

THE ONGOING PUBLIC DEBT CRISIS IN THE EUROPEAN UNION: IMPACTS ON AND LESSONS FOR VIETNAM

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Abstract

The current public debt crisis in the (European Union) EU began in Greece in November 2009, quickly spreading to Ireland (September 2010), Portugal (January 2012), Spain (June 2012), Italy (November 2012) and most recently, Cyprus (March 2013). This crisis has not only impacted on the Europe but also on the entire global economy, including that of Vietnam. This article will analyze the causes of this crisis, its impacts on the economy of Vietnam and lessons for Vietnam to avoid a potential public debt crisis and guarantee sustainable development.

1. The Public debt crisis in the EU.

a. Public debt and public debt crisis

Public debt is a relatively complex concept that most current approaches agree to refer to the sum of debt whose obligation to repay falls on the government of a country³. According to the World Bank (WB)'s approach, public debt is understood as the liability of four main groups of institutions: (i) Central government liability, (ii) Local government liability, (iii) Central banking institution liability, and (iv) Liabilities of independent organizations, state-owned enterprises of whose capital the state owns more than 50%, or other organizations whose debt the government has the responsibility to settle should they fails to do this⁴.

Owing to the widespread nature of public debt and the fact that countries can easily fall into public debt crisis – especially since the 80s of the 20th century – the global community had created a number of criteria to supervise and warn countries about to, or in the middle of a public debt crisis⁵. However, the criteria most commonly used to

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³ The public sector as defined by the United Nations System of National Accounting (SNA) includes public service (government) and state-owned enterprises. Hence, the term “public debt” is also taken to mean the same as such terms as “governmental debt” (United Nations, System of National Accounts 2008, para. 22.15, <http://unstats.un.org/unsd/nationalaccount/docs/SNA2008.pdf>: “the public sector includes general government and public corporations”). However, public debt differs from national debts in that the latter refers to a country's debt obligation in its entirety, including both governmental debt and private debts. In other words, public debt is only a component of national debt.

⁴ This definition is similar to that of the Debt Management and Financial Analysis System (DMFAS) of the United Nations Conference on Trade and Development (UNCTAD)

⁵ Supervisory criteria for a country's public debt and foreign debt includes: (i) Public debt as a percentage of GDP, (ii) Foreign debt as a percentage of GDP, (iii) National debt as a percentage of GDP, (iv) Foreign debt as a percentage of gross export value, (v) Public debt as a percentage of state budget revenue and so on.

estimate a country's public debt situation is public debt as a percentage of Gross Domestic Product (GDP). This figure reflects the size of a country's public debt as a fraction of the economy's income and is calculated as of the 31st December each year.

According to a 2010 research of the American National Bureau of Economic Research (NBER), a survey of more than 44 countries showed that when the public debt/GDP ratio exceeds 90%, it will negatively impact on economic growth and reduce the economic growth rate of the country in question by around four percent on average. In particular, for newly emerging economies like that of Vietnam, the healthy public debt/GDP ratio threshold is 60%, and exceeding this threshold will stall annual economic growth by around 2%. However, the ratio between public debt and GDP alone is not a comprehensive estimate of the safety or riskiness of a country's public debt – we need to examine public debt in a more comprehensive manner, in its relation with the system of macroeconomic criteria of a national economy⁶.

Public debt crisis refers to an escalated public debt situation – or worse, public insolvency – that damages the economy resulting from an imbalance between national budget revenue and expenditure. The typical scenario arises from an excess of governmental expenditure over revenue, forcing the state to borrow money in many ways such as government bonds, debentures or credit agreements. This results in the state's inability to repay its debt obligations. Persisting budget deficit will increase public debt. Should the state be unable to settle these debts in a timely manner will lead to an accumulation of interest, further exacerbating the problem.

Hyman Minsky (1986)⁷ gave an explanation to what would cause the serious crisis starting in 2007, a flaw of the financial-credit system. According to him, the financial-credit system plays a key role in a financial crisis: It led to a large amount of risky and speculative borrowing by firms and the public alike (borrowing far more than their existing assets, for instance) to seek profit from appreciating assets. However, if and when assets depreciates instead (the credit bubble pops), these speculators will lose much - if not all – of their solvency, resulting in the insolvency of the entire financial and credit system, leading to a financial crisis⁸. This happened because there was not yet the necessary systems to control and reduce these speculative and highly risky activities...

