PUBLIC INVESTMENT, PUBLIC DEBT AND STATE BUDGET SUSTAINABILITY

I. Overview of public investment, public debt and State budget sustainability

1. Public investment

Public investment generally refers to the use of state capital for investments aimed at fulfilling targets of public programs and projects in service of socio-economic development. Capital sources for public investment include: the state budget, state credit, ODA, revenues from taxes, fees and charges

Subjects of public investment: national target programs and projects for physical, technical, economic, social and environmental infrastructure, national defense and security development; national target programs and projects in service of activities of state bodies, non-business units, political organizations, socio-political organizations, including procurement and repair of fixed assets through non-business expenditure; investment projects of residential communities, political-social-professional organizations financed by state capital as per regulations of law; national target programs and other public investment projects as decided by the Government.

Role of public investment: public investment plays an important role in (i) speeding up industrialization and modernization, fostering economic development and ensuring social security; (ii) shaping and developing national socio-economic infrastructure; (iii) increasing agrregate demand; (iv) increasing aggregate supply and economic capacity; (v) kicking off investment, triggering and maintaining growth momentum; and (vi) generating jobs for the society.

2. Public debt

Public debt, in a broad sense, imply debt obligations of the public sector, including obligations of the central government, local authorities, central banks and independent organizations (those with operating capital subject to state budget decisions or having over 50% of state-owned capital and in case of default, the state must repay debt). In a narrow sense, public debt includes debt obligations of the central government, local authorities and debt of independent organizations with government guarantee.

Presently, depending on the economic and political institutions, the concept of public debt varies among countries. In accordance with the provisions of the law of

Vietnam, public debt is understood to include three groups as follows: government debt, government-guaranteed debt and local government debt.

Public debt classification

There are many criteria for public debt classification; each has different a meaning in management and utilization of public debt. General criteria for public debt classification include the following:

- *By geographical origins of capital*: Public debt consists of two categories: domestic debt and foreign debt.
- *By capital mobilization modality:* Public debt consists of two categories: public debt from direct deals and public debt from debt instruments.
- *By preferential nature of loans incurring public debt*: there are three types of public debt: Public debt from ODA loans, public debt from concessional loans and conventional commercial debt.
- *By liability for creditors*: Public debt is classified as public debt in need of payment and public debt with government guarantee.
- *By debt management levels*: Public debt is classified as public debt of central government and public debt of local authorities.

Public debt characteristics

There are various approaches to public debt. Basically, however, public debt has the following main characteristics: (i) Public debt refers to the binding debt repayment of the state; (ii) Public debt is managed in accordance with closely interconnected procedures with the participation of competent state bodies; and (iii) The ultimate goal of mobilization and use of public debt is to support economic development for the benefit of the community.

Public debt nature

Naturally, public debt refers to loans to finance budget deficits. These loans will require the repayment of principal and interest when due, and the state will have to increase taxes for compensation. So, ultimately, public debt just gives one the option to choose whether to tax today or tomorrow, whether to tax this generation or the next. Debt borrowing essentially refers to gradual taxing, which is widely used by governments to finance increased government spending. The ratio of public debt over GDP reflects the safety or risk of public debt only partially. The level of safety or danger of public debt not only depends on the ratio of public debt over GDP but, more importantly, on the level of development of the economy.

3. State Budget sustainability

Budget sustainability refers to the status of the state budget always being capable of providing the state with efficient financial tools; revenues, expenditures and debt of the state budget are all controlled proactively by the state in any circumstances; and the state is never pushed into bankruptcy, instability, and/or threatened in its financial security either in the short term, medium term or long term.

Criteria for evaluating budget sustainability cover important aspects which are closely interrelated, including: solvency, liquidity, vulnerability, ensuring sustainable growth, stability and fairness.

