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Original Article

Twin Deficits in Vietnam: Signs of Return and Some Recommendations

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Abstract: When a country's current account and government budget run into deficits at the same time, the country's economy falls into a twin deficit. The current account surplus since 2011 has helped Vietnam temporarily get rid of a twin deficit continuously for many years. The appearance of a scattered current account deficit from 2015 to now signals the possibility of a return of a twin deficit. This is seen more clearly when analyzing the imbalance of savings and investment, economic crisis and exchange rate movements in the market. The paper makes a number of policy recommendations to prevent the return of a double deficit, limit its negative effects, and promote macroeconomic stability in Vietnam.

Keywords: Twin deficits, current account, the government, Vietnam.

1. Introduction

To assess the overall health of an economy, it is necessary to consider general macroeconomic indicators, such as economic growth, inflation, exchange rates, interest rates, savings, and investment, etc. These indicators are correlated with each other and directly affect two important indicators: the State budget (SB) and the current account balance (CA). The State adopts policy tools to run the economy, and affect economic indicators. In the long term, all governments aim to achieve a current account surplus and balance the State budget. However, in fact, a ctate budget deficit (GBD) and current account deficit (CAD) are quite common in many countries.

A continuous large CAD is the cause of a macroeconomic imbalance, while the government budget is also the main cause of

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changes in economic variables, both of which have a great influence on the development process of the economy in the long run. GBD entails the increased risk of inflation and interest rates. Rising interest rates affect capital inflows, increase the exchange rate, and depreciate the local currency, increasing import demand and reducing export demand. On the other hand, expansionary fiscal policy causes a government budget deficit, and at the same time increases inflation, leading to an increase in the value of domestic goods relative to foreign goods, which is also the cause of increasing import demand, reducing exports and reducing export demand, leading to a deficit in the CA. The CAD causes the country to reduce foreign assets or increase the risk of borrowing from the rest of the world to finance new investment by selling fixed assets and financing. Therefore, a continuous CAD will cause the country to increase its net external debt, leading to a GBD. The CA and the government budget share a deficit, called a TD (TD), creating a big challenge and increased pressure for the government of each country to stabilize the macroeconomy.

In the world, there have been many in-depth studies on this phenomenon in order to find out the type of TD, the causes and the way to minimize the negative impacts that it causes to the economy of each country such as India, Malaysia, the United States, European countries, etc. In Vietnam, there have been a number of research papers discussing this issue. Dan (2014) believes that in Vietnam, the GBD increases investment demand and increases import demand, leading to a trade balance deficit, and reducing the current balance of payments. This inevitably results in leading to a TD. Trinh et al. (2013) have empirically analyzed the case of Vietnam to show that the only relationship is the current account deficit leading to fiscal deficit in Vietnam. Huong (2016) did a regression with panel data, showing that the unsustainability of the current account in Vietnam, and the current account situation in other countries in the region, stem from national spending and budget deficits. Based on the relationship between the CAD and GBD of Vietnam, the aforementioned studies propose long-term macro solutions to limit the negative impacts of a TD on the economy.

A TD occurred continuously in Vietnam from the time of opening up the economy up to 2011 and was especially serious in the period 2006 - 2009. After 2011, the CA turned to surplus, while the GBD continued to increase rapidly. However, previous studies have focused on analyzing the situation of Vietnam having a TD before 2011. In the context that Vietnam has escaped from a TD since 2011, there are some signs showing that there is a need for in-depth research to assess this risk and then propose some solutions to neutralize the risks.

The subjects of this study are the CA, and GB of Vietnam and the signs indicate that TDs are at risk of returning to Vietnam. The research focuses on analyzing the data and developments of the Vietnamese economy in the period 2015-2022, since the CA deficit reappeared.

2. Twin deficits and classification

In terms of formality, when the government budget and CA are both negative, it is called a TD. In terms of content, a double deficit is divided into 4 types depending on the correlation between the two types of accounts.

