Development of State Credit in the International Integration

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1. The role of state credit

In fact, the state credit could be seen as a budgetary expenditure because this credit implies a preferential rate of interest and the State has to spend part of its budget to fill the difference between the preferential and market rates of interest. However, the state credit could be used for reducing subsidies when the national budget is limited and force borrowers to bear full responsibility for repayment. Upon receiving repayments, the government can invest in major projects or depressed areas, thereby enhancing its effects on the economy. In the future, therefore, the government had better supply low-interest credit instead of subsidies. This mechanism also saves the government from keeping a close watch on the use of subsidies by subordinate bodies.

At present, supplying of state credit is responsibility of the Development Support Fund which is a governmental body that gives financial support to development projects, depressed areas, key industries and export programs. The role of the state credit could be seen in the following facts:

- Investment for long-term developments: in the years 2000-04, the DSF invested some VND48,000 billion in over 3,800 projects. By supplying the initial capital, the DSF has been able to mobilize some VND65,000 billion of commercial credit from various sources. If projects transferred by the General Department of Investment for Development are included, the DSF is now running over 6,000 projects with a total credit of VND69,000 billion (35,000 billion from domestic sources and 34,000 billion from the ODA source). In that period, the DSF had to pay VND750 billion in interest owed by some 1,300 projects in order to secure multibillion investments from banking institutions.

According to the MPI, the DSF source accounted for 14.5% of the gross investment in the past few years. The better part of this source was supplied to the manufacturing sector (59.65%), the rest was put in industries in rural areas (18.1%), roads and bridges (17.5%) and other industries (4.75%).

As we know, such projects require big investments that are beyond the reach of non-public sectors while their profitability is low. In the early 1990s when Vietnam suffered shortage of important inputs, such as power, steel, and cement, it's the state credit in these projects that helped increase the output of these products, thereby encouraging other industries to develop.

In rural areas, the state credit in infrastructure, especially irrigation systems, has allowed intensive farming and increases in food output, which helped Vietnam not only ensure the supply of food but also become one of leading exporters of rice in recent years. At present, the state credit is oriented towards the supply of public utility and better education and health care services to rural residents.

After the 1997 Asian financial crisis, investment from non-public sectors tended to decrease, the state credit became a stimulus for private investment and spending power, thereby maintaining high growth rates since then.

2. Requirements for the use of state credit

Generally, the DSF, like all financial institutions of the government, should meet three requirements: securing sources of finance needed for the supply of state credit, covering its overheads, and integrating into the world economy. Satisfying these requirements will ensure success for all state financial institutions, according to economists and international financial organizations. This means that it has to prove to be a source of finance and an effective supervisor of investment supplied (realizing strategic targets set by the government without going against international practices), and a sustainable institution (covering its overheads in spite of low interest payments received).

As for financial sources for state credits, the DSF is meeting with difficulties in mobilizing the needed capital because the interest rate it offers is lower than the market one while its capital is stuck in long-term projects. This situation forces it to reduce volume and maturity of credits supplied to projects, and choose to cover part of interest payment for projects in order to encourage project contractors to secure other sources of capital.

The shortage of sources of capital, if it is not solved by a flexible strategy, could lead to the following problems:

- The DSF will meet with difficulties in supplying credit to strategic projects when it has to satisfy both economic and social development targets. If it prioritizes profitable projects, it has to limit the credit for low-profit ones in depressed areas although these projects are socially meaningful. Although the DSF gives preferential treatment to projects in depressed areas, such as bigger loans, longer maturity and lower interest rate, this policy must be reviewed regularly in order to help the Fund operate smoothly. In addition, the shortage of capital can make it difficult for the Fund to supply short-term loan to export programs carried out by provinces that can not mobilize sufficient capital.

- The shortage of capital can make the Fund face adverse selection. When the source is limited, the Fund will prefer profitable projects to the lower ones because it wants to retrieve its investment as quick as possible. But most profitable projects involve high degrees of risk while the less profitable ones are usually less risky. If the Fund hasn't got an army of good project assessors who can select safe projects and creditworthy customers, it will face high credit risks.

- The limited source of capital also leads the Fund to decisions to invest in major projects that could change the structure of industry strongly and only gives guarantee when project contractors borrow bank loans or pays some interest for them. But most contractors, and local companies, are of small and medium sizes and they usually have no ability to run large-scale projects. And as a result, they are forced to work out large-scale projects to secure soft loans from the Fund. This situation leads to waste of investment and higher degrees of credit risk.

- The shortage of capital from the Fund also forces local governments to form their own funds for development investment, which only makes the shortage worse.

3. Overheads of the Fund

The credit risk and overheads in Vietnam, according to many experts, are usually too high. This is understandable because the financial strength of most local companies is poor; many of them rely too much on loan capital; there is no credit agency in Vietnam; and financial statements of companies are not reliable enough. That is why collecting information about borrowers' creditworthiness is costly. In addition, assessing the project is usually a difficult task for lending officials of commercial banks and the DSF as well.

When the risk and cost are high, the lender usually requires high interest rates in order to secure the capital invested, but the DSF can not requires such interest rates with the result that it sets forth strict and complicated requirements for potential borrowers. So it's always hard to get access to formal sources of state credits.

The DSF has branches all over the country and its staff comprises over 2,000 employees. This situation means heavy overheads and forces the Fund to review regularly the quality of its personnel. In the future, it had better find out ways to reduce its overhead while ensuring good performance for its machinery.

4. Trend of development of the state credit

In the international integration process, Vietnam has to ensure equal treatment to all sectors and cut governmental subsidies. The state credit could be seen as a kind of subsidy but experience from many countries show that it still exists over time as an essential support for the economy. The globalization only forces it to take a new form. The state credit in Vietnam may follow this common trend.

In the coming years when Vietnam becomes a WTO member, the preferential treatment will be cut by degrees and the interest rate will come nearer to the market rate. Borrowers then can only enjoy some favorable conditions such as longer maturity and grace period. The WTO usually allows its new members a period to remove all kinds of subsidies and the length of this period depends on levels of development of the member.

The following are some measures to develop the state credit when Vietnam integrates into the world market:

- Selection of favored borrowers must be based on their past achievements, demands posed by the economic growth and international practices.

- Replacing preferential rates of interest by other forms of support in order to avoid violating WTO requirements and shortage of capital.

- Developing new mechanisms for mobilizing idle money and limiting ineffective use of loan capital (one of feasible measure is to turn the Fund into a bank for development specializing in mobilizing long- and medium-term capital). ■

Photo by Huỳnh Thơ