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## Current Global Crisis, Fiscal Stimulus Package And Implication for Vietnam

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# Current Global Crisis, Fiscal Stimulus Package and Implication for Vietnam<sup>1</sup>

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**Abstract:** In the year 2008 and the first half of 2009, the world witnessed the unfolding and heavy repercussions of the global financial crisis. Being a small open, FDI-reliant and export-dependant economy, Vietnam has not been spared from this external shock. The global crisis has led to the reduction of investments inflow, lower global commodity prices and trade. The government of Vietnam has acted quickly, easing both monetary and fiscal policies. It seems that the expansionary policy has worked in preventing the economy from falling further. Pursuing such an expansionary policy puts extra-ordinary pressure on the economy. Given the fragility of the situation, a premature withdrawal of stimulus could cause recovery to halt; at the same time, the continuation of expansionary macroeconomic policies could also raise inflationary and debt sustainability concerns. This paper intends to examine the impact of this global financial crisis on Vietnam economy and discuss the policy responses and their implications on the fiscal sustainability of the government.

**Keywords:** Global financial crisis, fiscal stimulus, Vietnam.

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## I. Introduction

Since early 2008, the world has witnessed the unfolding and heavy repercussions of the global financial crisis. To date, the contagious impacts of the crisis have been felt in all continents as well as most nations. To respond to the complex development of the global crisis and to lessen the severity of the economic recession, governments around the globe have continuously applied economic stimulus packages to rescue their economies. Central banks of countries have adopted a lax monetary policy as well as drastically cutting interest rate to the lowest level ever seen in many years and using unconventional monetary tools to improve the liquidity of the banking system. Fiscal stimulus packages were also announced and introduced in aggressive manner in many countries.

The global crisis has led to the reduction of investments inflow, lower global commodity prices and trade. Being a small open, FDI-reliant and export-dependant economy, Vietnam has not been spared from this external shock. The negative shock was transmitted to the Vietnam economy in the late of 2008. Monthly export dropped successively in the last months of 2008 and early 2009. Industrial production in the fourth quarter of 2008 slowed down to 15.6% as compared with 17.4% in 2007. Foreign direct investments declined significantly. Consumer sentiment was adversely affected and the stock market index kept falling. Finally, GDP growth in 2008 was only 6.28%, much lower than the over 8% attained in 2007. The situation deteriorated further in early 2009 when the GDP growth rate in the first quarter was only 3.1% and for the first half 2009 it was only 3.9%.<sup>2</sup>

As the situation worsened, like most of the governments in other Asia countries, the government of Vietnam has acted quickly, easing both monetary and fiscal policies. In particular, the government reverses the course of monetary tightening and fiscal austerity policy implemented in 2008 when the economy overheated and put in place a large fiscal stimulus package (amounting to 8.3% of GDP)<sup>3</sup>. At the moment, it seems that the expansionary policy has worked. The GDP growth increased to 7.7% in the fourth quarter of 2009, from the 3.1% level registered in the first quarter, 4.4% and 5.2% in the

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<sup>3</sup> See the world bank (2009) Taking stock in June 2009.

second and third quarters. However, some element of uncertainty remains as trade deficit keeps rising and there are some signs of inflation coming back. Comparing with other Asian countries that managed to accumulate large foreign reserves and maintained healthy government budget, Vietnam was already in serious trouble with high inflation and twin deficits. Pursuing such an expansionary policy puts extra-ordinary pressure on the economy and it is unclear how much longer the current extraordinary stance of monetary and fiscal policies could be maintained. Given the fragility of the situation, a premature withdrawal of stimulus could cause recovery to halt; at the same time, the continuation of expansionary macroeconomic policies could also raise inflationary and debt sustainability concerns.

This paper intends to examine the impact of this global financial crisis on Vietnam economy and discuss the policy responses and their implications on the fiscal sustainability of the government. To do so we review the principal measures taken by the Vietnamese government during recent months in response to the global financial crisis, and discuss issues that have emerged out of the experience. The structure of the paper is as follow: Section 2 presents an overview of the Vietnam while section 3 first identifies the channels through which the global financial crisis affected economy describes the government policies in response to this global crisis and its implication. Section 4 provides concluding remarks and policy implications.

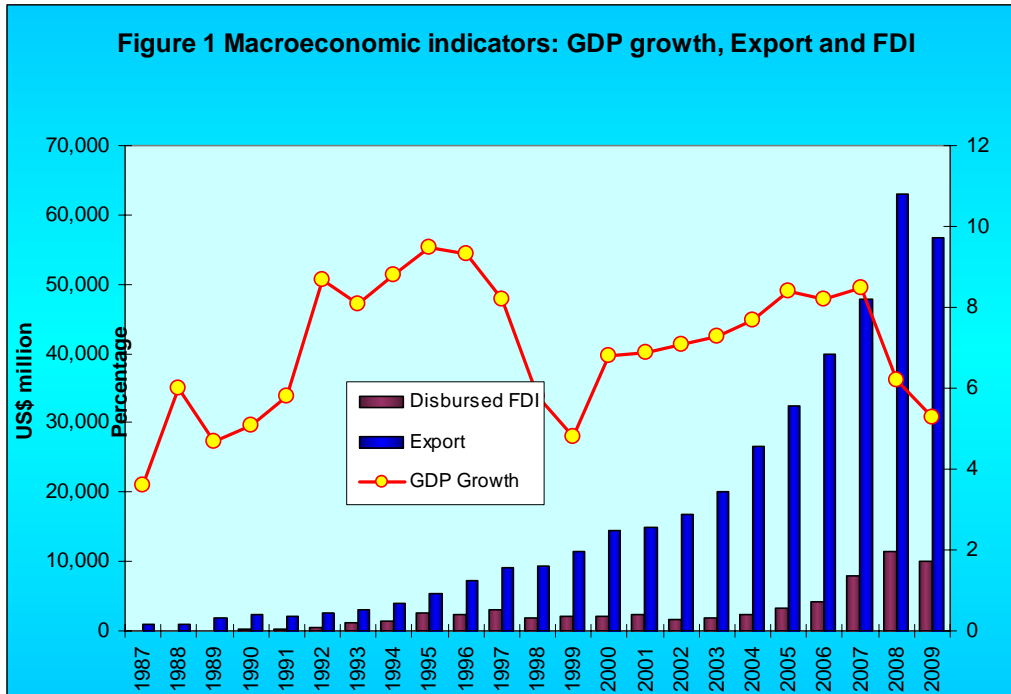
## **II. Recent economic development**

Since its the 1989-reforms, Vietnam has recorded remarkable achievements in terms of GDP growth, macroeconomic stabilization, export expansion, and poverty reduction. It is now generally recognized that Vietnam is among the best developing countries in terms of achieving relatively high economic growth and reducing poverty incidence.<sup>4</sup> Over the period 1990-2008, Vietnam's GDP growth rate averaged at over 7% per year. Still, today Viet Nam's growth rates remain among the highest in the region (second only to China). Figure 1 shows that since 2000, the economy has regained its momentum after the

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<sup>4</sup> High and continuous GDP growth rates and successful economic development over the period has resulted in overall improvement of people's welfare and significant poverty reduction. According to the Vietnam Household Living Standard Survey the total poverty incidence declined from 58% in 1993, to 37% in 1998, 29% in 2002, 19.5 in 2004 and 16% in 2006 (SRV 2003, Nguyen Viet Cuong 2009). Besides, there are improvements in other dimension of people's welfare such as the high percentage of literate adults (over 90%), higher life expectancy (over 70 years), lower under-five mortality rate (40 per 1000 live births in 2003).

financial crisis and grew at 7% per year, reaching 8.5% in 2007, before dropping back to an estimated 6.2% in 2008 and 5.3% in 2009 due to the impact of the global economic recession.<sup>5</sup>



Source: Government Statistical Office, 2009.

