

China's experience in managing off-budget state financial funds and policy suggestions

Dang Thu Thuy

Assoc.Prof.Dr., Institute for South Asian, West Asian, and African Studies, Vietnam Academy of Social Sciences

Email: thuy0183@gmail.com

Nguyen Xuan Cuong

Ph.D, Institute of Chinese Studies, Vietnam Academy of Social Sciences

Email: xuancuong@vnics.org.vn

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Abstract: *Extra-budgetary funds are a flexible financial tool that supplements the national budget and mobilizes social resources for public sector activities. These funds can be used to support investment in areas requiring encouragement, contributing to economic and social development. However, to ensure effectiveness and transparency, the government must tightly manage extra-budgetary funds, ensuring they align with the country's economic and social development at each stage. China's experience in managing these funds can be a valuable lesson for Vietnam as it refines relevant legal policies.*

Keywords: Extra-budget Fund, China, Experience, Policy, Vietnam

1. Introduction

Extra-budgetary state financial funds, commonly referred to as extra-budgetary funds (EBFs), are a prevalent financial structure in many countries, particularly those with transitioning economies. These funds operate independently of the national budget and are managed by local agencies, units, enterprises, and organizations in accordance with the national financial regulations. EBFs serve as a crucial supplement to the national budget, enabling government bodies, organizations, and social groups to collect, allocate, and utilize resources to fulfill legally mandated functions. They provide a flexible financial

tool for mobilizing societal resources for public sector activities, supporting investments in strategically prioritized sectors, thereby fostering socio-economic development.

2. Extra-budgetary funds (EBFs)

2.1. Principal definitions

According to the International Monetary Fund (IMF), Extra-budgetary funds (EBFs) refer to general government transactions that often involve distinct institutional and banking arrangements and are excluded from the annual state (federal) budget laws and the budgets of local authorities (Allen & Radev, 2006). The World Bank (WB) broadly defines EBFs as resources

that are directly or indirectly managed by government administrative bodies outside of conventional financial management processes (Christine Wong, 1999). In China, the State Council's Decision on enhancing the management of extra-budgetary funds dated July 6, 1996¹ specifies that EBFs are funds collected, allocated, and utilized by governmental agencies, organizations, and social groups to perform governmental functions in accordance with national laws and regulations, but are not integrated into the national budgetary financial management system.

Clause 19 Article 4 of the 2015 Budget Law of Vietnam stipulates: "*Extra-budgetary state financial funds, established by authorized bodies, operate independently of the state budget, with designated sources of revenue and expenditure responsibilities to fulfill tasks as stipulated by laws*".

2.2. Characteristics and roles of EBFs

EBFs act as supplementary financial resources to the national budget, collected and utilized by local authorities, state enterprises, and organizations in accordance with legal regulations. The primary sources of EBFs include additional local taxes and specialized funds managed by state enterprises. As supplementary resources, the establishment, management, and utilization of EBFs must comply with state regulations. EBFs play a crucial role in supporting the national budget by addressing specific needs at the local level and in designated sectors (Yang, 2021).

Moreover, EBFs serve several essential roles: (i) Fulfilling specific commitments: EBFs are fundamentally designed to address particular needs, offering reliable funding

that is allocated and utilized proactively and promptly. They are capable of resolving complex issues that conventional budgetary channels might not handle effectively, thus alleviating various challenges associated with national budget arrangements. (ii) facilitating business development: The flexible management of off-budget capital allows for tailored solutions suited to local conditions and circumstances. This flexibility significantly supports enterprise development; (iii) mobilizing supportive resources: EBFs play a key role in mobilizing additional resources for effective financial management (Yang, 2014).

3. The evolution of extra-budgetary funds in China

The establishment of EBFs has played a significant role in empowering local governments, departments, and organizations to tailor economic development strategies to local conditions. By granting autonomy to local authorities and administrative departments in fee collection, EBFs enable effective mobilization of resources for local development projects, contributing to increased revenue and reduced expenditure, addressing funding gaps in the national budget and alleviating the fiscal pressure on the national financial system.

