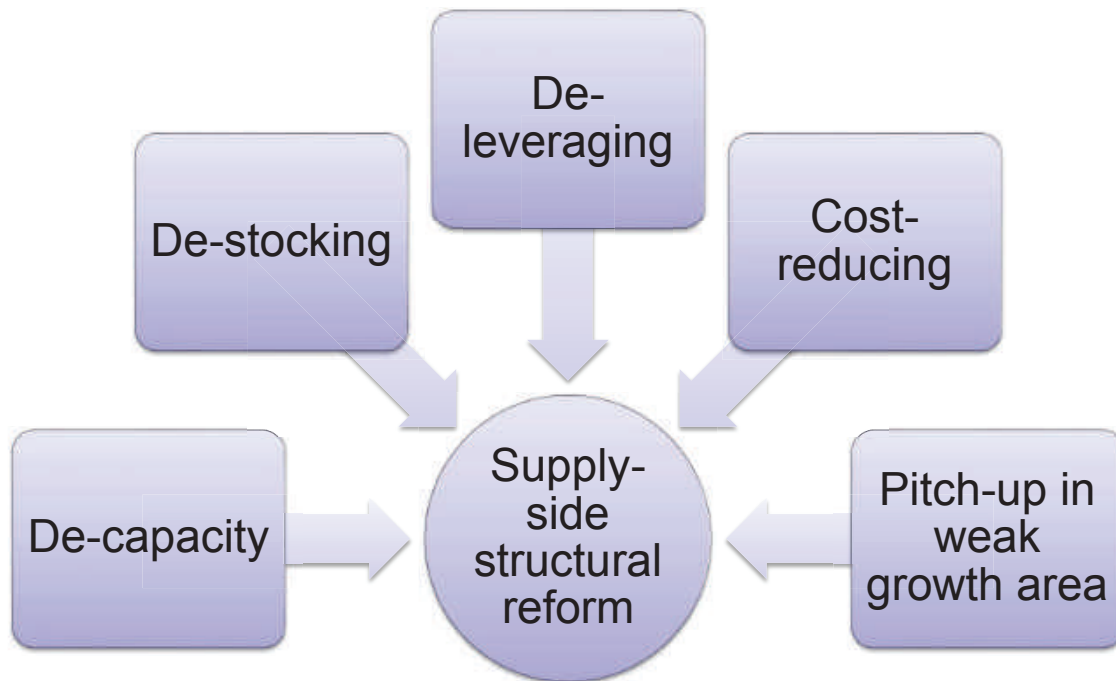
# China's local finance structure of 2015

- Local government general public budget revenue: 8298.266 billion yuan;
- the transfer payment and tax refund from central government: 5518.1 billion yuan;
- The surplus from last years and other: 705.512 billion yuan
- The total revenue of local government is 14521.878 billion yuan.



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# Supply-side structural reform



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## 2. The devil rebukes sin?

- In the supply-side reform, it is very crucial for the government to help the enterprises to reduce cost.
- While land finance is so important for China's local governments' finance as the result of soaring of the real estate price, central government is glad to see it. However, the government's financing desire may be the origin for the enterprises' high cost.



### 3. Land finance's two parts

- First is land use right granting revenue; second is the tax revenue from real estate industry.
- First part is one shot; and the second part may be more sustainable.
- The recent years' drop of first part may be that the central government make it more earmarked.
- Anyway, the government's revenue may become the enterprises' cost in the end. At the same time, it is too easy to make money from the real estate industry and the crowding-out effect for the other manufacture and service sectors is very obvious.

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### zigzag

- For example, the MOF provides that from 1, July,2011, 10% from the land-use-right granting revenue should be used for constructing irrigation and water conservancy, another 10% should be used for constructing low-income house.



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## the reform of the GDP- and revenue-pegged fiscal expenditure regime

- China is making progress against wasteful government spending as it overhauls a rigid fiscal management system tied to GDP and revenue growth, Finance Minister Lou Jiwei said in China Development forum 2016.
- The reforms are part of a broader effort that began in 2013 to modernize the country's budgeting processes.
- One of the efforts highlighted by Lou is the reform of the GDP- and revenue-pegged fiscal expenditure regime, under which spending in priority sectors, such as education and technology, is pegged to growth in revenue.
- In 2012 before the reforms began to unfold, 48 percent of government expenditure, or spending in seven categories, were pegged to GDP and revenue growth, Lou said. For example, education spending should increase in line with revenue growth to keep it above 4 percent of a locality's GDP.

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## Two cities land finance(2015)

	Shenzhen			Dongguan		
	Amount (billion)	increase	proportion	Amount (billion)	increase	proportion
Land-use right grant revenue	72.6	41%	—	12.1	-30.3%	—
Government fund	81.85	19.2%	88.70%	15.7	—	77.07%
General public budget revenue	177.43	36.7%	40.92%	51.8	10.2%	23.36%

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2015 Dongguan real estate tax	
tax	Thousand yuan
urban maintenance & construction tax	4009450
Real estate tax	1841150
Urban land use tax	1377410
Stamp tax	1068700
Land VAT	1493180
Arable land occupation tax	764750
Deed tax	3542760
subtotal	14097400
Tax total	51796820
proportion	27.22%

Most revenue of the 7 taxes are from real estate industry, while some of business tax, PIT, CIT are also from this industry. The tax subtotal 14.1 billion is roughly equivalent to the 12.1 billion of the land-use right grant revenue. These two account for about 39% of the total government revenue. Shenzhen's relevant data is not available.

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## Can we see the revenue from leasing land as some substitute?

- Self-sufficiency should not be tied to the leasing of land that is providing short-term revenue windfalls for many cities in China(40 percent of revenues on average) and Vietnam but is rapidly depleting source of municipal income.
- In the same article, the author argues that income and real property taxes generally constitute the bulk of local revenues(Shahid Yusuf, 2013).
- Considering that China has not yet levied property tax for the individuals to keep a real estate, can we see the revenue from leasing land as some substitute?
- The problem may be that the price of real estate and the leasing revenue increase too fast.

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## Not all the manufactures are sustainable

- For the cost of enterprises, aging population are increasing the human cost and we can't change the trend; on the other hand, the land finance is intentionally to raise the cost of the real economy.
- Of course, as to the real estate industry, neither the past high-energy consumption and high pollution industry is sustainable, and what we need to do now is to adding more value to our product with technology and knowledge. This is the only sustainable way for both the economy and finance.

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## Another two versions for the move of Hoawei

1. Shenzhen city may be updated to municipality directly under central government, Dongguan may become a part of Shenzhen, so the move doesn't have any meaning.
  2. We all know different cities should have different industry structure. With the development of Shenzhen, it is not surprised some will move out and the new one will emerge.
- A similar case is that Foxconn or part of it moved from Shenzhen in 2009 then it may move to India in 2016.

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## 4. The overall implementation of VAT and land finance

- From 1, May, 2016, the VAT has been implemented overall in all industries, including the real estate industry. If an enterprise buy a real estate, it can claim input tax credit, and the taxpayer can pay less tax than before. That will be very huge and the demand for real estate industry will increase greatly.
- With the booming of the real estate industry once again, the government's land finance will be reinforced for a short run at least.

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## National VAT and Business tax, 2015

	billion	proportion
Domestic VAT	3110.9	24.91%
Business tax	1931.3	15.46%
Total tax revenue	12489.2	—

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# 2012 Business tax Revenue

合计	157512244		
<b>construction</b>	<b>36937907</b>	<b>23.45%</b>	
Communication, storehouse, postal industry 交通运输、仓储及邮政业	10197648	6.47%	
Hotel and restaurant 住宿和餐饮业	5613044	3.56%	
information 信息传输、软件和信息技术服务	4721904	3.00%	
finance 金融业	28702343	18.22%	
<b>Real estate 房地产业</b>	<b>39011579</b>	<b>24.77%</b>	
Rent and commercial services 租赁和商务服务业	10513720	6.67%	
Culture, sports and entertainment 文化、体育和娱乐业	1500008	0.95%	
resident services 居民服务、修理和其他服务业	8650927	5.49%	
reseach 科学研究和技术服务业	3196210	2.03%	21 21

## 5. Conclusion

- 1. It is no wrong for the local government to develop real estate industry and get revenue from it, while it should be made clear that the primary industry is manufacture, service or commerce, and definitely should not be real estate itself.
- 2. The price of real estate and the leasing revenue increase too fast, at least not faster than the speed of the primary industry.
- 3. The smart city can achieve rapid and sustainable growth by fully mobilizing the human intelligence and brainpower. Seoul, Singapore, San Francisco or San Jose are good models. (Shahid Yusuf, 2013).

- 4. After accession to WTO in 2001 for China, foreign demand has been important. While after the financial crisis in 2008, both China's economy and revenue have to be transferred to domestic demand, and it boosts the real estate's price to get revenue for the government.
- 5. The land finance can get soft landing in the future with the improve of the foreign demand or the domestic manufacture and service sector's better development.

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# Thanks !



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# Impact of the comprehensive tax reform of “replacing business tax with VAT” on the sustainable development of the real estate industry\*

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## Abstract

In 2016, at the National People’s Congress and Chinese People’s Political Consultative Conference, we put forward the goal of the full realization of “replacing business tax with VAT”, expanding the scope of the tax reform to industries of transportation, real estate, finance, life services, and to ensure the tax incidence to be reduced. We examine the impact of replacing business tax with VAT on the real estate industry by analyzing three large real estate enterprises. Specifically, we calculate changes in the value-added tax, urban construction and maintenance tax and education surcharge, enterprise income tax for these three enterprises. The results suggest that the reform will reduce the tax burden of the real estate enterprises. Further, we explore the sustainable development of the real estate industry. We suggest that if the real estate supply-side effect and demand-side effect are both realized,

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a comprehensive tax reform of replacing business tax with VAT will promote a sustainable development of the real estate industry.

**Keywords:** comprehensive “replacing business tax with VAT”; destocking of the real estate; change of tax burden

## 1. Introduction

On the 25<sup>th</sup> January, 2016, Premier Li Keqiang chaired a forum, deciding to promote the tax reform of “replacing business tax with VAT” to reduce the tax burden of the enterprises. In March, 2016, at the National People’s Congress and Chinese People’s Political Consultative Conference, Li stated further that from the 1<sup>st</sup> May, 2016, the tax reform of replacing business tax with VAT would be implemented comprehensively, extending the scope of the tax reform to industries of construction, real estate, finance and service, and incorporating the new fixed assets of enterprises in the list of deductible items of the VAT, therefore to guarantee that all industries would enjoy decreased tax burden.

On 23<sup>rd</sup> March, 2015, the State Administration of Taxation published the regulation on “How to implement the tax reform to replace business with VAT”, regulating that businesses providing transportation, postal service, basic telecommunications, constructions, real estate rent, sales of real estate, transfer of land use rights would be levied a VAT tax with a rate of 11 percent. Meanwhile, except for purchasing housing individually, providing tangible and movable property leasing service and cross-border taxable behavior, taxpayers need to pay a VAT tax with a rate of 6 percent when the taxable activities happen. Besides this regulation, the State Administration of Taxation released several other regulations as the form of attachment, which have specific clauses on the definitions of simultaneous business, projects subject to no VAT, sales amount, financial lease and financial sale-leaseback businesses and so on. Moreover, the supplemental regulations listed 40 projects which will not be subject to VAT, and other preferential policies regarding VAT refunded immediately upon payment, taxation time on the interest revenue of the financial enterprises and sales of housing by individuals. According to the State Administration of Taxation, by the end of the year 2015, there were in total 5.92 million taxpayers. The tax reduction was remarkable and the accumulated tax reduction was 641.2 billion yuan since 2012 when the tax reform of replacing business with VAT started.

At present, China is in a critical period of economic slowdown and complicated international situation. Stimulated by the proactive fiscal policy and prudent monetary policy, policy of “reducing fiscal revenue and increasing fiscal expenditure”, expanding domestic demand and the supply-side structural reforms, China’s GDP in 2015 reached 67.6 trillion, increased by 6.9 percent compared with the previous year. However, the economy is still subject to downward pressure. Overall, the tax reform to reform business tax with VAT has profound effects on economy development, taxation and the reforms of the fiscal system and

the taxation system. However, at the same time when we focus on the tax reduction effect of promoting the tax reform of replacing business tax with VAT, we should look at the other aspects of this tax reform. This paper selects one aspect of the impact of the tax reform. That is, we analyze the impact of the tax reform on the sustainable development of the real estate industry, which accounts for a large part of China's economic development, by examining the impact of the reform on destocking of the real estate and changes of tax burden for real estate enterprises.

## 2. Literature overview

So far a number of studies have paid attention to research on the reform process from “business tax” to “VAT” in China. A large set of literature focuses on the design of the tax reform and its effectiveness on the economy. Based on the case study of Shanghai, which performed the reform on the so called “replacing business Tax with VAT” in 2012, Qiu (2012) suggests that the downward pressure on the economy and the “depression effect”<sup>1</sup> have speeded up the process of expanding the scope of tax reform around the pilot. However, the tax reform to replace business tax with VAT turns out to be insufficient to cut the overall tax burden (Qiu, 2012). In 2015, Li and Zhang use the difference-in-differences model to examine the deduction effect and the burden shift effect of the input tax, relying on firm-level micro data over the period of 2011-2013. They find that in regions which have conducted the reform to replace business tax with VAT, companies have incentives to increase investment in the factor of technology.

In terms of the scope of taxation, Cai (2010) argues that a narrow scope of taxation may lead to double taxation between VAT taxpayers and non-VAT taxpayers dealing goods and services, which contradicts the principal of tax neutrality. He suggests that we should follow an ideal taxation scope to cover all ranges of goods and services. However, because of the particularity, complexity and high cost of taxation, some industries should not be included in the process of expanding the taxation scope, for instance the financial and insurance industries (Cai, 2010).

Regarding the design of the tax, Jiang (2011) suggests that the tax rate should be unified for all industries. Relying on the “Chinese input-output tables 2007”, Jiang (2011) estimates that if the applicable tax rate is higher than 10 percent after expanding the taxation scope of replacing the business tax with VAT, tax burden for service industries will be significantly

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<sup>1</sup> “Depression effect” refers to the phenomenon that capital are likely to be attracted to places with low transaction costs.

increased. Instead, a 10 percent tax rate would guarantee that the tax burden for the manufacturing and service industries would be comparable with that before the tax reform. More specifically, at the tax rate of 10 percent, the average tax burden for the manufacturing industry would be decreased by 1.52 percent while it would be increased by around 1.2 percent on average for the service industry, of which some service sectors would face a decrease in the tax burden (see also He (2012) on the effects of the tax reform on service industry). Turning to tax payment, Wang and Yang (2009) point out that we can learn from foreign experience that in the public service sector, the VAT tax system can be kept but with a zero tax rate. That is, sales of items at the public service sector can be exempt from taxation (output tax is zero), while input tax will be refund.

Another set of studies put more attention to the impact of the reform process of replacing the business tax with VAT on industries and other taxes. For instance, Yang (2013) argues that in the context of promoting the reform process of replacing business tax with VAT, reforming the consumption tax is both necessary and facing a favorable opportunity. In 2013, Bai, Li and Ma (2013) conducted an analysis of 12 representative listed transportation companies, using data on purchasing goods, labor and increases in fixed assets of these companies. They find that imposing a low tax rate and meanwhile identifying possible deductible input tax contained in the new fixed assets can probably solve the problem of uneven tax burden for the transportation companies that may arise after the reform of replacing business tax with VAT. Similarly, Zhong (2014) points that the tax reform to replace business with VAT has impact on modern service industries on their tax burden, pricing mechanism and also international management. According to Peng and Xiao (2014), if the real estate industry applies an applicable tax rate after replacing business tax with VAT, the tax burden will increase for all companies.