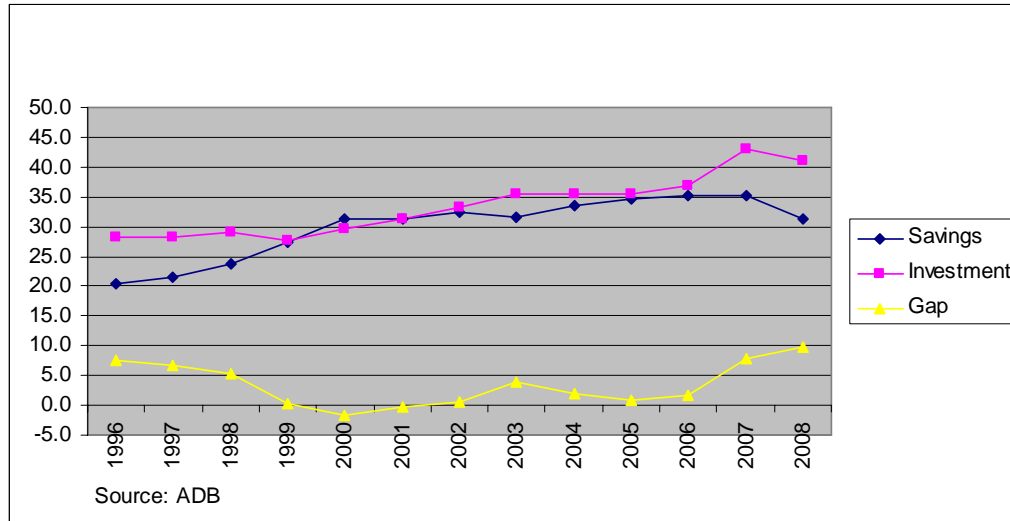
Although to some extent the economy recovered and grew, but it is not restructured to achieve a high level of growth in the future and there are disturbing structural issues facing the economy even before the 2008 global financial crisis occurred. The economy is depending on investment and export for growth and facing a twin deficit.

Vietnam has relatively high contributions of investment growth to GDP growth. The total investment as ratio of GDP has increased considerably during the period after 2000 reaching its peak at 43% in 2007 and 41% in 2008 and it is the large and increasing share of investment in GDP that explains in part the high growth rate accelerated since 2000 (Nguyen et al 2010, World Bank 2007). However, the efficiency of the high level of investment has been questioned by various researchers due to the high ICOR as compared with other countries such as Taiwan or Korean when these countries were at

<sup>5</sup> See Nguyen et al (2010) for further details of Vietnam recent economic development.

the same stage of economic development.<sup>6</sup> As the government follows a high growth strategy it is now surprise that until 2006, the state sector was still the most important source of investment in the country. State investment is made either directly into public infrastructure or through loans to state-owned enterprises (SOEs), or in the form of grants to municipalities and private enterprises.<sup>7</sup>

**Figure 2 Vietnam Investment – Saving Gap**



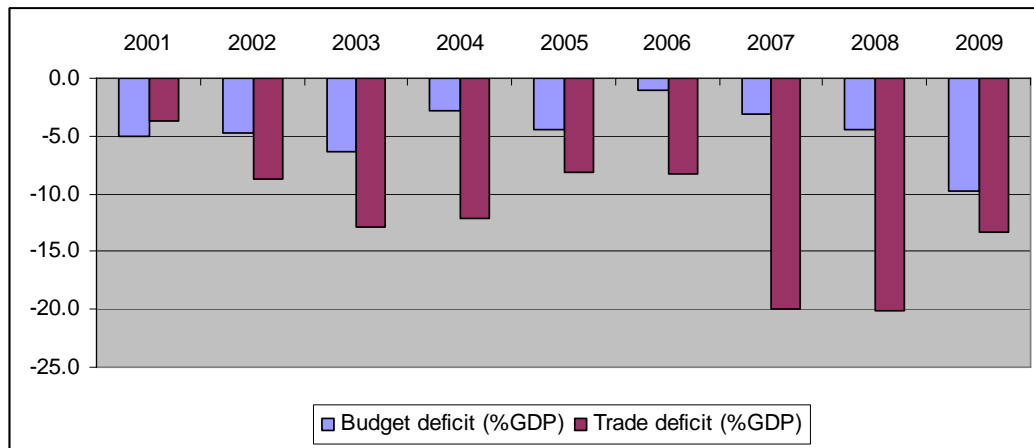
A direct consequence of adopting an investment-based growth strategy is the rising investment-saving gap. In comparison to other Asian countries, Vietnam domestic saving rate is relatively moderate, staying around 30% (Figure 2). Combining with a high investment rate, the gap widened and became very large in 2007 and 2008 reaching 9.8%. In order to meet the investment need and the growth target, Vietnam had to

<sup>6</sup> See also Rebalancing Growth in Asia by Prasad (2009) at <http://ftp.iza.org/dp4298.pdf>

<sup>7</sup> But the state's share in investment has declined from 60% in 2001, to 29% in 2008 as private domestic investment increases and the inflow of foreign direct investment (FDI) increases. The recent decline in the state's share is due more to the increased private investment than to new inflows of foreign investment, however. The domestic non-state domestic sector recorded a continuous upward trend as a significant source of investment. Private sector investment has increased from 27.6 in 1995 to 40% by 2008. Both continued involvement of the state and increased saving and investment by Vietnam's private sector have contributed to continuing high rates of economic growth. The FDI sector, during the 1990s and early 2000 saw a downward trend in their share of investment. FDI accounted for 30% of investment in the mid 1990s, but fell to 20% in the wake of the Asia financial crisis. Since then, the share of FDI in total investment kept falling until 2006. Very recently, new large FDI inflows have emerged, in part as a result of reforms committed to as part of WTO accession that relaxed rules restricting FDI and making Vietnam a more attractive FDI destination. In 2007 and 2008 FDI became the most important source of investment. The sudden increases in the share of the FDI sector during 2007-2008 can be partly explained by the WTO accession of Vietnam which created a hype expectation among international investors about the prospect of Vietnam. Although Vietnam has been successful in attracting FDI in recent years, the real benefits from FDI seem still controversial. Previous studies have found little evidence of technical spillover from FDI enterprises to local counterparts (Nguyen et al 2008). In addition, the country has become heavy dependent on FDI capital as an important source of input to sustain economic growth.

mobilize an amount of foreign savings equivalent to the order of 10% of its GDP if the domestic savings-GDP ratio does not improve. Comparing with other countries, especially China where the savings ratio reached 50% of GDP, the Vietnam's saving ratio is markedly low. With domestic investment in excess of savings, current account has been in deficit since 2000. The large current account deficit is not a recent development for Vietnam at all as Vietnam has long been a net importer. In addition to the large trade deficit, the government runs also a large fiscal deficit (i.e. twin deficit) (as indicated in Figure 3). Vietnam government budget has long been in deficit for a number of years. After the Asia financial crisis, with the implicit expansionary policy to stimulate the economy, the government budget deficit worsens. Even after the economy recovered, the government has been running on a persistent fiscal deficit. Though the fiscal deficit eased slightly from 2004 to 2007 it widened again in 2008.

