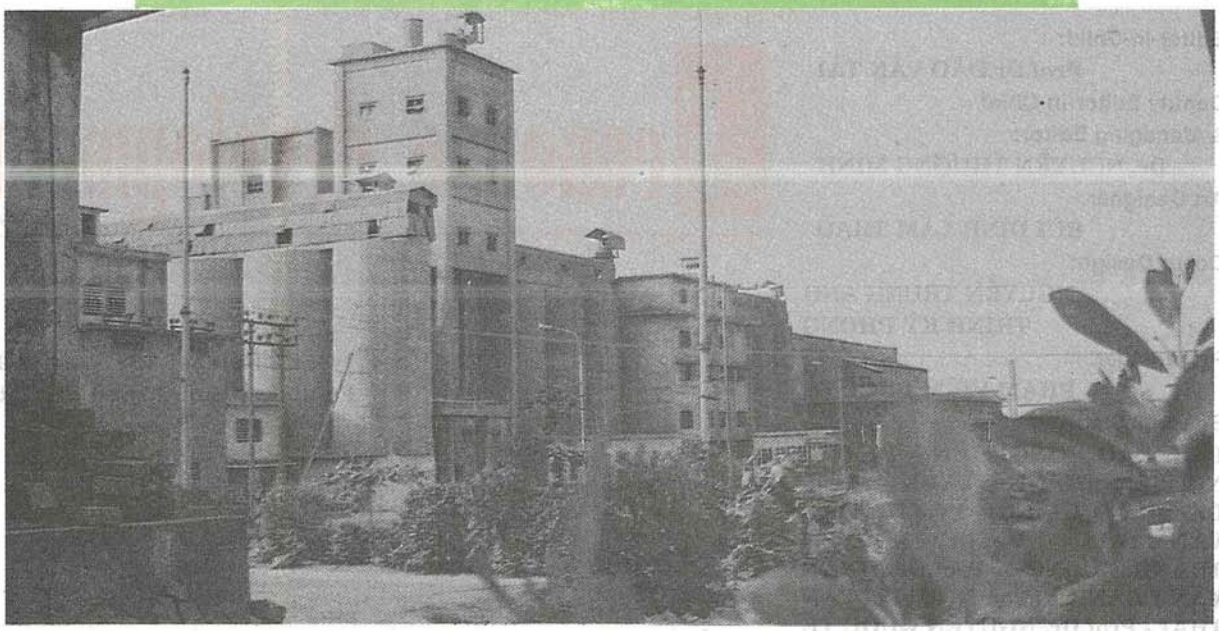

EXPENDITURES IN MICRO- AND MACRO-ECONOMIC POLICIES

by Dr. LÊ KHOA

I.EXPENDITURE IN THE CENTRALLY PLANNED AND MARKET ECONOMIES

In the centrally planned economy, the government is responsible for providing people with social benefits and employment, therefore it covers a lot of expenditures (on irrigation, road and waterway systems, power and water supply, etc.). The government also provides civil servants with accomodation. However, these services are of poor quality when the government runs short of fund. This happened in Vietnam when aid and loans from the former Soviet Union were cut in 1990.

Contrarily, in the market economy, all of these expenditures are divided into production costs plus profit (the profit margin must be higher than the bank's lending rate), therefore public utility companies charge higher prices for their services to ensure a reasonable profit margin. Civil servants and workers of state-run companies have to spend a considerable proportion of their income on public service bills (especially those who have to pay monthly house rent because they have no private houses). At present when many roads are built or enlarged, many industrial estates and residential areas are developed, local residents are required to pay for infrastructure fees and motorists for tolls. After the infrastructure is built, prices of land and houses starts to rise and land owners require reasonable compensation, and complaints about these problems start to be heard.

II.EXPENDITURE VIEWED FROM MICRO-ECONOMIC LEVEL

1.From personal viewpoint

In most families, expenditures arranged in order of importance are on food, housing, health care, clothing, education, recreation and tourism. In poor families in developing countries, from 60% to 80% of revenue is spent on food, and they have to live in slums or thatched cottages and never think of professional services. When the economy develops, other expenditures (on housing, education, health care or tourism) become more important. This situation is being seen in HCMC and many other cities in Vietnam. We can estimate the living standards of a family by studying the structure of expenditures.

