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STUDY S-337

THE FISCAL SYSTEM OF WARTIME VIETNAM

Douglas C. Dacy

February 1969

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INSTITUTE FOR DEFENSE ANALYSES  
PROGRAM ANALYSIS DIVISION



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PROGRAM ANALYSIS DIVISION  
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## FOREWORD

→ This Study gives an overview of South Vietnam's fiscal system from 1962 through 1967 and indicates some of the major fiscal problems of the Central Government (GVN). Economists have published very little on any aspect of the war economy of South Vietnam. The Central Government's revenue system and the disposition of its total expenditures are understood by only a few Western economists. In 1959, Dr. Milton C. Taylor wrote a series of monographs describing and analyzing several of South Vietnam's domestic taxes and in 1968 he did a study for the Lilienthal Joint Development Group entitled "Tax Policies for the Post-war Development of Vietnam." Erland Heginbotham wrote a piece for the Agency for International Development, "Central Government Finance, 1961-1963," which was published by that Agency in Studies on Vietnamese Economy (1964). In 1967, the Foley Report (Internal Revenue Service) dealt with tax administration. Mr. Ronald Geddes and Mr. Abdul Rahman (International Monetary Fund) have written on the Vietnamese income tax but their work is unavailable to a general audience. Only Heginbotham's study dealt with the entire revenue and expenditure systems, but his primary purpose was to set the accounting records straight.

This Study has both descriptive and analytical content. It is divided into two Parts which reflect these separate intentions.

Part I (Section 1) is a description of the total revenue system of South Vietnam's Central Government. It includes discussions of domestic taxes, customs, administrative revenues, and foreign aid. I have attempted to account for the rather significant "extra budgetary" receipts, and to my knowledge this is the first study since Heginbotham's attempting to incorporate these receipts into the Central Government's revenue system. Section 1 can serve as a brief guide to Vietnamese taxation for anyone interested in that subject.

I think it is useful to include a description of the Vietnamese tax system because people in policy positions who require a knowledge of the system are frequently confused about it. The reader who already understands the Vietnamese tax system sufficiently well can still profit from Part I (Section 1) of this study because of the data it contains. These data were peiced together from sources which are not easily accessible and some of the data have never been published before. However, a reader interested in analysis only can skip over Part I and begin directly with the second part.

A second major objective of this Study is to make a case for what is known as the functional approach to public finance, and this is discussed in Section 2 (Part II). Certainly in a wartime economy fiscal policy should be directed toward containing inflation rather than with income distribution. Discussion of tax incidence is not very meaningful in the inflationary context. To express my own views concerning the proper goals of tax policy in wartime Vietnam, I thought it was necessary to include such a theoretical discussion.

A third objective is to evaluate the revenue system in South Vietnam as of 1968. As a start this requires comparing total revenues with total expenditures (~~Section 3~~). Finally, in Section 4 I give a partial evaluation of the current tax system. I do not attempt a tax-by-tax evaluation; rather, I have concentrated upon a few significant characteristics of the system and demonstrate how they adversely affected the Vietnamese fiscal situation up to 1968.

In discussing the fiscal situation in South Vietnam, I have taken a rather conventional approach. I compare government expenditures with government receipts. If expenditures exceed receipts, the government runs a deficit. In general the deficit had to be financed by borrowing from the National Bank of Vietnam or, in crude terms, by "running the printing press." In any event it led to an increase in the money supply by the amount of the deficit, other things remaining equal. Economists with the US Mission in Vietnam concerned with price stabiliztion developed a different way of looking at money supply creation. Their approach is called "gap analysis."

Briefly, "gap analysis" is concerned with the balance between total "absorptions" and total monetary "injections." Absorptions, those economic activities which drain private money holdings, are the sum of imports, government revenues, and invisible outlays. Injections, or monetary demands, are Vietnamese governmental expenditures, US government expenditures in local currency, invisible earnings, and exports. If domestic private economic activity is constant, a surplus of injections over absorptions means an increase in the money supply.

The major difference between my conventional accounting and "gap analysis" is the treatment of imports and US piaster spending. If GVN financed imports and US piaster expenditures are equal, then the two approaches will indicate approximately the same results in terms of money supply creation. Or stated differently, conventional and "gap analysis" will yield approximately the same results if there is no change in Vietnam's foreign exchange balance.

Consider the following simplified version of "gap analysis":

$$I = E_g + E_u$$

$$A = M_g + M_u + R_g$$

where

$I$  is injections measured in piasters;

$E_g$  is GVN expenditures in piasters;

$E_u$  is US piaster expenditures in Vietnam;

$A$  is absorptions measured in piasters;

$M_g$  is GVN financed imports valued in piasters;

$M_u$  is US financed imports (i.e., CIP imports) in piasters; and

$R_g$  is GVN revenues exclusive of foreign aid.

Define  $R_T = R_g + M_u$  since  $R_T$  (total revenues) include foreign aid which, for all practical purposes is the value of US financed imports. Then,  $A = M_g + R_T$ . Define  $\Delta B = E_u - M_g$ . Change in foreign exchange balances ( $\Delta B$ ) is the difference between the US purchase of piasters with dollars and the GVN use of those dollars to finance imports. If  $\Delta B = 0$  then the relationship of injections to absorptions is the same as that between total government expenditures and total revenues

(as I have considered them in this Study), i.e.,  $I/A = E_g/R_T$ .

Thus, the crucial link between "gap analysis" and the accounting system I have used is  $\Delta B$ . The reader should be aware of the major implication of this statement. The inflationary effect of excess government expenditures over receipts is zero if the foreign reserve balance is reduced by the difference; or an excess of government expenditures over receipts is not necessarily inflationary. A concrete hypothetical example illustrates this point. Suppose that the United States discontinued its economic foreign aid to Vietnam. If government expenditures remained steady, the gap between expenditures and receipts (as they are measured in this study) would increase. However, if at the same time the GVN increased GVN-financed imports out of reserve balances by the same amount as US-financed imports (foreign aid) declined, then the widening gap between expenditures and receipts would not necessarily lead to an increase in the money supply, and since the amount of goods available on the market would not decrease, no inflationary pressure would be generated. In effect, the government would sell dollars to importers for piasters with which it could finance its excess expenditures and there would be no need to increase the money supply.

During the period of this Study, the GVN steadily built up its foreign reserve balance. Under that circumstance the gap between expenditures and revenues would not be less inflationary than one would believe by assuming that the entire deficit were financed by central bank borrowing. Conventional expenditure-receipts analysis is appropriate and useful.

In preparing this Study, I received much assistance from American and Vietnamese personnel in Saigon. Joseph Harmon, Senior US Tax Advisor in Vietnam, was most cooperative in allowing me to read memoranda from his files and in supplying me with data. Richmond Allen, Carl Cundiff, Larry Dash, and Miss Huynh Thi Yen were helpful in supplying data and informing me of certain problems in their own specialties related to my task. Mrs. Nguyen Van Thang was always pleasant and responded rapidly when I asked her to sort out data from

her own worksheets. I particularly appreciate the time Mr. Xuan Tho, Special Tax Advisor to the Minister of Finance, gave me to discuss with him the tax system. Dr. Charles A. Cooper, former US Economic Counselor in Vietnam, was always helpful to me in Saigon and also as a formal critic of this Study.

Dr. J. A. Stockfisch gave me excellent criticisms and in addition taught me something about functional finance, although I probably have not completely satisfied some of his objections. To other of my colleagues at the Institute for Defense Analyses, William Niskanen, Harry Williams, James Brown, Rolf Piekarz, and Edward Sanders I express my appreciation for their help. My excellent secretaries in Saigon and Arlington, Virginia, Marie Burba and Evelyn Cole, also deserve my gratitude.

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## SUMMARY

The Central Government of South Vietnam raises revenues from three principal sources: (1) taxes based on domestic activities, (2) taxes related to foreign trade, and (3) US economic assistance. Taxes related to foreign trade can be divided into two groups, those which derive from regular laws pertaining to customs and austerity taxes and other "administrative levies," usually called extra budgetary receipts by the Vietnamese, which are imposed by the Ministry of Economy and collected and enforced by the National Bank of Vietnam through its monopoly over the sale of foreign exchange to Vietnamese importers. From 1962 through 1967 total revenues, excluding foreign aid, rose by 350 percent and, including foreign aid, by 300 percent.

Over the same period of time, Central Government expenditures rose from 21.6 billion piasters to 109.8 billion piasters. Deficits occurred each year and they were financed through borrowing from the Central Bank. For the whole period the money supply rose by 380 percent, from 17.2 billion piasters at the end of 1961 to 82.6 billion piasters at the end of 1967. Also foreign exchange reserves accumulated by the National Bank of Vietnam increased by 20.6 billion piasters. The result was a 3.4-fold rise in prices. The inflation made it difficult for the Central Government to increase its share of national income.

The defects of the revenue system in relation to expenditures can be grouped into three categories:

(1) Tax administration: Some taxes are poorly administered. Some taxes are not "cost-effective" in the sense that the revenues they bring do not justify the government's effort in collecting them. In particular, customs regulations are evaded or not complied with fully.

(2) Limited tax base: Sixty percent of domestic tax revenues are collected from the activities of nine firms which employ only 5,000 workers. Beer and carbonated beverages, tobacco, and petroleum taxes are the major sources of domestic revenues. About 90 percent of all domestic taxes are collected in the Saigon area. Despite this narrow effective tax base, the government has been able to increase the revenues from beer and carbonated beverages by continually raising the specific tax rates on these products. Tobacco taxes have kept par with inflation but petroleum taxes have lagged far behind. A kind of puritan mentality has acted to restrain the government from raising additional revenues by increasing the tax rate on petroleum and some other products.

(3) Fixed exchange rates: As a result of fixed exchange rates (for dollars), Vietnamese importers have captured windfall gains because they could buy in a non-inflated international market with cheaply purchased dollars and sell in an inflated domestic market. The devaluation of the piaster in 1966 temporarily transferred these windfalls from the importer to the Treasury. However, as domestic prices have continued to rise windfalls are accruing to importers. An increase in customs rates, a second devaluation, or the utilization of a system of flexible exchange rates would result in additional government revenues.

**PART I**

**DESCRIPTION OF SOUTH VIETNAM'S REVENUE SYSTEM**

## THE REVENUE SYSTEM OF THE CENTRAL GOVERNMENT

In this first Section (Part I) we describe the revenue system of the Central Government of South Vietnam. The description includes a collection of data on taxes and other government revenues that have not heretofore been published in a single study. It is hoped, therefore, that Part I of this Study will serve as a useful guide for persons interested in the revenue side of the fiscal system of South Vietnam and as a data source for persons interested in analysis of the system.

### 1.1 THE CURRENT REVENUE SYSTEM

Revenues of the Central Government of Vietnam (GVN) are derived from three different sources: (1) domestic activities, (2) foreign trade and currency operations related to foreign trade, and (3) foreign economic assistance. For the first two sources there is a further distinction between budgetary and extra-budgetary receipts. Budgetary receipts are those levied by specific laws and collected and administered by the regular taxation directorates in the Ministry of Finance, e.g., the Directorate General of Taxation and the Directorate General of Customs. These revenues automatically accrue to the national budget and can be spent for general budgetary support. Extra-budgetary receipts are levied, collected, and administered outside of the regularized tax channels. In general they have become prominent during the war period because they require no specific legislation and are easy to collect. The principal agents in the collection of extra-budgetary receipts are the National Bank of Vietnam (NBVN) and the Ministry of Economy. Some of these collections are turned over to the Treasury for general budget support, but some are used by the collecting agency to support programs not included

in the national budget. Although these taxes which are not collected by the Ministry of Finance are called "extra-budgetary," we shall frequently refer to them as administrative taxes, a term which more accurately describes their general character.

In addition to the regular taxes and administrative levies the Central Government has access to some other types of revenues. The various ministries sell services of all kinds, and some government industries make profits. There are small pension funds and a popular lottery. The Treasury maintains literally hundreds of special accounts handling money flows. Unfortunately, these accounts are so esoteric that it is difficult to bring them into the scope of this discussion. In any event, the sum total of the revenues in the special treasury accounts is small in relation to total revenues. Therefore we shall ignore them.

#### 1.1.1 Revenues from Domestic Activities

Numerous taxes have been written into the Vietnamese laws.<sup>1</sup> This is not a nation lacking in theoretical forms, and an outsider is hard pressed to imagine a tax which is not already on the books in some manner. However, there has been no systematic attempt to eliminate the ineffective taxes and to strengthen those which have proved effective. Modern-style taxes, little understood by the Vietnamese, coexist with anachronistic levies which irritate the taxpayer out of all proportion to the revenues they raise.

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1. Two pamphlets have been used extensively in this study: Nguyen Cao Chinh, "The Current Tax Regime in Vietnam," American Chamber of Commerce in Vietnam (June 1967), and Directorate General of Taxation, Ministry of Finance, Republic of Vietnam, "Taxation in Vietnam: A Handy Guide for Professional, Business and Salaried Taxpayers," (Saigon, 1968). The reader interested in more detail than that which will be presented here or in an analysis of the Vietnamese domestic taxes as they exist in the late fifties should refer to the series of monographs by Milton C. Taylor: The Taxation of Real Property in Viet-Nam, 1959; The Patente (Business License Tax) in Viet-Nam, 1959; The Taxation of Income in Viet-Nam, 1959; The System of Indirect Taxes in Viet-Nam, 1960; The System of Excise Taxes in Viet-Nam, 1960, Michigan State University Viet-Nam Advisory Group, United States Operation Mission (USOM), (Saigon, Vietnam).

Total revenues generated from domestic activities are usually accounted for in five classifications. They are (1) direct taxes, (2) indirect taxes, (3) excise taxes, (4) registration taxes, and (5) other governmental revenues. These broad classifications have an historical rather than a logical basis. For example, the separation of excise taxes and indirect taxes is largely a false one if standard economic criteria can be used to draw a distinction. The incidence of the tax is similar in both cases, and the degree to which the tax can be passed on to the final consumer depends upon the manner in which consumers respond to price changes of the individual products. The question is not whether the tax can be passed on, but how much of it can be passed. Nor is there necessarily a distinction between luxury goods and necessities in the case of the indirect and excise taxes. Some excise taxes (on matches, for example) can hardly be considered luxuries in comparison to some indirect taxes (the tax on dancing, for example). Yet, for the purpose of describing the tax system of South Vietnam it is not important to make a logical distinction between the various types, and we shall use the traditional classification in the following discussion.

1.1.1.1 Direct Taxes. In standard economies a tax is considered to be direct if the intended payer of the tax cannot pass it on to someone else. The taxation of personal income is a good practical example of a direct tax, and a Ricardian-type tax on rent of land is the sui generis of the economist's concept of a direct tax.<sup>2</sup> The Vietnamese revenue system of direct taxes does include an income tax but it also includes other taxes which cannot be considered "direct" in the strict economic sense. According to the classification used by the Directorate General of Taxation, the direct taxes are considered as follows:

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2. An actual case in which the government might have put a tax on economic rent (but not involving land) is discussed in the analysis of customs revenues in Section 4. See pages 72-75.

(1) Income tax: The full income tax system in Vietnam consists of two taxes. First, the taxpayer is required to pay a salary or business tax and, second, he must pay a general income tax. Thus, income is taxed twice, or at two different stages, and the overall rate is not immediately discernable from the published tax schedules.

The system distinguishes between salaried and nonsalaried income, or between wage income and business income. Salary incomes are taxed according to a progressive schedule which starts at one percent on salaries up to P50,000<sup>3</sup> per year (after deductions) and rises to 16 percent for salaries above one million piasters per year. The business income tax applies to all industrial and commercial enterprises, the professions, rental of land and buildings, and agricultural enterprises such as rice, tea, and rubber. After deductions there are only two tax rates, 16 percent for individuals and 24 percent for corporations. It is apparent, therefore, that at this first stage the tax discriminates against business income and in favor of wage income.<sup>4</sup> An individual businessman pays a minimum of 16 percent whereas that figure is the maximum a wage earner has to pay at this first stage of the computation.

A new computation is required to determine the additional income tax liability. At the second stage the salary or business tax (or both if the activities are combined) is deducted from total income to determine the actual tax base for paying the general income tax. The newly computed income is subject to a rate of one percent on amounts up to P10,000 per year, which progresses to 50 percent for amounts above P800,000 per year. The general income tax rate does not distinguish between salary and business income, but the actual payment does depend indirectly on the manner in which income was earned because of the way deductions are allowed.

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3. The symbol P is used throughout this study to represent the Vietnamese unit of account, the dong, popularly called piaster.

4. This discrimination in the income tax system may be considered as one aspect of what we shall refer to in Section 4 as a kind of puritan mentality of the Vietnamese.

An example will help to clarify this system. Suppose that a salaried person and businessman both earn \$200,000 per year after deductions. The salaried person pays \$6,500 in salary taxes (3½ percent of \$200,000) and \$19,525 in income taxes (approximately 10.1 percent of \$200,000 minus \$6,500) for a total of \$26,025 and an effective overall tax rate of 13 percent. The businessman pays \$32,000 in business taxes (16 percent of \$200,000) and \$10,200 in income taxes (approximately 6.1 percent of \$200,000 minus \$32,000) for a total of \$42,200 or an effective overall tax rate of 21 percent.<sup>5</sup>

While the formal income tax structure discriminates against business incomes it is not clear that the businessman comes out poorly in practice. Persons on salaries, particularly those working for foreign firms, the GVN and the US Government usually cannot avoid the salary tax because a law which went into effect January 1, 1967,<sup>6</sup> requires that taxes be withheld from the workers' salaries. Thus, any company large enough to have to worry about the audit procedures must comply with the law insuring that the tax will be collected. On the other hand, relatively high rates on nonsalary incomes are hardly ever collected, because their collection depends upon the businessman's declaration which is easily falsified but difficult for the government to disprove.<sup>7</sup>

(2) Property tax: A large potential source of revenue is the property tax. Theoretically the property tax on agricultural land varies with the type of crop produced, and the tax on urban land and buildings is based upon their rental values. Agricultural land taxes accrue to the village budget and urban property taxes to the municipality or province. However, as can be seen in Table 1, actual taxes collected on property are insignificant in comparison with total tax receipts

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5. The exact schedules are given in the first two references cited in footnote 1.