**Figure 3: Budget deficit and trade deficit as percentage of GDP**



More recently, Vietnam has been struggling with a number of problems. The past two years (2007-2008) marked a memorable experience for Vietnam. In late 2007 and early 2008, Vietnam was confronted with the economic overheating resulting from huge credit expansion and massive capital inflows. After a long period of striving for high rate of economic growth in 2008, for the first time, the government publicly admitted the trade-off between economic growth and macroeconomic stability. Vietnam had experienced a huge credit expansion in 2007, which together with rising world energy and food prices has led to amounting inflationary pressures. In addition, in response to the huge capital inflow (both FDI and portfolio investment), the government inappropriately attempted to



absorb this capital inflow while maintaining a fixed exchange rate. All of these forced the government to shift their priorities from economic growth to stabilization in 2008: a tight monetary policy and cutting back public spending on large projects.<sup>8</sup> The policy worked and brought down inflation, stalled the housing market and even busted the financial bubble. As the macroeconomic situation somehow improved by the end of 2008, the country suffered very negative impacts of global financial crisis and recession.<sup>9</sup> Entering the year 2009, Vietnam is facing new difficulty and challenges additionally hit by the global financial crisis.<sup>10</sup>

### **III. The global crisis: Impacts, government responses, recovery and implications**

Being more deeply integrated into the regional and world economy, Vietnam gradually becomes more vulnerable to external shocks and crises. Unlike previous Asian Financial Crisis in 1997-1998 when Vietnam is still relatively isolated from the world and had pretty stable macroeconomic indicators, this time when the crisis occurred Vietnam has deeply integrated into the world economy and worse indicators of macro-economic conditions (such as high inflation, large current account deficit, volatile inflow of capitals, and fiscal imbalances).<sup>11</sup> As pointed out by Nguyen et al (2009) although the country has witnessed strong domestic consumption growth in recent years, Vietnam's economy has continued to be driven by high external trade and increased foreign direct investment (FDI). The country's total trades are now equivalent to about 150% of GDP, which is the second highest in the region (after Malaysia). Besides that, Vietnam has been one of the largest recipients of FDI in the world relative to the size of its GDP. Vietnam's macroeconomic conditions were also worse than other countries, especially regional neighboring countries when the global financial crisis hit the economy in 2008. In particular, in the early 2008, the economy was overheated with high inflation rate and the government had to adopt a monetary contraction policy. Therefore, the country is particularly vulnerable to the unexpected global economic slowdown and given the scale of the crisis and the conditions of the economy, the structure of the market and the policy

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<sup>8</sup> For further details, see WB (2008)

<sup>9</sup> Some would go further to argue that without the global crisis, Vietnam would still fall into recession by self-making anyway.

<sup>10</sup> By the end of 2008, the economy of Vietnam was still pre-occupied with the inflationary consequence of overheating and rising commodity prices.

<sup>11</sup> In 1997 when the crisis occurred, the GDP growth was over 8% and the inflation rate was at all time low at 3.6%. In 2008, the GDP rate was 6.2% and the annual inflation rate was reported at 19.9%. During the year, the headline inflation rate was as high as 30%.

options/ constraints, mitigating the negative impacts of the global crisis would be a stark job for Vietnam. With the global financial crisis unfolding, the GDP growth of Vietnam is forecasted to be lower than the previous years, ranging from 6.5% at the highest by WB to 5% by ADB and IMF and to 4,1% at the lowest by Deutsche Bank. For other countries, 5% GDP growth rate is something to desire for, but for Vietnam, an economy growing at 7.5-8% per year for a long period of time, the figure of 5% is worrying. In this section, we first discuss the impact of the global financial crisis on Vietnam: focusing on trade, FDI, labour market, capital flow, exchange rate and stock market. We then describe the policy responses by the government, the impact of the government policy on economic recovery. Finally we discuss the fiscal implication.

### 3.1 Impacts of the global financial crisis

Up to the first half of 2008 Vietnam was relatively unaffected by the financial turmoil. The financial and economic environment worsened in final quarter of 2008 and first quarter of 2009. Real GDP grew only 3.1% y-o-y in the first quarter of 2009 compared to the average of 7.5% of the first quarter of 2008. The industrial production growth was only at 2.9% in the first quarter of 2009. The depressing performance in the first quarter of 2009 confirmed the expectation that Vietnam faces a full-blown recession for the year 2009. There are a number of channel that the financial turmoil could impact the Vietnam economy. Some basic macroeconomic data of Vietnam during the crisis are presented in Table 1.

	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09
GDP (% y-o-y)	6.5	5.7	3.1	4.5	5.8	7.7
Industrial production (% y-o-y)	15.8	14.1	2.9	6.8	10.7	14
CPI, end quarter (% y-o-y)	27.9	19.9	11.3	3.9	2.4	6.9
Trade balance (% GDP)	-5.5	-5.9	8.5	-15.2	-19.7	-18.6
International reserves (USDbn)	24.1	24.2	23.3	19	18	16
Policy rate, end quarter (%)	14	8.5	7	7	7	8
5-yr yield, end quarter (%)	15.9	10	9.17	9.42	10.1	11.68
VND/USD, end quarter	16,600	17,483	17,797	17,798	17,841	18,479
VND/EUR, end quarter	23,572	24,301	23,492	24,917	26,048	26,425

Source: GSO

This crisis exposed the vulnerability of Vietnam's export dependent growth on the world market. Export-dependent countries like Vietnam suffered disproportionately from a collapse in international trade. In the fourth quarter of 2008, Vietnam's export fell significantly due to the direct and immediate impacts of the global financial crisis. The government had to revise downward its export growth rate, expecting a zero growth for export in 2009. According to official statistics from GSO, over the first ten months of 2009, Vietnamese exports declined by 13.8 percent compared to 2008 (See Table 2). The aggregate figure concealed the real situation. This is because although some of Vietnam major export products such as coffee, rice, pepper, rubber, crude oil and coal, report increases in volume in 2009, their decreased prices have led to the speculation that Vietnam may not be able to meet this revised growth rate.<sup>12</sup>

	Value (US\$ million, 2008)	Growth (in percent)		
		2008	10M-08	10M-09
<b>Total export earnings</b>	62,685	29.1	36.7	-13.8
Crude oil	10,357	22	43.2	-43
Non-oil	52,328	30.6	35.4	-7.6
<b>Total import value</b>	80,714	28.8	42.6	-21.7

