

## **CAREC Executive Leadership Development Program**

### **Case Studies on Public Finance Reforms**

**Dr. Eduardo Araral, Jr.**

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## Public finance in a transition economy: The Case of Vietnam



### HIGHLIGHTS

Vietnam is one of the best performing economies in the world over the last decade

Vietnam has become increasingly integrated with the world economy and has become a member of the WTO.

Recent growth is driven by the rising importance of the private sector.

Economic transition accompanied by an institutional overhaul.

Vietnam has outperformed many other countries in terms of progress towards achieving the Millennium Development Goals (MDGs).

Vietnam's economic success underpinned by reforms in public finance – tax and expenditure policy reforms including prudent fiscal management

Source: The World Bank (2009)

Until 1986, Vietnam followed the planned economy model of the former Soviet Union. Farms, factories and capital were collectivized. Millions of people were put to work in government programs. However, the model was plagued with inefficiency and corruption as well as restrictions on economic activities and trade. Hyperinflation and food shortages were common.

In 1986, the Sixth Party Congress introduced significant economic reforms with market economy elements as part of a broad economic reform package called "đổi mới" (*Renovation*). Today, Vietnam is widely regarded as a success story among former socialist republics.

**Vietnam is one of the best performing economies in the world over the last decade.** Real GDP has on average grown by 7.3 percent per year during 1995-2005 and per capita income by 6.2 percent per year. The economy has proven resilient to shocks and negative impacts from SARS, avian influenza, poor weather, high commodity prices, inflation, and anti-dumping suits. In US dollar terms, income per capita rose from US\$260 in 1995 to a 2007 level of US\$835. At this pace Vietnam would enter the ranks of middle income countries by surpassing US\$1,000 per capita in 2010. Gini coefficient is moderate at 0.36. Poverty levels have gone down from 58% in early 1990s to 20% in 2005.

**Vietnam has become increasingly integrated with the world economy** and has become a member of the WTO

. Exports have been the main drivers for growth, and foreign investments have been buoyant in recent years. Main manufacturing exports are garments, footwear, and wood products, reflecting Vietnam's comparative advantage of a low-cost but high-quality labor force. While external demand conditions have been generally favorable, the supply response has been made possible by domestic reforms that have dismantled controls on economic activity and strengthened the investment climate. Between 1995 and 2005, the share of agriculture in GDP has declined from 27 percent to 21 percent, while that of industry has risen from 29 percent to 41 percent.

**Recent growth is driven by the rising importance of the private sector.** The role of the state sector in manufacturing activity has declined appreciably: from 52 percent in 1995 to under 35 percent in 2006. But this has resulted more from the emergence of a vibrant private sector than from the dismantling of the state sector, which is being restructured and focused on more "strategic" activities. Macroeconomic policies in Vietnam have been generally prudent and key economic balances have been maintained at manageable levels.

**Economic transition accompanied by an institutional overhaul.** There has been significant progress in public financial management with the implementation of a new State Budget Law in 2004. The entire 2005 budget was disclosed to the public for the first time. The National Assembly is responsible now for the approval of budget, including allocations to lower levels of government.

## HIGHLIGHTS OF PUBLIC FINANCE REFORMS IN VIETNAM

### 1. Tax reforms

- Simplified tax system
- Modernize tax administration
- Broadened tax base
- Dynamic revenue growth

### 2. Expenditure reforms

- Participatory budgeting (PB)
- Public expenditure reviews (PER)
- Public Investment Program (PIP)
- Corruption control measures
- Improvements in the allocation and efficiency of public spending.
- Shares in total capital spending and total aggregate expenditure of education and training, and of science and technology increased
- Pro-poor inter-provincial budget transfers and revenue sharing
- Increased delegation to spending
- Procurement reforms

Source: Chu and Dickie (2003)

## MDG Progress by Vietnam

Decentralization is another important trait of the ongoing institutional transition. The planning process, as evidenced by the drafting process of the latest Socio Economic Development Plan, has also become considerably participatory.

