PAYING FOR URBAN INFRASTRUCTURE AND SERVICES: A COMPARATIVE STUDY OF MUNICIPAL FINANCE IN HO CHI MINH CITY, SHANGHAI, AND JAKARTA

Foreword

Ho Chi Minh City has emerged as Viet Nam's main commercial hub and an important motor of economic growth both regionally and nationally. But rapid economic and demographic change creates immense pressure on existing infrastructure and public services. Finding ways to finance investment in infrastructure and basic services in a sustainable and equitable manner is a tremendous challenge facing the city's policy makers.

In recognition of the growing importance of municipal finance to the future of Ho Chi Minh City, the People's Committee requested assistance from UNDP in the form of practical research to identify financing options over the medium to long term. The local authorities were particularly keen to learn lessons from the experiences of other major cities in the region.

In response to this request, UNDP and the Institute of Economics Research in Ho Chi Minh City teamed up with the Kennedy School of Government of Harvard University to produce a study comparing structures of municipal finance in Ho Chi Minh City, Shanghai and Jakarta. A preliminary version of the present UNDP Policy Dialogue Paper was presented at an international workshop organized in Ho Chi Minh City on this subject in October 2006. In addition to researchers, scholars and Ho Chi Minh City authorities, the workshop was also attended by representatives of local government from Shanghai and Jakarta. The final version of the paper incorporates many of the substantive comments and suggestions put forward by participants at this international workshop.

The intention of this Policy Dialogue Paper is to stimulate informed discussion and debate through the presentation of evidence in a clear and impartial manner. Although the views expressed in this paper are not necessarily those of UNDP and the Institute for Economic Research, we value the opportunity to contribute to policy discussions on this issue of vital importance to Ho Chi Minh City and the country as a whole.

We would like to take this opportunity to congratulate the researchers on their careful and stimulating treatment of this extremely complex issue. We look forward to future collaboration on this and other topic relating to sustainable and equitable development in Ho Chi Minh City.

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Executive Summary

I. Study Objectives, Methodology, and Limitations

The objectives of this study are to: analyze past trends and current practices in the generation and allocation of resources for the financing of municipal infrastructure and services in HCMC; perform the same analysis for Shanghai and Jakarta, and compare the results with the performance to date of HCMC; highlight effective policies and practices that should be continued, as well as those that require strengthening or modification; identify high-potential but untapped revenue sources; and suggest improvements in expenditure efficiency and effectiveness. This study is not an evaluation, audit, or inspection. Instead, it is an external assessment of what seems to be working well and where there is substantial room for improvement, with the goal of providing constructive recommendations to assist HCMC in fulfilling its development mission.

The study's methodology is based on formulation of a common conceptual framework for classifying, documenting, analyzing, and assessing local government revenue and expenditure in HCMC, Shanghai, and Jakarta. Revenue is divided into two categories to determine local government fiscal dependency on central government resources, "own source revenue" and "tax and revenue sharing." It is then disaggregated into subcategories by dividing "own source revenue" into "sustainable" and "incidental" revenue to further assess local government fiscal autonomy. Expenditure is split into two categories, "routine" and "capital" expenditure, to determine local government capacity to generate on-budget funds for investment in urban infrastructure and services. Using this conceptual framework, the research team collected a four-year time series of revenue and expenditure data for HCMC, Shanghai, and Jakarta. This included both on-budget and off-budget information, as many of the most innovative financing mechanisms in these three cities are not included in official budget presentations. Much of the off-budget information is anecdotal and indicative, so is presented in case studies documenting some of the most interesting fiscal initiatives in HCMC, Shanghai, and Jakarta.

Although the research team has collected as much relevant data as possible to understand fiscal policies and practices in HCMC, Shanghai, and Jakarta, and has taken great care to present this data in as fair a manner as possible, this study still has limitations. Public finance is both quite complex and extremely sensitive. Municipal managers have little incentive to share financial data with outsiders: there is no obvious direct benefit, but tremendous potential risk. Thus, there are apparently still some significant data gaps, which when filled, could alter the research team's findings and recommendations. Also, cross-country comparisons are commonly misinterpreted as proposals for replicating practices in one nation that might be inappropriate in another country, due to different historical and economic contexts and dissimilar political, social, and institutional environments. We should view similarities and differences between HCMC, Shanghai, and Jakarta not as "best and worse practices," but rather, as a source for discussion and reflection in the hope that experiences elsewhere might help us to better understand our own situation, as well as provide us with ideas that might be adapted to our own requirements and capabilities.

II. Municipal Finance in Ho Chi Minh City

Even though HCMC has been quite successful in mobilizing tax revenue, it has been permitted to keep but a small portion of these taxes, roughly 30 percent. This has been significantly short of HCMC's budgetary needs, and despite the city's very creative means of financing this "fiscal gap" in its routine and capital budgets, it has not been able to keep up with the city's rapid growth and concomitant resource needs. Moreover, over the next five years (2006-2010), the city must mobilize VND 100 trillion ($6 billion) for the city's budget and an additional VND 450 trillion ($27 billion) for off-budget expenditure, 1.7 and 2.4 times greater than the previous five years. Recent trends are not encouraging as well. For example, although average revenue increases have kept pace with gross regional domestic product (GRDP), both rising at a compounded annual rate of approximately 11 percent from 2001 to 2004, the rate of revenue growth during the last two years is less than half of the growth rate during the previous two years.

Revenue composition has changed over the past four years; local regular revenue has risen from one-quarter to one-third of city revenue, while local special revenue has fallen from almost 40 percent to 25 percent. However, despite this shift from incidental to sustainable own source revenue, HCMC's dependence on external revenue sources has increased steadily, so that the "correspondence" of own source revenue to expenditure assignment was only 57.8 percent in 2004 - the city's budget has depended largely on the negotiating ability of city leaders with external parties. This dependency has been exacerbated by the disincentive built into the tax sharing formula to increase own source revenue or decrease planned expenditure: either action could lead to a decrease in HCMC share of central government tax revenue.

Debt financing through the issuance of municipal bonds has become a significant source of income over the past four years, rising from zero to half of all local regular revenue; other revenue sources have risen only slightly during the same period, so their relative shares of total local regular revenue have declined. This probably still significantly underestimates HCMC borrowing, as the debt figures exclude the city's considerable contingent liabilities incurred through its explicit and implicit guarantees of off-budget borrowing by local government entities. For example, the HCMC Investment Fund for Urban Development (HIFU) has borrowed a total of approximately VND 3 trillion, and the Thu Thiem Urban Development Project Management Unit has borrowed hundreds of billions of VND over the past few years. This greatly limits the potential of a significant increase in HCMC debt financing to pay for future investments in urban infrastructure.

Roughly 80 percent of the second largest single source of local regular revenue, license and registration fees, comes from the registration of new and transferred real estate. This is not sustainable and is estimated to decrease over time. In contrast, only 6.3 percent of local regular revenue generated in 2004 came from annual fees and charges on the city's greatest store of wealth, its rapidly appreciating stock of land and buildings. This offers great promise for the adoption of a modern property tax in HCMC.

Vehicle related charges and fees also offer considerable potential to generate much more local regular revenue for HCMC. Less than 5 percent of local regular revenue comes from this source, and most is from the registration of new and transferred vehicles; both vehicle operating charges and parking fees are negligible. Making it more expensive to own and operate a vehicle would offer HCMC a double dividend: much more revenue with appreciably less traffic congestion and pollution.

Retained earnings of local government entities, largely a "pass-through," and budget carryovers from the previous year, declined both in value and share of total local special revenue from 2001 to 2004, while the share of revenue from the sale of land use rights and buildings more than doubled during the same period, increasing from 33 to 70 percent. This trend is not sustainable, as the sale of land use rights and buildings are one-time events, and the city will eventually run out of real estate to sell.

Until 2004, the value added tax and corporate income tax comprised most of HCMC's shared revenue. Since then, a new agreement to share excise taxes on domestic goods, primarily alcohol and tobacco products, has added a third significant component to HCMC's shared revenue; at the same time, central budget transfers dropped dramatically. The most significant "other" shared revenue source is the national gasoline fee, now approximately VND 400 per liter. HCMC keeps about 30 percent of the total amount of national taxes that it collects, and this share is subject to complex negotiations with the central government.

Local expenditure was only 28.3 percent of total revenue collected by the HCMC Tax Department and just 8.6 percent of national expenditure from 2001 to 2004; the balance of revenue collected went to the central government, comprising 30 percent of the national budget. Investment expenses are now more than half of all expenditure, much higher than the national average of 35 to 38 percent. However, investment expenditure is traditionally project-based and thus also includes routine expenses such as project management and administration. Transportation dominates investment expenditure, followed by services, industry, and education; investment in agriculture, commerce, hospitality services, science and technology, real estate, administration, health, culture and sport account for less than 20 percent, with each item below 5 percent of total investment expenditure. Economic activities and education dominate routine expenditure; a decline in health spending has accompanied an increase in spending on public administration.

Approximately 80 percent of total capital mobilized for investment in HCMC was generated by off-budget resources from 2001 to 2004. This highlights the importance of developing HCMC's "soft infrastructure": good municipal governance that creates an enabling environment conducive to attracting private resources to finance HCMC's "hard infrastructure" of roads, public transport, power, and communications. Foreign direct investment has equaled state budget investment allocations during this period, and households have invested almost twice as much in their homes and businesses as either state or foreign enterprises have invested in HCMC; state-owned enterprises and domestic private enterprises have each contributed 10 percent of investment capital in HCMC. Cumulative ODA in HCMC is estimated to total $1.07 billion at the end of 2005, comprising $135 million in grants and $939 million in loans to finance projects in urban infrastructure, water supply, the environment, and administrative reform.

HCMC has utilized some extremely innovative methods for mobilizing investment capital, such as creative partnerships with the private sector. This is especially true in transportation infrastructure: many of the main roads into HCMC have been constructed by use of the BOT (Build-Operate-Transfer), BT (Build-Transfer), or city land plus private construction mechanisms. Another example of HCMC's innovation in mobilizing capital is establishment of HIFU.

III. Municipal Finance in Shanghai

China instituted comprehensive fiscal reform in 1994, commonly referred to as the *Tax Sharing System* (TSS), or *fenshuizhi.* The objectives of the 1994 fiscal reform were to: reverse a steady decline in central government revenue, with the slogan "raising the two ratios" (revenue to GDP and central government share of total revenue); improve the tax system's economic efficiency and transparency, targeting both specific distortions and general opaqueness of the existing tax system; and restructure intergovernmental revenue sharing, providing local governments with a greater incentive to collect central government revenue and mobilize own source revenue.

Under TSS, the tax structure was rationalized and simplified; all taxes were designated as assigned to either the central or local government, or shared between the two; the central government introduced two measures to facilitate the transition to this new system, the "hold harmless" principle and a commitment to give back annually 30 percent of its increased VAT and consumption tax revenue to enable provinces to share in the growth of their reassigned ("lost") tax base; and tax administration was reformed.

Shanghai revenue has grown at a real average annual rate of 18.9 percent from 2000 to 2003, while the local budget has grown at a real average annual rate of 26.5 percent during the same period. Shanghai also made a substantial net contribution to the national budget from 2000 to 2003, as demonstrated by two key indicators: the ratio of total revenue collected in Shanghai to the national budget has been almost triple the ratio of Shanghai's budget to the national budget from 2000 to 2003, at 14.7 percent versus 5.7 percent; and the size of the local budget compared with revenue generated in Shanghai has averaged 38.8 percent since 2000.

From 2000 to 2003, local regular revenue has risen from just over half to almost three-fourths of total on-budget revenue, while shared revenue has fallen from 43 percent to 28 percent of total revenue. These trends are consistent with Shanghai's strategy to increase its fiscal self-reliance.

While all non-borrowing sources of local regular revenue have risen steadily from 2000 to 2003, their share of total local regular revenue has been relatively unstable, swinging between 59.5 to 80.5 percent.

Within the component of non-borrowing local regular revenue, almost half of all income since 2000 has come from a local business tax on the transaction value of services, real estate, and intangible assets such as land use rights. Income from user fees and charges has risen steadily over the same period, growing from 13.2 percent to 17.4 percent of all non-borrowing local regular revenue. The "fees and charges" category includes: 191 administrative fees; penalties and confiscated revenue for tax evasion; and special revenue from pollution fees, the water resource fee, and an additional education fee. A unique characteristic of Shanghai's municipal budget is the relatively large number of vehicle- related fees that are charged to finance the maintenance of roads and bridges.

Those organizations and individuals who pay the local business tax and the national consumption and VAT taxes must also pay the city maintenance tax. This is a surtax on the three taxes mentioned above; the tax base is the amount of the three taxes paid, and tax rate is 7.0 percent. The city maintenance tax contributed 5.9 percent of local regular revenue from 2000 to 2003.

Shanghai's real estate tax is similar to a property tax. The tax base is either the property's rental value or 80 percent of its capital value; the tax rate is 12 percent of rental value (the transaction contract price) or 1.2 percent of assessed capital value (80 percent of the market price). Currently, this tax is not well enforced, so most homeowners do not pay this tax: its share of regular local revenue was just 4.5 percent in 2000, and steadily declined to only 3.1 percent in 2003.

Another 10.4 percent of non-borrowing local regular revenue has come from local government enterprises from 2000 to 2003. The remaining 15.7 percent has come from miscellaneous other local taxes and revenues.

Shanghai's local regular revenue generated by taxes, user charges, and administrative fees has been supplemented by debt financing. Slightly more than half of local regular revenue from borrowing (54.4 percent) has come from domestic bank loans, with Shanghai borrowing about RMB 10 billion per year from 2000 to 2003. Most of the remaining debt, 38.8 percent of borrowing, has come from domestic funds; it appears that this refers to "self-financing" via the Shanghai Urban Development Investment Company, or UDIC. The balance of Shanghai's debt financing has come from foreign borrowing and domestic bonds, contributing 5.5 percent and 1.3 percent, respectively, to Shanghai's local regular revenue from borrowing during the 2000 to 2003 period.

The two most important shared taxes are the VAT and the enterprise income tax, each contributing just under 40 percent of total tax sharing revenue from 2000 to 2003. The share of revenue from the enterprise income tax has been relatively stable, while the VAT share has increased from 32.8 percent to 43.6 percent. However, revenue generated from Shanghai's share of the VAT is still about half of the revenue generated by its local business tax. The other significant contributor to shared tax revenue is the personal income tax, whose share was 18.9 percent from 2000 to 2003. Although revenue from the stock exchange stamp tax contributed 9.8 percent of shared tax revenue in 2000, this share had dropped to 0.6 percent by 2003. Shanghai retained only 16.7 percent of all the shared tax revenue it generated from 2000 to 2003.

There are provisions for two types of transfers from the central government: tax rebates and special transfers. Tax rebates are designed to facilitate the transition to the TSS. They have two components: the first to replace the "lost" CT and VAT tax bases under the "hold harmless" principle, equal to the amount of these taxes returned to the Shanghai government in 1993, the last year under the old system; the second is to capture the "foregone" growth of these reassigned tax bases, equal to 30 percent of increased CT and VAT revenue that would have been returned to local government. Although tax rebates are purported to comprise as much as one-third of total tax revenue in Shanghai, data for tax rebates were not available to confirm this belief. Special transfers are for national disasters, poverty reduction, and some educational, environmental, and health programs. Once again, data were not available to quantify the magnitude of special transfers to Shanghai from 2000 to 2003.

Roughly one-third of all Shanghai reported on-budget expenditure from 2000 to 2003 was for investment in local government enterprises, either as "Capital Construction" (building new plants and factories, as well as buying new equipment and machinery) or "Technical Upgrades" (transformation and modernization). One-fourth of expenditure was in social sectors, although it is unclear whether these are expenses to finance routine government operations or project-specific investments. It is also unlikely that all overhead costs were covered by only 3 to 4 percent of expenditure. Another 36.7 percent of total reported on-budget expenditure is not disaggregated in any public documents, so is categorized as "Other" in this study, while 16 percent of reported on-budget revenue from 2000 to 2003 is not accounted for at all in any public documents that present on-budget expenditure.

Shanghai's rapid growth over the past three decades has required a dramatic increase in municipal infrastructure and services that conventional revenue sources have not been able to finance. On-budget revenue has been generated in relatively small, constant, annual increments, and thus, has not been adequate to meet the needs of large-scale, lumpy, long-term investments. Shanghai has therefore resorted to a number of off-budget financing mechanisms such as international loans, land leases and land swaps, concessions, capital market resources, and public-private partnerships.

IV. Municipal Finance in Jakarta

The history of municipal finance in Indonesia is commonly divided into two periods: pre-Suharto and post-Suharto, with 1998 as the transition year between these two periods. The first era is generally characterized by a highly centralized system of municipal finance, while the second era is often seen as a period of dramatic fiscal decentralization and significantly enhanced local government finance. While this is certainly true from a *de jure* (legal) perspective, it is not accurate from a *de facto* (empirical observation) perspective.

Although fiscal decentralization legislation was drafted under President Suharto, no significant laws to enhance regional autonomy were passed other than the 1974 law on decentralization (Law No.5/1974). Furthermore, even this landmark legislation was not operationalized until the 1995 launch of the District Autonomy Pilot, a two-year experiment in which selected functions were transferred from central and provincial governments to 26 district governments.

However, after Suharto resigned in May 1998, a concerted effort was made to increase the power of subnational government as part of the realignment of power that was sweeping Indonesia's political landscape. This resulted in the passage of two major new laws in 1999: Law No. 22/1999 on Regional Government and Law No. 25/1999 on the Fiscal Balance between the Central Government and the Regions. These two new laws totally transformed the legal framework governing intergovernmental fiscal relations. Law No. 22/1999 replaced the hierarchal system of governance between Level I governments (provinces) and Level II governments (municipalities and districts) with a system that allowed considerably greater local autonomy. This law also made most deconcentrated central government offices at the subnational level the responsibility of their respective provincial and local governments. Law No. 25/1999 restructured the system of intergovernmental transfers. It delineated revenue sharing parameters for provincial and local governments, and replaced the Autonomous Region Subsidy (*Subsidi Daerah Otonom, SDO*) used to pay regional civil servants' salaries and development grants (*Instruksi Presiden, Inpres)* with a single block grant (*Dana Alokasi Umum, DAU*), to be financed by at least 25 percent of central government domestic revenue.

However, this expenditure-led fiscal decentralization has led to a substantial imbalance between assignment of expenditure and revenue responsibilities, creating a fiscal gap for many local governments that has actually increased their dependence on the central government: the decentralization legislation fails to assign local governments any broad-based taxes or significant new tax discretion with which to finance their new expenditure responsibilities. In contrast, despite the lack of new laws supporting fiscal decentralization under Suharto, tremendous progress was made both in the generation of own source revenue and discretion in the allocation of funds from the central government.

Total Jakarta nominal revenue has doubled over the past five years; in constant terms, revenue has still increased by 37.6 percent, rising at an average annual rate of 8.3 percent. During this period, the share of own source revenue has become ever more dominant, growing from about one-half to roughly two-thirds of total revenue, a positive trend in the context of Jakarta's desire to increase its fiscal autonomy. Local special revenue (internal financing) has fallen from 15.6 to 11.8 percent of total revenue, while shared revenue (equalization funds) has remained relatively constant in value but has fallen as a portion of total revenue from one-third to one-quarter.

As Jakarta has not utilized debt financing over the past five years, local regular revenue is comprised almost entirely of what it calls own source revenue, or *Pendapatan Asli Daerah (PAD)*, defined by the Government of Indonesia as consisting of: local taxes (*pajak daerah*); local user charges (*retribusi daerah*); profits or dividends from regionally owned enterprises (*bagi hasil BUMD*); and miscellaneous other sanctioned income (*lain-lain PAD yang sah*). Property-related taxes are included as local taxes in this analysis, just as they would be in most other countries, so that Jakarta can be placed in an international comparative perspective through use of a common analytic framework and terminology. Jakarta levies two such taxes: PBB (*Pajak Bumi dan Bangunan*), an annual tax on the capital value of land and buildings, and BPHTB (*Bea Perolehan Hak atas Tanah dan Bangunan*), a tax on the acquisition of land and building rights. Although PBB and BPHTB are co-administered tax sharing forms of local government revenue, all tax revenue from these sources goes to provincial and district/municipal governments under tax sharing formulas. Furthermore, utilization of PBB and BPHTB revenue is decided solely by Jakarta.

The dominant component of regular local revenue is local taxes, which have maintained a 90 percent share for the past five years. Most of the remaining ten percent is divided roughly equally between local user charges and other sanctioned revenue, with the residual coming from local government's share of local enterprise and local resource management revenue. Approximately 60 percent of local taxes come from vehicle-related taxes, primarily the motor vehicle registration tax (*Pajak Kendaraan Bermotor*) and the motor vehicle title transfer fee (*Bea Balik Nama Kendararaan Bermotor*). These revenues have remained robust due to a combination of rising tax rates, car prices, and vehicle sales in Jakarta, buttressed by the central government's deregulation of imported vehicles. Property-related taxes have remained constant at approximately one-quarter of local government taxes, split almost equally between PBB and BPHTB revenue. Nominal increases have been due mainly to recovering property values after the collapse of the real estate market during the East Asian financial crisis that began in mid-1997 and hit Indonesia hardest in 1998. The other significant local tax source is the Hotel and Restaurants Tax (previously known as PB I, the Provincial Development Tax, or *Pajak Pembangunan I*). This is a 10 percent local sales tax on hotels, restaurants, and entertainment. The remaining local taxes generate relatively little revenue.

When compared to local taxes, local user charges generate an extremely small and steadily declining share of total local regular revenue: in 2005, local taxes accounted for 88.6 percent of local regular revenue, while the share from local user charges was only 3.6 percent. About one-third of the revenue generated by local user charges comes from health service fees (*pelayanan kesehatan*), and another one-third from fees for building permits (*izin mendirikan bangunan*). The remaining third of local user charge revenue comes from 22 other service and licensing fees.

Revenue generated by Jakarta's ownership of local government enterprises (*Badan Usaha Milik Daerah, BUMD*) has not contributed significantly to the city's budget, totaling less than one percent of total local regular revenue over the past five years. Although profitable BUMDs tend to invest retained earnings to remain competitive and grow, many BUMDs forego profits to satisfy their development missions; others are not commercially viable enterprises. Other sanctioned revenue contributed only 5.0 percent to local regular revenue over the past five years.

In respect to loan and bond receipts, the central government must approve regional government proposals for foreign assistance. One key consideration for approval is the provision that the deficit in the national budget and the local government budget must not exceed the 3 percent benchmark. Thus far, Jakarta has not submitted proposals for foreign assistance. Jakarta has considered issuing municipal bonds to finance its infrastructure investments, but the city is still in a very preliminary preparation stage.

Jakarta's local special revenue consists entirely of income sources listed under "financing," as they are seen as ways of balancing the budget. These include carryover from the previous year's budget and transfers from a reserve fund. During the past five years Jakarta has experienced a budget deficit of between Rp 1 trillion and Rp 2 trillion, which has been financed entirely by the previous year's budget surplus (*Sisa Lebih Perhitungan Anggaran Tahun Lalu*) except in 2005, when the budget carryover was supplemented by a modest transfer from the reserve fund. No revenue is recorded in the Jakarta budget from the sale of local assets during the past five years.

Shared revenue consists of three types of central government Equalization Funds (*Dana Perimbangan*): Revenue Sharing Funds from Tax and Non-Tax Revenue (*Bagian Daerah dari Pajak dan Bukan Pajak/Dana Bagi Hasil)*; General Allocation Funds (*Dana Alokasi Umum, DAU*); and Special Allocation Funds (*Dana Alokasi Khusus, DAK*). The concept undermining General Allocation Funds and Special Allocation Funds is equalization of the fiscal gap, which is defined as a region's fiscal needs less its fiscal capacity. While the total amount of these three Equalization Funds has remained relatively constant in real terms for the past five years at between Rp 2.4 and Rp 2.5 trillion, there has been a steady decline in their share of total Jakarta revenue and a dramatic change in the composition of these funds. Equalization Funds as a share of total Jakarta revenue has fallen from 32.1 to 23.6 percent, with a concomitant rise of about the same magnitude in the share of local regular revenue.

Within the Equalization Funds category, the contribution of General Allocation Funds has fallen from almost two-thirds in 2001 to less than one-fourth in 2005, with a simultaneous rise in the portion of Revenue Sharing

Funds from Tax and Non-Tax Revenue from 36 to 77 percent. Both of these trends highlight increasing fiscal autonomy for Jakarta, as a growing share of total local resources are dependent on Jakarta's success in generating own source revenue and shared central government tax revenue. The growth in importance of tax and non-tax sharing revenue began in 2002, in part reflecting the central government's push to improve tax effort - most of the revenue in this category comes from Jakarta's 20 percent share of the personal income tax. This policy was augmented by the greater share of natural resource revenue given to local governments under Law No. 33/2004. Jakarta did not receive any Special Allocation Funds over the past five years.

Jakarta adopted performance-based budgeting in 2003. Under the new system, fund allocations are linked to achievement of goals by Work Units (*Unit Kerja*) of the Jakarta government. However, performance-based budgeting only works if performance standards are formulated against which to assess the quality of government and determine the level of subsequent budget allocations based on the relative success or failure of government Work Units; criteria and measurement metrics for assessing government performance are still under development. Another element of budget reform is adoption of a new format that uses a budget surplus/deficit approach - the previous budget format did not state explicitly the budget surplus or deficit.

The budget's "Expenditure by Sector" section has also been consolidated: it now consists of only eight sectors (*bidang*). Each sector is divided into functions (*fungsi*), and each function is broken down into programs (*program*). Budget performance is determined by the success of units in carrying out their assigned functions. This new format is significantly different from the previous format, in which expenditure was divided into Routine Expenditures (*Belanja Rutin*) and Development Expenditures (*Belanja Pembangunan*), and Development Expenditures were divided into twenty-one sectors.

Expenditures have been concentrated in three main sectors, which together have constituted slightly more than three-fourths of all expenditures each year: Government, Education and Health, and City Services and Infrastructure. However, the composition of expenditures has shifted among these three sectors, most notably a decline in Government expenditures from a one-third share to a one-quarter share and an offsetting rise from 19 to 27 percent in expenditures for City Services and Infrastructure. Expenditures are also divided into "Indirect Expenditures" and "Direct Expenditures"; the former are presumably for general administration and the latter for specific programs, but specific funds utilization is ambiguous in this format.

Jakarta also classifies expenditures by five Expenditure Groups (*Kelompok Belanja*): General Administration (*Belanja Administrasi Umum*); Operation and Maintenance of Public Services and Infrastructure (*Belanja Operasi dan Pemeliharaan Sarana dan Prasarana Publik*); Investment (*Belanja Modal*); Transfers (*Belanja Transfer*); and Miscellaneous (*Belanja Tidak Terduga*). However, analysis by expenditure group can only be done for the 2001 to 2003 period, because in 2004 and 2005, the first three categories were combined into a single group. Even this analysis is not very revealing due to overlap in subcategories designations. Post-2003 analysis is yet more problematic because the first three expenditure groups comprised an average of 98 percent of all expenditures from 2001 to 2003. Thus, the previously relatively opaque five expenditure groups have become even more difficult to interpret.

A third way Jakarta classifies its expenditure is by administrative jurisdiction: the provincial level (*propinsi*) and the district/municipality level (*kabupaten/kotamadya*). Since 2003, the provincial to sub-provincial shares of expenditure have remained constant at 63 percent to 37 percent, respectively, although Jakarta plans to increase the sub-provincial share of expenditure to 40 percent.

Beginning in 2004, Jakarta instituted "priority programs" in addition to the eight expenditure sectors described earlier. Priority programs are large-scale, urgent investments, financed by a "dedicated development budget" whereby a designated amount of funds is "locked" or earmarked only for development purposes, often for multi-year programs. There are eleven dedicated programs in the 2005 budget, including activities such as the Busway Project, flood canals, low-income housing, flyovers and underpasses, and public school building rehabilitation.

As with revenue, certain types of expenditure are contained in a third part of Jakarta's budget, "Financing." These include payment of loan principal, transfers to a reserve fund, capital investments, and surplus from the current year's budget. There were no reserve fund transfers or recorded current surpluses over the past five years. However, Jakarta has continued to service its debt for development assistance and made some capital investments, although neither of these expenditures has been very large. Debt repayment to the International Bank for Reconstruction and Development (IBRD) and the Overseas Economic Cooperation Fund (OECF) has continued to decrease from Rp 51 billion in 2001 to Rp 40 billion in 2005. Jakarta also increased its capital participation (*Penyertaan Modal*) to Rp 50 billion in 2005 from Rp 11 billion the previous year.