6. Withholding taxes for Vietnamese employed by the US Government went into effect July 1, 1967, but the US Government withholds only if the Vietnamese employees make allotments voluntarily.

7. See Section 4: Tax Administration.

Table 1

DOMESTIC TAX COLLECTIONS OF THE CENTRAL GOVERNMENT,<sup>a</sup> 1962 - 1967  
(million piasters)

Type of Tax	Year					
	1962	1963	1964	1965	1966	1967
<b>Direct Taxes<sup>b</sup></b>	<b>1323</b>	<b>1633</b>	<b>1072</b>	<b>1095</b>	<b>1417</b>	<b>3129</b>
Income	883	927	728	782	1085	2493
Property	220	467	133	92	66	77
Patente	204	223	206	217	258	388
Other	16	16	5	5	3	171
<b>Indirect Taxes</b>	<b>2032</b>	<b>2420</b>	<b>2493</b>	<b>2824</b>	<b>3912</b>	<b>4992</b>
Gasoline	1051	1214	1124	1165	1382	1669
Production	647	871	1020	1283	1942	2498
Entertainment	116	103	115	127	209	306
Meat	69	67	74	81	59	77
Motor Vehicle	52	53	53	56	88	202
Paddy (Rice)	31	41	29	30	25	20
Ice	18	21	26	29	35	44
Restaurant	5	7	6	10	66	102
Precious Metal	9	16	13	11	54	22
Films	6	6	7	7	10	15
Dancing	-	-	14	12	14	18
Other	28	21	12	13	18	19
<b>Excise Taxes</b>	<b>1409</b>	<b>1545</b>	<b>1734</b>	<b>2703</b>	<b>5162</b>	<b>7798</b>
Tobacco	919	1013	1076	1590	2710	4064
Beer <sup>c</sup>	231	316	425	756	1543	2359
Sugar	71	68	55	60	66	75
Alcohol	43	43	51	60	74	95
Carbonated Beverages	56	67	83	184	653	1067
Matches	17	18	25	39	49	71
Other	72	20	19	14	67	67
<b>Registration Taxes</b>	<b>685</b>	<b>906</b>	<b>850</b>	<b>1137</b>	<b>2254</b>	<b>3005</b>
Registration and Inheritance	353	462	408	536	1106	1350
Super Rent <sup>d</sup>	-	-	86	113	405	632
Dividend	207	301	245	305	425	589
Stamps	80	88	96	120	175	240
Public Property	13	20	18	19	58	40
Other	32	35	37	44	85	154
<b>Total</b>	<b>5449</b>	<b>6506</b>	<b>6189</b>	<b>7759</b>	<b>12745</b>	<b>18924</b>

- Source: Directorate General of Taxation, Vietnam.
- Includes taxes collected from prior years. Beginning in 1966 direct taxes were assessed and collected by the Directorate General of Taxation; in prior years they were assessed by the Directorate General of Taxation but collected by the National Treasurer.
- Includes special perequation tax collected by Ministry of Economy. The figure for 1966 includes ₪502 million for beer and ₪298 million for soft drinks. For 1967 the estimated perequation figures are ₪1033 million for beer and ₪667 for soft drinks.
- Super rent tax for 1962 and 1963 are included with registration and inheritance taxes.

(3) Patente tax: The patente is a business license tax. Basically the enterprise or professional pays a lump sum fee for the privilege of operating a business. However, in some cases a patente is charged depending upon the volume of business. Generally, there seems to be little rationale behind the way this tax is assessed. In any event it is not an important tax in terms of revenue it contributes. Also, since it is paid at the source of activity one should note that the patente can be passed on to the final consumer and therefore is not properly classified as a direct tax.

1.1.1.2 Indirect Taxes. Indirect taxes in the Vietnamese system can be distinguished from excise taxes only in that the former are collected by the Directorate of Indirect Taxes and the latter by the Directorate of Excise Taxes. A glance at the list of these taxes reveals little basis for their separation; however we shall follow the conventional classification. Indirect taxes are levied on gasoline, entertainment, meat, motor vehicle circulation, paddy rice, ice, precious metals, dancing, and other items. The most important tax belonging to the indirect group is the production tax, yet its inclusion emphasizes the lack of coherence in this classification of domestic taxes.

(1) Petroleum tax: The petroleum tax, one of the GVN's best revenue earners, is paid by the distributors of petroleum products, Esso, Shell, and Caltex. Of all the taxes in Vietnam this probably is the easiest to collect. The tax on automobile gasoline at the end of 1968 was  $\text{P } 3\frac{1}{2}$  per liter or approximately 30 percent of the retail price. Taxes are also assessed on other types of petroleum products such as kerosene and diesel fuel but exemptions on petroleum products for certain users have reduced collections considerably below their potential.<sup>8</sup>

(2) Production tax: The production tax came into existence in 1957. It was conceived as a broad-based tax on practically all

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8. See Note 5, Appendix B.

economic activity including domestic trade and foreign imports.<sup>9</sup> The rate has always been 6 percent of the value of production. Conceptually, it is useful to view this tax as a tax on value added at each stage of production; however, at present collections are taken from only a relatively small number of firms and not on a value added basis. Many exemptions have limited the effectiveness of this tax so that today it is principally "a selective gross receipts" levy on large manufacturing and construction firms.<sup>10</sup> In 1958 one half of the firms required to register for the production tax in the Saigon-Cholon area were exempt from paying it for some reason.<sup>11</sup> It is so reduced by exemptions and evasions that one writer has commented: "possibly no other levy in the Vietnamese tax system ... fails [so much] to live up to its real revenue potential."<sup>12</sup> Even considering its reduced scope, it is one of the major sources of government revenue in Vietnam today.

(3) Other indirect taxes: The Vietnamese revenue system includes many small and ineffective taxes in addition to the two major indirect taxes mentioned above. Some of these lesser taxes are listed in Table 1. The entertainment and restaurant taxes combined provided about eight percent of the indirect taxes collected in 1967. The rate schedules on these taxes are so confused that it is doubtful whether they are clearly understood by the tax officers; certainly they are difficult to enforce. The motor vehicle tax is an annual charge on automobiles, trucks and motor scooters. Up to 1968 it was not levied against the many thousands of motor bikes which have been imported into Vietnam since 1965. The meat tax is a specific levy which is

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9. The production tax on imports was withdrawn in the fiscal reform of December 1961. This and other taxes were replaced by the five-sevenths tax. See Banque Nationale Du Viet-Nam, Supplement au Bulletin Economique (Revue Semestrielle, No. 2-Annee, 1962), p. 4.

10. Milton C. Taylor, "The System of Indirect Taxes in Viet-Nam," Michigan State University Viet-Nam Advisory Group (March 1960, p. 23.

11. Ibid, pp. 31-32.

12. Ibid, p. 1.

easy to collect but applies only to those animals passing through the controlled slaughterhouses. However, it does not generate much revenue because of the very low rates on slaughtering.<sup>13</sup> There is an ice tax but, apparently, only one ice firm pays it.<sup>14</sup>

1.1.1.3 Excise Taxes. An excise tax is one which is levied on a specific product. According to the definition some of the taxes classified as indirect are more properly labeled excises, e.g., the petroleum tax. Historically in the Western world, excise taxes have been assessed against items which social philosophers have considered luxuries, and that convention appears to apply to the Vietnamese tax system.

The regular excise taxes along with the administrative levies on beer and carbonated beverages<sup>15</sup> collected by the Ministry of Economy form the backbone of the Vietnamese revenue system. The taxes on cigarettes, beer and carbonated beverages account for 45 percent of the domestic tax revenues. In addition to their contribution to total revenue they are easy to collect since the government has to deal with only three tobacco companies, one beer company, and two soft drink companies.

(1) Cigarette tax: The tax on cigarettes is a mixture of ad valorem and specific levies. Cigarettes using imported tobacco are taxed at 50 percent of their wholesale price, including the tax, plus a specific tax of \$1000 to \$2000 a case depending upon the retail price. These taxes combined account for about one-half the retail price of cigarettes. The tax is collected from the three large cigarette manufacturers in Vietnam. In addition to the standard tax

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13. See page 71 below.

14. John B. Mulvey, "Report of General Findings regarding Policies and Procedures in the Directorate of Indirect Taxes," Agency for International Development (Saigon: October 1967), p. 28.

15. This tax, called the perequation tax on beer and carbonated beverages, went into effect in July 1966. It is not normally considered an excise tax, but its contribution is included in Table 1 under excise taxes in order to show the true importance of these products as revenue earners for the Central Government. For a discussion of perequation taxes see below, pages 62-65.

there is a specific tax on leaf tobacco and lesser taxes on cigarettes made entirely out of domestic (black) tobacco.

(2) Beer and carbonated beverages: These taxes are stated as a specific amount per liter. The rates are high. For example, the regular excise tax on "33" beer is ₪13.5 per liter and the administrative levy or perequation tax adds ₪15.9 per liter. The total tax amounts to ₪9.7 per bottle. The average price of "33" beer in 1967 was ₪20.5 per bottle,<sup>16</sup> thus the tax bite was almost 50 percent of the retail price. There are two major carbonated beverage companies and one beer company in Vietnam, and since the tax is paid by the manufacturer, it is easy to collect. In fact tax collectors actually reside at these plants.

(3) Other excises: Other excise taxes are collected on sugar, alcohol, and matches. These taxes are relatively insignificant.<sup>17</sup>

1.1.1.4 Registration Taxes. If the Vietnamese actually complied with registration laws they would expend a significant percentage of their time doing so. Registration is required on the sale of real estate (18 percent tax rate on a first sale), sale of motor vehicles (15 percent on small passenger cars), rental contracts, letters of credit, business contracts, donations and scores of other transfers. Most of the rates are computed on an ad valorem basis and some of the rates are very high, e.g., 24 percent on donations to some relatives "outside the marriage contract." Aside from the fees paid on the registration of contracts and other papers the broad class of registration taxes include:

(1) Inheritance tax: This is a graduated tax. The exact rate depends upon the amount involved, the closeness of kinship, and the

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16. Of course, beer served in restaurants and bars was sold at a much higher price than ₪11 per bottle.

17. In 1966 a perequation tax was levied on sugar. Apparently the government received ₪500 million in taxes for that year. This amount is not included in Table 1 but rather in Table 5. See footnote c to Table 5 for specific reference to this sugar tax.

heir's nationality. The top rate of 50 percent applies to a kinless foreign heir who has been bequeathed P500,000 or more.

(2) Super rent tax: Super rent is defined in relation to the annual property tax paid by the owner. If the monthly rental exceeds one-third of the annual tax, the difference is considered super rent and it is taxed at a 40 percent rate. This means, of course, that the government has some concept of fair rent. Aside from raising revenue the intent the super rent tax is to penalize the property owner who attempts in any way to evade taxes by understating the value of the property. This law came into existence in 1962 but was poorly enforced until March 1966. The major source of the tax is due to US Government rental of properties in Saigon. That it raised twice as much revenue in 1967 as the business license tax attests to its effectiveness.

(3) Other duties: Other duties are paid on dividends and on any document which is required by law to be stamped. Many of these stamping requirements probably cost the government more money than they return and serve only as a nuisance to the citizen.

1.1.1.5 Other Central Government Revenues. The various ministries of the GVN collect revenues for services they perform or privileges they grant to individuals. The government earns revenues from telegrams, telephone, forestry contracts, identification cards, and dozens of other activities. In addition to earnings from government services, the GVN collects miscellaneous revenues from reimbursements and participation (with private businesses) and minor transfer of revenues from activities of previous years. Revenues from the Reconstruction Lottery have been included as a separate entry in Table 2. With the exception of 1966 they were not included in the GVN statistics as "other revenues." The Ministry of Economy collects large sums of money under present arrangements but we have excluded these collections from Table 2 as they are more logically classified under administrative levies.

Table 2

OTHER GOVERNMENT REVENUES, 1962-1967<sup>a</sup>  
(million piasters)

	1962	1963	1964	1965	1966	1967
Receipts from government agencies	626	701	969	1239	1356	1777 <sup>b</sup>
Miscellaneous and extraordinary receipts	499	307	365	1058	1667	1678
Special receipts <sup>c</sup>	239	227	314	497	270	1576
Reconstruction Lottery <sup>d</sup>	240	439	429	391	579	1013
Total	1604	1674	2077	3185	3872	6044

- a. Source: Agency for International Development, Joint Economic Office, Saigon, Annual Statistical Bulletin, No. 11.
- b. This figure excludes 8880 million piasters collected in per-equation taxes levied by Ministry of Economy and reported for the first time in 1967 as "receipts from government agencies."
- c. The source quoted above included the receipts from the Reconstruction Lottery only for 1966. This row excludes those receipts which amounted to \$579 million.
- d. Source: Eric Daenecki, "Report on the National Lottery System, Vietnam," Fiscal Branch, Public Administration Division, Agency for International Development (Saigon: May 8, 1967). Data for 1967 supplied by Mr. Daenecki.

Note: National Institute of Statistics, The Monthly Bulletin of Statistics, lists another type of revenue called "other revenues." In those figures the major component is called "ordinary revenues." These are receipts which have not yet been counted in the other classes of revenues. Eventually they are properly classified; thus adding them to the figures in this table would be double counting and therefore they have been excluded. The remaining "other revenues", reimbursements, combinations and participations (resulting from joint government-private activities) are considered in the above classification as miscellaneous and extraordinary receipts.

### 1.1.2 Revenues Related to Foreign Trade

The economy of Vietnam depends heavily upon foreign trade. In 1967 the National Bank of Vietnam estimated the gross national product at 350 billion piasters. For the same year the value of imports was approximately 538 million dollars. According to Vietnamese sources the value of imports in piasters was 43 billion.<sup>18</sup> This value was computed at the official exchange rate of ₪80 to \$1. If we use the actual exchange rate of ₪118 to \$1, the value of imports in the Vietnam economy would be ₪63 billion or 18 percent of the gross national product.<sup>19</sup> Calculated at the average true exchange rate which would be less than the black market rate (i.e., ₪160 to \$1) but more than the actual exchange rate, the economic value of imports would exceed 20 percent of the gross national product. This dependence on imports has had a major impact on the GVN budget and it also creates menacing problems for the future.

Revenues from foreign trade are of three kinds: (1) those levied on customs and austerity taxes on physical imports, (2) taxes raised from the sale of dollars for piasters to Vietnamese importers, and (3) special levies imposed by the Ministry of Economy in special cases. Technically, it would be possible to collect all of these revenues, as a single tax on imports, that is by raising either the customs rates or the foreign exchange tax rate; however, that is not the way it is done in Vietnam.

1.1.2.1 Customs and Austerity Duties. The Central Government presently collects about 80 percent as much in customs and austerity taxes as it does in all domestic taxes combined. This emphasizes the reliance the GVN places on foreign trade taxes. That the GVN is able to collect large revenues in foreign trade taxes is a source of

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18. See for example, National Institute of Statistics, Monthly Bulletin of Statistics, (July 1968), Table 8.2. The source for this data is the Directorate General of Customs.

19. The official exchange rate was set by the government in June 1966. However, a businessman who wishes to import goods must pay an additional tax of ₪38 to \$1 (Economic Consolidation Surtax) raising the actual rate to ₪118 to \$1. For a detailed discussion see below, p. 22.

strength but, at the same time it poses a problem for the future. It is a strength, because under the present conditions in Vietnam, customs and austerity duties are relatively easy to collect and they are a dependable and predictable source of revenue. However, since much of the importing in Vietnam is financed with US aid, customs and austerity duties will become a less reliable source of revenue when the present conditions no longer prevail.

Vietnamese imports are financed either out of accumulated foreign exchange reserves or directly by the United States Treasury through the Commercial Import Program (CIP) and the Food For Freedom (FFF) program. Over the period of this study, both foreign exchange reserves (dollars) and US financed imports have expanded because the military situation involved a large buildup of US troops to fight the war and a massive influx of US goods to fight inflation. When the military needed piasters to conduct its local affairs, it purchased them with dollars and built up the GVN's foreign exchange balance. However, as the war subsides the United States is likely to cut back its economic as well as military assistance. This cut-back will reduce foreign exchange earnings so that the volume of imports, relative to domestic production, must decline. Thus, duties collected on imports will decline also.

(1) Customs duties: Vietnamese customs schedules have been revised four times since 1961. The average theoretical rate of customs duties has varied between 50 and 75 percent, calculated at the official exchange rate, or between 30 and 50 percent<sup>20</sup> if calculated at the actual exchange rate. The actual collection rate has always been lower than the theoretical rate, a fact shown in Table 3. Our best guess, based upon the evidence we have seen, is that actual collections have been about three-fourths of the theoretical rate.<sup>21</sup>

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20. For 1962-1965 these theoretical rates were calculated in a Memorandum from Timothy Hallinan to Leroy S. Wehrle, Agency for International Development (Saigon: May 10, 1966), p. 2. Unfortunately, I was not able to find similar calculations for 1966-1967.