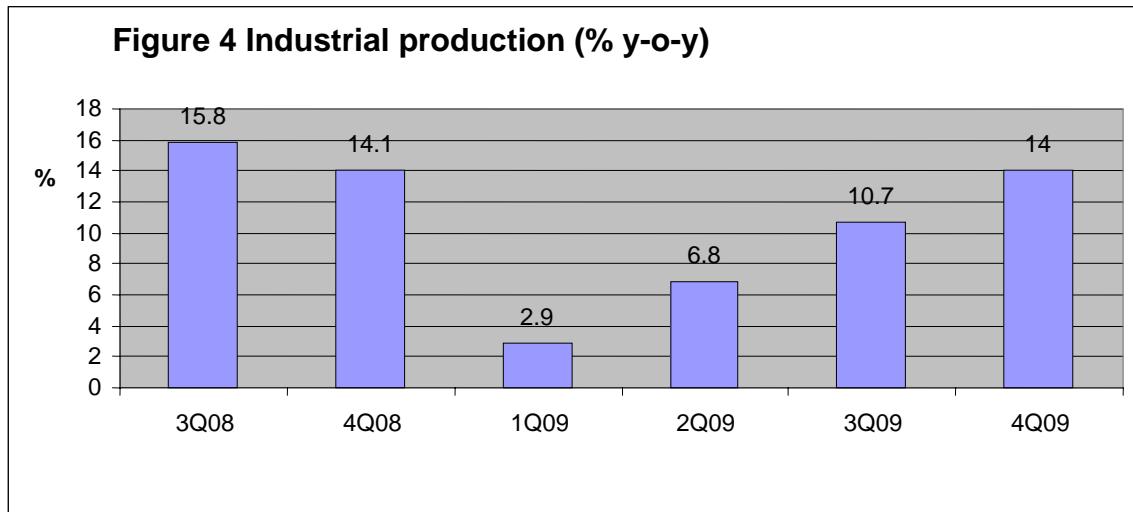
Source: World Bank, GSO

Vietnam's exports contain a high import component of intermediate goods. Therefore when exports fell, imports also dropped concomitantly, and, in fact, by a greater amount. The first 10 month of 2009 witnessed a dramatic decline in imports by 21.7%. The decline reflected the downturn of economic activity. The decline in import can be attributed to lower demand for capital investment and intermediate goods and falling import prices of petroleum products and materials.<sup>13</sup>

<sup>12</sup> For a country that has an annual export growth rate of around 20%, this is clearly a serious setback. There are two factors at work here (i) decreased aggregate demand in the export market; and (ii) a substantial reduction in the price of Vietnam's export commodities (especially crude oil prices and other primary commodities). In a recent study by Vietnam Academic of Social Sciences finds that although several export manufacturing sectors such as the textile, garment, leather and seafood processing industries were hit hard by the crisis, these industries are very much resilient and can bounce back once the world economy improves. This is because the demand for products of these industries is very inelastic. On the other hand, the report points to several sectors/segments of the economy such as furniture, electronics and the craft-village which are not very resilient and it may take time to improve because the world demand for these products are not inelastic.

<sup>13</sup> Although the crisis has led to a significant fall in the export, it also leads to a more manageable trade deficit in the early 2009 (WB 2009). However, trade deficit is expected to grow significantly once the economy recovers. This is because of the import-export structure of Vietnam: (i) Vietnam's exports rely heavily on agricultural and raw commodities, and most manufacturing products still embody low value

In 2009, there has been a slowdown in the inflows of foreign direct investment resulted from the constraints of disposal capitals and the tightening of the world credit market.<sup>14</sup> In the first 8 months of 2009, Vietnam has managed to attract about US\$ 10.4 billion of registered capital much lower than 2008. The actual disbursement from investment projects is over US\$ 6.5 billion also lower than 2008. All along the course of economic reform up to now Vietnam has relied more and more on FDI to sustain its high level of economic growth. The slowdown of FDI inflows in 2009 and the years to come will have serious consequences for Vietnam. The FDI sector plays an important role in Vietnam's export. According to official statistics, the FDI sector accounts for over 50% of Vietnam's export over the last 6 years.<sup>15</sup>



Source: GSO, ADB

added; (ii) Vietnam's imports of intermediate products and machinery for domestic production and export may keep rising more rapidly once the economy recovers; (iii) Overseas final products, particularly luxury ones, are imported with high value as they appeal to Vietnam's middle-income consumers.

<sup>14</sup> In 2008, there was a large influx of FDI into Vietnam reaching US\$ 64 billion of registered capital (tripled the registered FDI capital for 2007) and US\$ 11.6 billion of implementation capital (compared with US\$ 8 billion in 2007).

<sup>15</sup> An indirect but critical effect of the global financial crisis on the Vietnam economy is that, to mitigate the impact on the domestic economy and to stimulate short-term economic growth, the government might delay or neglect and cancel some of its structural adjustment policies (reform in the state-owned enterprises, the banking sectors, improvement of the business environment). These structural adjustments are absolutely necessary for the sustainable growth of the Vietnamese economy. One example is that, to stimulate short-term economic growth, the Vietnamese government might resort to refinancing the inefficient banking sector, subsidizing loss-making large stage conglomerates and reviving real estate investment. Although these measures are quite useful and effective to stimulate short-term economic growth, they cannot ensure long-term sustainable growth and might generate new risks. The global economic crisis, in addition to the direct effects of decreased exports and FDI inflows creating a sharp decrease in the aggregate demand, through the employment and income channels contributed to a further fall in the domestic demand as employment fell and domestic consumers and investors delayed their consumption and investment. Other impacts include the fall in visitors of the tourism industry, lower income of farmers due to lower commodity prices.

The impact of the global crisis through the financial and trade routes makes its way to the real economy in terms of loss in output and employment. Recent data released by the GSO showed that Vietnam's industrial production for first quarter of 2009 fell markedly (Figure 4).

We might thus expect Vietnam labour to be quite exposed to a global financial crisis, given its heavy dependence on exports and on relatively mobile international investment. The data on the impact of the crisis on labour market and employment in Vietnam is very much limited, therefore<sup>16</sup>, assessing the social impact of the growth slowdown is difficult in the absence of a reliable data. As pointed out by the World Bank (2009) the picture is mixed from current data and the impacts are heterogeneous across enterprises and across provinces. Using job search and vacancy data from an informal source, the World Bank (2009) reports that before Tet (around first quarter 2009) there was a noticeable drop in both job offers by employers and job seeking ads by individuals. According to a survey conducted by VASS<sup>17</sup> although there were numerous job losses, frequent reductions in working hours and wages, reduced remittances, and more reliance on informal sector jobs, major adverse effects such as falling into poverty, facing food shortages, having to pull children out of school or to sell land, or becoming homeless, were relatively uncommon.

In addition to the impact on trade, FDI, industrial production and labour market, the global crisis has implication for Vietnam's capital inflow, exchange rate and stock market. Like other Asian countries, Vietnam saw suffered capital flight since the second quarter of 2008. Banks and financial institutions in the United States and the West reduced their international businesses and focused on their home markets. There was a

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<sup>16</sup> See also a study by UNDP (2009). Other impacts include lower demand for Vietnamese workers in other countries such as Malaysia, Taiwan and Middle East countries.