V. Ho Chi Minh Finances in Comparative Perspective

A. Revenue and Expenditure Performance

The research team has assessed municipal revenue mobilization performance in HCMC, Shanghai, and Jakarta by addressing the following three questions: Have significant resources been generated? How buoyant and sustainable are current revenue mobilization mechanisms? What have been costs in terms of economic efficiency and social equity?

HCMC has been very successful in mobilizing revenue: real average revenue increases have kept pace with gross regional domestic product growth, both rising at a compounded annual rate of about 11 percent from 2001 to 2004. However, revenue has grown during the last two years at less than half the rate of the previous two years, and because HCMC may keep only about 30 percent of tax revenue it generates, its budget actually shrank by 3.1 percent in 2004. In contrast, the 26.5 percent real average annual growth rate of Shanghai's local budget revenue has surpassed the 18.9 percent total revenue growth rate, but both took a sharp drop in 2002. Jakarta's real rate of local revenue growth has averaged 8.3 percent annually from 2001 to 2005, also with considerable fluctuation but in a clear downward trend; data for total revenue mobilized in Jakarta are not available.

All three cities have generated approximately two-thirds to three-fourths of their on-budget resources from own source revenue since 2000, with HCMC at 61 percent, Shanghai at 67 percent, and Jakarta at 73 percent. The remaining one-third of on-budget resources in HCMC and Shanghai has been dominated by tax sharing revenue; in Jakarta the remaining one-fourth has been split at a ratio of roughly two-thirds from tax sharing and one-third from revenue sharing.

However, there are concerns regarding lack of buoyancy and sustainability when own source revenue is disaggregated. In HCMC local regular revenue is comprised of a large number of local user charges and fees, as well as a modest amount of local government debt. At present, there is no local government tax base that can be widely taxed annually at a low rate to generate significant own source revenue. Instead, HCMC derives much of its income from nuisance charges and fees, which are often expensive to collect relative to the amount of revenue they generate. In addition, more than half of own source revenue in HCMC has come from incidental sources such as the sale of local government assets, or from treasury operations such as budget carryovers. Over time, HCMC will inevitably run out of assets to sell, and will have depleted accumulated budget surpluses. The composition of shared revenue is a bit more reassuring, as it is spread out over several national taxes and is relatively evenly split between direct and indirect taxes.

The composition of own source revenue in Shanghai is a bit misleading, as the sale of local government assets and intangibles is off-budget but has generated a tremendous amount of revenue - long-term leases in downtown Shanghai and in Pudong district have financed much of the infrastructure development in these areas. However, within the category of local regular revenue, Shanghai has a more sustainable composition of revenue sources: it is generating a greater share from local user charges and fees, and it has a buoyant, high-yielding local business tax. Like HCMC, shared revenue in Shanghai is spread out over several national taxes, but is weighted more heavily towards direct taxes, usually more difficult to collect than indirect taxes.

In many ways Jakarta has the most sustainable composition of own source revenue. Not only do almost three quarters of all its resources come from own source revenue, but within this category, most of the funds come from two buoyant and sustainable tax bases that are usually best taxed at the subnational level, vehicles and property, at 39.0 and 15.7 percent of local government revenue, respectively.

Reliance on hundreds of local taxes, charges, and fees for local regular revenue and the sale of local government assets for incidental local revenue decrease the economic efficiency and social equity of revenue mobilization. They distort producer and consumer behavior in a number of ways, creating economic losses for society, and the burden tends to fall most on those least able to pay. These sources of revenue are also expensive to collect and provide numerous opportunities for collusion and corruption, especially since many are off-budget. In contrast, taxes and charges on viable local tax bases can be much more economically efficient, socially equitable, and fiscally remunerative. A well-designed and properly implemented property tax is difficult to evade, so is economically efficient. It is also fair in that it is a proxy for long-term income, and is roughly correlated to benefits received. Likewise, vehicle-related taxes and charges can be relatively straightforward to enforce, they should fall on those with private transport, rising as the mode of transport increases in value, and are linked to benefits derived. A third common local revenue base is a turnover or sales tax on local businesses.

The research team has assessed municipal expenditure performance in HCMC, Shanghai, and Jakarta by addressing the following three questions: Is expenditure reporting transparent enough to hold officials publicly accountable for their expenditure practices? Are expenditure practices cost-efficient and cost-effective? How have municipal governments try to close the fiscal gap between assignment of expenditure responsibilities and availability of resources?

The expenditure growth rate in HCMC is almost exactly the same as its revenue growth rate, while the two rates in Jakarta roughly follow the same trajectory and there does not seem to be any discernable relation between Shanghai's revenue growth rate and its expenditure growth rate.

Weaknesses in the reporting of municipal expenditures become even more apparent when the total amount of on-budget revenue is compared with the total amount of on-budget expenditure. While 94 percent of local revenue is covered in HCMC's expenditure budget, this number drops to 86 percent for Jakarta's budget and only 85 percent for Shanghai's budget. In short, based on data available to this research team, the budgets of HCMC and Jakarta balance only after correcting for an error in calculation methodology in HCMC and adjusting for unexpended revenue carried over to the following budget year in Jakarta; Shanghai's unaccounted revenue remains unexplained. While these discrepancies might appear to be trivial, they are nonetheless troubling because they highlight in the most basic crosscheck between revenue and finance offices. They are more disconcerting when one keeps in mind that these data only cover on-budget revenue, and significant sources of revenue are off-budget in all three cities.

Yet more questions are raised in the transparency and credibility of municipal expenditure disclosure when one tries to disaggregate expenditure. Not only is it difficult to discern expenditure use within a city regardless of classification system, but it is exceedingly difficult to make meaningful comparisons between cities. For example, 37 percent of Shanghai's expenditures are not disaggregated at all in any publicly available documents; or despite the impression that more than half of all on-budget expenditure in HCMC is for capital investment, Jakarta's presentation of greater than three-quarters going to routine expenditure is probably more accurate.

Given that we really do not know how HCMC, Shanghai, and Jakarta are spending their money, it is not possible with publicly available information to assess the cost-efficiency of expenditure on inputs or the cost-effectiveness of expenditure on outputs and outcomes. Jakarta is furthest along in trying to address this concern, as it is converting to a performance based budgeting system, although the city has yet to formulate criteria with which to assess expenditure performance.

HCMC, Shanghai, and Jakarta have all tried to bridge the fiscal gap by utilizing a wide variety of innovative off-budget financing mechanisms, for example: long-term land leases and land swaps; public-private partnerships and private sector participation in urban infrastructure such as BOT (build-operate-transfer), BT (build-transfer), BTO (build-transfer-operate), BOO (build-operate-own), and franchise contracting mechanisms; creation of local government investment companies such as HIFU in HCMC and UDIC in Shanghai; and debt financing via loans and bonds.

B. Recommendations for Improving Municipal Finance in HCMC

HCMC should increase generation of own source revenue while at the same time improve the economic efficiency and social equity in the way it generates this revenue. The long-term objective is to decrease dependency on central government fiscal policies and fiscal transfers by developing a buoyant, sustainable local revenue structure.

This entails: rationalization and consolidation of current taxes and charges on land and buildings into a viable annual property tax, as the fiscal component of an integrated urban land use policy; formulation of an integrated transportation strategy that combines provision of new roads and bridges with investment in mass transit and greatly increased taxes and charges on the ownership and operation of motor vehicles; preparation of a consolidated budget that includes all revenue sources and all funds under city management; and continued reform of tax administration to further increase tax collection yield while lowering taxpayer transaction costs of compliance.

HCMC should improve the transparency, accountability, cost-efficiency and cost-effectiveness of municipal expenditure. The long-term objective is to create more social value added by increasing the return HCMC residents get for their contributions to the municipal treasury.

This entails: preparation of a consolidated budget that includes all expenditure and all contingent liabilities; disaggregation and detailing of public expenditure in a manner that clearly and accurately reflects use of public revenue; design and implementation of a system to assess the cost-efficiency of budget inputs over time and in comparison with other large municipalities in Vietnam; and design and implementation of a system to assess the cost-effectiveness of budget outputs and policy outcomes, also over time and between comparable jurisdictions.

Chapter One: Introduction

I. Study Objectives

A combination of rapid urbanization rates and rising urban incomes in Vietnam is leading to a dramatic increase in the effective demand for the production and provision of essential municipal infrastructure and services throughout the country. This is placing considerable strain on scarce financial resources in Vietnamese cities and towns, highlighting the urgency of improving both municipal revenue generation and the efficiency and effectiveness of municipal expenditures.

In recognition of these demographic trends and the demands they are placing on municipal governments, the Ho Chi Minh City (HCMC) People's Committee approached the United Nations Development Program (UNDP) for assistance in reviewing its municipal finance practices and making suggestions for their improvement.

The UNDP then contracted with the Fulbright Economics Teaching Program (FETP) and Harvard University's Kennedy School of Government (KSG) to conduct applied policy research and analysis of municipal finance in HCMC and to formulate recommendations for enhancing future performance.

In subsequent discussions among participating institutions, the study was broadened to include Shanghai and Jakarta so that HCMC could be placed in an international comparative perspective.

Thus, the objectives of this study are to:

- analyze past trends and current practices in the generation and allocation of resources for the financing of municipal infrastructure and services in HCMC;

- perform the same analysis for Shanghai and Jakarta, and compare the results with the performance to date of HCMC;

- highlight effective policies and practices that should be continued, as well as those that require strengthening or modification; and

- identify high-potential but untapped revenue sources, and suggest improvements in expenditure efficiency and effectiveness.

This study is not an evaluation, audit, or inspection of municipal finance in HCMC. Instead, it is an external assessment of what seems to be working well and where there is substantial room for improvement, with the goal of providing constructive recommendations to assist HCMC in fulfilling its development mission.

II. Study Methodology

This study began with the design of a common conceptual framework for classifying, documenting, analyzing, and assessing local government revenue and expenditure in HCMC, Shanghai, and Jakarta. Each city has its own accounting and budgeting system, with very different protocols for how government income and expenses are arranged and presented, so it is essential to use the same framework for cross-city comparisons. This required the disaggregation and reaggregation of financial information in a format not used by any of these cities, both to highlight key strategic and tactical policy issues, as well as to facilitate the exchange of experiences between HCMC, Shanghai, and Jakarta.

Municipal revenue was divided into two main categories in an effort to determine local government fiscal dependency on central government resources:

- own source revenue (local taxes, local fees and user charges, revenue from local enterprises, local government borrowing, sale of local assets and intangibles, budget carryovers, transfers from reserve funds, and miscellaneous local revenue); and
- tax sharing and revenue sharing (local government share of national tax and non-tax revenue, and central government transfers to local government [1]).

Municipal revenue was further disaggregated into subcategories for each city, mainly by dividing "own source revenue" into sustainable ("local regular revenue") and incidental ("local special revenue") to further assess local government fiscal autonomy.

Municipal expenditure was also divided into two main categories, routine and capital expenditure, to determine local government capacity to generate on-budget funds for investment in urban infrastructure and services. Beyond this general classification of expenditure, the cities varied a great deal in terms of subcategories: expenditures were sometimes arranged by sector, but without a standard terminology, and sometimes by administrative jurisdiction or by a unique system based on local needs and practices.

The research team then tried to collect a four-year time series of revenue and expenditure data for HCMC, Shanghai, and Jakarta. This included both on-budget and off-budget data, as much of the most innovative financing mechanisms in these three cities is not included in official budget presentations.

Much of the off-budget information is anecdotal and indicative, so is presented primarily in a series of case studies documenting some of the most interesting fiscal initiatives in HCMC, Shanghai, and Jakarta. These case studies were prepared after conducting intensive interviews with key government and private sector officials in each city.

III. Study Limitations

The topic of this study is both quite complex and extremely sensitive. Municipal managers have little incentive to share financial data with outsiders: there is no obvious direct benefit, but tremendous potential risk.

In spite of these constraints, the research team has done its best to collect as much relevant data as necessary to understand fiscal policies and practices in HCMC, Shanghai, and Jakarta, and has taken great care to present this data in as fair a manner as possible.

Nevertheless, there are apparently still some significant data gaps, which when filled, could alter some of the research team's findings and recommendations; these gaps are duly noted as they appear in the text. Recommendations are also made at the end of the study on topics meriting further research and analysis.

The reader should also keep in mind that cross-country comparisons are commonly misinterpreted as proposals for replicating practices in one nation that might be inappropriate in another country, due to different historical and economic contexts and dissimilar political, social, and institutional environments.

Thus, the reader should view similarities and differences between HCMC, Shanghai, and Jakarta not as "best and worse practices," but rather, as a source for discussion and reflection in the hope that experiences elsewhere might help us to better understand our own situation, as well as provide us with ideas that might be adapted to our own requirements and capabilities.

[1] In the case of Jakarta, although the property tax is formally a national tax, because all of the revenue goes to local government, it is considered an assigned local tax rather than a shared tax and is thus part of "own source revenue" rather than "tax sharing and revenue sharing." This is also consistent with classification of the property tax as own source revenue in most countries.

Chapter Two: Municipal Finance Ho Chi Minh City

I. Introduction

Ho Chi Minh City (HCMC) is considered the economic center of Vietnam. Strategically located at a central point in Southeast Asia and at the crossroads of many of Southeast Asia's maritime routes, this city of approximately 6 million people (8 million including the greater metropolitan area) accounts for about 7.3 percent of the country's population and 0.6 percent of the country's area, but generated 18.4 percent of Vietnam's GDP in 2004 and 30.4 percent of national budget revenue from 2001 through 2004.

Even though HCMC has been quite successful in mobilizing tax revenue, it has been permitted to keep but a small portion of these taxes, roughly 30 percent. This has been significantly short of HCMC's budgetary needs, and despite the city's very creative means of financing this "fiscal gap" in its routine and capital budgets (the difference between expenditure responsibilities and available resources), it has not been able to keep up with the city's rapid growth and concomitant resource needs. Moreover, the development plan approved by the HCMC Eighth Party Congress at the end of 2005 estimates that, over the next five years (2006-2010), the city must mobilize VND 100 trillion ($6 billion) for the city's budget and an additional VND 450 trillion ($27 billion) for off-budget expenditure, 1.7 and 2.4 times greater than the previous five years.

Recent trends are not encouraging as well. For example, as indicated in the following table, although average revenue increases have kept pace with gross regional domestic product (GRDP), both rising at a compounded annual rate of approximately 11 percent from 2001 to 2004, the rate of revenue growth during the last two years is less than half of the growth rate during the previous two years:

Table II - 1: HCMC Revenue in National Context

VND billions

No	Items	2001	2002	2003	2004	Total
	Revenue in HCMC (nominal) [2]	30,732	36,902	41,544	48,133	157,311
1	**Revenue in HCMC (constant)**	**30,097**	**35,048**	**37,401**	**40,150**	**142,698**
2	Local budget	8,090	9,804	13,200	12,875	43,968
3	**Revenue growth**	**15.4%**	**16.4%**	**6.7%**	**7.3%**	11.4%
4	Local budget growth	25.7%	21.3%	34.5%	-3.1%	18.7%
5	**Revenue in HCMC / National budget**	**30.5%**	**34.5%**	**29.2%**	**28.9%**	**30.4%**
6	Local budget / National budget	8.2%	9.7%	10.3%	9.2%	9.4%
7	**Local budget / Revenue in HCMC**	**26.9%**	**28.0%**	**35.3%**	**31.9%**	**30.9%**

Sources: HCMC Tax Department, HCMC Finance Department, Ministry of Finance

Furthermore, when HCMC revenue is disaggregated in Section III below, it will be clear that revenue composition is both unstable and unsustainable.

In this paper, we will examine both the revenue and the expenditure side of public finance in HCMC, including on-budget and off-budget components. Based on performance to date and comparisons with Shanghai and Jakarta, we will offer suggestions for improving the economic efficiency, social equity, and total amount of revenue generation, as well as the cost-effectiveness of municipal expenditures. Although HCMC's 2,095 square kilometers is divided into 24 districts, most financial authority remains with the city, so our analysis will focus on the city-wide rather than district level.

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[2] This figure includes all revenue collected by the HCMC Tax Department for all levels of government, including revenue kept entirely by the central government.

II. Overview of HCMC's Revenue and Expenditure Design

A. HCMC Revenue and Expenditure Legal Framework

According to the national budget law and implementation regulations, there are three categories of revenue for HCMC: revenue retained 100 percent by the central government (hereafter referred to as "national revenue"); revenue retained 100 percent by HCMC (hereafter referred to as "own source revenue"); and revenue shared between HCMC and the central government (hereafter referred to as "tax sharing revenue").[3]

1. National Revenue

National revenue is comprised of: trade-related taxes; corporate income tax of "entire branch accounting units" (enterprise subsidiaries); taxes on oil and gas exploration and exploitation; official development assistance to the central government in the form of grants ("non-refundable aid"); revenue from charges and fees of central government agencies and units; Vietnam State Bank surpluses; budget carryovers from previous years; and revenue from central government fines and confiscation.

2. Own Source Revenue

Own source revenue is comprised of: real estate, vehicle, and business taxes and charges; other miscellaneous registration and licensing fees and charges; the natural resource tax (excluding oil and gas activities); lottery revenue; local budget contributions; revenues from the Provincial Reserve Fund; official development assistance to local government in the form of grants ("non-refundable aid"); voluntary contributions of organizations and individuals; revenue from charges and fees of local government agencies and units (excluding petrol and oil charges and registration fees); revenues from the mobilization of resources for investment in the construction of infrastructure (loans and bonds); revenue from budget surpluses; budget carryovers from previous years; revenue from local government fines and confiscation; and supplements from higher-level budgets.

3. Tax Sharing Revenue

Tax sharing revenue is comprised of: the value added tax (with specified exclusions); the corporate income tax (with specified exclusions); the income tax on high-income earners (personal income tax); the special consumption tax on domestic goods and services (excluding lotteries); and petrol and oil charges.

The proportion of central government revenue shared with HCMC is determined by the following formula:

- A is the total local budget (after subtracting supplemental expenditures for lower-level budgets, enumerated supplements from the central budget, loans, voluntary contributions, grant aid, foreign loans borrowed by the central government, and expenditures from the previous year's budget).
- B is own source revenue (after subtracting supplements from the central budget, loans, voluntary contributions, grant aid, the previous year's budget surplus, and carryovers from the previous year's budget).
- C is total tax sharing revenue generated by HCMC.
- If $A-B < C$, then Percentage Share = $(A-B)/C*100\%$.
- If $A-B = C$, the Percentage Share = 100%.
- If $A-B > C$, then the shortage is supplemented by the central budget.

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[3] Please see Appendix I for a detailed listed of revenue by these revenue categories.

The tax sharing formula and effective period of application are both proposed by the government and decided by the Standing Committee of the National Assembly. The formula for splitting revenue between the municipal budget and district budgets is decided by the HCMC People's Council.

4. Special Revenue Incentives

If HCMC exceeds its national and tax sharing revenue targets, it is permitted to keep 30 percent of the surplus as local discretionary revenue, up to the previous year's surplus. The central budget will earmark 70 percent of the surplus's remaining 70 percent for projects in HCMC. Thus, the city will get a total of 79 percent of its surplus (30 percent discretionary plus 49 percent earmarked). HCMC is permitted to keep all of the proceeds it receives from auctioning land use rights for development. The city may also mobilize resources through means such as the BOT (Build-Operate-Transfer) and BT models (Build-Transfer), providing it receives permission from authorizing agencies.

5. Expenditures

In principle, the HCMC budget must be balanced, with expenditures not exceeding revenue. The city may, however, mobilize other capital resources (debt through loans or bonds) for targeted programs, as long as the total amount of borrowing does not exceed the current year's investment expenditure. This is higher than the norm in Vietnam; the debt ceiling for cities other than HCMC and Hanoi is 30 percent of the investment budget.

B. HCMC Revenue and Expenditure Implementation Mechanisms

1. Revenue

Taxes are divided into two types, domestic taxes and trade-related taxes. The HCMC Tax Department is responsible for collecting domestic taxes for all levels of government. The tax department's collection activities are organized into divisions based on the legal form or economic sector of taxpayers, rather than by type of tax or tax administration function, as follows: foreign investment division, industrial parts and export processing zones division, non-state owned enterprise division (1,2,3), commercial division, registration fees and others division, industry and construction division, postal and transportation division, aquaculture and agriculture division, and culture and health division.

In addition, there is a tax office in every district. These offices are responsible for collecting taxes, fees, and charges from most small businesses and individual/household enterprises; the city's tax department is responsible for revenue from state-owned enterprises, foreign-invested enterprises, and large private enterprises. The city's tax department decides on the division of responsibility between itself and the district tax offices. There is an inverse relationship between staff size and revenue collection: a small proportion of total staff work in the city's tax department office but these officials collect most of the revenue in HCMC in terms of value, while the much larger number of staff based in the district offices collect a relatively small share of total revenue.

Tariffs (mostly import taxes) are the responsibility of the customs department, and, as noted earlier, are all retained by the central government. Both the General Department of Taxation and General Department of Customs are semi-autonomous units directly under the Ministry of Finance.

2. Expenditure and Treasury Operations

HCMC's Department of Finance prepares the city budget and manages city expenditures, while the Treasury Department serves as the city's cashier, handling collection and disbursement transactions.

III. Current Composition of HCMC On-Budget Revenue and Expenditure [4]

A. Overview of Revenue

For the purpose of international comparative analysis, HCMC revenue can be divided into two general classifications: "own source revenue" and "tax sharing/revenue sharing." "Own source revenue" can be divided further into "local regular revenue" and "local special revenue"; "local regular revenue" is a sustainable from of income while "local special revenue" is considered incidental income, and thus unsustainable.

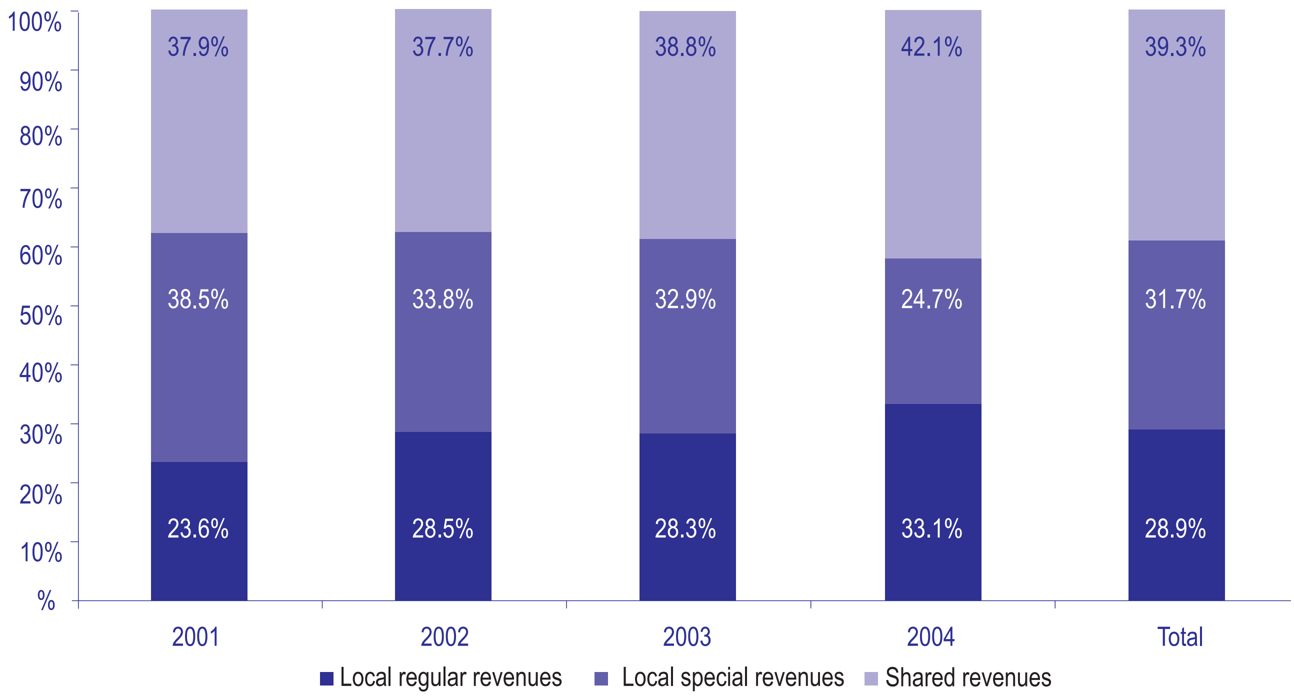
A consolidated summary of HCMC revenue from 2001 to 2004 is as follows:

Table II - 2: Consolidated Summary of HCMC Revenue [5]

VND billions

No	Items	2001	2002	2003	2004	Total
1	***Total city budget (nominal)***	***8,261***	***10,322***	***14,662***	***15,434***	***48,679***
2	**Total city budget (constant)**	**8,090**	**9,804**	**13,200**	**12,875**	**43,968**
2.1	Local regular revenue	1,908	2,799	3,740	4,266	12,713
2.2	Local special revenue	3,116	3,309	4,344	3,185	13,945
2.3	Shared revenue	3,066	3,694	5,115	5,426	17,300
3	**Total shared revenue generated**	**13,750**	**15,087**	**17,845**	**18,396**	**65,079**
4	% retained (2.3 ÷ 3)	22.3%	24.5%	28.7%	29.5%	26.6%

Figure II - 1: Composition of HCMC Revenue



Sources: HCMC Tax Department, HCMC Finance Department, HCMC Statistics Department

[4] The base year is 2000; please see Appendix II for annual deflators.

[5] The percentages in line 4 differ slightly from the amount of tax sharing revenue approved by the Ministry of Finance because the data in this table have been collected from several sources. For example, the share approved by the Ministry of Finance in 2004 is 29.0 percent, a difference of 0.3 percent. In any case, this is still a relatively small share, but the rising trend is encouraging.

The composition of HCMC revenue has changed over these four years: local regular revenue has risen from one-quarter to one-third of city revenue, while local special revenue has fallen from almost 40 percent to 25 percent. However, despite this shift from incidental to sustainable own source revenue, HCMC's dependence on external revenue sources has increased steadily, so that the "correspondence" of own source revenue to expenditure assignment was only 57.8 percent in 2004 - the city's budget has depended largely on the negotiating ability of city leaders with external parties. This dependency has been exacerbated by the disincentive built into the tax sharing formula to increase own source revenue or decrease planned expenditure: either action could lead to a decrease in HCMC share of central government tax revenue. Each of these three revenue components is detailed below.