21. According to Hallinan's computations, op. cit., the weighted schedule average for customs duties during the period 1962 to 1965 was

The variation of custom duties between items is great. For example, they start at 5 percent (#4 per \$1 of imports) and reach a high of 200 percent on whiskey. To the extent that some importers comply with the schedule and others do not, they probably are discriminatory. Undoubtedly the GVN could raise more revenue from customs by better policing and perhaps by revising the entire schedule. However, it is not possible to specify the optimal tariff for the purpose of revenue generation because we know so little about the responsiveness of consumers to price changes of the individual commodities.<sup>22</sup>

(2) Austerity taxes: Austerity taxes are additional duties placed on "luxury" goods. The austerity tax, first assessed in December 1961, has become an important source of revenue today. We hesitate to state that only luxury goods are subject to this tax since the schedule applies to a broad range of commodities. The effective average austerity rates are given in Table 3. They have varied between 3 and 6 percent, but the reader should bear in mind that these relatively low percentages are related to total imports, many of which carry no austerity tax at all. The lowest official rate is 10 percent and the highest rate at the present time is 210 percent on automobiles.

1.1.2.2 Extra Budgetary Receipts (Administrative Levies) Collected by the National Bank. Aside from the revenues which flow into the Treasury from taxes and customs duties, additional levies

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31 percent considering the actual exchange rate prevailing at the time. Actual customs collections during the same period amounted to 23 percent of the imports valued at the official rate of exchange. Today it is difficult to estimate the extent to which actual customs collections deviate from theoretical collections. Importers usually pay the proper rate according to their invoices but it is widely believed that the invoices are falsified either with regard to value of the imports or their quality which allows them to enter at a lower rate. For a further discussion of this problem see Section 4 below.

22. See Section 4 below, p. 59.

Table 3

VALUE OF IMPORTS AND CUSTOMS AND AUSTERITY TAX COLLECTIONS  
1962 - 1967

	1962	1963	1964	1965	1966	1967
Value of imports (mil US \$) <sup>a</sup>	264.5	286.2	297.8	357.3	495.6	538.0
GVN financed	78.6	77.7	95.0	85.4	167.8	302.0
US financed	163.4	187.8	168.7	246.7	299.3	235.3
Customs revenues (mil piasters) <sup>b</sup>	4219	4063	4147	4450	8908	11817
Austerity taxes (mil piasters) <sup>b</sup>	553	549	923	1120	2766	3792
Piasters collected per dollar of						
Customs	15.9	14.2	13.9	12.5	18.0	22.0
Austerity	2.1	1.9	3.1	3.1	5.6	7.0
Average rate of duty, percent (@ official exchange rate)						
Customs	44.9	40.1	39.7	35.7	23.2	27.5
Austerity	5.9	5.4	8.9	8.9	8.2	9.8
Average rate of duty, percent (@ actual exchange rate)						
Customs	26.5	23.7	23.2	20.8	14.4	18.6
Austerity	3.5	3.2	5.2	5.2	5.0	5.9

a. Source: Agency for International Development, Joint Economic Office, Annual Statistical Bulletin, No. 11, Table D-14.

b. Source: Agency for International Development, Joint Economic Office, data from worksheets (Saigon: September 1968).

Note on exchange rate: Before June 18, 1966 the official rate was P35 per dollar and the actual rate was P60 per dollar. After devaluation the official rate was P80 per dollar while the actual rate was P118 per dollar. The "rate of duty" calculations for 1966 are weighted averages of the first and second half-year periods with weights depending on the dollar value of imports in each period.

are collected by the National Bank of Vietnam. These receipts derive almost exclusively from the international financial transactions, interpreted broadly, in which the bank engages as agent of the National Government. Some of the funds are released to the government to help finance its budgetary expenditures, but some are retained by the bank to finance other government commitments called extra-budgetary expenditures. The latter are not counted in the national budget. The degree to which the total government fiscal operation is inflationary depends on the gap between total collections and expenditures including those received and paid out of extra-budgetary accounts.

Extra-budgetary receipts accrue to the NBVN in the first instance because it has the sole authority to buy and sell foreign exchange. Frequently it makes a profit (surtax) on these transactions and sometimes it deliberately exchanges at a loss (subsidy). In the typical case it profits by selling foreign exchange (dollars) to importers at rates above the official rate and loses by purchasing dollars from exporters at a price in excess of the official price. Superimposed on this basic structure is a system of multiple exchange rates (per-equation tax) which constitutes an additional source of revenue. Regardless of the immediate or particular source of these receipts they ultimately derive from the fact that the Bank has a legal monopoly in selling dollars to importers, and can charge whatever price it pleases, and is a monopsony in buying them from exporters.

(1) The basic source of extra-budgetary receipts: The actual rate at which foreign exchange is bought and sold in Vietnam is not always the same as the official rate. This difference creates the possibility for profitmaking in financial transactions. If the National Bank is able to buy dollars at the present official price of \$80 and sell those dollars to importers for \$118 per dollar, it stands to make a profit on the transaction of \$38 per dollar. In fact, the NBVN engaged in this kind of transaction on a very large scale in the past (to October, 1967).<sup>23</sup> The profits realized from

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23. See below, pp. 22-25.

this operation constituted a genuine source of revenue which the NBVN used to build up its foreign exchange reserves. Had these funds been used to finance additional imports, prices in Vietnam would have risen more slowly than they actually did rise. In other words these profits of the NBVN could have been used as a deflationary factor.

The Bank does not make a profit with each sale of dollars to importers. For goods imported under the CIP, there is no scope for profit because there is actually no sale of foreign exchange involved. The United States Treasury pays the US exporters. When the goods arrive in Vietnam, the importer pays the National Bank at the  $\text{P}118$  per dollar rate but the counterpart fund is then credited at the same rate. There are no piasters retained by the Bank in this case. However, in the case of imports financed by the GVN out of its foreign exchange reserves, profits are realized. Foreign exchange (US dollars) is carried on the books at the official rate but it is sold to Vietnamese importers at a higher rate. Thus assets of the NBVN increase as a result of that transaction. This is also a real profit because most of the foreign exchange was obtained at the official rate.

In most export transactions the Bank takes a loss. Exporters are allowed to sell their dollar earnings at a piaster price higher than the official rate. At the present time exporters sell their dollars at  $\text{P}118$  per dollar rather than at the official rate. The difference is a "commercial" subsidy to exporters in those cases involving actual exports of goods and a "financial" subsidy where no goods are involved. The best example of a financial subsidy is the sale of piasters to US citizens in Vietnam at the "accommodation" rate of  $\text{P}118$  per \$1. Table 4 takes note of the difference between commercial and financial transactions.

Since 1962 there have been three important "basic" taxes which have resulted in extra-budgetary receipts. Once again, "basic" here refers to a fixed difference in the actual and official exchange rates. They are:

(a) The five-sevenths surtax: The fiscal reform of December 1961 included as a major change the abolition of the old perequation

Table 4

MAJOR EXTRA-BUDGETARY COLLECTIONS OF THE NATIONAL BANK OF VIETNAM, 1966-1968,  
BY QUARTER YEAR<sup>a</sup>  
(million piasters)

	1966				1967				1968	
	I	II	III	IV	I	II	III	IV	I	II
Perequation tax revenues	1562	1023	1053	202	4768					
Five-sevenths tax					3840				5942	
Plus commercial sur-tax	1761	1199	1053	202	4215					
Less commercial subsidies	219	159	-	-	378					
Plus financial sur-tax	81	186	-	-	267					
Less financial subsidies	61	203	-	-	265					
Economic Consolidation tax		- 56	-526	1709	1127	947	2055	-374	3988	-402
Plus commercial sur-tax			720	3429	4150	2380	2617	3091	11066	2911
Less commercial subsidies			158	245	404	286	201	204	847	118
Plus financial sur-tax			574	662	1236	386	674	907	2979	831
Less financial subsidies		56	1662	2137	3856	1533	1730	4168	3964	4026
Equalization Tax		473	4553	3494	8520	1338	1043	248	4604	123
TOTAL					18255				14534	

a. Source: National Bank of Vietnam.

stabilization, statistic, and import production taxes and the inclusion of a Surtax for National Defense and Economic Development.<sup>24</sup> This tax, in effect from January 1962 to June 1967, was a major source of revenue during those five years. Net collections from the five-sevenths surtax are shown in Table 5. The name "five sevenths" derives from the fact that an additional charge of P25 per \$1 was added to the price importers had to pay for dollars when the official exchange rate was P35 for \$1.

(b) Economic Consolidation Surtax: The Economic Consolidation Surtax became effective at the time of devaluation in June 1966. The official exchange rate between the piaster and dollar was set at P80 per \$1, but importers were required to pay P118 for each dollar they required. The P38 difference is the surtax paid by importers.

The surtax would have no economic significance if the National Bank sold each dollar for P118 and bought each dollar for the same amount. In that case, there would have been no advantage for setting the official exchange rate at P80 per \$1 rather than at P118 per \$1. However, as we pointed out earlier in the discussion of extra-budgetary receipts, the National Bank did not always buy and sell piasters at the same rate. The Bank accumulated dollars by selling piasters to MACV at the official exchange rate and then sold those dollars to Vietnamese importers at the P118 per \$1 rate. Thus, for each dollar purchased from MACV and then sold to a Vietnamese importer, the National Bank made a profit of P38. This profit could be considered as a tax on US military operations in Vietnam conducted in local currency.<sup>25</sup>

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24. Banque Nationale du Vietnam, Supplement au Bulletin Economique, (Revue Semestrielle, No. 2 Annee 1962), p. 4.

25. To conduct operations in local currency, e.g., paying Vietnamese civilians hired by MACV and buying local products, for the year July 1966-June 1967 the United States purchased P19.6 billion at the official exchange rate. For those piasters the United States paid \$245 million. During the same period the United States purchased P14.3 billion at an "accommodation rate" of P118 per \$1, paying \$121 million. The accommodation rate applies to all purchases made by US civilians and servicemen for their own personal use. The

Table 5  
ADMINISTRATIVE LEVIES OF THE GVN RELATED TO FOREIGN TRADE<sup>a</sup>  
1962 - 1968  
(million piasters)

	1962	1963	1964	1965	1966	1967	1968
Five-sevenths tax (net)	884	367	1264	1350	3841		
Commercial (net)	795	162	1346	1236	3837		
Financial (net)	89	105	-82	114	4		
Economic Consolidation Surtax					1127	3988	-1098
Commercial (net)					3746	10219	5207
Financial (net)					-2620	-6231	-6305
Equalization tax					8520	4604	365
Perequation tax <sup>b</sup>					4768	5942	2821
Special Perequation tax <sup>c</sup>					991 <sup>c</sup>	1919	1298
Total	884	367	1264	1350	19247	16453	3386
Total for Budgetary Support					14279	12465	4484

- a. Source: National Bank of Vietnam and Ministry of Economy, private contacts.  
b. This does not include the special perequation tax on imports collected by the Ministry of Economy or the perequation tax on beer and carbonated beverages.  
c. This includes \$441 million in the special perequation tax and \$500 million in the perequation tax on sugar. See NBVN, Annual Report, Fiscal Year 1965, Part I, Chapter 3, p. 4 for reference to tax on sugar.

After October 1, 1967, all US piaster purchases have been made at the P118 per \$1 rate. Before that date the United States was allowed to purchase some piasters at the P118 per \$1 rate, called an "accommodation rate." For example, US civilians and servicemen in Vietnam were given the accommodation rate for all their own personal local expenditures. Given the accounting system, described very briefly above, on accommodation sales the P38 difference would be counted as a "financial subsidy," but sales at the P80 per \$1 rate would have no effect on the balance of extra-budgetary accounts. But when MACV started receiving P118 for each dollar rather than P80, the NBVN entered the additional P38 as a financial subsidy. The impact of the October agreement on extra-budgetary receipts is shown dramatically in Table 4. The more than twofold jump in financial subsidies between the third and fourth quarters of 1967 is attributed almost entirely to the new US purchasing rate. The table also shows that as a result of the new MACV purchasing rate the net Economic Consolidation Surtax in 1968 will be negative and therefore it will cease to be a potentially deflationary factor in the Vietnamese economic situation.<sup>26</sup>

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tax which the US Government paid by agreeing to purchase piasters at the official rate rather than the accommodation rate was \$79 million. Much of this amount was used to build up the GVN's foreign exchange reserve balance. Data for these calculations: Disbursing Office, American Embassy, Saigon, Monthly reports: Data for sale of piasters at the accommodation rate are from the National Bank of Vietnam, weekly issues of Statistiques Financieres.

26. I stress the phrase "potentially deflationary." When the Bank was building up foreign exchange reserves it could have used these reserves to finance additional imports. Of course, additional imports are deflationary because they "absorb" piasters, but for another reason, too. If the Bank was receiving more piasters because it was selling more dollars, then it would not have to print up additional money in order to transfer piasters to the US Government for local use. Should the need for US local expenditures continue unabated, the Bank can satisfy those needs by printing money or financing additional imports through reducing its foreign exchange reserves. So far, the GVN has shown a reluctance to reduce its foreign exchange reserves.

The NBVN makes a profit on some of its "financial" transactions. Foreign companies which wish to repatriate their profits (up to 95 percent) are allowed to do so by purchasing dollars from the National Bank at the rate of P118 per \$1. The same rate applies to students and other Vietnamese abroad. The accounts show a big increase in financial earnings in the third quarter of 1967 when the GVN paid some foreign contractors for construction work in dollars at the P118 per \$1 rate.<sup>27</sup>

(c) Equalization Tax: Before the devaluation of the piaster in 1966 importers were paying an effective rate of P60 per \$1. Because of the long delay between the ordering of goods and their actual arrival in Vietnam, many millions of dollars of imports were in the pipeline at the time of devaluation. An equalization tax amounting to 58 piasters per dollar of imports was imposed upon those goods in order to equalize the pre- and post-devaluation costs of goods. Without this tax the importers who had taken out licenses before devaluation would have captured a huge windfall. Instead it went to the NBVN. However, this is "one time tax" and will cease to contribute revenues eventually.

(2) The regular Perequation or "Add On" Tax: In addition to the standard charge of P38 per dollar mentioned above, the Ministry of Economy imposes another tax on importers who purchase goods from countries other than the United States. This tax, collected by the NBVN as an additional charge for foreign exchange, is known as the perequation tax, and corresponds to a system of multiple exchange rates. The perequation tax was discontinued in 1962 when the five-sevenths tax was announced, but it was reinstated on a few commodities

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27. The foreign contractors didn't really sustain a P38 loss per dollar even though the NBVN made that amount. In bidding for the contract in the first place that factor must have been taken into account. Thus, the GVN simply paid a higher piaster price for the work than it would have had to pay if the companies were allowed to convert piasters into dollars at the official rate. In the actual case GVN expenditures were probably higher by just the amount of the Bank's profits. Thus, this single transaction had a neutral effect on the money supply.

in July 1964<sup>28</sup> and fully in March 1966. The purpose of this tax is to raise revenues, but its justification is to equalize the prices of goods imported into Vietnam from the United States and other countries. Almost all US imports into Vietnam are financed under the Commercial Import Program (CIP). In effect they are purchased with "soft" piasters which are then given to the GVN in the form of foreign aid. Relative to comparable imports from Asian countries such as Japan and Taiwan, US prices are high. From the point of view of the GVN, it is advantageous to trade with the United States because that trade does not reduce their foreign exchange balance. However the importer of US goods would be undersold by his competitors who import the cheaper Asian products. To eliminate this possibility, the Ministry of Economy imposed a perequation tax on the purchase of foreign exchange used for non-US imports. For example, in order to buy a dollar's worth of iron and steel products from Taiwan, the Vietnamese importer has to pay P158 for \$1 whereas an importer under the US CIP program has to deposit the normal P118. The additional P40 is the perequation tax and its effect is to equalize the landed cost of Taiwanese and US steel. An importer of glass and crystal products has to pay an additional tax of P60 raising his cost of the dollar to P178. These separate taxes on foreign exchange amount to a system of multiple exchange rates.

Some observers of the customs situation in Vietnam insist that the perequation tax has lost its original purpose as a tax to equalize the landed costs of US and GVN financed imports. Today, CIP and GVN imports overlap only to a small extent as the tax has resulted in a change in the composition of goods imported under the two programs. It has been argued, with justification, that under present conditions the tax is simply another type of austerity tax intended to protect domestic producers. There can be no question that the customs and perequation taxes could be consolidated into a single tax to achieve

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28. The tax was imposed on imported cotton thread. See Nguyen Cao Chinh, op. cit., p. 23.

the same purpose now being served. Yet, while there is no analytical distinction, there still remains the administrative distinction, and it is valid to separate the two on legal grounds. To change the customs schedule requires an act of the legislature whereas the perequation tax can be changed by the Ministry of Economy without legislative approval. Thus, the perequation system is much more flexible than the customs system.

1.1.2.3 Special Perequation Tax. The regular perequation tax is fixed by the Ministry of Economy but collected by the National Bank as a tax on the sale of foreign exchange. In addition to this tax the Ministry of Economy has imposed a special perequation tax which is intended to eliminate extraordinary profits of importers relative to domestic products. Extraordinary profits are possible because of the significant passage of time between the ordering of goods and their actual arrival. A shortage of a domestically produced item will cause its price to rise. If a shipment of the same item arrives at the time of the shortage, the importer can release his imports in such a way to take maximum advantage of the relatively high price and maximize his profits. In order to eliminate this possibility, the Ministry of Economy has placed a special perequation tax on any product which, in the opinion of the Ministry, warrants the tax. It is not a general or scheduled tax, such as the regular perequation tax, but one imposed on a "case by case" basis. The following actual example demonstrates how this tax works.

In July 1968 the market price of garlic in Saigon was ₪240 per kilogram. Garlic is produced locally and also is imported. The customs, austerity, and perequation tax rates at the time were the following:

Customs, 130 percent	or	₪104 per dollar
Austerity, 100 percent	or	₪ 80 per dollar
Regular perequation		<u>₪ 50 per dollar</u>
Total		₪234 per dollar

After considering the above import taxes, cost of purchase from exporter, other costs, and a "fair" profit to the importer, the Ministry of Economy determined that a "profitable" selling price would be \$120 per kilogram. In order to equalize the domestic and imported costs the Ministry set a "special perequation tax" on garlic of \$120 per kilogram. This kind of tax can be placed on any good if the Ministry thinks that the imported costs are low in relation to the prevailing market price.