<sup>17</sup> Since early 2009, the Vietnam Academy of Social Sciences has conducted repeated Rapid Assessment Surveys to assess the impact of the global crisis on Vietnam. The first survey conducted in early 2009 found that job losses were widespread at industrial zones (both in the North and the South) but few took the form of open layoffs. Non-renewals of contracts and incentives for voluntary departures were more common. Job losses were frequent among seasonal workers, and those on short-term contracts. Some enterprises attempted several labour-hoarding measures to keep their skilled employees. The situation of the unemployed immigrants was very vulnerable due to the nonexistence of social security and non-reversible of immigration (the immigrated workers largely come from areas where arable land is scarce and other opportunities are few). Another survey on the impact of the global financial crisis on the labour in industrial parks is conducted by Central Institute for Economic Management (CIEM). Evidence from this survey suggests that Job losses were widespread in industrial parks in late 2008 and early 2009. Remittances to families staying in rural areas suffered as a result.

big drop in funds flowing into Vietnam. In response to the booming of the stock and housing markets during 2006-2007 short-term capital inflows surged to a high level. The crisis has led to a reversal of these capital inflows. The reversal of the portfolio capital flows due to the repatriation by foreign participants affected the stock market significantly with the VNindex to a record low of around 300 point in 2009 from its height at over 1000 point early 2007.<sup>18</sup>

Although the Vietnamese Dong has long been pegged with the US dollar, capital flows have had a significant impact on the Dong with several small adjustments of the trading bands and devaluation. Generally, capital outflows depress the price of the Dong; since the beginning of the year 2009, the Dong has lost almost several percentage points of its value against the US dollar.<sup>19</sup> Declines in exports as well as in remittance and foreign capital inflows have reduced the supply of foreign exchange, while expansionary monetary and fiscal policies have increased demand for it. Consequently, there has been a shortage of foreign exchange in the formal market and the dong's exchange rate against the US dollar has been transacted at the upper bound of its trading band. The Dong has been devalued by 2% by the widening of the trading band to +/-5% from +/-3% around the central bank reference rate. Rapid credit growth together with an expansionary fiscal policy, have led to a sustained increase in imports and a widening trade deficit. A larger demand of foreign exchange by importers, combined with market expectations that the dong would be devalued, led to a shortage of foreign exchange which was particularly severe in May-July, and again in November, imposing significant costs on enterprises. On the one hand, the shortage of foreign exchange in the formal market has helped narrow the trade deficit but on the other hand it creates difficulties for businesses in a time when the government would like to stimulate the business activities most.

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<sup>18</sup> The Vietnamese banking system has suffered from indirect impacts though not having been directly hit by the crisis. This is because the financial and banking sector has not fully integrated with the global network. Further, the absent of such regulation as mark-to-the-market has helped the banking system in time of crisis.

<sup>19</sup> This decline in the value of the Dong is primarily due to the declining demand in exports and portfolio outflows. The depreciation of the Dong may help to improve its export performance of the country, limiting the negative impact from the global recession. However, the study by Jongwanich (2007) for a group of 9 Asian countries found that there is a very weak link between the real exchange rate and export performance in these countries. On the contrary, world demand and production capacity play a more important role in determining exports of these groups of Asian economies.

### 3.2 The fiscal stimulus package

The government of Vietnam was quick to notice the impact of the global crisis and responded quite decisively.<sup>20</sup> The government reversed the course of monetary tightening and fiscal austerity policy implemented in 2008. In terms of monetary policy, the government aggressively loosens its policy by cutting the base rate from 14% per year to 7% per year within a few months. Ceiling lending interest rate (1.5 times base rate) was lowered accordingly, from 21% to 10.5% for productive activities. Lending interest rates for credit card and consumption are negotiable and fluctuating between 12% and 15%.

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**Table 3: Proportion of Stimulus package to GDP**

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Country	Stimulus Package(US\$, Billion)	Proportion to GDP
China	586	12%
Singapore	13.8	10.7%
Malaysia	18.1	10%
Philippines	6.1	4%
Thailand	8.3	3.3%
Vietnam	8	10%
Indonesia	4.5	0.9%

Source: CIMB Research House, MPI

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In terms of fiscal policy, Vietnam announced its fiscal stimulus in January 2009. The objective was to revive the economy by promoting consumption and investment. The stimulus package, initially announced as \$6 billion which aims at mitigating the impact of the global financial and economic crisis on the Vietnamese economy and its people, and preventing a general slowdown of economic activity. This figure was later revised to be USD 8 billion.<sup>21</sup> To put into perspective, Table 3 presents the values of stimulus packages that countries in ASEAN committed to fight the global recession. Based on the simple budget deficit metric, the budget plan of late 2008 put the Vietnamese stimulus package in the top tier of the regional comparison (Table 3).

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<sup>20</sup> In light of these events, the government has recently revised downwards its GDP growth forecasts for 2009, from 7.5 percent to 6.5 percent. The effectiveness of the fiscal stimulus packages that countries, developed and developing alike, are implementing has been questioned by Foster (2009) <http://www.heritage.org/Research/Economy/bg2302.cfm>

<sup>21</sup> Since the first announcement of the stimulus package several additional stimulus policies were adopted or announced, creating some confusion and prompting understandable concern about potentially unsustainable government spending.

No.	Policy measures	Amount
1	Interest subsidy	VND 17000 billion
2	State Development investment	VND 90800 billion
3	Tax holiday and exemption	VND 28000 billion
4	Other spending for social security and economic downturn prevention	VND 9800 billion
<b>Total</b>		VND 145600 billion (equivalent to USD 8 billion)

Source: Report by the Government to the National Assembly (2009)

The package includes a number of components, such as tax breaks and public investments for infrastructure, social transfer and interest subsidy. For example, the stimulus package includes one-off support of VND 200,000 per person for the poor on the last occasion of New Year Holiday; a reduction of 30 per cent of corporate income tax, an extension of nine months for the submission of 2009 tax payables and a temporarily refund of 90 per cent of VAT for exported goods with “justifiable payment documents”, personal income tax exemption for the first 6 months of 2009 and 4% interest subsidy being extended to longer-term loans of up to 2 years for investment in agriculture and other productive activities.<sup>22</sup>

VND trillion unless otherwise noted	Proposed stimulus package
<b>Revenue foregone</b>	25.4
Corporate Income Tax (CIT)	10.4
Personal Income Tax (PIT)	6.5
Value Added Tax (VAT)	7.4
Licenses and fees	1.1
<b>Additional expenditures</b>	117.6
Interest rate subsidy	17
Budget advanced from 2010	37.2
Government bond carried over from 2008	7.7
Investments funded by additional bond issuance	20
Expenditures carried over from 2008	22.5
Deferral of repayment of budget allowance for 2009	3.4
Social spending	9.8
<b>Overall fiscal stimulus</b>	143.0
In percent of GDP	8.5%

Source: Ministry of Finance, Ministry of Planning and Investment, World Bank, IMF

<sup>22</sup> See WB (2009) for further details



Details of the fiscal stimulus package breakdown in terms of measures are summarized in Table 4 and how the fiscal stimulus package is financed is presented in Table 5.

