THE EU DEBT CRISIS AND POLICY IMPLICATIONS FOR VIETNAM

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Abstract:

Since 2009, concerns of a sovereign debt crisis developed among fiscally conservative investors concerning several European Union (EU) and euro-zone member states, the so-called PIIGS, i.e. Portugal, Italy, Ireland, Greece, and Spain. That led to a crisis of confidence as well as the widening of bond yield spreads and risk insurance on credit default swaps (CDS) between these countries and other euro-zone members, most importantly Germany. Many observers argue that the creation of the European single currency has contributed to the debt crisis in Europe, and that the future of the Euro is a key concern for investors and markets. Hence, an objective of the paper is to illustrate the origins of the debt crisis, and some policy response in EU. Besides, this study recommends some policies for implementing a strategic plan on public debt, including restructuring debts, resending, or borrowing to finance important and effective programs and projects and ensure national financial security.

Keywords: *debt crisis, policy implications*

1. Overview of EU debt crisis and policy responses

1.1. Overview of EU debt crisis

From late 2009, fears of a sovereign debt crisis developed among fiscally conservative investors concerning some European states, with the situation becoming particularly tense in early 2010.

The euro zone does not look viable in its current form. Either the Europeans now go their own ways or - more likely - a core group moves toward greater integration, including integration of fiscal policy. But it seems unlikely that this new core will include Greece, and the thinking in financial markets is that Portugal and some others (Spain? Ireland?) will also be excluded. The need for a more integrated or complete political union remains more open; this seems less likely,

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even for countries that essentially share the same fiscal policy going forward.

1.2. Causes within the PIGS

The Greek economy was one of the fastest growing in the Eurozone from 2000 to 2007; during that period, it grew at an annual rate of 4.2% as foreign capital flooded the country. A strong economy and falling bond yields allowed the government of Greece to run large structural deficits. To keep within the monetary union guidelines, the government of Greece (like many other governments in the Euro zone) had misreported the country's official economic statistics. In the beginning of 2010, it was discovered that Greece had paid Goldman Sachs and other banks hundreds of millions of dollars in fees since 2001 for arranging transactions that hid the actual level of borrowing. The purpose of these deals made by several subsequent Greek governments was to enable them to continue spending while hiding the actual deficit from the EU. The emphasis on the Greek case has tended to overshadow similar serious irregularities, usage of derivatives and "massaging" of statistics (to cope with monetary union guidelines) that have also been observed in cases of other EU countries; however Greece was the most publicized case. Greece has been able to issue a great deal of debt — and run a big budget deficit — because European banks did not think it was dangerous to lend to a Eurozone country. This expectation has now been validated in large part by the bailout measures put in place over the weekend (Thesing, & Krause-Jackson, 2010; Tilford, 2010).

The Irish economy expanded rapidly during the Celtic Tiger years (1997–2007) due to a low corporate tax rate, low ECB interest rates, and other factors. This led to an expansion of credit and included a property bubble, which petered out in 2007. Irish banks, already over-exposed to the Irish property market, came under severe pressure in September 2008 due to the global financial crisis of 2007-2010 (Barbieri, 2010).

The story of Portugal is over-expenditure and investment bubbles. A report published in January 2011 demonstrated that in the period between the Carnation Revolution in 1974 and 2010, the democratic Portuguese Republic governments have encouraged over-expenditure and investment bubbles through unclear public-private partnerships and funding of numerous ineffective and unnecessary external consultancy and advisory of committees and firms. This allowed considerable slippage in state-managed public works and inflated top management and head officer bonuses and wages. Persistent and lasting recruitment policies boosted the number of redundant public servants. Risky credit, public debt creation, and European structural and cohesion funds were mismanaged across almost four decades. The Prime Minister Socrates's cabinet was not able to forecast or prevent this in 2005, and later it was incapable of doing anything to improve the situation when the country was on the verge of bankruptcy by 2011 (Hewitt,2011)

Spanish financial crisis became a part of the World Late-2000s financial crisis. In Spain, the crisis was generated by long term loans (commonly issued for 40 years), the building market crash which included the bankruptcy of major companies, and a particularly severe increase in unemployment, which rose to 13.9% in February 2009.