2.From business viewpoint

Controlling expenditures is a matter of great importance to companies. The main objective of business management is to maximize sales and minimize expenditures in order to make as much profit as possible.

Marx divides expenditures into fixed ones (on materials and depreciation) and variable one (on living labor). Value of fixed expenditures is transferred totally to finished goods (this value can't be increased because it is a result of dead labor), while the living labor, besides wages it receives, can produce a surplus value that the employer takes possession of. For example, an employer pays 100 for total fixed expenditure and 50 as wages for laborers. The finished goods is sold at, say, 250 and a profit of 100 is made. Suppose that this profit is divided as follows:

-60 for bank interest (in a Vietnamese company, payment made to laborers is usually smaller than bank in-

terest. This is considered as unreasonable but it keeps on existing),

-30 for tax payment, and

-10 as company's profit, 6 of which could be turned into divident and 4 into retained profit.

Thus, the sale of one unit of finished goods includes:

+ c (fixed or constant expenditure): 100

+ v (variable expenditure or wages for laborers): 50

+ m (surplus value): 100 which is divided into bank interest, tax payment, divident and retained profit.

This example, although it is only a supposition, can help us to see that the company will be on the brink of ruin if its products aren't saleable because of the presence of contraband goods. Contrarily, if the customs can prevent smuggling and import of consumer goods is limited, the company will be able to sell out of its products, and it will be able to pay bank interest and taxes and turn more retained profit into new investment, and as a result, a new economic boom will come.

III. EXPENDITURE VIEWED FROM MACRO-ECONOMIC LEVEL

From the above example, we can see that macro-economic policies (bank interest rate, taxation, import control, inflation control, credit control, etc.) have strong effects on companies' sales and profits, and on the economic development as a whole. So it's necessary to study the relation between public expenditures and the public finance policy.

The public finance policy is a wide topic, so we had better pay attention to one aspect: Vietnam, in its industrialization and modernization process, must concentrate as much investment as possible on industries that could produce the biggest multiplier effect, and at the same time, control the inflation and save all sources of foreign exchange for investment.

Policies to develop the economy and fight against inflation could be based on the quantity theory of money: if the money stock increases while supply of goods is unchanged (or increases slower) the general price level will rise helping companies obtain higher sales and profits. Frequent scarcity of goods (both consumer and capital ones) is a necessary condition for companies to make good sales and high profit. On the other hand, if the supply exceeds the demand, deflation and recession will take place. So we can come up with three methods of developing the economy and fighting against inflation.

1.Method 1

The central bank increases the money supply with a view to help companies (especially state-run ones) make new investment, and at the same time, the Ministry of Trade limit import of consumer goods (especially what can be made locally) in order to save foreign exchange. These measures will lead to inflation and a shortage of consumer goods. This situation allows local companies to increase their output by making the best use of new investment, thereby making big profits. Thus, there will be inflation and rise in the general price level at first, but all factories will work at full capacity, more jobs will be created, and high growth rate will be obtained. When the money stock increases, the exchange rate must be adjusted periodically in order to encourage export and reduce import. In the next stage, when new investment in the previous stage starts to produce profit (for example, new factories start to work) the rise in production will increase the supply of goods and lower the general price level. At that time, both inflation control and high growth rate are achieved.

In the mid-1980s, Vietnam followed this method. Sources of foreign exchange were limited then and Vietnam imported some 2,500 million ruble worth of goods every year (including fertilizer, petrol and food), however, part of this amount (some 700 million ruble) was used to import capital goods, and almost no foreign exchange was spent on import of luxury consumer goods. Although the former Soviet Union supplied equipment needed for major projects, such as Hoà Bình and Trị An hydropower plants, the Government had to increase the money stock to pay wages or expand rubber-growing area. The central bank also adopted the floating exchange rate system, so exporters could make good profit. The trade gap was reduced, the balance of trade became active in the years 1987-90, and in 1992 the export value was US$40 million higher than the import value. In the years 1991-92, major projects such as Trị An hydropower plant, Vietsovpetro oil rig, Hoàng Thạch and Bỉm Sơn cement plants came into operation and helped to increase the supply. In short, in the 1980s Vietnam succeeded in stabilizing and developing the economy, however, the high inflation rate in those years made the people's life more difficult, so in the early 1990s, the Vietnamese government adopted the method 2.

