Viet Nam: Improving Public Expenditure Quality Program

MANAGING FISCAL RISKS OF SUBNATIONAL BORROWING

50 YEARS

ADB

This brief summarizes the findings of policy advice prepared by the Asian Development Bank (ADB) for the Viet Nam Ministry of Finance (MOF) to support improvements in subnational public borrowing and debt management.

Fiscal Decentralization in Viet Nam

The implementation of fiscal decentralization in Viet Nam since the late 1980s has resulted in local authorities now controlling more than half of total government spending, and 60% of capital investment (Figure 1).

The State Budget Law (SBL), revised in 2015, has continued this process of decentralization by enhancing provincial responsibilities for borrowing and debt management. This has included allowing provincial governments to officially record budget deficits, expanding their ability to source funding from municipal bonds and commercial borrowing, and requiring provinces to take a larger share of responsibility for repaying official development assistance (ODA) and concessional loans mobilized by the national government on their behalf. At the same time, the 2015 SBL has relaxed provincial borrowing ceilings, putting in place a tiered system that allows (i) major cities to have accumulated borrowing of up to 60% of their retained local revenue, (ii) provinces that do not rely on central government balancing transfers for their recurrent expenditure (surplus provinces) to have outstanding loans up to 30% of their retained local revenue,[1] and (iii) provinces that do rely on central government balancing transfers for their recurrent expenditure (deficit provinces) to have outstanding loans up to 20% of their retained local revenue.

Consequently, since 2015, provincial borrowing and debt stocks have begun to grow. Between 2015 and 2017, total outstanding debt owed by provincial governments is expected to double to about $3.5 billion (Figure 2). These amounts remain relatively small against total national public debt levels of about $115 billion. However, further growth is expected. The government's Medium-term Debt Management and Borrowing Repayment Plan, 2016–2020 forecasts provincial government debt to reach $8.2 billion by 2020, a fivefold increase on their 2015 level.

While the devolution of public debt management has the potential to enhance accountability for how borrowed funds are used to lift service delivery, if not managed well, it also has the potential to create a build-up of fiscal risks. Ensuring provincial governments have the knowledge and systems to effectively manage and coordinate their new public borrowing responsibilities will be vital to avoid a buildup of liabilities and ensure reforms have their intended impact and are sustainable.

Key Issues

Several factors currently constrain the ability of provincial governments to effectively execute their new public borrowing and debt management powers. These include:

Incomplete regulations. The national government still has incomplete regulations to guide provincial debt management responsibilities. Revisions to the 2015 SBL and the Public Debt and Asset Management Law in 2017 provide high-level guidance on their new borrowing powers. Detailed guidelines are needed so that provincial governments know how to implement their new responsibilities, especially in preparing medium-term and annual debt borrowing and repayment plans; standards for consolidating and disclosing of provincial debt information; processing steps for mobilizing resources through onlending from the national government, municipal bond issuance, and commercial bank borrowings; and management of state infrastructure assets created by public borrowings.

Fragmented subnational debt functions. Adding to the challenge of subnational debt management is that responsibilities are split across various agencies. Provincial debt management roles are split between the Departments of Planning and Investment who oversee foreign debts including ODA, and Departments of Finance (DOFs) who monitor domestic debts accumulated through municipal bonds, state development banks, and the State Treasury. DOFs also monitor provincial government guarantees to state enterprises and development funds—but guarantee information is rarely included in provincial debt records nor consistently reported to national government. In most provinces' borrowing, disbursement, and repayment information collected from these various entities is managed through a system of spreadsheets with few checks and controls over data quality or consistency.

Varying levels of debt management capacity. Varying levels of staff capacity and weak debt management systems within provincial governments are also a major constraint. Through various arrangements with the central government, Viet Nam's largest four to five major cities have been undertaking public borrowing for many years and so have reasonably well developed debt management systems. In contrast, the remaining provinces that rely on state budget balancing have little to no experience in mobilizing or managing public debt. For most provinces, their main experience has been through the management of ODA and concessional loans, which have typically been fully on-granted to them by the central government and so have not required significant financial resources of repayment other than counterpart funding allocations. These provinces now need to develop the staff skills and

[1] The two large provinces of Hai Phong and Da Nang have subsequently been granted exemptions from this rule, allowing them to mobilize debt up to 40% of retained domestic revenue.

A banker assists his client at a Viet Nam commercial bank.

debt management systems required to ensure borrowing remains within sustainable limits and to maintain adequate cash flow to ensure timely repayment.

Lack of legal framework for direct borrowing from commercial banks. While the 2015 SBL legally allows provinces to borrow directly from commercial banks, several important impediments exist. Banks are often reluctant to finance local government projects as they view lending for infrastructure as too risky. There is an absence of legal recourse mechanisms for nonperforming loans against provincial governments and Viet Nam's limited capital base means substantial maturity mismatches exist between short-term deposits and the long-term financing needed for infrastructure projects. When past projects have been financed, it has often because commercial banks assume (rightly or wrongly) there exists an implicit guarantee by central government. Further, the continued heavy presence of state-controlled commercial banks in Viet Nam's financial sector creates opportunities for conflicts of interest to emerge.

ADB, through its Improving Public Expenditure Quality program, has provided policy and technical assistance to address critical public financial management weaknesses, increase the efficiency of public expenditure, and improve infrastructure and services for the people of Viet Nam since 2014.