**TABLE 3: PROGRESS TOWARDS THE MILLENNIUM DEVELOPMENT GOALS**

	Eradicate extreme poverty and hunger	Progress	Status
Target 1	Halve between 1990 and 2015 the proportion of people living in poverty	Poverty reduced by more two thirds between 1993 and 2006.	Already achieved
Target 2	Halve between 1990 and 2015, the proportion who suffer from hunger	Proportion reduced by more than two thirds between 1993 and 2006	Already achieved
Goal 2	Achieve universal primary education	Progress	Status
Target 3	By 2015 boys and girls to complete a full course of primary schooling	Grade 5 completion rate (gross) is 104 percent for boys and 98 percent for girls	Likely to be achieved
Goal 3	Promote gender equality	Progress	Status
Target 4	Eliminate gender gaps in primary and secondary education no later than 2015	Gender equality at all school levels, except for ethnic minorities	Already achieved
Goal 4	Reduce child mortality	Progress	Status
Target 5	Reduce by two thirds between 1990 and 2015, the under-five mortality rate	Reduced by 65 percent between 1990 and 2005 (down from 53 to 19 per 1000)	Likely to be achieved
Goal 5	Improve maternal health	Progress	Status
Target 6	Reduce maternal mortality by three quarters, between 1990 and 2015	Fell by two thirds, from 250 per 100,000 births in 1990 to 85 in 2007	Likely to be achieved
Goal 6	Combat HIV/AIDS and other diseases	Progress	Status
Target 7	By 2015 have halted and begun to reverse the spread of HIV/AIDS	Infection rate went up from 0.34 percent in 2001 to 0.44 in 2005	Likely to be achieved
Target 8	By 2015 halted and reverse the incidence of malaria and other diseases	Malaria cases severely reduced; with only 35 malaria-related deaths in 2007	Already achieved
Goal 7	Ensure environmental sustainability	Progress	Status
Target 9	Embrace sustainability and reverse the loss of environmental resources	Forest cover up but loss in closed-canopy forest and biodiversity	Uncertain to be achieved
Target 10	Halve, by 2015 the share of people without drinking water and sanitation	Rapid progress on drinking water; much slower on hygienic sanitation.	Uncertain to be achieved

Source: The World Bank, 2009

# Summary of public finance reforms in Vietnam: 1990-2005

Source: ADB (2007); Chu and Dickie (2003)

STRENGTHS	CHALLENGES
<b>Fiscal sustainability</b>	
<ul style="list-style-type: none"> <li>• Fiscal prudence</li> <li>• Small budget deficit</li> <li>• Small stock of debt</li> <li>• Positive fiscal trends</li> <li>• Sustainable fiscal balance</li> </ul>	<ul style="list-style-type: none"> <li>• Off budget bond issuance</li> <li>• Current expenditure arrears (transport, ARD)</li> <li>• Monitoring and management of fiscal risks</li> <li>• Implement Medium Term Fiscal Framework</li> </ul>
<b>Composition of public expenditure</b>	
<ul style="list-style-type: none"> <li>• Increase in public investment by 16% average annual rate (98-03)</li> <li>• Education / training / science / techno.</li> <li>• More budget transfers to poor provinces</li> <li>• Capital expenditures increased by 40%</li> </ul>	<ul style="list-style-type: none"> <li>• Budget for infrastructure maintenance should keep pace with capital investment</li> </ul>
<b>Institutions for public expenditure management</b>	
<ul style="list-style-type: none"> <li>• 2002 State Budget Law</li> <li>• Clarify powers and responsibilities</li> <li>• Strengthen decentralization</li> <li>• Promote administrative reform</li> <li>• Transparency and accountability in public finance</li> <li>•</li> </ul>	<ul style="list-style-type: none"> <li>• Strengthen joint efforts by finance / planning / sector ministries / provinces for MTEF</li> <li>• links b/w budget and performance indicators</li> <li>• Pilot testing of MTEF</li> <li>• Implement Treasury and Budget Mgt. Information System (TABMIS)</li> </ul>
<b>Financial accountability and transparency</b>	
<ul style="list-style-type: none"> <li>• Significant steps to improve transparency and accountability</li> <li>• Greater oversight by the National Assembly / People's Councils</li> </ul>	<ul style="list-style-type: none"> <li>• Independence of the State Audit of Vietnam</li> <li>• Public access to audit reports</li> <li>• Further rationalize audit / inspection functions</li> </ul>
<b>Decentralization to sub-national government</b>	
<ul style="list-style-type: none"> <li>• Extensive decentralization program since 1992</li> <li>• Increase budget to subnational govt. from 26% in 1992 to 48% in 2002</li> <li>• 2002 budget law improved decentralization</li> </ul>	<ul style="list-style-type: none"> <li>• Strengthen capacity of sub-national govt. to manage increase budget</li> <li>• Monitor fiscal decentralization especially poverty impact</li> <li>• Formula driven equalization grant</li> <li>• Strengthen conditional grants</li> <li>• Strengthen rules on borrowing by sub-national govts.</li> </ul>
<b>Delegation to spending units</b>	
<ul style="list-style-type: none"> <li>• Increased delegation to administrative and service delivery units</li> </ul>	<ul style="list-style-type: none"> <li>• Use of citizen report cards to monitor impacts of block grants</li> <li>• Minimize flexibility by managers on salaries</li> <li>• How to protect access by the poor on basic services</li> </ul>