Overall, until now most studies on the reform of replacing business tax with VAT focus on the effectiveness of the tax reform, the tax design and its impact on other taxes. However, little is known about the impact of the tax reform on the sustainable development of the real estate industry (Zhan, 2015). This is remarkable given that China is facing a grim situation to reduce the inventory of real estate. Therefore, this paper first makes a contribution to empirically analyze how the real estate industry has changed over the last few months. And then we examine to what extent has this change been affected by the tax reform of replacing business tax with VAT.

### **3. Impact of the tax reform to comprehensively replace business tax with VAT on the destocking of the real estate**

#### 3.1 An overview of the real estate development, January 2015 - March 2016 (15 months)

According to the National Bureau of Statistics (January 2016), at the national level investment in real estate reached 9.6 trillion yuan in 2015, with a nominal yearly growth rate by 1 percent (after deducting the effect of price, the real yearly growth rate was 2.8 percent). Residential investment accounted for 67.3 percent of total real estate investment, which was 6.5 trillion yuan and increased by 0.4 percent compared with the previous year. Monthly, the growth rate for total real estate and residential investment decreased by 0.3 percent in December 2015 compared with previous 11 months.

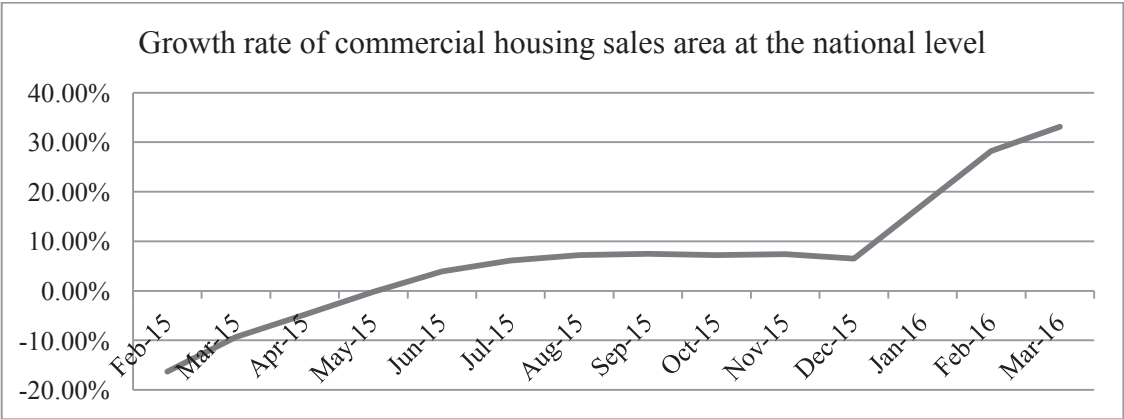
Moreover, in 2015, the real estate industry sold 1.3 billion square meters of its commercial housing, increased by 6.5 percent over the previous year. At the same time, the growth rate in November decreased by 0.9 percent compared with the previous 11 months. In 2015, the central government released several favorable policies, slowing down the downward trend in the growth of real estate sales area and amount of the sales (see Figure 1 and Figure 2). However, we should notice that the downward trend in the growth of investment in real estate development did not change. Figure 3 and Figure 4 show that from January 2015, the growth of the investment in real estate development continued to decline. In contrast, the growth rate of the capital in place of the real estate enterprises experienced a fall in the first three months but then an increase in the following months. Overall, during the period of the first six months of the year 2015, the growth rate of the investment in real estate development decreased by 5.8 percent while the growth rate of the capital in place of the real estate enterprises turned to be negative. Therefore, the main target over this period was to reduce the inventory instead of investment. From June 2015, the central government released a number of favorable policies, the growth rate of the real estate development decreased by 3.6 percent, implying a smaller decline compared with the first six months. On the other hand, the growth rate of the capital in place of the real estate enterprises became positive and reached 2.6 percent in December, which was the highest monthly growth rate in 2015.

Similarly, based on the National Bureau Statistics (April 2016), for the first three months in 2015, the national investment in real estate development was 1.8 trillion, increased by 6.2 percent nominally compared with the previous year (after deducting the effect of price, the real yearly growth rate was 9.1 percent). The monthly growth rate in March increased by 3.2



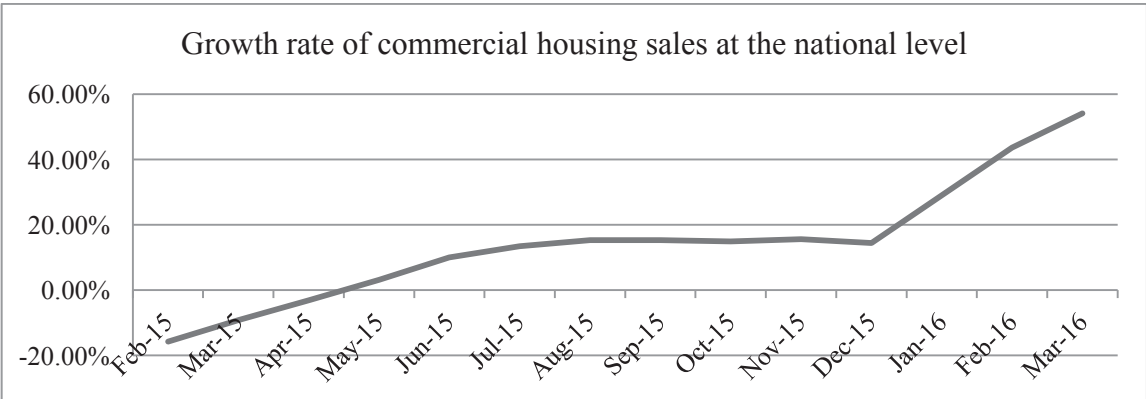
percent compared with that in February. Regarding the capital in place of the real estate enterprises, in March 2016 it was 3.2 trillion yuan, increased by 14.7 compared with the previous year. Interestingly, the monthly growth rate in February actually decreased by 1 percent (see Figure 3 and Figure 4). Furthermore, the sales area of the commercial housing was 242.99 million square meters by the end of March 2016, increased by 33.1 percent compared with the previous year. The monthly growth rate in March 2016 increased by 4.9 percent compared with that in February 2016. Nevertheless, by the end of March 2016, area of housing ready for sale was 735.16 million square meters, increased by 16.62 million square meters compared with the end of 2015, suggesting that the inventory of the real estate has actually increased.

Figure 1. Growth rate of commercial housing sales area at the national level, January 2015-March 2016



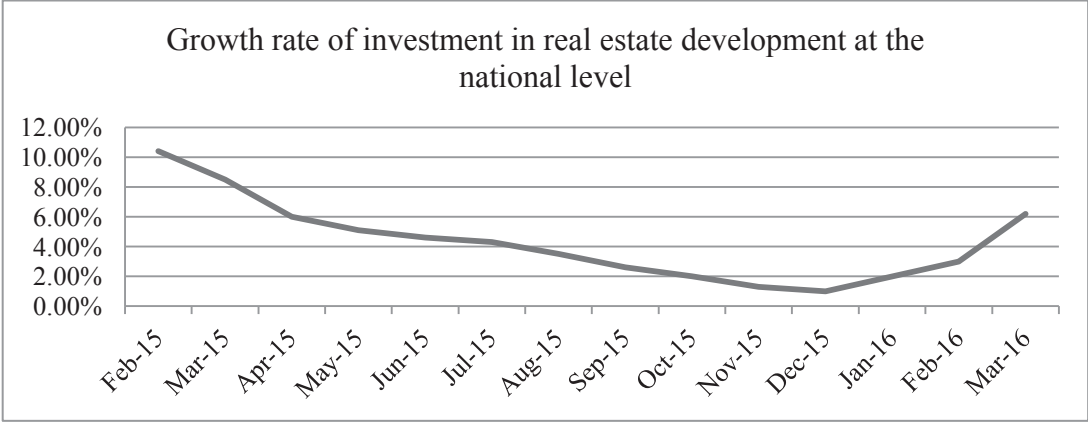
Source: National Bureau of Statistics.

Figure 2. Growth rate of commercial housing sales at the national level, January 2015-March 2016



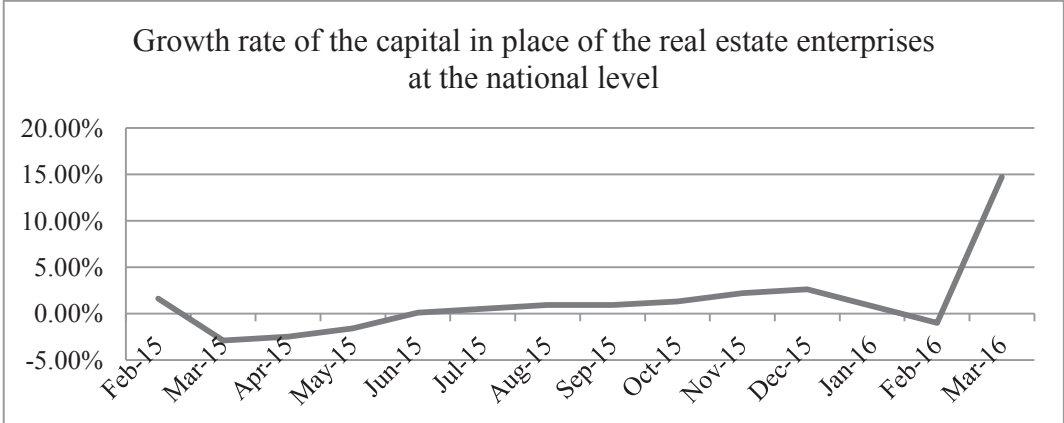
Source: National Bureau of Statistics.

Figure 3. Growth rate of investment in real estate development at the national level, January 2015-March 2016



Source: National Bureau of Statistics.

Figure 4. Growth rate of the capital in place of the real estate enterprises at the national level, January 2015-March 2016



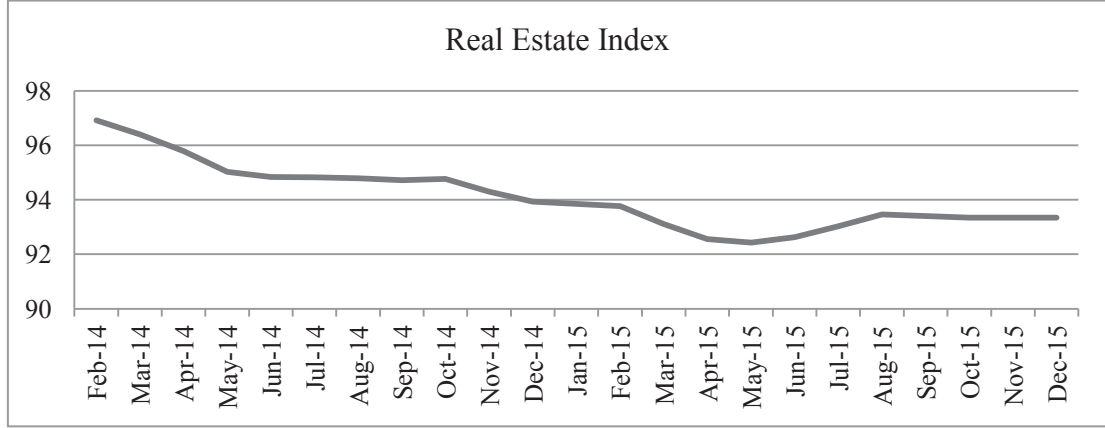
Source: National Bureau of Statistics.

In addition, this study applies a real estate index to show the changes of the real estate industry of China. The real estate index is a short form of the climate index of real estate in the whole country. This index is calculated based on the theory of economic cyclical fluctuations and the principle of climate index. The index is a weighted average composite index, calculated on the basis of categorized indices measuring investment in the real estate industry, capital, housing area and sales, excluding the influence of seasonal factors and other random factors. The real estate index selects the year 2000 as the base year and the value of

100 as the base line. The value above 100 belongs to the space of good climate or prosperity while the value below 100 belongs to the space of bad climate or depression.<sup>2</sup>

Figure 5 shows that since 2014, the real estate index has been declining over time. In February the index had a value of 96.91 points while by the end of the year 2015, it was decreased to 93.34 points. Especially, in May 2015, the real estate index decreased to 92.43 points, which was the lowest level since its introduction in 1997.

Figure 5. Real estate index, 2014-2016



Source: National Bureau of Statistics.

In order to overcome the pressure of the large inventory of the real estate enterprises, in 2014 and 2015 the governments released a series of favorable policies. For instance, in July 2014, the Ministry of Housing and Urban-Rural Development made a clear statement to “do everything possible to reduce the real estate inventory”. At the end of September 2014, the central bank and the China Banking Regulatory Commission put forward a new policy of mortgage to relax the credit limit and to strengthen support for individuals with housing loans and enterprises with reasonable financing needs. By the end of the year 2014, except for Beijing, Shanghai, Guangzhou, Shenzhen and Sanya, all other cities have fully canceled their former restrictions on housing purchase.

On the 1<sup>st</sup> of March 2015, the “Regulation on Temporary Registration of the Real Estate” became effective. This made buying and selling houses safer and more standardized and therefore protect better the interests of housing right holders. In 2015 more cities joined the group to cancel the restrictions on housing purchase. Some provinces even start applying the

<sup>2</sup> Usually, when the real estate equals to 100, it is said to be the most appropriate level. An index lies between 95 and 105 turns out to be moderate. An index lower than 95 or higher than 105 seem to be depart from the moderate level.

new rule to reduce the down payment proportion to 25 percent. Only Beijing, Shanghai, Guangzhou and Shenzhen still hold the housing purchase restrictions. Further, in 2015 the central bank adjusted twice the down payment for the second housing when using the housing fund loans. On 31<sup>st</sup> of March 2015, the central bank, the Ministry of Housing and Urban-Rural Development and the China Banking Regulatory Commission issued a joint notice that for households who have already owned a housing and payed off the loans, if they want to apply for a second housing using the housing fund loans, the lowest down payment proportion would be 30 percent. Later on the 1<sup>st</sup> of September, the Ministry of Housing and Urban-Rural Development, the Ministry of Finance, and the People's Bank of China lowered again the down payment proportion for the second housing using housing fund loans by 10 percent to 20 percent. By the 8<sup>th</sup> of October 2015, business of off-site housing fund loans was fully implemented at nation-wide. Since 2015, the central bank has lowered the interest rates and the reserve rates five times. Consequently, for both housing buyers and the real estate enterprises, it would be easier to get loans. The policies promulgated by the state in 2014 and 2015 do have positive effects on destocking the real estate industry, especially in the last six months in the year 2015 (see Figure 1 to Figure 4). However, this positive impact was not large.

### 3.2 The impact of the comprehensive replacing business tax with VAT on the tax burdens for real estate enterprises

For the first time, after the comprehensive tax reform of replacing business tax with VAT, increased real estate of the enterprises would be incorporated in the range of deductible items. This means that enterprises that would have increase in real estate by purchasing, renting and self-building would profit, which will undoubtedly have impact on the tax burden for these real estate enterprises. This paper computes changes in the overall tax burden for three biggest real estate companies in China – Vanke Real Estate Company (Vanke), Poly Real Estate Company (Poly) and China Fortune Land Development Company Limited (CFLD) – to examine whether the tax reform to replace business tax with VAT would have a tax increase effect or tax reduction effect.