⁶ These criteria are: (i) rate and quality of economic growth; (ii) total factor productivity; (iii) capital utilization efficiency (via the Incremental capital-output ratio – ICOR); (iv) budget deficit ratio; (v) domestic saving rate and gross domestic investment; and (vi) a number of other criteria. Additionally, such criteria as public debt structure, weight of different debt classes, interest structure and payment period also require in-depth analysis when addressing the sustainability of public debt. For instance, a public debt worth 100% of Greece's GDP caused its bankruptcy, while Japan's public debt is worth around 200% of its GDP and is still considered sustainable. Another example, Argentina, has a public debt ratio to GDP less than 60% yet is still undergoing public debt crisis. According to the Maastricht Treaty in 1992, the European Union countries are not allowed to have their public debt exceed 60% of their GDP.

⁷ Hyman Minsky, 1986, *Stabilizing an Unstable Economy*, Yale University Press, Yale.

⁸ Minsky classified borrowers into three categories: (i) hedge borrowers, who can repay their both principal and interest from their investment flows; (ii) speculative borrowers, who can repay interest but has to regularly roll over principal to stay afloat; and (iii) Ponzi borrowers, who operates on the basis of borrowing money from one creditor to repay another. His view was that a crisis would happen if the last two categories outnumber the first.

b. Cause of the EU public debt crisis

The current public debt crisis in the EU began in Greece when the Greece Prime Minister announced in November 2009 that the country's budget deficit for the year would be 12.7% of GDP, twice as high as a previously announced figure (Lane, 2012), and that he would try to save Greece from insolvency. In reality, the country's public debt had peaked at €300 billion (around US\$440 billion), equal to 124% of the country's GDP, twice as high as the level permitted by the Maastricht Treaty. Immediately, on December 22nd 2009, Moody's Investors Service had reduced Greece's public debt credit ranking from A1 to A2 because of its rising budget deficit. Previously, Fitch Group and Standard & Poor had reduced Greece's credit rating below investment grade. In April 2010, Greece's budget deficit had risen to 13.6%, followed by a spike in government bond interest rate; Standard & Poor reduced Greece's credit rating to “junk status” - the lowest possible rank⁹. Ireland followed Greece with a budget deficit of 32% GDP (September 2010), Portugal (January 2012), Spain (June 2012), Italy (November 2012) and presently Cyprus (March 2013), all fell into debt crisis¹⁰. Why did this debt crisis happen? There were several causes as follows:

i. Root causes:

First, the problem arises from inefficiencies of an economic model based heavily on banking and financial services¹¹ as well as shortfalls in the EU and Eurozone's management system. Every time an economic recession occurs or an election takes place, public debt would spike as governments have not brought forward long-term solutions to the public debt problem and instead focusing on short-term solutions. The accumulation of this problematic management and failure to solve the problem at its root results in an eventual loss of control of the public debt burden.

Second, the problem also owes to the rapid development of the financial and banking services based on exploiting market inefficiencies and based heavily on speculation and speculative investment of the early 90s, leading to a “fake prosperity”. This caused many instabilities in the labor structure, big gap of wealth and increasing unemployment and welfare dependencies. This development of the financial system also, paradoxically, stabilized the supply of credit, making it easier and promoting borrowing and rapid growth of credit. These contributed greatly to increasing public debt.

Third, the global financial crisis in 2008 was greeted with old policies – borrowing to sponsor credit funds, firms and unemployment support, while government bonds had come to maturity. This caused an overload as several decades' worth of debt

⁹ On the 2nd May 2010, the Prime Minister of Greece had accepted the aid package worth €110 billion (US\$143 billion) from Eurozone and IMF, which would come into effect over the following three years.

¹⁰ At the end of 2009, typical countries of the EU had the high public debt-GDP ratios such as Greece – 124%; Portugal – 84,6%; Italy – 120,1%; Germany - 84,5%; Ireland – 82,9%; France – 82,6%.

