

For Better Management of Vietnam's Public Debts

by MEcon. BÙI THỊ MAI HOÀI



I. FACTS OF PUBLIC DEBT MANAGEMENT

1. Legal framework

So far, the Vietnam's public debt management has been affected by the following legal documents:

- Law on the State Budget issued on December 16, 2002 (Articles 21 and 22);
- Government Decree 90/1998/N-CP dated November 7, 1998 and the Regulations on Lending and Repaying Foreign Loans;
- Government Decree 17/2001/N-CP dated May 4, 2001 and the Regulations on Managing and Using ODA funds;
- Government Decree 52/2003/N-CP dated May 19, 2003 on functions, tasks, rights and organization of the Vietnam State Bank;
- Government Decree 61/2003/N-CP dated June 6, 2003 on functions, tasks, rights and organization of the Ministry of Planning and Investment;
- Government Decree 77/2003/N-CP dated July 1, 2003 on functions, tasks, rights and organization of the Ministry of Finance;
- Government Decree 141/2003/N-CP dated November 20, 2003 on issuance of government bonds, government-guaranteed bonds and municipal bonds;
- Circular 100/2003/TT-BTC dated October 24,

2003 on the guidelines for management, allocation, payment and settlement of investment capital from government bonds; and

- Circular 09/2004/TT-NHNN dated December 21, 2004 on the guidelines for businesses' debt lending and repaying.

Therefore, the legal framework of Vietnam's public debt management includes a lot of documents promulgated by different agencies but it has not yet stated in details. The following features can be seen in these documents:

- More attention is given to foreign debt management. The legal framework has been initially set up for domestic public debts.
- Many points have different ways to understand; several functions and concepts have not been clarified, for example, planning and strategy for government and national debts; uniform management of government and national debts ...
- The coordination between different agencies in charge of debt management has been not yet detailed.
- The criteria of lending, guaranteeing and repaying are not clearly identified.
- The regulations on giving information about debts as well as measures to monitor and evaluate the capacity of debt management agencies.

2. Definition of public debts:

In Vietnam, there is so far no government's definition of public debts. In its Decree 90/1998, the Government specifies only foreign debts and its liability to them. Then, the 2002 Law on the State Budget and guiding decrees reaffirm the Government's liability to its domestic and foreign loans including loans guaranteed by the Government. As a result, according to the above-mentioned legal framework, Vietnam public debts include government debts and loans of other entities which are guaranteed by the Government.

Domestic public debts are represented by central government bonds, government-guaranteed bonds and municipal bonds. Government guaranteed bond is a type of debt securities issued by enterprises to mobilize funds for projects under the direction of Prime Minister, whose due repayment by the issuers is committed to by the Government with investors. In cases where the issuers fail to fulfill the settlement obligations when the bonds become due, the Government shall undertake to repay the debts in place of issuers.

Foreign public debts include loans signed by the Government or authorized agencies, other entities' borrowings guaranteed by the Government. Government guarantee is provided by the Ministry of Finance or the State Bank of Vietnam in compliance with the regulations on Government guarantee for foreign loans.

3. Amounts of public debt

In respect of domestic debts including borrowings from issuance of government bonds, government - guaranteed bonds and corporate bonds, according to our calculations (based on Table 1), the outstanding debts increased by more than VND4 billion annually on average in the 1999-2002 period. Therefore, as compared to an annual GDP growth (7%), the increase in domestic borrowings remains controllable.

Table 1: Domestic borrowings (VND bil.)

Indicators	1999	2000	2001(est.)	2002 (est.)
I. State Budget deficit	- 6,328	-12,402	-14,210	-13,584
II. Compensation to the State Budget deficit	6,328	12,402	14,210	13,584
III. Compensation from domestic sources	1,491	6,110	7,841	3,613
1. Bond issuance	- 509	6,110	7,841	3,613
Issuance amount	8,825	12,077	14,060	14,112
Principal repayment	9,334	5,967	6,219	10,449

Source: Ministry of Finance

In addition to domestic borrowings, the Government's policies on foreign borrowings have been devised and perfected. Until the end of 2002, total foreign debts of Vietnam reached US\$12 billion, 60% of which was Government debt and the rest was corporate debt including US\$1 billion guaranteed by the Government. Over the past years, the Government has used mainly ODA long-term loans with soft interest and grace period. In

