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Taxation and Welfare Provision in China and Vietnam

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Summary

China and Vietnam have a relatively low proportion of tax revenue contributing to public expenditure budget. Partly thanks to both governments' pro-growth priority, various forms of tax incentives are given to investors at the expense of tax revenue. Both countries, particularly China, increasingly rely on land rights transaction for public budgetary revenue. Social insurance premiums have also become an important component of fiscal revenue that underscores the policy design of universal social insurance schemes that require as many citizens' participation as possible. Although this has facilitated fast economic growth, China and Vietnam's public expenditure on social protection has been lagging behind most developed and developing economies, which constrains the scope and scale of social protection to citizens particularly the migrant workers. Instead, the costs of social protection in both countries, particularly for the working population, have been mostly shouldered by employers and employees, with increasing involvement of the market players.

Introduction

Taxation is closely related to government budget and public spending, thus shapes welfare provision in significant ways. This policy briefs starts with an overview of taxation revenues in China and Vietnam before illustrating the public expenditure structures in both countries. To do so, it seeks to explore the logics of revenue making and public spending, and how they work out for the welfare of the people. It then uses the example of social insurance contributions in China and Vietnam to demonstrate how the costs of social protection are disproportionately shouldered by employer and employees, suggesting insufficient public expenditure on social protection. In the context of the increasing fees for public goods and services, hidden taxes, and rising living costs, China and Vietnam's efforts to expand welfare provision only provide a thin layer of protection for their citizens.

An overview of taxation Revenue in China and Vietnam

China: The corporate income tax system in China is often used to stimulate economic growth and shape economic and industrial structures. Preferential treatments are given to certain sectors or areas that are in greater needs of attracting capital. Although all tax resident enterprises (TREs) are subject to the standard tax rate of 25% according to the corporate income tax (CIT) law, a lower CIT rate is available for certain sectors and industries. For instance, qualified new/high tech enterprises are eligible for a reduced CIT rate of 15%, and designated key software enterprises are eligible for the first 5-year of CIT exemption while enjoying a reduced CIT rate of 10% after the exemption period. To stimulate regional economic growth, from 2011 to 2030, preferred enterprises in the poorer Western Regions are eligible for a reduced preferential CIT rate of 15% (Worldwide Tax Summaries, 2021).

At the same time, National Governmental Funds increasingly rely on revenue generated by local authorities' allocation of the rights to use state-owned land. Local governments generate significant non-tax revenues by selling rural land-use rights acquired at low cost to urban property developers, the primary land market for expensive real estate and related developments. According to the Chinese Ministry of Finance, land revenue had grown from 64% of the total revenue (1 trillion yuan) in 2008 to 86% of the National Governmental Funds (7.54 trillion yuan) in 2018 (Chen, 2019). Land conveyance fees accounted for less than ten percent of total fiscal revenue in 2000, but they grew to a high of 46% in 2020 (Whiting, 2022).

In terms of personal income tax, although China's income tax rate seems nominally progressive (with a top tax rate of 45%), critics have pointed out that China's income tax is highly fragmented and generates little government revenue (Chandler & Lau, 2021). According to the International Monetary Fund, only 1.3% of GDP came from personal income tax in China in 2020, while that number was around 10% in the US. The burden of tax disproportionately fell on the poor, as the bottom 50% of Chinese households pay more tax than the next 45%

of households (Chandler & Lau, 2021). Moreover, the absence of property tax system contributes to the persistent gap between the rich and poor, although in recent years there have been pilot schemes testing out the implementation of property tax in certain cities. Overall, China's tax regime has limited effect on income and wealth redistribution and contributes relatively little to government's spending on social welfare.

Vietnam: Comparing to China, the standard corporate income tax (CIT) rate is lower in Vietnam, which stands at 20%, with preferential CTI rates of 10%, 15%, and 17% applied where certain criteria are met. For example, new investment projects related to high technologies, export-oriented manufacturing of garment, textile and footwear, and automobiles assembly or mechanics are entitled to CIT incentives. Besides tax incentives, qualified investors can also be considered to have CIT exemption for a period of time followed by a 50% tax rate for a further period. For example, some of the enterprises which invest on new projects in difficult socio-economic areas and socialized sectors are entitled to a 4-year tax exemption and subsequent 50% tax reduction for nine years (Worldwide Tax Summaries, 2022). Tax incentives are part of Vietnam's strategy of competing for foreign capital. Statistics from 2019 shows that Vietnam relied heavily on corporate income tax (26% of tax revenue) comparing to other OECD countries (10% of tax revenue) (OECD, 2021). However, since 2011, revenue collected from corporate income tax had been decreasing (Nguyen, 2017), despite much higher growth of foreign investment. While generous tax incentives had been given to enterprises, especially foreign investors, high income individuals were likely to pay more tax than enterprises do. Additionally, tax evasion is pervasive in Vietnam, which further reduces the revenue that could be used for public spending to reduce inequality (Nguyen, 2017).