2.1. One-way impact from CAD to government budget

When the CA runs a deficit, the economy operates based on borrowed resources from abroad. When a country receives support from abroad to develop its economy, it encounters the risk of a GBD. In fact, when countries experience an economic crisis, a financial crisis or a solvency crisis that is caused by the CAD, governments will have to use a large part of the budget fund to restore the financial system, improve the corporate governance system and reverse the recession. Thus, a CAD makes the economy grow at a slower rate, leading to an increase in the GBD.

For developing countries, whose small economies are open, the economy’s development is highly dependent on foreign direct investment and other foreign investment flows. This type of TD is more likely to occur in developing countries than in other countries. If the country uses fiscal policy to balance public expenditure, when public expenditure is in deficit, government spending will increase and tax revenue will decrease, slowing the economy's growth and increasing the GBD.

The Malaysia case study of Pual et al. (2006) shows a negative causal relationship from the current account to the state budget. Constantine (2014) studied European countries and found that there exists a causal relationship running from a trade deficit to a State budget deficit in the condition that a free trade equilibrium is not really achieved.

2.2. One-way impact from GBD to CAD

When the government budget is affected by an increase in public spending, it will lead to an increase in domestic income, stimulate import activities, and contribute to the deficit of the CA. Looking at formula number (1), according to the theory of John Maynard Keynes:

$$S_P - I = CA - GB \quad (1)$$

$$CA = (S_P - I) + GB$$ [1]

If the government budget is in equilibrium (GB = 0) then a tax cut or an increase in public spending will lead to $G > T$ or $GB < 0$, a decrease in public saving and then a decrease in national saving. Insufficient savings for domestic investment is a favorable condition for a wave of foreign direct investment (FDI) flowing into the economy, leading to a decrease in the exchange rate, stimulating imports, and reducing exports, exacerbating the status of the CA.

According to the Mundell-Fleming theory, an increase in the GBD in both the case of a fixed exchange rate and a floating exchange rate results in a more serious CAD.

Studies on TDs have been carried out since the 1980s in many countries around the world. Jayaraman (1993) pointed out that the nature of TDs in Vanuatu is that the choice of fiscal policy should prioritize recurrent spending or development spending will affect CA trends. Afonso (2022) studied panel data of 65 countries showing that the persistent global current account imbalance is caused by the state budget deficit related to fiscal policies.

2.3. Two-way impact between CAD and GBD

When the situations analyzed in 2.1 and 2.2 occur at the same time, there is a two-way effect between CAD and GBD. When the government budget is in deficit with a volatility greater than the change in the difference between private savings and investment, it will directly affect the CA, causing this account to be in deficit. In other words, the indirect GBD through interest rates and exchange rates will have a negative impact on the CA. The government needs to take measures to limit the increase in the CAD. The Government then increases public spending, making the GB worse. This process will continuously take place, forming a circle of impacts between the two balances.

In a 2016 study for the Indian market, Banday and Aneja (2016) concluded that there exists a two-way and long-term relationship between the two accounts and that exchange rates and inflation also affected TDs in India. Karras (2019) also showed that this two-way relationship existed when analyzing data for 17 countries. Experiments show that it takes a small amount of current account change to lead to a change in the government budget, while it takes a larger amount of state budget change to affect the CA change. The asymmetry in the impact dimensions will be seen more clearly in periods of crisis and war. Similarly, Rajakaruna (2021) also showed the existence of a 2-way causal relationship between the GBD and the CAD in South Asia, through data analysis of 5 countries.

[1] GB stands for Government Budget, CA for Current Account, S_P for private savings, I for domestic investments.

With their research results, the authors disagree with the view of "only applying fiscal policy" to solve the double deficit, but there is a need to implement measures to encourage trade at the same time.