¹¹ Two energetical crises in 1973-1974 and in 1979-1980 pushed countries in Europe and America into recession. That was the time when Europe and America restructured and transformed their economies from industrial production into banking and financial services with the boom of portfolio investment.

obligation fell on these governments at the worst possible timing. While governments have realized the unsustainability of an economy heavily stilted towards financial services, they have been unwilling to give up the old habit of a “false” economy, instead they were opting for a short-term solution of borrowing new funds to repay old debts and keep insolvent banks afloat.

Fourth, owing to structural problems, the European Union is heavily restricted in managing its economy as a whole, lacking mechanisms that would enable the governments of member countries to reduce budget deficit (Guillen, 2012). This leads to monetary policies not being consistent with fiscal policies, especially tax reform and labor policies. While the EU has a limit on member countries' budget deficit and public debts, the managing and supervisory institutions remain lax, making it easier for countries to borrow and much harder for the group to control said borrowing. The EU and the European Central Bank had responded too slowly when the crisis struck. When the politics of opposing national interests is taken into the equation, the mechanism becomes even more complicated and self-defeating (Bastasin, 2012).

Fifth, this was the emergence of the Euro (€). This allowed smaller countries to attract a huge amount of foreign investment owing to the common currency¹². However, this also caused a major challenge: When the capital flow exceeds the economy's capability to sustainably absorb it, the excess capital would easily be wasted on activities that do not efficiently benefit the economy, leading to an increase in bad debts among banks, causing an even faster outbreak of a debt crisis. This is one of the ways the sovereign debt crisis is linked to the banking crisis in Europe (Shambaugh, 2012)

Sixth, the monetary flows into smaller economies in the EU were too great, resulting in a huge monetary supply and an increase in price level, causing a far higher rate of inflation in smaller economies compared to larger ones, sometimes even greater than the rate of interest (causing, among others, the value of debts to decrease with time, causing borrowers to gain rather than lose). The consequence of taking advantage of external monetary flows was a long-term current account balance deficit, yet countries were unable to control this by their own monetary policies because of the common currency. Additionally, the use of an external monetary flows would further increase budget deficit (for want of stimulating domestic production), exceeding the 3% of GDP as allowed by the EU. This long-term budget deficit plays a contributing role to exacerbating public debt.

ii. Direct causes

First and foremost, causes pertaining to interior characteristics of countries undergoing crisis:

¹² For instance, the small countries of EU like Greece, Ireland were allowed to borrow money with interest rates equal to that of Germany, France. In other words, the small countries took advantage of the whole EU for their benefit.

First, all of the countries currently undergoing public debt crisis have lax fiscal discipline. End-of-year spending realization of budget would always exceed the expenditure decision of their respective Parliaments as announced at the beginning of the year. In addition, these countries had undergone a missed opportunity to tighten fiscal policies throughout the earlier part of the last decade, owing in no small part to their poor analytical framework (Lane, 2012).

Second, the distribution of capital, in many cases, is influenced more by political rather than economic goals. (for examples: defense and security expenditure, social welfare, retirement wages, interest subsidy of banks for social welfare projects, governmental protocols or celebrations and so on)

Third, state projects generally are not completed in a timely manner. This causes an increase in interest payable over the borrowed funds.

Fourth, low capital utilization efficiency (often lower than that of private projects with commercial loans), since the borrower in the state sector are not directly held responsible for its repayment. This is to say borrower responsibility is not high as those in charge of borrowing are not necessarily those who have to settle the debt, especially if they have a slim chance of being reelected into office.

Fifth, these governments have the capability to hide problematic issues of the country's public debt situation over an extended period (up to ten years), making it impossible to make readjustment in a timely manner. In fact, the severity of the crisis can be attributed to the governments' lack of initiative in the years leading up to, as well as during the 'lulls' in between the crises (Lane, 2012). Coupled with the complex and overlapping nature of this crisis (Shambaugh, 2012), this inactivity has proven to be extremely damaging.

Second, causes pertaining to external factors:

First, credit rating and risk analysis firms like Standard & Poor, Moody's and Filch Group is a contributing factor to the instability of the market and the crisis itself, owing to their announcement of lowering the credit rating of these government bonds, thereby decreasing investors' confidence in these markets¹³.