Land revenue is also an important source of government budget in Vietnam, as multiple levels of governments rely on land development to relieve pressure on finding resources for their expenditures (Nguyen, Duan & Zhang, 2018). Land-use revenue in Vietnam was based mainly on Agricultural Land Use Tax, land-use charge, land rental, and the sale of state-owned housing. In 2008, land-related revenue constituted up to 46% of Hanoi's municipal budgets (Loan & Mccluskey, 2010). The percentage was substantially lower than China, yet it also points to the crucial role of land revenue in constituting government budget.

Similar to China, Personal Income Tax is not sufficiently progressive in Vietnam, with the top personal income tax rate as 35%, which only applies to people with monthly taxable income of more than 80 million VND. In 2021, personal income tax comprised 10% of Vietnam's tax revenue, which was substantially lower than OECD's average ratio of 24% (OECD, 2021). Notably, Vietnam has no separate taxation category for social security contributions, compared to OECD countries with 26% of tax revenue coming from social security contributions. Moreover, Vietnam's tax on goods and services (34%) were remarkably higher than OECD countries (12%), which means that low-income groups such as migrant workers

are subject to high consumption taxes to maintain everyday subsistence (OECD, 2021).

Tax Revenue, Public Spending and Welfare Provision

China and Vietnam have a relatively low proportion of tax revenues contributing to public expenditure budget. Table 1 demonstrates how the ratio of tax revenue contributing to GDP were both relatively low in China (9.4%) and Vietnam (18.5%) comparing to other developing and developed countries such as South Africa (28.4%) and Germany (38.2%). Accordingly, public expenditure on healthcare was much lower in China (2.9%) and Vietnam (2.7%) comparing to South Africa (4.4%) and Germany (8.7%).

China's total public spending is generally high, with the ratio of 34.15% of GDP in 2019, which was close to the OECD average standard at 40.8% of GDP in 2019. However, the proportion of public spending on basic welfare and public goods (e.g., education,

Table1. Tax revenue & public spending of selected countries

	China	Vietnam	South Africa	Germany
Population	1.4 billion	96.5 million	58.6 million	83.1 million
Economic freedom index	107th mostly unfree	90th moderately free*	99th mostly unfree	29th mostly free
GDP (PPP)	$27.3 trillion	$1.0 trillion	$804.7 billion	$4.4 trillion
GDP growth (5-year compound)	6.7%	6.9%	0.8%	1.7%
FDI inflow	$141.2 billion	$16.1 billion	$4.6 billion	$36.4 billion
GDP per capita (PPP) 2020	$16,785	$8,374	$12,999	$56,052
Tax revenue to GDP ratio	9.4%	18.5%	28.4%	38.2%
Public expenditure on healthcare 2017	2.9%	2.7%	4.4%	8.7%
Labour rights index	Rating 5 No guarantee of rights	Rating 4 Systematic violations of rights	Rating 3 Regular violations of rights	Rating 1 Sporadic violations of rights

Source: developed by authors, data of economic freedom from www.heritage.org; data of public expenditure on healthcare from ILO's website www.social-protection.org (WSPR 2017-19). *Vietnam's economy broke through into the 'moderately free 'category in 2021 for the first time. Labour rights

health, social security) is relatively low. An OECD report (2005) specifically points out that local-level governments in China normally lacked sufficient tax revenue to finance their expenditure. Since 1980s, welfare provision and social protection has become mainly local governments' responsibilities, which leads to regional disparities and variations in welfare provision that some call 'welfare regionalism' (Mok & Qian 2019). The stark regional differences on welfare provisions are closely related to differing local fiscal capacities. Cities with better fiscal capacities such as Shanghai provide much more public services and welfare programs for residents with local household registration (hukou). Such regional disparities are less pronounced in Vietnam with a more centralized welfare system.

China and Vietnam have increased their public spending on welfare in recent years but it has not caught up with the even more rapid rise of costs of social protection. Since 2003, China has committed to expand its welfare programs, with the percentage of government expenditure on social security and social assistance, education and health increasing from 4.69% of the GDP in 2003 to 7.82% in 2013 (Mok & Qian, 2019). Similarly, Vietnam has also increased state expenditures for social protection, which reached 4.7% of the GDP in 2009, exceeding other South East Asia countries (Nguyen, 2017). Yet, access to public services and public goods increasingly comes with a price tag in both countries. In the name of socialisation (*Xa hoi hoa*), the Vietnamese government mobilises citizens to use out-of-pocket payments via introducing various fees and charges to public services, which have disproportionately impacted people with low income (Nguyen, 2017). Various public institutions such as schools, clinics and hospitals are being transitioned into 'public service providing enterprises' with increasing fees and charges. As a result, people have to pay much more for essential public services that used to be provided for free or a nominal fee, which creates greater burdens for lower income groups. Similar trends can also be observed in China, as the expanding welfare programmes only lead to a thin layer of protection, especially for the migrant workers, who increasingly turn to other sources such as family care, private providers in the market, and financial institution for social protection (Lin & Nguyen, 2021). The following section takes social insurance contribution as an example to explore China and Vietnam's commitment to expand welfare provisions in recent years and their actual outcomes.