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Reform Priorities

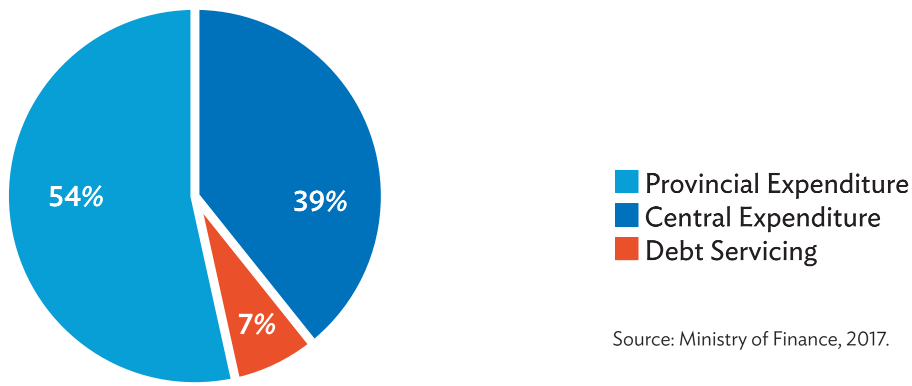
Upgrade national regulations guiding provincial debt management. Incomplete regulations guiding provincial debt management responsibilities need to be addressed. As a first step, this will include detailed guidelines by the national government on how to prepare medium-term debt management plans. Over time, support will also be required for clarifying ODA and onlending policies, commercial bank borrowing processes, procedures for municipal bond issuances, provincial debt reporting processes, and management of provincial state infrastructure assets created by public borrowings.

Strengthen capacity and systems for provincial debt management. At the same time as regulations are being upgraded provincial governments also need to strengthen their own staff capacity to manage public borrowing and repayment. Based on the requirements of the 2015 SBL and Public Investment Law (2014) provincial governments will now have to (i) prepare medium-term debt management plans that link provincial public investment plans and fiscal policies, (ii) strengthen intergovernmental coordination for provincial public debt information by improving debt reporting and recording systems, and (iii) upgrade their own provincial regulations on public debt management.

Manage subnational public debt information. To ensure national government can maintain tight control of total public borrowing, it is essential that a disciplined, transparent, subnational borrowing recording system is put in place. Exactly which debt information management system is most appropriate for Viet Nam's needs will require further analysis, but as provincial borrowing grows, the existing system of spreadsheets will not serve this purpose. Detailed guidelines are also needed to inform the consistency of provincial government debt management information to ensure that provincial government are using the same financial assumptions when calculating repayment needs, debt and borrowing limits, and cash flow forecasts. A well-developed debt information management systems would also help to track and report against a range of subnational debt metrics including—total debt to revenue, deficit-to-revenue ceilings, and debt service to expenditure or revenue ceiling—to monitor repayment capacity and verify that certain provincial governments are not increasing their deficit to revenue to receive subsidies or paying unsustainable interest expense charges to service their debt.

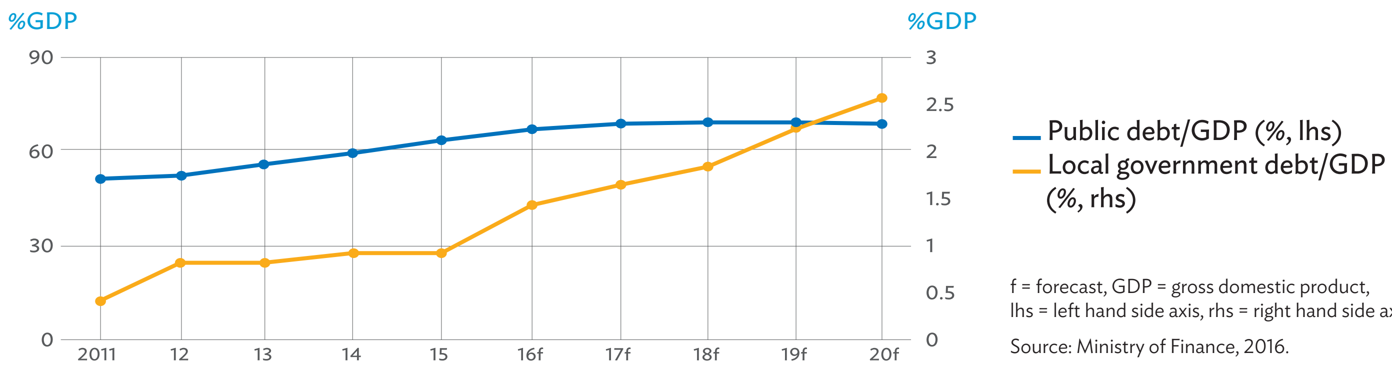
Develop stronger legal basis for commercial bank borrowing. Legal upgrades are needed to provide a clear legal framework for banks to handle default or insolvency by provincial governments that considers the interests of all parties. The legal framework should include the enforcement of budget constraints as well as mechanisms for renegotiating or liquidating the outstanding provincial debt. Ideally, new regulations should include a provision that acknowledges commercial bank loans as "lawful financial sources" for borrowing by provincial people's committees. Commercial banks should be free to determine the risk premiums for different provincial governments, based on a comprehensive risk management review process with credit quality of the borrower and bankability of the projects driving their credit decisions.

Figure 1: Composition of National and Provincial Expenditure (2017), % total expenditure



Source: Ministry of Finance, 2017.

Figure 2: Public Debt and Local Government Debt, 2011-2020



f = forecast, GDP = gross domestic product, lhs = left hand side axis, rhs = right hand side axis.

Source: Ministry of Finance, 2016.

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