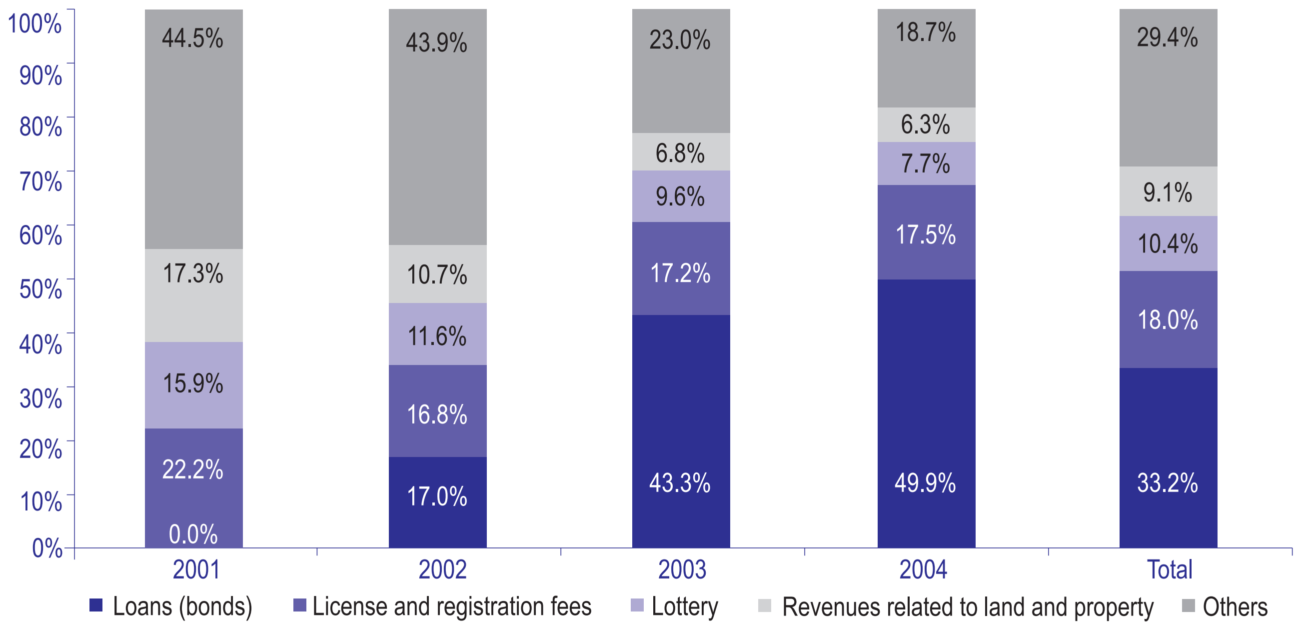
B. Local Regular Revenue

Table II - 3: HCMC Local Regular Revenue

VND billions

No	Items	2001	2002	2003	2004	Total
	Total (nominal)	***1,908***	***2,858***	***3,938***	***4,740***	***15,243***
I	**Total revenue (constant)**	**1,908**	**2,799**	**3,740**	**4,266**	**12,713**
1	Loans (bonds)	-	475	1,621	2,127	4,222
2	License and registration fees	424	471	645	745	2,285
3	Lottery winnings	304	324	358	330	1,316
4	Revenue related to land and property	330	300	255	267	1,153
5	Other revenue	850	1,229	861	797	3,737
II	**Structure of revenue**	**100%**	**100%**	**100%**	**100%**	**100%**
1	Loans (bonds)	0.0%	17.0%	43.3%	49.9%	33.2%
2	License and registration fees	22.2%	16.8%	17.2%	17.5%	18.0%
3	Lottery winnings	15.9%	11.6%	9.6%	7.7%	10.4%
4	Revenue related to land and property	17.3%	10.7%	6.8%	6.3%	9.1%
5	Other revenue	44.5%	43.9%	23.0%	18.7%	29.4%

Figure II - 2: HCMC Local Regular Revenue



Sources: HCMC Tax Department, HCMC Finance Department, HCMC Statistics Department

Trends in the generation of local regular revenue are summarized in the preceding table and figure. Debt financing through the issuance of municipal bonds has become a significant source of income over the past four years, rising from zero to half of all local regular revenue; other revenue sources have risen only slightly during the same period, so their relative shares of total local regular revenue have declined.

However, this probably still significantly underestimates HCMC borrowing, as the debt figures exclude the city's considerable contingent liabilities incurred through its explicit and implicit guarantees of off-budget borrowing by local government entities. For example, the HCMC Investment Fund for Urban Development (HIFU) has borrowed a total of approximately VND 3 trillion, and the Thu Thiem Urban Development Project Management Unit has borrowed hundreds of billions of VND over the past few years (see Section IV C below). This greatly limits the potential of a significant increase in HCMC debt financing to pay for future investments in urban infrastructure.

Roughly 80 percent of the second largest single source of local regular revenue, license and registration fees, comes from the registration of new and transferred real estate. This is not sustainable and is estimated to decrease over time. In contrast, only 6.3 percent of local regular revenue generated in 2004 came from annual fees and charges on the city's greatest store of wealth, its rapidly appreciating stock of land and buildings. This offers great promise for the adoption of a modern property tax in HCMC.

Vehicle related charges and fees also offer considerable potential to generate much more regular revenue for HCMC. Less than 5 percent of local regular revenue comes from this source, and most is from the registration of new and transferred vehicles. Both vehicle operating charges and parking fees are negligible. Making it more expensive to own and operate a vehicle in HCMC would offer the city a "double dividend": generation of significant revenue, and reduction of traffic congestion and pollution.

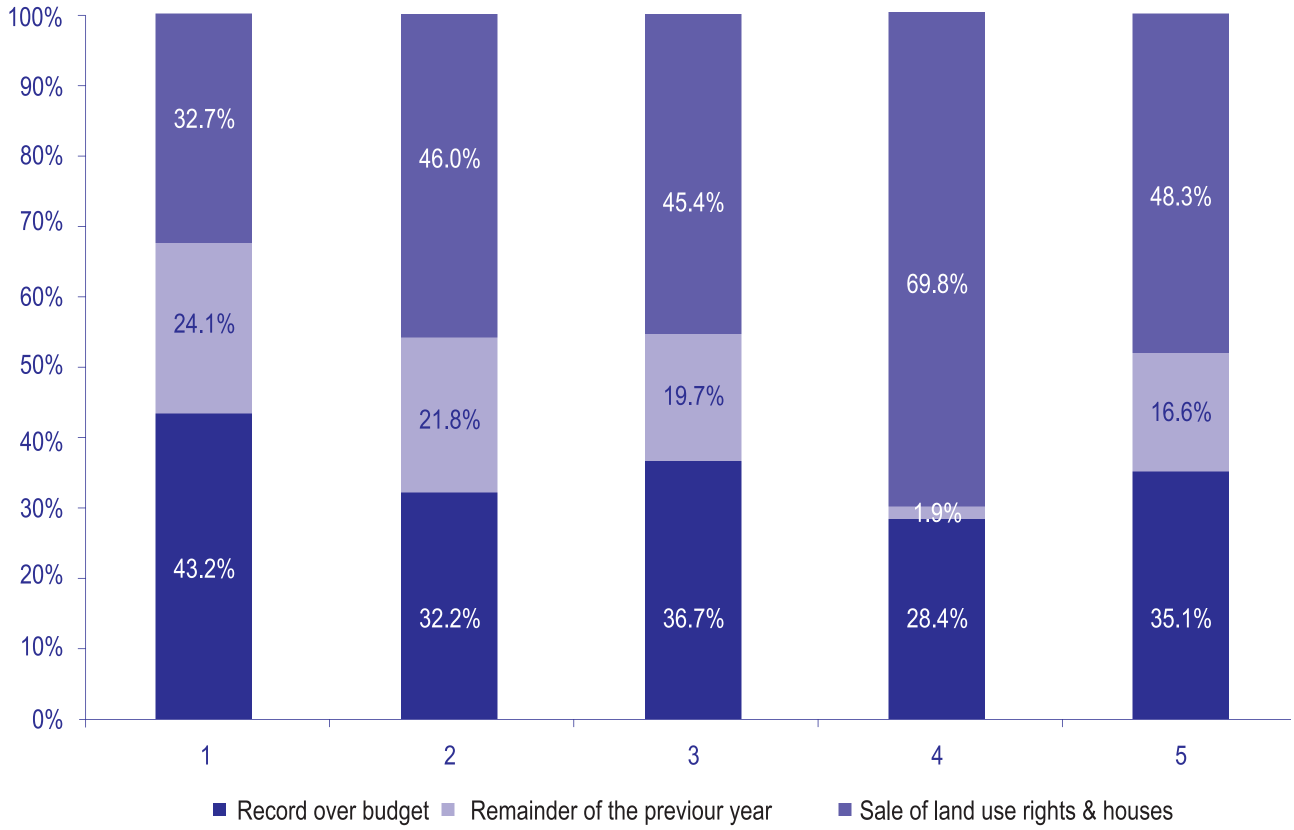
C. Local Special Revenue

Table II - 4: HCMC Local Special Revenue

VND billions

No	Items	2001	2002	2003	2004	Total
	Total (nominal)	***3,116***	**3,378**	***4,574***	***3,539***	***16,720***
I	**Total revenue (constant)**	**3,116**	**3,309**	**4,344**	**3,185**	**13,945**
1	Retained earnings	1,347	1,066	1,594	903	4,901
2	Carryover from previous year	751	721	778	59	2,309
3	Sale of land use rights and buildings	1,018	1,522	1,972	2,223	6,735
II	**Structure of revenue**	**100%**	**100%**	**100%**	**100%**	**100%**
1	Retained earnings	43.2%	32.2%	36.7%	28.4%	35.1%
2	Remainder of the previous year	24.1%	21.8%	17.9%	1.9%	16.6%
3	Sale of land use rights & houses	32.7%	46.0%	45.4%	69.8%	48.3%

Figure II - 3: HCMC Local Special Revenue



Sources: HCMC Tax Department, HCMC Finance Department, HCMC Statistics Department

Trends in the generation of local special revenue are summarized in the preceding table and figure. Retained earnings of local government entities [6] and budget carryovers from the previous year declined both in value and share of total local special revenue from 2001 to 2004, while the share of revenue from the sale of land use rights and buildings more than doubled during the same period, increasing from 33 to 70 percent. This trend is not sustainable, as the sale of land use rights and buildings are one-time events, and the city will eventually run out of real estate to sell.

D. Shared Revenue

Until 2004, the value added tax and corporate income tax comprised most of HCMC's shared revenue. Since then, a new agreement to share excise taxes on domestic goods, primarily alcohol and tobacco products, has added a third significant component to HCMC's shared revenue; at the same time, central budget transfers dropped dramatically. The most significant "other" shared revenue source is the national gasoline fee, now approximately VND 400 per liter. As noted earlier, HCMC keeps about 30 percent of the total amount of national taxes that it collects, and this share is subject to complex negotiations with the central government.

These trends are summarized in the following table and figure:

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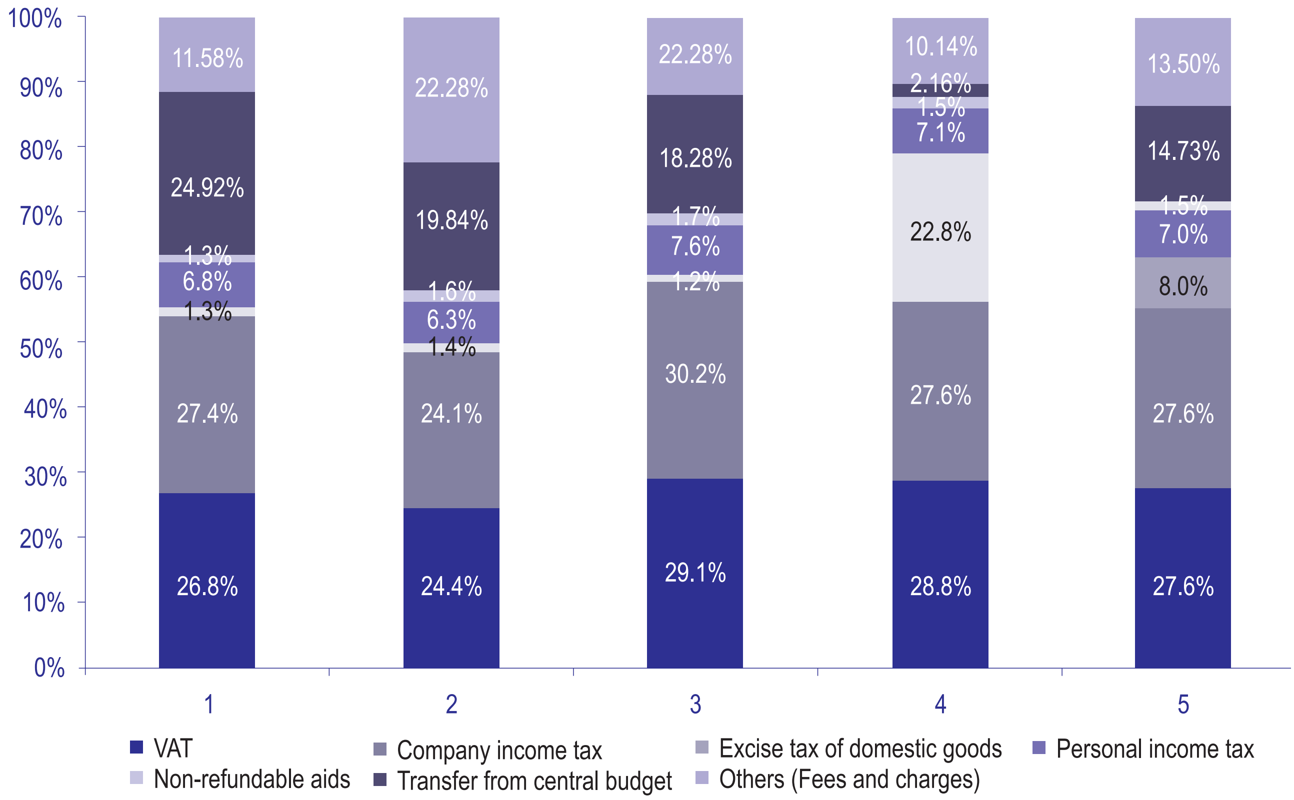
[6] Formally called "record over budget," these are retained earnings of local government entities such as HCMC Television and HCMC Radio. The entities are allowed to keep and reinvest profits, so such surpluses are essentially a budget pass-through, and are recorded with simultaneous credit-debit entries.

Table II - 5: HCMC Shared Revenue

VND billions

No	Items	2001	2002	2003	2004	Total
	Total (nominal)	***3,066***	***3,772***	**5,386**	**6,028**	***20,743***
I	**Total revenue (constant)**	**3,066**	**3,694**	**5,115**	**5,426**	**17,300**
1	Value Added Tax (VAT)	822	902	1,486	1,560	4,770
2	Corporate Income Tax (CIT)	839	892	1,547	1,497	4,775
3	Excise taxes on domestic goods	39	52	61	1,238	1,389
4	Personal Income Tax (PIT)	208	234	390	383	1,216
5	Non-refundable aid (grants)	39	58	87	81	265
6	Central budget transfers	764	733	935	117	2,549
7	Other	355	823	609	550	2,336
II	**Structure of revenue**	**100%**	**100%**	**100%**	**100%**	**100%**
1	Value Added Tax (VAT)	26.81%	24.42%	29.05%	28.75%	27.57%
2	Corporate Income Tax (CIT)	27.36%	24.15%	30.24%	27.59%	27.60%
3	Excise taxes on domestic goods	1.27%	1.41%	1.19%	22.82%	8.03%
4	Personal Income Tax (PIT)	6.78%	6.33%	7.62%	7.06%	7.03%
5	Non-refundable aid (grants)	1.27%	1.57%	1.70%	1.49%	1.53%
6	Central budget transfers	24.92%	19.84%	18.28%	2.16%	14.73%
7	Other	11.58%	22.28%	11.91%	10.14%	13.50%

Figure II - 4: HCMC Shared Revenue



Sources: HCMC Tax Department, HCMC Finance Department, HCMC Statistics Department

E. Overview of Expenditure

Local expenditure was only 28.3 percent of total revenue collected by the HCMC Tax Department and just 8.6 percent of national expenditure from 2001 to 2004; the balance of revenue collected went to the central government, comprising 30 percent of the national budget.

As indicated in the following table, there are two main types of expenditure, routine expenses and investment expenses, with the remainder made up of debt repayment and the credit-debit pass-through of local government enterprise retained earnings:

Table II - 6: Overview of HCMC Expenditure

VND billions

No	Items	2001	2002	2003	2004	Total
1	***Total expenditure (nominal)***	***7,399***	***9,358***	***13,100***	***14,707***	***44,564***[7]
2	**Total expenditure (constant)**	**7,246**	**8,888**	**11,794**	**12,268**	**40,198**
3	Investment expenses	2,978	4,427	6,333	6,735	20,473
4	Routine expenses	2,807	3,172	3,759	4,033	13,771
5	Retained earnings	1,347	1,066	1,594	903	4,901
6	Debt repayment	114	223	109	615	1,061
7	Expenditure/revenue in HCMC	24.1%	25.4%	31.5%	30.5%	28.3%
8	Expenditure/national budget	7.3%	8.8%	9.2%	8.8%	8.6%
9	Investment expense ratio (3 ÷ 2)	41.1%	49.8%	53.7%	54.9%	50.9%

Sources: HCMC Tax Department, HCMC Finance Department, HCMC Statistics Department

Investment expenses are now more than half of all expenditure, and are much higher than the national average of 35 to 38 percent. However, investment expenditure is not all capital expenses, as it is traditionally project-based and thus usually also includes routine expenses such as project management and administration.

F. Routine Expenditure

As indicated in the following table and figure, economic activities and education dominate routine expenditure; the decline in health spending coupled with the increase in spending on public administration is disconcerting:

[7] The difference between total revenue and total expenditure is caused primarily by incorrectly summing annual carryovers; the net amount of this figure is the maximum carryover during the four years, not the sum as it was calculated.

Table II - 7: HCMC Routine Expenditure

VND billions

No	Items	2001	2002	2003	2004	Total
1	***Routine expenditure (nominal)***	***2,866***	***3,340***	***4,175***	***4,835***	***15,216***
2	**Routine expenditure (constant)**	**2,779**	**3,161**	**3,747**	**4,022**	**13,708**
3	Economic sector activities	757	851	1,018	1,069	3,694
4	Education and training	741	771	918	925	3,356
5	Health	426	440	478	477	1,821
6	Public administration	237	267	376	591	1,471
7	Social	90	176	213	221	701
8	Other	528	654	744	739	2,665
	Routine expenditure structure	**100%**	**100%**	**100%**	**100%**	**100.0%**
9	Economic sector activities	27.2%	26.9%	27.2%	26.6%	27.0%
10	Education and training	26.7%	24.4%	24.5%	23.0%	24.5%
11	Health	15.3%	13.9%	12.8%	11.9%	13.3%
12	Public administration	8.5%	8.5%	10.0%	14.7%	10.7%
13	Social	3.2%	5.6%	5.7%	5.5%	5.1%
14	Other	19.0%	20.7%	19.8%	18.4%	19.4%

Sources: HCMC Tax Department, HCMC Finance Department, HCMC Statistics Department

G. Investment Expenditure

Table II - 8: HCMC Investment Expenditure

VND billions

No	Items	2001	2002	2003	2004	Total
1	***Investment expenditure (nominal)***	***3,041***	***4,661***	***7,034***	***8,074***	***22,810***
2	**Investment expenditure (constant)**	**3,404**	**4,969**	**5,663**	**5,955**	**19,991**
3	Transportation	1,297	2,537	2,452	2,589	8,875
4	Public and private services	718	569	895	1,154	3,336
5	Industry	458	758	335	538	2,090
6	Education and training	464	428	672	471	2,035
7	Other	467	677	1,308	1,203	3,656
	Investment expenditure structure	**100%**	**100%**	**100%**	**100%**	**100%**
8	Transportation	38.1%	51.0%	43.3%	43.5%	44.4%
9	Public and private services	21.1%	11.4%	15.8%	19.4%	16.7%
10	Industry	13.5%	15.3%	5.9%	9.0%	10.5%
11	Education and training	13.6%	8.6%	11.9%	7.9%	10.2%
12	Other	13.7%	13.6%	23.1%	20.2%	18.3%

Sources: HCMC Tax Department, HCMC Finance Department, HCMC Statistics Department

Transportation dominates investment expenditure, followed by services, industry, and education; investment in agriculture, commerce, hospitality services, science and technology, real estate, administration, health, culture and sport account for less than 20 percent, with each of these items below 5 percent of total investment expenditure.

IV. HCMC Consolidated Revenue and Expenditure

A. Overview of On-Budget and Off-Budget Capital Resources and Investment

Approximately 80 percent of total capital mobilized for investment in HCMC was generated by off-budget resources from 2001 to 2004. This highlights the importance of developing HCMC's "soft infrastructure": good municipal governance that creates an enabling environment conducive to attracting private resources to finance HCMC's "hard infrastructure" of roads, public transport, power, communications, and the like.

As indicated by the following table, foreign direct investment has equaled state budget investment allocations during this period, and households have invested almost twice as much in their homes and businesses as either state or foreign enterprises have invested in HCMC; state-owned enterprises and domestic private enterprises have each contributed 10 percent of investment capital in HCMC:

Table II - 9: HCMC Investment Capital By Source

VND billions

No	Items	2001	2002	2003	2004	Total
1	***Investment capital (nominal)***	***22,558***	***26,320***	***30,128***	***34,986***	***113,993***
2	**Investment capital (constant)**	**22,093**	**24,998**	**27,124**	**29,184**	**103,399**
3	City budget	3,651	5,249	5,602	6,238	20,740
4	SOEs	4,153	2,962	3,263	1,585	11,963
5	Non-SOEs	3,264	2,035	2,449	2,581	10,329
6	Other (households)	5,001	9,088	9,897	14,381	38,368
7	FDI	6,024	5,664	5,913	4,398	21,999
	Investment capital structure	**100%**	**100%**	**100%**	**100%**	**100.0%**
8	State budget	16.5%	21.0%	20.7%	21.4%	20.1%
9	SOEs	18.8%	11.8%	12.0%	5.4%	11.6%
10	Non-SOEs	14.8%	8.1%	9.0%	8.8%	10.0%
11	Other (households)	22.6%	36.4%	36.5%	49.3%	37.1%
12	FDI	27.3%	22.7%	21.8%	15.1%	21.3%

Sources: HCMC Tax Department, HCMC Finance Department, HCMC Statistics Department

Over one-third of HCMC investment capital has been allocated to industry, and roughly one-fifth of the total has been invested respectively in both transportation and services. Other sectors, such as agriculture, commerce, hospitality services, science and technology, real estate, state administration, education, health, culture, and sport account for a bit more than another one-fifth of total investment, but the amount invested in each of these sectors is less than 5 percent of the total:

Table II - 10: HCMC Investment Capital By Sector

VND billions

No	Items	2001	2002	2003	2004	Total
1	***Investment capital (nominal)***	***23,186***	***26,319***	***30,128***	***34,986***	***114,620***
2	**Investment capital (constant)**	**22,707**	**24,997**	**27,124**	**29,184**	**104,013**
3	Industry	8,598	9,569	10,096	9,184	37,446
4	Transportation	4,045	5,830	5,710	4,725	20,310
5	Public and private services	4,650	4,397	5,247	8,144	22,437
6	Other	5,414	5,202	6,072	7,132	23,819
	Investment capital structure	**100%**	**100%**	**100%**	**100%**	**100%**
7	Industry	37.9%	38.3%	37.2%	31.5%	36.0%
8	Transportation	17.8%	23.3%	21.0%	16.2%	19.5%
9	Public and private services	20.5%	17.6%	19.3%	27.9%	21.6%
10	Others	23.8%	20.8%	22.4%	24.4%	22.9%

Sources: HCMC Tax Department, HCMC Finance Department, HCMC Statistics Department [8]

B. Official Development Assistance

The figures in the preceding two tables do not include official development assistance (ODA) due to difficulties in obtaining and verifying data. However, cumulative ODA in HCMC is estimated to total $1.07 billion at the end of 2005, comprising $135 million in grants and $939 million in loans. These funds area believed to have financed approximately twelve projects in urban infrastructure, water supply, the environment, and administrative reform [9].

C. Innovative Methods for Mobilizing Investment Capital

HCMC has utilized some extremely innovative methods for mobilizing investment capital for the past few years, such as creative partnerships with the private sector. This is especially true in transportation infrastructure: many of the main roads into HCMC have been constructed by use of the BOT (Build-Operate-Transfer), BT (Build-Transfer), or city land plus private construction mechanisms, for example:

- BOT Binh Trieu II (VND 341 billion), BT Nguyen Tri Phuong (VND 213 billion), BOT An Suong-An Lac (VND 830 billion), and the South Saigon Highway (Nguyen Van Linh Road) (VND 1.250 trillion).
- The total capital of these projects is VND 3.5 trillion, equal to 33 percent of total capital budget for transportation and 14 percent of the total capital invested in transportation development for the past five years.

Another interested example is the refinancing of Hanoi Highway (Dien Bien Phu Road), Hung Vuong Road, and Nguyen Huu Canh Road by HCMC Infrastructure Investment Joint Stock Company, which paid HCMC VND 1 trillion in exchange for toll road collection rights. [10]

A third example of HCMC's innovation in mobilizing investment capital is establishment of HIFU.

The following section presents case studies of these innovative methods for mobilizing investment capital.

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8 The figures in this table vary slightly from those in the preceding table because although they are from the same sources, they are drawn from different data bases.

9 The Ministry of Planning and Investment web site (www.mpi.gov.vn/oda) and The Saigon Times Daily, May 16, 2006.

10 This joint stock company has just been listed under "CII" on the HCMC Stock Exchange.

V. HCMC Case Studies

A. Ho Chi Minh City Investment Fund for Urban Development (HIFU)

Ten years ago, when Vietnam financial markets were still in their embryonic stage, there were almost no investment institutions. The commercial banks were very young and in the stage of enhancement and recovery. Long and medium term capital was very limited, and there was almost no financial instrument for mobilizing capital. At the same time, the need for investment capital for infrastructure development in HCMC was both very great and quite urgent. The municipal government explored many ways to mobilize capital, most noticeably by attracting external resources as well as establishing a special institution to undertake this difficult task.

In 1997, with the enthusiastic support of central government agencies, especially the Ministry of Finance, the city submitted a proposal to the prime minister to establish the Hochiminh City Investment Fund for Urban Development (HIFU), a pilot local investment and development fund.

This type of financial institution has been tried in several countries, with mixed results. Many developing countries argue that until capital markets are better developed or alternative financing mechanisms are available, establishing these institutions is a pragmatic way to finance high-cost infrastructure projects. As transitional mechanisms, these funds serve two purposes. First, they allow the leveraging of government resources by attracting co-financing from domestic and foreign private resources. Second, they can assist in identifying, appraising, and monitoring infrastructure projects.

However, these institutions are often faulted for not showing a capacity for sustained investment, largely due to under-capitalization, poor financial discipline, and substantial amount of bad debt (Thành 1997). They have also been criticized for lack of transparency and good governance, as they are usually off-budget and weak on financial disclosure.

From 1997 to 2005, HIFU has lent approximately VND3 trillion ($190 million) for about 200 projects. HIFU's financing has focused on key projects to develop critical urban public infrastructure such as transportation, water supply networks, industrial parks, and health and education facilities.

In addition to lending its own funds, HIFU has arranged for many other institutions, such as banks and insurance companies, to co-finance infrastructure development projects. A total of VND1.4 trillion ($88 million) for 40 projects has been committed in this way.

In addition, HIFU has used its funds to invest in enterprises. The total direct investment at the end of 2004 was VND156 billion ($9.8 million). Investment activities focus on equitized state-owned enterprises and firms building houses for deferred payment in industrial parks. HIFU has also bought shares and managed enterprises to support its activities.

Since 2001, the fund has implemented a new investment method by contributing money to establish joint stock companies in order to socialize investment and attract capital resources for urban development.

The equity of the fund is VND687 billion ($43 million). Recently, the Ministry of Finance has granted HIFU permission to increase charter capital to VND1 trillion ($63 million) to strengthen HIFU's financial capacity.

A summary balance sheet of HIFU is as follows:

Table II - 11: HIFU Balance Sheet

VND billions

Items	1997	2001	2002	2003	2004
Cash		358	392	370	209
Loans		1,057	1,277	1,696	2,608
Loans from HIFU's capital		*524*	*716*	*1,116*	*1,935*
Loans from mandated capital		*533*	*561*	*580*	*673*
Direct investment		24	65	128	156
Other		3	1	10	40
Total assets		**1,441**	**1,736**	**2,204**	**3,013**
Mandated capital		746	756	830	857
Mobilized capital		143	346	368	821
Capital entrusted by HCMC government		-	-	300	492
Other		173	230	253	155
Equity	500	380	405	453	687
Total liabilities and equity		**1,441**	**1,736**	**2,204**	**3,013**
Growth of assets			20.5%	26.9%	36.7%

Source: HIFU

Results over the past decade demonstrate that, thus far, the HIFU model has been successful not only as an efficient channel for distributing capital, but also as a means to mobilize VND4.5 trillion ($283 million) for HCMC by issuing municipal bonds.

According to HIFU's master plan, by 2010, HIFU will have VND6 trillion in equity, VND40 trillion in mobilized capital, VND38.5 trillion in loans outstanding, and VND3.5 trillion in direct investment.

B. Private Sector Participation in Public Infrastructure: An Effective Solution To Improve HCMC's Transportation System

There is no province or city in Vietnam whose growth rate was as high as HCMC's in the "Doimoi" ("Renovation") period that began in 1986. At the end of 2005, HCMC accounted for 18.4 percent of national GDP and its budget revenue contributed to 28.9 percent of Vietnam's state budget revenue. However, in a city designed for only 3 million people (the population was about 3.4 million in 1975) with a badly prepared plan, urbanization is unsystematic and spontaneous, while the population has been increasing at very fast rate - at the end of 2004, the registered population was 6.1 million people (or about 8 million people if unregistered residents are included).