2.4. No correlation between CAD and GBD

In cases where government spending is stable over a long period of time with tax funding, with years of tax revenue exceeding expenditure, the government will lend; conversely, when tax revenue is less than expenditure, the government has to borrow. Thanks to a stable spending curve over the years, the Government can forecast a reasonable tax rate for the future. When the Government decides to cut taxes, it is forced to use the money from borrowing to cover the budget deficit. When the Government decides to raise taxes, the extra money will be used to pay for the bond yields of Government loans. In addition, in the private sector, current and future disposable income both affect current consumption decisions.

Under perfect conditions with the above hypotheses, if the Government cuts taxes, it will reduce government budget revenues, reduce public savings due to stable expenditure, and government budget deficits. However, tax cuts help increase private savings, as people decide this path based on current circumstances and future expectations; they think current tax cuts will need to be offset in the future by increasing tax rates, so they increase their savings to prepare to pay the increased tax in the future. When considering the sum of the two dimensions, the effect of reducing public savings and increasing private savings is not affected. Thus, the government budget deficit does not affect national savings, thereby not affecting the capital structure.

On the contrary, when the Government cuts taxes, the real income of people increases and the demand for imports also increases. People think that in the future, taxes will increase, the opportunity to buy imported goods will decrease, so people focus on importing right now, making the CA tend to go into deficit. Since the tax delay is temporary, the increase in import demand is also short-term in the private sector. The deficit in the public sector slows down economic growth, but tax cuts encourage investment and economic growth. The sum of the two effects is that the economy is stable in the short term, so it does not affect the GB. Thus, the CAD does not affect the GBD.

The above hypothesis is known as the Ricardian effect by Barro (1974) and developed by Buchanan (1976).

Bon (2014) pointed out that a TD appears in 10 Asian countries, but the CAD and GBD do not have correlation. The authors Suchismita Bose and Sudipta Jha (2011) have compiled the results of the TD study of some previous studies to serve the Indian case study. Statistics have shown that the nature of a TD in different countries is not the same, or in an economy but over different periods is also different.

3. Signs of a twin deficit return to Vietnam

Trinh et al. (2013) have shown that for the Vietnamese market, the only causal relationship is the current account deficit leading to a fiscal deficit. In the study of Anh (2018), through the results of the Granger causality test in the VAR model with 60 observation periods, the author has found a type of TD in Vietnam that has an impact from the CAD to the GBD. This is a common type of TD when economies face a crisis, or economies are strongly influenced by foreign investment flows. Vietnam's economy has both of the above characteristics. In the 2018 study, the author forecast that although the CA had a surplus since 2011, there was a tendency to reduce the trade surplus, which will gradually return to a deficit in the near future. Besides, the government budget continued to overspend and could not be balanced soon. The situation of TD was at risk of returning to Vietnam soon after 2015. Observing developments in the Vietnamese market in the period 2015-2022 shows some signs of a TD returning to Vietnam in the near future:

3.1. CA continuously changes direction, GB continues to be in deficit

The fact shows that after a short period of surplus, the trend of the CA in Vietnam has not been stable since 2015 until now (Table 1). The trade surplus is thanks to Vietnam's efforts to join FTAs, especially after 2018 when Vietnam signed the EVFTA with the EU. In the period 2018-2020, interest rates in Vietnam were lower than before, supporting production activities, promoting imports and exports, and increasing the trade surplus.

The year 2020 will record Vietnam's outstanding results in the fight against the COVID-19 pandemic. When the whole world was delayed because of COVID-19, Vietnam still conducted strong production and exports, filling the market gap, and creating a large export surplus. In early 2021, the disruption of the global supply chain negatively affected Vietnam's import, production, and export activities. In the second half of 2021 and the beginning of 2022, Vietnam witnessed the strong devastation of COVID-19 in all fields of health, society and economy. COVID-19 prevention policies were continuously issued and adjusted, production activities were disrupted, and the economy declined, and these were the main reasons leading to the large CAD.