At the present time all the extra-budgetary receipts with the exception of the economic consolidation surtax are turned over to the Treasury for budgetary support. There is considerable ambiguity about the disposition of the former five-sevenths tax, and Table 5 excludes it from the total administrative levies for budgetary support.

#### 1.1.3 US Economic Assistance

A large percentage of GVN revenues is due to US economic assistance. The figures given in Table 6 pertain only to economic assistance (excluding military assistance). While the value of US aid, as shown in the table, is large, in one way those figures understate their actual contribution. Most US aid enters Vietnam in the form of imported goods which are then taxed at the customs and austerity rates. Thus, the total contribution of US aid to the Vietnamese budget (direct and indirect) are the values shown in Table 6 plus an additional amount, already discussed under import duties.<sup>29</sup>

The major source of foreign aid to the GVN is the Commercial Import Program (CIP). Under this program the United States agrees to finance Vietnamese imports purchased in the United States.<sup>30</sup>

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29. This statement should not be interpreted to mean that customs revenues necessarily would decline if the United States temporarily suspended its commercial aid. In that situation the GVN could maintain the flow of imports, and hence customs revenues, by using its foreign exchange reserves.

30. Ten percent of the value of CIP imports can be purchased from other countries.

Table 6

UNITED STATES FOREIGN AID TO VIETNAM, 1962-1967  
(million piasters)

Source	1962	1963	1964	1965	1966	1967
CIP Counterpart <sup>a</sup>	7202	7524	4590	8485	15274	22814
Food for Freedom <sup>b</sup>	1198	1170	2873	2625	4168	11480
Less trust fund <sup>c</sup>	113	212	502	761	1854	4157
Total aid released to GVN	8287	8482	6961	10349	17588	30137
Aid reported in GVN statistics <sup>d</sup>	7509	7369	6359	9284	19777	24627

- a. 1962-1966; Agency for International Development, Office of Joint Economic Affairs, Annual Statistical Bulletin, No. 10, Table H-9, "withdrawals from counterpart funds." Data for 1967 was supplied by Financial Management Division, Agency for International Development, (Saigon).
- b. 1962-1966; ibid., Table H-5, "receipts for GVN military support." Data for 1967 was supplied by Financial Management Division.
- c. Data supplied by Local Currency Branch, Division of Financial Management, Agency for International Development (Saigon: September 18, 1968).
- d. Agency for International Development, Joint Economic Office worksheets (Saigon: September 1968).

Note: Under the FFF program all piasters earned are deposited in a U.S. Treasury account in the NBVN (Acct. 20FT680). Subsequently, they are released to two accounts: the one for GVN use is deposited in the US Disbursing Office (USDO) account 72FT745; and the piasters for US use are deposited in account 20FT400. When funds are released to the USDO account, technically their ownership passes to the GVN. USDO then disburses funds to the GVN and the disbursement constitutes a payment or actual receipt of aid by the GVN. This table uses the disbursements of funds by USDO as the actual financial aid available to the GVN under the FFF program.

In the case of counterpart (CIP), all funds belong to the GVN and they are held in the counterpart special account #44-20 at the NBVN. A "withdrawal" means that AID has authorized use of counterpart funds by the GVN. At this point, therefore, the funds are actually made available to the GVN. The figures in the table for CIP counterpart are counted at this stage of transfer, i.e., when they are actually made available. The GVN does not necessarily draw the funds as soon as they are authorized. Some might not count authorized but unused funds as a part of foreign aid and this difference in definition is a possible source of discrepancy between the "released" and "reported" figures given in the above table.

The exporter is paid in dollars by the U.S. Treasury and when the goods arrive in Vietnam, the importer has to pay the GVN for them in piasters at the rate of ₪118 per \$1 of imports.<sup>31</sup> These piasters are credited to the Counterpart Fund and eventually are made available for budgetary support for projects specified in prior agreements between the GVN and the United States. In effect, under the Commercial Import Program the United States gives goods to the GVN who sells them for piasters and then uses the piasters to support its budget.

The Food for Freedom (FFF) program (formerly Food for Peace) accounts for most of the remainder of GVN foreign aid. The mechanics of this program are essentially the same as under the CIP. The notable differences are: (1) The GVN does not receive all the piasters raised by FFF imports. With each FFF agreement between the United States and the GVN the piaster exchange rate is set and the percentage of the total which can be used by the GVN is specified. Prior to 1966 ninety percent of FFF sales were made available to the GVN, but the percentage has declined to eighty percent and one agreement involving 300,000 tons of rice in 1967 set aside no funds for GVN use.<sup>32</sup> The part not set aside for GVN use is available for US use. (2) The funds made available to the GVN are not destined for general budgetary support but must be spent on the military effort.

Table 6 gives figures on foreign aid raised through these sources. In 1962-1963 FFF funds were relatively small compared to Counterpart. Both have grown over the years but especially those realized from Food for Freedom. The big increase in FFF funds in 1967 is a result of the larger rice importation program which became necessary as Vietnamese domestic rice production declined.

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31. Since the total of ₪118 to \$1 is credited to Counterpart, the National Bank cannot collect an economic consolidation surtax on these imports. Accordingly, extra-budgetary receipts due to the economic consolidation surtax are not affected by imports under CIP.

32. Agency for International Development, Office of Joint Economic Affairs, (Saigon), Annual Statistical Bulletin No. 10, p. 190.

## 1.2 SUMMARY OF CENTRAL GOVERNMENT REVENUES

The Central Government of the Republic of Vietnam has access to three regularized sources of revenue over which the Budget Directorate has complete legal and operational control. They are (1) domestic taxes, (2) receipts from government administrative agencies and miscellaneous activities, i.e., "other revenues," and (3) customs and austerity duties collected on imports. In addition to the regularized channels, the National Bank of Vietnam and the Ministry of Economy collect revenues which we have referred to as administrative levies. These administrative levies are called extra-budgetary receipts in Vietnam because they are not accounted for in the national budget and do not necessarily come under the control of the Ministry of Finance which includes both the Treasury and Budget Directorate.<sup>33</sup> Foreign aid, which accrues to the GVN primarily through the Commercial Import Program and the Food for Freedom program, is the remaining large source of Central Government revenues. The government has other sources of revenues in the dozens of small accounts held in the Treasury, but we have not been successful in accounting for these receipts. In any event, they are minor in comparison to those listed above.

Table 7 gives the total GVN revenues for the period 1962 through 1967. Total revenues increased fourfold since 1962. This trend did not continue in 1968 partly because the Tet and May Communist offensives reduced production and made tax collection difficult. However, the seriousness of the GVN revenue problem can only be understood in the broader context in which expenditure needs are also considered. A comparison of expenditures and revenues is made in Section 3.

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33. However, for convenience we have included the administrative levies on beer and soft drinks with the regular excise taxes on these products. See above, page 8, Table 1, footnote c.

Table 7

TOTAL GVN REVENUES, 1962-1967<sup>a</sup>  
(million piasters)

	1962	1963	1964	1965	1966	1967
Domestic taxes	5449	6506	6189	7759	12745	18924
Other revenues	1604	1674	2077	3185	3872	6044
Customs and austerity	4772	4612	5070	5570	11674	15609
Total regular sources	<u>11825</u>	<u>12792</u>	<u>13336</u>	<u>16514</u>	<u>28291</u>	<u>40577</u>
Administrative levies					14279	12465
Foreign aid	7509	7369	6359	9984	19777	24627
Total GVN Revenues	19334	20161	19695	26498	62347	77669

- a. Source: Tables 1, 2, 3, 5, 6 this chapter. Note that only the administrative levies turned over to the Treasury have been included in this table.

## Part II

### ANALYSIS OF SOUTH VIETNAM'S FISCAL OPERATIONS

Part II is divided into three Sections. Section 2 contains a discussion of some theoretical aspects of a tax system under conditions of continuous inflation. This conditions was a major feature of the Vietnam economy from 1965 to the present. We consider the purpose of tax policy to be the regulation of employment and the general price level. This view, called "functional finance" in the literature of economics, was argued forcefully by Abbe P. Lerner in 1943<sup>1</sup> at a time when the major economic problem in the United States was changing from depression unemployment to wartime inflation. In Section 3 the revenue system of the Central Government is compared to its total expenditures. Finally, in Section 4, the revenue system is evaluated by the criteria discussed in Section 2.

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1. Abbe P. Lerner, "Functional Finance and the Federal Debt," Social Research, Vol. 10 (February 1943).

## SOME ECONOMIC ASPECTS OF WARTIME TAXATION

The urgency of wartime expenditures impose burdens upon the population which do not exist under normal circumstances. Minimizing those burdens for a given level of government expenditures is a legitimate goal of economic policy. Borrowing from a national bank in order to finance the war effort or any other extraordinary expenditure in lieu of raising taxes could be self-defeating. Government officials who hesitate to raise taxes because they fear popular unrest, or tax experts who hold up policy decisions because they are overly concerned with tax equity, tend to set policies which undermine the very goals they articulate. History records more instances of governments which could not govern because they allowed monetary matters to get out of hand than it does of governments which failed because they raised taxes to finance necessary expenditures.

Starting with the assumption that expenditures in wartime tend to outgrow revenues, in general we shall not question the level or composition of public expenditures. We assume they are desirable. We assume also that governments must resort to inflationary finance if they cannot raise sufficient revenues from domestic taxes and foreign sources. These assumptions have been chosen to facilitate the following theoretical analysis, but the practical observer surely will note that most of the assumptions do not deviate significantly from the situation in Vietnam today.

Thus, we begin with an inflationary situation and one which cannot be controlled by reducing government expenditures. The central question of this section is: What kind of tax system should a wartime government impose upon the population if it faces the prospect of a high or accelerating rate of inflation due to a widening gap between its expenditures and revenues?

## 2.1 CONSIDERATIONS FOR A SYSTEM OF TAXES

### 2.1.1 Maxims of Taxation

What kind of a tax system is best for a nation depends upon its particular social goals. Taxation is a major economic measure for redistributing welfare among the individual members of society, and the tax authority usually cannot avoid promoting the welfare of some relative to that of others even if the apparent goal simply is to procure for the government a larger share of income to be spent in the "public interest." Governments, therefore, should take great care in any contemplated reform or revision of an existing tax system to determine whether a particular change will have economic effects which are consistent with the social ends it seeks.

Adam Smith established four maxims of taxation: (1) Equality; each person should pay taxes in proportion to the revenue which he enjoys "under the protection of the state;" (2) Certainty; the amount of the tax should be known in advance and not arbitrarily assessed; (3) Convenience; payment should be made when the taxpayer has the funds to pay; (4) Economy; the cost of collection should be low relative to the tax.<sup>1</sup>

The "goodness" of any tax system ultimately is a philosophical question. Thus, it is possible to argue for one kind of tax system and against another depending upon one's ideas about the proper goals of society. If one is most concerned with total economic output, a proportional tax system probably is better than a progressive system because the former impairs normal economic incentives less than the latter. But if one thinks that the poor ought to be favored over the rich, he will argue for a progressive system. However, once society (or its social philosophers or leaders) have decided upon what is meant by equity in taxation, then many empirical questions become the relevant ones. Principal among these is who actually pays a tax and how much.

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1. Adam Smith, The Wealth of Nations (New York: Modern Library Random House, 1937), pp. 777-778.

### 2.1.2 Tax Incidence and Functional Finance

The question of who actually pays a tax and how much of it he pays is known as the "incidence" of a tax. In the case of an excise tax, the manufacturer is held responsible for collection and payment to the government, but who bears the real burden of the tax is a complicated matter. In traditional tax theory, incidence usually referred to "forward shifting." It was recognized that the manufacturer (or nominal taxpayer) would attempt to collect the full amount of the tax from the consumer, that is, the tax would be shifted forward to the final consumer in the form of higher prices. The degree to which forward shifting is possible depends upon the responsiveness of consumers and suppliers to changes in price (demand and supply elasticities) of the product being taxed.

It is also possible to consider incidence by referring to "backward shifting." Backward shifting means that the real burden is borne by the factors of production. For example, suppose that an additional tax is placed upon cigarettes. The price of cigarettes will rise (assuming that the demand elasticity is not perfectly elastic) and the quantity demanded will fall. To produce the smaller quantity demanded at the new price will require less labor, capital, etc. As a result, some workers will be laid off or their wages will fall. If these workers happen to be cigarette smokers as well, then they will be double losers. However, if no new money is created, the general price level will not rise because some of the factors released from the cigarette industry will seek employment in other industries reducing the supply price of other products. Thus, it is almost impossible to state who really gains and who really loses in the context of overall equilibrium.

For the purpose of this discussion, it is neither necessary nor helpful to consider tax incidence. In fact, we shall argue that prolonged discussions about tax incidence in an inflationary environment are harmful because they focus attention on the wrong effect of taxation for that particular situation. In an excellent article, J. A.

Stockfish has argued that the traditional concept of incidence has become obsolete.<sup>2</sup> According to Stockfish there are two "basic" and important effects of taxation: (1) the income effect and (2) the price reallocation effect.

The income effect of a tax is measured by the amount of money (purchasing power) it takes out of the private sector of the economy.<sup>3</sup> Assuming full employment of resources, a government can obtain a larger share of the national product without causing inflation only if it is willing to reduce purchasing power in the private sector. The tax advisors, therefore, must be concerned primarily with the income effect of taxation. This consideration is closely related to the concept of functional finance.

The theory of functional finance stresses the role of the budget as a balance wheel in the economy. By controlling the size and use of budgetary resources, the central government can have a major influence on some important economic variables such as employment and the general price level. Price reallocation effects are important because of their impact on income distribution and for that reason they should not be ignored. However, they must be subordinate to income effects when significant price inflation is impeding the efficient allocation of resources. If one goal must be accomplished at a time, inflation must be controlled before the important question of income distribution can be considered.

Take the following hypothetical case as an example.<sup>4</sup> Suppose society thought that it was in the public interest to promote the welfare of people who use gasoline at a time when it was also necessary to increase public expenditures. Among the various alternatives for raising revenues, the government probably would not want to tax gasoline. It could tax rice, or beer; or it could simply print up

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2. J. A. Stockfish, "On the Obsolescence of Incidence," Public Finance, Vol. 14, No. 2 (1959).

3. Ibid., p. 126 and Earl R. Kolph, "A Proposed Revision of Excise Tax Theory," Journal of Political Economy, (April 1952), p. 103.

4. This case was selected because it is highly relevant to the present situation in Vietnam. See pages 70-72.

additional money to finance the necessary expenditures. Any of the proposed taxes will divert income to the government through the income effect, and the burden must be borne by someone. Printing up money appears easy, but it usually is a short-run expedient. In the long-run society certainly will have to pay through sacrifice (mis-allocation of resources or through a breakdown of the money payment system at the extreme). Therefore, an enlightened government must take account of the ill effects of inflation caused by deficit spending as well as the income effect of a tax in making its decision about the proper method for raising additional funds. It is quite possible that inflation might obstruct social goals related to total output and its distribution more than any tax which is the principal alternative to inflationary finance.

### 2.1.3 Taxation in an Inflationary Situation

Discussions on income distribution usually presume a constant price level. If one product is taxed, its price may rise but this price increase will be compensated by small price declines in other products so that the overall price level would not change. This overall price result will obtain so long as there are no monetary or velocity effects associated with the tax. In an inflationary situation caused by increases in the money supply and/or velocity in relation to total availability of goods, the traditional framework for discussing the welfare effects of a tax must be discarded. Tracing the incidence of a tax in an inflationary framework may have some relevance but it is not so important as it is within the context of a static system.

In a dynamic or inflationary situation, the analyst must think out the consequences of a particular tax on the general welfare, but he must also think through the chain of events that the alternative to not taxing will have on the economy and welfare. Because one must consider not only tax incidence but also the inflationary consequences of deficit finance, the former loses some of its relative importance in any discussion of tax reform. In particular, Vietnamese thinking on tax reform, to the extent that it is organized along economic lines,

is cast too much in the mould of conventional tax theory, i.e., tax incidence. It should be more concerned with those effects that could negate the desired distributional results of imposing certain specific taxes.

In considering a tax system in a dynamic situation, the policy-maker must take account of the political consequences that follow any public action or inaction as well as equity. If the population is patriotic and feels a deep commitment to the economic and political goals of its government, there should be no reason why the government has to run a deficit in attaining those goals. The people would not object to high taxes. But if the people are not deeply committed to goals expressed by the government, there is a limit to how much and what kind of taxes the people will be willing to pay. They will object if taxes are high, and, particularly, if they think the tax system is inequitable; but the inflation alternative to high taxes could become more objectionable in the longrun.

Inflation imposes its own kind of hardship, and there are compelling reasons why it should be avoided or reduced if possible even at the expense of creating some political unrest that might result from raising taxes.

(a) Inflation tends to be cumulative (if it effects people's expectations about future price rises) whereas a rise in taxes establishes a higher level of sacrifice but not a cumulative one. Therefore, in the longrun cumulative inflation causes a greater loss of welfare than high taxes. As the situation worsens, the people are likely to demand political change--and they will have their wish in the end--for a high rate of inflation is the major economic indicator of a weak government.