Shortly after the announcement of the EU's new "emergency fund" for Eurozone countries in early May 2010, Spain's government announced new austerity measures designed to reduce the country's budget deficit. The socialist government had hoped to avoid such deep cuts, but weak economic growth as well as domestic and international pressure forced the government to expand on cuts already announced in January. As one of the largest Euro zone economies the condition of Spain's economy is of particular concern to international observers, and faced pressure from the United States, the IMF, other European countries and the European Commission to cut its deficit more aggressively(Johnson, 2011).

How does a country the size of Greece possess the ability to send shock waves throughout the world?

First, many governments have common lenders, including big international banks and hedge funds. A large loss in one national market lowers the total amount of capital they can commit. Often they pull back across a broad front.

Second, concerns about debt sustainability in one-country acts as a wake-up call to investors, who scour their holdings for risks posed by other economies in similar circumstances. When they look hard enough, they usually find cause for concern, triggering a withdrawal of funds. Citizens of Greece and Japan may speak different languages, but a worried portfolio manager hears only that both countries have ongoing budget deficits and a large outstanding stock of debt. Indeed, those inclined to be nervous about government finances do not have to look beyond the borders of Europe. Ireland, Portugal and Spain are running large budget deficits in proportion to their respective G.D.P.'s.

Third, Greece casts a long shadow on the European continent because 15 other countries share a common currency with it, the euro. Greece's debt problems have raised a question that European officials thought had been buried with the introduction of the single currency in 1999: Will the euro survive? For an international investor, this means that the price of any European asset should incorporate some compensation for currency risk.

That situation meant two things. One was that the economic pressures on these European Union members, as their downturns deepened, would lead them to exit the euro (so they could devalue their economies to spur a recovery). The second was that the shock waves, both to the European banks, and via a euro zone recession, would have an impact on other economies.

1.3. Policy responses

In the short term, first**, a**n emergency funding program called the European Financial Stabilization Mechanism (EFSM) is established, reliant upon funds raised on the financial markets and guaranteed by the European Commission using the budget of EU as collateral (Council of the EU). Meanwhile, a legal instrument named European Financial Stability Facility (EFSF) was created on May 2010 upon the agreement of EU's 27 member states. This special purpose vehicle has the short-term target of providing financial assistance to Eurozone states in economic difficulty and long-term goal of preserving financial stability in Europe.

Table 1: Loans of EFSF to Euro zone countries in financial troubles

Date	Beneficiary country	Amount disbursed	Effective lending cost	Maturity
29/06/2011	Portugal	€2.2 billion	5.32%	05/12/2016
22/06/2011	Portugal	€3.7 bllion	6.08%	05/07/2021
01/02/2011	Ireland	€3.6 billion	5.90%	18/07/2016

Source: European Financial Stability Facility, http://www.efsf.europa.eu/about/operations/index.htm

However, the implications of the rescue package require fiscal austerity. Actually, higher taxes, damping growth and possibly extending economic hardship, "While money is available now on the table, all this money is conditional on all these countries doing fiscal adjustment and structural reform" which is expressed by New York University professor Nouriel Roubini in an interview with Bloomberg Radio (Childs & Keene 2010).

Second, Austerity and loan agreement had been offered. On March and April, 2010, the European Commission, the IMF and ECB set up a tripartite committee, named Troika, to prepare a suitable program for a massive loan to Greece. A loan agreement was then reached between Greece, the other euro zone countries, and the IMF. The deal consisted of an immediate €45 billion in loans to be provided in 2010, with more funds available later. (Thesing& Krause-Jackson 2010). Moreover, the loan did come with its conditions. France and Germany demanded that their military dealings with Greece be a part of their participation in the financial rescue. Beside this, the Greek government had to impose extended austerity measures, for example, a cut on public sector allowances, a pay cut for public sector employees. This fiscal tightening is considered "unexpectedly tough" by Citibank and consists of 5% of GDP tightening in 2010 as well as a further 4% tightening in 2011.

In Ireland, the negotiations between the Irish government, the ECB and the IMF resulted in the €85 billion bailout agreement in November 2010 (93 94), including €22.5 billion from EFSM, €22.5 billion from EFSF, €17.5 billion from the Irish sovereign National Pension Reserve Fund and bilateral loans from the United Kingdom, Denmark and Sweden. The Irish government also implements a painful four-year austerity plan involving deep cuts in spending and public-sector jobs, a lower minimum wage and higher taxes (Rooney 2011).