II. Status of public investment, public debt and state budget sustainability in Vietnam

1. Status of public investment

Public investment in Vietnam is generally referred to investment from capital sources of the state, including development investment funded through the state budget, government bonds, state credit, ODA, development investments of state-owned enterprises (SOEs) and other state capital sources. In line with the strong development of the country in recent years, total social investment capital has steadily increased. Public investment has accounted for a relatively large proportion of total investment and has proven to play a very important role in socio-economic development.This is particularly reflected in the following facts: public investment has had an important contribution to maintaining and promoting economic growth; public investment has contributed to infrastructure development; public investment has proactively ensured social security; and public investment has made a significant contribution to macroeconomic stability.

However, actual performance of public investment in Vietnam is still subject to many constraints, leading to low efficiency, waste and loss of state capital. These constraints can summarized as follows: investment mechanisms have not been reasonable and effective; investment has soared for many years, causing substantial budget deficit; low investment efficiency has been due to a lack of rationality in the structure of investments, the protfolio spread of investments, low construction quality, slow and delayed construction progress, lack of transparency regarding information about investments and weak accountability, together with chronic corruption and high waste of investment resources.

The above-mentioned limitations stems from several causes, notably including the following reasons: investment decisions go beyond the capacity of the economy, leading to scattered investment, repeated delays; an asymmetric investment structure results in a lack of synergies; lack of close and effective monitoring and supervision of investments; operation and maintenance with regard to infrastructure funded by the state budget lack behind the level of investment; lack of proactive execution of major macro balances in the economy; planning, particularly investment planning, fails to accommodate regional strengths and advantages; decentralization of investment management is exposed to various problems, including a lack of corresponding capabilies at the management level.

2. *Status of public debt*

In recent years, Vietnam's public debt has increased rapidly both in absolute terms as well as in terms of the ratio of public debt over GDP. According to data from the Ministry of Finance, if in 2006, public debt accounted for 44.5% of GDP, then in 2012, the debt increased to 55.7% of GDP. At the same time, foreign and domestic debt have tended to increase; the successful issuance of government bonds together with attracting ODA from external sources has led to an average increase of 43% in total government debt in the last 3 years.

Although in Vietnam the rate of public debt remains under control, it is still too high compared to the average level in developing economies. Besides, the use of public debt in Vietnam is not efficient; delays in the disbursement of investment capital from the state budget and government bond funds take place quite often. There remains a lack of effort and determination to overcome the status of slow and delayed construction progress. These constraints, together with a lack of financial discipline in public investment and in the operation of SOEs and large business corporations results in scattered investment, waste , loss of investment capital at all stages of the management of investment projects. All of the aforementioned limitations have exposed Vietnam to numerous risks in the management of public debt, notably including the following:

- The percentage of Vietnam's public debt has tended to increase, both domestic debt and foreign debt, at 5-7% of GDP per annum. With the current growth rate of public debt, it is estimated that after 5 years, Vietnam's public debt will exceed 100% of GDP and at that time, a debt crisis may occur;
- The volatility of interest rates and exchange rates toward a depreciation of the Vietnamese Donghas created pressure on interest rates for domestic debt and pressure on exchange rate for foreign debt;

- The international monitoring capability on the safety of debt through the monitoring indicators of Vietnam has remained low given the fact that state budget accounting has not been standardized and publicized;

- Lack of transparency in public debt information;

- Vietnam has just only paid attention to mandatory debt management, but not hidden debt management

3. Relationship between public investment, public debt, and state budget sustainability

According to the current regulations of Vietnam, public investment and public debt are closely related. Specifically:

- The State budget shall be balanced on the principle that the total revenue from taxes, charges and fees must be larger than the total regular expenditures and should accumulate more and more funds for spending on development investment; eventually the balance between budget revenue and expenditures shall be achieved.

- The state's budget deficit shall be funded from domestic and foreign sources. Borrowing to make up for the state's budget deficit must comply with the principle that they must not be used for consumption, but only for development purposes and it must be ensured that the budget arrangement include an initiative to repay all debt when due.

