Keeping the Budget Balance As a Measure to Reduce Foreign Debt

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Budget deficit is one of factors that lead to foreign debts and difficulties in repaying them. Studying relations between the budget deficit and foreign debt, therefore, could be seen as the first step to reduce and avoid the debt burden in the future.

According to Daniel Cohen, to fill the budget deficit a government could (1) issue more money; (2) reduce government expenditures; (3) borrow from domestic creditors and (4) borrow from foreign creditors. Each solution has its own advantages and disadvantages. According to Oliver Blanchard, the present value of the tax take must be equal to the original debt plus present values of expenditure; and changes in the government debt must be equal to the deficit in the fiscal year, if a government wants maintain the budget balance.

Blanchard also proves that the proportion of debt will rise when (1) interest rate rises; (2) growth rate decreases; (3) original debt is high; and (4) proportion of budget deficit increases. Thus, full attention must be paid to relations between debts and growth rate and interest rate. In other words, the debtor must keep a balance between costs of debt and economic growth rate. If a government wants to fix the proportion of debt to the GDP it should try its best to change the budget deficit based on predicted interest rate and economic growth rate.

In Vietnam, there are different statistics about the budget deficit. If debts borrowed by the government as a middleman for other borrowers are included, the budget deficit is usually higher than the budget for administration. All sources, however, agree on the fact that the budget deficit is common but not serious (see Table 1). This means that Vietnam has succeeded in keeping the deficit under 5% in recent years as required by the Budget Law and that budgetary authority has decided to follow a cautious approach.

To cover the budget deficit in the years 1981-1991, more money was issued while internal debts were very small. Increases in the money supply accounted for 54% in 1981-1985 and 57% in 1986-1990 of the deficit (see Table 2). And as a result, the inflation rate rose quickly and brought the economy to a state of disorder. From 1991 on, the government increased borrowings and limited increases in the money supply which was equal to only 8.8% of the deficit. From 1992, the increase in the money supply used for cover the budget deficit was brought to an end [3] and borrowings were used for this purpose.

Data show that the budget deficit and instrument for covering it were managed with care, which could avoid high inflation rate but the budget incomes and expenditures were not stable because:

(1) Budget incomes are not diverse and stable because of the low productivity of the economy, delayed tax payments. The main

Table 1: Proportion of deficit to the GDP in 1986-2004 (%)

Sources	1986-90	1991-95	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
[2]	-7.8	-4.3			-3.1	-4.2	-3.6	-4.9	-5.0				
[13]								-1.6	-2.9	-3.1	-2.6		
[11]			-1.4	-0.5	-0.2	-1.7	-0.1	-1.6	-2.8	-2.9	-1.9	-2.0	
[10]*						-1.7	-0.1	-0.8	-5.0	-5.0	-4.5	-5.0	-3.5
[10]						-1.7	-0.1	-0.8	-2.7	-2.8	-1.9	-2.0	-0.8
[12]								-1.6	-2.8	-2.5	-1.9	-2.0	

* including debt for re-lending

Table 2: Structure of source for covering the budget deficit in 1976 – 2004 (%)

Year	1976-80	1981-95	1986-90	1991	1992	1997	1998	1999	2000	2001	2002	2003	2004
SourcesMoney supply	13.1	54.0	56.8	8.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Internal debt		1.4	0.3	7.4	26.0	96.3	-800	-50	46.4	65.5	47.4	21.4	49.0
Foreign debt	86.9	44.6	42.9	81.8	74.0	1.9	900	150	53.6	34.5	52.6	78.6	51.0

Sources: [1]; [9] for 1997-2003 and [13] for 2004 incomes are from crude oil and fee on the land use right. Receipts from state-owned companies are not as high as expected. Only 15 out of 62 provinces and cities make some contribution to the budget income. As for tax receipts, major sources of income are from corporate income tax (22.4%), VAT (15.6%) and customs duties (12.2%) [13]. In near future when cuts in customs duties as required by trade agreements signed by Vietnam, these sources of income will decrease remarkably and Vietnam should generate new sources.

(2) Public expenditures are less effective. In 2004, regular expenditure accounted for 64.4% while public investment represented 32.2% [13]. Public investment has become a thorny problem because of its poor efficiency and concentration and of waste and losses in all projects financed by this source. In addition, the budget expenditures are sometimes turned into working capital and debt payments for state-owned companies. The public sector still demands guarantee of their borrowings and interest rate subsidies from the national budget [4].

Increasing payments in internal and foreign principal and interest over years in both absolute and relative terms is a worrying tendency and makes the budget deficit bigger. In 2004, the payment in interest accounted for 3.3% of the total expenditure, in principal of internal debt 9.5% and in principal of foreign debt 1.5% [calculated from data supplied by 13]. These payments totaled 14.4% of the budget expenditure compared with 11.7%; 13.7% and 14.8% in 2001, 2002 and 2003 respectively [15]. Payments in interest are from the budget while payments in principal of internal and foreign debts are from new loans. This practice, without strict control, could make Vietnam run into debt in the future. More worrying is the fact that there is no mechanism for supervising the use of budget expenditures. The lack of transparency and sense of responsibility lead to corruption and waste [6].

Table 3: Oil income and its relations with foreign aid and total budget income (VND1,000 billion)

Income	1997	1998	1999	2000	2001	2002	2003	2004
Total budget income and foreign aid	65.4	73.0	78.5	90.7	103.9	119.0	123.7	166.9
Oil income		14.6	18.5	28.5	35.7	35.4		37.4
Oil income as % of the total budget and foreign aid		20.0	23.6	31.4	34.4	29.7		22.4

Sources: [9] and [13]

When borrowing from both internal and foreign sources, the government should pay full attention to the following problems:

- Keeping the proportion of foreign debt to the GDP below a preset level by putting a limit on the budget deficit: In the Direction for the Fiscal Development by 2010 made by the Government, the government debt is set at 50% of the GDP at most. Calculations allow us to know the maximum budget deficit according to the 50% limit should not be higher than 2.44%. This target is achievable because the budget deficit in recent years has been below 2%. However, it's necessary to control strictly the government borrowings, including ones for relending.

- Balancing internal and foreign debts: High internal debt can hinder investment from the private sector while high foreign debt will leave a heavy burden to next generations. At present, the internal debt is still low and equal to only 6.5% of the GDP. When borrowing internal debts, a low interest rate will fail to attract idle money and a high one will leave a burden of payments in interest in the future.

- The government could secure sources of budget income by (1) controlling taxation, especially the VAT and corporate income taxes; (2) struggling actively against tax evasion; (3) punishing acts of giving and taking bribes between taxpayers and tax officials; and (4) publicizing information about tax system.

- Control over budget expenditure could be carried out by (1) reducing grant-in-aid to provincial governments; (2) setting limits on administrative expenses with a view to encouraging administrative machinery to practice thrift and enhance their sense of responsibility; (3) avoiding making guarantee for foreign debts borrowed by state-owned companies and banks; and (4) enhancing the transparency in order to struggle against corruption and waste.■

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