Table 1: CA and GB in Vietnam, 2015-2022

Year	CA* (Billions of USD)	GB** (Billions of VND)
2015	-2.04	-190,940
2016	0.63	-161,070
2017	-1.65	-136,962
2018	5.77	-153,110
2019	12.17	-161,491
2020	15.06	-216,406
2021	-7.19	-286,487
2022	1.13	-372,900

Source: *IMF (2023),
**Vietnam Ministry of Finance (2023).

Regarding the GB, the deficit has tended to increase clearly and rapidly (Table 1). Especially in the period of 2020-2022, there was a sudden increase in government budget expenditure compared to government budget revenue. This was a difficult period when Vietnam had to fight the COVID-19 pandemic with health measures and policies to subsidize people and businesses, etc. This directly increases the GBD.

3.2. Imbalance between savings - investments

In formula (1), where Sp – I is the net savings of the private sector, the GB (government budget) is the net savings of the Government sector. Thus, when the CA is in deficit, it reflects a negative national net saving, which means that the investment rate is higher than the saving rate. The low savings rate with the high investment rate shows that Vietnam's economy is dependent on foreign investment capital since domestic savings have been mobilized for investment.

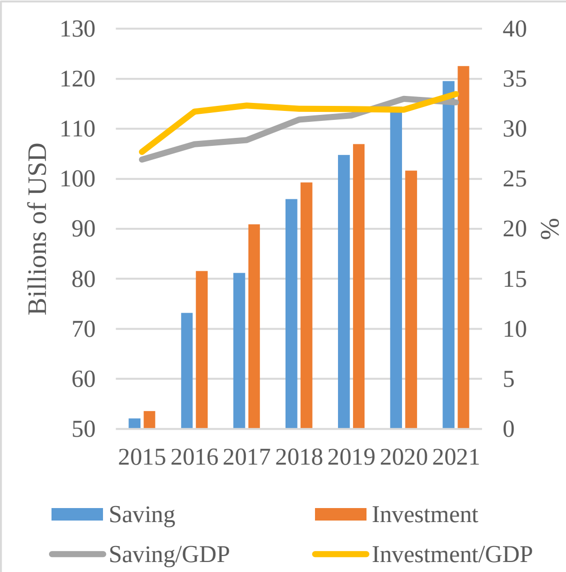

Figure 1: Difference between savings and investments in Vietnam, 2015-2021
Source: Data of World Bank (2023).

In the context of the increasing inflation and macroeconomic instability in the years 2015-2022, the nascent and weak financial market led to a smaller net savings contribution from the household sector compared to capital sources flowing into investment activities (Figure 1). At this time, the market witnessed asset bubbles such as securities, real estate, and corporate bonds because the State Bank could not regulate the sudden increase in cash flow from the surge in foreign investment inflows. The asset bubble stimulated consumption in the population, reducing net savings. Besides, businesses always require a large amount of investment compared to saving, especially for developed countries. With the Government's policies to stimulate economic growth, the scale of credit loans for businesses has continuously grown. However, loose control policies, weakness in banking operations and a short-term investment psychology, etc. have resulted in a series of inefficient businesses falling into bankruptcy. Investment efficiency is absent, while net saving is negative.

3.3. Imbalance in roles between economic sectors

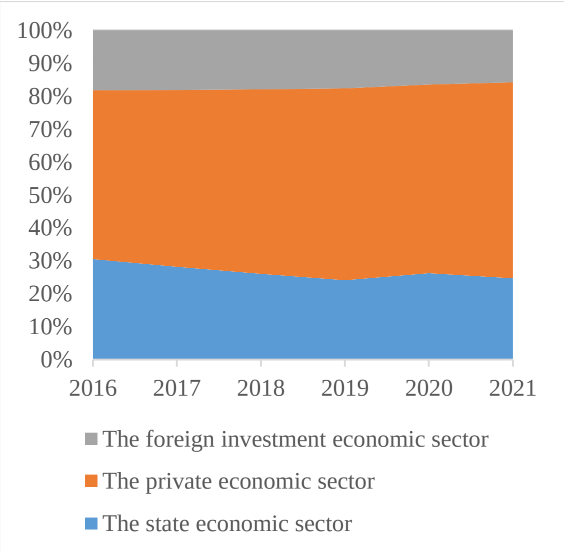

Figure 2: Investment capital for social development by economic sectors, Vietnam, 2016-2021
Source: Data of General Statistics Office (2023).