Inflation becomes cumulative when it generates expectations of even higher prices. Once these expectations become widespread and people learn that holding cash reduces their consumption in the long run, they then act to reduce their cash holdings. Given a constant output prices rise; and they will continue to rise faster and faster as spenders see their own intentions frustrated by further price

increases. This kind of inflation undermines governmental authority by reducing its popularity among the middle class. Thus, the group of people which the government usually attempts to pacify by not raising taxes in the first place is the very group which eventually turns against the government if inflation becomes cumulative. Not raising taxes is popular at first, but it is politically unsettling in the long run.<sup>5</sup>

(b) Inflation also undermines the authority of the government through its discriminatory effects on the civil service and the army. Civil servants have little legitimate power to protect themselves against inflation. In underdeveloped countries their chief recourse is to accept bribes or to find other jobs on the side. To the extent that inflation induces civil servants to become corrupt, the government becomes discredited in the eyes of the people. And to the extent that civil servants find additional jobs or the better ones leave the civil service completely, productivity declines and efficient administration of public affairs becomes almost impossible.

(c) Taxation and inflation both are economic means for redistributing income. Neither are precision tools but taxation is more precise than inflation. Inflation benefits the speculator, the importer, persons engaged in illicit trade, or anyone who can protect himself in advance against price rises. It tends to draw people away from productive but relatively unrewarding jobs and into less productive but relatively rewarding speculative ventures. For this reason it probably reduces total output. It is conceivable that a government might want to redistribute income in favor of the group which benefits from inflation and, in that case, borrowing from a central bank would be a proper measure for financing government expenditures. However, a government cannot redistribute income in

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5. If the government is weak at a particular period of time but has good prospects for becoming strong before the inflation psychology becomes a part of the public's thought, then inflationary finance could be used to political advantage. However, it is not likely that the strength of a democratic government can improve sufficiently and quickly to permit it to raise taxes before people have developed an inflation psychology.

favor of any other group by using inflationary finance. Thus, inflation is a circumscribed or limited tool for achieving equity in income distribution. On the other hand, taxation can be used to favor any group including the group aided by inflation. Taxation is not a circumscribed tool for bringing about a desired redistribution of income. Therefore, it would be only coincidental that inflation could ever be as good a measure for achieving equity in income distribution as taxation. (However, since inflation has no associated "administrative cost" it might be considered a better tool than taxation if, coincidentally, society decided to reward the group which benefits from inflation.)

(d) Inflation causes a general welfare loss aside from that which might be due to income redistribution and loss of productivity. Assuming no loss of output and no redistribution effects from inflationary finance, there is still a loss in total welfare. This is true because inflation is primarily a tax on cash holdings. Inflation will induce people to reduce their real cash balances in favor of goods which do not lose real value; i.e., people will attempt to alter the proportions in which they hold all forms of wealth, including goods and money. If they were maximizing their total welfare before inflation set in by holding the various forms of wealth in just exactly the right proportions, then evidently they will suffer a loss of welfare any time they are forced to adjust the proportions for any reason beyond their control. Inflation is one outside event which will force people to alter their wealth portfolios.

The actual loss of welfare due to inflation depends upon the rate of inflation and the elasticity of demand for real cash balances. If the demand for cash is quite elastic and the rate of inflation is low, the welfare loss due to inflation will be relatively small. But for high rates of inflation and inelastic demand curves, the welfare loss will be very high. This last result has been demonstrated empirically by M. J. Bailey.<sup>6</sup>

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6. Bailey estimated welfare costs in the seven hyperinflations analyzed by Cagan, and he also described in some detail how the loss

(e) The worst possible consequence of inflation is a complete breakdown of the money system. When people lose all confidence in money as a medium of exchange, as in the case of hyperinflations, they turn to barter. Barter greatly limits the division of labor and greatly increases the nonproductive efforts of searching for ways to avoid the money economy. It destroys modern production techniques with a consequent degradation in the standard of living.

The above discussion suggests that inflation is neither a political or economically desirable method for financing extraordinary expenditures. It follows that governments should avoid inflationary finance if that method will cause prices to rise rapidly and particularly if the inflation is likely to become cumulative. Perhaps for underdeveloped countries a mixture of taxes and low rates of inflation would result in less loss of welfare than excessive rates of either.

A government should attempt to reduce the rate of inflation by raising taxes. It should do so regardless of the source of the tax revenues. The maxim of wartime finance, if sizeable inflation is the only alternative to taxing, should be no tax. Other considerations such as equity frequently make tax officials too cautious. Equity is always an important concern of tax officials; but in a wartime, inflationary situation it is most unlikely that the society will maintain any semblance of the pattern of income distribution that its people once thought to be equitable. If concern with tax incidence inhibits the government from raising taxes on incomes, production or commodities, and by default turns the government to inflationary finance, one can state with some confidence that the resulting pattern of real income distribution will be worse than that produced by simply raising taxes across the board, or raising them at all points where the government can collect them. In other

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of welfare actually is brought about. See Martin J. Bailey, "The Welfare Costs of Inflationary Finance," Journal of Political Economy, LXIV (April 1956), pp. 93-111, and Phillip Cagan, "The Monetary Dynamics of Hyperinflation," in Studies in the Quantity Theory of Money, Milton Friedman, ed., (The University of Chicago Press, 1956), particularly pp. 77-86.

words, in wartime governments should tax wherever they can--imports, production, commodities, and income--in order to avoid a worse outcome, rapid inflation and eventual political instability.

## 2.2 INFLATION PROTECTION

To finance extraordinary expenditures over a sustained period a government should move as rapidly as possible to a system of ad valorem or progressive taxes.<sup>7</sup> This kind of system assures that tax revenue will grow at least in proportion to the increase in national income. It will not necessarily provide enough revenues to finance larger expenditures, but in comparison with a system of specific levies--fixed collections per unit of sale--it will reduce the need or temptation to resort to inflationary finance. This kind of tax system can be called "inflation protected." The theory of inflation protected taxes will be examined in more detail in order to outline ways of transforming tax systems which are not protected against inflation into one which is protected.

### 2.2.1 Ad Valorem and Specific Taxes

A tax system is neutral with respect to inflation if government revenues grow in proportion to national income, assuming that the government desires to spend a constant share of the national income. In an environment of perfectly stable prices with increasing output the share of income automatically accruing to the government will remain constant regardless of whether the tax system is ad valorem or specific. In that case real tax receipts will increase proportionately with output; and whether one prefers ad valorem or specific taxes on commodities and production is a matter of tax administration and not of economics. Tax theorists normally have used stable prices as their frame of reference for recommending various kinds of taxes. Consequently most systems mix ad valorem,

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7. Progressive taxes have different income distribution effects than ad valorem or specific taxes. Therefore, the analyst who is concerned with income distribution as well as with preventing inflation must not treat progressive and ad valorem taxes together.

specific, and progressive taxes with the latter usually assessed against income. A mixed system in which progressive taxes is one element will, of course, allow the government to increase its share of the national income if total income increases because real output increases. In an inflationary situation where income is increasing partly because prices are rising, the government is not assured a constant share of real income even if it has a mixed tax system including some progressive taxes.<sup>8</sup> Thus, using inflation as the frame of reference reduces some of the conclusions reached in traditional tax theorizing to irrelevance.

The major feature of an inflation protected system is that relative to a system of specific or head taxes it is deflationary. Where taxes are stated as a fixed amount per unit, total revenues expressed in money remains constant if output is unchanged; but if prices are rising, the government's share of national income will fall. Under the assumption that the government needs to spend a constant percentage of the national income, it must seek other sources of revenue to satisfy its needs. If it resorts to borrowing from the central bank it reinforces the inflationary process. With a system of ad valorem taxes the government's money receipts will increase proportionately with prices and its real revenues will remain a constant share of national income. In this case no additional deficit financing will be required, and the impact of the tax system on the inflationary process is neutral, rather than reinforcing. A mixed system of ad valorem taxes on commodities and production and progressive taxes on income is deflationary. It will allow the government to procure a larger share of the national income as national income grows regardless of whether the growth is measured in real or money terms.

It is useful to compare specific and ad valorem levies in a situation in which the government has a "one time" need for higher revenues. Suppose that in a war situation government has to finance

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8. Whether the government's share remains constant in this case depends upon the proportion of total taxes raised by specific and progressive taxes and the rate of inflation.

an extraordinary purchase of capital goods. Suppose that the share of national income to be spent by the government increases from 20 to 30 percent for only one year and then it returns to 20 percent in the next year. Suppose, also, that the only means available to government to raise additional money immediately is to print it. In this situation the government can print up enough money to increase its share of real income to 30 percent, assuming some lag in price adjustment. As a result of the increase in the money supply prices will rise, and they will continue to rise until people's real balances have been reduced to a level they desire given real incomes. Then prices will stabilize at some new equilibrium level. But as prices rise so will government revenues. At the new equilibrium the government's share of real national income will be 20 percent. Prices will be higher than before but there will be no further inflation.

Given the above assumptions with a system of specific taxes, the outcome would be worse. After the initial increase in the money supply, prices would rise but tax revenues would remain constant. The share of national income secured by the government would automatically fall below 20 percent; and to maintain the desired share the government would have to continue printing money. Inflation would be a continuing problem.

#### 2.2.2 Transforming a Tax System

A mixed system of ad valorem and progressive taxes works to the advantage of the government in any situation where the government's needs are growing faster than real income. Tax systems usually mature over a long period of time by combining different kinds of taxes which were initiated for different reasons; therefore, it is not likely that any system will be entirely suitable for all occasions. While a government facing unusual circumstances is, for all practical purposes, stuck with the previously existing system, it need not completely abandon that system because it is unsuitable to finance growing requirements. Only minor adjustments are required

to transform a nonprotected system into one that is automatically inflation protected.

The specific tax rate established in the past can be transformed effectively into ad valorem taxes by periodic and automatic revision set to a cost of living or other price index. This kind of adjustment would be well suited for commodity or excise taxes which originally were established as fixed rates per unit. In an inflationary situation this method would not be precisely as efficient in raising revenues as an ad valorem tax because the adjustment could not be made and ought not to be made each day. Because the adjustment would always lag behind price changes, tax revenues would lag behind growth in money income. However, an approximate adjustment could be made to remedy this deficiency. To assure that tax receipts did not lag behind changes in income, the rate adjustment rule would simply be to raise rates slightly higher than those indicated by the cost of living index. How much higher would depend upon the rate of inflation and the frequency of adjustment.

The same kind of adjustment could be made with respect to import duties. Under a regime of fixed exchange rates, government customs collections tend to fall behind the increase in national income due to rising prices. Even though customs rates are usually stated as ad valorem rates, effectively they behave like specific duties, e.g., so many units of local currency for one unit of foreign currency. If foreign prices are relatively stable, then a given volume of imports valued in foreign prices will yield constant customs revenues in domestic currency even though domestic prices might be rising. The share to government measured in local currency declines. One way of preventing this outcome is to adjust customs rates by a price index of imported commodities. Of course, use of flexible exchange rates would automatically insure that customs collections would not lag behind increases in income.<sup>9</sup>

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9. See pages 76 and 77.

## VIETNAM EXPENDITURES IN RELATION TO REVENUES

Over the war years expenditures of the Central Government of South Vietnam have expanded faster than revenues, increasing the GVN's dependence on deficit financing. The predictable result has been inflation. This Section shows how the budgetary gap has widened since 1962. In the final section some weaknesses of the revenue system are pointed out, which, if overcome by administrative reform, could result in some closing of the gap and reduce the rate of inflation.

## 3.1 CENTRAL GOVERNMENT EXPENDITURES, 1962-1967

Actual government expenditures increased fivefold between 1962 and 1967. During the same period the Saigon price index rose threefold. Considered in relation to the gross national product of Vietnam, GVN expenditures increased from about one-fourth to one-third. Thus inflation, due partly to deficit financing, has made it very difficult for the government to increase its share of the national income.

The defense budget accounted for much of the increase in spending. About 51 percent of the total increase from 1962 to 1967 was due to increased defense expenditures, as the military budget increased from 50 percent to 60 percent of the total budgeted expenses during that period. If one views the Vietnam war in relation to the resources of Vietnam as their equivalent of World War II in the United States, he will be surprised that military expenditures did not account for all of the increased spending, because normally under conditions of "total war" a country would find it imperative to reduce its civilian expenditures, not increase them. But this was not a normal war. The Vietnamese government, confronted with competing claims of the Viet

Cong, that is, having to fight "the other war" as well, spent more money on civilian programs, too. Civilian expenditures through 1967 also increased on the order of fivefold over 1962.<sup>1</sup> These calculations are derived from data given in Table 8.

The analyst must be cautious in making statements about government expenditures because total expenditures of the government are not usually accounted for in the GVN national budget. In addition to the normal budgetary accounting, there are literally hundreds of extra-budgetary accounts in the Treasury and National Bank; and the cash inflow from these accounts does not necessarily balance with the cash outflow. There are special accounts for rice importation, fertilizer, subsidized companies such as Air Vietnam, the Hatien Cement Company, the Vietnam Railroad, etc. For the early years of this study, these additional expenses were relatively small and were paid out of special extra-budgetary receipts (not counted as GVN revenues). However, for 1966 and 1967, extra-budgetary expenditures and receipts were too significant to be ignored. For example, the rice subsidy alone in 1967 was in the neighborhood of \$6 to \$7 billion and that accounts for a large portion of the entry in Table 8 called "other" expenditures.<sup>2</sup>

Another troublesome problem is caused by the fact that the Vietnamese use a 17-month accounting period. The Vietnamese fiscal year includes 17 months. For example, fiscal year 1965 includes some of the receipts and expenditures for the first five months in 1965, all of the fiscal activities for the last seven months, and some of the activities for the first five months in 1966 (this latter five months is called the "complementary period"). If receipts and expenditures in the complementary period in 1966, which are counted in fiscal 1965, just exactly equal the receipts and expenditures in the complementary

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1. The quantitative statements in this paragraph should be received with caution because they are based upon my own estimate of defense spending in 1967. See note d of Table 8.

2. Counting storage costs, diversionary losses, spoilage, inventory buildup, and the timing of payments, the rice account could easily have been \$4 to \$5 billion more.

Table 8

GOVERNMENT EXPENDITURES AND FINANCING, 1962-1967  
(billion piasters)

	1962	1963	1964	1965	1966	1967
Total expenditures <sup>1</sup>	<u>21.6</u>	<u>23.1</u>	<u>30.2</u>	<u>52.0</u>	<u>64.4</u> <sup>a</sup>	<u>109.8</u> <sup>b</sup>
Civil <sup>2</sup>	10.0	11.1	14.4	21.2	25.8	38.1 <sup>3</sup>
Defense <sup>3</sup>	11.6	12.0	15.8	30.8	38.6 <sup>c</sup>	57.0 <sup>d</sup>
Other						14.7 <sup>d</sup>
Financing	<u>21.6</u>	<u>23.1</u>	<u>30.6</u>	<u>52.0</u>	<u>64.4</u>	<u>109.8</u>
Taxes and administrative receipts <sup>4</sup>	11.8	12.8	13.3	16.5	23.3	40.6
US aid <sup>4</sup>	7.5	7.4	6.4	10.0	19.8	24.6
Other resources <sup>5</sup>	1.2	.3	4.6	9.7	11.0	25.3
NBVN advances to Treasury <sup>5</sup>	1.1	2.6	6.3	16.2	5.3	7.2
NBVN advances to government agencies						12.1 <sup>e</sup>

Sources:

1. Note 1, Appendix B, except where indicated otherwise.
2. Data supplied by Mr. Nguyen Uyen, Agency for International Development, Joint Economic Division, (Saigon: September 1968), except where otherwise noted.
3. Residual except where indicated otherwise.
4. Table 7, this Study.
5. Residual, see Note 2, Appendix B.
6. The figures in this row are the differences in the year-end balance of "temporary advances to government" reported by the National Bank and conveniently published by the National Institute of Statistics in the Monthly Bulletin of Statistics.

- a. National Bank of Viet Nam, Annual Report, Fiscal Year, 1966, Appendix Table 17. Includes provincial and municipal budgets.
- b. National Bank of Viet Nam, "Inflationary Gap, 1967-1968," (August 2, 1968). Includes provincial and municipal budget.
- c. This figure is a residual but it corresponds almost exactly to data from National Bank of Viet Nam, Annual Report, Fiscal Year 1966, p. 23.
- d. This figure is the author's estimate. It assumes that defense expenditures in 1967 were 60 percent of GVN budgetary expenditures or the same percentage as in 1966.
- e. National Bank of Viet Nam, Annual Report, Fiscal Year 1967, Ch. IX, p. 2. This was an advance made to the Ministry of Economy (in a special account) to finance rice purchases.

period in 1965, which are counted in fiscal 1964, then the fiscal accounting for 1965 will exactly equal the cash intake and outflow for calendar year 1965. If prices are stable and government operations are not growing rapidly, then the use of data based upon the fiscal accounting system serve as an adequate proxy for cash flows for the same calendar year. Changes in 1966-1967 were too rapid to assume that fiscal accounting would serve as a good indication of government operations in 1966-1967. Therefore, an effort was made to put all years on a calendar year basis (forgetting the complementary periods).<sup>3</sup> While we make no claim of pinpoint accuracy in our figures, we do not believe that the true expenditure figures and those estimated in Table 8 diverge sufficiently to invalidate any conclusions we shall draw from them; certainly there can be no doubt regarding the trend in Central Government finance over the six year period covered in the table.

### 3.2 ADEQUACY OF REVENUES

The adequacy of a nation's revenue system must be considered in relation to its needs. In Vietnam, those needs have expanded tremendously over the war period; but revenues raised through internal sources, i.e., excluding foreign aid, have lagged considerably behind. However, a widening gap between internal receipts and expenditures is not necessarily an indication that the revenue system is inadequate for a country's needs. One must take a longer range or broader view of the situation.