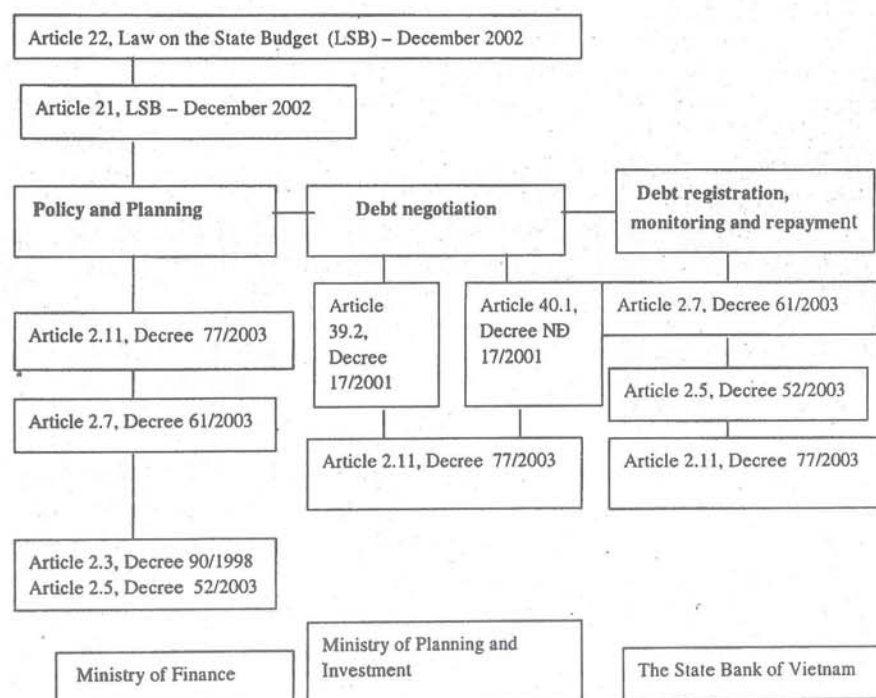
the 1993-2002 period, the international donors committed to offer Vietnam a combined loan of US\$22 billion. The Government has negotiated and signed borrowing agreements totally capitalized at US\$15 billion; including US\$11 billion already disbursed. (Source: Ministry of Planning and investment; Ministry of Finance).

International financial institutions and credit rating agencies claim that Vietnamese public debts in general and foreign debts in particular are controllable, for example:

- Fitch: "Vietnam's foreign debt burden still has good credit rating", November 2003.

- Moody's: "Vietnam's

Figure 1: Vietnam's legal framework of public debt management



foreign debt ratios remain favorable and stable, even a bit better". This company recently increased Vietnam's creditworthiness by two grades.

Table 2: Ratios used to evaluate Vietnam's public debts
(December 2003)

Ratio	Vietnam's ratio	Reference
Debt burden Foreign debt/GDP Public debt/GDP	173% in 1993; 34% in 2002 30-40% (in late 2003)	60% (Maastricht for EU)
Cash demand/Debt repayment/Export value	24% (in late 1999) 19% (in late 2001) 6% (in late 2002)	20% (HIPC)
Current value Debt / Export value Debt / Treasury receipts	70% (in late 2002) 192% (in late 2002)	150% (HIPC) 250% (HIPC)
Debt sustainability Growth rate / real interest rate	6.8% (in late 2002)	100% (Greenspan)
Vulnerability Official reserve / foreign debt	130% (in late 2002)	100% (Greenspan)

Source: Philippe Mauran, Crown Agents, Malta, 2003- Project of Vietnam's Debt Management.

- "If the Government keeps the deficit at 2 to 3% of GDP and the national economy grows 7 to 8% per year, then the ratio of debt to GDP will be controllable" (Report of PER' IFA, June 2004).

As a result, in the near future, whether Vietnam's public debt is controllable or not depends on the ratio of State Budget deficit and economic growth rate. This is really a challenge to Vietnam because domestic borrowings from bond issuance to compensate the deficit are increasing and the issuance will be implemented in foreign markets. In addition, once Vietnam gets out of the poverty line, the source of preferential credit will go down. Therefore, the uniform coordination between policies on debt management and those on finance, money and foreign exchange is extremely important. On the other hand, the current debt ratios are still safe, that does not mean the exclusion of careful management of public debts, and the loans need be used more effectively. An IMF research shows as many as 55% of insolvent nations have the ratio of public debt and GDP of the previous year is less than 60%.