<b>Public investment management</b>	
<ul style="list-style-type: none"> <li>Public investment has grown rapidly</li> <li>Capacity of MPI to manage strengthened through PIP</li> <li>Role of provinces in PI increasing</li> </ul>	<ul style="list-style-type: none"> <li>PIP should evolve into a comprehensive screening process</li> <li>Strategic review of roles of national and sub-national govts.</li> <li>MPI to strengthen capacity to guide, train, support, supervise implementers</li> <li>Investment planning manual and standards</li> <li>Balance capital &amp; recurring costs</li> </ul>
<b>Public procurement management</b>	
<ul style="list-style-type: none"> <li>Public procurement increased from \$2B to \$4.9B (1999-2003)</li> <li>Strengthening of Department of Procurement at MPI</li> <li>Public procurement bulletin</li> <li>Standardized bid documents</li> </ul>	<ul style="list-style-type: none"> <li>How to handle procurement complaints</li> <li>Finalize procurement law</li> <li>Capacity building for procurement, supervision and enforcement</li> </ul>
<b>Education Sector Expenditure Reforms</b>	
<ul style="list-style-type: none"> <li>Poverty reduction and economic growth driven by substantial investment in education</li> <li>Improved infrastructure</li> <li>Increased participation rates</li> </ul>	<ul style="list-style-type: none"> <li>Need to further improve quality, equity and effectiveness</li> <li>Reduce user charge</li> <li>Improve teacher qualifications</li> <li>Improve classroom infrastructure in poor areas/Tie teacher salaries to school performance</li> </ul>
<b>Transport sector expenditure reforms</b>	
<ul style="list-style-type: none"> <li>Quality and extent of transport infra has improved (almost all communes connected to all weather roads)</li> <li>Size of vehicle fleet increase</li> <li>More efficient transport key role in export growth</li> </ul>	<ul style="list-style-type: none"> <li>Need to balance capital expenditures and maintenance budget</li> <li>Capital expenditure should be sustainable</li> <li>How to improve private sector investment in infrastructure</li> </ul>
<b>Health sector expenditure reforms</b>	
<ul style="list-style-type: none"> <li>Significant progress along with poverty reduction and growth</li> <li>National strategy to help the poor on health care costs (health insurance coverage)</li> </ul>	<ul style="list-style-type: none"> <li>Equitable access by segments of poor population</li> <li>HIV/ SARS/ Avian flu</li> <li>Implementation of health insurance program for poor</li> <li>Means testing</li> </ul>
<b>Agriculture and rural development sector expenditure reforms</b>	
<ul style="list-style-type: none"> <li>Market incentives key to substantial growth in sector</li> <li>Growth supported by investments in education, health, infrastructure</li> </ul>	<ul style="list-style-type: none"> <li>Balance capital and maintenance costs in irrigation (deferred maintenance / completion of projects)</li> <li>Increase budget for agri. R&amp;D</li> <li>Reduce burden of agric. SOES on public budget</li> </ul>



# Fiscal Discipline: The case of Singapore

## HIGHLIGHTS

### Singapore's International Reputation

Category	Rank	No. countries
Ease of Doing Business '06	1st	175
Globalization index '05	1st	62
Competitiveness '06	3rd	60
Quality of life '05	11th	111
Int'l. math & science tests '03	1st	46
Quality of public service '07	1st	WEF
GDP Per capita	17 <sup>th</sup> \$30,700	175

