A PANORAMIC VIEW ON EFFECTS OF SUBSIDIZED INTEREST RATE FOR COMPANIES AND SOME SUGGESTIONS

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1. Financial crisis and responses of some governments

In early 2007, the U.S. economy showed signs of decline caused by housing bubble, easy credit conditions and losses suffered by baking system. On Jan. 28, 2008, former President George Bush refused to recognize the decline of the U.S. economy. On March 15, 2008, he recognized the U.S. economy, especially in realty and finance markets, underwent difficulties. And he only admitted for the first time that the economy was in decline on Dec. 5, 2008.

Table 1: Largest U.S. bankruptcies

Top 10 largest U.S. bankruptcies	Assets	Date of bankruptcy filing
Lehman Brothers Holdings	US$691 billion	15-Sep-08
Washington Mutual	US$327.9 billion	26-Sep-08
WorldCom	US$103.9 billion	21-Jul-02
General Motors	US$82 billion	1-Jun-09
Enron	US$65.5 billion	2-Dec-01
Conseco	US$61 billion	17-Dec-02
Chrysler	US$39 billion	30-Apr-09
Thornburg Mortgage	US$36.5 billion	1-May-09
Pacific Gas and Electronic Co. (PG&E)	US$36 billion	6-Apr-01
Texaco	US$34.9 billion	21-Apr-87

Source: www.cnn.com

After that, President Bush persuaded the Senate, with considerable difficulty, to approve the first stimulus package of US$800 billion to ameliorate the economy. Instead of waiting for American actions, the U.K., Germany, Russia, China, Japan and many other countries also offered their own stimulus packages.

At present, governments are injecting trillions of dollars to the markets in order to get away quickly from the crisis. On February, President Barack Obama approved the second stimulus package of US$787 billion two months after his inauguration. This package is used for federal expenditure, tax cuts and creation of millions of jobs, building of roads and bridges; high-speed rail and parks, allowance of US$50 billion for residents in Arizona those whose houses were foreclosed because it was one of states most severely affected by the mortgage crisis.

Table 2: Stimulus packages by some countries

Nation	Package
Republic of Georgia	$2.2 billion
China	$586 billion
The U.S.	$1.500 billion
Malaysia	$2 billion
Germany	€50 billion
Australia	$10 billion
Thailand	$3.3 billion
Spain	€11 billion
Japan	$225 billion
France	$24.5 billion
EU	€ 200 billion
Swiss	$1.3 billion
Poland	€24 billion
Vietnam	$9 billion
Russia	$340 billion
India	$18.7 billion
Pakistan	$7.8 billion
The U.K	$38 billion

2. Subsidized interest rate in Vietnam and its effects

The Vietnamese economy and its finance market in particular hasn't integrated fully into the world market, therefore effects of the global crisis were slow to come. These effects, however, are no less serious, and they forced the Vietnamese government to take measure to deal with them. One of the measures is a demand stimulus package of US$1 billion approved on Jan. 15, 2008 and used for paying an interest rate of 4% for loans used as working capital from commercial banks.

After the package is approved, many interpretations of this package are offered. The demand stimulus is interpreted correctly as "encouragement to spending" but this package aims at encouraging both spending and supply. Thus, this package can be better called an aid package, or "bail-out" as used by the U.S. government.

On April 20, PM Nguyễn Tấn Dũng announced that the Government had decided to increase the package to US$8 billion instead of 6 billion as announced in previous months. This package is divided into eight parts of different values. And theses parts are as follows:

Table 3: Division of the stimulus package (VND)

1. Used as public investment in major projects	37,200 billion
2. Transfer of public investment planned for 2008 to 2009	30,200 billion
3. Tax breaks and cuts	28,000 billion
4. Issue of government bond	20,000 billion
5. Interest- rate subsidy for commercial loan	17,000 billion
6. Increases in credit guarantee for companies	17,000 billion
7. Public expenditures to reduce recession and ensure social welfare	7,200 billion
8. Retrieval of advanced investment in major construction projects	3,400 billion

Source: Government report on management of the stimulus package

The major cause of the crisis in Vietnam is a high inflation rate that forced the government to adopt a tight-money policy to bring it under control. On May 28, 2007 when the SBV issued the Directive 03 causing a war of interest rates between banks that made it top the 20% mark. After that, effects of the global crisis were felt in Vietnam.