2.Method 2

In this period, the central bank reduced the money stock in order to have a balanced budget. The Ministry of Trade allowed import of expensive consumer goods (cars, TV sets, motorbikes, air conditioners, etc.). Increases in foreign aid and loans also helped Vietnam import certain capital goods. The value of domestic currency was kept high, so the import of consumer goods and smuggling brought in big profit. Since 1975, expensive foreign consumer goods were always scarce, so this open policy could help to reduce the inflation rate. The economy kept on developing and by 1995, the growth rate reached 9.5%.

However, difficulties started to make their appearance: the growth rate reduced from 9.0% in 1996 to 8.8% in 1997; the foreign debt accumulated (around US$13 billion in 1997); the price index stayed negative in many months and a lot of companies suffered losses. The government had to reduce the amount of state-owned companies from 12,000 to some 5,000 and planned to reduce more. That is why from 1997 on, the government adopted the method 3.

3.Method 3

This method is the coordination of methods 1 and 2, however the method 2 was still considered as the most important: the exchange rate was kept high with only minor changes now and then, the gross investment was low.

***

We have reviewed three methods the government used in three successive periods. The price of each method we had to pay is very high. Let's study what we had to pay for each method.

a.Price of the method 1: In those years, Vietnam suffered hyperinflation and great shortages of food and consumer goods. However, in the early 1990s, major investment projects came into operation helping to increase the supply of goods and reduce the inflation rate. So Vietnam became an important exporter of rice and coffee on the world market. However, this method received little public support because it forced people to tighten their belts.

b.Price of the method 2: In the years 1990-96, the economy developed well (see Table 1): GDP increased from US$9.6 billion in 1991 to 22 billion in 1995 and 24 billion in 1996 while the export value increased from

Table 1: GDP, Gross Investment and Sources of Finance (US$ million)

Indicators	1991	1992	1993	1994	1995	1996	1997
GDP (1)	9,656	11,770	15,478	19,100	22,000	24,000	26,112
Import (2)	2,049	2,540	3,924	6,825	7,500	10,640	11,200
Export (2)	2,009	2,552	2,952	4,054	5,200	6,903	8,850
Trade Gap (2)	40.0	-12.0	972.0	2,771	2,300	3,737	2,350
Import/GDP	0.212	0.216	0.254	0.357	0.341	0.443	0.429
Export/GDP	0.208	0.217	0.191	0.212	0.236	0.288	0.339
Import's effect	4.713	4.634	3.944	2.799	2.933	2.256	2,331
Investment/GDP (3)	0.168	0.214	0.295	0.304	0.292	0.301	0.307
Gross investment	1,622.2	2,518.8	4,566.0	5,806.4	6,424.0	7,224.0	8,016.4

Table 1a: Structure of Gross Investment

	1991	1992	1993	1994	1995	1996	1997
From Government (3)	0.150	0.252	0.228	0.160	0.187	0.209	0.175
From companies' retained profit	0.101	0.024	0.014	0.015	0.027	0.039	0.077
From shareholders	0.016	0.017	0.017	0.018	0.018	0.018	0.018
From banks	0.083	0.027	0.059	0.074	0.068	0.084	0.099
From private persons (3)	0.500	0.460	0.323	0.328	0.308	0.267	0.242
Total domestic investment	0.850	0.780	0.701	0.595	0.608	0.617	0.611
From ODA			0.035	0.087	0.053	0.044	0.050
From foreign investors (3)	0.150	0.220	0.264	0.318	0.339	0.339	0.339
Total foreign investment	0.150	0.220	0.299	0.405	0.392	0.383	0.389
Grand total	1.000	1.000	1.000	1.000	1.000	1.000	1.000