The requirements imposed by war place a difficult burden on the internal revenue systems even of countries which have highly developed and well-administered tax systems. While it might not be reasonable to expect as much from an underdeveloped country engaged in a costly war as from a developed country, the poorer nation somehow must do a better job of raising tax revenues. A widening gap between expenditures and tax receipts probably is more economically disrupting in

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3. See Note 1, Appendix B.

the Vietnamese situation than it would be for a country with highly developed financial institutions, because the only way that the gap can be filled (neglecting foreign aid) in the former is by inflationary finance, i.e., borrowing from the central bank. To a large extent, developed countries can avoid this channel of last recourse because they have options open to them which, evidently, are not available to the Vietnamese. A developed nation can ease the pressure of inflationary finance by selling war bonds, and it can constrain and defer inflationary forces directly by rationing and price controls.

A comparison of Vietnam of today with the United States during the second World War will clarify this point. During the period 1940 to 1945, the US Treasury sold \$230 billion in bonds, of which 80 percent were sold to the public.<sup>4</sup> These public bond sales amounted to 60 percent of total defense expenditures in those years and served as a significant alternative to consumption (or, at least, trying to consume). At the same time, rationing was imposed upon the people. The overall result was a precipitous decline in the consumption share in the national income, from 74 percent in 1939 to 52 percent in 1944. In Vietnam consumption has shown only a modest 3 point decline in the six year period, 1962-1967.<sup>5</sup> The exact trends are given in Table 9.

The Vietnamese Government does not possess the administrative capability of imposing direct controls on consumption. Nor has the government felt it could sell bonds without undermining its own authority. Bond sales require a rather sophisticated populace and one which sincerely thinks it is going to "win." If there is any doubt in the average citizen's mind, an effective bond program could be launched only at very high interest rates. High interest rates, various officials have argued privately with some justification,

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4. The "public" means every holder except US Government investment accounts and the Federal Reserve Banks.

5. Because Vietnam is an underdeveloped country one should not expect as large a percentage decline in consumption as that experienced in the United States during World War II. The point is that there has been virtually no decline in Vietnamese consumption.

Table 9

PERCENT OF GNP IN PRIVATE CONSUMPTION, FEDERAL EXPENDITURES AND  
NATIONAL DEFENSE DURING WARTIME, VIETNAM AND THE UNITED STATES<sup>a</sup>

Vietnam			United States			
Year	Private Consumption	Public Consumption	Year	Private Consumption	Federal Expenditures	Defense
1962	82.9	21.0	1939	73.8	5.6	1.3
1963	84.5	20.9	1940	71.0	6.1	2.2
1964	80.7	21.8	1941	64.7	13.6	11.1
1965	74.1	22.4	1942	56.0	32.9	31.3
1966	77.7	22.9	1943	51.8	42.3	41.6
1967	79.6		1944	51.5	42.4	41.6

a. Source: Appendix A, Table A1.

would be a visible indication that the people put little faith in their government, and they might serve as an effective piece of propaganda for the Viet Cong. Others have suggested that the rates could be lower, if the bonds were backed by a free world guarantee. But the Vietnamese have felt that would be an "infringement" on their sovereignty and might help the Viet Cong propagandists even more.

Denied practical alternatives, therefore, the adequacy of Vietnam's revenue system must be judged solely in relation to the budgetary gap. The budgetary gap is given in Table 10 after contributions of foreign aid are taken into account. If foreign aid is considered with the deficit, then the situation seems really desperate, for up to 1968 foreign aid may have saved the Vietnamese economy from virtual collapse. Preliminary figures for 1968 indicate that price increases have come mainly in protein foods and vegetables and these are not products that can be imported easily into Vietnam in view of the lack of freezing facilities in that country. For this reason additional foreign aid is not likely to prove effective in stabilizing prices, and, if that is the case, the inadequacy of internal revenues will be made more obvious in the future should the expenses of war continue to rise.

### 3.3 DEFICIENCY OF THE INTERNAL REVENUE SYSTEM

Considering the criterion set out in the preceding section, the internal revenue system of Vietnam is grossly inadequate in relation to the growing expenditures of the Central Government. Revenues and other receipts collected through regularized channels usually have amounted to less than one-half of total GVN expenditures, and sometimes less than 40 percent, while the major share of expenditures have been financed through administrative levies, US aid, borrowing from the National Bank, and other sources. The exact percentages are given in Table 10.

Table 10

PERCENT OF TOTAL GOVERNMENT EXPENDITURES RAISED FROM VARIOUS SOURCES, 1962-1967<sup>a</sup>

	1962	1963	1964	1965	1966	1967
Domestic tax receipts	25.2	28.2	20.5	14.9	19.8	17.2
Other receipts	7.4	7.2	6.9	6.1	6.0	5.5
Customs and austerity	22.1	20.0	16.8	10.7	18.1	14.2
Total regularized sources	<u>54.7</u>	<u>55.4</u>	<u>44.2</u>	<u>31.7</u>	<u>43.9</u>	<u>36.9</u>
Administrative levies					22.8	11.4
US aid	34.8	31.9	21.1	19.2	30.7	22.4
Deficit finance <sup>b</sup>	10.5	12.7	34.7	49.1	3.2	29.3

a. Source: Data for computations in this table are given in Tables 7 and 8.

b. Deficit finance has a special meaning in the context of this table. See Note 3, Appendix B.

In 1965 the fiscal situation in Vietnam reached a dangerous point. Expenditures rose more than 50 percent but tax collections from regularized sources increased only slightly. Also in that year US aid was at a relatively low level. As a matter of necessity the government turned to deficit financing, borrowing \$16 billion from the National Bank or 56 percent of the previous year's money

supply. Prices rose 27 percent in the second half of the year.<sup>6</sup> Some actions aimed at improving the revenue situation were taken in the last half of the year. Specifically, the beer and soft drink tax was more than doubled, and the austerity tax rates on 220 luxury imports were raised.<sup>7</sup>

The fiscal situation continued to deteriorate in early 1966. The limited actions taken in 1965 proved too weak to stem the tide of inflation. Prices rose 56 percent in the first half of 1966, but people in responsible positions clearly saw what the consequences would be, and strong and effective programs were undertaken to improve the balance between expenditures and receipts. Actions taken in 1966 clearly demonstrate the extent to which rational economic policy can reverse a very bad trend, even in an underdeveloped country where the effective tax base is limited.

The economic reform picture of 1966 was dominated by the devaluation of the piaster that went into effect on June 18th. However, considering the budgetary imbalance, two administrative levies made available for budgetary support proved most effective. A general perequation tax on imports was decreed in March. This tax along with an equalization tax, which resulted in an additional collection of ₪58 per dollar of imports ordered prior to devaluation, brought in ₪13.7 billion and contributed over 20 percent of the total revenue for that year.

On the domestic side, beer and tobacco taxes were raised.<sup>8</sup> As a result domestic tax receipts increased from 15 percent of total expenditures in 1965 to 20 percent in 1966.

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6. According to the working class family price index. The rise for the whole year was 35 percent.

7. NBVN, Annual Report, Fiscal Year 1965, Part I, Ch.3, p. 7.

8. Beer, with a perequation tax which doubled the total tax intake for the last six months and a special surtax on tobacco levied on each pack sold, increased tobacco tax revenues by 50 percent on the average for the last five months in 1966. See Appendix B, Note 4.

Customs and austerity taxes, two other regularized sources of revenue, more than doubled in 1966. The large increase in these taxes was due to the higher austerity rates that went into effect in 1965, a much more generous CIP program sponsored by the United States, and a larger share of total imports financed by the GVN which carry higher customs rates.

The net result of these economic reforms was an almost complete freeing of the government from its dependency on deficit financing. The government did, in fact, borrow from the National Bank, but it was unnecessary to do so. It had sufficient resources to handle its expenditures without borrowing. And the ultimate result, of course, was that the pace of inflation abated in the last half of the year.

While the fiscal relief in 1966 was essential, it did not come in the best way possible. Most of the relief came in the form of greater US aid and the customs revenues derived from that aid. Much of the relief came in the form of administrative levies rather than tax reform. Both forms brought only temporary relief. Domestic tax collections did improve as a percentage of total expenditures, but the percentage declined again in the following year, and they remain inadequate at the present time.

In the future, unless internal revenues can be raised a great deal, the government probably will have to turn more and more to deficit financing with disastrous effects. The following section discusses some of the problems of the current internal revenue system.

## EVALUATION OF SOUTH VIETNAM'S REVENUE SYSTEM

In the previous section we showed that the revenue system of South Vietnam is inadequate in relation to the expenditures of the Central Government. This inadequacy is due partly to poor tax administration which, of course, is not unusual for an underdeveloped country. The effective tax base of the government is severely limited to a few commodities and an uncertain income tax system; but even with these severe limitations, the system could yield more revenues than it does. There is a kind of puritan mentality on the part of tax officials which partly explains the deficiency of domestic taxes, and the system of fixed exchange rates has resulted in a slower rise in customs revenues than the money value of imports.

## 4.1 TAX ADMINISTRATION

In 1966 a US Internal Revenue tax team was assigned to study the tax problems of Vietnam. In a general statement of the problem the investigator found that:

...the problem lies in the non-compliance by Vietnamese taxpayers with a rather complex and sophisticated system of tax laws and inadequate tax administration. This non-compliance flows from poor enforcement, which in turn is the result of tax personnel inadequate as to numbers, ability and authority. Procedures are antiquated and cannot cope with the workload.<sup>1</sup>

Complete tax evasion or cheating is widespread in Vietnam. Auditing of corporation tax payments in the years 1962 through 1965 resulted in additional revenues of approximately one million piasters

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1. Internal Revenue Service Foreign Tax Assistance Staffs, "Vietnam Tax Administration" (Survey team headed by Mr. John E. Foley), 1966, p. 7. This study was done in cooperation with the Agency for International Development.

per audit.<sup>2</sup> Only a small percentage of the firms are audited, however. Tax officials are aware of widespread evasion, not only from small and medium-size firms but also from some large firms from which tax collections should be easy. In citing the case of ice, one investigator said flatly, "evasion by small producers is suspected and accepted."<sup>3</sup> Because some are required to pay taxes and others easily avoid them, the system of taxes, aside from being inefficient, is also inequitable, even though there may have been some justification for the various taxes and exemptions at the time they were written into the law.

A few taxes in Vietnam are subject to pyramiding. Beer, for example, is taxed five times. It is subject to the patente, production tax, excise tax, special perequation tax on beer, and tax on bars and restaurants. Petroleum products are taxed as imports by the Directorate of Customs and later as an indirect tax by the Directorate of Indirect Taxes. A restaurant-night club, if it pays taxes, is assessed the patente, a special tax on bars and restaurants, entertainment tax, and the dancing tax. According to one study, tax officials are aware of this "heavy" burden but when they asked the Finance Minister to abolish or reduce the rates on some of these taxes, their recommendation was rejected on the grounds that "if the government ever needs additional money in the future it would be difficult to get re-enactment through the legislature."<sup>4</sup>

Undoubtedly, tax administration is the major tax problem in Vietnam. This is probably true of other underdeveloped countries as well. The problem does not seem to be one of theoretical domestic tax base.<sup>5</sup> Vietnam has almost every tax on the books that one

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2. Ibid., p. 22.

3. John B. Mulvey, "Report of General Findings Regarding Policies and Procedures in the Directorate of Indirect Taxes," Agency for International Development, (Saigon: October 1967), p. 28.

4. Ibid., p. 23.

5. However, the actual tax base is very narrow. See below, page 66.

might reasonably imagine, and as the above mentioned studies imply, if collections were made according to the laws, the GVN revenue collections probably would be adequate. At least, its reliance on foreign economic assistance would be reduced greatly. But the government does not collect taxes according to the law as the following four examples demonstrate.

#### 4.1.1 Income Tax

It is not realistic to think that the income tax can attain anywhere near its full potential in the present environment. Tax collections in 1967 more than doubled over 1966 and collections for the first seven months in 1968 increased about 50 percent over the same period in 1967. However, this large increase was due mainly to the tax withholding provision that went fully into effect in July 1967;<sup>6</sup> and the gain would appear to be a "once and for all" gain, meaning that if equally large improvements are to continue into the future, they must come from better collections from the general public rather than salaried employees of the big firms. Thus, there is little hope that this broad based tax will attain its potential until the situation in Vietnam becomes more stable.

It should be stressed that the relatively poor contribution of income taxes to total needs has nothing to do with lack of will of the government, corruption, or any other similar thoughts often expressed by Americans and journalists concerning Vietnamese administration. Let it suffice at this point to note that it is difficult to collect income taxes where one does not know for certain how many people live in a city, much less how much money they earn.

#### 4.1.2 Taxes on Profits

In 1967 only 500 businessmen in Cholon out of 30,000 located there claimed to have made a profit. However, even though 4700 others

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6. Actually the withholding provision became effective 1 January 1967 but it was not until July that the US Government had to comply. At present the United States withholds only if its employees make voluntary allotments.

contended they had lost money in their transactions they agreed to pay some taxes.<sup>7</sup> The source from which these figures were taken also stated the amount of taxes paid by government and private firm employees in 1967 (¥700 million) and expressed a concern that the employees had paid four times the amount paid by all businessmen in Saigon and Cholon.

This is not only a problem of tax administration. It is a problem whose solution requires great imagination. If people are not used to paying taxes, and if many of them keep no books, how is the government to know how to assess them? Schemes which have been successful in Western countries are not necessarily the ones needed in Vietnam where the whole cultural environment is different.

#### 4.1.3 Motor Vehicle Tax

The number of motor vehicles in Vietnam subject to the motor vehicle "circulation tax" have increased greatly over the past four years. In addition to these vehicles which are required legally to be registered, tens of thousands of motor bikes, which did not require registration until September 1968, have been imported into Vietnam. No one who has observed the increasing traffic congestion in Saigon would argue that the data published on vehicle registration gives an accurate picture of the number of vehicles actually in use. One analyst using official data determined that revenues collected from the motor vehicle tax in 1967 in the Saigon-Cholon area were only sixty percent of the amount that should have been collected.<sup>8</sup>

#### 4.1.4 Evasion of Customs Duties and Foregone Tax

Probably the best example of tax evasion that conceivably could be remedied falls within the sphere of trade taxes. The actual loss

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7. Reported in Saigon Daily News, (September 21, 1968), p. 2 and attributed to a statement made by the Director General of Taxes.

8. John B. Mulvey, "Report of General Findings Regarding Policies and Procedures in Directorate of Indirect Taxes," Agency for International Development, Division of Public Administration, Saigon, October 1967, p. 28.

of government revenues due to evasion of customs duties and the perequation tax is open to speculation, although the fact of evasion is widely accepted. The cause for evasion, of course, is profiteering, but lax customs administration is a tempting inducement.

Some evasion of the perequation tax can be blamed on the confusion which arises from the use of two different and incomparable customs schedules. When he takes out a license, the importer specifies the type of goods to be imported according to the Nhap Cang (NC) classification system used by the Division of Commerce. The descriptive classifications in this code are so vague and general that it is usually possible for an importer to argue that his planned imports belong to a classification with a low perequation tax rate rather than one with a higher rate. If the goods are checked when they arrive by a customs examiner, they are classified according to the Brussels Tariff Nomenclature (BTN). Because the goods are declared under one code and checked under a different and incomparable one, enforcement is very difficult.<sup>9</sup> Since the BTN is more detailed than the NC, required classification according to the BTN would result in higher effective perequation duties and would strengthen, as well, the enforcement procedure. One study estimated that approximately five billion additional piasters could have been raised in 1967 by a change in the code.<sup>10</sup>

Underinvoicing of imports is believed to be a common practice. An importer of two or more products can underinvoice the good with the highest rate and overinvoice the good with the lowest rate. Thus, he can apply for the proper amount of foreign exchange, since the total value of imports has been properly stated, but the weighted tariff rate might be considerably below what it should have been.

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9. Beginning in June 1968 importers have been required to classify their goods according to the BTN. This decree by the Ministry of Economy should eliminate much tax evasion if it is properly enforced. Unfortunately, the decree is not being enforced. According to one observer "some importers do not specify BTN; some are listing several BTN codes, but with only one FOB value; and many are simply misclassifying." Richmond Allen in letter to author, dated October 11, 1968.

10. Study by Miss Ingrid Naiman and Miss Huynh Thi Yen, Joint Economic Division, Agency for International Development (Saigon: July 1966).

Once again lack of adequate policing allows the importer to succeed in this deception.

A more risky practice involves the importer in a black market operation. In this case the importer takes out a license and applies for foreign exchange, understating the value but properly stating the quantity. The difference between the stated amount for which he receives foreign exchange legitimately and the real value is financed with foreign exchange purchases on the black market. Whiskey is a good, if not a typical, example of the saving the importer can realize. For a dollar's worth of whiskey imports, the importer pays \$118 for the dollar plus \$40 for the perequation tax plus \$268 in customs and austerity, a total of \$526 to get a dollar's worth of imports. If he can obtain the dollar on the black market for \$200, he will realize a substantial saving.

More conventional practices are probably used also. For example, one simply "buys off" the inspector or someone at a higher level to connive either at misclassification or permitting illegal imports. Another practice is illegal off-loading into barges so that the goods do not pass through customs.

Apparently, cheating is pervasive and the system appears to lack efficient organization and policing. No one has ever made a reliable estimate of the amount of additional customs revenues that could be raised by changing the customs laws in various ways and with proper enforcement. Off-the-cuff estimates vary a good deal but almost every observer of the Vietnamese customs system believes that many improvements can be made.