From then on, companies had to pay more interest for their loan capital and sources of short-term loans from banks also reduced. Not that business performance is poor, so the Government had better facilitate access to formal loans at market-based interest rate instead of offering subsidized interest rate. This policy will make companies more cautious about securing bank loans.

The U.S. Government can't offer such subsidies because the stimulus package is from the tax take, and it's unfair to use the public fund to support companies. The U.S. Government decided to buy shares of these companies and will re- sell them when the market gets warmer to take back the tax take, plus some profit if possible. In Vietnam, however, the government used the tax take to support certain companies and has no way to retrieve the money only to increase the budget deficit.

Vietnam's export value decreased steadily from early 2008 to May 2009. In the first half of 2009, the export value only reached US$27.57 billion falling by 10% compared with the corresponding period last year while the personal income fell because of inflation and cuts in wages. That is why corporate spending power decreased drastically. In such a situation, companies had to cut their output, lay off more workers and reduce their expenses. So it's hard to say that the first package of US$1 billion used for offering subsidized interest rate to companies is effective because companies had no need for working capital when their output is contracted.

Table 4: Export value in the first half of 2009 (US$ billion)

	Jan	Feb	March	April	May	June
Export value	3.8	4.3	4.7	4.5	4.4	5.9
Compared with previous month	-18.60%	13.16%	9.30%	-16.00%	2.84%	33.41%
Compared with the same month in 2008	-24.20%	1.10%	-2.80%	-0.10%	-24.90%	-6.70%

Source: General Office of Statistics

Moreover, the Government is preparing to launch the medium- and long-term stimulus package of US$8 billion, and one billion of which is used for supplying long- and medium – term loans to companies that want to modernize their production lines and expand their operations. At present, goods in stocks by companies tend to accumulate because of decreased market demand and nobody knows when the situation is improved. If these loans are used for modernizing their machines and increasing their output, a surplus crisis becomes possible.

If no interest rate subsidy is offered, will companies seek for bank loans? The government support has encouraged companies to rush to secure bank loans unnecessarily. When the market demand is on the decrease, will companies employ effectively such loans? If they can sell their output, companies can't repay principal and interest with the result that bad debts in banks will increase. Up to June 18, 2009, VND347,282.37 billion worth of subsidized- interest loan have been extended. If both banks and companies face such risks and difficulties, will the government act as a passer by or offer another stimulus package making a bigger hole in the tax take?

In early May 2009, a series of banks in Vietnam publicized their business performance in the first five months of the year. Their reports show that most of them made huge profits, even the small ones earned dozen billions of VND. Where are such profits from when most industries are suffering losses or only gained a small profit? Some 70% of banks' profits are from lending service. When the interest subsidy is offered, all companies try to get bank loan, which makes banks lending, and profit from this service, increase quickly. Up to the end of May 2009, before-tax profits for banks are as follows: VND470 billion for Maritime Banks; 900 billion for ACB; 304 billion for LienVietBank; 789 billion for Techcombank, and 660 billion for Sacombank, etc. (http://www.vneconomy.com.vn)

Who benefit most from the stimulus package? First of all, taxpayers lose an amount to cover the subsidized interest rate of four percent, the companies enjoy some benefit but they can suffer big costs on bank interest and even bankruptcy. The banks benefit most from this subsidy when their sales skyrocket. But all profits have their own prices. Of their enormous outstanding loan, the banks may fail to collect repayments timely and suffer huge bad debts. And then they will pay the penalty for the super-profit they gain now.