Congestion is more serious everyday. According to Ministry of Transportation estimates, the daily loss due to traffic jams in HCMC is about VND5 billion ($0.3 million), which over a year is equivalent to 1.8 percent of HCMC's annual GDP. Addressing traffic congestion has been one of the highest priorities in the Congress Resolutions of HCMC's Party Committee, the city's highest development oriented document.

For years, many projects and programs for transportation development have frequently been built and implemented. Capital for transportation development always accounts for the biggest share of state budget expenditure. For five years (2000-2004) it accounted for 18.8 percent of total investment capital in the city, and transportation development accounted for 43 percent of HCMC's total budget expenditure. Furthermore, many new and diversified methods have been used for transportation infrastructure development. One of these noticeable methods is mobilization of nonconventional resources for transportation infrastructure development.

Thanks to these solutions HCMC's transportation has improved remarkably, especially ring roads and main access roads to the city. Although state budget expenditure plays a key role in transportation development, HCMC's most innovative measures have been mobilizing participation of external resources for transportation infrastructure development. The most popular ways have been transferring land for infrastructure, as well as the BOT (Build, Operate, Transfer), BT (Build, Transfer), and BTO (Build, Transfer, Operate) models.

In this case study, we consider such projects that have created a new face for HCMC. They include the:

- Transferring of land for the infrastructure project of the Phu My Hung new residential area (Nguyen Van Linh Road);
- Binh Trieu II BOT road and bridge project;
- An Suong - An Lac BOT road project;
- Nguyen Tri Phuong BT road and bridge project; and
- Hung Vuong BTO extended road and Dien Bien Phu road project.

Total investment capital of these projects is about VND3.5 trillion ($236 million), equivalent to 34 percent of the city's expenditure for transportation infrastructure investment and 14 percent of total transportation investment in HCMC in the 2000-2004 period.

1. Transferring of land for the Phu My Hung new residential infrastructure project

In the early 1990s, beyond the Te canal (Districts 4, 7, and 8) was considered the slums of HCMC; a little further was deserted. Everything has changed today thanks to the development of the Phu My Hung residential area and Nguyen Van Linh road. This result is due to successfully implementing the land transfer for infrastructure policy of HCMC. After only ten years, the Phu My Hung joint venture has built a 750 ha modern residential area, especially a very modern 17.8 km road, whose second stage is completed and third stage is nearly finished. Total investment in this road is about $75 million.

This measure has helped HCMC to achieve three goals: (1) contribute to the success of its inner city depopulation program; (2) develop transportation infrastructure; and (3) raise trillions to augment the city budget.

An interesting point of this project is that because of detailed planning and good implementation, the project timetable and investment capital are almost the same as the projected schedule and budget. In return for granting the residential development rights of 600 ha, the city received a 30 percent share in a joint venture foreign invested enterprise valued at $600 million, and was able to mobilize resources to construct a major access road to a relatively poor and remote area. This, in turn, has provided the basic infrastructure that has enabled the rapid development of Phu My Hung.

Some consider these results relatively modest compared to planned targets, as an additional 2,000 ha adjacent to the new road are now being developed without the city's equity participation, and thus, share of asset appreciation and profits. The challenge now of HCMC is to capture some of the gains of private sector development for the city budget through an equitable, efficient, and sustainable system of urban taxes and charges.

2. Binh Trieu II BOT road and bridge project

After 30 years of liberation, there have been many ideas and projects to build bridges over the Sai Gon River, but only one bridge has been constructed to date, namely the Binh Trieu II Bridge.

In 1996-97, a difficult period for finding capital for investment projects in general and infrastructure transportation projects in specific, the Civil Engineering Construction Corporation No.5 (CIENCO5), a state-owned enterprise (SOE) locating in Da Nang City about 1,000 km from HCMC, was chosen to implement the Binh Trieu II road and bridge project in the BOT mode. Another interesting point about this project is the bank that lent money for this project was not in HCMC, but was instead in a central province (Binh Dinh) about 700 km to the north of HCMC.

There were some difficulties in the implementation process. The plan was for work to begin in 1996 and finish in 2001. But the project's launch was delayed until February 3, 2001, pushing the "completion" to the middle of 2004 - while the bridge is constructed, the planned budget of VND 342 billion (about $22.8 million) is exhausted while much remains to be done, such as land assembly and road construction on approaches to the bridge. According to current estimates, total investment capital of the adjusted project is VND 2 trillion ($132.3 million), 5.8 times higher than the original plan. The HCMC People's Committee has submitted a request to the Government to change the investment mode from BOT to financing by HCMC expenditure, with cost recovery by toll collections, so that the full project can be completed.

The results of this project are disappointing when compared to planned targets. Perhaps the implementation difficulties encountered were unanticipated, planned capital was insufficient to implement the project, and the contractor's capacity was not ensured, all which necessitated project changes. Although this project has several shortcomings, the city now has a new bridge over the Saigon River, which contributes to reducing traffic jams in the northeast gateway to the city. In addition, unsuccessful implementation of this project is a good experience that should assist the city in choosing the appropriate investment mode and partners for carrying out future infrastructure projects.

3. An Suong - An Lac BOT

In contrast to the Binh Trieu II project managed by HCMC, the An Suong - An Lac (East-West) BOT project was managed by the Ministry of Transportation (My Thuan Project Management Unit - PMU My Thuan). The investment plan for this project is part of the Ministry of Transportation's national transportation system master plan.

The project was supposed to start in April 2001 and be completed in March 2003, but only 30 percent of the project was finished by its target ending date, according to PMU My Thuan. In a report sent to the Ministry of Transportation, reasons given for the delay were change of project scale, increase of land clearance expenditures, and most importantly, slower provision of the contractor's capital contribution than their commitment. In December 2004, the project was completed and began formal operations. Planned total investment was VND 323 billion ($20.8 million), but the final cost was almost triple the estimate at VND832 billion ($55.5 million). Due to this project, vehicles can now move between Southeast and Southwest HCMC without passing through inner city, helping to reduce both traffic congestion and pollution.

4. Nguyen Tri Phuong BT project

In the early 1990s, transportation from the inner city to the southern suburban districts such as District 8, Binh Chanh, and Nha Be was very bad. In this area, there were only two bridges (Nhi Thien Duong and Y Bridge) over the Te Canal. These bridges were low grade and frequently overloaded. Building the Nguyen Tri Phuong road and bridge was very necessary. Many solutions for mobilizing capital were submitted (even including borrowing from abroad), but all of them failed. In 1997-1999, HCMC agreed to have the 12 Bridge Company, a subsidiary of Thang Long Construction Corporation (an SOE under the Ministry of Transportation), do a project using the Build and Transfer mode.

Like other key projects, implementation was slower than scheduled. With VND123 billion ($8.2 million) in investment capital, the project was launched on May 19, 2000, with a scheduled completion date of May 19, 2002. But the project was finished on September 01, 2004 at a cost of VND213 billion ($14.2 million) investment capital, nearly double the estimated cost.

Nguyen Tri Phuong has greatly improved the flow of traffic from downtown HCMC to the southern suburbs using a mechanism that allowed road and bridge construction despite the city's acute shortage of transportation infrastructure investment capital.

5. Hung Vuong extension and Dien Bien Phu road BTO projects

Investment capital for one of HCMC's key transportation projects, the Hung Vuong road extension and Dien Bien Phu road project, was first raised from the state budget via two HCMC SOEs. Total Hung Vuong investment was VND310 billion, and Dien Bien Phu investment was VND353 billion. However, after finishing construction, HCMC's budget had difficulty paying for these projects. HCMC committee then decided to transfer toll collection rights to a joint stock company for VND1 trillion ($67 million). This is one variation of a BTO project. After transferring these projects, HCMC's budget got some money to cover this project as well as other investments.

Implementing the above-summarized projects has created a new face for HCMC. At the same time, HCMC has gained some valuable experience in undertaking such projects, especially in planning and budgeting, because all projects were behind schedule and over budget except the Nguyen Van Linh road project.

Table II - 12: Summary of Infrastructure Investment Projects in HCMC

No	Project	Year Planning Began	Launch Date		Completion Date		Total Investment (Mil $)		
			Planned	Actual	Planned	Actual	Planned	Actual	Actual/ Planned
1	Phu My Hung	1993	Dec-96	Dec-96	2007	2007	75.0	75.0	1.00
2	BOT Binh Trieu II	1996	1999	Feb-01	2001	2004	22.8	132.3	5.80
3	BOT An Suong - An Lac			Apr-01	Mar-03	Dec-04	20.8	55.5	2.67
4	BT Nguyen Tri Phuong	1990		May-00	May-02	Sep-04	8.2	14.2	1.73
5	BTO Hung Vuong & Đien Bien Phu								

Sources: HCMC Tax Department, HCMC Finance Department, HCMC Statistics Department

Chapter Three: Municipal Finance in Shanghai

I. Introduction

Bordering Jiangsu Province on the west, Shanghai is washed by the East China Sea on the east and Hangzhou bay on the south. North of the city, the Yangtze River pours into the East China Sea. Shanghai also assumes a central location along China's east coast. Owing to its advantageous geographic location and easy accesses to a vast hinterland, Shanghai has now become an excellent sea and river port.

Shanghai is China's center of economy, finance, trade and navigation. The structure of Shanghai's Regional Gross Domestic Product (GDP) in 2003 and 2004 is as follows:

Table III - 1: The Structure of Shanghai's Regional Gross Domestic Product

RMB billions

Components of Regional Gross Domestic Product	2003	2004
Total Regional Gross Domestic Product	**625.1**	**745.0**
By Stage of Industry		
Primary Industry	9.3	9.7
Secondary Industry	313.1	378.8
Tertiary Industry	302.7	356.5
By Sector/Subsector		
Industry	286.6	349.3
Construction	26.5	29.5
Transportation, Warehousing, and Post	30.7	36.2
Transportation	27.3	32.5
Warehousing	1.8	1.9
Information Transmission, Computer Service, and Software Industries	22.8	26.1
Retail and Wholesale Industries	57.0	60.9
Hoteling and Eateries	13.9	17.8
Financial Industry	62.5	74.2
Real Estate Industry	46.4	62.3
Leasehold and Business Services	8.3	
Scientific Research, Technology Service, and Geological Prospecting	7.4	
Water Conservancy, Environment, and Public Facility Management Industries	5.1	
Community Service and Other Service Industries	6.2	7.2
Education	16.1	19.1
Health, Social Security, and Welfare Industries	9.3	10.1
Culture, Sports, and Entertainment	7.2	8.2
Public Administration and Social Organizations	9.8	

Source: Shanghai Statistical Year Book (2005)

Shanghai's 2005 targets for the 10th Five-Year Plan are to:

- maintain an average yearly GDP growth rate of between 9 and 11 percent, with the city's GDP reaching RMB 730 billion (in year 2000 prices) and average per capita GDP exceeding RMB 54,000 (about $6,750);
- readjust the ratio among tertiary, secondary and primary industries to 55:44:1;

- boost the city's foreign trade to $85 billion, including exports of $40 billion;
- lift the city's retail sales to RMB 250 billion, representing an average annual growth of 7.8 percent;
- handle 10 million TEU containers, representing an average annual increase of 9 to 13 percent;
- increase the percentage of the spending on R&D to between 2.2 and 2.5 percent of the city's GDP;
- increase internet coverage of business and the general population to 50 percent; and
- ensure that the average annual per capita disposable income of urban and rural residents reaches RMB 15,000 and RMB 7,100, respectively;

Shanghai is divided into 19 districts, comprising 9 inner city district governments and 10 suburban district governments. The administrative structure in Shanghai is called "two levels of government, three levels of administration": the two levels are municipal government and district government, while the three levels are the prior two levels plus the township in the suburbs and urban sub-district offices in the inner city.

This third level is not formally part of the government, but serves as a de facto extension of government agencies because it bears government responsibilities. The village committee and neighborhood committee are autonomous organizations of the public, but they maintain close relations with the government and operate under the administrative supervision of the government.

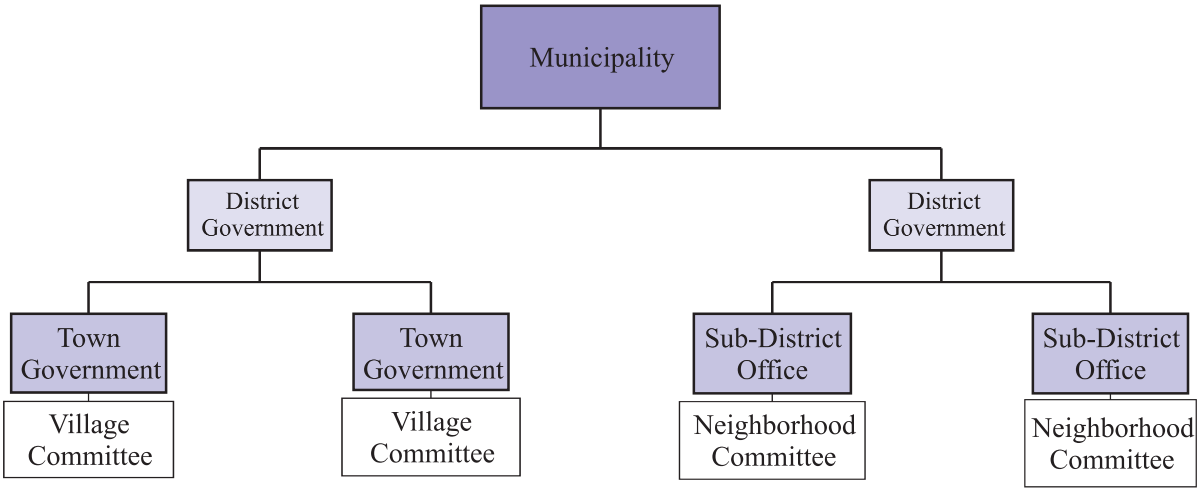
Key data for Shanghai's districts are presented in the following table, and Shanghai's administrative structure is presented in the following figure:

Table III - 2: Snapshot of Shanghai's Districts

District	Area (square kms)	Suburban Townships	Urban Sub-District Offices	Neighborhood Committees	Village Committees
Total	**5,528.3**	**114**	**103**	**3,365**	**1,920**
Pudong New Area	522.9	13	11	550	265
Huangpu	12.4		9	135	
Luwan	8.1		4	74	
Xuhui	54.8	1	12	344	14
Changning	38.3	1	9	176	6
Jing'an	7.6		5	85	
Putuo	54.8	3	6	206	8
Zhabei	29.3	1	8	207	1
Hongkou	23.5	1	9	268	
Yangpu	60.7	1	11	302	
Baoshan	415.3	9	5	233	165
Minhang	371.7	9	3	289	166
Jiading	458.8	8	3	89	169
Jinshan	586.1	14	1	60	139
Songjiang	604.7	10	4	109	118
Qingpu	675.5	8	3	57	184
Nanhui	687.7	14		64	185
Fengxian	687.4	8		65	276
Chongming	1041.2	13		52	224

Sources: Shanghai Statistical Yearbook (2005); www. Shanghaigov.cn

Figure III - 1: The Administration Structure of Shanghai



II. Historical Context of Current Resource Generation and Allocation in Shanghai

In 1994, China instituted a comprehensive fiscal reform, commonly referred to as the Tax Sharing System (TSS), or *fenshuizhi.*[11] The objectives of the 1994 fiscal reform were to:

- reverse a steady decline in central government revenue, with the slogan "raising the two ratios" (revenue to GDP and central government share of total revenue);
- improve the economic efficiency and transparency of the tax system, targeting both specific distortions and general opaqueness of the existing tax system; and
- restructure intergovernmental revenue sharing protocols, providing local governments with a greater incentive to collect central government revenue and mobilize own source revenue.

Thus, under TSS:

- The tax structure was rationalized and simplified. Special attention was paid to indirect taxes, and the value-added tax (VAT) was extended to all turnover, thereby eliminating many product and business taxes. Many aspects of the income tax were also consolidated and unified.
- All taxes were designated as assigned to either the central government ("central fixed income") or local government ("local fixed income"), or shared between central and local government.
- The central government introduced two measures to facilitate the transition to this new system. The first was the "hold harmless" principle, whereby the central government agreed to rebate to each province an amount equal to the reduction in its local tax base caused by TSS. The second was a commitment to give back annually 30 percent of its increased VAT and consumption tax (CT) revenue to enable provinces to share in the growth of their reassigned ("lost") tax base.
- Tax administration was reformed. Existing tax bureaus were split into a national tax system and a local tax system: the national tax offices were responsible for the direct collection of central government revenue (mostly VAT and CT), and the local tax offices were to collect local government revenue.[12]

[11] For a summary of public finance in China under the "Maoist" centrally-planned economy, as well as a description of pre-reform transitional initiatives from 1979 to 1993, please see: Christine P.W. Wong, "Central-Local Relations Revisited," China Perspectives, no. 31 (September-October 2000), pp. 52-63.

[12] For a comprehensive examination of the 1994 TSS reform and its impact on public finance in China, please see: Poverty Reduction and Economic Management Unit, East Asia and Pacific Region, World Bank, China National Development and Sub-National Finance: A Review of Provincial Expenditures, Report No. 22951-CHA (Washington, D.C.: World Bank, April 9, 2002); and Le-Yi Zhang, "Chinese Central-Provincial Fiscal Relationships, Budgetary Decline and the Impact of the 1994 Fiscal Reform: An Evaluation," The China Quarterly, no. 157 (March 1999), pp. 115-141.

The following table provides an overview of Shanghai's revenue growth from 2000 to 2003, as well as its share of total revenue in China:

Table III - 3: Shanghai Revenue in National Context

RMB billions

No	Items	2000	2001	2002	2003	Total
	Revenue in China	1,340	1,459	1,906	2,131	6,835
	Revenue in Shanghai (nominal)	191	234	249	331	1,005
1	**Revenue in Shanghai (constant)**	**191**	**231**	**248**	**321**	**991**
2	Local budget	66	89	101	134	390
3	**Revenue growth**		**20.9%**	**7.4%**	**29.6%**	**18.9%**
4	**Local budget growth**		**33.9%**	**13.7%**	**32.8%**	**26.5%**
5	**Revenue in Shanghai / National budget**	**14.3%**	**16.0%**	**13.1%**	**15.5%**	**14.7%**
6	Local budget / National budget	5.0%	6.1%	5.3%	6.3%	5.7%
7	**Local budget / Revenue in Shanghai**	**34.7%**	**38.0%**	**40.5%**	**40.6%**	**38.8%**

Sources: Shanghai Statistical Yearbook (2005) and China Statistical Yearbook (2005).

Shanghai revenue has grown at a real average annual rate of 18.9 percent from 2000 to 2003, while the local budget has grown at a real average annual rate of 26.5 percent during the same period. Shanghai also made a substantial net contribution to the national budget from 2000 to 2003, as demonstrated by two key indicators: the ratio of total revenue collected in Shanghai to the national budget has been almost triple the ratio of Shanghai's budget to the national budget from 2000 to 2003, at 14.7 percent versus 5.7 percent; and the size of the local budget compared with revenue generated in Shanghai has averaged 38.8 percent since 2000.

III. Current Composition of Shanghai On-Budget Revenue and Expenditure

A. Overview of Revenue

For the purpose of comparative international analysis, Shanghai on-budget revenue can be divided into three main sources:

- local regular revenue;
- local special revenue; and
- tax sharing/revenue sharing.

As in the case of HCMC, the first two of these sources would normally be considered "own source revenue," the former sustainable and the latter incidental. However, in Shanghai, there is no on-budget local special revenue as defined in this study - principal sources of incidental revenue are off-budget in Shanghai (see Section IV).

An overview of Shanghai's revenue composition is summarized in the following table and Shanghai's overall revenue structure is depicted in the following figure: [13]

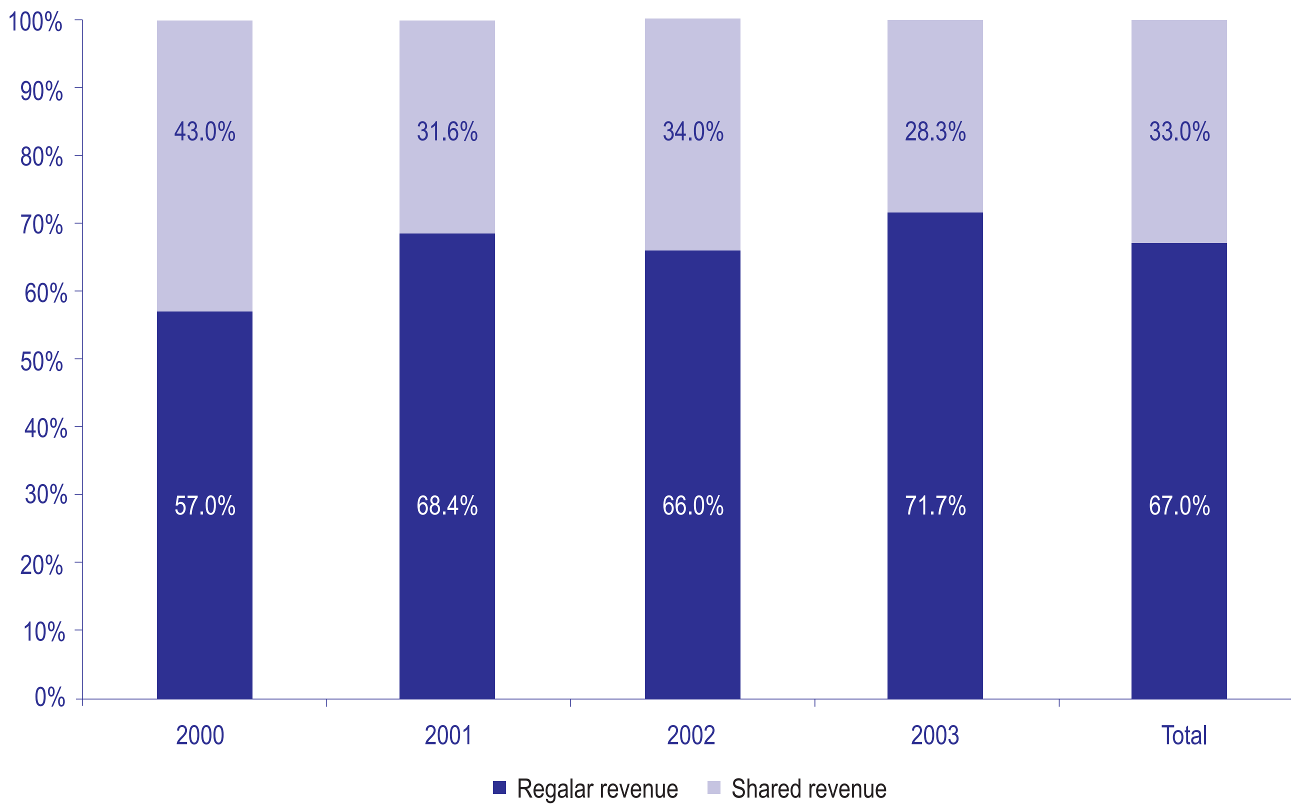
[13] Shanghai groups all tax revenue, whether from local or national taxes, into a category designated as "local fiscal revenue"; this is equivalent to the tax part of the "regular revenue" and all of the "tax sharing revenue" categories used in this paper.

Table III - 4: Consolidated Summary of Shanghai Revenue

RMB billions

No	Items	2000	2001	2002	2003	Total
	Total city budget (nominal)	***66.3***	***89.8***	***101.6***	***137.9***	***395.6***
I	**Total city budget (constant)**	**66.3**	**88.8**	**101.0**	**134.1**	**390.2**
1	Regular revenue	37.8	60.7	66.6	96.1	261.3
2	Special revenue	0	0	0	0	0
3	Shared revenue	28.5	28.0	34.3	38.0	128.8
II	**Structure of revenues**	**100%**	**100%**	**100%**	**100%**	**100%**
1	Regular revenue	57.0%	68.4%	66.0%	71.7%	67.0%
2	Special revenue	0	0	0	0	0
3	Shared revenue	43.0%	31.6%	34.0%	28.3%	33.0%

Figure III - 2: Composition of Shanghai Revenue



Source: Finance Service Office of Shanghai Municipality

From 2000 to 2003, local regular revenue has risen from just over half to almost three-fourths of total revenue, while shared revenue has fallen from 43 percent to 28 percent of total revenue. These trends are consistent with Shanghai's strategy to increase its fiscal self-reliance.

B. Local Regular Revenue

The composition of Shanghai local regular revenue is shown in the following table:

Table III - 5: Shanghai Local Regular Revenue

RMB billions

No	Items	2000	2001	2002	2003	Total
	Total (nominal)	***37.8***	***61.4***	***67.0***	***98.9***	***265.2***
I	**Total revenue (constant)**	**37.8**	**60.7**	**66.6**	**96.1**	**261.3**
1	Revenue from Local Enterprises	3.0	2.9	6.7	7.2	19.8
2	Business Tax	15.4	18.9	25.0	32.3	91.6
3	Fees and Charges	3.9	5.5	8.6	12.2	30.2
4	Locally Raised Revenue	1.2	1.1	1.1	1.3	4.7
5	City Maintenance Tax	2.2	2.4	3.0	3.5	11.1
6	Real Estate Tax	1.3	1.4	2.0	2.2	6.9
7	Other Taxes	2.4	3.9	7.2	11.5	25.0
	Non-Borrowing Subtotal	***29.4***	***36.1***	***53.6***	***70.1***	***189.3***
8	Debt Financing	8.4	24.6	13.0	26.0	72.0
II	**Structure of revenue**	**100%**	**100%**	**100%**	**100%**	**100%**
1	Revenue from Local Enterprises	7.9%	4.8%	10.1%	7.5%	7.6%
2	Business Tax	40.7%	31.1%	37.5%	33.6%	35.1%
3	Fees and Charges	10.3%	9.1%	12.9%	12.7%	11.6%
4	Locally Raised Revenue	3.2%	1.8%	1.7%	1.4%	1.8%
5	City Maintenance Tax	5.8%	4.0%	4.5%	3.6%	4.2%
6	Real Estate Tax	3.4%	2.3%	3.0%	2.3%	2.6%
7	Other Taxes	6.3%	6.4%	10.8%	12.0%	9.6%
	Non-Borrowing Subtotal	**77.8%**	**59.5%**	**80.5%**	**72.9%**	**72.4%**
8	Debt Financing	22.2%	40.5%	19.5%	27.1%	27.6%

Source: Finance Service Office of Shanghai Municipality

While all non-borrowing sources of local regular revenue have risen steadily from 2000 to 2003, their share of total local regular revenue has been relatively unstable, swinging between 59.5 to 80.5 percent.

<u>Non-Borrowing Local Regular Revenue</u>

Within the component of non-borrowing local regular revenue, almost half of all income since 2000 has come from a local business tax on the transaction value of services, real estate, and intangible assets such as land use rights. The tax rates are: 3 percent for transportation, construction, and postal services; 5 percent for financial services, transfer of intangible assets, and sale of real estate; and 20 percent for the entertainment industry. Most revenue has come from the real estate, financial services, and construction sectors.

Income from user fees and charges has risen steadily over the same period, growing from 13.2 percent to 17.4 percent of all non-borrowing local regular revenue. The "fees and charges" category includes: 191 administrative fees; penalties and confiscated revenue for tax evasion; and special revenue from pollution fees, the water resource fee (1 yuan per ton), and an additional education fee (similar to the maintenance tax described below). A unique characteristic of Shanghai's municipal budget is the relatively large number of vehicle- related fees that are charged to finance the maintenance of roads and bridges (see "Shanghai Case Studies" in Section V).

Those organizations and individuals who pay the local business tax and the national consumption and VAT taxes must also pay the city maintenance tax. This is a surtax on the three taxes mentioned above; the tax base is the amount of the three taxes paid, and tax rate is 7.0 percent. The city maintenance tax contributed 5.9 percent of local regular revenue from 2000 to 2003.

Shanghai's real estate tax is similar to a property tax. The tax base is either the property's rental value or 80 percent of its capital value; the tax rate is 12 percent of rental value (the transaction contract price) or 1.2 percent of assessed capital value (80 percent of the market price). Currently, this tax is not well enforced, so most homeowners do not pay this tax: its share of regular local revenue was just 4.5 percent in 2000, and steadily declined to only 3.1 percent in 2003. [14]

Another 10.4 percent of non-borrowing local regular revenue has come from local government enterprises from 2000 to 2003. The remaining 15.7 percent has come from miscellaneous other local taxes and revenues.

Local Regular Revenue from Borrowing

Shanghai's local regular revenue generated by taxes, user charges, and administrative fees has been supplemented by debt financing.