One of the peculiar features of Vietnam's stimulus package is the interest rate subsidy program which has received both criticism and praise. The program started in April 2009 and has been expected to have had a quick knock-on impact. The interest subsidy, which was made available until the end of year 2009, subsidizes a 4 percent portion of the interest payments imposed on medium to long-term loans for two years. By the end of 2009, the government announced to extend the interest rate subsidy program but lowers the subsidy to 2 percent.

### **3.3 Impact on Economic recovery**

Together with the global recession bottoming-out, signs of economic recovery for Vietnam could be seen as early as August 2009.<sup>23</sup> As Tables and 3 indicate, industrial production and GDP growth picked up in the third quarter of 2009. Although the economic recovery is in large part due to the revival of external demand for Vietnam's export and FDI inflow, it is commonly believed that the policy adopted by the government worked in helping the economy through the recession. In order to assist the economy further, the government was even considering the second stimulus package. According to a report by GSO (2009), together with the recovery in other Asian countries, the prospect of Vietnam's economy was improving and some attributed such recovery to government stimulus policy.<sup>24</sup> While there has been wide spread agreement that the prompt introduction of the stimulus package provided quick protection for the economy, there remains some debate around whether or not package was able to target the most effective businesses and sectors and evaluating the effectiveness and efficiency of the government stimulus package is a daunting task in the absence of reliable data. Here we will only present patchy evidence of the effectiveness of the stimulus package.<sup>25</sup>

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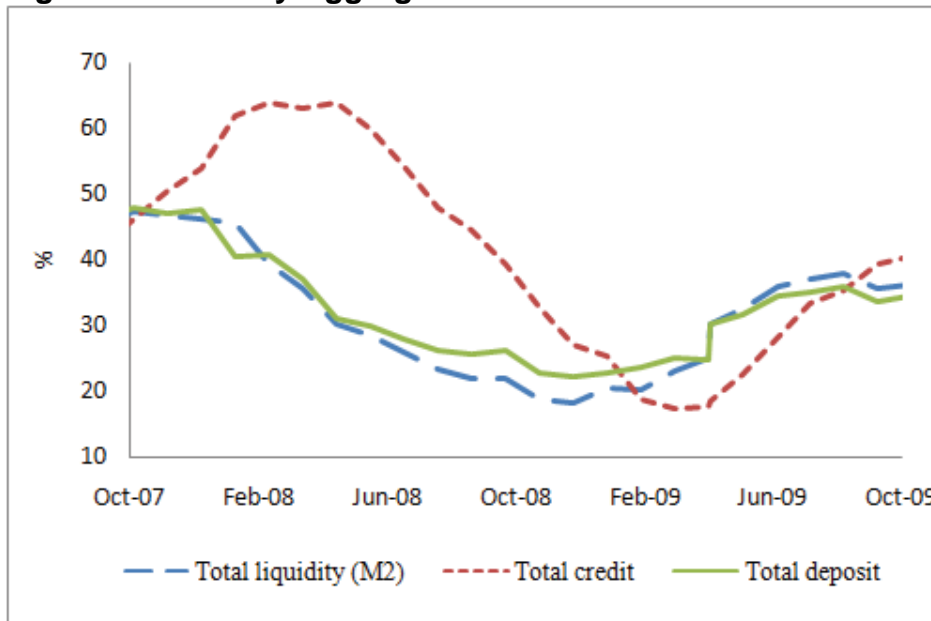
<sup>23</sup> <http://www.vneconomy.vn/20090828091054122P0C10/kinh-te-8-thang-buc-tranh-dang-sang.htm>

<sup>24</sup> <http://vneconomy.vn/20090901102716178P0C5/he-mo-kha-nang-tao-buoc-dem-cho-nen-kinh-te.htm>

<sup>25</sup> An overall and full assessment of the stimulus package may be necessary but falls outside the scope of this paper.

The most obvious impact of the stimulus package implemented by the government may be in keeping the credit to flow to the economy and assisting enterprises to clean up their balance sheet by replacing the high interest bearing loans with subsidized loans. This reduced the financial burden of borrowing by easing costs during a period of economic pressure and enabled businesses to maintain production and jobs. Spurred by the introduction of government interest rate subsidies, growth of credit and money supply accelerated in the first half of 2009. The growth of total liquidity (M2) increased to 35.8% in the second quarter 2009 from 20.3% in the fourth quarter of 2008.<sup>26</sup> As discussed above, the government also adopted an expansionary monetary stance to support economic activity. The growth of liquidity and credit, however, was relatively modest during the first quarter of 2009 due to some lag. As time passes, the economic activities get more and once the determination of the government to boost growth rates became clear, bank lending picked up again (See Figure 5).

**Figure 5: Monetary Aggregates**

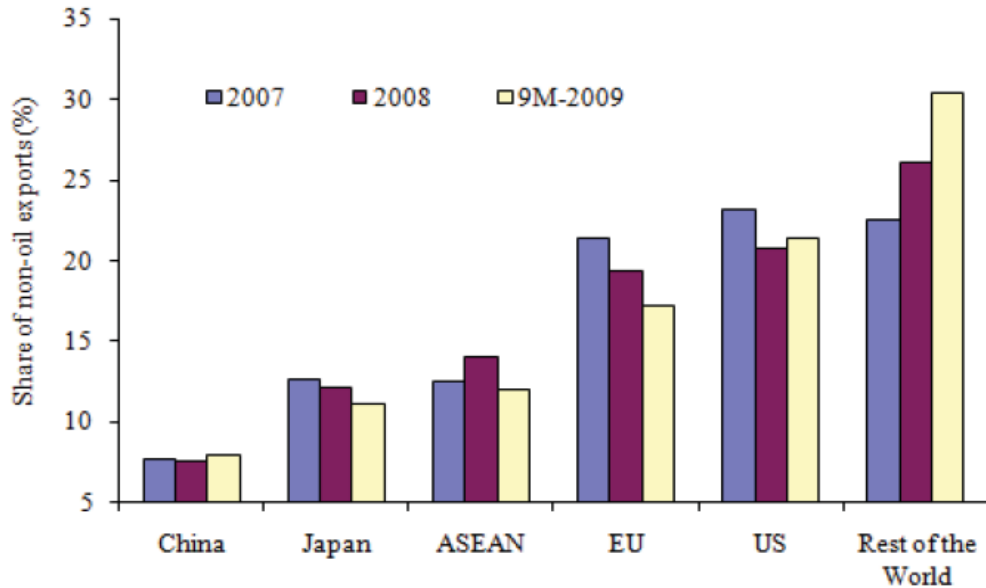


Source: SBV and IMF. Figures are year-on-year changes, in percent

On the other hand, only a limited number of enterprises can access to the subsidy program. According to a report by State Bank of Vietnam, only 20 percent of enterprises

receive support from the interest rate program. The rest face difficulty in accessing capital. The credit expansion has also led to rally in the stock market.