Table 1b: Structure of Gross Investment (US$ million)

	1991	1992	1993	1994	1995	1996	1997
From Government (3)	243.3	634.7	1,315.0	929.0	1,201.3	1,509.8	1,402.9
From companies' retained profit	163.8	60.5	63.9	87.1	173.4	281.7	617.3
From shareholders	26.0	42.8	77.6	104.5	115.6	130.0	144.3
From banks	134.6	68.0	269.4	429.7	436.8	606.8	793.6
From private persons (3)	811.1	1,158.6	1,474.8	1,904.5	1,978.6	1,928.8	1,940.0
Total domestic investment	1,378.9	1,964.6	3,200.8	3,454.8	3,905.8	4,457.2	4,898.0
From ODA			159.8	505.2	340.5	317.9	400.8
From foreign investors (3)	243.3	554.1	1,205.4	1,846.4	2,177.7	2,448.9	2,717.6
Total foreign investment	243.3	554.1	1,365.2	2,351.6	2,518.2	2,766.8	3,118.4
Grand total	1,622.2	2,518.8	4,566.0	5,806.4	6,424.0	7,224.0	8,016.4

Note:

(1)From *Asian Development Outlook* and *Thời Báo Ngân Hàng* (May 29,1997): GDP 1997 equals GDP 1996 multiplied by growth rate of 8.8%.

(2)From monthly reports made by the PM Office and General Department of Statistics.

(3)Đào Ngọc Lân "Về nguồn vốn và sử dụng nguồn vốn đầu tư để tăng trưởng", *Kinh Tế và Dự Báo* (Economy & Forecasts Magazine), March 1997.

US$2 to 6.9 billion during the same period. In the 1980s, the gross investment was put mainly in power, rubber, oil and cement industries and in the early 1990s, new investment was continuously put in these industries but many industrial estates, export processing zones and infrastructure works were built. The living standard was improved, the supply of goods increased and the inflation rate was kept low. In this period, the economic policy received great public support but we had to pay a high price for it (see Table 1)

c.Import effect: The import effect decreased year after year: an import value of US$1 helped to produce US$4.71 of GDP in 1991, US$2.79 in 1994 and US$2.25 in 1996. The import effect is the relation between GDP and import as shown in the equation:

GDP = k . Import (where k is the import effect)

GDP 1991 = US$9.6 billion = 4.7 x US$2,049 million worth of import

GDP 1995 = US$22.0 bbillion = 2.7 x US$6,825 million worth of import

GDP 1996 = US$24.0 billion = 2.2 x US$10,640 million worth of import

GDP 1997 = US$26.1 billion = 2.3 x US$11,200 million worth of import

Suppose that we could rise k to 5.0 in 1994; 5.2 in 1995; 5.4 in 1996; and 5.5 in 1997, the value of GDP would be: (see Table 2 on next page)

The difference between the real GDP and the supposed one is the price, or cost, of the policy to import consumer goods, especially ones that could be made locally. This analysis helps us understand why Japan became an economic power within two decades, from 1945 to 1965, because they could increase the value of k to 10 while ours is somewhere between 2.3 and 4.7. Japan only imported cheap raw materials and made them into expensive consumer goods. From US$1 worth of imports, Japanese people could produce US$10 worth of exports, while Vietnam could make a much

Table 2: Price (US$ million) paid for the policy to control inflation by importing consumer goods, instead of capial goods

	1991	1992	1993	1994	1995	1996	1997
Import	2,049.0	2,540.0	3,924.0	6,825.0	7,500.0	10,640.0	11,200.0
Import Effect (real)	4.713	4.634	3.944	2.799	2.933	2.256	2.331
GDP (real)	9,656.0	11,770.0	15,478.0	19,100.0	22,000.0	24,000.0	26,112.0
k (supposed)	4.713	4.8	4.9	5	5.2	5.4	5.5
GDP (supposed)	9,656.0	12,192.0	19,227.6	34,125.0	39,000.0	57,456.0	61,600.0
Price to paid (1)-(2)	0	422.0	3,749.6	15,025.0	17,000.0	33,456.0	35,488.0

smaller value (from US$4.7 in 1991 to 2.3 in 1996) from US$1 worth of import.