Lee Kuan Yew School of Public Policy

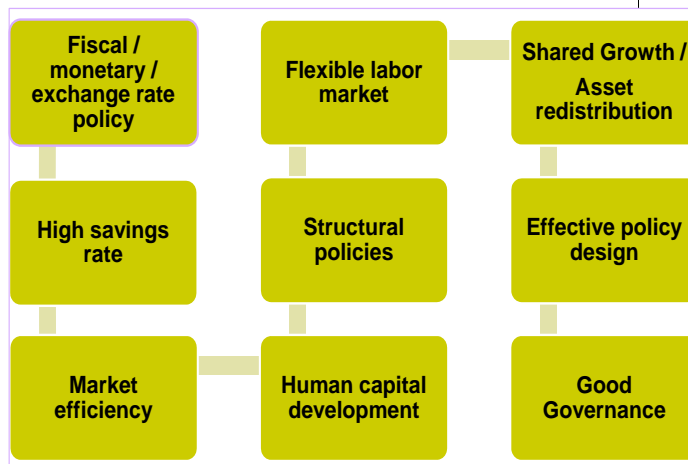
### Sources of growth: 1960-2005

Source: Ghesquiere, H. 2006.

- Investment in physical capital
- Increased labor input
- Improvement in human capital
- Total Factor Productivity

### Drivers of Singapore's Economic Growth

Source: Ghesquiere, 2006



## HIGHLIGHTS OF SINGAPORE'S FISCAL, MONETARY AND EXCHANGE POLICIES

- low inflation, stable currency
- binding budget constraints
- sound fiscal management (no costly welfare schemes, no subsidies to loss making SOEs, food, petroleum, electricity)
- no external debt, low interest payment
- Huge annual surpluses
- Healthy fiscal policy



## Fiscal Policy Measures



S/N	Measure	Monetary Terms (\$ billion)			As % of GDP		
		2005	2006	2007	2005	2006	2007
<b>[A] Fiscal Balance</b>							
1	Gross Operating Balance	15.14	15.50	25.06	7.52	7.01	9.96
2	Primary Gross Operating Balance	15.34	15.64	25.10	7.62	7.07	9.98
3	Net Lending/Borrowing	14.17	17.52	32.06	7.04	7.92	12.74

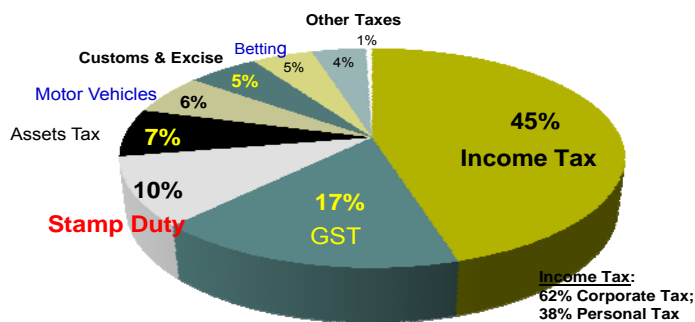
## Fiscal Policy Measures



S/N	Measure	Monetary Terms (\$ billion)			As % of GDP		
		2005	2006	2007	2005	2006	2007
<b>[B] Macro Economic</b>							
4	Fiscal Burden	25.20	28.72	36.06	12.52	12.99	14.33
5	Total Expenditure	22.42	21.90	18.95	11.14	9.91	7.53
6	a. Health	1.77	1.94	2.20	0.88	0.96	1.10
	b. Education	6.08	6.96	7.53	3.02	3.46	3.74
	c. Defence	9.25	9.63	10.01	4.60	4.78	4.97
7	Gross Investment	0.97	(2.02)	(7.00)	0.48	-0.91	-2.78

Source: Ong Bee Luan et al (2009)