3.1. The period 1958-1985²

Since its inception, China has employed a highly centralized and unified system of revenue and expenditure. Following the First Five-Year Plan (1953-1957), efforts to garner local support led to a partial allocation of initial budgetary revenues to off-budget management, thus giving rise to the concept of extra-budgetary funds (EBFs). Consequently, EBFs

¹ 国务院关于加强预算外资金管理的决定 (国发〔1996〕29号1996年7月6日).

² Associated with the decentralization of EBF management.

emerged during the planned economy era and expanded rapidly following the economic reforms and opening-up. Through numerous adjustments aimed at decentralizing financial authority, the scale of EBFs in China increased substantially, accounting for 35.5% of budgetary revenue by 1976 (Qiao et al., 2022). After the 1978 reforms, EBFs developed swiftly, becoming a crucial component of China's financial system. The scale of EBFs saw a significant rise, comprising 35.5% of budgetary revenues by 1976. The growth rate of EBFs continued to accelerate, surpassing RMB 140 billion by 1985, equivalent to 81% of budgetary revenues (Qiao et al., 2022). During the 1980s, amid the process of opening up and economic reforms, China enhanced its budgetary management system to a certain extent. By adjusting the allocation of financial resources and fiscal authority between the central and local governments, China implemented a contract management responsibility system and began to establish the relationship between the state and enterprises. The decentralization of EBF management, reform of enterprise fund systems, and the "profit taxation reform" contributed to the expansion of extra-budgetary financial resources, facilitating China's socio-economic development during this period.

3.2. The period 1986-2011

During this phase, EBFs experienced an exponential growth, surging elevenfold from 1978 to 1992, and emerged as China's "second budget," constituting 97.7% of total fiscal revenue. The growth trajectory of the EBFs outpaced that of GDP and budgetary revenues, leading to a pronounced dispersion of these funds. Structurally, the management of EBFs

was predominantly under the purview of enterprises and regulatory authorities. However, lax fiscal management resulted in the reallocation of financial funds, leading to several issues, such as the conversion of public funds into private ones, a diminished budget revenue-to-GDP ratio, and the expansion of investment funds alongside fixed asset consumption (Qiao et al., 2022). Prior to 1993, China's EBFs encompassed numerous special funds established by state-owned enterprises and competent authorities, as well as EBFs managed by local and central authorities. From 1980 to 1990, the scale of EBFs was nearly on par with budgetary funds, peaking in 1992 when extra-budgetary revenues amounted to 98% of budgetary revenues. However, in 1993, the EBFs sharply declined to RMB 143.3 billion. Subsequently, the EBFs resumed robust growth, reaching RMB 389.3 billion by 1996. Following comprehensive reforms in 1993, the scope of extra-budgetary revenues was recalibrated. Concentrated capital from enterprises with legal personhood and proprietary rights, along with their competent authorities, were no longer classified as extra-budgetary. From 1993 to 1995, EBF revenues comprised solely administrative fees and local financial revenues. Since 1996, central government funds (fees), electricity construction funds, and railway construction funds were incorporated into budgetary management. From 1997 onwards, the abolition of local financial revenues led to an increase in government fund revenues, state-owned enterprise and authority revenues, and other income sources (Qiao et al., 2022; Chen, 2019). Consequently, EBF revenues included administrative fees, government fund revenues, self-organized

township funds, state-owned enterprise and authority revenues, and other income, with administrative fees constituting 69.4% of total EBF revenues (Chen, 2019). Under the new regulations, the scale of EBFs consistently contracted from 1997 to 2010¹ before being incorporated into budgetary management as of January 1, 2011, according to the “Notice on the Incorporation of extra-budgetary fund revenues into budgetary management” issued by the Ministry of Finance of China in June 2010², marking the end of the EBF (Chen, 2019).

According to 2011 statistics, approximately RMB 6 billion from central government sources and around RMB 250 billion from local government sources, initially managed as EBFs, have all been incorporated into budgetary management (Qiao et al., 2022).