However, despite all the measures taken, in April 2011, Moody's, the well-known credit rating agency downgraded the Irish banks' debt to junk status and the question of whether or not Ireland needs a second bailout is still discussed.

In Portugal, the Eurozone leaders approve a €78 billion bailout package in May, 2011. This loan will be equally split between the EFSM, the EFSF and the IMF (Hewitt 2011). To satisfy the conditions of the bailout, Portuguese government agreed to eliminate its golden share in Portugal Telecom to pave the way for privatization. (Hewitt, 2011).

In Spain, austerity measures have been imposed in hope to escape the high budget deficit without seeking for a bailout packages like the three previous countries. Due to weak economic growth, domestic and international pressure, Spain had to expand on cuts more aggressively. This resulted in a successful reduced deficit from 11.2% of GDP in 2009 to 9.2% in 2010 (Johnson 2011).

Third, reform and restructuring had been pointed out to to solve the current predicament, as long as cross border capital flows remain unregulated in the Euro Area, asset bubbles and current account imbalances are likely to continue. For example, Germany's large trade surplus means that it is in the net export position and acts as the lender to other countries to encourage them to buy German goods. The 2009 trade deficit for Italy, Spain, Greece, and Portugal was about $122.5 billion in total (CIA Factbook Data 2009) whilst Germany's trade surplus was $109.7 billion.

Among discussions on the imbalance resolutions, a suggestion of a common fiscal policy to achieve long-term stability has been made. Besides losing control over monetary policy and foreign exchange policy, the EAMS would therefore also lose control over domestic fiscal policy.

In the long term, European leaders are under intense pressure to come up with a long-term solution to the debt crisis, which is very likely to drag the EU to its breaking point. In such a challenging context, economists, scholars, and analysts have brought up several options.

Some suggest that Greece and the other debtor nations should unilaterally leave the Eurozone, default on their debts, regain their fiscal sovereignty, and readopt national currencies. Others recommend that Germany should return to the Deutsche Mark, or create another currency union with Netherlands, Austria, Finland, and other European countries having a positive current account balance, such as Denmark, Norway, and Sweden. Then these seven current account surplus countries can have more effective using of monetary policy, and the remained French led euro countries will then have the flexibility to keep interest rates low and implement quantitative easing or fiscal stimulus in support of a job-targeting economic policy (Evan-Pritchard, 2011).

However, the way to end this Euro land's sovereign debt crisis is still at question and some economists doubt about a satisfactory and effective solution in sight (Rooney 2011). The Euro zone would have to find out what bears greater costs: allowing the Euro zone to fail or support the existence of it.

2. Policy implications for Vietnam

2.1. Overview of Vietnam's public debt

National Debt is the total stock of all outstanding treasury bonds created by annual deficit flows. In Vietnam, the government defines DEBT as the sum of Governmental debt, Company debt guaranteed by government and Local debt. With international practice, debt is calculated by the Governmental debt *plus* Company debt guaranteed by government *plus* local debt *plus* Company debt without governmental guarantee (Vietnam Public Debt Management Act 2009; WB 2002;IMF, 2010)

Debt is divided into 2 main kinds: Internal debt (the government held by national households and institutions) and External debt (the government debt held by foreign households and institutions).

Public debt has become a hot topic when

debt crisis is a "phantom" covering over many countries. Vietnam is not the exception. After the Asian financial crisis, Vietnam's government suffered from chronic budget deficit. The overspending ratio peaked 8.9% GDP in 2009 when Vietnam faced with economic downturn and had to provide demand stimulus policy.

State budget is always on high level of overspending while economic growth, in the general, is not high; therefore, the increase of government's debt-to-GDP is inevitable. However, the figure of public debt situation in Vietnam was not consistent. There is a big difference between some domestic organizations' figure. This is difficult for government to account and public debt situation. In this paper, we use the statistics of the Economist Intelligence Unit (EIU) magazine. In the period 2007-2011, Vietnam's total public debt and debt per capita increased considerably. In 2007, total debt was 30 billion USD; debt-to-GDP ratio was 47%. In 2010, total debt was 48 billion USD (51.7%) and reached 48.7 billion USD (55.4%) in 2011. This means in 2011 public debt per capita was approximate $600 USD. Some economists predict that the ratio will continuously go up and can be 64% in 2015 and 80% in 2020. Vietnam still is a developing country. Because the debt-to-GDP is safe zone for a developing country is 50%, Vietnam almost reached to the edge. If the government cannot control the debt, it will put a great pressure on Vietnam's economy (EIU 2011, GSO 2011).