**Figure 6: Diversification of export market**



Source: GSO

Recognizing the importance of export in its economic growth performance, although details of the export promotion allocated from the stimulus package are not available, there are some indications that the government has increased its budget for export promotion, and directly assisted companies which have to lay off workers in such sectors as textiles, shoe-making and aquaculture.<sup>27</sup> As a result, the market composition of Vietnam's export shows a clear market diversification towards regions less adversely hit by the global crisis. As in previous years, in 2009 the United States remains the biggest importer, absorbing about a fifth of Vietnam's exports, and nearly 22 percent of non-oil merchandise exports. It is followed by the European Union, Japan and ASEAN countries. However, a distinctive feature of Vietnam's export pattern in recent years has been the sustained growth in the share of exports to other countries, including Latin America, Africa and the Middle East (Figure 6). Among industrial countries, the United States held better than others, reflecting an earlier and stronger recovery compared to

<sup>27</sup> <http://www.tuoitre.com.vn/Tiaynon/Index.aspx?ArticleID=302432&ChannelID=11>

the European Union and Japan. On the other hand, China's share remained fairly stable, in contrast with what has been observed elsewhere in the region.

There is evidence that the stimulus package helped mitigating the impact of the financial crisis on the part of the workers. In a recent study, Manning (2009) suggest that the impact on labour is milder than might have been expected for a country quite heavily exposed internationally and this can in part attributed to the timely stimulus package implemented by the government.<sup>28</sup> And the market for semiskilled and skilled workers recovered well after the Tet break (March 2009).<sup>29</sup>

Vietnam's agricultural sector employs more than two-thirds of the country's population and accounts for a major proportion of exports. And the sector has been hit hard by the global downturn. On April 2009, the government introduced a series of stimulus measures targeting the rural economy. The new policies include interest-free loans for purchases of farm equipment and subsidized loans for fertilizer and other agricultural inputs. However, the impact on the rural areas is very limited. For example, in the first stimulus package, farmers, who account for 70 percent of the population, were only able to access 880 billion VND (\$48 million) of credit, too small a proportion of the total package of of 400 trillion VND (about 22 billion USD) disbursed.

In summary, the stimulus package has been seen as a “rescue” remedy to help enterprises access loans to get back on track, remain in production and create jobs. The package made an important contribution to improving the liquidity of the banking system and maintaining debt payment. The package also provided some social protection to the vulnerable.

### **3.4 Public debt and Fiscal implication**

Although the decisive implementation of Vietnam's economic stimulus package is encouraging, the government's aggressive approach has also raised concerns about its

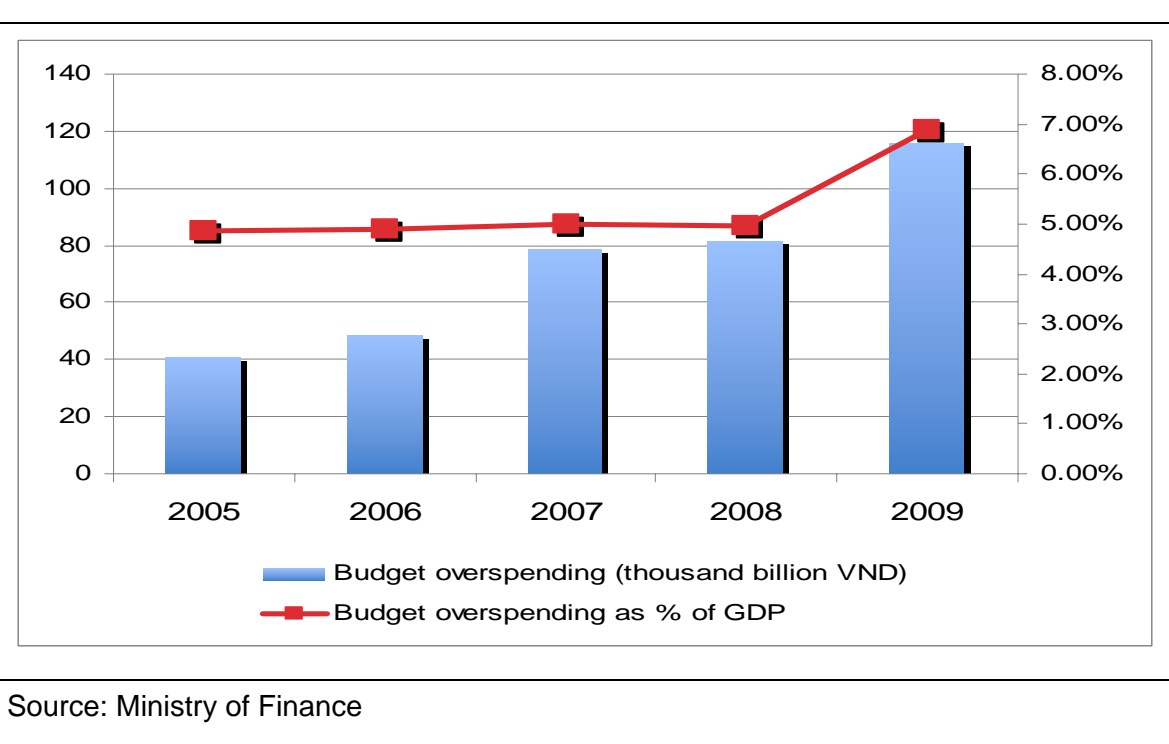
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<sup>28</sup> Other factors include the tight labour market before the crisis, the competitive nature of Vietnam's key exports and the private sector's capacity to compete globally despite cutbacks in the demand for key export commodities (Manning 2009)

<sup>29</sup> This is consistent with evidence from a rapid assessment survey conducted by VASS in May 2009 which found that there was evidence of green shoots with enterprises receiving orders and recruiting more employees.

impact on the public finances. Figure 7 illustrates the evolution of the budget deficit of Vietnam during the last few years. The government's operating expenditure has been rising more sharply than its tax revenue since 2000. Vietnam has a narrow tax base and only a small segment of the Vietnamese working group pays income tax as the majority of the working population are low wage earners. Besides, about 20% of the government tax revenue is derived from the oil revenue. According to the latest report issued by the Ministry of Planning and Investment, the State budget deficit in 2009 is expected to stay at 6.9 percent which is lower than the 8% percent forecasted in May.<sup>30</sup> However, the deficit in 2009 is much higher than the previous years. Vietnam's budget deficit in 2010 is expected to be 6 percent of the GDP, and according to a recent report by the Ministry of Planning and Investment (MPI), as high as 6.5%.

**Figure 7: Budget collections and expenditures**



In Vietnam, increasing government spending at a time of recession with contracting revenues poses complicated questions. The already-deficit national budget was being put under further strain by a marked reduction in revenue (lower revenue from lower

<sup>30</sup> This is partly due to the fact that revenue collection in 2009 was in excess of the planned revenue.

economic activities due to global crisis, lower crude oil royalties due to falling price). When the crisis hit in 2008, the national budget was already being put under strain by a marked reduction in revenue. In the recent past, crude oil royalties have been an important source of revenue (and export earnings) for the government as 16% of government revenue comes from oil export, but with global oil prices falling sharply from the highs that they reached in 2008, the government's revenue position is weak, leaving less scope for generous spending plans.