4. China’s management of extra-budgetary funds and policy recommendations for Vietnam

In China, EBFs of the central government can be categorized as follows: (i) EBFs managed by the Ministry of Finance, (ii) EBFs with fee-based utilization, and (iii) EBFs and funds managed by various central authorities (including subordinate units). At the local level, EBFs can be classified into: (i) EBFs of local financial authorities, (ii) EBFs disbursed based on utilization needs, and (iii) EBFs of public institutions and administrative units (Zhan, 2009).

¹ The proportion of extra-budgetary local financial funds within local expenditures declined from 50.9% in 1996 to 40.0% in 1997. This ratio further decreased to 26.4% by 2002 and 7.3% by 2010 (Qiao et al., 2022).

² Subsequently, the Budget Law of the People’s Republic of China 2014 stipulates that all government revenues and expenditures must be incorporated into the budget.

4.1. China’s management of EBFs

Following the 3rd plenary session of the 11th Central Committee of the Communist Party of China (1978), China embarked on decentralization reforms, ceding authority and interests, which led to the transfer of funds from the budget to extra-budgetary management. However, this shift also resulted in fund dispersion and issues such as illegal fee collection, revenue diversion, off-plan projects, ineffective management, resource wastage, exacerbating the central government’s financial difficulties, and weakening regulatory capacity. To enhance EBF management, the State Council issued the “Notice on Strengthening EBF management” in 1986³. *Firstly*, it established definitions, scope, and forms of EBF management, delineating EBF projects as regulated by the Ministry of Finance, mandating special reserve and management for extra-budgetary funds of administrative agencies⁴, and implementing financial accounting and planned management. *Secondly*, it defined the EBF management model, requiring each region, department, and unit to plan, finalize the annual financial reconciliation of extra-budgetary fund revenues and expenditures, and report on quarterly implementation. *Thirdly*, it clarified the principles for using extra-budgetary funds, stipulating that the use of such funds must adhere to targeted funding principles. Concurrently, several documents were issued in 1987, 1990, 1993, and 1996 to address and rectify issues related to

³ 国务院关于加强预算外资金管理的通知, 13/4/1986.

⁴ It specified that “EBFs managed by agencies and administrative units should, in principle, be deposited into and planned within special accounts held by the financial department”.

arbitrary fees, discretionary fines, varying assessment standards, and other EBF-related concerns.

In March 1994, the Budget Law of the People's Republic of China was officially enacted. This was a significant milestone in standardizing budget management and holds immense historical importance. However, the 1994 Budget Law did not address EBF management.

Subsequently, a supplementary provision of the 1994 Budget Law stipulated: "Governments at all levels, departments, and units must strengthen the management of EBFs. The EBF management measures shall be formulated by the State Council". The primary aspects of EBF management include: (i) Strengthening the oversight of EBF revenues, with a particular focus on rigorously inspecting and approving fees (funds); (ii) Enhancing the management of special financial accounts. The Ministry of Finance shall establish a special financial account and implement a dual management for the revenues and disbursement of EBFs, thereby modifying previous practices of integrating revenues and expenditures of extra-budgetary funds; (iii) Paying close attention to the management of EBF expenditures; and (iv) Reinforcing the supervision of EBFs.

In July 1996, the State Council further issued the "Decision on reinforcing EBF management"¹ which rigorously classified EBFs as financial funds, thereby requiring all government agencies and organizations to submit EBF revenue and expenditure plans to financial authorities as well as introducing the fundamental method of "dual management" for revenues and

expenditures that outlines the basic direction for EBF management. This decision is considered a significant breakthrough in both breadth and depth, as evidenced by: (i) The proposal to reinforce EBF management by gradually incorporating them into budgetary management rather than continuously expanding their scale. No financial revenue or expenditure should remain outside the state budget or beyond government oversight; (ii) The clear designation of EBFs as national financial funds, rather than private funds of agencies and units, which must be integrated into the budget and governed by the "dual-management of income and expenses"; (iii) The transformation of previous management methods, which departments and units independently mobilized and spent their funds, now requiring them to adopt budget management models and establish comprehensive budgetary and final accounting systems for EBFs; (iv) The explicit assignment of financial departments as the responsible entities for EBF management, mandating that they actively fulfill their duties in servicing and timely allocating extra-budgetary funds; (v) The recommendation to temporarily manage social welfare funds using the EBF management approach before the establishment of a formal social welfare budget.