The composition of debt financing is summarized in the following table:

Table III - 6: Shanghai Debt Financing

RMB billions

No	Items	2000	2001	2002	2003	Total
	Total (nominal)	***8.4***	***24.9***	***13.1***	***26.7***	***73.1***
I	**Total revenue (constant)**	**8.4**	**24.6**	**13.0**	**26.0**	**72.0**
1	Domestic Bank Loans	10.1	10.2	8.1	10.7	39.2
2	Bonds	0.5	(0.3)	0.8	Na	1.0
3	Foreign Debt	(0.8)	4.0	1.2	(0.4)	4.0
4	Domestic Funds	(1.4)	10.7	2.9	15.7	27.9
II	**Structure of revenue**	**100%**	**100%**	**100%**	**100%**	**100%**
1	Domestic Bank Loans	120.1%	41.5%	62.4%	41.3%	54.4%
2	Bonds	5.6%	-1.3%	6.1%	Na	1.3%
3	Foreign Debt	-9.7%	16.3%	9.3%	-1.7%	5.5%
4	Domestic Funds	-16.1%	43.5%	22.2%	60.4%	38.8%

Source: Finance Service Office of Shanghai Municipality

Slightly more than half of this borrowing (54.4 percent) has come from domestic bank loans, with Shanghai borrowing about RMB 10 billion per year from 2000 to 2003.

Most of the remaining debt, 38.8 percent of borrowing, has come from domestic funds; it appears that this refers to "self-financing" via the Shanghai Urban Development Investment Company, or UDIC (see "Shanghai Case Studies" in Section V).

The balance of Shanghai's debt financing has come from foreign borrowing and domestic bonds, contributing 5.5 percent and 1.3 percent, respectively, to Shanghai's total local revenue from borrowing during the 2000 to 2003 period.

[13] There are two other significant but poorly implemented property-related taxes: a tax on the value added of land, which is 35 percent of the value added when transferring land or buildings on the land; and a contract tax, which is 3 to 5 percent of the value of the land or building transaction.

C. Tax Sharing Revenue

The third major component of Shanghai's on-budget revenue is shared revenue with the central government from national taxes.

The composition of shared tax revenue is summarized in the following table:

Table III - 7: Shanghai Tax Sharing Revenue

RMB billions

No	Items	2000	2001	2002	2003	Total
	Total (nominal)	***28.5***	***28.4***	***34.5***	***39.1***	***130.5***
I	**Total revenue (constant)**	**28.5**	**28.1**	**34.3**	**38.0**	**128.9**
1	Value Added Tax	9.4	11.1	13.6	16.5	50.6
2	Enterprise Income Tax	10.3	11.3	13.9	14.2	49.7
3	Stock Exchange Stamp Tax	2.8	1.0	0.2	0.2	4.2
4	Personal Income Tax	6.0	4.7	6.7	7.0	24.4
II	**Structure of revenue**	**100%**	**100%**	**100%**	**100%**	**100%**
1	Value Added Tax	32.8%	39.4%	39.6%	43.6%	39.2%
2	Enterprise Income Tax	36.2%	40.3%	40.4%	37.4%	38.5%
3	Stock Exchange Stamp Tax	9.8%	3.5%	0.6%	0.6%	3.3%
4	Personal Income Tax	21.1%	16.8%	19.4%	18.4%	18.9%
III	**Total shared taxes**					
	Total Shared Tax Collected	159.1	178.0	193.5	242.4	772.9
	Shanghai Share	17.9%	15.8%	17.7%	15.7%	16.7%

Source: Finance Service Office of Shanghai Municipality

The two most important shared taxes are the VAT[15] and the enterprise income tax [16], each contributing just under 40 percent of total tax sharing revenue from 2000 to 2003. The share of revenue from the enterprise income tax has been relatively stable, while the VAT share has increased from 32.8 percent to 43.6 percent. However, revenue generated from Shanghai's share of the VAT is still about half of the revenue generated by its local business tax.

[15] The VAT is applied to all goods sold in China, including imported goods, and the services related to those goods. The standard tax rate is 13 percent, except for items regulated by the central government, which are taxed at 17 percent; some items are also zero tax rated. VAT revenue is shared as follows: 75 percent for the central government and 25 percent for local government.

[16] The enterprise income tax is assessed on the income of companies located in China. The tax is divided into two categories: the domestic company income tax and the foreign company income tax. Domestic companies are subject to tax rates of 33, 27, or 18 percent, while foreign companies are subject to a tax rate of 30 or 20 percent. However, often local governments offer foreign companies more preferential tax policies, such as "two years' waiver and three years' half "; on average, foreign companies in China pay half the tax rate that domestic enterprises pay. Prior to 2002, the central government and local government shared the enterprise income tax equally; beginning in 2002, the central government's share rose to 60 percent and local government's share fell to 40 percent.

The other significant contributor to shared tax revenue is the personal income tax,[17] whose share was 18.9 percent from 2000 to 2003. Although revenue from the stock exchange stamp tax[18] contributed 9.8 percent of shared tax revenue in 2000, this share had dropped to 0.6 percent by 2003. Shanghai retained only 16.7 percent of all the shared tax revenue it generated from 2000 to 2003.

D. Transfers from the Central Government

There are provisions for two types of transfers from the central government to Shanghai: tax rebates and special transfers.

Tax rebates are designed to facilitate the transition to the TSS described in Section II above. They have two components: the first to replace the "lost" CT and VAT tax bases under the "hold harmless" principle, equal to the amount of these taxes returned to the Shanghai government in 1993, the last year under the old system; the second is to capture the "foregone" growth of these reassigned tax bases, equal to 30 percent of increased CT and VAT revenue that would have been returned to local government.[19] Although tax rebates are purported to comprise as much as one-third of total tax revenue in Shanghai, data for tax rebates were not available to confirm this belief.

Special transfers are for national disasters, poverty reduction, and some educational, environmental, and health programs. Once again, data were not available to quantify the magnitude of special transfers to Shanghai from 2000 to 2003.

E. On-Budget Expenditure

Roughly one-third of all Shanghai reported on-budget expenditure from 2000 to 2003 was for investment in local government enterprises, either as "Capital Construction" (building new plants and factories, as well as buying new equipment and machinery) or "Technical Upgrades" (transformation and modernization). One-fourth of expenditure was in social sectors, although it is unclear whether these were expenses to finance routine government operations or project-specific investments. It is also unlikely that only 3 to 4 percent of all Shanghai expenditure went to the overhead of government from 2000 to 2003.

Another 36.7 percent of total reported on-budget expenditure is not disaggregated in any public documents, so is categorized as "Other" in this study, while 16 percent of reported on-budget revenue from 2000 to 2003 is not accounted for at all in any public documents that present on-budget expenditure.

These trends in Shanghai's on-budget expenditure are summarized in the following table:

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[17] The personal income tax is assessed on income of RMB 800 per month or more, starting at a 5 percent tax rate and rising to the highest marginal tax rate of 45 percent. The RMB 800 tax threshold was set in 1980, and has not been adjusted since. However, in the past 25 years, median income has risen to RMB 3,650 per month and the mandatory lowest wage is RMB 790 RMB per month in Shanghai, so an adjustment is long overdue; the government is planning to raise the tax threshold to RMB 1,600 per month in 2006. Tax revenue is shared as follows: 60 percent for the central government and 40 percent for local government.

[18] The stock exchange stamp tax is applied at a rate of 0.2 percent for "A" stocks and 0.3 percent for "B" stocks. Prior to 1998, the central government and local government shared this tax equally; beginning in 1998, the central government's share rose to 88 percent and local government's share fell to 12 percent.

[19] For example, if in 1993, Shanghai gave RMB 1.0 million to the central government and the central government returned RMB 0.5 million to the local government, and in 1994, Shanghai gave RMB 1.1 million to the central government, an increase of 10 percent, then the tax returned to Shanghai in 1994 should increase by .10*.30=.03, that is 0.5+0.5*(1.1-1)/1*0.3 = RMB 0.515million.

Table III - 8: Shanghai On-Budget Expenditures

RMB billions

No	Items	2000	2001	2002	2003	Total
	Total expenditure (nominal)	***62.3***	***72.6***	***87.8***	***110.3***	***333.0***
	Revenue - Expenditure	4.0	17.2	13.8	27.6	62.6
I	**Total expenditure (constant)**	**62.4**	**71.8**	**87.3**	**107.3**	**328.5**
1	Capital Construction	13.2	14.3	18.3	21.9	67.7
2	Technical Upgrades	7.8	10.0	12.1	15.2	45.0
3	Science and Technology	0.1	0.1	0.2	0.2	0.6
4	City Maintenance	3.6	4.0	4.7	5.4	17.7
5	Science, Education, Culture, and Health	13.6	15.4	17.0	19.1	65.0
6	Administration	2.3	2.7	3.6	3.4	11.9
7	Other	21.8	25.3	31.4	42.1	120.6
II	**Structure of Expenditure**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**
1	Capital Construction	21.3%	19.9%	21.0%	20.4%	20.6%
2	Technical Upgrades	12.5%	13.9%	13.8%	14.2%	13.7%
3	Science and Technology	0.2%	0.2%	0.2%	0.1%	0.2%
4	City Maintenance	5.7%	5.6%	5.4%	5.1%	5.4%
5	Science, Education, Culture, and Health	21.8%	21.5%	19.4%	17.8%	19.8%
6	Administration	3.6%	3.8%	4.1%	3.1%	3.6%
7	Other	35.0%	35.2%	36.0%	39.3%	36.7%

Source: Finance Service Office of Shanghai Municipality

IV. Shanghai Off-Budget Revenue and Expenditure

A. The Need for Off-Budget Financing

Shanghai's rapid growth over the past three decades has required a dramatic increase in municipal infrastructure and services that conventional revenue sources have not been able to finance. Shanghai's on-budget revenue has been sufficient to pay for routine operational expenditures, special projects, and small-scale investments. However, on-budget revenue has been generated in relatively small, constant, annual increments, and thus, has not been adequate to meet the needs of large-scale, lumpy, long-term investments. Shanghai has therefore resorted to a number of off-budget financing mechanisms to meet these investment needs, as summarized below.

B. Loans from International Financial Institutions

Shanghai's predominant form of off-budget financing from the mid-1980s to the early 1990s was borrowing from international financial institutions (IFIs). These loans helped to cover approximately RMB 1.9 billion per year of infrastructure investments. For example, during this period the municipal budget financed the Shanghai inner circle elevated highway, while $3.2 billion in loans from the Asian Development Bank financed the NanPu and YangPu bridges.

However, rather than borrow money directly from IFIs, Shanghai established more than ten local government infrastructure investment companies, with each company being responsible for a particular sector. For example, the Shanghai Urban Development Company (see "Shanghai Case Studies" below) has been responsible for the financing and construction of bridges, roads and tunnels, and Shanghai JiuShi is mainly responsible for the construction of the subway system.

C. Land Leases and Land Swaps

IFI loans were not sufficient to meet Shanghai's investment needs, so the government began to raise funds using long-term land leases. This financing tool was used primarily in downtown Shanghai: 70-year land leases with foreign investors generated approximately RMB 100 billion from the mid-1990s to 2000. The revenue from land leasing and land swaps is estimated to comprise between 20 to 30 percent of local fiscal revenue. Part of the proceeds from land leases was used for the construction of new infrastructure, but most of the revenue was used for the rebuilding of Shanghai's inner city: from 1990 to 2000, roughly 33 million square meters of slum housing was torn down and about 650,000 households were removed from the inner city.

D. Concessions

Beginning in the mid-1990s, Shanghai raised capital via the granting of regulated concessions. For example, in 1994, the operation rights of the NanPu and YangPu bridges were sold to a private company, CITIC Pacific Ltd, for 20 years. However, CITIC Pacific Ltd did not receive revenue from the tariff directly, which was RMB 15 per vehicle from the PuXi area to the PuDong area. Instead, it received a 14 to 15 percent fixed return on assets, dominated in U.S. dollars. As the deposit interest rate was 12 percent, this fixed return was quite reasonable, and the annual revenue of RMB 800 million from the tolls was able to generate enough cash flow to pay this fixed return. In exchange, Shanghai received RMB 2.4 billion. These funds were used to build a third bridge over the HuangPu river, the XuPu bridge; the operation rights of the XuPu Bridge were then sold to CITIC using the same model. Shanghai also sold the operation rights of the North-South elevated highway, the inner city elevated highway, and the YanAn East Road elevated highway for RMB 5.6 billion.

Although the government was able to use this model to pay for many new infrastructure investments, it no longer worked when the bridge toll was eliminated to encourage more investors to PuDong area, and the central government placed restrictions on the use of foreign currency to pay a fixed return to foreign investors. So Shanghai renegotiated the concession contracts with private investors to enable the government to repurchase bridge rights ahead of schedule and to provide compensation to the private investors, for example, equal to the revenue generated by one year of tolls.

E. Capital Markets

Another important means of mobilizing investment capital was via the stock and bond capital markets. The basic model was to list qualified infrastructure development companies on the stock market, and then use the funds raised by these companies for new infrastructure development. For example, the RMB 34.8 billion raised by the RMBShui and Lingqiao Companies was used to upgrade Shanghai's and water treatment plants and water distribution system, and the RMB 1.3 billion raised by Zhangjian Hi-Tech was used to build industrial parks. Debt financing was another important way to raise investment capital. For example, the Shanghai JiuShi Company issued RMB 4 billion in bonds to finance two elevated railway projects.

F. Public Private Partnerships

Public Private Partnerships (PPP) is a fifth model used by Shanghai to generate investment capital. This financing mechanism was used primarily by local government investment companies with sufficient assets and capital. In the late 1990s, most infrastructure projects that could generate ample revenue and had strong positive externalities were built using the PPP model, such as the expressway from Shanghai to Jiangsu province and the subway in Shanghai.

Expressways were built by organizing joint ventures with those private investors who terminated their concession contracts on bridges ahead of schedule. Usually, there were three parties involved in these projects: private investors, government-owned investment companies, and district governments. Private investors and government-owned investment companies contributed a specified amount of cash, and district governments provided land as equity; revenue was split among these three shareholders.

Subway projects adopted the same joint venture model as the highway projects, but with an additional key revenue source, namely ticket receipts. This could cover operation and maintenance costs at current capacity. If the capacity of the subway is expanded by shortening the interval between trains from 5 minutes to 3 minutes, which is feasible as the full capacity of the subway is running trains at 2.5-minute intervals, ticket revenue could cover 20 percent of bank loan payments. However, the main source profits and debt repayment is the appreciation of real estate values around the subway stations.

While PPP is the most prevalent financing model in Shanghai today, the municipal government still uses the other financing mechanisms as appropriate. For example, Shanghai launched an environmental project using a World Bank loan in 2002.

V. Shanghai Case Studies

A. Shanghai Urban Development Investment Company (UDIC)

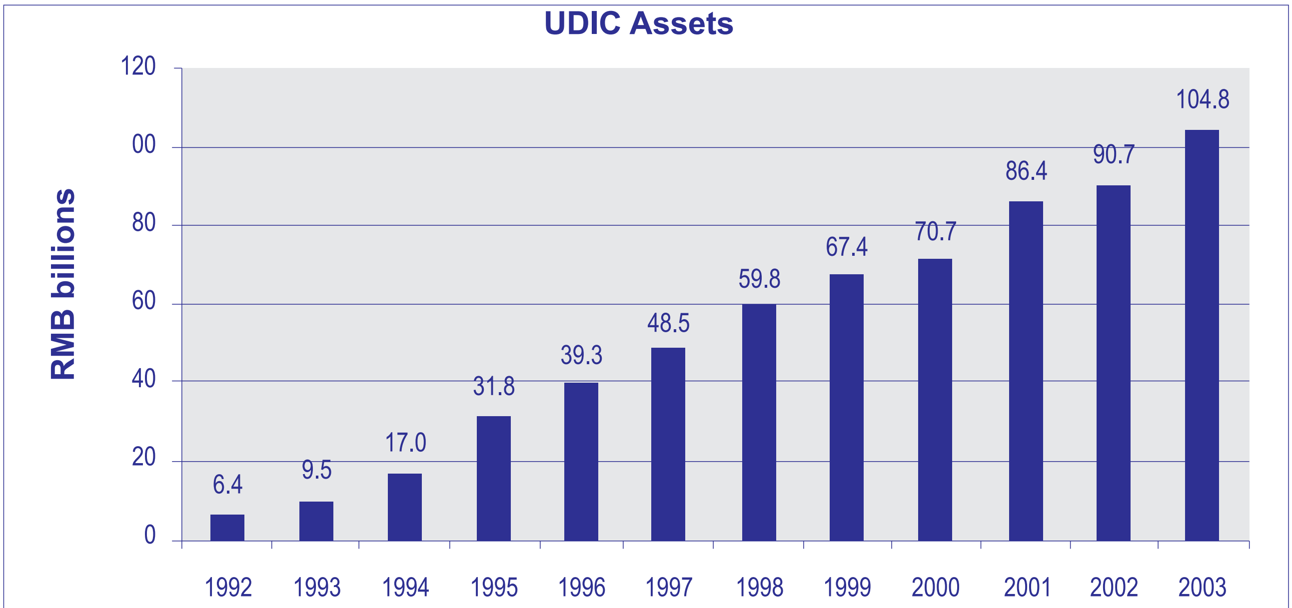
The Shanghai Urban Development Investment Company (UDIC) was established in July 1992. Its main function is financing and managing urban construction authorized by the Shanghai municipal government.

The Shanghai State-Owned Assets Committee assigned UDIC its initial assets; at present, UDIC assets total more than RMB 104 billion. During the past ten years, UDIC has successfully generated more than RMB 130 billion for the construction of Shanghai infrastructure.

The main sources of UDIC financing are: loans from commercial banks and IFIs such as the World Bank and the Asia Development Bank; funds raised from the capital markets by the listed subsidiary company; and the issuance of bonds.

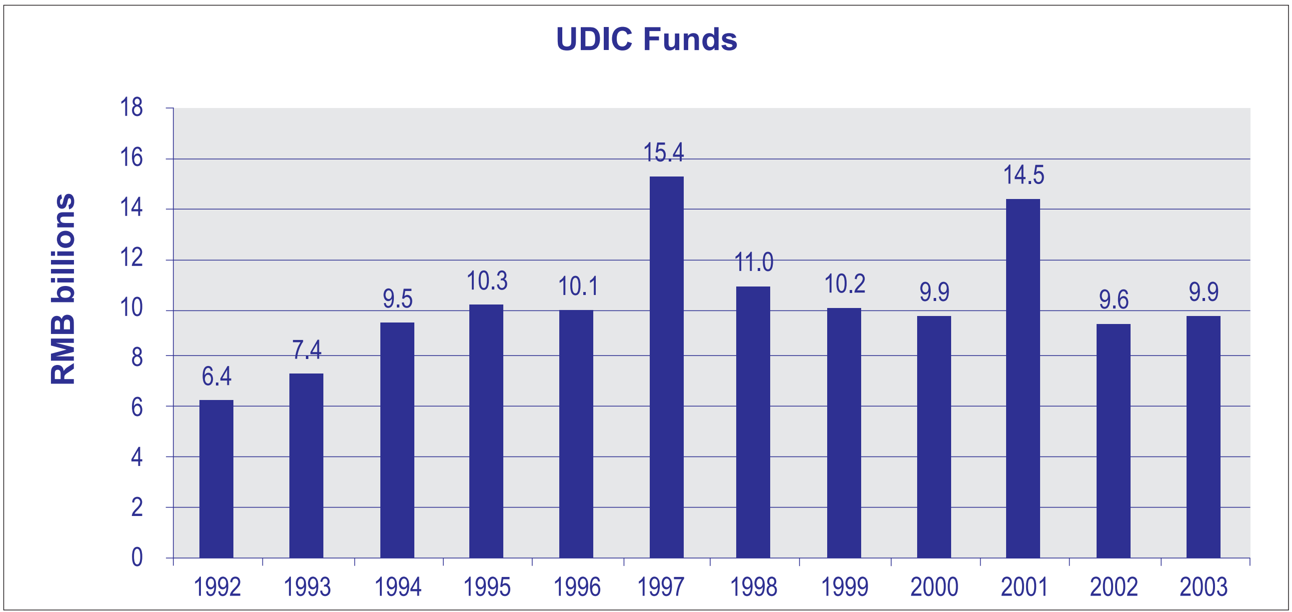
UDIC is involved in three main areas: bridges and roads, environmental instrastructure, and real estate. In the area of bridges and roads, UDIC's principal projects are: all of the elevated highways; the YangPu and XuPu bridges over the HuangPu River; the Yan'an Tunnel; and the Shanghai-Hangzhou highway. UDIC's main environmental infrastructure projects are: the Millennium Forest Park; the Wild Animal Zoo; the Around-the-City Green Belt; the World Bank District Financing Vehicle (DFV) Project; and the Suzhou Creek Project. UDIC's assets, sources of funds, and organizational structure are depicted in the following three figures:

Figure III - 3: Shanghai UDIC Assets



Source: Adapted from UDIC website

Figure III - 4: Shanghai UDIC Funds



Source: Adapted from UDIC website

Figure III - 5: Shanghai UDIC Organizational Structure

<table>
<tr><td colspan="6">Urban Development Investment Company</td></tr>
<tr><td rowspan="2">Administration Department</td><td colspan="3">Business Department</td><td colspan="2">Subsidiary Companies</td></tr>
<tr><td>Division of Roads and Bridges</td><td>Division of Environment</td><td>Division of Real Estate</td><td>Shanghai Water Assets Operation Co.</td><td>Shanghai Transportation Investment Co.</td></tr>
</table>

Source: Adapted from UDIC website

B. Vehicle-Related Fees and Charges

At the end of 2004, Shanghai had nearly two million automobiles. Given limited road and administrative capacity, this has created very serious traffic congestion in Shanghai. In an attempt to control the number of automobiles, the Shanghai municipal government has adopted a policy that all private automobile operators must bid for a license plate. This has greatly increased the cost of owning a car. From 2002 to 2004, the government has released an average of about 4,000 license plates per month; the bidding price for a license plate has increased from RMB 15,000 to RMB 40,000, and now equals about one-third of the typical price of a family car.

Some automobile owners in Shanghai have tried to evade this cost by registering their cars in neighboring cities such as SuZhou and HangZhou, which charge only several hundred RMB per license plate; there are now about 120,000 such automobiles in Shanghai. In response, the Shanghai municipal government prohibits vehicles with non-Shanghai license plates from using the elevated highway during rush hours (7:00 to 9:00 a.m. and 4:30 to 6:30 p.m.). In addition, these vehicles must pay an extra road usage fee of RMB 100 per month, or RMB 1,200 annually.

The following figure itemizes vehicle-related taxes, fees, and charges in Shanghai, which now almost equal the average purchase price of an automobile - Shanghai has complemented this policy with substantial investment in mass transportation systems:

Figure III - 6: Vehicle-Related Taxes, Fees, and Charges in Shanghai

Items	Rates and Ranges	Example	Notes (all figures in 1000RMB)
1.Purchase Price	40-200	100	Households usually buy vehicles in this price range
2.VAT	17%	17	VAT is transferred to the buyers
3.Vehicle Sales Tax	10%	10	
4.License Plate	30-40	35	Shanghai releases about 4,000 license plates every month; vehicle owners must bid for them
5.Driver's License	4-5	4.5	Everyone must go to a designated driving school to get a driver's license
6.License Issuance Fee	1	1	Including the cost of making the license plate and driving certificate
7.Vehicle Usage Fee	0.1	0.1	Paid annually
8. Insurance	5-7	6	Paid annually
9.Road Maintenance Fee	3	3	Paid annually
10. Parking Fee		3.6	On-the-ground parking: 1,200-3,600 annually; indoor parking: 2,400-7,200 annually; temporary parking: RMB 10/hour
Total		180.2	

Source: Authors' formulation, adapted from several sources

Chapter Four: Municipal Finance in Jakarta

I. Introduction

Jakarta is both Indonesia's commercial and political center. Formally known as DKI Jakarta, or the Special Capital Region of Jakarta (Daerah Khusus Ibukota Jakarta), it is a sprawling city of approximately 10 million residents covering more than 650 square kilometers (410 square miles). Jakarta is the capital of Indonesia with provincial status, and is divided into five mayoralities (East, West, North, South, and Central Jakarta), and one administrative regency (Pulau Seribu, or Thousand Islands). Jakarta is further divided into 43 subdistricts, 256 villages, and thousands of precincts and wards (Rukun Tetangga and Rukun Warga) which are under the jurisdiction of the subdistricts.

Jakarta's "footprint" does not stop at its administrative borders, but instead extends to the neighboring districts of Bogor, Tangerang, and Bekasi. The Jakarta greater metropolitan area is referred to as Jabotabek, an acronym formed by combining the first part of each jurisdiction's name. The population of Jakarta and the urban communities bordering Jakarta is about 15 million, and there is considerable daily flow of people and commerce between Jakarta and its neighboring suburbs.

Thus, Jakarta is a large and complex megalopolis, and it is beyond the scope of this case study to present a comprehensive examination of municipal finance in this grand city whose origins go back 500 years. The objective of this case study is to place HCMC in a comparative perspective by applying a similar framework to help understand how Jakarta finances its infrastructure and services.

The study addresses key questions facing both cities such as:

- Where does Jakarta's revenue come from, and how are these funds spent?
- How dependent is Jakarta on central government resources?
- How sustainable is the current composition of revenue in Jakarta?
- What is the economic and social impact of Jakarta's current revenue structure?
- Are there significant untapped sources of local revenue?
- How efficiently and effectively does Jakarta spend its money?
- How transparent and accountable are Jakarta's expenditure practices?

II. Historical Context of Current Resource Generation and Allocation in Jakarta

The tale commonly told today in Indonesia is that the history of municipal finance can be divided into two periods: pre-Suharto and post-Suharto, with 1998 as the transition year between these two periods. The first era is generally characterized by a highly centralized system of municipal finance, while the second era is often seen as a period of dramatic fiscal decentralization and significantly enhanced local government finance. This is certainly true from a legal, or de jure perspective, but not from empirical observation of actual practices, or a de facto perspective.

Although fiscal decentralization legislation was debated for years under President Suharto, no significant laws to enhance regional autonomy were passed other than the 1974 law on decentralization (Law No.5/1974). Furthermore, even this landmark legislation was not operationalized until the 1995 launch of the District Autonomy Pilot, a two-year experiment in which selected functions were transferred from central and provincial governments to 26 district governments.

However, after Suharto resigned in May 1998, a concerted effort was made to increase the power of subnational government as part of the realignment of power that was sweeping Indonesia's political landscape. This resulted in the passage of two major new laws in 1999: Law No. 22/1999 on Regional Government and Law No. 25/1999 on the Fiscal Balance between the Central Government and the Regions.[20]

[20] These laws were superceded in October 2004 by Law No. 32/2004 on Regional Government and Law No. 33/2004 on the Fiscal Balance Between the Central Government and the Regions.

These two new laws totally transformed the legal framework governing intergovernmental fiscal relations. Law No. 22/1999 replaced the hierarchal system of governance between Level I governments (provinces) and Level II governments (municipalities and districts) with a system that allowed considerably greater local autonomy: mayors and district heads were now selected by local legislatures rather than appointed by provincial governors. This law also makes most deconcentrated central government offices at the subnational level the responsibility of their respective provincial and local governments. Law No. 25/1999 restructured the system of intergovernmental transfers: the most important change was replacement of the Autonomous Region Subsidy (Subsidi Daerah Otonom, SDO) used to pay regional civil servants' salaries and the many development grants (Instruksi Presiden, Inpres) with a single block grant (Dana Alokasi Umum, DAU), to be financed by at least 25 percent of central government domestic revenue. This law also delineated revenue sharing parameters for provincial and local governments.

However, this expenditure-led fiscal decentralization has led to a substantial imbalance between assignment of expenditure and revenue responsibilities, creating a fiscal gap for many local governments that has actually increased their dependence on the central government: the decentralization legislation fails to assign local governments any broad- based taxes or significant new tax discretion with which to finance their new expenditure responsibilities. In contrast, despite the lack of new laws supporting fiscal decentralization under Suharto, tremendous progress was nevertheless made both in the generation of own source revenue and discretion in the allocation of funds from the central government.[21]

III. Current Composition of Jakarta On-Budget Revenue and Expenditure

A. Overview of Revenue

For the purpose of comparative international analysis, Jakarta on-budget revenue can be divided into three main sources:

- local regular revenue;
- local special revenue; and
- tax sharing/revenue sharing.