Tax administration in Vietnam has been discussed at length by several investigating teams. No useful purpose is served in this essay in summarizing those discussions more than has been done above. Rather we shall concentrate on certain economic aspects of the tax system which have received far too little attention in Vietnam or other underdeveloped countries experiencing high rates of price inflation. We shall start with the inefficient system of administration as it exists and the poor attitude on the part of the people toward paying

taxes and concentrate on other aspects of the revenue problem. It would be nice if Vietnam had better and more highly trained tax officials, a more rational tax system, and better taxpayer attitudes. However, we believe that habits and thought patterns die hard and it will be a long time before the Vietnamese will be able to put into practice an effective and equitable tax system.<sup>11</sup>

#### 4.2 DOMESTIC REVENUES

Economic, social, and political conditions, as well as poor tax administration, help to explain why the domestic tax system fails to generate more revenue. These factors are intermingled to such a degree that it is not always possible to disentangle them.

Tax systems take many years to mature; they do not simply spring up full grown overnight, especially during an uprooting struggle. In the few years of relative peace which the Vietnamese have experienced since the Second World War, and particularly before that war, the Central Government had no rational or adequate tax system. Since the time of partition the country has been highly dependent on US aid and customs revenues (which derived almost entirely from foreign aid). Some effort was expended to increase domestic revenues, but with little success.

There is a good reason why the government was unsuccessful in building rapidly its domestic tax base. Vietnam has been predominantly an agricultural country, but there is not one single effective

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11. The reader should recall that it took the United States 121 years to write a permanent income tax law, and the tax became really effective only during the Second World War when the 1943 tax law put the federal income tax on a "pay-as-you-go" basis, i.e., on a withholding basis. William B. Shultz and C. Lowell Harriss, American Public Finance, New York: Prentice-Hall, 1950, p. 418. Between 1943 and 1944 personal income tax receipts tripled and became a larger source of revenue than the corporate income tax for the first time. In fact, as late as 1942, excise taxes in the United States were a more important source of federal revenue than the personal income tax. I simply note in passing that the United States was certainly more developed in the early forties than Vietnam is today. The first federal income tax in the United States was levied in 1861 as a measure to finance the Civil War, but it was repealed within a decade. Ibid., p. 378.

agricultural tax on the books of the Central Government. There are only two taxes which even remotely resemble agricultural levies, a paddy (rice) tax and a meat tax. The former was collected at the milling stage and the latter at government controlled slaughterhouses.

The combined revenues from these "agricultural taxes" in 1962 contributed about one-fourth of one percent to total expenditures at a time when an estimated 80 percent of the population was engaged in agriculture. Today "agricultural taxes" contribute less than one-tenth of one percent of the needs of the Central Government<sup>12</sup> while an estimated 90 percent of internal revenues are collected in the Saigon/Cholon-Gia Dinh area.<sup>13</sup>

With agriculture excluded the real tax base of the GVN is severely circumscribed. Despite the rapid percentage growth in industrial production, Vietnam is a long way from having a broad industrial tax base. Today the taxes on tobacco, beer, carbonated beverages, petroleum, and the share of income and production taxes contributed by nine companies account for about 60 percent of total taxes collected in all of Vietnam.<sup>14</sup> Combined, these companies employ approximately six thousand workers, maybe one-half of one percent of the total work force of Vietnam. A knowledge of this very restricted tax base available to the Central Government carries one a long way toward an understanding of the difficult revenue problems of the government.

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12. Of course, given the present economic situation in Vietnam and the state of security in the countryside, the GVN could not collect agricultural taxes even if it desired to do so. But the situation was relatively calm in the late fifties and there was no effort to collect taxes during that period.

13. Foley Report, op. cit., p. 13.

14. The companies are: Tobacco; Manufactures Indochinoises de Cigarettes (MIC), Manufacture Indochinoise de Tobacs et Cigarette (MITAC), Societe Indochinoise de Tobacs, J. Bastos (BASTOS): Beer and Soft Drinks; Brasseries et Glaciers d L'Indochina (BGI), Societe de Eaux Gazeuses D'Indochina (SEGI), Phuong Toan; Petroleum, Shell, Esso, Caltex. These are the big Vietnamese companies and probably contribute a large share of the withholding taxes as well as the excise and indirect taxes. Counting withholding taxes these nine companies might contribute 65 percent of total domestic taxes. See Appendix Table A3.

Given this limited tax base, the GVN has demonstrated that it can collect taxes if it is willing to incur some political risks. They are not always willing to incur risks even if in the opinion of US observers the risks are small. We believe that GVN tax officials have moved slowly in assessing or raising taxes on some products because of their concept of ethics which we shall refer to as puritanism. Puritanism had its origin in England, but the concept is understood and certainly forms a part of the thought process of many Vietnamese. With regard to taxation it suggests that "good" things should be taxed lightly, if at all, and "bad" things should be taxed heavily.

The puritan mentality is clearly manifested in the distinction between luxury items and necessities.<sup>15</sup> Vietnamese officials are aware that items such as beer and cigarettes are consumed by the poor as well as the rich and therefore are not luxuries in any traditional sense, but if not luxuries, they certainly do not consider these items as necessities. On the other hand, gasoline, which at one time may have been a luxury,<sup>16</sup> today is considered a necessity. This implied distinction has had an adverse effect on Vietnamese taxes.

The ill effect of the puritan mentality can be appreciated by comparing the revenues collected from several of the products which bear excise taxes and some others subject to indirect taxes. The essential presumption in this comparison is that the selected products subject to excises are not considered as necessities, and therefore can and should be taxed heavily whereas those subject to indirect taxes are considered to be necessities and should not be taxed heavily. Excise taxes are levied on tobacco, beer, and soft drinks, and the indirect taxes are levied on petroleum, meat and ice. Relevant information for the comparison is given in Table 11.

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15. For a list of luxuries and necessities see Taylor, op. cit., Appendices A and B. The list was drawn up so that a higher production tax (35 percent) could be placed on luxuries than on necessities (15 percent). The production tax on imports was abolished in 1962 and was replaced by an austerity tax.

16. Light petroleum products appears on the luxury list. See previous footnote.

Table 11

CHANGES IN PRODUCTION, PRICES, AND TAX REVENUES FOR SIX PRODUCTS<sup>a</sup>  
1962 - 1967

Product	Production (Units given below)		Price (piasters/unit)		Tax Collections (mil. piasters)		Percent Increase 1962-1967	
	1962	1967	1962	1967	1962	1967	Price x Prod	Tax
Tobacco	4433	11326	8.0	14.0 <sup>b</sup>	919	4064	346	342
Beer	59.8	130.0	8.5	20.5 <sup>c</sup>	231	2359 <sup>d</sup>	423	921
Soft drinks	38.1	89.5	3.5 <sup>g</sup>	8.2 <sup>e</sup>	56	1067 <sup>d</sup>	450	1805
Total excise group					1206	7490		521
Petroleum	663	1292	7.0	10.8 <sup>f</sup>	1051	1669	200	59
Meat	1063	1258	63.1	234.0 <sup>g</sup>	69	77	338	12
Ice	117	237	.9 <sup>h</sup>	7.6 <sup>i</sup>	18	44	1613	145
Total indirect group					1138	1790		57

a. Source: National Institute for Statistics, Viet Nam Statistical Yearbook, 1966-67, and various Monthly Statistical Bulletins.

b. BASIOS cigarettes, per pack

c. "33" beer, per bottle

d. Includes perequation tax

e. Orangeade, per bottle

f. Kerosene, per liter

g. Pork, boneless leg, per kilogram

h. January 1965

i. Per kilogram

## Units of Measure for Production

Tobacco	100 metric tons
Beer & soft drinks	million liters
Petroleum	1000 metric tons
Meat	1000 animals
Ice	1000 metric tons

Tax collections in 1962 from the indirect group were about equal to collections from the excise group. However, for the five year period under review, taxes from the excise group rose 521 percent whereas collections from the other group increased only 57 percent. Some of this remarkable difference in performance can be explained by the larger production increases of the first group compared with the second. But most of the difference is to be explained by the types of taxes and by what we have called the puritan mentality.

In an inflationary situation specific taxes, i.e., those stated as a fixed amount per unit, are less desirable than ad valorem taxes.<sup>17</sup> Ad valorem taxes are inflation protected; collections rise proportionately with price if output remains constant. With the ad valorem tax form, the government does not have to revise rates continually to insure that its real share of revenue will not decrease. If tax revenues automatically rise when prices rise, the government will not have to depend upon deficit financing to maintain a constant share of real national income. All other things equal, and given an ad valorem tax regime, there is no need for the government to increase the money supply in order to pay its bills; and if there is no increase in the money (or velocity) then there can be no inflation. It follows, therefore, that a system of inflation-protected taxes acts as an automatic price stabilizer, or that an inflation protected tax system is one kind of insurance that there will be no inflation, at least insofar as government fiscal operations are the cause.<sup>18</sup>

The tobacco tax in large measure is inflation protected. Principally it is an ad valorem tax.<sup>19</sup> Note in Table 11 that tobacco tax

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17. Refer back to section 2.2.1, page 66.

18. Mr. Carl Cundiff estimated the tax revenues from specific and ad valorem taxes for the first seven months of 1968. Of 28 listed taxes 12 were specific and they generated 23 percent of internal tax revenues. The remaining were ad valorem and they generated 77 percent of the internal tax revenue. Memorandum from Carl C. Cundiff to Joseph P. Harmon, Agency for International Development (Saigon: October 1, 1968).

19. The tobacco tax actually is a combination of ad valorem and specific levies. Specific taxes in each case were imposed in July 1965. For an estimate of the effectiveness of this specific tax on cigarettes (called a surtax) see note 4 of Appendix B.

collections rose equally with the combination of output and price. That is, receipts increased because production increased and also because prices rose at the same time. The tobacco tax has caused very little administrative strain on the government and has been an excellent revenue earner.

The taxes on beer and soft drinks are not inflation protected in principle. They are specific; but the puritan thought of the government has driven it to raise the specific rates from time to time. In fact the tax on beer and soft drinks, as a result of governmental action, has performed better than an ad valorem tax. In the period 1962 to 1967, the specific duty on Larue beer increased 3.4 fold, on "33" beer 6.5 times, and on soft drinks 8.5 times.<sup>20</sup> The increase in revenues, compared with price and production increases shown in Table 11, has been remarkable and demonstrates the power of the tax authority to raise revenues when the need arises, even if it has to tax products which are very popular with the people.<sup>21</sup>

In 1967 the three "luxury" items earned about 40 percent of all domestic taxes. These taxes form the backbone of the Vietnamese tax system, but at the same time they point to one of its weaknesses. The weakness lies in the fact that the government has continued to accept a false distinction between those items which are necessary and those which are not. Such a distinction might be tolerable under conditions of stable prices, but under wartime conditions it is harmful. In an inflationary situation the government ought to raise tax revenues from whatever sources are possible.<sup>22</sup>

Contrast the revenue performance of beer with petroleum. Both are specific taxes in form but the similarity stops with that observation. Petroleum is considered a necessity, and the government has

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20. Including the perequation tax assessed by the Ministry of Economy, see Appendix Table A3.

21. The government fixes the price of cigarettes and beer, but actual prices have undoubtedly gone up faster than the official price on which the calculations in Table 11 are based.

22. See Section 2.

been most reluctant to raise the petroleum tax rate, in addition to which a significant percentage of petroleum sales are tax exempt.<sup>23</sup> The tax rate on petroleum has been the same since 1960 and consequently, tax receipts have increased only 59 percent, even though price and output taken together has increased 200 percent. In 1962 the petroleum tax was four times as important as the tax on beer; in 1967 it was only 70 percent as effective as the beer tax. In 1962, petroleum contributed 19 percent of all domestic tax revenues; in 1967 the figure was 9 percent.

Apparently the attitude with regard to the meat and ice tax is the same as that with regard to petroleum. The meat tax per pig has been 50 piasters since 1957,<sup>24</sup> when the meat tax was first introduced. At that time the tax was 2.1 percent of the wholesale price whereas today it is less than one-half of one percent. This tax illustrates well a defect of specific taxes in an inflationary situation.

Why has the government refused to raise the specific levies on some products? We have speculated that it is due partly to their puritan concepts. We can only infer this underlying reason from the GVN actions, not their statements. Ostensibly, the GVN has failed to act on raising petroleum taxes for the following reasons: Petroleum is thought to be a price leader; thus all prices will be raised if the price of petroleum is increased; it would be unpopular with the people; and it would be unpopular with the legislature which would have to approve a rise in petroleum taxes. In short, it is frequently claimed that in the interest of political stability the price of petroleum must not be allowed to rise, and holding the line against petroleum demonstrates a strong resolve of the government to protect the people against inflation.<sup>25</sup>

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23. See Note 5, Appendix B.

24. Taylor, op. cit., p. 70.

25. I believe that the GVN has created its own dilemma with regard to the petroleum tax problem. It has made such an issue of not raising petroleum prices that it can hardly back down now. No doubt, the government feels this is a politically sensitive matter, but their fears are probably exaggerated. Rice was the big issue at one time,

No doubt, as the IRS tax team stated, "The entire Vietnamese government structure is extremely sensitive to public opinion and reaction. This follows from the civil strife which the country is undergoing. Tax actions are usually geared to a consideration of what the public reaction will be."<sup>26</sup> Yet economics must play its role, too. Narrowing the gap between expenditures and domestic revenues, by raising taxes when they can be raised, probably will elicit some public complaint in the short run, but it will prove politically stabilizing in the long run as the requirement for deficit financing will be reduced, thereby reducing inflationary pressures in general.

#### 4.3 CUSTOMS AND AUSTERITY DUTIES

##### 4.3.1 Customs and Austerity Duties Under Fixed Exchange Rates

The concept of inflation-protected taxes takes on special meaning when applied to foreign trade transactions. In a country with a rapid rate of inflation, the reliance on foreign trade taxes is a major handicap. One reason is that there is no automatic tax increase associated with rising prices; that is, foreign trade taxes are not inflation-protected. Given a fixed exchange rate, the prices paid by importers will rise only as rapidly as the prices of imports valued in foreign currency. If prices in the exporting country rise slower than prices in the importing country, then customs duties and foreign exchange taxes will rise at a slower rate than domestic prices. Consequently, the government's claim over real resources will decline.

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yet the average retail price of rice has increased threefold since 1965 with little visible public reaction in Saigon. No doubt, also, a rise in gasoline prices would be passed along in higher transportation costs, and higher prices for some other products such as electricity, but the extent to which these prices would increase has not been determined, and probably has been grossly exaggerated in the politician's eye. Also, it seems a little ridiculous that the price of gasoline in Vietnam (approximately 33¢ per gallon) is so much lower than in most countries when the prices of essential foodstuffs is so much higher.

26. Foley, op. cit., p. 6.

It is possible that a part of the government's real loss due to differential price changes could be recouped if imports increased, and imports would increase if real incomes were rising or if the prices of local goods were rising faster than the prices of imports valued in local currency, or both. In countries with rapidly rising prices it is not likely that real incomes are rising much, and so the treasury is not likely to receive the potential rewards from a marginal propensity to import greater than unity. On the other hand, the price differential effect could result in significant increases in revenues; but whether it will contribute much to governmental revenues depends upon the degree of competition among importers. If import licenses were issued freely to everyone, competition in the import trade would keep import prices below those for domestic goods (assuming no scarcity of foreign exchange) at least for a time, causing a substitution away from local products to imports with the amount of substitution depending upon cross-elasticities. Thus, even with a fixed exchange rate, customs and foreign-exchange tax revenues would rise, but the increase in customs collections would be due to the increase in the volume of imports and not their prices. Volume effects, however, presume intense competition among importers.

Suppose, however, that import licenses were not issued freely and that specialty importers had monopolies over their own specialties. In that case, the volume effects would be reduced because of the well-known monopoly practice of maximizing profits by restricting output. In this case, average import prices would maintain pace with the prices of domestic products<sup>27</sup> minimizing substitution of imports for domestic products. Importer's profits would soar and governmental collections on customs might even decline.

The actual situation in Vietnam in the years prior to the 1966 devaluation was somewhere between the monopoly and competitive cases. Importing was not an open affair but there were enough importers for a general line of goods so that the prices of imported goods, at

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27. Assuming that the demand elasticities for imports were about the same as for domestic products.

least so far as the official statistics reveal, did not rise as fast as the consumer price index. Nevertheless, sizeable rents were obtained by the importing community.

In order to make an estimate of the excess profits importers were realizing before devaluation in consequence of their privilege of buying dollars at fixed exchange rates while selling the goods at rising prices, relevant information has been assembled in Table 12. Higher austerity rates became effective late in 1965; but other than that change, the tariff schedule was fairly stable for the four-year period. Therefore, the changing of tariff rates has little effect on the conclusions. Also during this entire period, the effective exchange rate was fixed at ₦60 per dollar except on some Food for Peace imports for which the importers were paying ₦73 for each dollar.

The last column of Table 12 shows the additional revenues the government could have raised had exchange rates or customs duties risen in proportion to the wholesale price of imported products. For example, in 1965 importers were selling their goods at prices 21 percent higher than in January 1962, yet the importer paid the same price for his goods<sup>28</sup> at both times. Had import duties been raised in line with wholesale prices, the effective tariff in 1965 would have been ₦19.4 per dollar rather than the actual rate of ₦16 per dollar. Given the dollar value of imports for that year, customs and austerity collections would have been ₦1.36 billion higher than they actually were. This difference can be considered a rent (due to a special privilege) of the importing community or excess profits, if profits as of the base period are considered "normal."

Column 7 is called "minimum rents" because the calculations are based upon the premise that the actual volume of imports would not

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28. The calculations do not take into account storage and domestic handling costs and for this reason tend to exaggerate the excess profit. However, the reasons why the calculations are an underestimate probably outweigh the former. For example, the prices on which these calculations are based are "official prices" and probably are lower than the prices importers were actually charging.