Right after the Government announced the US$8-billion stimulus package, and one billion of which will be used for subsidizing the interest on long- and medium-term loans, all banks decide to offer higher deposit rates. On June 16, 2009, HD-Bank offered a rate of 10.1% a year on 36-month deposits compared with 8.8% suggested by ACB; and SHB paid a rate of 9.25% a year for saving accounts. From now till the end of the year, a war of interest rate may break out between banks in preparation for the second stimulus package- a source of profit they couldn't afford to overlook.

3. Some suggestions about effective use of the stimulus package

Economic activities take place continuously and all participants should make continuous efforts to keep abreast with changes in the market, especially during the economic crisis, which forces the Government, banks and companies cooperate in a close, consistent and continuous manner if they want to surpass difficulties quickly and effectively. To achieve this aim, stimulus packages are timely and necessary. To use them more efficiently, especially in the form of subsidized interest rate, the Government, banks and companies should pay full attention to the following aspects.

(1) First of all, the Government should assess exactly the situation; causes and characteristics of the crisis; and groups that are most seriously affected by the crisis, thereby selecting appropriate and efficient measures. Experience from other countries, especially the U.S. one, is worth studying, not imitating.

(2) Secondly, the Government should introduce specific regulations on the use of stimulus packages, and identify objectives and criteria for measuring efficiency. Investigation of implementation of these packages should be carried out regularly in order to work out new measures thereby avoiding waste and social injustice. Officials responsible for implementing the packages must be identified. Moreover, need for loan capital by companies and ability of the banks to supply credit and collect repayments must be assessed correctly.

(3) The use of the packages must be publicized.

At present, information about the use of them is not transparent. This means that the public can't supervise the use and basis for identifying responsibility is still lacking. We had better learn from the way the U.S. government use the public fund. A website (www.recovery.gov) is opened to publicize details of the stimulus package and the publication of information is carried out in a surprisingly simple manner. It also presents a video clip in which President Obama talks about the necessity of the website.

He said that the size and scope of this plan requires unprecedented efforts to get rid of waste and unnecessary and inefficient expenditures. This website publicizes all necessary information to show that the approved packages are spent timely on the planned objectives in a transparent manner. Instead of having such money divided by politicians behind closed doors, American taxpayers can check the way of spending every dollar of their tax payments. Whenever a dollar is spent, citizen will know how, when and where it is spent.

(4) The Government should help companies get access to new markets and surpass their break-even. If the companies find no market for their output, they never look for bank loans even if these loans are interest- free. When the market is contracted, honest companies are not unwise to increase their debts and expose themselves to risks. Thus, the problem now is market for the output, not the interest rate.

(5) In addition, the Government should control strictly the growth of credit, especially loans used as risk capital by, for example, investors in realty and stock markets. Limits on such loans must be reset, for example, only 20% of legal capital for loans to investors in securities; and a 30% limit on the growth of credit, etc. At present, capital of banks shows an upward tendency while solvency of companies become weaker, such limits may be much higher than the safe limit. On the other hand, it's necessary to encourage consumption loan by cutting the lending rate remarkably, and simplifying lending procedures and conditions. At present, it's not appropriate to set the interest rate on consumption loan higher than the ones on other kinds of loans.

(6) Companies should review their business strategies and need for capital, and develop structure of target capital thereby working out efficient plan to mobilize the necessary capital. Companies had better refrain from borrowing too much because it may harm their solvency. Companies must base all strategies on specific business performance in order to ensure a sustainable development.

(7) Finally, the banks should observe strictly lending requirements and supervise the use of loans by companies in order to tack timely action if need be. Banks had better limit sub-prime credit just because of profit as seen in the first half of 2009. The banks have to make plan to deal with the possible war of interest rate that may break out in the second half of the year in which the deposit rate may be very high while the maximum lending rate is set at 10.5%, which will certainly lead to huge losses. When the banking system suffers such losses, the government is force to intervene, and one of measure may be a higher base rate with the result that the crisis may take place again when the companies have to pay very high interest rates for their loan capital as the case seen in 2008■

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