Compared to Southeast Asia countries, Vietnam's debt ratio is in 4th place after Singapore, Malaysia, and Laos, much higher than many countries. Although debt ratios in Laos and Malaysia tend to reduce, Vietnam's ratio tends to increase more and more. The scenario is the same as comparing Vietnam with other countries. In 2010, average debt ratio in the world was 46.7%, ratio in developing countries was 35.09%, and in developing countries in Asia was 31.03%, while in Vietnam this ratio reached to 52.85%. Even when compared with China, which has the same political institutions and large-scale public sector, ratio of this country was only 17.71% (Do Thien Anh Tuan, 2013).

According to the statistics at the end of 2009, in public debt structure, government debt was 79.3%, government guaranteed debt was 17.6%, and local debt was 3.1%. In government debt structure, external debt accounts for a large proportion (approximate 60%). Beside, government debt has major proportion in external debt, with more than 80%; the rest is private debt. Now the proportion of government debt decrease but still high. The important issue lies on debt management capacity and efficient use of debt of the state and local. There is no guarantee that loan will be used more efficient in public sector than in private sector.

One more important thing is that the proportion of government guaranteed debt went up rapidly, from 7% in 2006 to 14.29% in 2010. In structure of new loan, government guaranteed debt reached to 18.5% in 2010. Moreover, the interest rate of these loans was very high; from 13.08% in 2006 to 32.07% in 2010. One of the reasons is that interest rate for loans guaranteed by the government are often twice or three times as high as the rate of government loans.

In the period 2006-2012, budget deficit increased considerably more than the previous

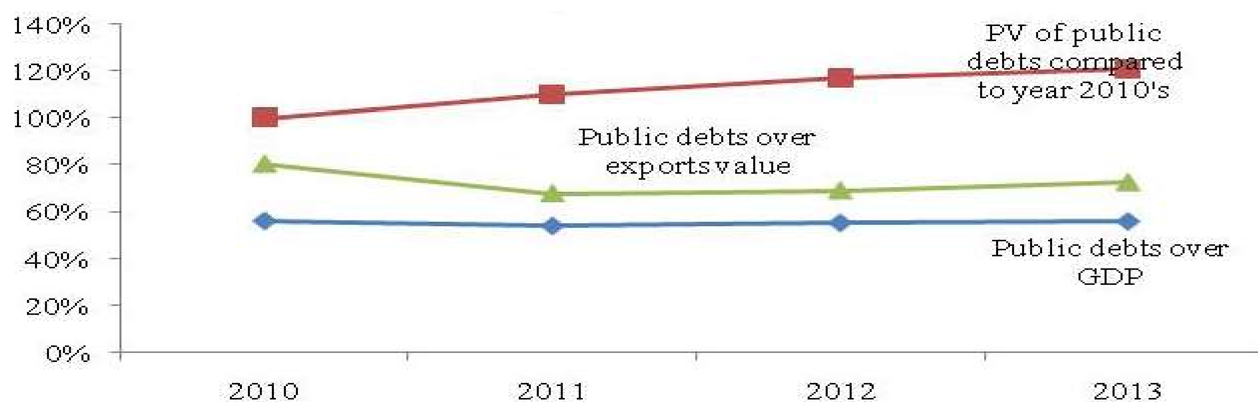
period. As reported by the government, until the end of 2011, Vietnam's public debt ratio was equal to 54.9 percent of GDP and as of the end of 2012; it was 55.7 percent, still under the allowable level. However, if estimated public debt including enterprises 'debt without governmental guarantee is higher than 105%GDP of Vietnam. Besides, the issues of public debt management and national financial security guarantee depend on the debt structure and solvency, so the government has to increase the deployment of necessary measures and strict control of public debts, ensuring the debt repayment capacity and maintaining the national financial security. Notably, the spending transfer from 2011 to 2012 was 246.69 trillion dong, accounting for 23.9 percent of the total state budget spending and continuing to increase highly against previous years. Furthermore, the budget deficit was 5-6.9% GDP, not to mention many off-budgets spending which can push the deficit up 10%. Commonly, budget deficit is offset by borrowing from foreign countries as long as from domestic organizations, through releasing bonds. However, when these loans are not used efficiently and effectively, it is another topic. VINASHIN's bankruptcy is a typical example. Hundreds of million USD of international bonds were transferred to this group lending. More lending but less efficiently investment put VINASHIN to the edge of bankruptcy. By the end of 2009, total assets of the group were more than 102.500 billion VND, in which 86.700 billion VND (80%) was liabilities, consisted of 750 million dollars of government-guaranteed born, the bank debt and partners' debt. VINASHIN's case is the biggest economic case in Vietnam, with the loss of four billion USD, which is four times as large as government's demand stimulus policy in 2008. In addition, many statistics show the huge debts of economic groups. Account for 31/12/2011, total debt of economic groups and state corporations were 1,292,400 billion VND, increased 18.9% more than in 2010. Specifically, Vietnam Electricity group (EVN)'s overdue debt was 10,149 billion VND, with 99,260 billion VND of external debt. Petro Vietnam's overdue debt was 1731 billion VND. Budget deficit and huge debt set the economists to strengthen management and monitoring public debt.