As with HCMC and Shanghai, the first two of these sources would normally be considered "own source revenue," the former sustainable and the latter incidental. In Jakarta, local special revenue consists of internal financing such as budget carryovers and reserve fund transfers, while shared revenue is referred to as "equalization funds."

The share of each revenue component from 2001 to 2005 is as follows:

[21] Bureau for Regional Financial Analysis, Agency for Financial and Monetary Analysis, Ministry of Finance, Monitoring Indicators for Repelita VI, Urban Policy Action Plan - Implementation Results, Main Text and Annexes; Christopher Silver, Iwan J. Azis, and Larry Schroeder, "Intergovernmental Transfers and Decentralisation in Indonesia," Bulletin of Indonesian Economic Studies, vol. 37, no. 3, 2001, pp. 345-62; and James Alm, Robert H. Aten, and Roy Bahl, "Can Indonesia Decentralise Successfully? Plans, Problems and Prospects," Bulletin of Indonesian Economic Studies, vol. 37, no. 1, 2001, pp. 83-102.

Table IV - 1: Overview of Jakarta Revenue Composition

IDR billions

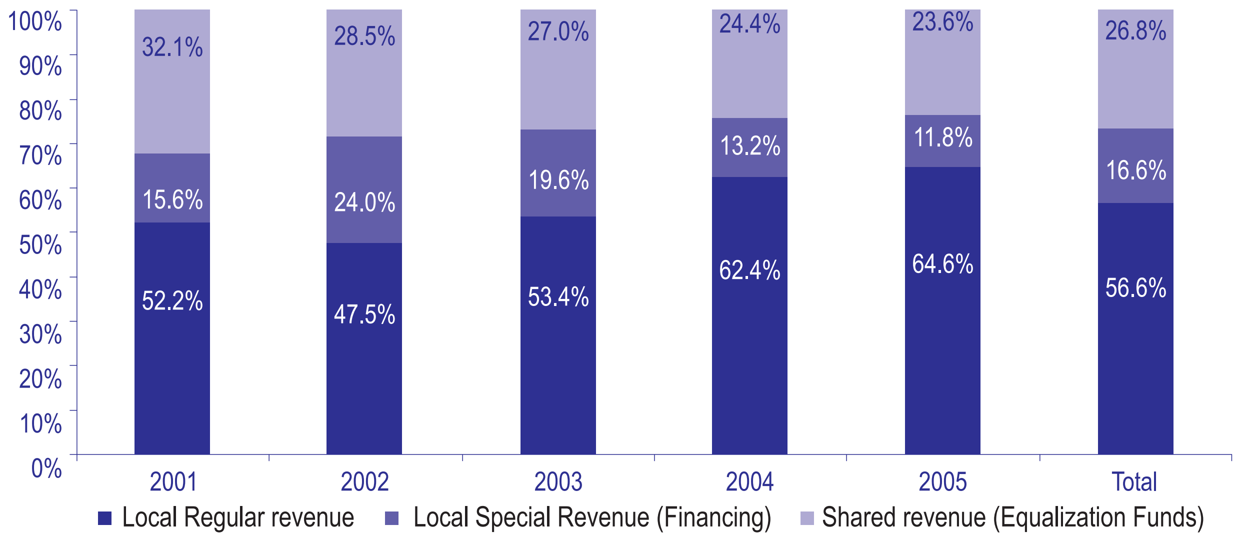
No	Items	2000	2001	2002	2003	2005	Total
	Total Revenue (nominal)	***7,365***	***9,580***	***10,983***	***12,686***	***14,010***	***54,623***
	Revenue Growth (constant)		**16.7%**	**7.4%**	**8.9%**	**0.8%**	**8.3%**
I	**Total Revenue (constant)**	**7,365**	**8,594**	**9,228**	**10,050**	**10,134**	**45,372**
1	Local Regular Revenue	3,846	4,079	4,931	6,267	6,550	25,674
2	Local Special Revenue[a]	1,153	2,065	1,809	1,326	1,194	7,546
3	Shared Revenue[b]	2,366	2,450	2,488	2,457	2,391	12,152
II	**Structure of Revenue**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
1	Local Regular Revenue	52.2%	47.5%	53.4%	62.4%	64.6%	56.6%
2	Local Special Revenue	15.6%	24.0%	19.6%	13.2%	11.8%	16.6%
3	Shared Revenue	32.1%	28.5%	27.0%	24.4%	23.6%	26.8%

Sources: Nota Keuangan APBD DKI Jakarta 2001-2005 [DKI Jakarta Regional Budget Financial Notes for 2001-2005]
[a] Internal Financing *[b] Equalization Funds*

Total Jakarta nominal revenue has doubled over the past five years; in constant terms, revenue has still increased by 37.6 percent, rising at an average annual rate of 8.3 percent. During this period, the share of own source revenue has become ever more dominant, growing from about one-half to roughly two-thirds of total revenue, a positive trend in the context of Jakarta's desire to increase its fiscal autonomy. Local special revenue (internal financing) has fallen from 15.6 to 11.8 percent of total revenue, while shared revenue (equalization funds) has remained relatively constant in value but has fallen as a portion of total revenue from one-third to one-quarter.

These trends are depicted graphically below:

Figure IV - 1: Jakarta's Revenue Structure



Sources: Nota Keuangan APBD DKI Jakarta 2001-2005 [DKI Jakarta Regional Budget Financial Notes for 2001-2005]

B. Local Regular Revenue

As Jakarta has not utilized debt financing over the past five years, local regular revenue is comprised almost entirely of what it calls Own Source Revenue, or Pendapatan Asli Daerah (PAD), defined by the Government of Indonesia as consisting of:

- local taxes (pajak daerah);

- local user charges (retribusi daerah);
- profits or dividends from regionally owned enterprises (bagi hasil BUMD); and
- miscellaneous other sanctioned own source revenue (lain-lain PAD yang sah).

The only other local income source considered local regular revenue in this study is listed in the Jakarta budget as "Other Sanctioned Local Revenue" (Lain-lain Pendapatan Daerah yang Sah), but this never contributed more that 1.6 percent of total revenue.

In addition, property-related taxes are also included as local taxes in this analysis, just as they would be in most other countries, so that Jakarta can be placed in an international comparative perspective through use of a common analytic framework and terminology.

Jakarta levies two such taxes: PBB (Pajak Bumi dan Bangunan), an annual tax on the capital value of land and buildings, and BPHTB (Bea Perolehan Hak atas Tanah dan Bangunan), a tax on the acquisition of land and building rights.

Although PBB and BPHTB are technically co-administered tax sharing forms of local government revenue, and are so classified under Indonesian law, all tax revenue from these sources goes to provincial and district/municipal governments under tax sharing formulas,[22] and utilization of PBB and BPHTB revenue is decided solely by these sub-national governments. Furthermore, the government plans to formally reassign this tax in 2008. Thus, PBB and BPHTB revenue is much more akin to own source revenue than to Jakarta's tax sharing and revenue sharing equalization funds, which are described in greater detail below.

The composition of local regular revenue from 2001 to 2005 is as follows:

Table IV - 2: Jakarta Composition of Local Regular Revenue

IDR billions

No	Items	2000	2001	2002	2003	2005	Total
	Local Regular Revenue (nominal)	3,846	4,547	5,869	7,911	9,055	31,228
I	**Local Regular Revenue (constant)**	3,846	4,079	4,931	6,267	6,550	25,674
1	Local Taxes	3,664	3,680	4,371	5,455	5,806	22,974
2	Local User Charges	156	226	272	303	236	1,192
3	Share of Local Enterprise & Local Resource Management Revenue	27	53	0	81	75	235
4	Other Sanctioned Revenue [a]	0	121	288	428	434	1,272
5	Local Government Debt	0	0	0	0	0	0
II	**Local Regular Revenue Structure**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
1	Local Taxes	95.3%	90.2%	88.6%	87.0%	88.6%	89.5%
2	Local User Charges	4.0%	5.5%	5.5%	4.8%	3.6%	4.6%
3	Share of Local Enterprise & Local Resource Management Revenue	0.7%	1.3%	0.0%	1.3%	1.1%	0.9%
4	Other Sanctioned Revenue a	0.0%	3.0%	5.8%	6.8%	6.6%	5.0%
5	Local Government Debt	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Sources: Nota Keuangan APBD DKI Jakarta 2001-2005 [DKI Jakarta Regional Budget Financial Notes for 2001-2005]
[a] Including "Other Sanctioned Own Source Revenue" and "Other Sanctioned Local Revenue"

22 For PBB, 90 percent of revenue is divided as follows: 16.2 percent to provinces, 64.8 percent to regencies (districts and municipalities), and 9 percent to cover collection costs. The remaining 10 percent is the central government's share, which is rebated to regencies as follows: 65 percent equally distributed to all regencies, and 35 percent distributed to regencies as an incentive for exceeding selected collection targets. For BPHTB, 80 percent of revenue is divided as follows: 16 percent to provinces and 64 percent to regencies. The remaining 20 percent is the central government's share, which is distributed equally to all regencies.

The dominant component of regular local revenue is local taxes, which have comprised a 90 percent share for the five-year period. Most of the remaining ten percent is divided roughly equally between local user charges and other sanctioned revenue, with the residual coming from local government's share of local enterprise and local resource management revenue. The composition of local taxes from 2001 to 2005 is as follows:

Table IV - 3: Jakarta Composition of Local Taxes

IDR billions

No	Items	2000	2001	2002	2003	2005	Total
	Local Taxes (nominal)	***3,664***	***4,102***	***5,202***	***6,886***	***8,025***	***27,878***
I	**Local Taxes (constant)**	**3,664**	**3,680**	**4,371**	**5,455**	**5,806**	**22,974**
1	Taxes related to vehicles	2,098	2,108	2,458	3,290	3,429	13,383
2	Taxes related to recreation & hospitality (hotels, restaurants, entertainment)	389	413	515	583	626	2,525
3	Other taxes	251	261	305	315	340	1,471
4	Property-related taxes	927	898	1,092	1,267	1,411	5,595
II	**Structure of Local Taxes**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
1	Taxes related to vehicles	57.3%	57.3%	56.2%	60.3%	59.1%	58.3%
2	Taxes related to recreation or hospitality (hotels, restaurants, entertainment)	10.6%	11.2%	11.8%	10.7%	10.8%	11.0%
3	Other taxes	6.8%	7.1%	7.0%	5.8%	5.9%	6.4%
4	Property-related taxes	25.3%	24.4%	25.0%	23.2%	24.3%	24.4%

Sources: Sources: Nota Keuangan APBD DKI Jakarta 2001-2005 [DKI Jakarta Regional Budget Financial Notes for 2001-2005]

Approximately 60 percent of local taxes come from vehicle-related taxes, primarily the motor vehicle registration tax (Pajak Kendaraan Bermotor) and the motor vehicle title transfer fee (Bea Balik Nama Kendararaan Bermotor). These revenues have remained robust due to a combination of rising tax rates, car prices, and vehicle sales in Jakarta, buttressed by the central government's deregulation of imported vehicles.

Property-related taxes have remained constant at approximately one-quarter of local government taxes, split almost equally between PBB and BPHTB revenue. Nominal increases have been due mainly to recovering property values after the collapse of the real estate market during the East Asian financial crisis that began in mid-1997 and hit Indonesia hardest in 1998. [23]

The other significant local tax source is something referred to as the Hotel and Restaurants Tax (previously known as PB I, the Provincial Development Tax, or Pajak Pembangunan I). This is a kind of local sales tax on hotels, restaurants, and entertainment set by local government law - the rate is 10 percent.

The remaining local taxes generate relatively little revenue. These are the motor fuel tax, advertising tax, street lighting tax, groundwater utilization tax, and parking tax. Jakarta also includes tax penalties in the category of local government taxes.

The composition of local user charges from 2001 to 2005 is as follows:

[23] The PBB tax rate is set nationally by law at 0.5 percent of assessed value for all properties, regardless of property value, location, or use. The assessment ratio range is specified by national law as between 20 and 100 percent of market capital value, but is set by Minister of Finance decree. At present, the assessment ratio for all property valued at less than Rp 1 billion (about $100,000) is 20 percent, and the assessment ratio for all property valued at Rp 1 billion or more is 40 percent. There is now a Rp 12 million (about $1,200) building exemption per property; this is periodically adjusted due to price rises from inflation. The BPHTB tax rate is also set nationally by law, at 5.0 percent of the property's market value less an exemption, which is now Rp 60 million (about $6,000) per property.

Table IV - 4: Jakarta Composition of Local User Charges

IDR billions

No	Items	2001	2002	2003	2004	2005	Total
	Local User Charges (nominal)	***156***	***252***	***324***	***382***	***326***	***1,439***
I	**Local User Charges (constant)**	**156**	**226**	**272**	**303**	**236**	**1,192**
1	Charges related to health and sanitation services	72.7	94.6	119.1	144.1	89.4	520
2	Charges related to vehicles & transportation[a]	33.4	48.4	44.4	33.3	34.0	194
3	Charges related to land	29.0	57.7	81.8	97.9	85.9	352
4	Other charges	20.6	24.9	26.9	27.4	26.6	126
II	**Structure of Local User Charges**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
1	Charges related to health and sanitation services	46.7%	41.9%	43.8%	47.6%	37.9%	43.6%
2	Charges related to vehicles & transportationa	21.5%	21.5%	16.3%	11.0%	14.4%	16.2%
3	Charges related to land	18.6%	25.6%	30.1%	32.4%	36.4%	29.6%
4	Other charges	13.3%	11.0%	9.9%	9.1%	11.3%	10.6%

Sources: Nota Keuangan APBD DKI Jakarta 2001-2005 [DKI Jakarta Regional Budget Financial Notes for 2001-2005]

[a] *Including parking, inspections, routes, etc.*

When compared to local taxes, local user charges generate an extremely small and steadily declining share of total local regular revenue. For example, in 2005, local taxes accounted for 88.6 percent of local regular revenue, while the share from local user charges was only 3.6 percent. About one-third of the revenue generated by local user charges comes from health service fees (pelayanan kesehatan), and another one-third from fees for building permits (izin mendirikan bangunan). The remaining third of local user charge revenue comes from 22 other types of service and licensing fees.

When all local user charges are grouped into four main categories, charges related to health and sanitation services still dominate: 43.6 percent of the revenue generated for the past five years has come from these sectors. Another 29.6 percent has come from charges related to land, while 16.2 percent has come from charges related to vehicles and transportation; the remaining 10.6 percent has come from miscellaneous charges.

Revenue generated by Jakarta's ownership of local government enterprises (Badan Usaha Milik Daerah, BUMD) has not contributed significantly to the city's budget, totaling less than one percent of total local regular revenue over the past five years. Although profitable BUMDs tend to retain their earnings for investments necessary to remain competitive and grow, many BUMDs forego profits in efforts to satisfy their development missions; others simply are not commercially viable enterprises.

Other sanctioned revenue, consisting of miscellaneous own source revenue (lain-lain PAD yang sah) and other sanctioned local revenue (lain-lain pendapatan yang sah) contributed only 5.0 percent to local regular revenue over the past five years.

In respect to loan and bond receipts, the central government must approve regional government proposals for foreign assistance. One key consideration for approval is the provision that the deficit in the national budget and the local government budget must not exceed the 3 percent benchmark. Thus far, Jakarta has not submitted proposals for foreign assistance. Jakarta has considered issuing municipal bonds to finance its infrastructure investments, but the city is still in a very preliminary preparation stage.

C. Local Special Revenue

Jakarta's local special revenue consists entirely of income sources listed under "financing," as they are seen as ways of balancing the budget. These include:

- carryover from the previous year's budget;
- transfers from a reserve fund;

During the past five years Jakarta has experienced a budget deficit of between Rp 1 trillion and Rp 2 trillion, which has been financed entirely by the previous year's budget surplus (Sisa Lebih Perhitungan Anggaran Tahun Lalu) except in 2005, when the budget carryover was supplemented by a modest transfer from the reserve fund.[24] No revenue is recorded in the Jakarta budget from the sale of local assets during the past five years.

The composition of Jakarta's local special revenue is shown in the following table:

Table IV - 5: Jakarta Composition of Local Special Revenue

IDR billions

No	Items	2001	2002	2003	2004	2005	Total
	Local Special Revenue (nominal)	***1,153***	***2,302***	***2,153***	***1,674***	***1,650***	***8,931***
I	**Local Special Revenue (constant)**	**1,153**	**2,065**	**1,809**	**1,326**	**1,194**	**7,546**
1	Carryover from Previous Year's Budget	1,153	2,065	1,809	1,326	1,013	7,366
2	Transfers from Reserve Fund	-	-	-	-	181	181
II	**Structure of Local Special Revenue**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
1	Carryover from Previous Year's Budget	100%	100%	100%	100%	84.8%	97.6%
2	Transfers from Reserve Fund	0.0%	0.0%	0.0%	0.0%	15.2%	2.4%

Sources: Nota Keuangan APBD DKI Jakarta 2001-2005 [DKI Jakarta Regional Budget Financial Notes for 2001-2005]

D. Shared Revenue

Shared revenue consists of three main types of central government Equalization Funds (Dana Perimbangan)[25]:

- Revenue Sharing Funds from tax and non-tax revenue sources (Bagian Daerah dari Pajak dan Bukan Pajak/Dana Bagi Hasil);
- General Allocation Funds (Dana Alokasi Umum, DAU); and
- Special Allocation Funds (Dana Alokasi Khusus, DAK).

While the total amount of these three Equalization Funds has remained relatively constant in real terms for the past five years at between Rp. 2.4 and Rp 2.5 trillion, there has been a steady decline in their share of total Jakarta revenue and a dramatic change in the composition of these funds:

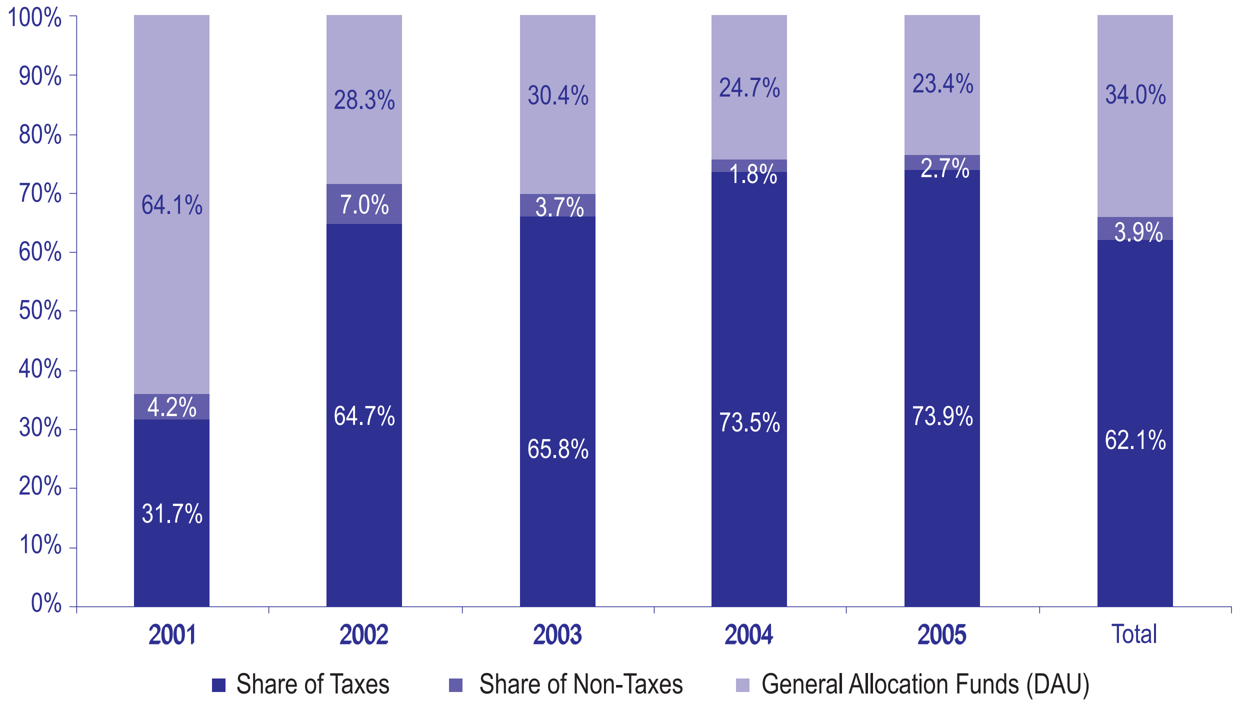
- Equalization Funds as a share of total Jakarta revenue has dropped from 32.1 percent to 23.6 percent, with a concomitant rise of roughly the same magnitude in the share of local regular revenue;
- Within the Equalization Funds category, DAU funds have fallen from almost two-thirds in 2001 to less than one-fourth in 2005, with a simultaneous rise in the portion of revenue from tax and non-tax sharing from 36 percent to 77 percent.

[24] Use of carryover funds to finance current year expenditures can be done without the approval of the regional legislature (Dewan Perwakilan Rakyat Daerah, DPRD), but use of the budget surplus to set up a reserve fund or participate in local enterprises is subject to the approval of the DPRD. These carryover funds are essentially unexpended budget allocations.

[25] As noted earlier, for the purposes of this discussion, Equalization Funds exclude property related taxes (PBB and BPHTB).

Both of these trends highlight increasing fiscal autonomy for Jakarta, as a growing share of total local resources are dependent on Jakarta's success in generating own source revenue and central government tax revenue that is shared with the regions These trends are depicted in the following chart:

Figure IV - 2: Jakarta Equalization Funds



Sources: Nota Keuangan APBD DKI Jakarta 2001-2005 [DKI Jakarta Regional Budget Financial Notes for 2001-2005]

A more detailed breakdown is as follows:

Table IV - 5: Jakarta Composition of Shared Revenue (Equalization Funds)

IDR billions

No	Items	2001	2002	2003	2004	2005	Total
	Shared Revenue (nominal)	***2,366***	***2,730***	***2,962***	***3,101***	***3,305***	***14,465***
I	**Shared Revenue (constant)**	**2,366**	**2,450**	**2,488**	**2,457**	**2,391**	**12,152**
1	Share of Taxes	750	1,585	1,639	1,806	1,767	7,547
2	Share of Non-Taxes	100	171	92	44	65	472
2	General Allocation Funds[a]	1,516	694	758	607	559	4,133
II	**Structure of Share Revenue**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
1	Share of Taxes	31.7%	64.7%	65.8%	73.5%	73.9%	62.1%
1	Share of Non-Taxes	4.2%	7.0%	3.7%	1.8%	2.7%	3.9%
2	General Allocation Funds	64.1%	28.3%	30.4%	24.7%	23.4%	34.0%

Sources: Nota Keuangan APBD DKI Jakarta 2001-2005 [DKI Jakarta Regional Budget Financial Notes for 2001-2005]
[a] The actual (not budgeted) nominal amount of General Allocation Funds was constant for the past five years at Rp. 773.1 billion, and Jakarta will not receive any more of these funds beginning in 2008.

The growth in importance of tax and non-tax sharing revenue began in 2002, in part reflecting the central government's push to improve tax effort - most of the revenue in this category comes from Jakarta's 20 percent share of the personal income tax.[26] This policy was augmented by the additional shares of natural resource revenue given to local governments under Law No. 33/2004.

The concept undermining General Allocation Funds and Special Allocation Funds is equalization of the fiscal gap, which is defined as a region's fiscal needs less its fiscal capacity. General Allocation Funds are resources to finance expenses in support of the decentralization process or regional autonomy; they are allocated to ensure the continued operation of regional governments by equalizing financial capacity among regional governments. Under Law No. 33/2004, the total amount of General Allocation Funds each year must be at least 26 percent of Net Domestic Revenue (Pendapatan Dalam Negeri Netto) as established in the national budget (Anggaran Pendapatan dan Belanja Negara, APBN). However, the 26 percent rule is not effective until 2008; prior to 2008, total General Allocation Funds must be at least 25.5 percent of Net Domestic Revenue, still a modest increase from the 25 percent stipulated in Law No. 25/1999.

Special Allocation Funds are given by the central government to assist regional governments in financing their special activities, primarily investments in education, health, and infrastructure. Jakarta did not receive any Special Allocation Funds over the past five years, and this funding mechanism has been scarcely used elsewhere.

E. Expenditures

1. Budget Reform

In 2003, Jakarta gradually began to adopt a new approach in constructing its budget (Anggaran Pendapatan dan Belanja Daerah, APBD). This is performance-based budgeting, as mandated by Government Decree No. 105/2000 (Peraturan Pemerintah No. 105 Tahun 2000 Tentang Pengelolaan dan Pertanggungjawaban Keuangan Daerah). In contrast to the traditional budget format whereby expenses are listed by type of input, this approach presents expenditures by output in attempt to assess government success in achieving its stated objectives. The hope is that Jakarta will be able to go beyond examining expenditure cost efficiency, and instead evaluate expenditure cost effectiveness. Thus, under the new system, fund allocations are linked to the achievement of the goals in the respective Work Units (Unit Kerja) of the Jakarta government.

However, performance-based budgeting only works if pre-determined performance standards or benchmarks are formulated against which to assess the quality of government and determine the level of subsequent budget allocations based on the relative success or failure of government Work Units. Unfortunately, although the budget presentation has been rearranged as described below, criteria and measurement metrics for assessing government performance are still under development in Jakarta.

Another element of budget reform in Jakarta is adoption of a new format that uses a budget surplus/deficit approach as stipulated by Regional Decree No. 8/2001 (Peraturan Daerah No. 8 Tahun 2001 Tentang Pokok-pokok Pengelolaan Keuangan Daerah). The previous budget format did not state explicitly the budget surplus or deficit.

The budget's "Expenditure by Sector" section has also been consolidated: it now consists of only eight sectors (bidang). Each sector is divided into functions (fungsi), and each function is broken down into programs (program). Budget performance is determined by the success of units in carrying out their assigned functions. This new format is significantly different from the previous format, in which expenditure was divided into Routine Expenditures (Belanja Rutin) and Development Expenditures (Belanja Pembangunan), and Development Expenditures were divided into twenty-one sectors.

[26] The tax sharing formula for the Personal Income Tax Articles 21, 25, and 29 is as follows: 80 percent for the central government and 20 percent for the regions, of which 60 percent is for the regencies (districts and municipalities) and 40 percent for the provinces. There are five personal income tax brackets, from the lowest marginal tax rate of 5 percent for income less than or equal to Rp 25 million (about $2,500), to the highest marginal tax rate of 35 percent for income greater than Rp 200 million (about $20,000).

2. Expenditure by Sector

The new expenditure classification is divided into 8 sectors, which are:

- Law, Peace, Public Order, and National Unity (Hukum, Ketentraman, Ketertiban Umum, dan Kesatuan Bangsa);
- Government (Pemerintah);
- Economy (Ekonomi);
- Education and Health (Pendidikan dan Kesehatan);
- Population and Employment (Kependudukan dan Ketenagakerjaan);
- Social Culture (Sosial Budaya);
- Natural Resources and Environment (Sumber Daya Alam dan Lingkungan); and
- City Services and Infrastructure (Sarana dan Prasarana Kota).

These 8 sectors consist of 32 functions and 107 programs.

It is difficult to analyze Jakarta expenditures by sector for the past five years because in 2001 and 2002, the budget was still organized by twenty sectors, and these do not correspond directly with the new eight-sector format. Thus, analysis of Jakarta expenditures by sector is restricted to the last three years.

Expenditures have been concentrated in three main sectors, which together have constituted slightly more than three-fourths of all expenditures each year: Government, Education and Health, and City Services and Infrastructure. However, the composition of expenditures has shifted among these three sectors, most notably a decline in Government sector expenditures from one-third to one-quarter of all expenditures and an offsetting rise from 19 to 27 percent in expenditures for the City Services and Infrastructure sector.

Government expenditures actually peaked in 2003 as Jakarta began implementation of the new budget system. The upward trend in City Services and Infrastructure expenditures was to finance construction of several new bridges, flyovers, and underpasses, in addition to general expansion of Jakarta's roads. Jakarta also increased its spending for flood control, particularly in building East Flood Canal (Banjir Kanal Timur); most funds have been used for compensation in acquiring land for the project (pembebasan lahan), in addition to building the canal itself.

