



Environmental Taxation in Viet Nam

Tackling both environmental problems and state deficits with economic instruments

The challenge

Viet Nam is one of the fastest growing economies in South-East Asia with an average growth rate of 7.3 % since 2000. However, this rapid development comes with a significant drawback, as it is currently coupled with a rise in environmental pollution, such as increased exhaust fumes, noise pollution and growing problems of solid waste disposal and wastewater sewage. As Viet Nam has now entered the ranks of middle income countries, it needs to build the foundations for a green economy to ensure its sustainable development and to avoid draining its natural resources. Otherwise, damages could be irreversible or too costly for future generations to redress.

Against this background, in 2004 the Vietnamese Prime Minister Nguyen Tan Dung asked for an environmental tax law to be introduced by 2012. Environmental taxes are considered economic instruments, as are marketable permits, refund systems, subsidies and performance bonds. The advantage of economic instruments is that they use market signals (prices) rather than regulations to create incentives and disincentives for consumers, producers, and service providers to invoke a shift to environmentally friendly production and consumption patterns. However, they do not substitute, but rather complement and strengthen regulatory and other approaches in the respective policy area.

Approach of Vietnamese-German Cooperation

Vietnamese-German development cooperation in the context of public finance can build on more than 15 years of trustful partnership with the Vietnamese Ministry of Finance. The bilateral Macroeconomic Reform Programme, carried out by GIZ on behalf of the Federal Ministry for Economic Cooperation and Development (BMZ), has supported the Ministry of Finance with regard to environmental taxation since 2008, following a joint project between Viet Nam and the EU on this matter. One objective is to support the Vietnamese Tax Policy Department in implementing an environmental tax

law in accordance with international standards – a challenging task, as the law needs to provide information on taxable objects and the appropriate tax rate. Furthermore, questions regarding political acceptance, environmental impacts, administrative burden as well as non-intended economic and social impacts need to be tackled.

A key feature in supporting the design of the environmental tax law was the successful transfer of international know-how through an international expert on environmental taxation and through the iterative discussion process with the Vietnamese partners in which GIZ national staff served as the main communication bridge. In order to provide the Vietnamese Tax Policy Department with access to international knowledge on environmental taxation, the Macroeconomic Reform Programme facilitated two study tours to selected European countries notably experienced in environmental fiscal reform and provided access to global networks, such as the annual Global Conference on Environmental Taxation and expert groups in the European Union and the OECD. Viet Nam officials and civil servants used these opportunities not only to acquire methodological and technical expertise, but also to study different ways to implement environmental fiscal reforms and to advance the formulation of the respective Vietnamese law. By organising multi-stakeholder workshops and training events at national and regional level, the Vietnamese Tax Policy Department ensured from the beginning a broader involvement of different opinions, concerns and interests.

As Vietnamese legislation requires a regulatory impact assessment for each law, the Macroeconomic Reform Programme, in cooperation with the Institute of Development Studies (University of Sussex), the University of Copenhagen and Viet Nam's Central Institute for Economic Management, supported Viet Nam's Tax Policy Department in launching an ex-ante impact assessment. The different socio-economic and environmental effects of taxation were analysed using a general equilibrium model.

Outcomes and impacts

After several discussions and revisions, the Vietnamese parliament passed the bill in mid-November 2010 with the support of a large majority of the parliamentarians. As the law will come into force in 2012, Viet Nam has succeeded in becoming a frontrunner in South-East Asia on environmental taxation. The Vietnamese government will levy taxes not only on energy in terms of refined fuels and coal, but also on environmentally harmful substances, such as hydrochlorofluorocarbons (HCFCs), selected pesticides and soft plastic bags. The exact tax rates will be determined by the central government for each tax period. As an example, petrol will have tax rates ranging between VND 1,000 and 4,000 per litre – which corresponds at present to an ad valorem tax rate of between 5.9 % and 17.6 % – and will abolish the current petrol charge in the amount of VND 1,000.

According to the ex-ante impact assessment, the environmental taxes will contribute to the weak state budget, with up to 1.5 billion euros in additional tax revenues expected for 2012, depending on the tax rate applied. These additional tax revenues will be divided between the state budget and the provincial budgets, thereby strengthening fiscal decentralisation.

Environmental taxation is also expected to contribute largely to reducing Viet Nam's greenhouse gas emissions. The ex-ante impact assessment analysed quantitative changes in the domestic use of fossil fuels and translated it into changes in carbon emissions. For the year 2012, the model results suggest a reduction in greenhouse gases of between 2.3 % and 7.5 %, which equals three to nine million tons of saved CO₂ emissions, depending on the tax rate applied.

With regard to the socio-economic impacts, the assessment provided detailed information on the effects on different income groups and sectoral outputs resulting from the environmental taxation. Simulation results show a significant shift in purchasing power from the household sector to the government sector. That means that households will bear the major burden of energy taxation. However, analysing the effects on different income groups reveals that the tax burden will be carried by enterprises and private households equally and that lower income households will not be adversely affected by environmental taxes.

The impact assessment further indicates that fuel intensive sectors like road and air transportation will shrink significantly,



while sectors with low fuel intensity like the clothing and textile sectors will expand output and employment considerably. Thus, shifts in production and consumption patterns are expected and desired. Nonetheless, the fuel tax is associated with significant adverse effects for the fishery sector, as fuel accounts for almost 50 % of their costs. From a purely environmental perspective, this might be considered a beneficial side effect of the environmental tax, as the contraction of capture fishery reduces the pressure on fragile ecosystems. However, the Vietnamese capture fishery sector mainly consists of individual (vulnerable) fishermen and women, and fish-related sectors employ a considerable fraction of Viet Nam's labour force. Model results suggest that these unintended side effects can be largely eliminated through an output subsidy for the capture fishery sector.

Outlook

Compensation measures, such as the above mentioned output subsidy in the fishery sector, are probably going to be discussed at the political level throughout 2011 when formulating the necessary decrees for implementation of the law. Encouraged by the overall multiple advantages of economic instruments, Viet Nam's Tax Policy Department is working on a new decree for the regulation of fees and charges on vehicle exhaust fumes, where the amount to pay would vary with emission levels. The effectiveness of the instrument, however, needs to be evaluated. Remaining challenges are, e.g., the price of coal.

Overall, Viet Nam seems to be on the right track. In addition to the general Law on Environmental Protection, which entered into force in 1994, the government recently adopted a series of more specific laws, regulations and decrees focused on issues and sectors, including the National Strategy for Environmental Protection for the period between 2010 and 2020. A key success factor for a better environment will be its implementation and enforcement.

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