Subsequently, the Ministry of Finance issued supplementary documents, including the "Measures for the implementation of extra-budgetary fund management" and the "Interim provisions on the financial account management of central budgetary funds", to ensure the effective standardization and regulation of extra-budgetary funds.

Since 2001, China has embarked on reforms of the "dual management of

¹国务院关于加强预算外资金管理的决定, 06/7/1996.

revenues and expenditures”, incorporating various administrative fees and government funds into the formal financial budget. In 2004, the Ministry of Finance issued the “Notice on Reinforcing the management of government non-tax revenues”, advocating that “government non-tax revenues should be progressively integrated into the financial budget and subjected to dual management of revenues and expenditures”. Existing EBFs were to be transferred to the State Treasury and subsumed within the financial budget, marking the evolution of EBF management towards an era dominated by non-tax revenue governance, with a gradual transition towards comprehensive budgetary oversight (People's Republic of China, 2021).

In March 2010, following a series of budgetary reforms, the Budgetary Affairs Committee of the National Assembly Standing Committee and the Ministry of Finance, in collaboration with relevant agencies, proposed a draft amendment to the Budget Law, explicitly stating: “All government revenues and expenditures must be incorporated into the budget”. In June 2010, the Ministry of Finance issued the “Notice on the Incorporation of EBF revenues into budgetary management”, stipulating that from January 1, 2011, incomes from EBFs under budgetary management would be integrated into the budget. By 2014, the new Budget Law was officially enacted, mandating that “all government revenues and expenditures must be included in the budget” (Qiao et al., 2022).

4.2. The current state of EBFs in Vietnam
 Vietnam currently administers over 40 extra-budgetary funds (EBFs) that function independently from the state budget. These funds are established to mobilize

supplementary societal resources aimed at advancing socio-economic development objectives. EBFs play a critical role in achieving specific social goals, attracting both domestic and international capital, and augmenting the financial resources available to the national budget.

Based on their foundational purposes, EBFs can be categorized as follows: (i) *Reserve funds:* These are allocated to mitigate economic and social risks and uncertainties, characterized by flexible financial mechanisms and centralized management, allowing for prompt responses to unforeseen contingencies; (ii) *social welfare funds:* These funds are dedicated to providing benefits to eligible beneficiaries, ensuring that revenue and expenditure adhere strictly to state policies while maintaining fiscal balance; (iii) *funds for supporting socio-economic activities:* These funds are designed to facilitate socio-economic initiatives through mechanisms that ensure capital recovery and offer preferential interest rates, thereby effectively channelling idle capital within the economy (Pham Thi Phuong Hoa, 2017).

Based on their institutional frameworks, these funds can be classified into the following categories: (i) Funds established to circumvent constraints within the traditional budgeting process that might impede the government's ability to address emergent tasks arising outside the budget, managed by the Ministry of Finance or the National Treasury (e.g., the Petroleum price stabilization fund); (ii) funds designed with distinct expenditure controls applied to budgetary units, administered by relevant ministries or other expenditure authorities (e.g., the Social insurance fund, Health insurance fund, Environmental protection

fund); (iii) funds administered by local authorities, such as local development investment funds (Nguyen Minh Tan, 2016). The management, monitoring, and supervision of EBFs in Vietnam reveal significant shortcomings, resulting in the inefficacy of certain funds and, in some instances, redundancy with the state budget. In August 2019, drawing on 119 reports from various agencies and funds, oversight activities in localities, and consultations with 19 funds and 8 localities, ministries and administrative agencies, the supervisory delegation of the National Assembly Standing Committee produced a report recommending that the competent authorities immediately abolish 6 funds (including the Road maintenance fund)¹ and a phased termination of 3 additional funds (including the Stabilization fund for petroleum prices) (Pham Thi Phuong Hoa, 2017).