#### *Change in VAT*

To calculate the amount of VAT after the tax reform, we rely on the data derived from the annual reports of the three real estate companies, including main business income, main business cost, machinery and equipment, new buildings for own use, accrued wages,

accumulated depreciation of fixed assets and other indicators. Information on these indicators for the three real estate companies in 2015 are shown in Table 1. The equation for VAT is expressed as follows:

$$\text{VAT payable} = \text{Output tax} - \text{land transfer payments} - \text{deductible input tax of the main business cost} - \text{deductible input tax of new equipment} - \text{input tax of new real estate}$$

where the output tax and land transfer payment are calculated based on main business income. Deductible input tax of new equipment and input tax of new real estate are computed based on the value of the machinery and equipment and new real estate for own use. These data can be obtained from the annual reports of the real estate companies. The deductible input tax of the main business cost is calculated based on the following equation:

$$\text{Deductible input tax of the main business cost} = (\text{Main business cost} - \text{land transfers payment} - \text{labor cost}) * \text{deductible proportion}$$

here the deductible proportion is based on intermediate input from the 2010 extended table of the input-output table. That is, total input of the input-output table = intermediate input + net production tax + wages + depreciation of fixed assets + operating surplus. Therefore, in order to get the result of the deductible input tax of the main business cost, information on accrued wages and accumulated depreciation of fixed assets are required.

Table 1. Basic statistics of the three real estate companies in 2015 (unit: yuan)

	Vanke	Poly	CFLD
Main business income	193,183,219,650.42	123,386,340,634.89	38,090,766,546.68
Main business cost	57,954,965,895.13	37,015,902,190.47	11,427,229,964.00
Machinery and equipment	137,813,751,647.40	82,453,089,187.47	24,883,488,846.95
New buildings for own use	333,085,027.86	238,673,199.00	116,436,006.28
Accrued wages	4,898,319,731.44	3,166,638,228.64	2,366,379,565.16
Accumulated depreciation of fixed assets	1,379,846,070.42	122,677,701.18	514,983,223.08

Source: Annual report of Vanke, 2015; Annual report of Poly, 2015 and Annual report of CFLD, 2015.

Business tax rate for the real estate companies is 5 percent. After the reform, the output tax rate of VAT is 11 percent. The input tax rate varies between the items based on the regulations of the State Administration of Taxation (2016): (a) after the tax reform, the land transfer payment can be fully deductible. In this study we assume the land transfer payment

equals to 30 percent of the main business income and the input tax rate is 11 percent<sup>3</sup>; (b) regarding new equipment, the input tax rate is 17 percent; (c) in terms of new real estate, the input tax rate is 11 percent. Regarding the deductible input tax of the main business cost, the deductible proportion is based on the intermediate input, which will be shown as in Table 2.

Table 2. Deductible input tax of the main business cost for real estate companies (unit: ten thousand yuan)

Source of intermediate input	Intermediate input	Proportion in the total input	Input tax rate	Amount can be deductible
Industry excluding water, electricity and gas	1965280	0.530404477	17%	Intermediate input*17%/(1+17%)
Water, electricity and gas	67509	0.018219834	13%	Intermediate input *13%/(1+13%)
Transportation industry	131661.316	0.035533741	11%	Intermediate input *11%/(1+11%)
Postal industry	14093.829	0.003803748	11%	Intermediate input *11%/(1+11%)
Wholesale and retail trade	67391.955	0.018188245	17%	Intermediate input *17%/(1+17%)
Services	437103.849	0.117968859	6%	Intermediate input *6%/(1+6%)
Tangible personal property leasing services	247084.608	0.066685043	17%	Intermediate input *17%/(1+17%)
Construction	150656.298	0.040660249	11%	Intermediate input *11%/(1+11%)
Total	3705247.762			399749.1483

Source: 2010 extended table of the input-output table (42 sectors).

Hence, the VAT for the three real estate companies can be calculated as follows:

$$\text{Output tax} = \text{Main business income} * 11\% / (1+11\%) \quad (1)$$

$$\text{Land transfer payment} = \text{Main business income} * 30\% \quad (2)$$

$$\text{Deductible input tax of new equipment} = \text{Amount of the new machinery and equipment} * 17\% / (1+17\%) \quad (3)$$

$$\text{Input tax of new real estate} = \text{Amount of the new real estate} * 11\% / (1+17\%) \quad (4)$$

<sup>3</sup> The Ministry of Land and Resources conducted a survey on the prices of land for real estate projects. The results show that among 620 cases, for most real estate projects, the prices of land lie between 15 and 30 percent of the housing price. 78 percent of the cases have the prices of land below 30 percent of the housing price. On average, the land price constitutes 23.2 percent of the housing price.

$$\text{Deductible input tax of the main business cost} = (\text{Main business cost} - \text{land transfers payment} - \text{labor cost}) * \text{deductible proportion} \quad (5)$$

$$\text{Deductible proportion} = \text{Total amount can be deductible in Table 2} / \text{Main business cost} \quad (6)$$

$$\text{VAT payable} = \text{Output tax} - \text{land transfer payments} - \text{deductible input tax of the main business cost} - \text{deductible input tax of new equipment} - \text{input tax of new real estate} \quad (7)$$

$$\text{Change of tax burdens} = \text{VAT} - \text{Business tax} \quad (8)$$

$$\text{Growth rate of tax burdens} = \text{Change of tax burdens} / \text{Business tax} \quad (9)$$

The results for the left items in the equations (1)-(9) are shown in Table 3. We find that after the tax reform, the tax burdens decreased but to different degrees in the three real estate companies. In Vanke, the tax burden was decreased by 40.94 percent while it decreased by 50.27 and 86.28 for Poly and CFLD respectively. In the ranking of the real estate companies, Vanke ranker higher than Poly and then CFLD. Therefore, we may expect that for the real estate companies, the lower they rank, the more likely their tax burden would be lowered, therefore profiting from the tax reform.

Table 3. Changes of tax burdens after the tax reform (unit: yuan)

	Vanke	Poly	CFLD
Output tax	19,144,283,028.42	12,227,475,198.05	3,774,760,648.77
Land transfer payment	5,743,284,908.53	3,668,242,559.42	1,132,428,194.63
Deductible input tax of the main business cost	2,247,119,058.17	2,165,162,617.34	2,019,314,803.08
Deductible proportion	2.9%	4.8%	16.1%
Deductible input tax of new equipment	48,396,969.86	34,679,011.82	16,918,052.19
Input tax of new real estate	485,419,072.49	313,810,995.63	234,506,083.03
VAT payable	10,620,063,019.38	6,045,580,013.85	371,593,515.83
Business tax	17,980,426,847.11	12,156,910,342.35	2,709,024,575.04
Change of tax burdens	-7,360,363,827.73	-6,111,330,328.50	-2,337,431,059.21
Growth rate of tax burdens	-40.94%	-50.27%	-86.28%

Source: Annual report of Vanke, 2015; Annual report of Poly, 2015, Annual report of CFLD, 2015 and own calculations.

### *Changes in urban construction and maintenance tax, education surcharges and corporate income tax*

As we know, urban construction and maintenance tax rate is 7 percent and the rate of education surcharges is 3 percent. Corporate income tax rate is 25 percent. As such, after the tax reform, we can get the following taxes:

$$\text{Urban construction and maintenance tax and education surcharges} = \text{VAT} * 12\% \quad (10)$$

$$\text{Corporate income tax} = (\text{Profit} + \text{Business tax} - \text{VAT}) * 25\% \quad (11)$$

From Table 3, we already get the results of the business tax and VAT for the three companies. Table 4 further present the results of the changes in urban construction and maintenance tax, education surcharges and corporate income tax. Overall, the results suggest that the tax reform has the tax deduction effect. The three companies have seen decreases in the tax burden of urban construction and maintenance tax and education surcharges by 883.24 million yuan, 733.4 million yuan and 280.5 million yuan respectively. However, the tax reform have a tax increase effect on corporate income tax. Especially, the corporate income tax was increased by 1840.1 million yuan, 1527.8 million and 584.4 million yuan respectively (see Table 4).

Table 4. Changes in tax burdens of urban construction and maintenance tax, education surcharges and corporate income tax (unit: yuan)

	Vanke	Poly	CFLD
Urban construction and maintenance tax and education surcharges (before the tax reform)	2,157,651,221.65	1,458,829,241.08	325,082,949.00
Urban construction and maintenance tax and education surcharges (after the tax reform)	1,274,407,562.33	725,469,601.66	44,591,221.90
Change of tax burdens	-883,243,659.33	-733,359,639.42	-280,491,727.10
Corporate income tax (before the tax reform)	6,487,359,506.58	4,206,929,466.35	1,246,772,826.56
Corporate income tax (After the tax reform)	8,327,450,463.51	5,734,762,048.47	1,831,130,591.36
Change of tax burdens	1,840,090,956.93	1,527,832,582.13	584,357,764.80

Source: Annual report of Vanke, 2015; Annual report of Poly, 2015, Annual report of CFLD, 2015 and own calculations.

#### 4. Conclusion and discussion

Based on the empirical analysis above, we can get the results of the overall changes of the tax burden for the three companies. Specially, after the tax reform to replace business tax with VAT, the tax burden for Vanke decreased by 7360.4 million yuan, the urban construction and maintenance tax and education surcharges decreased by 883.2 million yuan, the corporate income tax increased by 1840.1 million yuan, and therefore the overall tax burden decreased by 6430.5 million yuan. Similarly, the overall tax burden for Poly decreased by 5316.9 million yuan and the overall tax burden for CFLD decreased by 2033.6 million yuan. Since Vanke, Poly and CFLD are representative of the real estate industry, the decreases of tax



burdens for these companies suggest that the tax reform has a profound impact on the real estate industry. Therefore, we expect that at the beginning, the tax reform may have a tax reduction effect. However, on the other hand, compressive replacing of business with VAT may increase the demand for real estate as the fixed assets can be deductible after the reform. Accounting for the fact that the VAT has become the largest tax in China, the tax reform may have substantial positive impact on governments' tax revenue, even fiscal revenue. Moreover, the impact of the tax reform on the real estate industry is from the demand-side. We can imagine that if the tax reform can impose both the demand-side as well as the supply-side impacts, the real estate industry will get unprecedented opportunities to develop.

However, we should still be reminded that at present, the comprehensive tax reform actually obeys the target to reduce the inventory of the real estate, which may lead to an unsustainable development of the real estate industry. For instance, because of the global financial crisis in 2008, the housing price declined substantially. This led to a decreasing price of the banks' repossessed property, shrinking the banks' assets. Consequently, the banks did not have more liquidity to invest in more qualified loan projects, sharply decreasing the banks' revenue. Recession in the banking industry imposed a negative impact on enterprises which relied on banking loans due to lack of liquidity and operational difficulties. Subsequently, unemployment increased, stock price decreased and also purchasing power declined as a result of the bursting bubble of the real estate industry. In China, the real estate industry has been closely connected to other industries, for instance market research, production positioning, land acquisition, planning and designing, finance, construction, marketing, legal counseling and so on (Zhou, 2008). That is, the unsustainable development of the real estate industry would also harm the other industries, thereby increasing risks and insecurity for the national economy. Because of the strong dependence of the national economy on the real estate industry, the reform to reduce this dependence would be long-term and progressive. This does not mean an absolute shrink of the real estate industry. Instead, the development of the real estate industry should be kept at a stable and medium-low speed of development and the third industry should develop at a high speed. Consequently, the share of real estate in total national economy would be lowered and stable over time, decreasing the risk of functioning national economy.

Generally speaking, destocking of the real estate could help to promote the urbanization process, eliminating the gap between urban and rural development. In order to realize a stable and sustainable development of the real estate industry, the reforms taken on this industry should be combined with other reforms. First of all, a comprehensive reform of replacing

business tax with VAT can help to reduce the inventory of the real estate. Second, reform on personal income tax can be conducted to reduce the cost of banking loans for individuals and increase their disposable income, therefor stimulating their housing demand. Third, for the livelihood of the common people, it is demanding for the state to reduce the inventory of the real estate and to transform the shanty towns, combining with the construction of security housing. Finally, integration of regional economies, reforming the overall tax system, clarifying the fiscal relationship between the central and local governments and reforming the land system and the social security system are essential to obtain a sustainable development of the real estate industry.

The results suggest that the comprehensive reform of replacing business tax with VAT has significant tax reduction effect on real estate companies, which is in line with China's current economic performance and national policy to reduce taxes and costs and to conduct supply-side tax reforms. Meanwhile, the tax reform has changed the tax burden for second-hand housing. From the 1<sup>st</sup> May, 2016, except for the cities of Beijing, Shanghai, Guangzhou and Shenzhen, in all non-first tire cities, individuals who sell housing, which they have bought for two or more than two years, are exempt from VAT. If they have bought the housing for less than two years, they need to pay a full 5 percent of VAT when they want to sell the housing. In Beijing, Shanghai, Guangzhou and Shenzhen, individuals need to pay a full 5 percent of VAT when they sell a housing which they have bought for less than two years. Housing which they have bought for more than two years would be classified into non-ordinary and ordinary housing, where the former would be levied a 5 percent of VAT on the difference between the sales revenue and the purchase price of the housing while the later would be exempt from taxation when it is sold. These regulations suggest that for ordinary housing already bought for over two years, the VAT taxes would be comparable to the former business tax before the tax reform but for ordinary housing bought for less than two years, the tax burden would be decreased. To conclude, so far the state supports the real estate industry by mainly relying on the comprehensive reform of replacing business tax with VAT. However, the tax reform should be improved from both the demand-side as well as the supply-side, and thus to promote the sustainable development of the real estate industry.

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**Speakers**

Mr. Withee Pharnichwong  
Senior Economist, Fiscal Policy Office, Ministry of Finance, Thailand



Mr. Lee Yong-Chul  
Assistant Mayor for Planning and Coordination, Incheon Metropolitan City, Republic of Korea



Mr. Yanfeng Bai  
Professor, Dean of the School of Public Finance and Tax, Central University of Finance and Economics,  
Beijing, China



**Discussion**

Mr. Kim Pilhyun  
Research Fellow, Korea Institute of Local Finance









## Session 3

### Ensuring Efficient Financial Management for Local Governments

#### Speakers

##### ***Strengthening Efficiency in Sub National Finance in Cambodia***

- Mr. Hoy Vicheth, Chief Office of Budget Control and Monitor for District and Municipality, General Department of Finance for Sub-national Administration, Ministry of Economy and Finance, Cambodia

##### ***The Strategies to improve the Efficiency of Local Finance in Korea***

- Ms. Kim Su-Kyung, Local Finance Team Manager, Local Finance Policy Division, Ministry of Interior, Republic of Korea

##### ***Financing Options for Local Development and Monitoring the Fiscal Performance of Local Governments in the Philippines***

- Mr. Niño Alvina, Director of Local Government Units Operations Service, Bureau of Local Government Finance, Department of Finance, Philippines

#### Discussion



## Session 3

### Ensuring Efficient Financial Management for Local Governments



**Mr. Hoy Vicheth**

*Chief Office of Budget Control and Monitor for District and Municipality,  
General Department of Finance for Sub-national Administration,  
Ministry of Economy and Finance, Cambodia*

Hoy Vicheth, a Cambodian national and received a bachelor degree in economics from Northern Illinois University and earned a master degree in economics from Western Illinois University in United State of America. He has been working in the Ministry of Economy and Finance of Cambodia since 2012. He is active in both policy and budget affair for sub national administrations. He engages in strengthening efficiency in sub national government budget implementation and supports the ministry of economy and finance on producing a budget strategy plan for sub national administrations which is a part of the national public financial management reform program.