Vietnam's economic sector is divided into the state economic sector, the private economic sector, and the foreign investment (FDI) economic sector. The FDI sector played an important role in improving the CA in the 2011-2021 period, helping Vietnam have many years of trade surplus. This is an area that has received support, incentives and development policies (Figure 2), but its contribution to the state budget is unbalanced and unstable (Figure 3). In fact, state budget revenue from the foreign-invested sector has not seen a clear positive change, although this sector's contribution to capital expenditure has increased. Investment and support for an area but not getting commensurate results is also the reason contributing to the difficulty of state budget improvement.

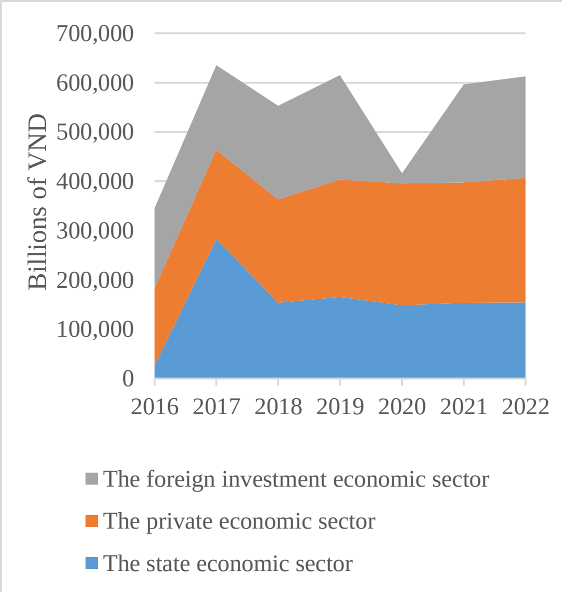

Figure 3: Contribution to state budget revenue, Vietnam, 2016-2022
Source: Data of Ministry of Finance (2023).

Improving the structure and competitiveness of Vietnam's imports and exports is not the factor leading to the surplus of the CA in the period 2011-2021, but the main factor comes from the decline in aggregate demand for domestic goods after the crisis period and the sudden increase in exports of FDI enterprises. This factor does not help the sustainable surplus of the CA and when domestic demand recovers, Vietnam will face difficulties in controlling the trade deficit.

Although the FDI sector has brought positive impacts to the Vietnamese economy in recent years, it cannot become a key economic sector. This is because FDI enterprises mainly take advantage of the cost of the labor, land and open-door policies of Vietnam. Although FDI activities are more and more exciting, they still and is difficult to predict due to the influence of security and politics, making the budget revenue from oil unstable.

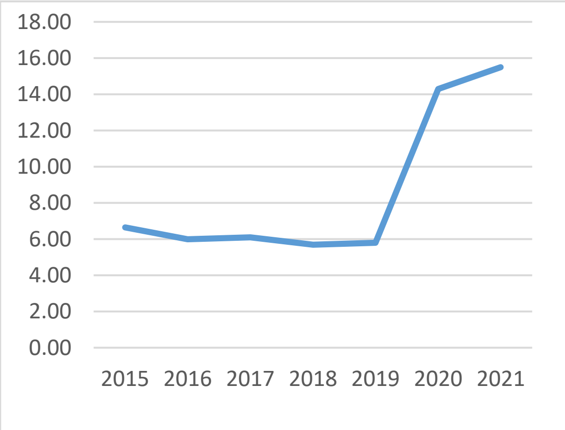

Figure 4: ICOR indicator of Vietnam, 2015-2021
Source: Data of General Statistics Office (2023).