## Sources of Tax Revenue (2007)



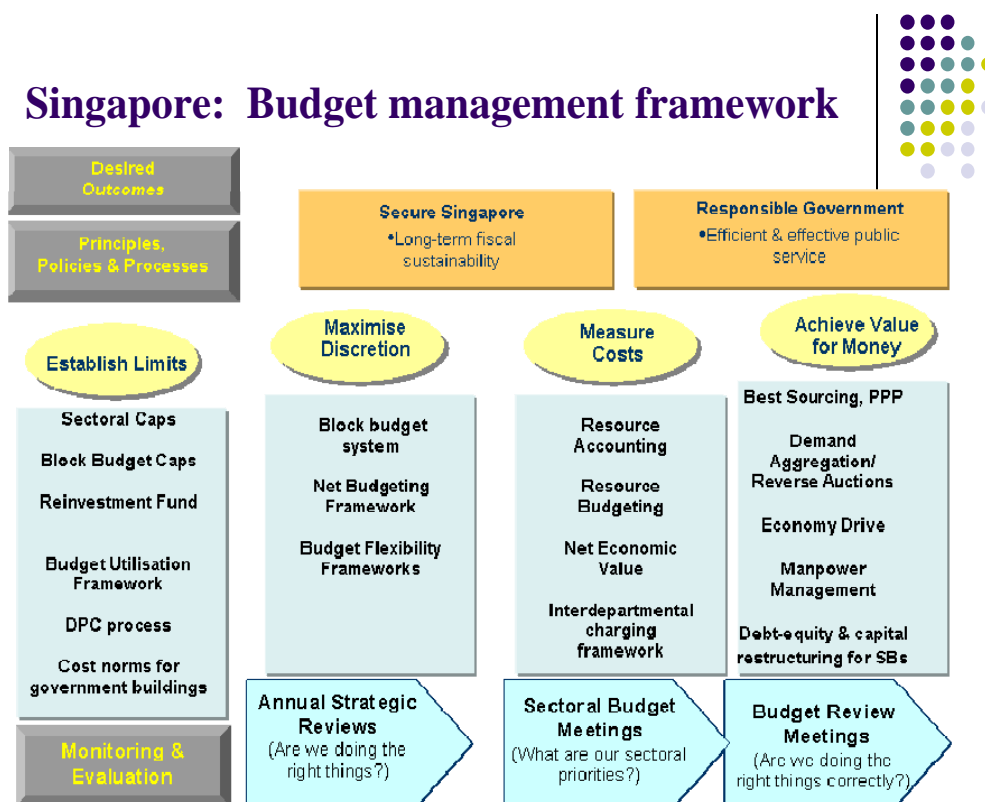
Source: Ong Bee Luan et al (2009)

# Public financial management Performance Measurement Framework: Case of Singapore

Source: Ong, et al 2009

1. **Credibility of the budget** - budget is realistic / implemented as planned
2. **Comprehensiveness and transparency** - The budget and the fiscal risk oversight are comprehensive, and fiscal and budget information is accessible to the public.
3. **Policy-based budgeting** - The budget is prepared with due regard to government policy.
4. **Predictability and control in budget execution** - The budget is implemented in an orderly and predictable manner and there are arrangements for the exercise of control and stewardship in the use of public funds.
5. **Accounting, recording and reporting** – Adequate records and information are produced, maintained and disseminated to meet decision-making control, management and reporting purposes.
6. **External scrutiny and audit** - Arrangements for scrutiny of public finances and follow up by executive are operating