4. Transparency problem and responsibility in public debt management

Over the past years, the determination of responsibilities between debt management agencies and some important problems in basic debt management have been publicized. Nevertheless, it is hardly to make access to the information about debt

structure (term, currency, and interest rate), the Government's financial position. One of requirements for transparency and responsibility in public debt management is that debt management activities should be yearly audited by an independent organization. Regrettably, this practice has not yet been conducted in Vietnam.

5. Institutional framework

The institutional framework in Vietnam's public debt management has been mostly established for foreign debt management while the management of domestic loans remains divergent and equivocal. In fact, domestic borrowings are based on the State Budget planning and carried out by the National Treasury. The Ministry of Finance makes a general review but no evaluation of results. The management of domestic public debts is only to meet the spending requirements of the State Budget and has not yet focused on other goals of debt management.

Three Vietnamese agencies in charge of managing public debts are the Ministry of Finance, the Ministry of Investment and Planning and the State Bank. Meanwhile, the existing Law on the State Bank (January 2002) rules that the Ministry of Finance is responsible for managing debts (Article 21.5 and 21.1). However, the coordination between these agencies is still loose; the definition of their functions and tasks remains vague and overlapping.

The global experience shows the decentralization of debt management is generally ineffective. There should be an only agency the debt management office. It should be deliberated whether it is located independently or in a certain agency. In respect of nations with low and medium income, it is commonly under the Ministry of Finance.

- Independent debt management offices:

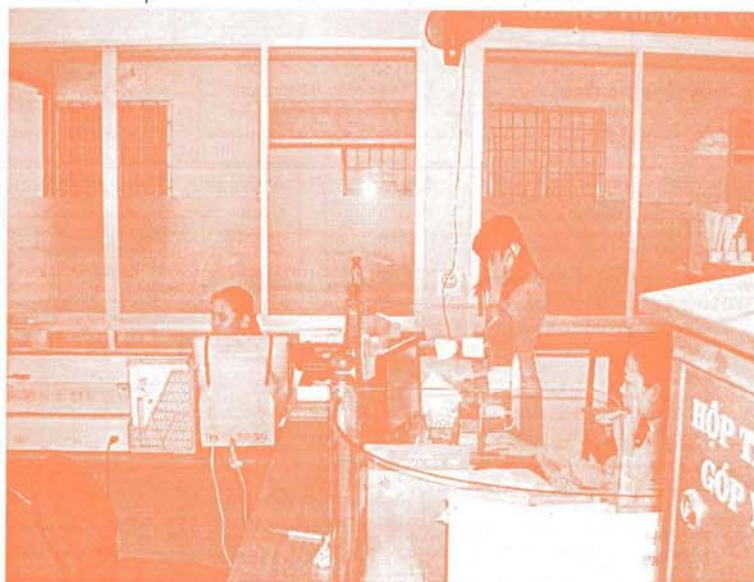
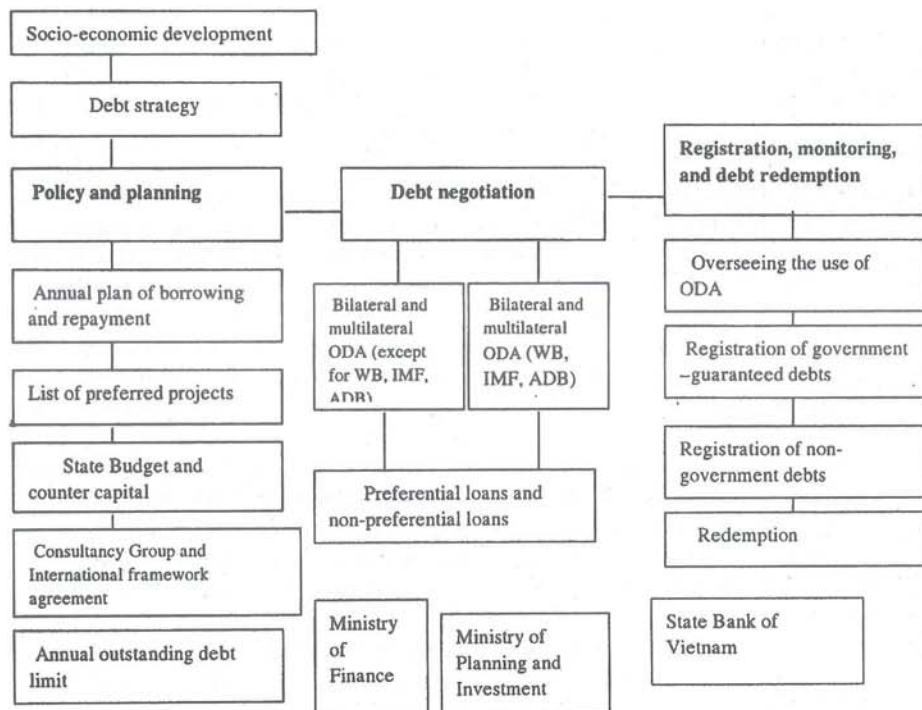