d.Illegal import:If we take the value of illegal import, which is estimated at some US$1 billion a year, into consideration, the import effect will be smaller. The illegal import has reduced the foreign exchange reserve and market shares of local companies (many of them are on the brink of bankruptcy because they have fallen into arrears with bank loans and tax payments). If all of these losses are taken into account, then the cost of the unsuitable exchange control (keeping the external value of domestic currency high, buying foreign currencies at low prices) will be much bigger, reaching billions of dollars.

e.Wrong employment of bank credit: The Vietnam banking system hasn't succeeded very much in mobilizing and supplying capital to the economy. The Table 1a shows that the proportion of capital from banks to the gross investment was small in recent years. Why did the banking system fail to supply better services when the central bank has rights to control flows of foreign exchange and issue money if need be? In our opinion, the main reasons are: the banking system gave priority to inflation control, not to investment for development; the system failed to control its officials, especially high-ranking ones, with the result that many of them had broken banking regulations and laws; the system failed to supply long-term capital while charging too high interest rate. The following table can help us estimate the price we have to pay for wrong employment of bank credit.

IV.CONCLUSION

In Tables 2 and 3, we have estimated the prices of the policy "to control inflation by importing consumer goods" in comparison with the policy "to give priority to import of capital goods and investment projects". Our calculation isn't much exact because many values presented there, such as the import effect k and the multiplier effect, are estimates only, however, if we put together all prices or costs of import of consumer goods, of smuggling and of wrong employment of bank credit, we will see that Vietnam GDP has been reduced by billions of dollars for years. These losses were so big that Đỗ Mười had to write on *Nhân Dân* (Jan. 11,1995): *"Recently, we have spent too much money on luxury consumer goods. Why don't we use the money to industrialize rural areas and agriculture, and fight against poverty and hunger? Current expenditures are unacceptable and far beyond our means. Leadership of all levels must discuss this problem. We can't let our country become a consumer society."* Therefore the central bank adopted new policies in 1997: to adopt the floating exchange rate system, control flows of foreign exchange and import strictly, eliminate venal officials and struggle against smuggling. These policies helped to increase the import effect from 2,25 in 1996 to 2,3% in 1997. The proportion of investment from banks to the gross investment also increased from 0.301 to 0.307. The progress isn't satisfactory but it's promising. If the method 1 is adopted again in 1998 when the foreign exchange in hand reaches US$12 billion a year and the supply of many essential goods (food, cement, iron, power, etc.) is reliable, and even if the import of certain consumer goods is allowed, Vietnam will be able to import and produce more capital goods than in the 1980s, and succeed in both controlling inflation and developing the economy■

Table 3: Price paid for the failure to concentrate bank credit on investment projects

	1991	1992	1993	1994	1995	1996	1997
GDP (supposed) (1)	9,656.9	12,192.0	19,227.6	34,125.0	39,000.0	57,456.0	61,600.0
Investment/GDP (a)	0.168	0.214	0.295	0.304	0.292	0.301	0.307
Gross investment	1,622.4	2,609.1	5,672.1	10,374.0	11,388.0	17,294.3	18,911.2
Proportion of investment from banks	0.083	0.027	0.059	0.074	0.068	0.084	0.099
Investment from banks (US$ million)	134.7	68.0	269.4	429.7	436.8	606.8	793.6
If (a) increases to	0.083	0.09	0.095	0.1	0.12	0.14	0.16
Investment from banks will be	134.7	234.8	538.9	1,037.4	1,366.6	2,421.2	3,025.8
Increase in investment	0.0	166.8	269.5	607.7	929.7	1,814.4	2,232.2
Estimated multiplier effect	3	3	3	3	3	3	3
Prices paid (US$ million)	0.0	500.4	808.4	1,823.2	2,789.2	5,443.1	6,696.5

(1)taken from the Table 2.