Actually, low interest rate which is mainly at 1%-2.99%, is the most highlighted feature of Vietnam's foreign debt. However, in comparison with previous years, in 2010, Vietnam's loans had higher interest rates and floating interest rate loans have been increasing, putting further pressure on the government debt. However, average interest rate of government foreign debt have had increased from 1.54%/year in 2006 to 1.9%/year in 2009 before reached 2.1% in 2010. Hence, if this situation does not change, obviously the cost of interest rate will be an increasing burden on government budget.

Vietnam's foreign debt has a various structures, which is supposed to limit the risk of exchange rate and reduce pressure on foreign debt repayment obligations of the government, in theory. However, in fact this structure also entails the risk of fluctuations in world financial markets. High proportion of loans in USD (22.95%) and JPY (38.25%) cause a rising risk of principal and interest payment due to the upward tends of VND/USD and USD/JPY exchange rate.

According to the report of Ministry of Finance, the 2013 outstanding public debt is expected at 56 percent of GDP, outstanding governmental debt of 43.5 percent of GDP and outstanding national debt of about 45.2 percent of GDP. However, these ratios remain below public debt's safety limits under the Public Debt Strategy (Prime Minister 2011, Decision 958/QĐ-TTg). Beside this, some public debts targets are also required in the Strategy, which are public debt outstanding to reach a safety threshold of 65 percent of GDP, governmental debt stock less than 50 percent of GDP, national debts outstanding less than 50 percent of GDP. (CPV, 2011)

Figure 1: Vietnam public debt outlook 2013



Source: MoF2012, Department of Debt management and external finance[1]

Moreover, PDA(2012), the World bank and the IMF have confirmed that Vietnams public debt remains below safety limits, the public debts over exports value was much below 150 percent, even more revenues are always insured to grow year-to-year, and reasonably debts repayments are sustained (IMF, 2012). However, Vietnamese Government tends to increase the State Budget deficit's ceiling from 4,8% to 5,3%. (Chinh phu, 2013).

2.2. Policy implications for managing public debt in Vietnam

The Vietnamese Government should develop a strategic plan on public debt, which is based on the socio-economic development plan, and the state budget spending in each stage and period. The strategic plan should specify the objectives of loans (to offset state budget deficit), restructure debts, resend, or borrow to finance important and effective programs and projects and ensure national financial security. It also stipulates the mobilization limit of short, medium, and long-term loans from domestic and foreign lenders with suitable forms of principle and interest mobilization. The plan should also identify borrowers, expected effectiveness, borrowing duration, the volume of debts in each stage to avoid prolonged unused loans or unreal needs for loans. We can carry out some policies and

[1] PVs are the present value of public debts over years and converted to year 2010 to contrast, with calculated market banking interest about 10%/year.

instruments for debt management through two stages: short term and medium term as follows:

In the short-term from 2011-2015

First, Vietnam needs to issue a full and uniform set of mechanisms and policies on managing public debts and national foreign debts. Besides, the Government needs to focus on amending and supplementing regulations on managing and using ODA capital. Moreover, public debts in terms of their sources, mechanisms for enterprises have to take and repay foreign loans in the model of self-control, local governments' loans and repayments, mobilization. It is necessary to use the preferential loans, foreign trade loans, risk management, and national credit rating in order to create a legally effective environment for debt management in conformity with international practices.