Figure 2: Vietnam's debt management framework



principal. Until the end of 2003, the amount of outstanding ODA loans reached US\$2.4 billion, of which 75% was offered to the power sector. Guarantees are provided for profitable projects. The guarantee costs have not been applied uniformly; the outstanding amount totaled US\$1.1 billion in late 2003 excluding commitments which had not been disbursed.

Vietnam's criteria for term-based public debt are facing a lot of risks. According to Vietnam's legal documents of borrowing and public debt management, for example, according to Decree 90, a short-term loan has a term of one year, medium and long-term loans have a

commonly in Europe and North America including Austria, Switzerland, Germany, the UK, Hungary, Portugal ...

- Debt management offices in the Ministry of Finance: Argentina, Colombia, India, Jamaica, Panama, South Africa, Sri Lanka, Thailand.

6. Debt management strategy and risk management framework

Vietnam has not yet built its master strategy on public debt management and established a model to allow managers to identify and control the convertibility between expected costs and risks in the profile of public debts. The market of government bonds and municipal bonds as well as government-guaranteed bonds has not developed in Vietnam. This is one of barriers to the reduction of costs and risks in the long-and medium-term strategy of public debt management.

Especially, relent and guaranteed ODA funds often result from requests and are not in accordance with estimates and evaluations of credit risks. Until June 2004, the insolvency accounted for 2.3% but according to Philippe Mauran, Crown Agents the real figure could be higher due to inadequate input data. Relending ODA funds is a part of the process of attracting ODA, the beneficiaries are income-generating projects. Financial conditions are based on the

term of over one year. In fact, there are public debts with a term of over one year but at the time of statistics; the time of payment is under one year. This is an extremely important warning in the debt repayment plan and decision of new short-term loans at the time of statistics with a view to ensuring the solvency of a nation in the near future. Therefore, the classification of debts based on terms (especially foreign debts) has strong effects on a nation's policy to manage debts in general, and public debts and short-term foreign debts in particular. This is one of main factors sparking off the Asian financial meltdown in 1997.

7. Evaluation of strength and weakness

The public debt management of Vietnam has strength and weakness as follows:

Strength:

- The legal and institutional framework of public debt management has been established and step by step perfected.

- Forms of borrowing are diversified: issuing debt securities; borrowing ODA funds; and using commercial credit relations.

- Attention is given to the sustainability of public debt management by diversifying the term of borrowing (short, medium and long term, preferring medium and long-term loans to meet requirements for development investment) and basic macro criteria are

established and maintained including criteria reflecting the sustainability of the economy and criteria reflecting the solvency.

- Policies are made clearly for the balancing of local and foreign debts. Regarding foreign debts, the Government has tapped mainly ODA sources due to their soft interest, long term and grace period.

Weakness:

- The legal framework remains inadequacy; there is no close coordination between the public debt management system with systems of State Budget management, monetary policy, corporate financial management and investment.

- Debt management is undertaken by a lot of agencies but the transparency and responsibility, the mechanism of decentralization and the coordination between management agencies are facing defects and inefficiency.

- The quality of public debt managers is still weak.

II. SOME PROPOSALS

1. In respect of legal matters: the legal framework of public debt management should be adjusted as follows:

- Identifying the responsibility of public debt management agencies and their coordination mechanism.

- Specifying the indicators of debt borrowing, guaranteeing and repaying.

- Issuing regulations on publicizing debt information; monitoring and evaluating the capability of public debt management agencies.

2. In respect of institutional framework:

- Assigning the task of public debt management to the Ministry of Finance: It has to cooperate with relevant agencies (Ministries of Planning and Investment and State Bank of Vietnam). Therefore, it assumes the responsibility for managing all government guarantees, including those for credit institutions. Otherwise, it has to manage all debts in the public sector while the State Bank of Vietnam has to manage debts in the private sector which are not directly guaranteed by the Government.