Table 12

IMPORTER PROFITS DUE TO FIXED EXCHANGE RATES, 1962 - 1966

Year	(1) Value of imports <sup>a</sup> (\$ mil)	(2) Customs and Austerity taxes <sup>b</sup> (\$ mil)	(3) Customs and Austerity taxes (\$ per \$)	(4) Price index of imports <sup>c</sup>	(5) (3) x (4)	(6) (1) x (5)	(7) Minimum rents (\$ mil) (6) - (2)
1962	265	4772	18.4	1.04	19.1	5061	289
1963	286	4612	16.6	1.09	18.1	5177	565
1964	298	5070	17.5	1.15	20.1	5990	920
1965	357	5570	16.0	1.21	19.4	6926	1356
1966 (6 mos)	198	3305	17.0	1.28	21.8	4316	1011

Sources and note:

- a. U.S. Agency for International Development, Office of Joint Economic Affairs, Annual Statistical Bulletin, No. 10, Table D-11.
- b. Table 3, this study.
- c. U.S. Agency for International Development, Office of Joint Economic Affairs, Annual Statistical Bulletin, No. 10, Table B-5. The average wholesale price index for imported products in January 1962 is used as the base year number.

have declined had the government charged the tariff rates shown in column 5. If we assume that importers were satisfied with the volume of imports in early 1962, and that they were satisfied with their profit margins, then any subsequent price increase must be viewed as a pure windfall gain, if costs remained constant; thus raising the tariff rates would tax away only the excess profits due to the price effect and would not influence their attitude about the volume of imports. In other words, if they were already charging "what the traffic would bear," any additional tax on the importers could not be passed on to the consumer. It would come out of the pure rent. On the other hand, if the government would have raised rates beyond those shown in column 5, importers would have cut back on their imports in order to maximize their profits under the new tariff schedule. Supply would be cut back, and prices to consumers would rise. Therefore the incidence of the tax would be borne partly by the consumers. In this situation, it would not be possible to say what the effect on government revenues would be without a knowledge of the responsiveness of consumers to price changes on imports.

#### 4.3.2. Digression on Flexible Exchange Rates

The possibility of excess profits on imports occurs only because a system of fixed exchange rates allows the importer to buy cheap and sell dear if domestic prices are rising faster than international prices, which has been the situation in Vietnam vis-a-vis the United States and other exporting countries since 1962. Under a regime of flexible exchange rates and open import licensing, excess profits would not be possible. If inflation in domestic prices rose more rapidly than international prices, local currency would depreciate automatically, in this case raising the piaster costs of imports. Import competition and the automatic foreign exchange mechanism would act in concert to eliminate all extra profits (rents). In addition, if the customs rates were established as percentages of the piaster costs of imports, the government treasury, rather than the import community, would be the beneficiary.

An alternative to flexible exchange rates, which central bankers tend to dislike, would be to tie the customs rates to some index of domestic inflation. The calculations in Table 12 assume that the wholesale price of imported products is the proper price index, and the estimates shown in that table can be considered as the analytical equivalent of the amount of customs collections that would have accrued to the Treasury had Vietnam operated under a system of flexible exchange rates.<sup>29</sup>

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29. The wholesale price of imports is not necessarily the proper index to use for the calculation. It is tempting to use the black market rate as the true value of the piaster in terms of foreign exchange. But the black market rate would understate the true value of the piaster if a system of flexible exchange rates were in effect. The current black market price is as high as it is because dollars are not freely available to finance trade and other activities.

Appendix A  
SUPPORTING TABLES

## Tables

A1	Gross National Product, Private Consumption, and Federal Expenditures during W-rtime . . . . .	81
A2	Tax Rates on Beer and Soft Drinks in Vietnam . . . . .	82
A3	Total Taxes Paid by Four Industries in Vietnam . . . . .	83

Table A1

GROSS NATIONAL PRODUCT, PRIVATE CONSUMPTION, AND FEDERAL EXPENDITURES DURING WARTIME,  
VIETNAM AND THE UNITED STATES

Year	Vietnam <sup>a</sup> (billion piasters)			United States <sup>b</sup> (billion dollars)			
	GNP	Private Consumption	Public Consumption	GNP	Personal Consumption	Federal Expenditure	National Defense
1962	93.8	77.8	19.7	1939	66.8	5.1	1.2
1963	100.3	84.8	21.0	1940	70.8	6.0	2.2
1964	114.5	92.4	25.0	1941	80.6	16.9	13.8
1965	144.8	107.3	32.5	1942	88.5	51.9	49.4
1966	240.9	187.2	55.2	1943	99.3	81.1	79.7
1967	352.0	280.0		1944	108.3	89.0	87.4

a. 1962-1965, Banque Nationale du Viet Nam, Bulletin Economique, No. 7-8, 1967, p. 35.  
1966-1967, NBVN estimate supplied to IMF, December 1967.

b. Council of Economic Advisers, Economic Report of the President, 1967.

Note: Public consumption figures for Vietnam are lower in these accounts than those given in Table 8 in text.

Table A2

TAX RATES ON BEER AND SOFT DRINKS IN VIETNAM  
( $\text{P}$  per 100 liters)

Effective Date	Regular Tax	Perequation Tax	Total
July 1960			
"33" beer	450		450
Larue	450		450
Soft drinks	150		150
July 1965			
"33" beer	1350		1350
Larue	900		900
Soft drinks	450		450
June 1966			
"33" beer	1350	1588	2938
Larue	900	650	1550
Soft drinks	450	830	1280

a. Source: Directorate General of Taxation, Vietnam.

Table A3

TOTAL TAXES PAID BY FOUR INDUSTRIES IN VIETNAM, 1962-1967<sup>a</sup>  
(million piasters)

Item	Year					
	1962	1963	1964	1965	1966	1967
Tobacco		<u>1144.1</u>	<u>1221.1</u>	<u>1768.9</u>	<u>2991.2</u>	<u>4520.4</u>
Excise	919.4	1013.1	1075.6	1589.5	2709.7	4064.3
Production		112.3	124.7	153.8	241.3	390.9
Patente		18.7	20.8	25.6	40.2	65.2
Beer <sup>a</sup>		<u>393.3</u>	<u>519.1</u>	<u>866.5</u>	<u>1893.6</u>	<u>2711.7</u>
Excise	230.9	316.2	425.3	756.3	1140.8	1326.1
Perequation					502.0	1033.0
Production		66.1	80.4	111.6	215.0	302.2
Patente		11.0	13.4	18.6	35.8	50.4
Soft Drinks		<u>77.8</u>	<u>96.8</u>	<u>205.0</u>	<u>696.8</u>	<u>1215.3</u>
Excise	56.2	67.2	82.5	184.1	354.8	400.0
Perequation					298.0	667.0
Production		9.1	12.3	17.9	37.7	55.6
Patente		1.5	2.0	3.0	6.3	92.7
Petroleum		<u>1411.2</u>	<u>1327.1</u>	<u>1408.6</u>	<u>1753.1</u>	<u>2202.7</u>
Indirect	1051.1	1214.3	1124.5	1165.1	1382.1	1669.3
Production		169.1	173.7	208.7	318.0	457.2
Patente		27.8	28.9	34.8	53.0	76.2

- a. Sources: Excise and Production taxes from Directorate General of  
of Taxation.  
Perequation Tax from Ministry of Economy  
Patente is estimated by author as 1/6 of production tax.
- b. Includes the production tax paid on carbonated beverages by BCI.

Note: Production and patente taxes for 1962 unavailable. Perequa-  
tion tax went into effect in June 1966.

Appendix B

NOTES

## Appendix B

### NOTES

#### Note 1: Calendar Year Expenditures

Data on annual cash expenditures of the GVN are subject to much doubt. This is particularly true for the years 1962 through 1965. One reason is poor accounting, but a more significant reason is that the GVN accounting year includes seventeen months rather than twelve. Generally, the Vietnamese fiscal year corresponds with the calendar year. However, funds obligated during a calendar year in most cases have to be expended within that same year or the first five months of the following year in order to be accounted for as an expenditure in the fiscal year in which they were obligated. For example, funds obligated in August 1966 and expended in March 1967 will be counted as an expenditure in FY 1966; but if those funds are not actually spent until June 1967, they will be counted as an expenditure in FY 1967. The first five months in each year are set aside as a "complementary period."

Since our revenue data have been collected on a calendar year basis, we must attempt to convert fiscal year expenditure data to a calendar year basis. This is difficult because of the complementary period problem mentioned above and also because no two sets of figures on fiscal year expenditures agree with each other. The following data show the range of differences.

<u>Source of Data</u>	<u>Billion Piasters</u>			
	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>1965</u>
NBVN, <u>Annual Report</u> , FY 1965, Part II, Ch. 2, p. 6	24.1	27.1	35.4	52.0
DGBFA as reported in USAID, <u>Annual</u> <u>Statistical Bulletin</u> , No. 10, p. 49 (budgeted expenditures)	22.7	27.1	37.1	51.3

For the years 1962 through 1964 actual expenditures were less than budgeted expenditures. In the case of the civil budget, actual calendar year expenditures are available and they can be compared with the budgeted civil expenditures.

	<u>Billion Piasters</u>			
	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>1965</u>
DGBFA, budgeted civil expenditures reported in USAID, <u>Annual Statistical Bulletin</u> , No. 10, p. 49	10.6	13.0	17.7	20.9
DGBFA, CY Civil expenditures computed by Mr. Nguyen Uyen, AID Economics Division, for Dacy	10.1	11.1	14.4	21.2
Percent, row 2 of row 1	95.3	85.4	81.4	101.4

Unfortunately we have no reliable data on military expenditures, and therefore cannot make the simple addition of civil and military expenditures to obtain total calendar year expenditures. In order to estimate total calendar year expenditures for 1962 through 1965, we shall make the following crucial assumption: The ratio of actual calendar year civil expenditures to budget civil expenditures also gives the proper relationship between actual calendar year total GVN expenditures and budgeted expenditures. Our estimate of total calendar year expenditures are computed below:

	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>1965</u>
Budgeted expenditures (P bil)	22.7	27.1	37.1	51.3
Adjustment ratio	.953	.854	.814	1.014
Estimated CY expenditures (P bil)	21.6	23.1	30.2	52.0

There are two justifications for the above estimating procedure: (1) Actual expenditures historically have been less than budgeted expenditures and our estimates deviate from published figures in the proper direction for 1962 through 1964. (2) About 80 percent of GVN expenditures are for salaries and wages. This applies for the military

as well as civilian agencies. Therefore, it seems reasonable to use a known civilian ratio to adjust implicitly for military expenditures. Or the complementary period expenditures are less meaningful in a situation where most expenditures are made on wages.

Note 2: Treasury Resources

In Table 8 total government expenditures usually exceed total government collections, including borrowing from the National Bank, by a wide margin. The difference has been called "other resources." Vietnamese publications which compare expenditures and financing refer to the deficit as "Treasury's own resources." (See, for example, National Bank of Vietnam, Annual Report, Fiscal Year 1966, Appendix Table 12.) We have little concrete knowledge of the Treasury operations (accounts) which generate the money flows sufficient to fill the gap between total expenditures and total government receipts and Central Bank borrowings. This note attempts to account for as much of the difference as can reasonably be explained by use of other data not included in Table 8; but the reader should understand that these speculations have not been confirmed by any Vietnamese official. Speculation is required in this case because of the difficulty of finding anyone in Vietnam who knows just exactly what is meant by Treasury's own resources.

Some possible factors explaining the difference between expenditures and receipts listed in Table 8 are:

(1) Estimates of government expenditures are inaccurate. A ten percent variation would make a big difference in the residual called "other resources." However, there is no reason to expect a systematic bias in the estimates of total expenditures and a persistent overestimation of expenditures would be necessary to explain the positive values in the "other resources" row.

(2) Provincial and Municipal government expenditures are included in total expenditures but revenues from these sources are not included in total receipts. We know this is true for 1966 and 1967 and, therefore, can make the proper adjustment. However, we can only speculate for the prior years.

(3) Administrative levies (perequation taxes, etc) are not included in taxes and administrative receipts in Table 8.

(4) We could not determine whether the NBVN actually turned over any "extra-budgetary revenues" to the Treasury prior to 1966, therefore the administrative levies before 1966 cannot be overstated but may be understated.

(5) The Treasury sells some bonds to the public and commercial banks. In addition it holds commercial bank deposits, and some demand and time deposits of private individuals. These liabilities of the Treasury could be a source of Treasury financing. On the other hand, the Treasury deposits money with the NBVN, commercial banks, and holds some funds within the Treasury. These are Treasury assets. If liabilities from these flows build up faster than assets, the difference could be used to finance government expenditures.

(6) More foreign aid is usually made available to the Government than it actually spends. In effect the Treasury can borrow from the excessive foreign aid funds.

The tabulation below shows the extent to which the measurable factors might account for the gap between estimated expenditures and publicized sources of financing. It indicates clearly that there are significant gaps in our understanding of GVN Treasury operations.

<u>"Other resources"</u>	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>1965</u>	<u>1966</u>	<u>1967</u>
Provincial and Municipal revenues <sup>a</sup>				1.3	1.4	
Administrative levies <sup>b</sup>					14.3	12.5
Plus increase in financial liabilities <sup>c</sup>		.7	2.6	4.7	-1.0	1.3
Less increase in financial assets <sup>d</sup>		.2	.4	3.5	4.6	1.4
Foreign aid surplus <sup>e</sup>		1.1	.6	.4	-2.2	5.5
<b>TOTAL</b>		<u>1.6</u>	<u>1.8</u>	<u>2.9</u>	<u>7.9</u>	<u>17.9</u>
Other Resources from Table 8		.3	4.6	9.7	11.0	25.3

Sources and explanations:

- a. Total Provincial and Municipal Revenues, less subsidies from National Budget; Vietnam Statistical Yearbook, 1966-1967, Tables 221 and 222. These data pertain to fiscal years or a 14 month period. They probably differ only insignificantly from calendar year figures. Figures were derived by subtracting Central government subsidies from total Provincial and Municipal government revenues. This difference could not be computed for other years because governmental subsidies are not given.
- b. Table 7, this study.
- c. Banque Nationale Du Viet Nam, Statistiques Financieres (Documentation Interieure) various monthly issues. These figures are summed changes in balances of the following accounts from December to December: Commercial bank deposits in the Treasury, deposits in post office, treasury bonds; Private sector time and demand deposits in Treasury, demand deposits in post office, and private holdings of treasury bonds.
- d. Same as c. These accounts show Treasury and other government agency deposits in the National Bank, Treasury cash, and Treasury deposits in commercial banks.
- e. Table 6, this study.

Note 3: Meaning of Deficit Finance

Deficit finance in Table 10 is computed as a residual. It mainly includes Treasury borrowing from the National Bank, but also includes borrowing by other government agencies (the large rice subsidy loan extended to the Ministry of Economy in 1967) and the use of "Treasury's own resources." See Note 2 for a possible explanation of these resources.

Note 4: Increase in Tobacco Excise Taxes due to Specific Levy per Case

In July 1965 a special surtax was placed upon all cigarettes which were subject to 50 percent circulation tax. The surtax rates were established as follows:

₦4 per pack on cigarettes selling above ₦10 per pack

₦2 per pack on cigarettes selling between ₦4 - 10 per pack

₦1 per pack on cigarettes selling below ₦4 per pack

Data are not available on the number of cases sold for each price, but a very rough estimate of the impact of the surtax can be made by using published data on total cigarette production by weight. Some relevant data for estimating the impact of the surtax on tobacco excise revenues is assembled in the following tabulation.

<u>Period</u>	<u>Cigarette Tax Receipts<sup>a</sup></u> (₦ mil)	<u>Cigarette Production<sup>b</sup></u> (metric tons)	<u>Tax/ Production</u> th. ₦/ton	<u>Cigarette price change from Previous Period<sup>c</sup></u>
Jan-July 1965	771	4579	168	
Aug-Dec 1965	819	3057	268	23%
Jan-July 1966	1375	5031	273	7%
Aug-Dec 1966	1335	3687	362	26%

- Sources:
- Director General of Taxation
  - National Institute of Statistics, Monthly Bulletin of Statistics
  - National Institute of Statistics, average retail price of "Cotab" and "Bastos" cigarettes as reported in Monthly Bulletin of Statistics.

After the imposition of the surtax tax collections per ton increased 60 percent for the rest of the year. Without the surtax tax collections would have increased by 23 percent since the original tax was levied on an ad valorem basis. Thus, the surtax raised cigarette tax collections from an estimated ₦207,000 per ton to ₦268,000 per ton, an increase of 30 percent. In 1966 collections per ton continued to rise but the rises were due entirely to price changes.

Note 5: Exemptions from Petroleum Tax

Civilian exemptions from the petroleum tax reduce government tax revenues from petroleum to approximately 55 percent of potential collections. This estimate is based upon the 1967 civilian sales data and tax rates given in the tabulation below:

<u>Product</u>	<u>Civilian Sales<sup>a</sup></u> <u>(mil liters)</u>	<u>Tax Rate</u> <u>₰ per Liter</u>	<u>Implied Taxes</u> <u>₰ mil</u>
Gasoline	306.4	3.25	996
Kerosene	271.1	1.75	474
Aviation gasoline	69.4	2.50	174
Turbine fuel	138.2		
Gas oil	127.5		ave 1.50 <sup>b</sup>
Diesel oil	238.8		
Fuel oil	389.9		
Lubricating oil	31.5		<u>1388</u> 3032

Notes and Sources:

- a. National Institute of Statistics, Monthly Bulletin of Statistics, August 1968, Table 4.8.
- b. This is the arithmetic average of the low and high tax rates given for these kinds of products. The actual tax rates are not stated according to this breakdown of petroleum products.

Actual petroleum tax collections in 1967 were ₰1669 million or ₰1363 million below the amount that could have been collected had there been no exemptions. We believe that Vietnamese officials are not really aware of the degree to which potential tax revenues from petroleum products, even given the present low rates, have been reduced by exemptions.