In each of the eight sectors, expenditures are further divided into "Indirect Expenditures" and "Direct Expenditures"; the former are presumably for general administration and the latter for specific programs, grouped by thematic function. This distinction is not clear for the Government sector, where 58 percent of expenditures are "Indirect" and 42 percent are "Direct" in 2005. However, it is interesting to note that 53 percent of all Health and Education sector expenditures are "Indirect" while only 11 percent of City Services and Infrastructure sector expenditures are "Indirect" in 2005. It is possible that when the "Indirect Expenditures" in all sectors are included, the total amount Jakarta spends annually on routine operations is far greater than the 25 to 33 percent listed under "Government," given that each sector has its own overhead and administrative costs.

A summary of these expenditure trends by sector is presented in the following table:

Table IV - 6: Jakarta Expenditures by Sector

IDR billions

No	Items	2003	2004	2005	Total
	Expenditures (nominal)	***10,959***	***12,631***	***13,920***	***37,510***
I	**Expenditures (constant) [CPI 2002=100]**	**10,369**	**11,203**	**11,296**	**32,868**
1	Law, Peace, Public Order, and National Unity	433	688	512	1,633
2	Government	3,393	2,704	2,837	8,934
3	Economy	428	406	415	1,249
4	Education and Health	2,546	3,342	2,925	8,813
5	Population and Employment	159	148	141	448
6	Social Culture	741	870	754	2,365
7	Natural Resources and Environment	592	582	639	1,813
8	City Services and Infrastructure	1,993	2,414	3,000	7,407
9	Local Disbursements	84	49	73	206
II	**Structure of Expenditures**	**100%**	**100%**	**100%**	**100%**
1	Law, Peace, Public Order, and National Unity	4.2%	6.1%	4.5%	5.0%
2	Government	32.7%	24.1%	25.1%	27.2%
3	Economy	4.1%	3.6%	3.7%	3.8%
4	Education and Health	24.6%	29.8%	25.9%	26.8%
5	Population and Employment	1.5%	1.3%	1.2%	1.4%
6	Social Culture	7.1%	7.8%	6.7%	7.2%
7	Natural Resources and Environment	5.7%	5.2%	5.7%	5.5%
7	Natural Resources and Environment	19.2%	21.5%	26.6%	22.5%
8	Local Disbursements	0.8%	0.4%	0.6%	0.6%

Sources: Nota Keuangan APBD DKI Jakarta 2001-2005 [DKI Jakarta Regional Budget Financial Notes for 2001-2005]

3. Expenditure by Expenditure Group

Jakarta also classifies its expenditures by the following five Expenditure Groups *(Kelompok Belanja)*:

- General Administration (Belanja Administrasi Umum);
- Operation and Maintenance of Public Services and Infrastructure (Belanja Operasi dan Pemeliharaan Sarana dan Prasarana Publik);
- Investment (Belanja Modal);
- Transfers (Belanja Transfer); and
- Miscellaneous (Belanja Tidak Terduga).

However, analysis of Jakarta expenditure by expenditure group can only be done for the 2001 to 2003 period, because in 2004 and 2005, the first three categories were combined into a single group without further disaggregation of the data. Even this analysis is not very revealing due to overlap in subcategories designations: both General Administration and Operation and Maintenance of Public Services and Infrastructure are subdivided into Personnel, Goods and Services, Maintenance, and Official Travel. Post-2003 analysis is even more problematic because the first three expenditure groups comprised an average of 98 percent of all expenditures from 2001 to 2003. Thus, the previously relatively opaque five expenditure groups have become even more difficult to interpret.

4. Expenditure by Administrative Jurisdiction

A third way Jakarta classifies its expenditure is by administrative jurisdiction: the provincial level (propinsi) and the district/municipality level (kabupaten/kotamadya). As noted earlier, the province is formally designated as DKI Jakarta, which is divided into North Jakarta, South Jakarta, East Jakarta, West Jakarta, Central Jakarta, and Thousand Islands.

Data for 2001 and 2002 for this type of expenditure classification are not available. Consequently, analysis can only be done for the 2003 to 2005 period. Since 2003, the provincial to sub-provincial shares of expenditure have remained constant at 63 percent to 37 percent, respectively, although Jakarta plans to increase the sub-provincial share of expenditure to 40 percent. The sub-provincial shares of total expenditure have been distributed as follows: approximately 6 percent each year for Central and North Jakarta; 7 percent for West Jakarta; 8 percent for South Jakarta; 10 percent for East Jakarta; and 1 percent for Thousand Islands.

5. Expenditure for Special Investments

Beginning in 2004, Jakarta instituted "priority programs" in addition to the eight expenditure sectors described earlier. Priority programs are large-scale, urgent investments, financed by a "dedicated development budget" whereby a designated amount of funds is "locked" or earmarked only for development purposes. The programs that are financed in this manner are called "dedicated programs." The term "dedicated" also means that these programs are not one-year activities but multi-year programs. Funds dedicated to these programs may not be used to finance other programs.

There are eleven dedicated programs in the 2005 budget, as follows:

1. East Flood Canal (Banjir Kanal Timur)
2. Busway Project
3. Low-Middle Income Apartments (Rumah Susun)
4. Flyovers and Underpasses
5. Rehabilitation of Public School Buildings
6. The preservation of Angke Canal, Ciliwung Canal, and small lakes (Pelestarian Kali Angke, Kali Ciliwung dan Situ-situ)
7. Civilian Empowerment Program (Program Pemberdayaan Masyarakat Kelurahan, PPMK)
8. Welfare Improvement for Teachers, Paramedics, and Civil Servant (Tambahan Kesra Guru, Paramedis, dan Pegawai)
9. Management Improvement (Penguatan Manajemen Kecamatan dan Kelurahan)
10. Islamic Center
11. Revitalization/Regreening of City Parks (Penghijauan)

Examples of dedicated programs are presented in case studies below.

6. Financing Expenditure

As with revenue, certain types of expenditure are contained in a third part of Jakarta's budget, "Financing." These include payment of loan principal, transfers to a reserve fund, capital investments, and surplus from the current year's budget. There were no reserve fund transfers or recorded current surpluses over the past five years. However, Jakarta has continued to service its debt for development assistance and made some capital investments, although neither of these expenditures has been very large. Debt repayment to the International Bank for Reconstruction and Development (IBRD) and the Overseas Economic Cooperation Fund (OECF) has continued to decrease from Rp 51 billion in 2001 to Rp 40 billion in 2005. Jakarta also increased its capital participation (Penyertaan Modal) to Rp 50 billion in 2005 from Rp 11 billion the previous year.

VI. Jakarta Case Studies

A. Dedicated Programs

The Busway Project, East Flood Canal, and preservation of Angke Canal, Ciliwung Canal, and small lakes are three examples of large-scale, multi-year dedicated programs requiring large amounts of funds over an extended time period.

The budget allocation for the Busway Project is Rp 458.8 billion. The Busway Project is an activity that procures special buses and constructs a special traffic lane with custom bus terminals along some of Jakarta's most congested roads. The project's objective is to attract motorists to use public transportation for their daily commutes, thereby reducing their usage of private cars and the traffic congestion caused by these cars. In 2003, the first Busway corridor became operational. However, critics have said that the Busway road network is not yet large enough to accommodate motorists, because most motorists live near the city limits not yet reached by the network. The feeder solution to solve the problem is also ineffective because the quality of the service provided by the feeder buses and Busway buses are drastically different. Thus, motorists still prefer to drive rather than take the bus. Nevertheless, Jakarta is currently expanding the Busway road network and its service, and the city government is still optimistic that the project will be successful.

In 2001, Jakarta experienced its worst flood to date, which paralyzed the city. To alleviate the same problem in the future, the city decided to build the East Flood Canal. The program received Rp 450 billion, most of which has gone for land compensation. The building of the canal requires 401.2 hectares, but the city had just acquired 36 hectares in 2004, so there is still a long way to go. The preservation of Jakarta's rivers (Kali Angke and Kali Ciliwung) and several small lakes received a budget of Rp 401.5 billion. This large amount of funds is sensible since the rivers that pass through Jakarta are heavily polluted, also contributing to the city's flood problems.

B. Six New Toll Roads

Jakarta is planning to build six inner city toll roads, in order to mitigate traffic problems in the city. Currently, Jakarta streets stretch a total of 7,576 km, which has to accommodate approximately 4.7 million vehicles per day, plus intercity vehicles that also use inner city roads. City officials projected that if there were no significant developments to solve traffic problems, traffic jams in the city would result in complete gridlock by 2014.

The development of the 85 kilometers of toll roads is in line with the macro transportation plan of Jakarta. However, construction of the six new toll roads itself is not in accordance with SISTRAN (The Master Study of Integrated Transportation for Jabotabek Phase II). Despite this controversy, the central government gave city officials permission to begin construction. Toll roads in Indonesia are categorized as national roads, meaning that any new toll roads have to be approved by the central government.

The project is estimated to cost more than US$ 2.5 billion (about Rp 23 trillion). Project development time is expected to last four to five years, and the entire project is to be funded by private investors. According to city officials, the project is estimated to generate an internal rate of return (IRR) of 17.5% per annum. The design of the roads themselves will be mostly elevated roads.

The following is a list of the planned new toll roads:

- Rawa Buaya-Sunter (18.6 km)
- Ulujami-Tanah Abang (8.7 km)
- Kampung Melayu-Tomang (12.3 km)
- Pasar Minggu-Casablanca (9 km)
- Kemayoran-Kampung Melayu (9.65 km)
- Sunter-Pulo Gebang (12.5 km)

The project is expected to commence in mid-2006. In April 2006, the government of DKI Jakarta just submitted the feasibility study for the construction of the six new toll roads to the Toll Road Regulatory Body (Badan Pengatur Jalan Tol, BPJT). Thus, the tender process can now begin.

Interestingly, after a number of appeals, the central government has given the government of DKI Jakarta the right to build and operate the six new toll roads, provided that Jakarta's BUMD (local government enterprise), PT. Pembangunan Jaya, wins the tender. Common practice dictates that roads that fall into the category or national roads are under the authority of the central government. Peraturan Pemerintah Nomor 4/1978, Article 9 clearly states the building and operation of toll roads are under the central government authority, by which the central government appoints PT. Jasa Marga to develop and operate toll roads. However, city officials mentioned that according to UU Nomor 34/1999 on the special autonomy of DKI Jakarta (Otonomi Daerah Khusus Ibukota Jakarta), local government has the right to plan and manage its own area, including roads. Therefore, the tender participants consist of a BUMD, a BUMN (state owned enterprise), and several private parties.

As yet, there has not been any news regarding the tender process or its participants. This activity is heavily criticized because the building of new toll roads will create more incentive to drive cars rather that using public transportation, only prolonging the traffic problems in Jakarta.

C. The Jakarta Monorail Project

The Jakarta monoral project is perhaps the city's most ambitious and controversial project. The proposed monorail network consists of two lines, the green line and the blue line. The 14.3 kilometer green line will run through Jl. Rasuna Said-Jl. Gatot Subroto-Sudirman Central Business District-Jl. Pejompongan-Jl. Rasusa Said. The 13.5 kilometer blue line will pass through Kampung Melayu, East Jakarta, to Roxy in West Jakarta. The project underwent numerous changes in the developer and serious financial problems.

The project was initially awarded to Malaysia's M. Trans Holding, and the Governor signed the MoU in 2003. The project itself is worth US$540 million. To begin with, the initiative to build a monorail service in Jakarta did not come from the government of DKI Jakarta, rather from M. Trans Holding, via the ITC (Indonesia Transit Central) local consortium. The project underwent heavy criticism due to its lack of transparency, since the initiative came from M. Trans Holding and there was no open tender. The ITC, consisting of PT. Adhi Karya, Global Profex Synergy and Radiant Pillar Pacific, decided to drop M. Trans Holding. The main reason was that M. Trans Holding failed to resolve technical and financial issues, therefore delaying the early stages of construction. The deadline for M. Trans Holding to give a final decision on whether it was still committed to the project was February 28, 2004.

After dropping the Malaysian-based company, the city administration signed a MoU with a new consortium, led by Hitachi, to continue the monorail project. The consortium consists of the Indonesian companies grouped in ITC, and several foreign companies: Omnico Holdings, Hitachi, Temasek and four other Singaporean companies, which were grouped under the Omnico consortium. The new consortium, or the two groups, will carry the name "PT. Jakarta Monorail." ITC owns a 55 percent stake in PT. Jakarta Monorail, while Omnico holds the remaining 45 percent stake. Hitachi is to provide technology in the construction of the monorail, while Temasek and Singapore Mass Transit are to provide the financing. The Indonesian companies will build the support structure for the monorail network. Under the new agreement, the project is estimated to cost US$650 million, much higher that what the Malaysian company had offered. The Japanese company was awarded the project, as it promised to meet all the requirements set by the city administration.

However, PT. Jakarta Monorail (JM) had difficulties securing the funds needed for the project. Foreign investors then asked the city administration to finance at least 30 percent of the US$650 million project. This contradicts the MoU, which states that the consortium would fund the whole project and the city administration would only have to provide the required legal permits. In addition, JM also requested the city to guarantee its loan repayments, by giving it an annual subsidy worth US$20 million for seven to eight years, which would keep the fare at an affordable level of Rp 5,000.

In addition, there were issues on which technology would be used in the monorail, maglev monorail or straddled type monorail. Omnico suggested the use of maglev monorail using Korea's Rotem technology, while ITC opted for the straddle type which was cheaper. ITC eventually had their way and appointed ICMI (Indonesia Consortium of Monorail Industries), a consortium consisting of U. S. investment bank J. P. Morgan, the Bukaka group, state-owned PT. INKA, which produces train cars, state electronic maker PT. LEN, the Hongkong based Mass Rapid Transit Railway Cooperation, and Siemens. The monorail will use Siemens technology. The technology only cost US$495 million compared to Rotem's US$826 million. The decision was contested by Omnico and prompted and internal dispute inside JM; the matter was taken to the Central Jakarta Court. ITC eventually would own a 98 percent stake in JM and Omnico was reduced to a mere 2 percent. This composition was the result of the shareholder's meeting on December 9, 2005.

According to the MoU, which was signed on May 31, 2004, JM is required to complete a financial closing within a year, which could be extended six months. Beyond that mark, the two parties may have to sign another agreement. The city administration also declared that if the total cost of the project is less than US$500 million, the city administration will give a subsidy. The MoU expired in June 2005, but the government of DKI Jakarta extended it six months to provide an opportunity for JM to complete its financial closing. Despite the extension, as of September 2005 there was still no news regarding the financial closing. The city administration then ordered JM to complete its financial closing by January 31, 2006 or the contract to build the monorail would be terminated.

On Tuesday, March 21 2006, Governor Sutiyoso announced that the consortium has secured a US$500 million loan from a consortium of Dubai banks, after much speculation, thereby securing the future of the ambitious project. The green line is expected to be operational by October 2007, while the blue line is expected to completed in mid-2008.. Nevertheless, problems may still occur to due the legal action taken by Omnico, which could disrupt the project; there have been no updates regarding Omnico's legal action.

Chapter Five:
Ho Chi Minh Finances in Comparative Perspective

I. Similarities and Differences Between HCMC, Shanghai, and Jakarta

A. Revenue Mobilization Performance

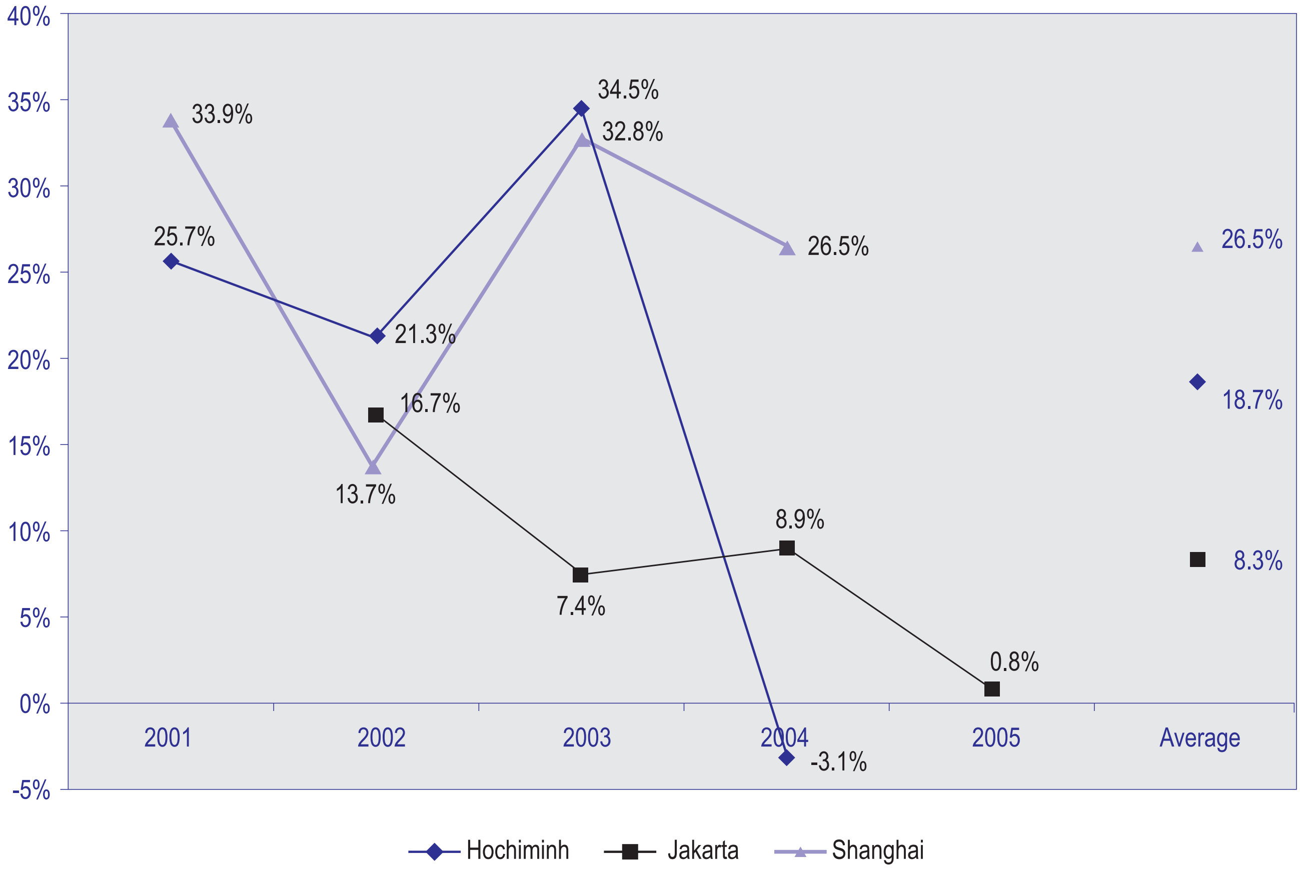
The research team has assessed municipal revenue mobilization performance in HCMC, Shanghai, and Jakarta by addressing the following three questions:

- Have significant resources been generated?
- How buoyant and sustainable are current revenue mobilization mechanisms?
- What have been costs in terms of economic efficiency and social equity?

<u>Quantity of Revenue Generated</u>

A comparison of local budget revenue growth rates for HCMC, Shanghai, and Jakarta is depicted in the following figure:

Figure V - 1: Local Revenue Growth Rates in HCMC, Shanghai, and Jakarta



Source: Authors' calculations

HCMC has been very successful in mobilizing revenue: real average total revenue increases have kept pace with the growth in gross regional domestic product, both rising at a compounded annual rate of approximately 11 percent from 2001 to 2004. However, the rate of total revenue growth during the last two years was less than half of the growth rate during the previous two years. Also, because HCMC may keep only a small portion of the total tax revenue it generates, roughly 30 percent, HCMC's budget actually shrunk by 3.1 percent in 2004 despite the preceding three years of rapid local budget growth.

HCMC officials believe that their on-budget revenue not only has fallen considerably short of its expenditure responsibilities in the past, but that this fiscal gap will grow over the next five years, during which time the city must mobilize VND 100 trillion ($6 billion) for the city's budget and an additional VND 450 trillion ($27 billion) for off-budget expenditure, 1.7 and 2.4 times greater than the previous five years.

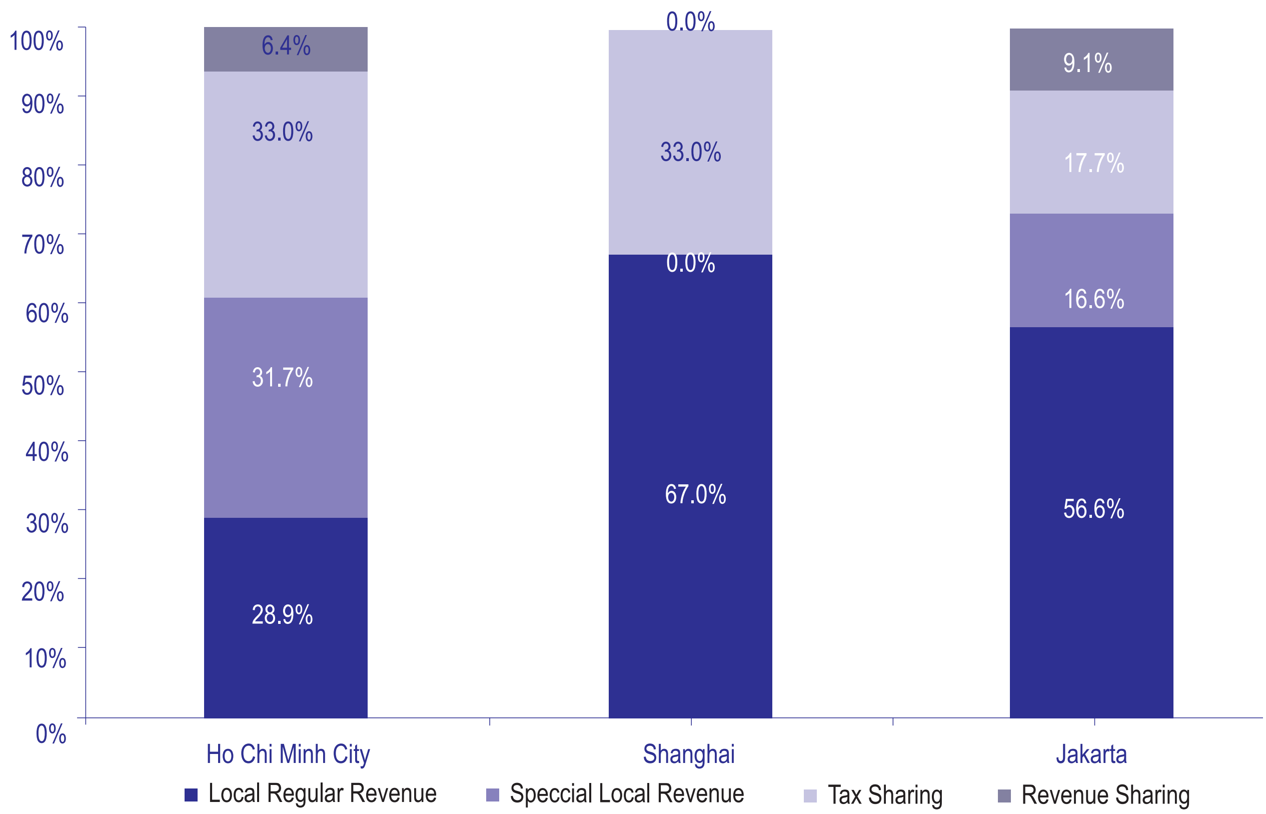
In contrast, the 26.5 percent real average annual growth rate of Shanghai's local budget revenue has surpassed the 18.9 percent total revenue growth rate, although both took a dramatic drop in 2002.

The real rate of local revenue growth in Jakarta has averaged 8.3 percent per year from 2001 to 2005, also with considerable fluctuation but in a clear downward trend; data for the total amount of revenue mobilized in Jakarta during this period are not available.

Buoyancy and Sustainability of Revenue Mobilization

The general composition of revenue in HCMC, Shanghai, and Jakarta is depicted in the following figure:

Figure V - 2: Revenue Composition in HCMC, Shanghai, and Jakarta



Source: Authors' calculations

All three cities have generated approximately two-thirds to three-fourths of their on-budget resources from own source revenue since 2000, with HCMC at 61 percent, Shanghai at 67 percent, and Jakarta at 73 percent. The remaining one-third of on-budget resources in HCMC and Shanghai has been dominated by tax sharing revenue; in Jakarta the remaining one-fourth has been split at a ratio of two-thirds from tax sharing and one-third from revenue sharing.

However, there are concerns regarding lack of buoyancy and sustainability when own source revenue is disaggregated:

Table V - 1: Revenue Composition in HCMC, Shanghai, and Jakarta

USD millions

Items	Ho Chi Minh City US$1=VND14,512 in 2000			Shanghai US$1=RMB8.28 in 2000			Jakarta US$1=IDR10,261 in 2001		
Own Source Revenue	**1,837**	**60.6%**	**100.0%**	**31,558**	**67.0%**	**100.0%**	**3,238**	**73.2%**	**100.0%**
Local Regular Revenue (Sustainable)	*876*	*28.9%*	*47.7%*	*31,558*	*67.0%*	*100.0%*	2,502	56.6%	77.3%
Local Taxes	0		0.0%	16,256		51.5%	2,239		69.2%
Local User Charges and Fees	158		8.6%	3,647		11.6%	116		3.6%
Revenue from Local Enterprises	0		0.0%	2,391		7.6%	23		0.7%
Local Government Debt	291		15.8%	8,696		27.6%	0		0.0%
Other Revenue	428		23.3%	568		1.8%	124		3.8%
Local Special Revenue (Incidental, Treasury)	*961*	*31.7%*	52.3%	0	0.0%	0.0%	736	16.6%	22.7%
Sale of Local Government Assets	464		25.3%	0		0.0%	0		0.0%
Budget Carryovers	159		8.7%	0		0.0%	718		22.2%
Transfers from Reserve Fund	0		0.0%	0		0.0%	18		0.5%
Enterprise Retained Earnings	338		18.4%	0		0.0%	0		0.0%
Shared Revenue	**1,192**	**39.4%**	**100.0%**	**15,568**	**33.0%**	**100.0%**	**1,184**	**26.8%**	**100.0%**
Tax Sharing	*998*	*33.0%*	*83.7%*	*15,568*	*33.0%*	*100.0%*	782	17.7%	66.0%
PIT	84		7.0%	2,947		18.9%	736		62.1%
CIT	329		27.6%	6,002		38.6%	0		0.0%
VAT	329		27.6%	6,111		39.3%	0		0.0%
Excise	96		8.0%	0		0.0%	0		0.0%
Other	161		13.5%	507		3.3%	46		3.9%
Revenue Sharing	*194*	*6.4%*	*16.3%*	*0*	*0.0%*	*0.0%*	403	9.1%	34.0%
Grant (Non-Refundable Aid)	18		1.5%	0		0.0%	0		0.0%
Central Budget Transfers	176		14.7%	0		0.0%	403		34.0%
Tax Rebates (Returns)	0		0.0%	0		0.0%	0		0.0%
Total Revenue	**3,029**	**100.0%**		**47,126**	**100.0%**		**4,422**	**100.0%**	

Source: Authors' calculations

For example, HCMC local regular revenue is comprised of a large number of local user charges and user fees, as well as a modest amount of local government debt. At present, there is no local government tax base that can be widely taxed annually at a low rate to generate significant own source revenue. Instead, HCMC derives much of its income from local nuisance charges and fees, which are often expensive to collect relative to the amount of revenue they generate.

Furthermore, more than half of own source revenue in HCMC has come from incidental sources such as the sale of local government assets, or from treasury operations such as budget carryovers.[28] Over time, HCMC will inevitably run out of assets to sell, and will have depleted accumulated budget surpluses. The composition of shared revenue is a bit more reassuring, as it is spread out over several national taxes and is relatively evenly split between direct and indirect taxes.

[28] Revenue from "enterprise retained earnings" is a bit misleading, because this is more of a tax expenditure since these funds never enter the government coffers - local government entities are allowed to keep the money for reinvestment.

The composition of own source revenue in Shanghai is a bit misleading, as the sale of local government assets and intangibles is off-budget but has generated a tremendous amount of revenue - long-term leases in downtown Shanghai and in Pudong district have financed much of the infrastructure development in these areas.