Second, political pressure from speculators, major financial organizations and economic powerhouses managed to persuade governments to adjust rather than reform their financial institutions. Governments had to spend many billions of Euros to bail out banks and on stimulus packages to save banks and the economies from collapse. This would invariably lead to an increase in public debt. At the same time, private banks

¹³ At the beginning of 2009, the long-term interest of EU countries' government bonds reached an all-time low by the time the governments issued new bonds, but within a few weeks the bond market had undergone significant changes. As S&P's Ratings Services and Fitch Group began to examine Greece's debt and ranked her bonds as junk, their bond interest started to increase dramatically while the stock market index went down quite as dramatically.

received funds from central banks at a low interest rate (around one percent) to finance enterprises for production, but instead, they used these funds to repurchase government debts and debentures at a higher interest rate (4 to 5 percent).

Third, arbitrage activities with an aim to raise government bond interest to the highest possible level for maximum arbitrage profit. In practice, public debt is usually negotiated through private banks and priced by these private institutions. Such financial institutions like Alpha Bank, Bank of America, Merrill Lynch, ING Group and so on have ample opportunities to artificially raise government bond interest¹⁴.

2. The Vietnamese economy under the impact of the EU public debt crisis.

The public debt crisis in the EU in addition to the current problems of the Vietnamese economy may have a number of negative impacts on it:

First, an increased difficulty in exporting to the EU market. According to the General Office of Statistics of Vietnam, EU has been Vietnam's largest export market (the EU alone consumed around 17.5% of all products produced in Vietnam in 2012, worth US\$20 billion)¹⁵. In 2012, difficulties in the Eurozone economies (high inflation, lowered income, increase in unemployment) resulted in a general tendency to reduce spending among EU consumers, giving rise to the demand of goods and services – including those from Vietnam – not rising. Additionally, EU countries have been increasing protectionistic measures to protect domestic industries, resulting in greater difficulties for Vietnamese exports, in addition to competition from other exporters. While the major relatively inexpensive export products such as agricultural and forestry products, seafood and foodstuff experienced a low drop in demand, the other products like furniture, handicraft, textile and footwear suffered a major demand hit.

Second, there was an increase in domestic market competition. In the backdrop of the ongoing public debt crisis and the difficulties challenging the entire global economy, Vietnamese firms are under pressure from foreign investors looking to diversify their market and hedge risks. These foreign firms are additionally granted advantageous borrowing rates (in many foreign countries, interest rates of commercial loans for their own firms are very low), and have greater competence and stronger trademarks than Vietnamese products, making Vietnamese firms being severely disadvantaged all but inevitable.

¹⁴ For example, IMF's report on the 22nd of April 2010, stating that the economy of Portugal that was deteriorating, would grow less than forecasted and would not be able to reduce her deficit. This caused the interest on Portugal's 10-year bond to increase significantly, and as at present Portugal, Spain, Greece, Ireland and Italy are countries that are almost certain to meet with extreme difficulties reducing their public debt.

¹⁵ Nguyễn Sinh Cúc, “An overview on the economy of Vietnam in 2012 and a forecast for 2013”, *Communist Magazine*, Hanoi, Jan 2013, pp 69-73. The impact of the European public debt crisis on Vietnam's export goods are not very large owing to Vietnam's exports mainly being necessities. In 2012, the amount of goods exported did not decrease, yet did not increase as much as expected.

Third, foreign investment and investors' confidence in Vietnam decreased. The crisis had forced European firms to constrict production and lay off employees owing to a decrease in consumption in both the EU and the world. The most obvious countermeasure is decreasing inefficient foreign investment. As a result, foreign direct investment flow from both Europe and the world into Vietnam has decreased. In 2009, Europe's FDI into Vietnam took up 18% of total FDI. This figure was reduced to 11% in 2011, continued to decrease in 2012 and seems to continue on this downward trend in 2013.¹⁶