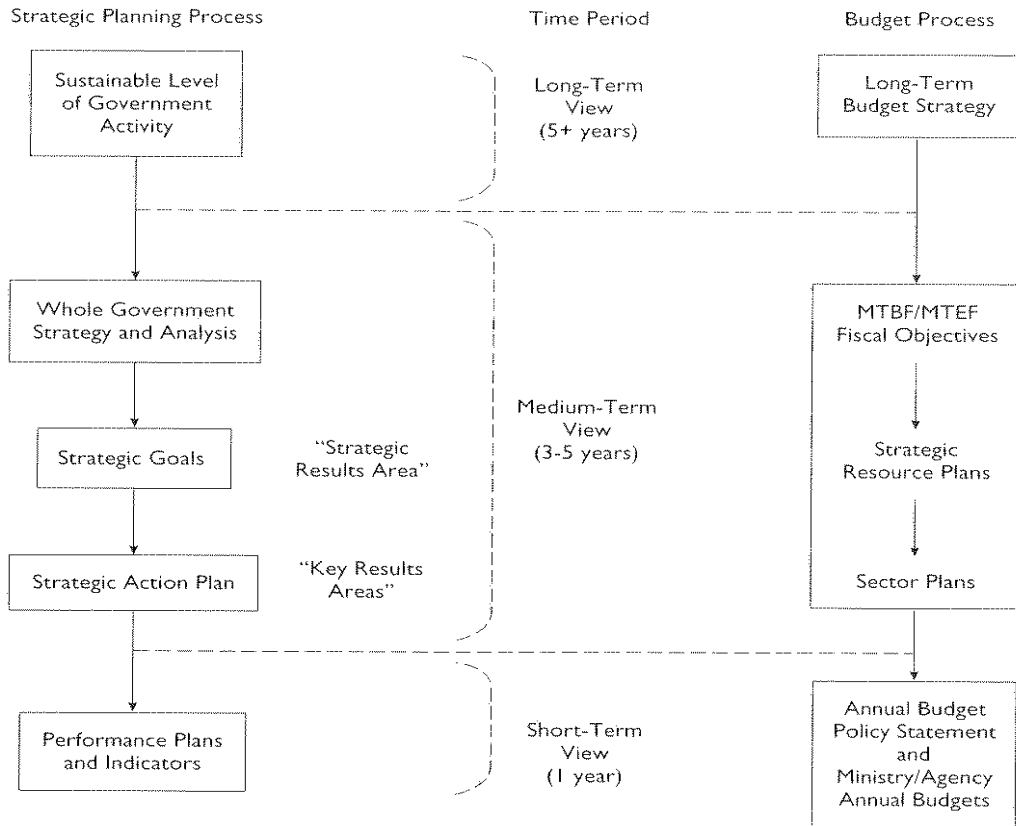
## Singapore: Budget management framework



Source: Singapore Ministry of Finance

# Budgeting and Planning

**Box 12. Connecting Planning with Budgeting**



Source: Diamond, 2005

## Budget System Reforms: The Case of Russia

Source: Diamond (2005)

	Percentage of OECD Countries
1. Government organizations receive one appropriation for all their operating expenditures	26
2. Government organizations receive separate appropriations for salaries and operating expenditures	26 9
3. No restrictions on transfers between appropriations	36
4. Transfers are allowed but only with MoF approval	30
5. Transfers between programs allowed with MoF approval	31
6. Transfers between capital and other expenditures allowed with MoF approval	19
7. Ability to carry over unused appropriations for operating costs at year's end:	19
a. Without limit	23
b. Up to a maximum percentage	17
c. Allowed case by case by MoF	8
8. Ability to carry over unused appropriations for investments at year's end:	29
a. Without limit	48
b. Up to a maximum percentage	22
c. Allowed case by case by MoF	22
9. Ministries and government organizations maintain cash accounts separate from the MoF:	88
a. Not allowed	65
b. Fully separate	
c. Balances are swept to the treasury account periodically	
10. Each ministry is in charge of its own procurement (operating within certain central limits)	
11. Internal audit is organized at ministry/department level	

Source: OECD (2003, Tables 3.2.a, 3.2.b, 3.3.b, 3.4, 4.1).

Reforms in budget procedures were introduced with the Budget Process Reform Concept Paper for 2004-2006, whose main principles were agreed in 2004. The declared objective of the reforms is to move from a system of budget management focusing on costs to a system of management by results. There are five main elements of this reform:

- **Reform of the budget classification and accounting.** This involves a move away from excessive detail in budget nomenclature, and toward the approval of main items contained in the Budget Code. This is consistent with a single chart of accounts (CoA) for government institutions, close to internationally approved standards, that will allow a phased transition to accrual accounting. The main changes proposed to the budget classification affect the classification and are intended to reduce current 27 categories to 11.
- **A clear differentiation between existing and new policy commitments** when preparing the budget. Recognizing that 90-95 percent of commitments are already “locked in” and that new programs only occupy 5-10 percent of the budget, a differentiated treatment is proposed for approval of a baseline budget and approval of new policies, which will further lock in the budget in the future.
- **Introduction of medium-term budget planning** as part of the 2006 budget covering the period 2006-08. A move away from the annual approach to budgeting to the approval of an indicative rolling budget framework for three years, broken down by government department.
- **A streamlining of the budget process.** Most notably, the number of readings for the budget is reduced from four to three. The first reading will only discuss the broad parameters and the committed "old policy" budget; the second reading will discuss new policy; and the third reading will be a general review of the entire budget with detailed annexes for each main budget institution. The existing practice of approving the detailed budget classification under a separate federal law is replaced by a law fixing only the main codes of the classifications that are mandatory for all budget levels.
- **Introduction of program and performance budgeting methods.** Introduced as a two-year "experiment," budget institutions were invited to prepare and execute their budgets on a results-oriented basis for the 2005 and 2006 budgets. Specifically, there is a requirement for budget institutions to report on results and to develop mechanisms for monitoring efficiency in resource use. This implies that federal "earmarked programs" for large investment, research, and structural projects will be restructured to reflect efficiency objectives (and their number will be reduced). Departments will also introduce "targeted programs," smaller in scale and focused on extension of services or projects, along with agreed procedures that emphasize objectives, indicators for these objectives, and measures of results. Budget institutions will be required to submit annual reports on the results of their main activities, with an assessment of the efficiency of spending by previously determined indicators and with agreed powers and responsibilities for different management units for each activity.