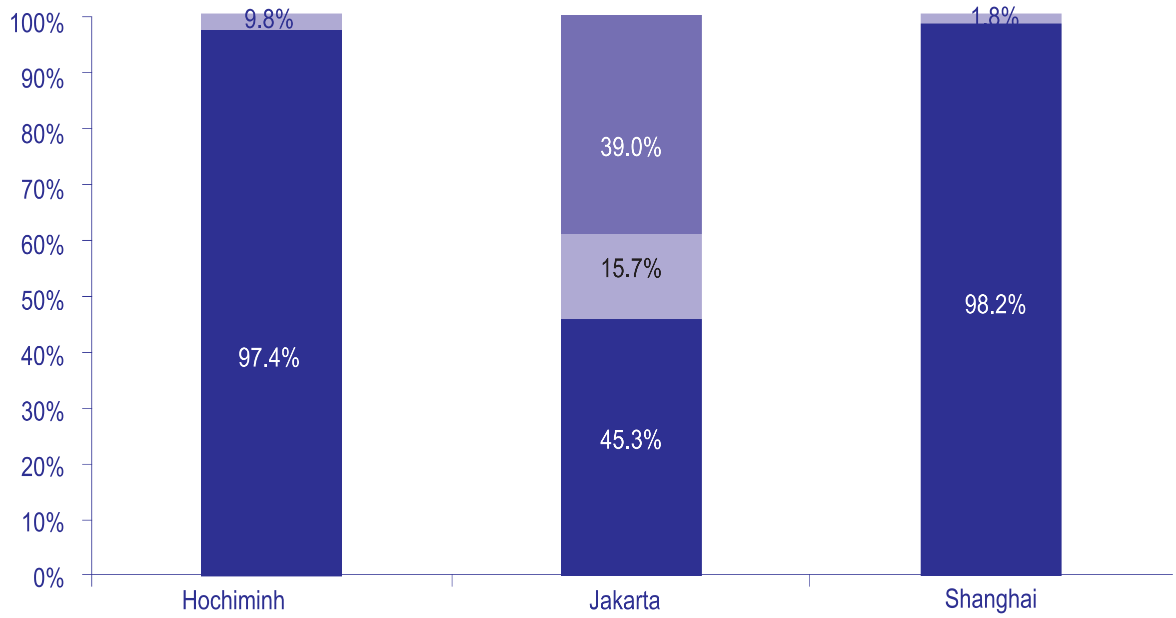
However, within the category of local regular revenue, Shanghai has a more sustainable composition of revenue sources: it is generating a greater share from local user charges and fees, and it has a buoyant, high-yielding local business tax. Like HCMC, shared revenue in Shanghai is spread out over several national taxes, but is weighted more heavily towards direct taxes, which are usually more difficult to collect than indirect taxes.

In many ways Jakarta has the most sustainable composition of own source revenue. Not only do almost three quarters of all its resources come from own source revenue, but within this category, most of the funds come from two buoyant and sustainable tax bases that are usually best taxed at the subnational level: vehicles and property.

Shared revenue in Jakarta also comes from several national taxes, but some is received as tax sharing and some as revenue sharing. However, all of this shared revenue is considered "equalization funds" in Indonesia, and the revenue sharing component is a formula-driven, nationally legislated central government transfer of domestic tax revenue.

The following figure compares local government revenue from real estate and vehicles:

Figure V - 3: Real Estate and Vehicle Revenue in HCMC, Shanghai, and Jakarta



	Hochiminh	Jakarta	Shanghai
Vehicle	0.0%	39.0%	0.0%
Rral Estate	2.6%	15.7%	1.8%
The others	97.4%	45.3%	98.2%

Source: Authors' calculations

<u>Economic and Social Cost of Revenue Mobilization</u>

The implications of relying on hundreds of local taxes, charges, and fees for local regular revenue and the sale of local government assets for incidental local revenue are unfavorable in terms both of economic efficiency and social equity. They distort the behavior of producers and consumers in a number of ways, creating economic losses for society as a whole, and the burden tends to fall most on those least able to pay. These sources of revenue are also expensive to collect and provide numerous opportunities for collusion and corruption, especially since many are off-budget.

In contrast, taxes and charges on viable local tax bases can be much more economically efficient, socially equitable, and fiscally remunerative. For example, a well-designed and properly implemented annual tax on the capital value of land and buildings is difficult to evade, so is economically efficient. It is also fair in that it is a proxy for long-term income, and is roughly correlated to benefits received. Likewise, vehicle-related taxes and charges can be relatively straightforward to enforce, they should fall on those with private transport, rising as the mode of transport increases in value, and are directly or indirectly linked to benefits derived. Moreover, property taxes can be an integral fiscal component of land use policies, while vehicle taxes and charges can be an important part of an integrated urban transportation strategy. A third common local revenue base is a turnover or sales tax on local businesses, which if modest, can complement local direct taxes and local user charges and fees.

Please refer to Annex III for criteria for making subnational tax choices and Annex IV for a representative assignment of taxing powers.

B. Expenditure Performance

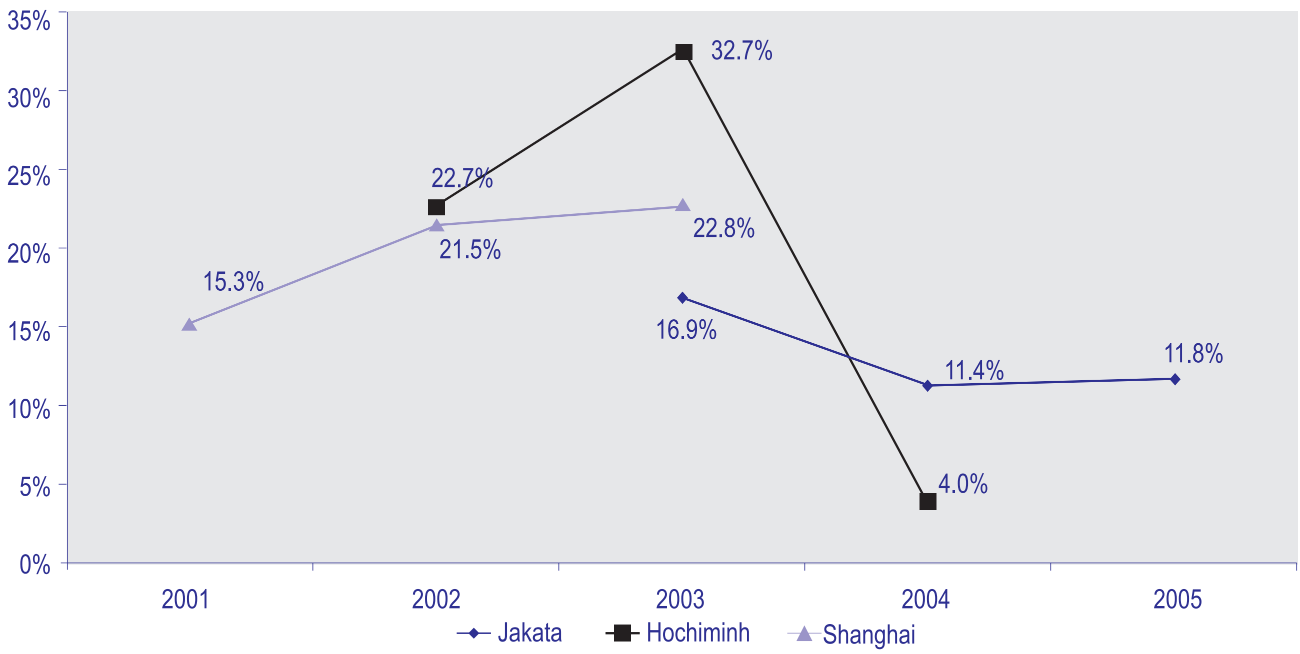
The research team has assessed municipal expenditure performance in HCMC, Shanghai, and Jakarta by addressing the following three questions:

- Is expenditure reporting transparent enough to hold officials publicly accountable for their expenditure practices?
- Are expenditure practices cost-efficient and cost-effective?
- How have municipal governments try to close the fiscal gap between assignment of expenditure responsibilities and availability of resources?

<u>Quality of Expenditure Disclosure</u>

A comparison of local budget expenditure growth rates for HCMC, Shanghai, and Jakarta is depicted in the following figure:

Figure V - 4: Local Expenditure Growth Rates in HCMC, Shanghai, and Jakarta



Source: Authors' calculations

The expenditure growth rate in HCMC is almost exactly the same as its revenue growth rate, while the two rates in Jakarta roughly follow the same trajectory and there does not seem to be any discernable relation between Shanghai's revenue growth rate and its expenditure growth rate.

Reported expenditure composition in HCMC, Shanghai, and Jakarta is shown in the following table and figure:

Table V - 2: Expenditure Composition in HCMC, Shanghai, and Jakarta

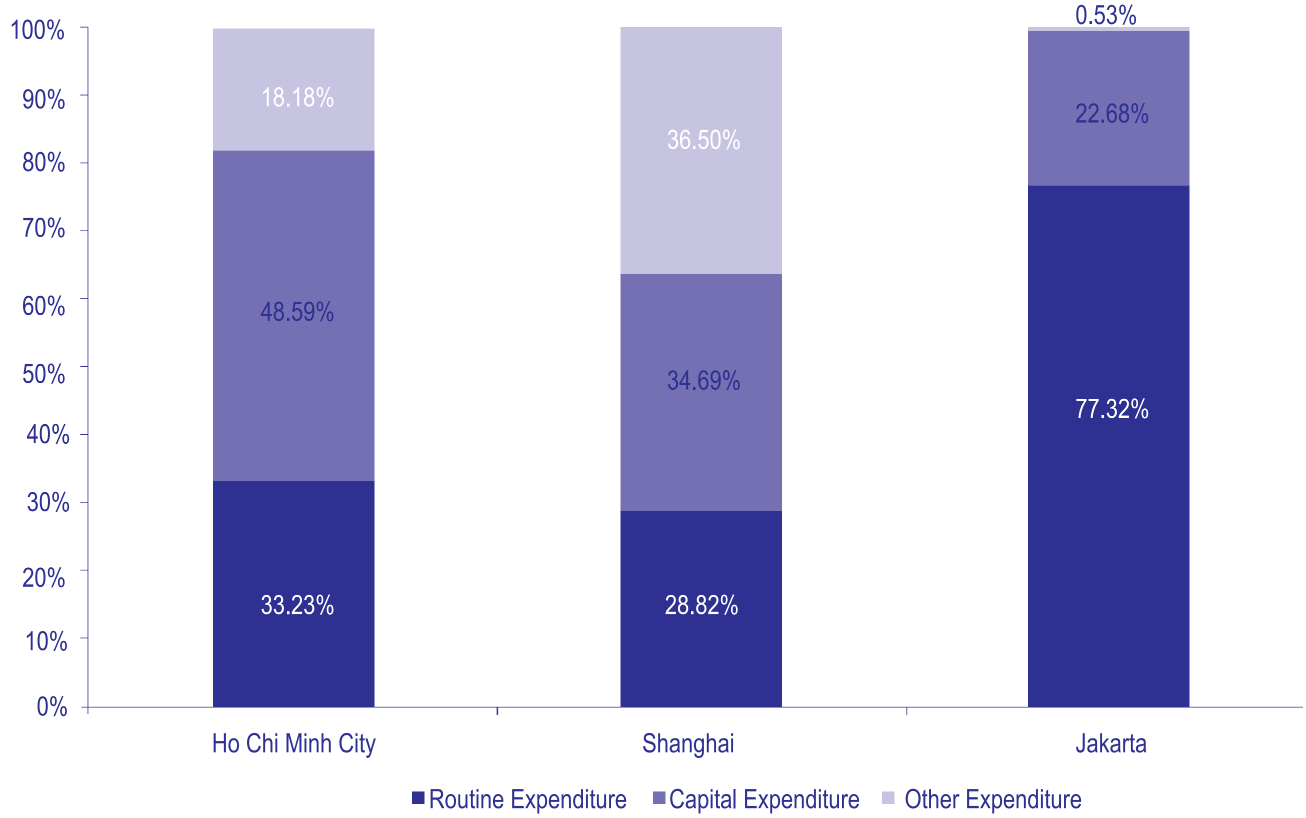
USD millions

No	Items	Ho Chi Minh City US$1=VND14,512 in 2000			Shanghai US$1=RMB8.28 in 2000			Jakarta US$1=IDR10,261 in 2001		
I	**Routine Expenditure (Recurrent)**	**945**	**33.2%**	**100.0%**	**11,498**	**28.8%**	**100.0%**	**2,945**	**77.3%**	**100.0%**
1	**By Sector**	**945**	**33.2%**	**100.0%**	**11,498**	**28.8%**	**100.0%**	**2,945**	**77.3%**	**100.0%**
	Economic Sector Activities	255		26.9%	-		0.0%	146		4.9%
	Education and Training	231		24.5%	-		0.0%	-		0.0%
	Science and Technology	-		0.0%	73		0.6%	-		0.0%
	Science, Education, Culture and Health	-		0.0%	7,850		68.3%	-		0.0%
	Health	126		13.3%	-		0.0%	-		0.0%
	Health and Education	-		0.0%	-		0.0%	1,028		34.9%
	Public Administration	101		10.7%	1,437		12.5%	1,042		35.4%
	City Maintenance	-		0.0%	2,138		18.6%	-		0.0%
	Social	48		5.1%	-		0.0%	276		9.4%
	Other	184		19.4%	-		0.0%	454		15.4%
II	**Capital Expenditure (Investment)**	**1,381**	**48.6%**	**100.0%**	**13,841**	**34.7%**	**100.0%**	**864**	**22.7%**	**100.0%**
1	**By Sector**	**1,381**	**48.6%**	**100.0%**	**-**	**0.0%**	**0.0%**		**0.0%**	**0.0%**
	Transportation	612		44.3%	-		0.0%	-		0.0%
	Public and Private Services	230		16.6%	-		0.0%	-		0.0%
	Industry	144		10.4%	-		0.0%	-		0.0%
	Education and Training	144		10.4%	-		0.0%	-		0.0%
	Other	252		18.2%	-		0.0%	-		0.0%
2	**Other**	**-**	**0.0%**	**0.0%**	**13,841**	**34.7%**	**100.0%**	**864**	**22.7%**	**100.0%**
	Capital Construction	-		0.0%	8,406		60.7%	-		0.0%
	Technical Updates	-		0.0%	5,435		39.3%	-		0.0%
	City Services and Infrastructure	-		0.0%			0.0%	864		100.0%
III	**Other Expenditure**	**517**[a]	**18.2%**		**14,563**[b]	36.5%		**20**	**0.5%**	
IV	**Total Expenditure**	**2,843**	**100.0%**		**39,901**	100.0%		**3,809**	**100.0%**	
V	**Revenue-Expenditure**	**186**[c]	**→ 6%**		**7,224**[d]	→15%		**613**[e]	**→14%**	

Source: Authors' calculations

[a] *Includes debt repayment, rebated earnings, and carryover differences between years*
[b] *The difference between total expenditure reported and the sum of disaggregated expenditure reported*
[c] *This residual is due to an error in calculation methodology (see footnote 7)*
[d] *There is no publicly available documentation to explain this difference*
[e] *Total unexpended revenue (carried over to following budget year)*

Figure V - 5: Expenditure Composition in HCMC, Shanghai, and Jakarta



Source: Authors' calculations

Weaknesses in the reporting of municipal expenditures become even more apparent when the total amount of on-budget revenue is compared with the total amount of on-budget expenditure. While 94 percent of local revenue is covered in HCMC's expenditure budget, this number drops to 86 percent for Jakarta's budget and only 85 percent for Shanghai's budget. In short, based on data available to this research team, the budgets of HCMC and Jakarta balance only after correcting for an error in calculation methodology in HCMC (see footnote 7) and adjusting for unexpended revenue carried over to the following budget year in Jakarta; Shanghai's unaccounted revenue remains unexplained. While these discrepancies might appear to be trivial, they are nonetheless troubling because they highlight in the most basic crosscheck between revenue and finance offices. They are more disconcerting when one keeps in mind that these data only cover on-budget revenue, and significant sources of revenue are off-budget in all three cities.

Yet more questions are raised in the transparency and credibility of municipal expenditure disclosure when one tries to disaggregate expenditure. Not only is it difficult to discern expenditure use within a city regardless of classification system, but it is exceedingly difficult to make meaningful comparisons between cities. For example, 37 percent of Shanghai's expenditures are not disaggregated at all in any publicly available documents; or despite the impression that more than half of all on-budget expenditure in HCMC is for capital investment, Jakarta's presentation of greater than three-quarters going to routine expenditure is probably more accurate.

Expenditure Cost-Efficiency and Cost-Effectiveness

Given that we really do not know how HCMC, Shanghai, and Jakarta are spending their money, it is not possible with publicly available information to assess the cost-efficiency of expenditure on inputs or the cost-effectiveness of expenditure outputs and outcomes. The furthest along on trying to address this concern is Jakarta, which is in the process of converting to a performance based budgeting system, although the city has yet to formulate criteria with which to assess expenditure performance.

Bridging the Fiscal Gap

HCMC, Shanghai, and Jakarta have all tried to bridge the fiscal gap by utilizing a wide variety of innovative off-budget financing mechanisms. Examples include: long-term land leases and land swaps; PPP (public-private partnerships) and PSP (private sector participation) in urban infrastructure such as BOT (build-operate-transfer), BT (build-transfer), BTO (build-transfer-operate), BOO (build-operate-own), and franchise contracting mechanisms; creation of local government investment companies such as HIFU in HCMC and UDIC in Shanghai; and debt financing via loans and bonds. Many of these techniques are highlighted in the text and in the case studies of Chapters Two (HCMC), Three (Shanghai), and Four (Jakarta).

II. Recommendations for Improving Municipal Finance in HCMC

A. Revenue Mobilization Performance

HCMC should try to increase generation of own source revenue while at the same time improve the economic efficiency and social equity in the way it generates this revenue. The long-term objective is to decrease dependency on central government fiscal policies and fiscal transfers by developing a buoyant, sustainable local revenue structure.

This entails:

- rationalization and consolidation of current taxes and charges on land and buildings into a viable annual property tax, as the fiscal component of an integrated urban land use policy;
- formulation of an integrated transportation strategy that combines provision of new roads and bridges with investment in mass transit and greatly increased taxes and charges on the ownership and operation of motor vehicles;
- preparation of a consolidated budget that includes all municipal revenue sources and all funds under municipal management; and
- continued reform of tax administration to further increase the revenue yield of tax collection efforts while lowering the taxpayer transaction costs of compliance.

B. Expenditure Performance

HCMC should try to improve the transparency, accountability, cost-efficiency and cost-effectiveness of municipal expenditure. The long-term objective is to create more social value added by increasing the return HCMC residents get for their contributions to the municipal treasury.

This entails:

- preparation of a consolidated budget that includes all municipal expenditure and all municipal contingent liabilities;
- disaggregation of public expenditure into categories and in a level of detail that accurately reflects the use of public revenue;
- design and implementation of a system to regularly assess the cost-efficiency of budget inputs over time and in comparison with other large municipalities in Vietnam; and
- design and implementation of a system to regularly assess the cost-effectiveness of budget outputs and policy outcomes, again over time and between comparable jurisdictions.

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Annex I: Key Indices

Vietnam

No	Items	2000	2001	2002	2003	2004
1	Deflator	1.000	1.021	1.053	1.111	1.199
2	Exchange rate (VND vs. USD)	14,512	15,081	15,396	15,637	15,800

Sources: State Bank of Vietnam, HCMC Statistics Department

China

No	Items	2000	2001	2002	2003	Total
1	Deflator	1.00	1.01	1.01	1.03	
2	Exchange rate (RMB vs. USD)	8.28	8.28	8.28	8.28	

Sources: People's Bank of China

Indonesia

No	Items	2001	2002	2003	2004	2005
1	Deflator	1.00	1.11	1.19	1.26	1.38
2	Exchange rate (Rupiah vs. USD)	10,261	9,311	8,577	8,939	9,705

Sources: Bank Indonesia

Annex II: Budget management, Decentralization, and the Relationship between Different Budget Levels in Vietnam

(Decree No. 60/2003/ND-CP)

1. Revenues enjoyed 100% by the central budget,

a) Value added tax on import goods;

b) Export tax, import tax,

c) Special consumption tax on import goods;

d) Enterprise income tax of entire branch accounting units.

e) Tax amounts and other revenues from oil and gas exploring and exploiting activities, land surface rent, water surface rent, recovered central budget capital at economic establishments, recovered loans of the central budget (both principal and interest), revenue from the central financial reserve fund, revenues from contributed capital of the central budget;

f) Non-refundable aid provided to the Vietnamese Government by foreign Governments, organizations and/or individuals;

g) Amounts payable to the State budget, as prescribed by law, from charges and fees collected by central agencies and units, excluding petroleum charges and registration fees,

h) Amounts payable to the budget, as prescribed by law, from non-business revenues of units directly managed by central agencies,

i) Positive difference between revenue and expenditure of Vietnam State Bank '

j) Revenue from central budget remainder, Revenue from transfer of central budget sources of the preceding year;

k) Fines, confiscation and other revenues from the central budget as provided for by law.

2. Revenues divided in percentages between the central budget and the local budgets:

a) The value added tax, excluding value added tax on import goods prescribed and value added tax collected from construction lottery activities;

b) The enterprise income tax, excluding enterprise income tax of the entire branch- accounting units and the enterprise income tax collected from construction lottery activities,

c) Income tax on high-income earners, not to mention taxes

d) Special consumption tax collected from domestic goods and services, excluding special consumption tax collected from construction lottery activities;

e) Petrol and oil charges.

3. Revenues enjoyed 100% by the local budgets:

a) House and land tax;

b) Natural resource tax, excluding natural resource tax collected from oil and gas activities;

c) License tax;

d) Land use right transfer tax;

e) Agricultural land use tax;

f) Land use levies;

g) Land rent, water surface rent excluding water surface rent collected from oil and gas activities;

h) Land-related damage compensation;

i) Money earned from lease and sale of State owned houses;

j) Registration fee,

k) Revenue from construction lottery activities;

l) Revenues from contributed capital of local budgets, retrieved money of the local budget capital at economic establishments, revenues from the provincial-level Financial Reserve Fund under the

m) Provisions

l) Non-refundable aid provided by foreign organizations or individuals directly for localities under the provisions of law;

m) Amounts payable to the budget, as provided for by law, from charges and fees collected by local agencies or units, excluding petrol and oil charges and registration fees

n) Revenues from public land funds and yields from other public properties;

o) Amounts payable to the budget under the provisions of law from non-business revenues of units under the local management;

p) Mobilizations from organizations, individuals under the provisions of law;

q) Voluntary contributions of organizations and individuals inside and outside the country,

r) Revenues from mobilization for investment in the construction of infrastructure works as provided for at Clause 3, Article 8 of the State Budget Law,

s) Revenue from local budget remainder,

t) Fines, confiscations and other revenues of the local budgets under the provisions of law,

u) Supplements from high-level budgets;

v) Revenues transferred from the previous year's local budget source to the following year's local budget source.

Annex III: Criteria for Making Subnational Tax Choices

Criteria/Objective	Comment	Taxes that Satisfy the Objective	…And Those That Fail
Accountability: Local policymakers responsive to citizen preferences. Those taxed have political redress	Local officials determine "own" tax rates; tax burdens borne locally; transparency	Local Personal Income Taxes (may conform to higher level tax base with rate set locally). User Charges	General Business taxes Visitor (tourist) Natural resource taxes (petroleum, minerals)
Revenue Productivity: Taxes that promote "adequacy" in order to finance an agreed flow of public services.	As a system, recognizes a balance between a bases responsive to changes in economic conditions growth (elasticity or buoyancy) and stability (certainty)	Ad valorem property tax (distinguish between land and improvements) & or Area-base property tax Personal Income Tax General Broad Based Business Tax (e.g., gross receipts/turnover) Single stage sales taxes Some terminal taxes (e. g., octroi) and market taxes	Corporate profits Many user charges Low- effort Property taxation
Benefits-Received: To extent possible taxes should function as a "price" for flow of services that accrue to the taxpayer/citizen	Taxes perform tax price quid-pro-quo and may be tailored to local and regional variations and benefit areas. Service spillovers (+ or -) may call for (i) special districts; (inter-local cooperation); (ii) middle tier governments.	Whenever possible charge Visitor Taxes Business taxes (generalized benefits; e.g., value added)	Non-resident based income tax (assumes non-residents are subject to alternative taxes for services received: e.g., user charges, sales taxes, visitor taxes, general business tax)
Non-Distortion: taxes should not unintentionally interfere with private decisions of consumers, factor suppliers and producers; they should be "neutral"	Variability in tax rates possible; Immobile tax bases rate high as do taxes with relatively high price inelasticity of demand; case for uniform tax bases; certainty in taxation	Taxes on immoveable property Land value tax plus charges User Charges Resident based Personal Income Sumptuary Taxes Taxation of "bads" Poll and communal taxes	Non-resident based income tax Gross receipts taxes Severance Taxes (if high rate) Octroi
Tax Equity: Tax burden should be reasonable and fair	Vertical equity (differential treatment unequal as usually measured by income or wealth-"gresssivity"); Horizontal (equal treatment of those in equal circumstances as measured by income, consumption, or wealth)	Progressive Resident Personal Income Taxes Ad valorem property taxes Some local sales taxes; excises	Poll and communal taxes Area-based property taxes Gross receipts taxes
Simplicity: administration & compliance	Citizens should be able to understand and control the system; cash flow preferable to accruals; standardized tax bases	Piggyback Personal income Single stage sales and excise (market tax) Wage taxes Turnover/receipts taxes Some user charges Market taxes	Multi-rate taxes Potentially broad based taxes narrowed by exemptions, deductions & tax preferences Property tax

Source: Robert D. Ebel and Robert Taliercio, "Subnational Tax Policy Design and Administration," in Motohiro Sato, ed., Fiscal Decentralization in East Asia Revisited (Tokyo: Routledge, 2006).

Annex IV: A Representative Assignment of Taxing Powers

Types of Tax	Determination of Base	Collection and Rate	Administration	Comments
Customs	F	F	F	International trade taxes.
Corporate income	F, U	F,U	F,U	Mobile factor, stabilization tool.
Resource taxes				
Resource rent (profits/income) tax	F	F	F	Highly unequally distributed tax bases.
Royalties, fees, charges; severance taxes; production, output, and property taxes	S,L	S,L	S,L	Benefit taxes/charges for state-local services.
Conservation charges	S,L	S,L	S,L	To preserve local environment.
Personal income	F	F,S,L	F	Redistributive, mobile factor, stabilization tool.
Wealth taxes (taxes on capital, wealth, wealth transfers, inheritances, and bequests)	F	F,S	F	Redistributive.
Payroll	F,S	F,S	F,S	Benefit charge, e.g., social security coverage.
Multi-stage sales taxes (value-added tax, [VAT])	F	F	F	Border tax adjustments possible under federal assignment; potential stabilization tool.
Single stage sales taxes (manufacturer/wholesale/retail)				
Option A	S	S,L	S,L	Higher compliance cost.
Option B "Sin" taxes	F	S	F	Harmonized, lower compliance cost.
Excises on alcohol and tobacco	F,S	F,S	F,S	Health care a shared responsibility.
Betting, gambling	S,L	S,L	S,L	State and local responsibility.
Lotteries	S,L	S,L	S,L	State and local responsibility.
Race tracks	S,L	S,L	S,L	State and local responsibility.
Taxation of "Bads"				
Carbon	F	F	F	To combat global/national pollution.
BTU taxes	F,S,L	F,S,L	F,S,L	Pollution impact may be national, regional, or local.
Motor fuels	F,S,L	F,S,L	F,S,L	Tolls on federal/provincial/local roads.
Effluent charges	F,S,L	F,S,L	F,S,L	To deal with interstate, intermunicipal or local pollution issues.
Congestion tolls	F,S,L	F,S,L	F,S,L	Tolls on federal/provincial/local roads.
Parking fees	L	L	L	To control local congestion.
Motor vehicles				
Registration, transfer taxes, and annual fees	S	S	S	State responsibility.
Driver's licenses and fees	S	S	S	State responsibility
Business taxes	S	S	S	Benefit tax.
Excises	S,L	S,L	S,L	Residence-based taxes.
Property	S	L	L	Completely immobile factor, benefit tax.
Land	S	L	L	Completely immobile factor, benefit tax.
Frontage, betterment	S,L	L	L	Cost recovery.
Poll	F,S,L	F,S,L	F,S,L	Payment for local services.
User charges	F,S,L	F,S,L	F,S,L	Payment for services received.

Note: U is supranational agency, F is federal, S is state or province, L is municipal or local. Source: Shah (1994).

Source: Anwar Shah, Fiscal Decentralization in Developing and Transition Economies: Progress, Problems, and the Promise, Policy Research Working Paper 3282 (Washington, D.C.: World Bank, April 2004).