## **Royal Government of Cambodia**

**Ministry of Economy and Finance**

**General Department of Finance for Sub-national Administrations**

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### **Strengthening Efficiency in Sub National Finance in Cambodia**

**Presented by : Mr. Hoy Vicheth**

**Chief of Office, Budget Control and Monitor for District and Municipality**

**Asian Public Governance Forum on Local Finance Management**

**June 13-14 June 2016**

**Incheon, Korea**

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## **Contents**

1. Cambodia at a Glance
2. Administration System
3. Sub National Administrations (SNAs) Budgeting
4. Budget Allocation for SNAs
5. Public Financial Management Reform Program(PFMRP)
6. Financial Management Information System(FMIS)
7. Public Expenditure and Financial Accountability(PEFA)
8. Revenue Mobilization Strategy

# 1. Cambodia at a Glance



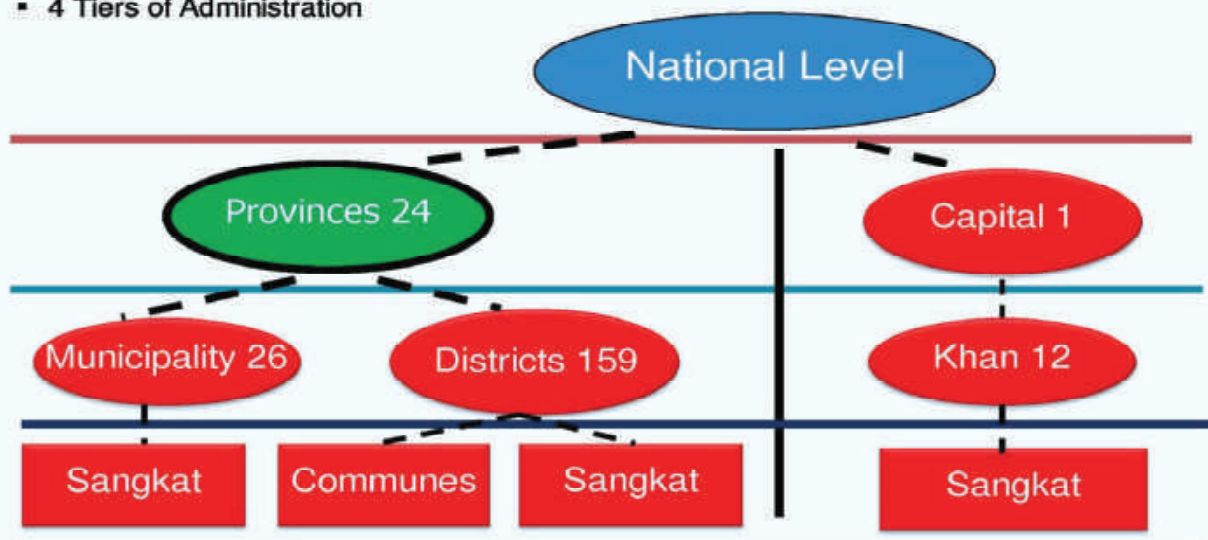
## Kingdom of Cambodia

- Capital: Phnom Penh
- Area: 18 035 KM<sup>2</sup>
- Border: Thailand, Lao, Vietnam.
- Population: >15M
- Language: Khmer
- Currency: Riel
- Religion: Buddhist

# 2. Administration System (Cont.)

## Current Administrative Management Structure

- 4 Tiers of Administration



- Total C/S = 1633 (Commune = 1407 Sangkat =226)

### 3. Sub National Administration Budgeting

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- Capital/ Province Budget (CP Budget)
- District/ Municipality Fund (DM Fund)
- Commune/ Sangkat Fund (CS Fund)

### 4. Budget Allocation

---

Budget allocates based on the following indicators and formula as below:

• **Admin Operation was allocated;**

- Equal shares: 40%
- Number of councilors: 20%
- Number of Board of Governor: 20%
- Number of staff: 20%

• **Local development component was allocated;**

- Equal shares: 40%
- Number of population: 20%
- Poverty scores: 20%
- Number of Districts/Municipalities: 20%

## 4. Budget Allocation (Cont.)

Royal Government of Cambodia has been transferred state budget to SNAs in the following rate;

### ➤ CP Budget

- 0.96% of current national revenue

### ➤ DM Budget

- 0.80% of current revenues (2012-2015)
- 0.90% of current revenues (2016)
- 1% of current revenues (2017-2019)

### ➤ CS Fund

- from 2% - 2.80% of current revenues (2002-2018)

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## 4. Budget Allocation (Cont.)

Year	CP Budget	DM Fund	CS Fund
2013	124.23M	14.42M	50.4 <sup>1</sup> M
2014	158.23M	16.74M	58.58M
2015	186.16M	19.19M	67.15M
2016	225.83M	24.48M	76.15M

- Sub-national administration budget plan for 2017 is 1.81% of GDP
- Increment rate of CP budget 2017 is 19.46% compared to CP budget 2016.
- increment rate of DM funds 2015 is 35.24% compared to DM funds in 2016.
- Increment rate of CS funds 2015 is 21.39% compared to DM funds in 2016

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## 5. Public Financial Management Reform Program

The PFMRP was launched in December 2004, and has begun implementation in early 2005 with Platform I. The PFMRP is a comprehensive and long term reform program from 2005 to 2025 with ambitious vision to improve Cambodia public financial management system to international standard level through four Platforms:

**(i) Improving budget credibility(2005-2008):** focuses on improving budget credibility through enhanced revenue collection, budget procedures and processes, and the introduction and expansion of the use of the banking system, especially with the establishment of treasury single account (TSA), in order to improve cash management.

## 5. Public Financial Management Reform Program(Cont.)

**(ii) Improving financial accountability(2009-2015):**building upon improved budget credibility toward achieving better financial accountability.

**(iii) Improving budget policy linkages(2016-2020):** Budget system reform, budget strategy plan, program budgeting, budget entity.

**(iv) Improving performance accountability(2021-2025):** Monitoring and Evaluation system. The scope of this program covers areas of activities that include budget formulation and execution, budget monitoring and evaluation, revenue policy and administration, and human resource development and management.

## **6. Financial Management Information System (FMIS)**

- FMIS is a tool for automating all current manual PFM processes into a fully integrated total PFM system covering budget formulation, budget implementation, accounting, reporting, monitoring and auditing. It covers more than software and hardware which includes people, organization and managing changes and in those aspects bring about new business processes.
- It will transform all the financial processes from mainly manual system supported by some subsidiary systems built to support some operations in some areas of MEF to electronic system (Computer based).

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## **6. Financial Management Information System (Cont.)**

- The FMIS implementation is to support and underpin the general PFM reform activities in all stages by improving accountability, effectiveness, efficiency, and modernization of the public financial management system in Cambodia.
- This will provide timely and comprehensive information on budget revenue and expenditure as well as in the longer term the FMIS will provide automated support (turn-key solution) to budget planning and formulation and budget execution processes, with stronger system reinforced controls.

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## 7.Public Expenditure and Financial Accountability

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- Public Expenditure and Financial Accountability(PEFA) enables us to evaluate the progress, challenging problems, and necessary work to revise and continue to implement the Public Finance Management Reform Program, especially showing about the changes in capability and capacity of the government.
- PEFA has helped to determine the condition or shortages of public finance management systems to be revised and strengthened.

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## 7.Public Expenditure and Financial Accountability(Cont.)

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- Public Expenditure and Financial Accountability (PEFA) performance assessment – conducted in 2015 - is the second such assessment in Cambodia. The main objectives of the current assessment are to provide a basis for formulating the next action plan for implementation of the PFM Reform Program and to track the progress since the last assessment. The assessment follows the PEFA Framework methodology and supporting guidelines and clarifications to the Framework.
- The PEFA assesses the transparency of transfers from central government to sub-national governments and accountability for the use of these funds during the last completed FY. In line with the description of the sub-national administrative system, the SNAs prepare and implement their budgets with high degree of autonomy and are accountable to the local constituency through directly elected councilors.

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## 8. Revenue Mobilization Strategy

### ❖ Sub-National Investment Fund

- to determine the establishment and functioning of Sub-National Investment Fund (SNIF) to promote socio-economic development at the sub-national level by financing strategic public investments by Sub-National Administrations and to provide Sub-National Administrations (SNAs) with incentives to improve their overall performance and public investment management.
- to define the legal framework for managing Sub-National Investment Fund following the National Program for Sub-National Democratic Development
- to cover the management of Sub-National Investment Fund for financing public investment project implemented by Sub National Administrations (SNAs). The tier of SNAs to implement the fund will be prioritized by SNIF Board.

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## 8. Revenue Mobilization Strategy (Cont.)

### ❖ Conditional Grants

- To promote expenditure assignment to Sub- national administrations in delivering public service through general process functional assignment, adequate resources and in accordance with national policy on Sub-national democratic development.
- To set general principles for implementing conditional grant to Sub- national administrations to manage and execute one or more functions assigned to Sub-national administration in form of functional assignment or delegated function and response to local need.
- To cover conditional transfer from ministries, institutions, departments to Sub-national administration and between Sub-national administrations.

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## 8. Revenue Mobilization Strategy (Cont.)

### ❖ Revenue Assignment

- aims at determining the tax revenues to be shared from the provincial administration to district/municipal administration. The shared tax revenue is to promote accountability of the councils toward citizens in performing their obligatory and permissive functions as well as to strengthen the effectiveness of state revenue collection and public spending and to provide more autonomy to the councils in line with the national program for sub-national democratic development.
- to determine legal framework for sharing tax revenue between sub-national administrations.
- To cover tax revenue sharing between provincial administration and district/municipal administration in the Kingdom of Cambodia.

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## 8. Revenue Mobilization Strategy (Cont.)

### ❖ One Window Service Office (OWSO)

- The OWSO unique in Cambodia is that the fees for the various services are transparent and are publicly displayed for all to see in the OWSO and the service is provided in a timely and consistent manner. The OWSO is a single office for delivery of certain administrative services commonly required by citizens and small business at the local level.
- The OWSO consists of a '**front office**' for interacting with citizens, giving out forms and collecting documents, and a '**back office**' which consists of 'competent agents' who are delegated here from the 6 line ministries that have transferred functions to the OWSO. The OWSO provides around 30 different services among others the registration of motorbikes, small shops and licenses for constructions for houses up to 500 square meters.

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**THANK YOU**

## Session 3

### Ensuring Efficient Financial Management for Local Governments



**Ms. Kim Su-Kyung**

*Local Finance Team Manager, Local Finance Policy Division  
Ministry of Interior, Republic of Korea*

Kim Su-Kyung is Team Manager of Local Finance Policy Division of the Ministry of Interior, Korea. As a senior Deputy Director, she is currently responsible for Korea's 'Local Finance Reform' to enhance local fiscal soundness and coordinates basic plans and major policies in response to environmental changes in administration. She has been working in the field of local government fiscal affairs including local tax for more than 12 years. In her previous positions, she worked at the Civil Service Commission as Deputy Director of the Performance Management Division, and as Deputy Director of Local Tax Policy Division.





# Strategies to Improve the Efficiency of Local Finance in Republic of Korea

July 13, 2016



Ministry of the Interior

## Contents

- I . Local Autonomy and Finance in Korea
- II . Current Financial Conditions in Local Gov'ts
- III . Enhancing the Efficiency of Local Finance

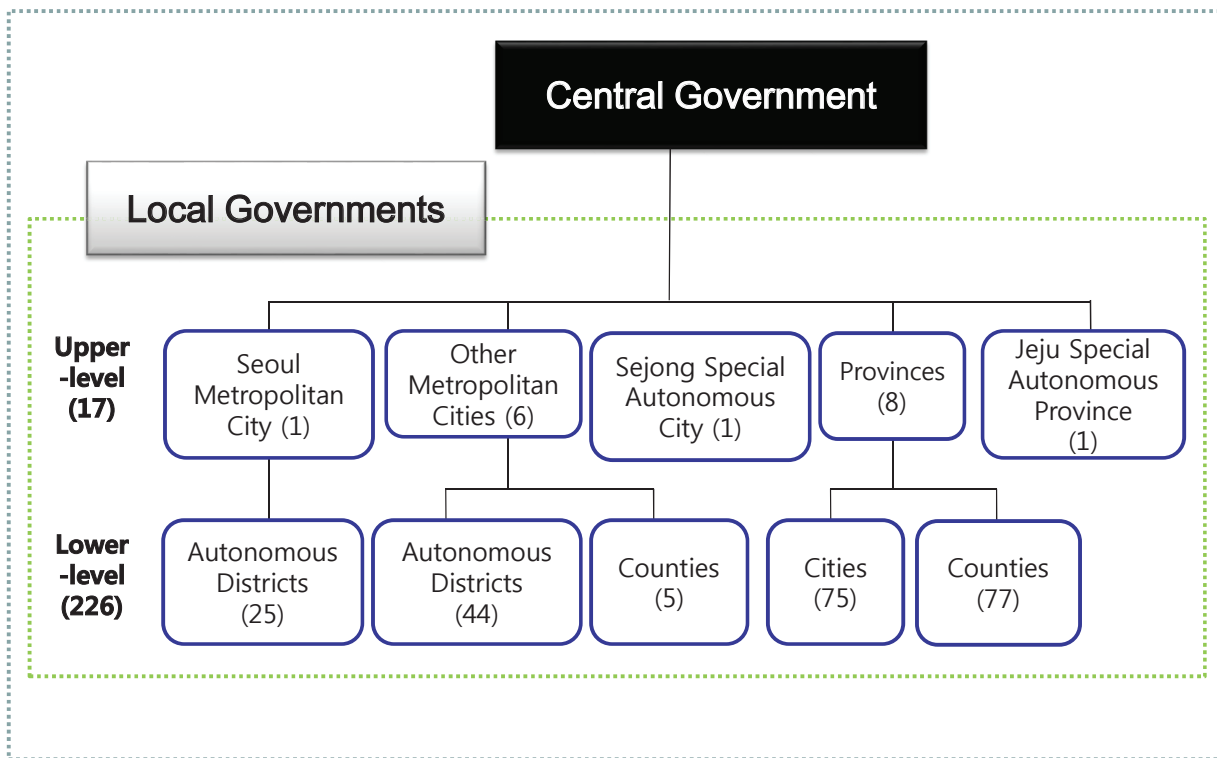
# I . Local Autonomy and Finance in Korea

## 1. History of Local Autonomy

- (1949) The Local Autonomy Law was enacted.
- (1952) The local self-government system with local council was introduced.
- (1961~1991) The local elections were abolished; local autonomy was postponed.
- (1991) The local elections for local councils revived.
- (1995) Mayors and governors were directly elected.