- The Ministry of Finance is required to establish the Debt Management Department in the medium term. This agency will take

charge of planning and managing public and national debts; coordinating and overseeing the whole public debts; evaluating and comparing the ability of borrowing and repaying foreign debts in combination with macro balances and the Government policies on socio-economic development; and assessing the efficiency of projects using public debts. The department includes two sections: one for dealing and another for accounting and storing information with separate functions, tasks and reports. However, one more section may be needed for risk management. This section will analyze risks, monitor risk reports relating to the debt profile and assess debt managers based on an available benchmark. A dealer and an accountant must be two different persons. The difference will help improve the independence of the dealers and supervisors and create favorable conditions for internal auditing.

Box 1: Vietnam's debt management framework

1. New regulations in the 2002 Law on the State Budget

- * Ministry of Finance undertakes the uniform management of borrowing and repaying government debts and national debts. (Article 21.5)

- * Ministry of Finance undertakes the building of strategies and plans of borrowing and repaying domestic and foreign loans. (Article 21.1)

2. Functions of Ministry of Finance (Decree 90/1998, Decree 17/2001, Decree 77/2003)

- * Undertaking the uniform management of borrowing and repaying government and national debts.

- * Building plans and strategies of government and national debts; and devising policies and mechanisms to manage the borrowing and repaying of government and national debts.

- * Providing guarantees to non-credit institutions and refinancing organizations.

- * Undertaking financial management of government debts (including ODA).

- * Making negotiations of specific loan agreements (Except for ADB, WB, and IMF).

3. Functions of the Ministry of Planning and Investment (Decree 90/1998 and Decree 61/2003)

- * Submitting the draft plan of socio-economic development to the Government and great balances of the economy.

- * Making negotiations of ODA framework agreements.

- * Building strategies and plans to attract and use ODA sources.

- * Monitoring projects and programs using ODA funds.

4. Functions of the State Bank of Vietnam (Decree 90/1998 and Decree 52/2003)

- * Managing the borrowing and repaying of foreign debts of Vietnamese businesses.

- * Cooperating with the Ministry of Finance to plan local and foreign debts.

- * Providing guarantees for credit institutions.

- * Signing specific loan agreements with ADB, WB and IMF.

3. Improving the transparency -

The information system in public and national debt management should be perfected. This not only obtains necessary and exact debt data for timely repayment, but also improves the quality of reports and the transparency in public debt management.

- Disclosing public debts on the Government's and ministries' websites.

- Publishing annual reports of debt management audited by a specialized organization in order to secure the transparency and responsibility.

4. Debt management strategy and risk management framework

- * The public debt management has set four goals as follows:

- Securing sources for the Government's capital demand.

- Reducing borrowing costs.

- Controlling risks at an acceptable rate.

- Giving supports to the local financial market.

These four goals are hardly attained at the same time. Nevertheless, Vietnam is required to reach these goals in its debt management because of the integration trend and the pressure of financial liberalization.

- * The total debt limit and indicators of public debts and foreign debts should be identified for the planning of public debts and national debts. The Government must plan the private sector's total foreign debts not guaranteed and reserve funds to settle contingent liabilities. In fact, the Government must be responsible for liabilities of the private sector in an indirect and default manner because their bankruptcy will be harmful to the national credit rating. At present, the State Bank of Vietnam takes charge of managing businesses' borrowing and repaying foreign loans, including those guaranteed by the Government. In the near future, if the Ministry of Finance manages the whole public debts, then the central bank still control foreign debts of the private sector. As a result, the bank must improve its managerial skill to monitor credit activities of intermediary banks.

- * The Government should offer guarantees for borrowing foreign loans only to important investment projects with huge capital which are within the planning, the general balances of the economy and safe limit of the total debts.

- * The Government may use the ALM model in debt management in the long run. To do this, debt managers must obtain skills of the financial market such as profile management and risk analysis and they



have to know public policies. The requirement relates to education and wage policy.

- * The Government should change the debt term in accordance with the Bank for International Settlements (BIS): short-term debts are those having the term of remaining repayment less than one year. Medium-and long-term loans are those having the term of remaining repayment as one year or more. The classification of debts (especially foreign debts) based on terms greatly affects the national policies on managing debts in general and public debts and foreign debts in particular. The BIS classification standards will help reduce settlement and liquidation risks and prevent debt crises.

- * The market of government bonds, municipal bonds and government-guaranteed corporate bonds should be enhanced in the trend of promoting the market liquidity with the aim to reduce costs and risks in the strategy of managing medium and long-term public debts. The Government is required to boost the issuance of long-term bonds with a term of over 10 years; open the door to the bond market; encourage foreign investors to invest in bonds; expand bond derivatives and perfect the tax on income from bonds

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