Fourth, according to the evaluation of WB, Vietnam's business environment index is on the decrease (in 2011, Vietnam's business environment ranked 98th out of the 183 ranked economies, falling eight ranks compared to 2010), showing the faltering confidence of foreign investors on the Vietnamese business environment. The main reason behind this is that the public debt crisis in Europe had caused investors and credit ratings services firms pay greater attention to the public debt issue. The three groups of main criteria used as early warning are: (i) excessive debts, reflected in a high public debt over GDP ratio; (ii) excessive spending, reflected in a high budget deficit over GDP ratio; and (iii) a continually decreasing GDP growth rate. In 2011, Vietnam's public debt was 106% of GDP (see Table 1), state budget deficit was 4.9% of GDP (see Table 3), the GDP growth rates continually decreased¹⁷ (see Table 2), making it the riskiest economy in the ASEAN region, with a S&P credit rating of BB- (a deterioration from the BB rating at the beginning of the year). This not only negatively impacted on the ability to attract foreign investment and borrowings, but also increased the cost of borrowing from international financial organizations owing to a higher interest.

Table 1: Vietnam's public debt, 2011

Figure	Billion VND	Billion USD	Percentage of GDP
Public debt according to Vietnam's definition	1,391,478	66.8	55%
State debt	1,085,353	52.1	43%
State guaranteed debt	292,210	14	12%
Local government debt	13,915	0.7	1%

¹⁶ In addition, according to general analysis, global FDI in general and of the EU in particular into Vietnam, aside from the present crisis, are subject to a number of limiting factors: (i) low general effectiveness of FDI, still mainly being assembly and processing projects with little value added and low capability to participate in the global value chain; (ii) low ratio of disbursed to registered capital, small project scale, many projects slow on the execution; (iii) the majority of technologies attracted via FDI is not modern and is only average compared to the world, very few firms bringing high technology; (iv) the number of employment created by FDI is not high, as is the living quality of FDI firm employees, as well as an increasing number of labor disputes, (v) there appear many cases of price transferring and tax evading in FDI firms with an increasing level of sophistication (falsely raising the capital value, input costs, overheads, education and so on) to create "real profit, false losses", (vi) low diffusion value to other economic sectors, and (vii) a number of projects cause environmental pollution and waste of resources.

¹⁷ In 2012, GDP growth rate of Vietnam economy that was only 5.03% compared with that of 2011, was lowest growth rate since 2000 (Nguyễn Sinh Cúc, 2013, Ibid). In 2010, although GDP growth rate was 6.8%, but this rate attributed to estate bubble and consequence of economic stimulus packages of 2009 whose utilization was not strictly controlled and supervised, therefore was not used in proper manner.

Public debt according to the international definition	2,683,878	128.9	106%
Public debt according to the Vietnam definition	1,391,478	66.8	55%
State-owned enterprise debts	1,292,400	62.1	51%

Source: Vũ Quang Việt, “Public and banking debts of Vietnam at a glance”, *Forum Magazine*, Hanoi, 25/11/2011.

Fifth, there was an increase in exchange rate risk. In the short term, the appreciation of the US\$ relative to the € will decrease Vietnam's export goods into the Eurozone owing to Vietnam's export goods being valued in USD. In addition, recently the USD is also appreciating relative to the VND (Vietnamese currency) owing to high inflation in Vietnam from 2008 to 2011 (see Table 3), creating a pressure to adjust exchange rate, yet Vietnam has maintained the same rate. This causes a risk of existing two interest rates and the potential risk of smuggled import owing to cheaper import. This will put a greater pressure on Vietnam's national foreign exchange reserve.

3. Lessons for Vietnam in public debt crisis prevention

a. Current difficulties of the Vietnamese economy.

The main reason causing Vietnam's current difficulties began to emerge in 2006 and was rooted before that. To promote high growth, Vietnam had promoted investment very strongly and over an extended period had had an investment-to-GDP ratio, rating second only behind China (see Table 2). The rate of increase in money and credit supply was also among the world's highest and consequently the rate of inflation was record high in the world. This can be clearly seen when comparing Vietnam's exceedingly high investment-to-saving ratio from 2005 to 2011.