Second, the Government has to issue mechanisms and policies on PPP (public-private partnership), BOT, BTO, BT, etc in order to allocate social capital sources effectively infrastructure development and fruitfully exploit these sources, and decreasing the State budget's investment burden.

Third, Government need to apply debt instruments such as strategies, detailed plans, or debt monitor indicators to mobilize and use loans to serve socio-economic development in specific periods.

Last, it is necessary to renew and improve plans on loan mobilization and use, minimizing tautology and waste while raising efficiency of capital use. Government has to speed up the process of revising, supplementing and adjust norms and technical standards in line with Viet Nam's specific realities and international practices.

In the medium term, from 2016 to 2020

First, the implementation of the Law on Public Debt Management should be reviewed, amended, and supplemented. Besides, further improving efficiency of loan mobilization and use by harmonizing procedures and minimizing the Government's foreign trade loans and guarantees for enterprises. Furthermore, all of loans to balance the State budget must be strictly controlled, to secure the overspendings as set in the Strategy and gradually update the methods of calculating State budget overspendings in line with international practices.

Second, Government has to enhance supervision and management of risks, guaranteeing debt safety and national financial security and to control loans through debt instruments.

Third, it is necessary to speed up inspection and supervision over the use of loans in order to ensure debt capacity and to monitor enterprises' mobilization, distribution. Beside this, Government's authorities have to inspect debt payment, so as to ensure that all debts are refunded completely on time and that, no overdue debts are accumulated and can affect international commitments.

Forth, Government has to build up the database of debts, which can be used to forecast, analyze, evaluate, and warn risks in the list of public debts and national foreign debts. At the same time, it is essential to propose solutions for dealing with all potential risks in the debt list.

Fifth, in order to develop domestic capital market, we have to build the bond market, focusing on renewing the method of issuance, regulation etc. to increase the mobilization of capital in Vietnamese currency and to boost bond transactions in the market, and attach the issuance market and the transaction market.

Next, Government has to improve the effectiveness of management of debts in State-owned groups and corporations by reviewing and completing institutions, mechanisms, policies. Furthermore, it is necessary to speed up rearrangement and equalization of State-owned economic groups, corporations, and enterprises, to consolidate and strengthen their capability, efficiency, self-sufficiency, and self-responsibility.

Moreover, it is necessary to enhance publicity, transparency, accountability in public debt management and remove public anxiety. Public debt is the debt of nation, thus government should manage public debt publicly, and transparently, the information of size and structure of public debt should be correct and easily approached. Information of debts must be made open and transparent through reports, both periodical and unscheduled, on the mobilization, distribution, use of loans as well as on refunding public debts and national foreign debts, in conformity with the Law on Public Debt Management and international practices. Accurate information helps policymakers make sound management policies, consistent with the economy. In addition to, publicity and transparency may promote the possibility and efficiency of management and use of public debt. Therefore, public debts should be reflected fully in the state budget balance sheet, audited, and certified by independent professional agencies.

Last, the Government will maintain its uniform management over public debts and national foreign debts through relevant agencies with specific responsibilities. By establishing, an independent and professional debt management organization and applying equipment and technology will be fully provided in order to improve the efficiency of the information system and modernize the collection, summation, and analysis of the debt structure to facilitate advanced debt management. Meanwhile, administrative procedures have to be further reformed, investment and construction procedures harmonized, the distribution of State budget and the refinance of loans strictly monitored.

3. Conclusion

While the sovereign debt increases have been most pronounced in only a few euro zone countries, they have become a perceived problem for the area as a whole now. There are many causes for the crisis – problems in each country and problems in EU as a whole. This structural imbalance will not be easily addressed, but until it is fixed, the EU and the euro, are at risk of a great political and fiscal fracturing.

The bailout and loans are being issued, the governments across Europe are struggling in their austerity efforts, and the area's economy as well as the world is just getting out of the previous financial crisis. There may be no easy answers or any miraculous escape, the Europe Union and Euro zone member states

are coming to one of the toughest decision of evaluating which is the best option: separating or holding on together. In this continuing changing situation worldwide, although the default risk in Vietnam is small and considered safe, we should learn from this crisis to have suitable policies for more efficiency in public debt management.❑

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