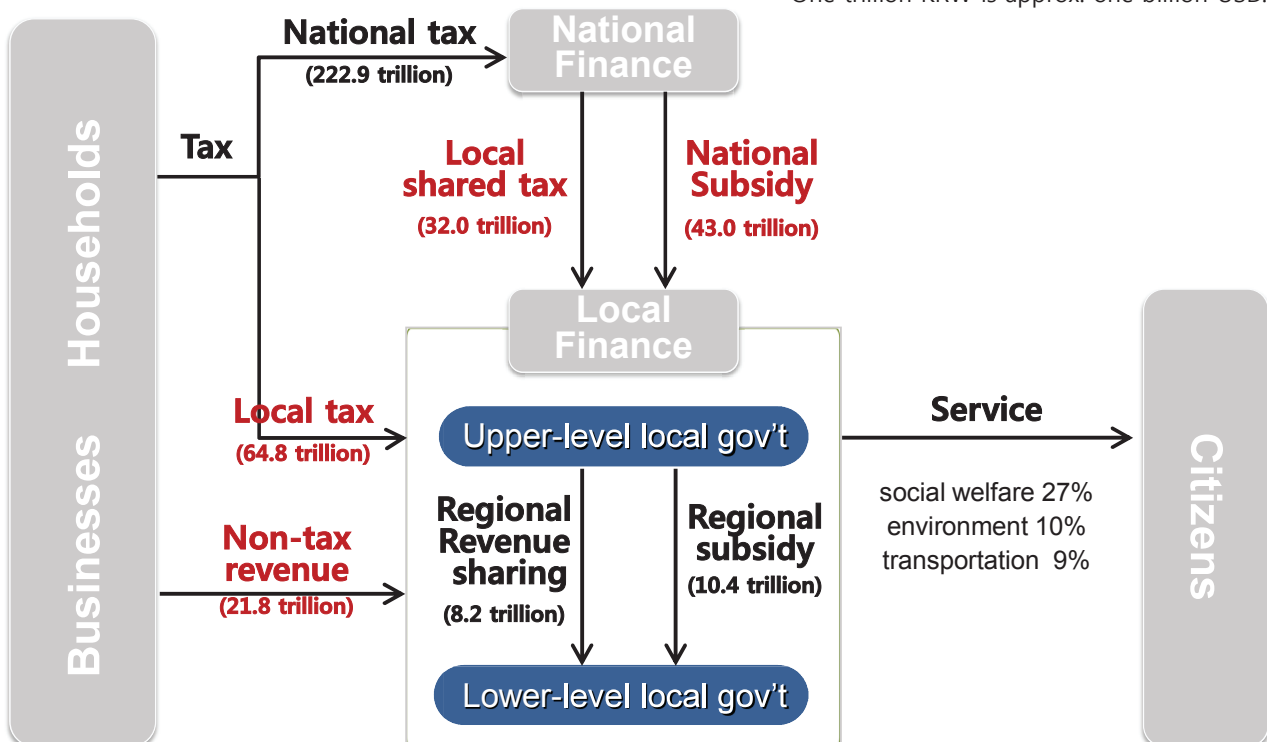
## 2. Local Autonomy System



## 3. Overview of Local Gov't Finance (2016)

**Unit:** Korean Won, %

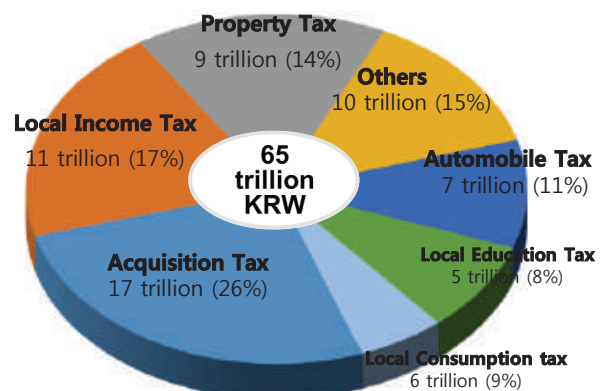
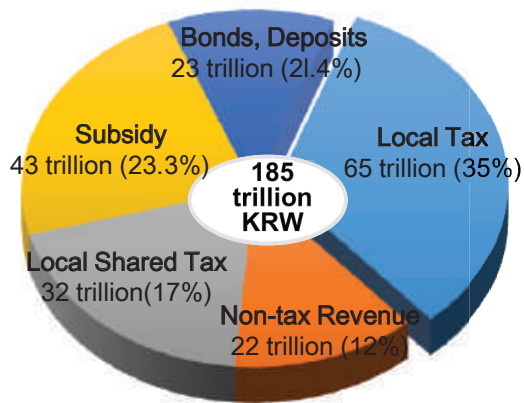
\* One trillion KRW is approx. one billion USD.



# 3-1. Local Revenue

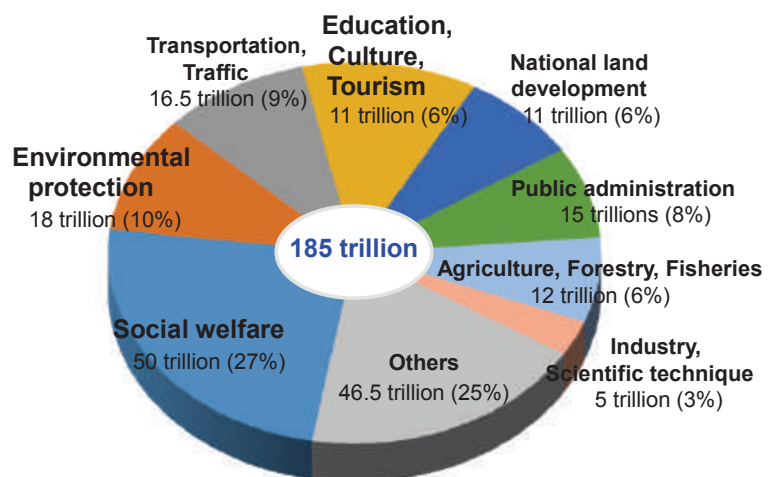
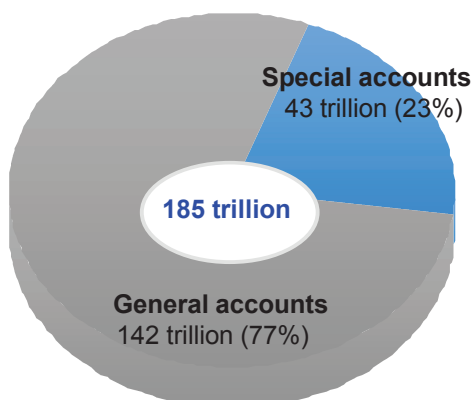
Unit: One trillion KRW, %

Total	Own-source Revenue 86.7 (47.0%)		Intergovernmental Transfers 74.9 (40.6%)		Etc. (12.4%)
184.6 (100%)	Local tax	Non-tax revenue	Local Shared tax	Subsidy	Bonds, Deposits
	64.8 (35%)	21.8 (12%)	31.9 (17.3%)	43.0 (23.3%)	23.0 (12.4%)



# 3-2. Local Expenditure

Unit: KRW, %



## II. Current Financial Conditions in Local Gov'ts

### 1. Insufficient and Unstable Revenue

- Local finance has grown bigger.
  - \* 43 trillion won in 1995 → 185 trillion won in 2016
- But, local revenue bases are vulnerable.
  - Imbalance between national tax & local tax
  - Property-related taxes are susceptible to fluctuation in real estate economy.

## 2. Increasing Demand for Social Welfare

- Low birth rates & Rapidly aging population

\* Social welfare spending: 26.5 trillion in 2012 → 50 trillion in 2016

- New demand (public safety & job creation etc.)

➔ The financial burden has become greater on local governments.

## Ⅲ. Enhancing the Efficiency of Local Finance

# 1. Expanding Local Revenue

- Local consumption tax rate (5% → 11%) and national subsidies on childcare increased in 2013.
- Reducing the local tax exemption
  - \* local tax exemption ratio: 23% in 2012 → 15% in 2017
- Preventing the local revenue leakage
  - 'Integrated Tax Data Management System'

# 2. Efficient Management of Expenditure

## A mid-term Local Finance Plan

- 5-fiscal year finance plan about medium-term purpose, finance, forecast, investment plan of Local Governments

## Financial Analysis and Evaluation System

- The Ministry of Interior shall analyze the financial conditions of all the local governments and then diagnose the financial problems on inferior governments.

## Management the Debts of the Local Government

- The heads of local governments shall issue bonds within the amount limit for local government bonds.
- The limit shall be determined by the Ministry of the Interior, in consideration of the amount of obligations and other conditions.

## 2. Efficient Management of Expenditure

- The Examination of Financial Investment Projects
  - Research organizations do an in-depth analysis in **advance** of the examination.
- Set a Ceiling on the Total Budget for Regional Festivals & Events
- Opening and Sharing Local Finance Information
  - Encouraging citizen participation in budgeting



**Thank you !**



## Session 3

### Ensuring Efficient Financial Management for Local Governments



**Mr. Niño Alvina**

*Director of Local Government Units Operations Service  
Bureau of Local Government Finance, Department of Finance, Philippines*

Niño Raymond B. Alvina is the Director of Local Government Units Operations Service of the Bureau of Local Government Finance, an attached agency of the Department of Finance. Prior to formally joining the Government in 2015, he has worked on property valuation and taxation reforms, and other projects on local finance in various capacities from 2005 to 2014. In his current role, he supports policy development and is in-charge of the Bureau's oversight functions on local treasury and assessment services, capacity building, and project management. His recent initiative is on benchmarking performance standards and setting up the fiscal sustainability scorecards of all local governments in the Philippines.



SESSION 3 : Ensuring Efficient Financial  
Management for Local Governments



## Financing Local Development and Monitoring the Fiscal Performance of Local Governments in the Philippines



**NINO RAYMOND B. ALVINA**  
Bureau of Local Government Finance  
Department of Finance

## Outline of Presentation

- Overview of Philippines fiscal decentralization
- Recent fiscal trends: revenues and expenditures
- Financing support for local governments
- Results of performance monitoring
- Key challenges, emerging issues and way forward



## PH Fiscal Decentralization



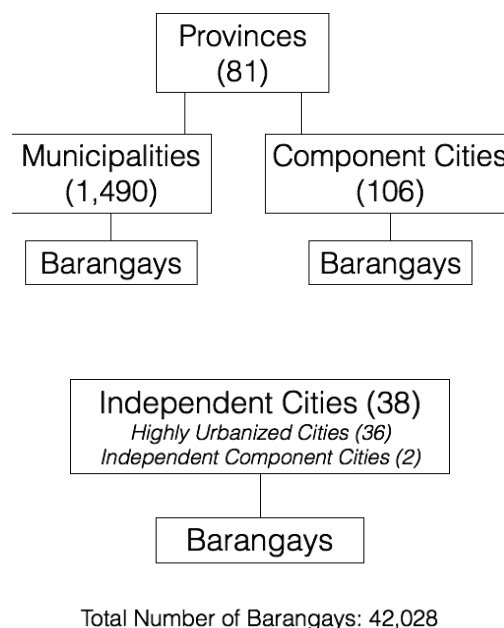
- **Long history of fiscal decentralization**
  - ✓ Local Autonomy Act of 1959: Republic Act No. 2264
  - ✓ Decentralization Act of 1967: Republic Act No. 5185
  - ✓ Local Government Code of 1983: Batas Pambansa No. 337
  - ✓ Local Government Code of 1991: Republic Act No. 7160
- **Changing policy frameworks overtime that broaden local autonomy landscape**
- **The 1991 Local Government Code:** Providing local governments broader fiscal mandates--revenue assignments, devolved expenditure responsibilities, intergovernmental transfers, and subnational debt/credit financing
- **Responding to the geographic demands for better, more efficient delivery of public goods and services:** 7,107 islands

PHILIPPINES Country Presentation  
2<sup>nd</sup> Asian Public Governance Forum on Local Finance Management | July 2016 | Incheon, South Korea

## Decentralized Structure



- **As of 2015**
  - ✓ 81 Provinces
  - ✓ 144 Cities
  - ✓ 1,490 Municipalities
  - ✓ 42,028 Barangays/villages
- **Provinces, cities, and municipalities headed by locally elected chief executives:** Governor for provinces, and Mayor for cities and municipalities, each with a Vice Mayor/Vice Governor
- **Each local government level has a local legislative council called “Sanggunian”** (Provincial Board; City/Municipal/Barangay Council) composed of locally elected councilors, with the Vice Governor/Vice Mayor/Punong Barangay serving as Presiding Officer



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## Taxing Powers

Base	P	C	M	B
• Business	x	✓	✓	x
• Real property; Sand, gravel & other quarry resources	✓	✓	w/ share	w/ share
• Idle land; Real property transfers; Printing and publication; Delivery vans and trucks; Professionals; Franchise	✓	✓	x	x
• Amusement places	✓	✓	w/ share	x
• Community tax	x	✓	✓	w/ share

- May impose regulatory fees and user charges
- Largely fixed (with maximum rates/ceilings) and not indexed to inflation
- Tax rates can only be adjusted up to 10% and once every 5 years
- Rates/levies must be legislated through local council

## Expenditure Responsibilities

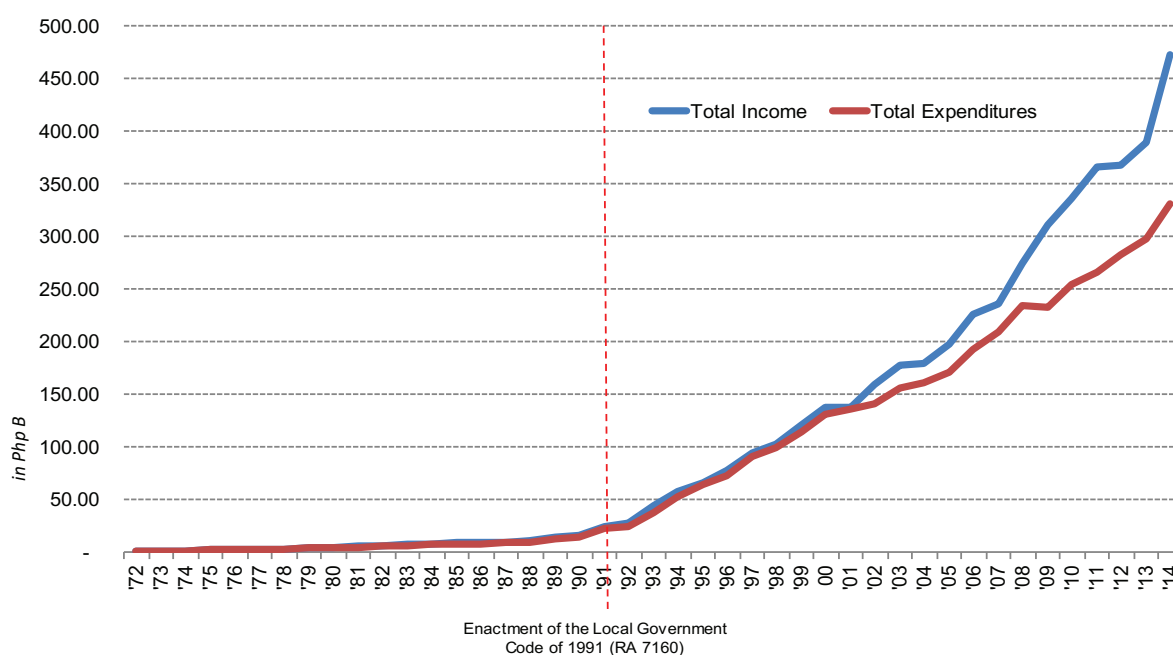
- ✓ Health & Social Services
- ✓ Agriculture
- ✓ Environmental Protection & Management
- ✓ Infrastructure
- ✓ Tourism
- ✓ Regulatory Functions