In parallel with the fiscal deficit, Vietnam also faced with the chronic current account deficit which many time led to balance of payment near-crisis in the last 2-3 years. The trade deficits and current account deficits have reached a level that is much higher than the commonly believed sustainable level of 5% of GDP. The continuing current account deficit was mainly driven by the growing domestic credit associated with the financing of the fiscal deficit, the increase in private consumption by households and an overvalued currency and a loss of competitiveness. As a results, some researchers (Pincus 2009) has argued that the policy options available for Vietnam's government are much more limited than those of China or other neighboring countries. While China and other Asian neighboring countries have maintained a surplus current account and sound fiscal balances, for several consecutive years Vietnam is plague with a twin deficit (a large current account deficit of 12% in 2008 and double digit fiscal deficit). Despite the fact that these deficits are in part the result of structurally necessary, medium-term investments they do give rise to economic vulnerability and raise questions of financial sustainability.

Countries	Public debt/GDP
Singapore	113.70%
Malaysia	42.77%
Thailand	42.00%
Indonesia	30.10%
Philippines	56.50%
Vietnam*	44.4%

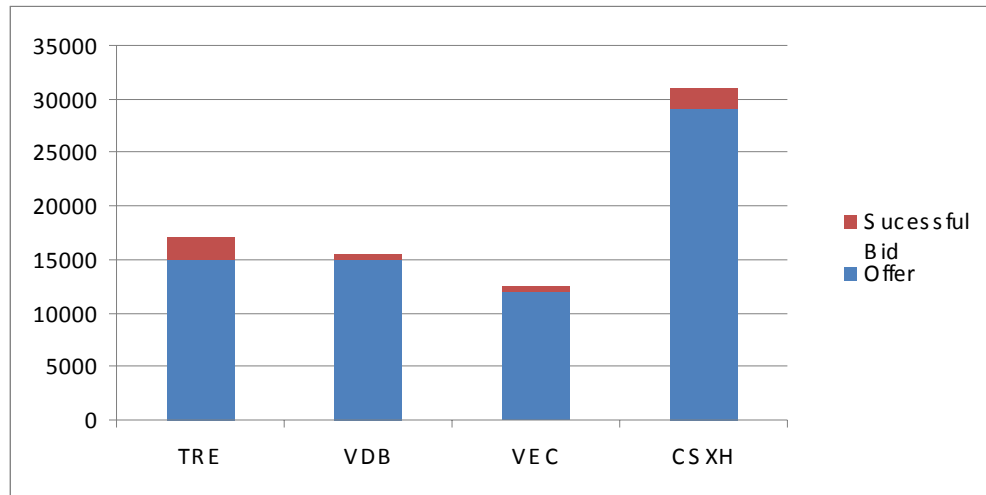
Source: CIA's World Fact Book, World Bank\*

Table 6 shows the public debt to GDP ratio for Vietnam and some of its neighboring countries. As the Table indicates, the level of public debt of ASEAN countries is relatively low (except for Singapore). Comparing with these countries, the level of public debt of Vietnam is quite manageable. The level of public debt, at 44.4% of GDP, is moderate and is considered to be sustainable. The indebtedness is similar to other ASEAN countries. Therefore we could expect that a moderate fiscal stimulus package would not cause serious fiscal impairment. Even though Vietnam runs a large fiscal stimulus program but in terms of % to GDP, the public debt is still manageable.

Some analysis done by the World Bank, however, suggests that there are rooms for fiscal policy implementation in Vietnam and the fiscal position of the country remains strong (World Bank 2009). The baseline scenario of the most recent Debt Sustainability Analysis (DSA) by the World Bank and the International Monetary Fund (IMF) estimates public and publicly-guaranteed debt to increase from 44 percent of the GDP in 2007 to around 51 percent by 2016, and decline slightly thereafter. There are two important aspect of Vietnam's debt: First, Vietnam government has a long history of prudent external debt and a large component of Vietnam's external debt is highly concessional with long repayment periods and low interest rates. Therefore, although this increase is large and significant it is still considered within manageable limits. External debt, both public and private, is projected to decline somewhat: from a little over 30 percent of GDP to just under 26 percent in 2017. The ratio of external debt service payments to exports is estimated to remain about 4 percent during 2007 to 2017. The DSA concludes that Vietnam should thus remain at low risk of external debt distress.

A question may be raised next is how the Government can fund the deficit. It is planned that the Government will issue VND 64 trillion worth of bonds in of 2009, and VND 6 trillion in 2010. However, the failures of recent bond issuances has shown that this is not currently an effective way for of capital mobilization in Vietnam. In an effort to raise additional funds for its stimulus package, the government has recently attempted to sell US\$1bn of dollar-denominated domestic bonds of various tenors in 2009. However, these efforts were barely successful with investors demanding higher yields than the government is willing to offer (See Figure 5).

**Figure 5: Freezing bond market**



Source: BIDV

In face of the government's growing need to secure additional fundings for its expansionary project, the official development assistance (ODA) takes on greater importance. This is especially true when foreign direct investment inflows and falling export earnings fall. On this front, the Japanese government has resumed its ODA for Vietnam, the Asia Development Bank granted Vietnam a budget-support USD 500 million and most recently, the government has secured an unprecedented level of ODA from international donors at USD 8 billion.

## V. Summary and Policy implications

1. In 2008, as the global financial crisis unfolds, the severe impacts have been felt on all continents including Vietnam. The economy is weathering the global economic crisis quite well thanks to the decisive, timely and determined policy responses. The experience in Vietnam points to the importance of strong fiscal policy to confront the falling aggregate demand due to the global economic downturn. Experience also shows that engineering a good stimulus package that is timely, well targeted and fiscally sustainable is not an easy task as shown by the still ongoing debates on the stimulus package. In retrospect, it appears that the government of Vietnam chose an effective mix



of stimulus measures. The rapid loosening of monetary policy, together with the first phase of the interest rate subsidy scheme acted as a “mass bail-out” for the frozen banking and credit sector and exemptions and deferrals of tax payments succeeded in preventing a more severe economic downturn. The interest rate subsidy has kept credit flowing to the economy, at a time when banks could have preferred to sit on their liquidity and avoid taking risks. It allowed the refinancing of enterprise debts contracted at very high interest rates, which could have led to numerous defaults in a context of rapid disinflation. And it boosted the profits of commercial banks, at a time when the deterioration in the quality of their portfolios and thin interest rate margins could have made them vulnerable.

2. Unlike other countries, Vietnam does not have modern social insurance mechanisms yet, thus lacking an important automatic stabilizer in the economic turbulent time. Instead, Vietnam had to rely on other mechanism such as cash transfers which is fraught problems.

3. While striking the right balance between stimulus and stability becomes more pressing, the macroeconomic debate should not relegate other key policy reform agendas to the backburner. There is a need to support economic activity and to preserve stability, and the government should strike the right balance between them. But there are also key structural reforms which are required to sustain long-term growth. The crisis highlights the necessity and offers the opportunity to tackle structural problems. The most important issues are boosting competitiveness and improving the environment for investment.

4. Despite all these short-term challenges, though, Vietnam's positive medium-term growth outlook still rests on a sound footing. This includes its young and relatively well-trained population which promises to yield a positive demographic dividend. Although there are some concerns about budget deficit and the debt sustainability, overall the fiscal sustainability of Vietnam is still within the manageable range.

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