## Strengthening Basic Public Expenditure Management (PEM) Systems: The Case of China

Source: Brumby (2004)

The 1994 organic budget law, recognized as having weaknesses, is under review. While imposing identical budget procedures at all five levels of government, the procedures are hierarchical across levels, causing considerable delays in approving lower-level budgets. Current and development expenditures are split, with oversight under different agencies and with different rules for their preparation. There is no medium-term budget framework and no performance information.

- **Improve budget preparation and classification systems.** Budget remains a small summary document. Recently, this increased in size and was supplemented with detailed departmental budgets, including the expenditure of "self-raised funds." The MoF has enlarged and improved its projects database, with a focus on new projects. Classification does not specify costs to a sub-item level and is insufficient for detailed cost analysis and accounting control. Recent reforms involve deepening economic objects classification, with financing items moved below the line.
- **Strengthen the technical basis of budget preparation, introducing a performance orientation.** There is a push for greater transparency with departments splitting their budgets between "basic" expenditures and "projects." Budgets are compiled using manpower and other input-based norms, with project evaluations including expected outputs. Emphasis is on planned activities rather than last year' budget, with input norms developed for clusters of similar operations. The approach is termed "zero- based." A spur to improved budgeting is increasing the importance of "preliminary scrutiny" of the Finance and Economics Committee and its subcommittee. The MoF now prepares annual three-year fiscal rolling outlooks, but these are not yet integrated into the budget preparation.
- **Establish a treasury system, based on a Treasury Single Account (TSA).** The new Treasury Department was created in 2000, replacing the People's Bank of China's (PBC) treasury system which was based on a multitude of bank accounts and was viewed as a source of corruption. A parallel PBC system continues, with the budget executed using credit limits at spending units' bank accounts that are reimbursed through the PBC branch network ("quota system"). The Treasury Department also developed its own direct payments system through a TSA at the PBC. The latter has caused elimination of thousands of bank accounts and a reduction of government float. Capital construction expenditures are executed centrally through the Accounting Division of the MoF Budget department using an account at the China Construction Bank that transfers funds to the accounts of spending units that pay suppliers. Along with improved central cash management, the emphasis has been on improved agency financial management, focusing on internal controls and procurement.
- **Introduce a government financial management information system (GFMS).** There is no integrated information system across the central government. In parallel with the increasing use of the TSA, the MoF has developed specifications for a countrywide GFMS and by mid-2003 had introduced a pilot system based on a mixture of five systems developed in-house and three Oracle Financial™ packages (general ledger; payment accounting; and cash management, which is used for reconciliation of payment orders). The authorities are working on an appropriate information technology strategy as the basis for a more advanced GFMS in the future.

## Fiscal Discipline: The case of Brazilian Fiscal Responsibility Law, 1999

The Brazilian Fiscal Responsibility Law of 1999 has the following key features:

- Specifies the principles of responsible fiscal management.
- Benchmarks focus on:
  - Restrictions on public indebtedness
  - Disciplining the growth in long-term spending, especially on social security
  - Limits on increases in personnel expenditure
  - Prudential limitations on credit operations and financial and asset management
- Defines necessary fiscal procedures to meet these principles (how restrictions, discipline, and limits will be imposed), consolidating existing laws and regulations.
- Requires fiscal reporting and enables transparency to ensure principles are upheld.
- Requires explanation of deviations from principles, future corrective action to remedy deviations, and any penalties to ensure accountability of governing authorities and managers.
- Covers all levels of government (federal, state, and municipal).