## Historical Subnational Profile



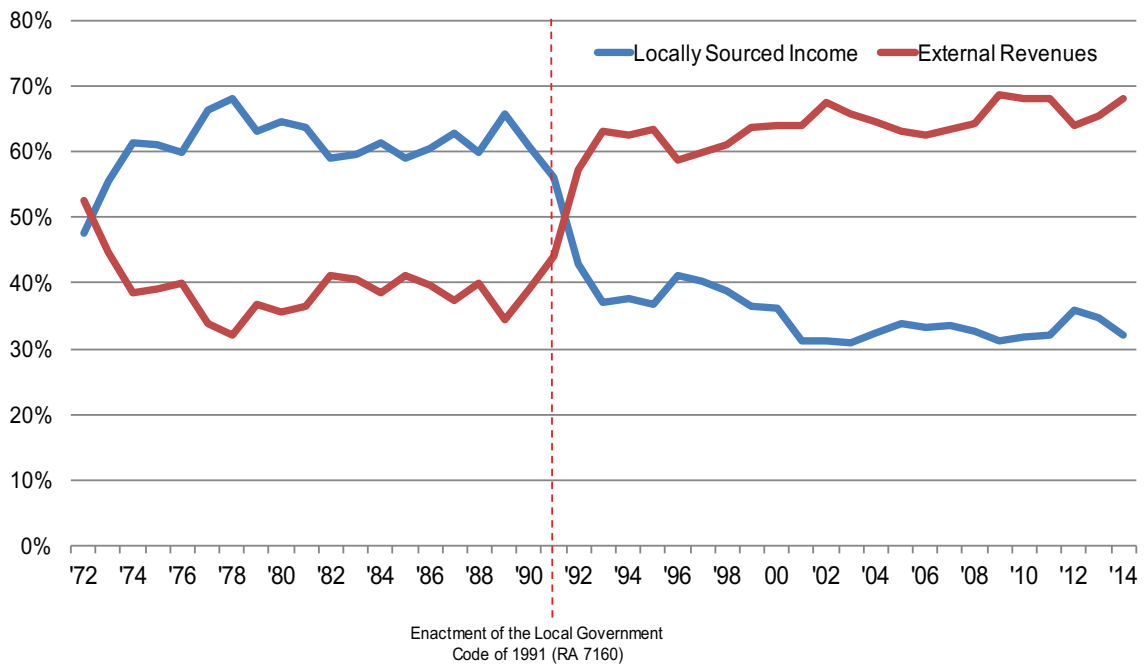
### Income & Expenditures: FY1972-2014



# Historical Subnational Profile



## Share Local and External Revenues: FY1972-2014

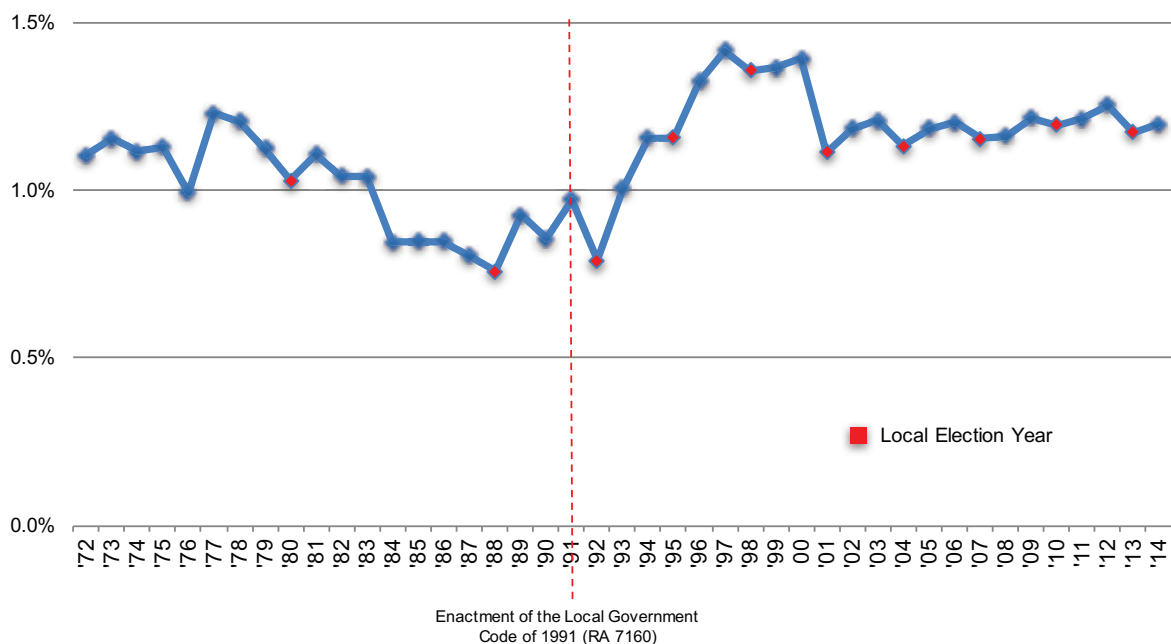


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# Historical Subnational Profile

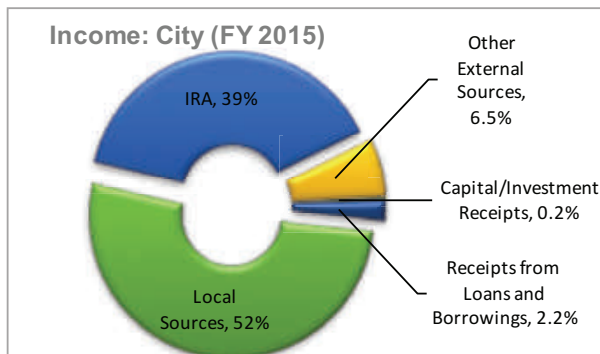
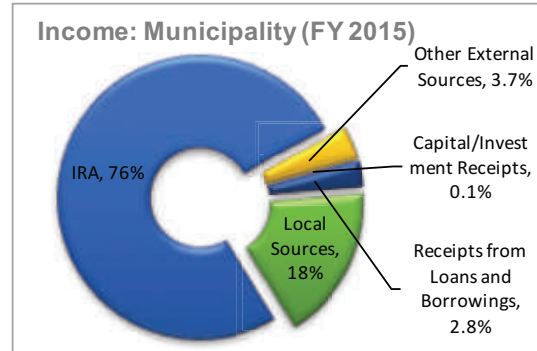
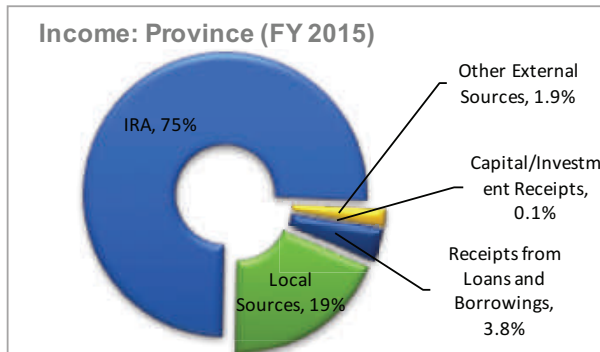


## Local Income to GDP Ratio: FY1972-2014



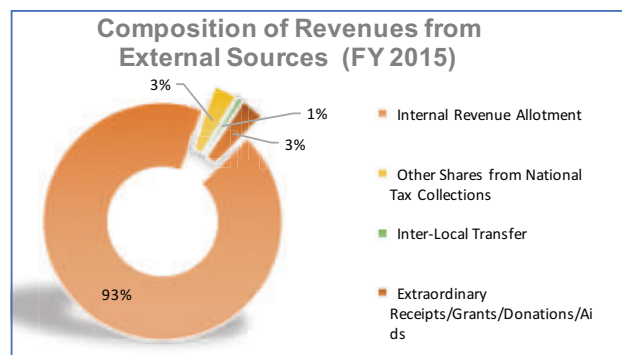
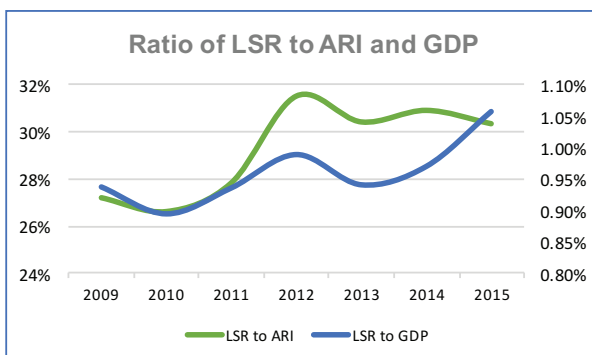
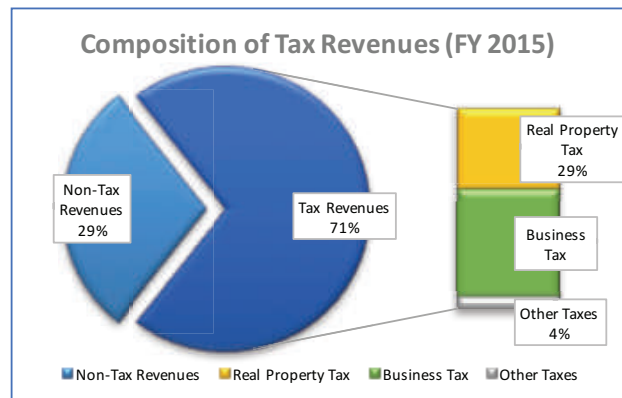
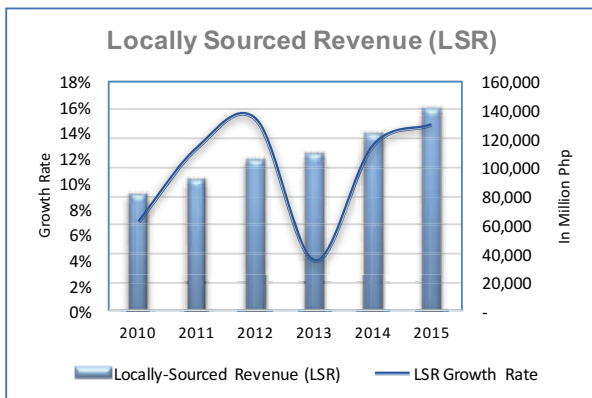
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# Recent Trends: Subnational Fiscal Profile



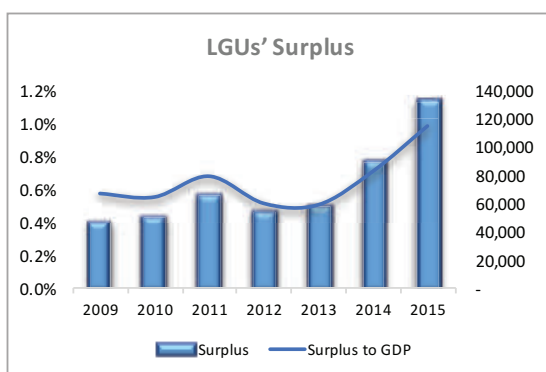
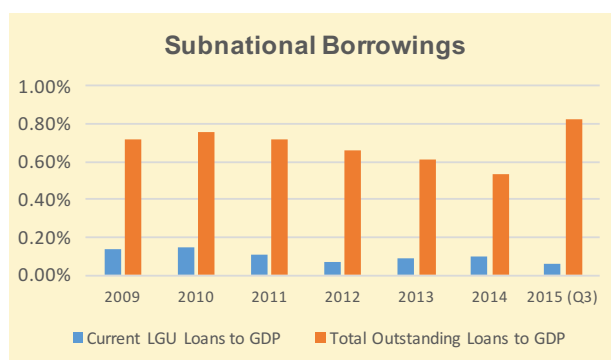
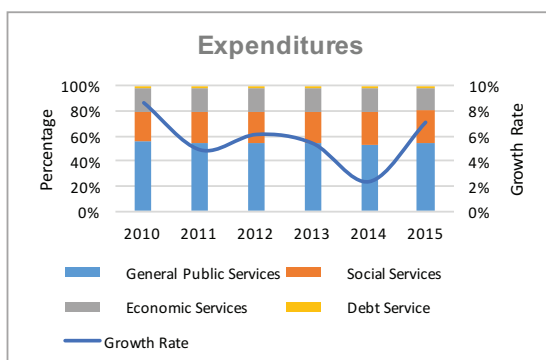
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# Recent Trends: Subnational Fiscal Profile



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## Recent Trends: Subnational Fiscal Profile



- Aggregate levels of LGU Borrowing grew 6% on average from FYs 2009 to 2014
- The annual flows of LGU Borrowing fell from 0.14% in FY2009 to 0.10% of GDP in FY 2014
- Aggregate stock of LGUs Outstanding Loans increased by 0.76% in FY 2010 (Php68.24B/US\$1.451B) and continuously fell to 0.53% in FY 2014 (Php68.11B/US\$1.449B)

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## Financing Support for Local Gov'ts



### • National government transfers

- Annually, LGUs receive 40% of national internal revenue taxes based on the collection of the 3<sup>rd</sup> fiscal year preceding the current fiscal year
- Share determined using the BIR-certified basic income, which is net of non-cash collections, tax expenditure fund and special funds or special accounts/shares (payment to COA, GOCCs), insurance benefits, etc.; customs collections are not included
- Cost of devolved services in 1992 is Php6.5B

### • IRA, as a formula-based block grant, is distributed as:

- By Level: Provinces - 23%; Cities - 23%; Municipalities - 34%; Barangays - 20%
- By Share: 50% Population (NSO); 25% Land Area (LMB); 25% Equal Sharing
- Barangay Share: 60% Population; 40% Equal Sharing

### • Other Non-IRA Transfers to LGUs:

- Shares: National Wealth; Tobacco Excise Tax; EcoZones; EVAT; PCSO/PAGCOR
- Grants: Performance Challenge Fund, Bottom-Up Budgeting, PAMANA fund

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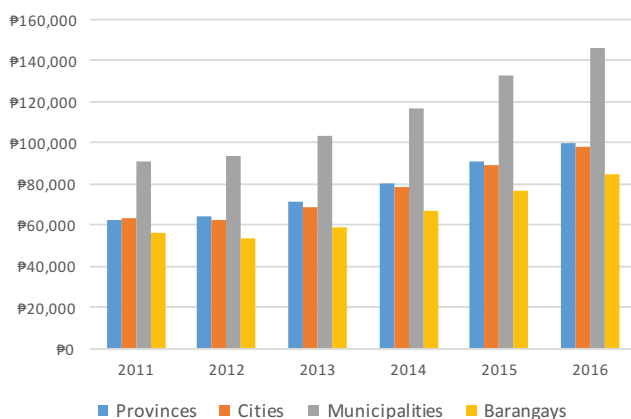
## National Transfers



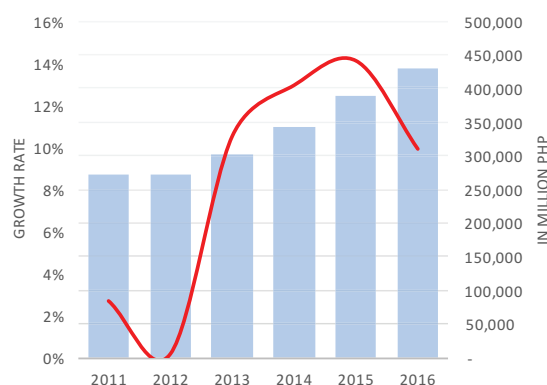
### IRA continuously grew in recent years:

- Ave 12% in the last 4 years; highest in 2015 @ 14%
- Ave 2.52% of GDP; 2.93% in 2015

IRA TRANSFERS (By LGU Type): 2011-2016



IRA TRANSFERS: 2011-2016



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## Additional Financing Support



### Bottom-Up Budgeting Support for Local Governments

- Budget support of NG for social and anti-poverty programs
- Aims to make budget more responsive, encourage local participation, deepen democracy and empower citizens

	2013	2014	2015	2016
Amount of Projects	Php8B	Php20B	Php20.9B	Php24.7B
	US\$170M	US\$426M	US\$445M	US\$525M
Recipient Cities & Municipalities	595	1,225	1,590	1,514