Table 2: GDP growth rate and the rate of investment and saving of Vietnam (2000-2011)

Figure Year	2000 -2004	2005	2006	2007	2008	2009	2010	2011
Investment/GDP (%)	33	38	41	43	40	38	39	33
Saving/GDP (%)		28	28	26	23	23	23	24
Difference between investment and saving (%)		10	13	17	17	15	16	9
GDP growth rate (%)	7.1	8.4	8.2	8.5	6.3	5.5	6.8	5.9

Source: Vu Quang Viet, *Crisis and the financial-credit system: Practical analysis in regard to the American and Vietnamese economy*, Washington D.C., February 2013; Nguyen Anh Tuan; *Vietnamese External Economic Syllabus*, National Political Publisher, Hanoi 2005.

The rate of investment was much higher than saving; some years up to 16-17% of GDP (see Table 2). To achieve this there were only two ways: (i) borrowing from foreign sources, or (ii) extensive (excessive) issuing of credit lines, resulting in bad debts and very high inflation as of the last few years (see Table 3). As a result of high inflation while the government did not adjust the exchange rate between the VND and the USD, import was highly stimulated, resulting in an unprecedented trade balance deficit, some years as high as US\$18 billion (See table 3). This excessive investment while efficiency was low resulted in an excessive public debt. As shown in Table 1, Vietnam's public debt could have reached US\$129 billion, equal to 106% of GDP in 2011, in which state-owned enterprises' were US\$62.1 billion (see Table 1).

Table 3: Increase in money supply, credit, CPI, trade balance deficit and state revenue-expenditure of budget in Vietnam (2006-2011)

Figure Year	2006	2007	2008	2009	2010	2011
Increase in money supply (%)	34.0	46.0	20.0	29.0	33.0	12.0
Increase in credit (%)	25.0	50.0	28.0	46.0	32.0	14.0
Inflation (CPI) (%)	7.1	8.3	23.1	5.9	10.0	18.6
Change in exchange rate (%)	0.9	0.7	1.2	4.7	9.1	10.1
Balance of trade (billion USD)	-5,1	-14,2	-18,0	-12,9	-12,6	-9,8
State revenue (Trillion VND)	na	na	357.4	390.6	456.0	590.5
State expenditure (Trillion VND)	na	na	398.9	441.2	581.0	725.6

Source: ADB, *Annual Report 2011*, Manila 2012; General Office of Statistics of Vietnam, *Annual Report 2012*, Hanoi 2013.

b. Lessons and suggestions for public debt crisis prevention in Vietnam

i. Basic Guidelines

In order for the Vietnamese economy to avoid negative impacts from the public debt crisis, we need to examine intrinsic factors within the Vietnamese economy as well as the causes of the public debt crisis in the EU and its existing impact on Vietnam as previously analyzed. There are a number of suggestions:

First, in order to manage and prevent public debt crisis, the most pressing requirement is an effective governmental regulatory mechanism in order to control financial activities and the flows of financial sources. This includes transparency of information, the effective maintenance of macro-level supervisory mechanism, while guaranteeing the needs for social welfare and mobilizing and combining resources to develop the country in a sustainable manner.

Second, it is necessary to properly manage and improve efficiency of state investment. In the long term, state investment needs to be actively reduced while investment from non-budget sources needs to increase relative to total social investment; shift the focus of state investment outside of economic activities so as to concentrate on social and infrastructural investment. In the same time, there is also a need to reform and standardize the state investment process in an appropriate manner so as to serve as a selection and standardization criteria for public projects¹⁸.

Third, state-owned corporations and enterprises diversifying investment outside of their main business and production must cease. State-owned enterprises should be concentrated on key industries of the national economy, mainly those related to and dealing with socio-economic infrastructure, public services and those pertaining to macroeconomic stability.

Fourth, systemic stability, prevention of side effects and debt “traps” and practical efficiency in both SOE and financial-banking sector restructuring should be ensured. At the same time, proper care should be taken to effectively handle such matters as firm acquisitions and mergers, unemployment insurance and social welfare.

ii. In-depth suggestions and areas for attention

On the basis of the guidelines above, we can draw a number of in-depth lessons and suggestions for public debt crisis prevention in Vietnam.

First, there are a number of issues pertaining to state-owned enterprises (SOEs), as followed: (i) cease excessive investment into SOEs and only maintain a minimal, manageable number of SOEs (between one to two dozen)¹⁹; (ii) put an end to diversification outside of expertise (especially letting a SOE own a bank, or vice versa)²⁰; (iii) every decision to found new SOEs must be carefully discussed and approved by the National Assembly. The government needs to stop spending more than the budget previously approved by the National Assembly (notably, in a number of countries this is considered illegal)²¹.