Social insurance contributions

China and Vietnam have increasingly relied on collecting social insurance contributions to sustain their toward-universal-coverage welfare systems. In China, for instance, social insurance premiums accounted for 28% of tax revenues in 2019, much higher than most developing countries, and even higher than the OECD average, which stood at 26% (OECD, 2021). Social insurance contributions to pension funds, medical care, unemployment, work-related injury, and maternity insurance are mandatory for Chinese employers and employees according to the China Social Insurance Law (2011). Monthly employer and employee social

security contribution rates, applicable caps, etc. are governed by local rules, which may vary by jurisdictions. Vietnam also passed Law on Social Insurance in 2006, which requires workers with contracts longer than one month to participate in a mandatory scheme that covers pension, sick leave, maternity leave, survivorship allowance, work accident and occupational disease; informal workers, in contrast, can voluntarily join the social insurance scheme, which only covers pension and survivorship allowance (Chan & Hui, 2022).

In both countries, the official contribution rates of social insurance, particularly from the employers, are very high by international standards, even for the OECD countries (see table 2). This means that the social protection costs have been disproportionally shouldered by employers and employees, and increasingly involving other for-profit market players in China and Vietnam, whereas the governments contribute less in comparison to the OECD countries. Notably, social insurance payment to employees can be treated as reasonable salary expenses, therefore can be deducted from corporate income tax (Zhou, 2021).

In recent years, social insurance coverage has expanded from urban workers to migrant workers in most cities by law in China. Vietnam's Law on Social Insurance also includes voluntary social insurance scheme for informal workers. However, weak compliance is evident in both countries. It is still common for employers to pay inadequate social insurance contributions for migrant workers. Research data shows that the actual coverage rate of social insurance for rural-urban migrants in China was just around 10% (Chan 2012). This sometime has led to worker protests, such as China's Yue Yuen Strike (2014) and Vietnam's Pou Yuen Strike (2015), both of which called for better pension provisions and stricter enforcement of the law (Chan and Hui, 2022). Because of weak compliance, social insurance fund deficits are also a pressing issue in both countries. Finding sustainable ways to finance social protection may

Table 2. Social insurance contribution in China and Vietnam

Social Insurance	China		Vietnam	
	Worker	Employer	Worker	Employer
Pension	8%	14%	8%	14%
Medical (Maternity inc.)	2%	6.35%	1.5%	6%
Unemployment	0.2%	0.32-0.8%	1%	1%
Work-related injury	-	0.1-0.7%	-	0.5%
Total	10.2%	20.77-21.85%	10.5%	21.5%

Source: developed by authors, with data from *Social Security Programs throughout the World: Asia and the Pacific, 2018* (ISSA, 2019)

Note: In contrast to China, Vietnamese workers have to pay 2% towards trade union contributions.

require governments to increase tax revenue (especially from the enterprises and the wealthy) and reallocate more public expenditures to social protection (ILO, 2018). This remains a challenge in both countries, which similarly prioritize economic growth over social protection.

Conclusion

In summary, the taxation systems are regressive in both China and Vietnam, with tax incentives largely given to corporations in order to attract investment and develop local economies. At the same time local governments from both countries rely heavily on land-use transaction for alternative revenues. Low tax revenues are clearly related to relatively low public spending on welfare and social protection. For rural migrant workers, who rely on land as a major form of social welfare, land expropriation by local governments for development strips them of the one last resource of social protection on which they have depended for generations. If we regard tax as a form of social contract between citizens and the state[1], low tax in China and Vietnam would inevitably lead to low public expenditure on welfare. However, both these constitutionally socialist states promise to expand social policy coverage not just for the sake of workers' welfare, but increasingly for their own agenda of maintaining social stability and political legitimacy. Moreover, the rapidly rising costs of living and privatisation of public services constitute a form of hidden taxes for ordinary people particularly the migrant workers. Future tax and social policy reforms should take these issues into account and aim for building a more effective and equitable tax regime that provides sufficient fiscal support for a more progressive and redistributive social welfare system.

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[1] Although this perspective has been increasingly challenged as well, see: Makovicky, N. and Smith, R. (2020)

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