#### Qualifications



Compliance with the **Good Financial Housekeeping (DILG)**



Submission of the **Public Financial Management Improvement Plan (DBM)**

Online reporting and monitoring:

[openbub.gov.ph](http://openbub.gov.ph)



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# Fiscal Performance Monitoring of LGUs



<http://iskor.blgf.gov.ph>

*Initiated in 2015, the LGU Fiscal Sustainability Scorecard baselined the LGU performance on revenue generation, expenditure management and compliance reporting from FY2009 to FY2012.*

*It covered 80 provinces, 144 cities, and 1,478 municipalities and were officially released and published to all LGUs.*

## Key Results Areas



### **KRA1 - 60 points** **Revenue Generation Capacity**

- 1.1. Regular Income Level
- 1.2. Local Revenue Level
- 1.3. Local Revenue Growth
- 1.4. Dependence on Locally Sourced Income
- 1.5. Dependence on IRA
- 1.6. Dependence on Other Shares from National Tax Collection

### **KRA2 - 10 points** **Local Collection Growth**

- 2.1. *Tax Revenues*
  - 2.1.1. Basic Real Property Tax
  - 2.1.2. Tax on Business
  - 2.1.3. Other Taxes
- 2.2. *Non-Tax Revenues*
  - 2.2.1. Regulatory Fees
  - 2.2.2. User/Service Charges
  - 2.2.3. Income from Economic Enterprise/s

### **KRA3 - 20 points** **Expenditure Management**

- 3.1. Total Expenditure Per Capita
- 3.2. Use of IRA for Local Development Projects
- 3.3. Limitation on Expenditure for Personal Services
- 3.4. Limitation on Debt Service Ratio

### **KRA4 - 4 points** **Timely and Accurate Submission of Statement of Receipts and Expenditures**

*Compliance with DOF Department Order No. 8-2011*

### **KRA5 - 3 points** **Regular Updating of the Schedule of Market Values and Conduct of General Revision of Property Assessments**

*Compliance with Sec. 219 of the Local Government Code and DOF-DILG JMC No. 2010-01*

### **KRA6 - 3 points** **Timely and Accurate Submission of the Quarterly Report on Real Property Assessments**

*Compliance with BLGF Circulars*

# Sample Scorecard

Key Result Area		Indicator	Max Score	2010	Score	2011	Score	2012	Score
1. Revenue Generation Capacity (60 points)	1.1 Regular income level <sup>2</sup>		10	Very Good	10	Very Good	10	Very Good	10
	1.2 Local revenue level <sup>3</sup>		15	Very Good	15	Very Good	15	Very Good	15
	1.3 Local revenue growth		20	3%	5	17%	15	11%	15
	1.4 Dependence on locally sourced income <sup>4</sup>		10	Fair (35%)	6	Fair (38%)	6	Good (43%)	8
	1.5 Dependence on IRA		10	Fair (64%)	6	Fair (62%)	6	Low (57%)	8
	1.6 Dependence on Other Shares from National Tax Collection		5	Low (0.38%)	5	None (0%)	5	Low (0.19%)	5
2. Local Collection Growth (20 points)	2.1 Tax Revenues		5	3%	2	17%	4	11%	4
	2.1.1 Real property tax (Basic)		5	4%	2	20%	4	13%	4
	2.1.2 Tax on Business		5	1%	2	16%	4	10%	4
	2.1.3 Other Taxes		5	12%	2	22%	4	18%	4
	2.2 Non-Tax Revenues		5	2%	2	18%	4	9%	4
	2.2.1 Regulatory Fees		5	16%	2	10%	4	15%	3
	2.2.2 User/Service Charges		5	-7%	2	22%	4	-0.06%	3
2.2.3 Econ. Enterprise		5	-4%	2	19%	4	12%	3	
3. Expenditure Management (20 points)	3.1 Total Expenditure Per Capita <sup>5</sup>		5	Fair	3	Very Low	1	Low	2
	3.2 Use of IRA for Local Development Projects <sup>6</sup>		5	Passed (77.7%)	5	Failed (8.7%)	0	Failed (14.0%)	0
	3.3 Limitation on Expenditure for Personal Services <sup>7</sup>		5	N/A <sup>8</sup>	5	Passed (30.4%)	5	Passed (31.4%)	5
	3.4 Limitation on Debt Service Ratio <sup>9</sup>		5	Passed (10.9%)	5	Passed (13.5%)	5	Passed (11.2%)	5
<b>SUB-TOTAL: QUANTITATIVE INDICATORS (90%)</b>			<b>100</b>	<b>62.1 PTS.</b>	<b>68.4 PTS.</b>	<b>72 PTS.</b>			
4. Submission of Timely and Accurate Statement of Receipts and Expenditures per DOF Order No. 8-2011		40	Non-Compliant	20	Compliant	40	Compliant	40	
5. Regular Updating of Schedule of Market Values and Conduct of General Revision of Property Assessments per Sec. 219 of the Local Government Code and DOF-DILG Joint Memorandum Circular No. 2010-01		30	Compliant (SMV is 1 year old.)	30	Compliant (SMV is 2 years old.)	30	Compliant (SMV is 3 years old.)	30	
6. Submission of Timely and Accurate Quarterly Report on Real Property Assessment (QRRPA)		30	Complete	30	Incomplete	15	Incomplete	15	
<b>SUB-TOTAL: QUALITATIVE INDICATORS (10%)</b>			<b>100</b>	<b>8 PTS.</b>	<b>8.5 PTS.</b>	<b>8.5 PTS.</b>			
<b>OVERALL SCORE<sup>10</sup></b>			<b>100</b>	<b>70.1 PTS.</b>	<b>76.9 PTS.</b>	<b>80.5 PTS.</b>			
<b>OVERALL RATING</b>				<b>B</b>	<b>B</b>	<b>A</b>			
				<b>VERY GOOD</b>	<b>VERY GOOD</b>	<b>EXCELLENT</b>			

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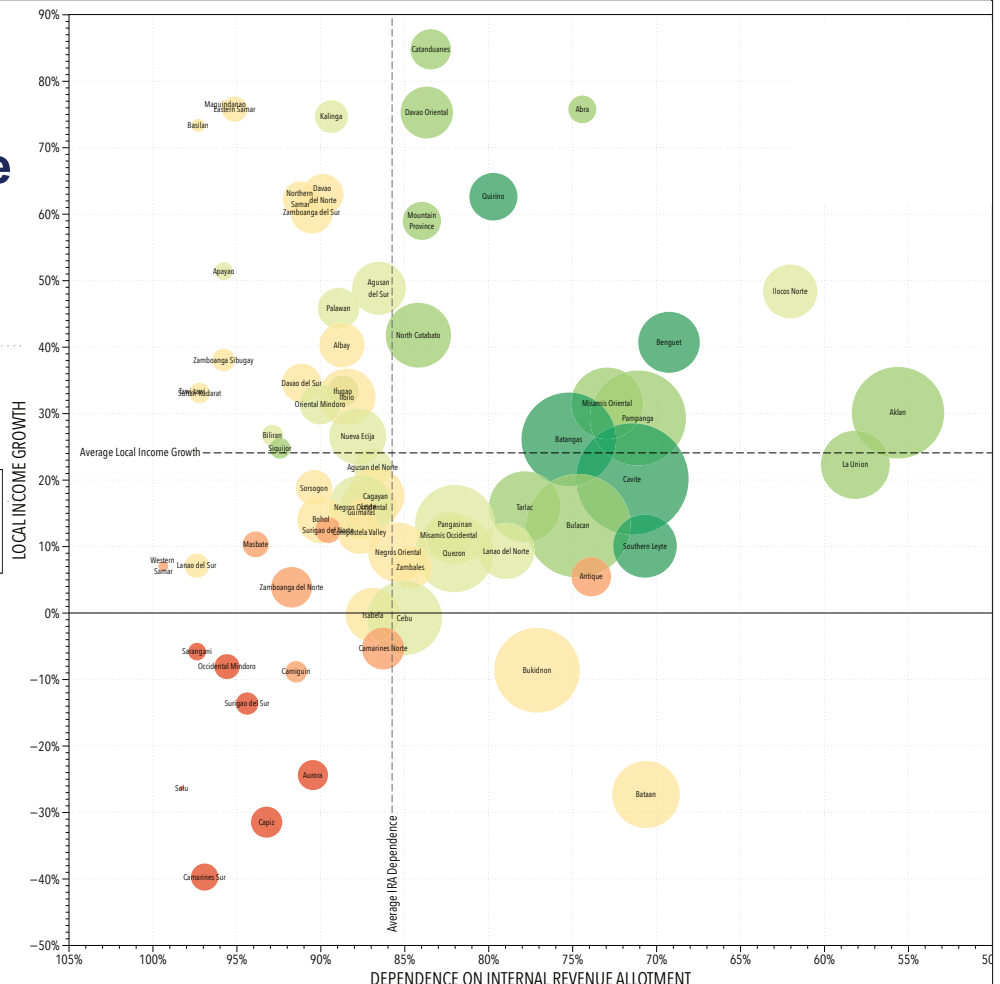
## 2012 Provinces Performance

**LGU FISCAL SUSTAINABILITY RATING**

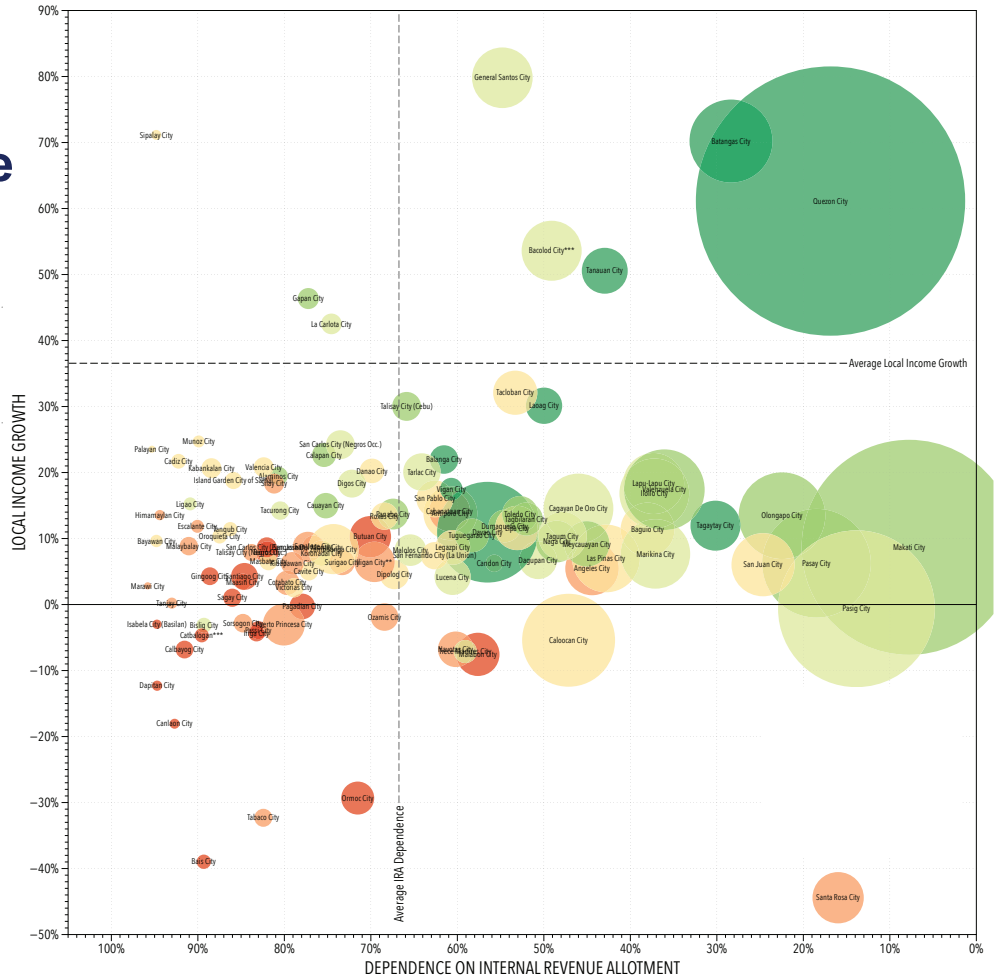
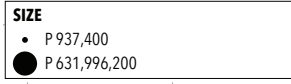
- Poor
- Needs Improvement
- Average
- Good
- Very Good
- Excellent

**SIZE**

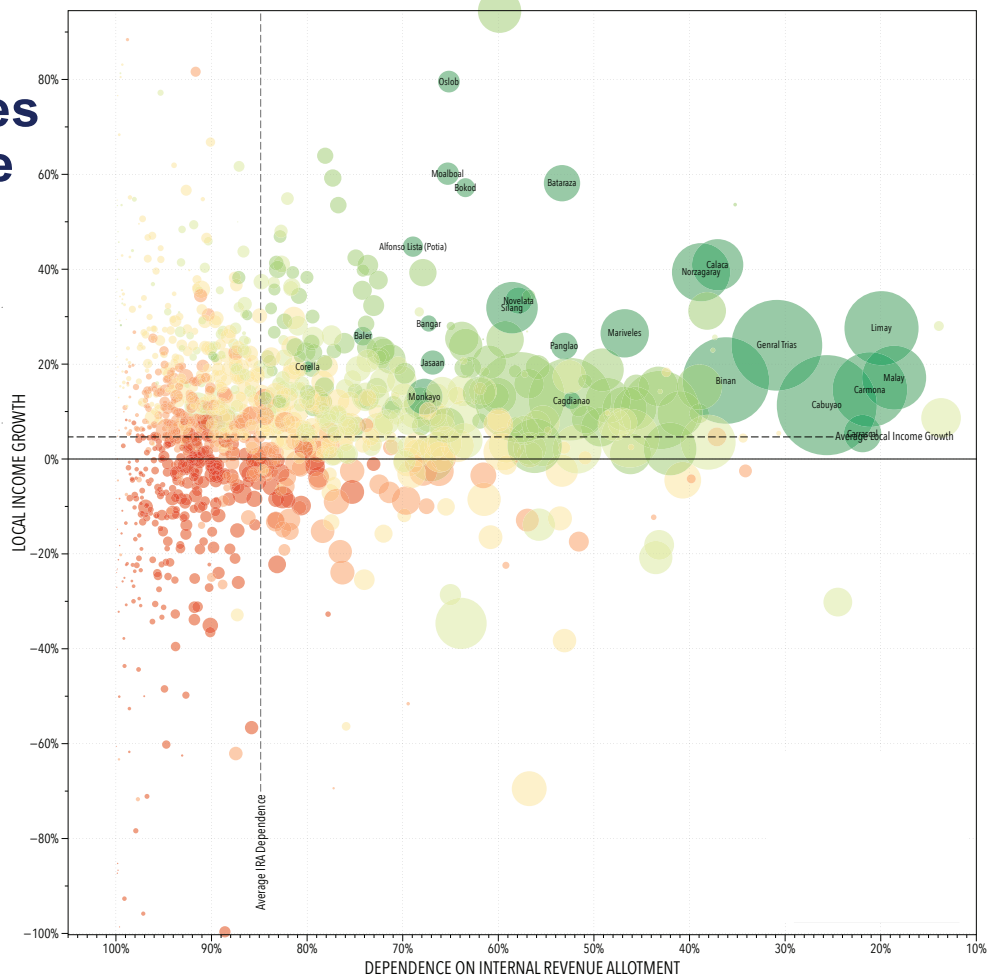
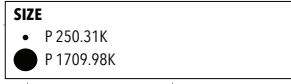
- P 937,400
- P 631,996,200



# 2012 Cities Performance



# 2012 Municipalities Performance



## Moving Forward



- Pursue legislative reforms on fiscal decentralization, and review current regulations on utilization of national transfers, local fiscal incentives, subnational borrowing, etc.
- Continuous monitoring/technical assistance through oversight agencies: improve accountability and transparency, more capacity building for resource mobilization, harmonize PFM tools at the local levels, among others
- Focus on rural areas/local governments with high poverty incidence
- Making LGUs more accountable; make local finance service oriented, felt by the people

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# Thank you!