¹⁸ In particular, there is a need to distinguish between two classes of goals and criteria for assessing the efficiency of public investment (for- and non-profit investment), alleviate the confusion between capital for for profit and for non-profit activities as well as the social responsibility of state-owned enterprises.

¹⁹ This can be achieved by promoting equitization of SOEs, reduce the weight and number of SOEs of which the state owns controlling shares, only maintaining SOEs with 100% state capital in industries and fields that the state needs to maintain a monopoly, or hold a key role in the economy, or that the private sector cannot or is unwilling to take part in. Additionally, this can also be done by promoting a multi-owner corporations where SOEs play a key role that can take on the role as the economy's lead, while operating according to economic laws, on the basis of voluntary agreement and cooperation between independent legal entities.

²⁰ At present, the Credit Law of Vietnam permits this.

²¹ Since 2007 the government of Vietnam has been spending more than the amount approved by the National Assembly on a yearly basis: In 2007, exceeding 31%; 2008 - 29%; 2009 - 46% and 2010 - 11%.

Second, the government should not continue to have the State Bank issue money for spending and credit distribution, especially for SOEs as a spearhead for development owing to its lack of efficiency and also owing to the very large existing budget deficit (from 5% to 7% of GDP, while in these times a 3% of GDP deficit is already seen as a warning threshold in some countries). Stimulation of demand through budget deficit is only a temporary solution and should only be used when there are no other options when the economy – for any reason – falls into a crisis owing to plummeting demand. It should never be used as a method for stimulating economic growth because it will lead to high inflation and loss of stability, since budget deficit would invariably be remedied by printing money. The reason for Vietnam's current economic situation is the stimulation of demand via credit growth (which increased from 35% to 125% of GDP between 2007 and 2011), but without good control of the utilization of credit flow.

Third, it is necessary to raise the ratio of equity (paid-up or owner's capital) in both private firms and SOEs to ensure stable development. Currently, in Vietnam the debt-to-equity ratio is 1.77, much higher than in the United States or Europe (around 0.7). This high ratio of debt can very quickly lead to financial distress and insolvency should the interest rate rise.

Fourth, there is a need to focus the power for development investment into seven regions of Vietnam instead of on a provincial basis in order to avoid waste owing to overlapping construction investment, as well as to reduce the influence of the locality on the central organs located in provinces²². In addition, management of territory, forests, rivers and seas needs to be stratified between central, regional and local government so as to concentrate power for infrastructural development. Local governments should not be permitted to issue their own bonds to foreign markets. Furthermore, local government bonds should be tightly regulated so as to avoid uncontrollable layering of debts.

Fifth, it is worth noting that the excessive expansion of credit in Vietnam (See Table 3) is because the State Bank lacks the independence according to the standard of a market economy and of a central bank. Because of this, it had acted not on the ultimate goal of maintaining market price stability, but according to the government's directive to print money for SOEs to become as spearheads for the economy (that, in reality, was quite inefficient), but consequence of that was the detriment of the economy. The difficulties facing the Vietnamese economy occurred when the government began to execute stimulus packages but did not closely supervise them. Hence most of those funds were not invested on production but on stocks and real estate. When the bubble pops, this caused great difficulties for the financial-banking system with an increasing ratio of bad debts.²³

(calculation based on the statistics on budget estimates approved by the National Assembly and the budget liquidation at the end of each year).

²² In other words, all branches of central organs like the State Bank, the Ministry of Finance, the Ministry of Planning and Investment, the General Office of Statistics and so on would be stationed on a region rather than provincial basis, as they are at the moment.