- In principle, the local budgets shall be balanced with the total expenditures not exceeding the total revenue. Where provinces or centrally-run cities need to invest in infrastructure projects which run under the scope of the provincial-level budgets and are on the list of investment projects in the five-year plans already decided by the provincial-level People's Councils, but are beyond the balance capability of the provincial-level budgets in the estimation year, they shall be allowed to mobilize domestic capital but must balance the annual provincial-level budgets so as to take initiative to repay all debt when it is due. The debit balance from the mobilized capital source must not exceed 30% of the provincial-level budget's annual investment capital for construction. .

III. Recommended solutions for efficient use of public investment, public debt and improved budget sustainability

There are various ways to improve the efficiency of public investment, ensure public debt safety and enhance state budget sustainability. However, comprehensive solutions must include the following elements:

Economic restructuring

Restructuring the economy is directed towards in-depth development, providing moreadded value for the economy through ensuring sustainable development of infrastructure, human resources and finance. Promoting internal resources of the economy and increasing domestic savings aims at gradually reducing excessive dependence on foreign capital inflows. This solution is the basis for increasing budget revenue, meeting expenditure needs for development investment and reducing the risks associated with decreased foreign investment inflows and global volatility of interest rates and exchange rates, etc.,. It is also necessary to restructure SOEs that fail to operate efficiently. Gradually reduce the economy's dependence on bank loans and foreign investment capital. Onlyrestructuring the economy and improving growth quality can help Vietnam to sustain high growth in the future.

Public investment restructuring

Restructuring of public investment and diversification of investment capital sources aim to improve the investment efficiency for society. The public investment policy must primarily serve to promote and support sustainable development and enhance the quality of life and welfare for everyone. Restructuring of public investment should not only target high growth rates based on reduced public investment but also aims at the harmonious combination of economic development and better assurance of justice and social progress, including the rational use of land and water resources, protection of the environment, and ensuring sustainable development.

In the restructuring of public investment, it is necessary to increase investment in the development of services for agricultural production, consumption of agricultural products, science and technology, education and health; to reduce the provision of the state budget for state corporations and business groups; to refocus public investment to invest in infrastructure and social development. At the same time, there should be a strong determination not to carry out investment projects that fail to meet criteria of socio-economic efficiency and to focus budget resources on projects that demonstrate the ability to be completed within deadlines and that exert a high level of efficiency. Furthermore, the number of public investment projects funded through the state budget that are big in scope and require long-time investment but are not urgent should be reduced. It is important to stress that strict control of public investment is important to help reduce budget deficits.

Development and implementation of a debt management strategy

The development and implementation of a debt management strategy should clearly state purpose and scope of tools and activities as well as a long-term perspective in debt management. At the same time, it is necessary to inspect and monitor closely the implementation of the strategy and the execution of debt management policies, including the development of a debt limit and the monitoring compliance with the set limits. The strategy must focus on the risk management of debt portfolios, including currency risk on loans, interest rates, exchange rates, liquidity and operations. It should also include an analysis of debt sustainability to propose appropriate responses. Debt management tools should be divesified through continued development of the secondary market in order to enhance the ability to manage risks through derivative transactions. Debt management organizations need to be restructured to gradually strengthen and promote the role of debt management so that they are capable of uniformly managing domestic and foreign debt.

Improving transparency, publicity and enhancing public accountability in the use of public resources

Improvement of transparency, publicity and public accountability with regard to the use of public resources would require the following: (i) Expand forms and contents of publicity; enhance accountability and overcome the current situation of formalistic publicity; (ii) Enable people to have access to information on principles, objectives and orientations of fiscal policy as well as data relating to the state budget. This should expand and enhance public policy consultation and discussion by communities and society; (iii) Enhance oversight responsibilities of the National Assembly for national key projects, of the People's Council with regard to investment projects in the locality; and (iv) Strengthen community supervision, improving mechanisms for people to check and monitor activities relating to budget, land and property of the state.