4.3. Policy recommendations for Vietnam

China, with its economic prosperity and substantial financial resources, has accumulated valuable experience in managing EBFs. Adopting and applying these strategies and policies is crucial for enhancing Vietnam's financial management system. China has focused on developing a robust EBF system while ensuring transparency and efficiency. A key strength is the mechanism for interaction between funds and the state budget, which helps prevent overlap and duplication of activities. Additionally, the regular assessment and elimination of unnecessary funds have enabled China to maintain

flexibility and effectiveness in financial management.

Drawing from China's experience, the government of Vietnam should prioritize in developing clear and detailed legal regulations, enhancing oversight and supervisory mechanisms, and creating opportunities for public involvement in decision-making and oversight by:

- The lack of National Assembly oversight over EBFs allows local governments to reallocate budget funds outside the official budget or even beyond the system, thereby circumventing parliamentary scrutiny and potentially causing waste.
- The fragmented distribution of financial resources among various government agencies at different level results in a lack of centralized control, undermines the government coordination and macroeconomic oversight, and affects the capacity for economic and social development.
- The maintenance of EBFs may disrupt the allocation of resources between central and local governments, between the government and businesses, and between the state and individuals, while also affecting the integrity of the national budget.

The eradication of EBFs and the integration of all government revenues and expenditures within the budgetary management represent a critical milestone in the reform of budgetary management systems. *Firstly*, this approach standardizes the allocation procedures for government funds, ensures the integrity of the national budget, and promotes the establishment of an integrated government budgeting system that encompasses public financial budgets, governmental fund budgets, state capital expenditure budgets, and social insurance fund budgets. *Secondly*, it strengthens the

¹ On January 13, 2020, the Government promulgated Decree No. 09/2020/ND-CP regarding the abolition of specific legal normative documents pertaining to the Road maintenance fund.

order of the market economy, reduces adverse phenomena such as arbitrary fees, arbitrary fines, and arbitrary allocations, and facilitates the prevention of corruption at its source. *Thirdly*, it facilitates the enhancement of oversight over financial funds by the National Assembly and various societal stakeholders, while also improving financial management, transparency, and legal compliance.

Provided that EBFs continue to be maintained, it is imperative to conduct regular inspections, oversight, and audits of these funds, focusing on the following aspects: (i) Whether the management of off-budget funds complies with policies and legal regulations, and whether any violations of these regulations have occurred; (ii) Whether incomes, fee calculation standards, withdrawal rates, etc., adhere to legal requirements; (iii) Whether off-budget expenditures conform to expenditure regulations, follow appropriate procedures, and whether there are any unanticipated expenditures; (iv) Whether there is a robust EBF management system in place, whether the procedures for collection and disbursement are transparent, whether records are accurate and properly maintained, and whether regular audits are conducted.

5. Conclusion

China's management of EBFs offers valuable experience for Vietnam in refining its financial management system. *Firstly*, China's state financial management model fosters close interaction between funds and the national budget, which helps prevent undesirable overlaps and redundancies. *Secondly*, the regular assessment and review of funds have enabled the identification of deficiencies and the elimination of unnecessary funds, ensuring

the system remains flexible and effective. *Thirdly*, the focus on transparency and community involvement in evaluation and decision-making has built public trust and support. For Vietnam, it is essential to focus on several key aspects such as developing and clearly communicating policies, implementing rigorous inspection and oversight mechanisms, and promoting community participation in decision-making. Additionally, Vietnam should periodically review and adjust its policies to maintain effectiveness and adaptation to economic fluctuations. By adopting the insights from China's EBF management practices, Vietnam can optimize resource allocation and advance sustainable economic and social development □

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