²³ Until the 31st of May 2012, the total outstanding debts of the banking system of Vietnam are around VND2,500 trillion. If we assume 10% of this figure is bad debt, it would have an absolute value of 250 trillion. According to senior banking expert, Mr Nguyen Tri Hieu, bad debts in Vietnam are around

Sixth, according to the Credit Organizations Law (2010), many banks that had been given permission for establishment but whose sole purpose was to help local governments and clienteles to carry out rent seeking activities because the Law does not distinguish between commercial and investment bank. According to the experience from the EU and the US, commercial banks use deposits from clients to lend, while investment banks mainly implement portfolio investment using their own money, or serve clients to invest in portfolio for the service fees. Hence, in order to avoid risks for the financial-banking system and crisis, there is an urgent need to amend this law to emphasize on the difference between the role and function of these two categories of banks, as well as stopping allowing a bank to own a non-financial enterprises, or conversely, a non-financial enterprises founding a bank to serve itself.

Seventh, the state bank should establish a standard for minimum capital for each category of banks, as well as set up and announce basic statistics of each bank in particular and the financial-monetary system in general to serve both policy-makers and users of financial services. The Vietnamese financial-banking system has (i) 101 banks and foreign bank branches including (a) 5 national commercial banks, each of which having more than US\$1 billion in chartered capital and total assets of between US\$15 to US\$25 billion, (b) 39 private commercial banks, of which only a few banks are large like Eximbank with chartered capital of US\$630 million, Sacombank - US\$550 million, ACB - US\$470 million²⁴; (c) 53 foreign bank branches and banks with 100% foreign capital; (d) 5 foreign joint banks; (ii) 18 financial firms, 12 financial-lease firms and 1,202 public credit funds, (iii) 105 stock companies, 47 investment funds, 43 non-life insurance and 10 life insurance firms²⁵. This financial system is a very complicated, overlapping that was not properly supervised and controlled²⁶.

4. Conclusion

As the public debt crisis in Europe continues, casting further doubt on the already tumultuous and shaky macroeconomic and financial system worldwide, two questions demand a satisfactory answer. The first, what should be done to save those economies already engulfed in it and bring them back to financial healthiness. The second, what

15% (VND370 trillion) of which 50% (VND190 trillion) is irretrievable (according to international precedences), which is very large compared to the banking system's provident fund (VND70 trillion). At the same time, State Bank Governor of Vietnam Nguyen Van Binh insinuated that the rate of bad debt is only 4.47% (around VND117 trillion) and 84% of all debts have collaterals worth 135% total outstanding debts. On the other hand, according to the banking inspectional body, the rate of bad debts is closer to 8.6% of outstanding debts (VND202 trillion).

²⁴ According to the 141-ND-CP decree dated the 22th November 2006, up to 31st December 2010, each private commercial bank has to have a minimum chartered capital of VND3 trillion (more than US\$150 million). However, at that time there were 21 banks with a chartered capital less than VND2 trillion, 9 banks having a chartered capital between VND2 to VND3 trillion, and only 9 banks with a chartered capital of above VND3 trillion. At the meantime, the average global commercial bank has a typical chartered capital of US\$1 to US\$2 billion.

²⁵ Vũ Quang Việt, *Crisis and the financial-credit system: Practical analysis in regard to the American and Vietnamese economy*, Washington D.C., February 2013 .

²⁶ *Labor (Người lao động)*, Market-dominating financial group, 23/1/2013, (<http://nld.com.vn/20130123104917462p0c1002/tap> doan tai chinh lung doan thi trung.htm)

should be done for economies not yet in the crisis to avoid its ripple effect, or worse, being involved in its own crisis. This paper seeks to find an appropriate answer for the second question in a manner that is relevant to the Vietnamese economy.

As has been discussed, the macro-economy of Vietnam is currently displaying a number of worrying issues and symptoms. The crisis has struck in the wake of Vietnam's rapidly changing economy and exposed a number of key weaknesses in the country's macro-economy such as inflation, state budget deficit and the inefficient use of SOEs as spearhead for the economy, to name a few. This article has named a number of suggestions to restructure the economy so as to alleviate these deficiencies at the root, while avoiding a potential public debt crisis.

While a number of issues underlying the European crisis – one may even say key issues – are inapplicable to Vietnam, namely the dependence on a shared currency and fiscal policies and the political costs thereof, the situation in Europe has proven that weaknesses in government budget, in the banking system and low growth are inseparable and one cannot be examined or solved without the other. Considering the present state of the Vietnamese banking and financial sector and its many issues, how these three problems interact and how to tackle them is an important area that policymakers and future researches should pay attention to.

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