### Speakers

Mr. Hoy Vicheth

Chief Office of Budget Control and Monitor for District and Municipality, General Department of Finance for Sub-national Administration, Ministry of Economy and Finance, Cambodia



Ms. Kim Su-Kyung

Local Finance Team Manager, Local Finance Policy Division, Ministry of Interior, Republic of Korea



Mr. Niño Alvina  
Director of Local Government Units Operations Service, Bureau of Local Government Finance,  
Department of Finance, Philippines



## Discussion











## Closing Session

### Takeaways from the Forum

- Ms. Antonina Levashenko, Director of Russia-OECD Centre, Russian Presidential Academy of National Economy and Public Administration, and Ms. Alexandra Koval, Director of Russia-OECD Club

### Closing Remarks

- Mr. Deok Soo Park, Director General, Public Governance Programme, OECD Korea Policy Centre



**Takeaways from the Forum**

Ms. Antonina Levashenko  
Director of Russia-OECD Centre, Russian Presidential Academy of National Economy and Public Administration



Ms. Alexandra Koval, Director of Russia-OECD Club



**Closing Remarks**

Mr. Deok Soo Park, Director General, Public Governance Programme, OECD Korea Policy Centre

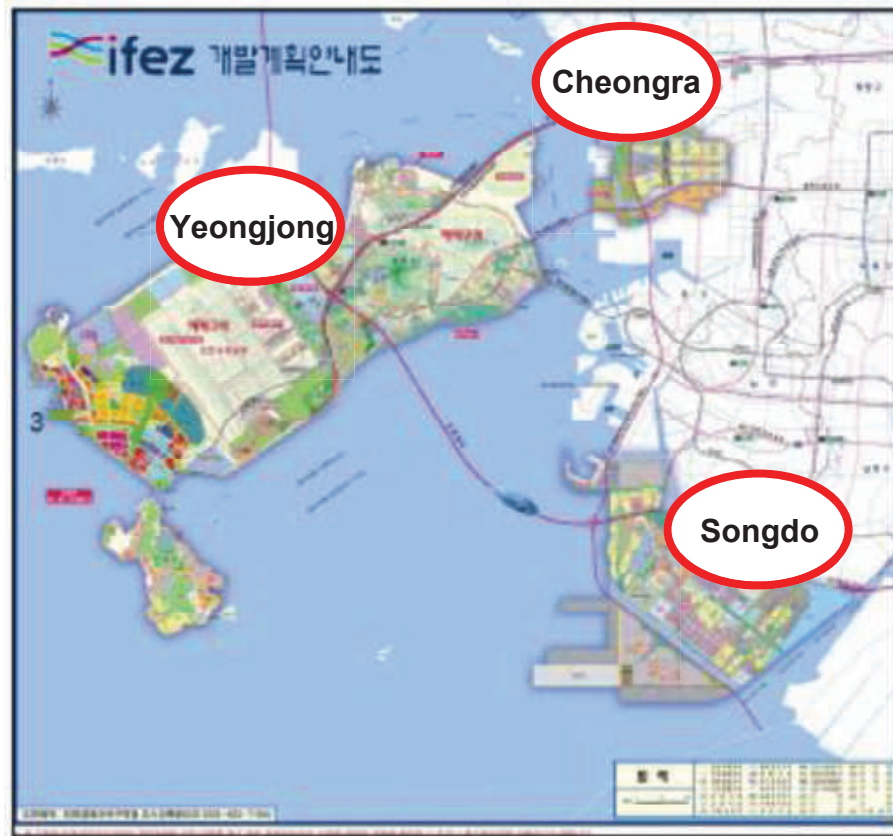


## Visits to Incheon's Key Project Sites



- Incheon Free Economic Zone
- Ifez U-City Operation Centre
- Incheon Global Campus
- Incheon Chinatown
- Incheon Transit Corporation
- Incheon Asiad Main Stadium

## Incheon Free Economic Zone



Incheon Free Economic Zone (IFEZ) is the first free economic zone ever designated in Korea. The designation was made in Aug, 2003, and the construction of the IFEZ is scheduled to be completed by 2022. The zone is divided into three areas: Songdo, Yeongjong, and Cheongra.

Free Economic Zone guarantees free business and economic activities of foreign investors by fostering an environment and system specialized and tailored for that purpose. IFEZ is part of the Korean government's mission to make Korea an economic center of North East Asia. The Incheon International Airport, and Incheon Port as well as Songdo, Yeongjong and Cheongra are all located in the zone. The Zone is 8 km away from Incheon, which is the gateway to the west coast of the Korean Peninsula as well as the pivot of Korea's national, economic and industrial development.

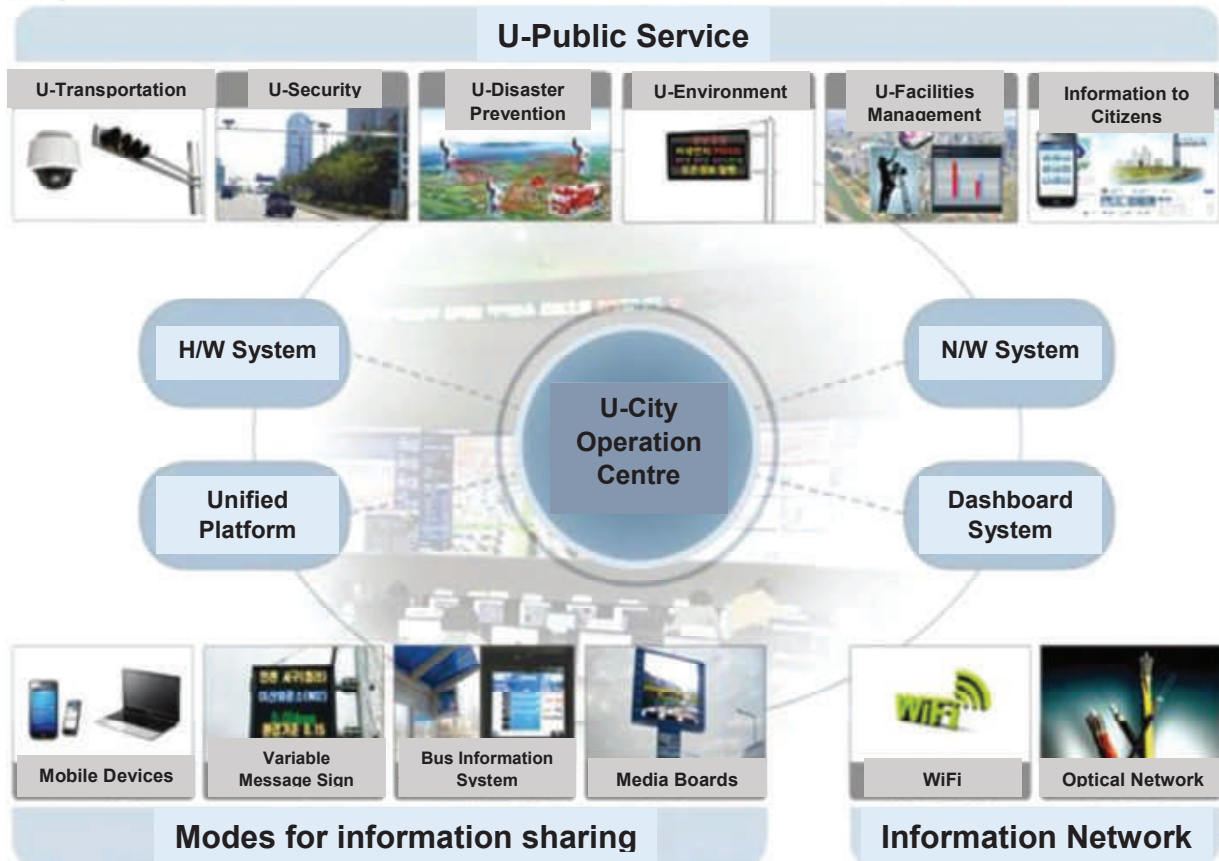
The Zone is as big as 123.8 km<sup>2</sup>, 1.4 times the size of Manhattan and 4.2 times Yeouido, Korea. When completed, the Zone will be capable of accommodating 536,000 people and 204,000 households. Currently, the Zone is home to 247,688 people in total including 4,280 foreign nationals. The project expense for IFEZ is some 79 trillion Korean won (~\$68 billion), and about \$8 billion of FDI has been reported to be made on this project and \$ 4 billion of it has actually been made as of Mar. 31, 2015.





## Ifez U-City Operation Centre

### U-System Architecture



ifez U-City Operation Centre systematically and comprehensively manages the ifez's transportation, crime and disaster prevention, environment, and facilities management based on a ubiquitous system. The center takes advantage of IT technologies to receive public governance information from relevant institutions, thereby better responding to public governance matters and providing necessary information to citizens.

The ifez U city project is about providing the most optimized and cutting edge IT infrastructure to businesses, by fostering a convenient and safe metropolitan environment. The goal is to provide converged, integrated, intelligent and innovative services based on ubiquitous computing, information and communications technologies.

The ifez U city project was launched in 2003. From 2003 to 2009, as the first stage, the project focused on establishing informatization strategy and communications infrastructure. Afterwards, from 2010 to 2016, as the second stage, the project started to build U-city service in a full-fledged manner, carrying out test operation, establishing three u-city districts, and laying a foundation for private-public cooperation. As the third and final stage, the project sought to advance and expand the u-city services, while operating and managing what is already in place and developing new services.



## Incheon Global Campus



Incheon Global Campus is a national project established together by the Korean government and Incheon metropolitan city, aiming to innovate education system and nurture next generation of global leaders. The campus will host 10 global prestigious universities by 2025; currently housing State University of New York, Korea, the George Mason University Korea, Ghent University Global Campus, University of Utah Asia Campus. Fashion Institute of Technology and University of Nevada, Las Vegas are scheduled to open in 2017.

Incheon Global Campus is a national project established together by the Korean government and Incheon metropolitan city with an investment of \$1 billion. The project aims to innovate education system and nurture next generation of global leaders in the fields of education, economics, industry, culture and arts.

Students will receive the identical degree to the one from the home campus upon successful completion of the program. As of 2016, 25 degree programs are offered, including degrees in communication, computer science, economics, mechanical engineering, psychology, and public health.



## Incheon Chinatown



Incheon's Chinatown is Korea's only official Chinatown. It claims to be the largest Chinatown in Korea with its 11-meter high Chinese-style gateway, paifang, an official landmark gifted by Incheon's sister city Weihai. It is famous for the various Chinese cuisines and attractions, and is known to be the home of jajang-myeon, Koreans' favorite Chinese food.

Incheon's Chinatown area came into being with the opening of the Incheon Port in 1883 and Incheon's designation as an extraterritoriality of the Qing Dynasty. Korea started modern trade by signing the China–Korea Treaty of 1882.

In the past, the area held many stores trading goods imported from China, but most Chinese businesses are now restaurants. Today, the Chinese residents of Chinatown are mostly 2nd or 3rd generations of early Chinese settlers. While not all traditional cultures of the first generation have been preserved, the area still harbors many of the flavors of China. About 50,000 overseas Chinese currently reside in the city.



The construction project of Incheon Subway Line 2 was launched on Jul. 1. A total of 2,184 billion Korean won (~\$1.9 billion) was invested; 60% covered by the Korean government and 40% covered by the Incheon Metropolitan City.

When completed, the subway will connect 27 stations, running 29.2 km, with three transferable stations. The subway is expected to accommodate 260,115 passengers per day, with 3 minute interval during rush hours and 6 minute during normal hours.

There are a total of 37 trains; four of which are reserved for emergency or unforeseen use. On weekdays, about 460 rounds of operation are made, and during weekends, 376 rounds. The subway system supports driverless metro trains on steel railway tracks.

Currently 368 people under 6 teams are working for the construction of the subway. The subway is under a test operation and expected to open on Jul. 30, 2016.





## Incheon Asiad Main Stadium



Completed in 2015, the Incheon Asiad Main Stadium is was the main venue of the 2014 Asian Games and 2014 Asian Para Incheon. Built on a 631,975m<sup>2</sup> lot, the five-story stadium has a total floor area of 113,620m<sup>2</sup> with a capacity of roughly 30,000 people. The construction of the Stadium took about four years from 2011 to 2015 and costed the city some 490 billion Korean won (~\$426 million).

The Incheon Asiad Main Stadium has a main stadium, a supplementary stadium and a cricket ground. The main stadium is 69,432.43 m<sup>2</sup> in size, and it is equipped with an IAAF Class 1 certified track with 9 running lanes enclosing a regulation-size soccer field. Outside, there's a tennis court, a subsidiary stadium, and the Yeonhui Cricket Ground. The supplementary stadium is also equipped with 10 running lanes and natural grass field. The cricket ground is the one and only stadium specialized for cricket in Korea.

This stadium meets the requirements to support the main stadium as venue for an essential training. It has also obtained the highest level of barrier-free certification with its facilities for people with disability. In order to establish a self-sustaining venue without city's financial support, it strives to diversify its use by organizing festivals and regular community exercise programmes, hosting concerts, film-making and training camps, and leasing venues for movie theaters and wedding halls.





## ORGANIZING PARTIES

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### OECD Korea Policy Centre Public Governance Programme



The OECD Korea Policy Centre has its mission in disseminating advanced public policy systems to the Asia-Pacific region in cooperation with the OECD. Established by a Memorandum of Understanding between the OECD and Korea's Ministry of Security and Public Administration, the Public Governance Programme seeks to be a bridge between the OECD and the Asia-Pacific region, sharing OECD member countries' public governance policy experiences with non-members. It regularly holds international meetings and capacity building programmes on governance topics including public innovation, local finance, public-private partnership and regulatory reform.

### Incheon Metropolitan City



Incheon is located in the middle of the Korea peninsula, bordering Seoul and Gyeonggi Province. and is not only close to Seoul but also next to the Yellow Sea. Incheon is one of Korea's major port cities and a gateway to the metropolitan area of Korea. Through the world-renowned Incheon International Airport and Incheon port, which make up a logistics hub of Northeast Asia, the city also provides easy access to many parts of the world. Today, about 3 million people live in the city, making it Korea's third most populous city after Seoul and Busan. The city's growth has been assured in modern times with the development of its port due to its natural advantages as a coastal city and its proximity to the South Korean capital. Incheon has since led the economic development of Korea by opening its port to the outside world, ushering in the modernization of Korea as a center of industrialization. In 2003, the city was designated as Korea's first free economic zone. Since then, large local companies and global enterprises have increasingly invested in the Incheon Free Economic Zone, including Samsung which chose Songdo International City as its new investment destination for its bio industry. As an international city, it has 22 countries and 34 cities as sister & friendship cities and it is home to 13 international organizations.

## OECD KPC PUBLIC GOVERNANCE PROGRAMME

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# **Asian Public Governance Forum on Local Finance**

**Achieving Fiscal Sustainability of Local Governments**