In fact, Vietnam's public investment efficiency is low, reflected in the high ICOR coefficient and the tendency to spike during the COVID-19 period (Figure 4), and in addition to the incentives on natural resources, land, mechanisms and policies. The proportion of capital held by the public investment sector is high, but the contribution to national economic growth is low.

4. Some recommendations

The government needs to come up with policies to help prevent the return of a TD and its negative impacts on the economy.

Firstly, it is necessary to focus on increasing the efficiency of public investment activities. Vietnam faces an imbalance between savings and investment. It means that investment is lower than savings, and therefore investment is not efficient. In Vietnam, public investment is the most inefficient sector, while the government's net savings are negative. Hence, it is necessary to focus on increasing the efficiency of public investment activities to solve this problem.

There is a contradiction that investment is required to maintain growth, but the more investment, the larger the budget deficit and the larger the public debt. To overcome this problem, it is necessary to increase the efficiency of public investment activities in Vietnam, including the investment structure and investment quality.

Regarding the investment structure, it is necessary to consider cutting down unreasonable expenditures in recurrent expenditure, such as streamlining the apparatus to reduce expenditures, paying wages according to labor capacity to increase the efficiency of the public administration apparatus, indirectly increasing the efficiency of recurrent expenditures. When inappropriate recurrent expenditures can be saved, the proportion of development investment spending from government budget revenues will gradually increase.

Regarding the quality of development investment, it is necessary to focus on projects with high feasibility. Right from the time of planning, projects need to be rigorously evaluated for feasibility in consultation with domestic and international experts and scientists. It is essential to focus on completing a few quality projects to shorten the implementation time, instead of investing in many projects, with slow progress and decade-lasting time, slowing down the overall economic development of society. Finalizing each project within the approved time will help stabilize the investment capital, eliminate the situation of capital pooling many times, and reduce the situation of the unexpected increase in budget expenditure.

Secondly, it is necessary to encourage the development of the domestic economic sector. Vietnam's economy is experiencing an imbalance in the roles between economic sectors. The FDI sector receives a great amount of investment, helping to improve the CA but does not make a commensurate contribution to the state budget. Therefore, Vietnam's CA has a surplus, but the state budget still has a deep deficit. Besides, although the FDI sector has contributed to the CA's surplus, this relationship is not sustainable. The CA is dependent on the moves of foreign-invested enterprises. Therefore, Vietnam needs to encourage the development of the domestic economic sector, which brings about sustainable impacts to both the CA and GB.

Vietnamese enterprises need to focus on improving production capacity and increasing competitiveness for Vietnam's export goods, especially supporting policies and encouraging the development of industrial clusters. Each enterprise, when competing in the market itself, will face many difficulties and risks. Moreover, because the common competitive feature of Vietnamese enterprises is the cost factor, when businesses stand alone, they will have to consider the trade-offs between cost and quality, between size and scale, market and production capacity risk and liquidity risk... When enterprises put themselves in a value chain, a production chain, associate with other enterprises to develop into a cluster of industries, related problems to the internal force are resolved more easily. Business clusters help reduce input costs, actively control quality, increase operational productivity and production capacity, improve competitiveness, and promote creativity, association and commercialization. The strength of the industrial cluster is that the production capacity of enterprises in the cluster will develop evenly according to the requirements of the market, limiting the situation of lame and synchronous development. Besides, when standing in the value chain, a business developing the market will lead to the development of businesses in the chain, which means the chain effect will help businesses grow exponentially.

5. Conclusion

Like all other countries, curbing government budget revenue and increasing the surplus of the CA are important macro goals of Vietnam, helping to stabilize and create a driving force for the economy's development. Therefore, recognizing the signs of the TD phenomenon is of great significance in the promulgation and implementation of economic policies to prevent the risk of TD from occurring and lasting.

As mentioned above, TDs in Vietnam have an impact from the CAD to the GBD, which is a common type of TDs in countries that are heavily affected by foreign investment or the economy is in crisis. Currently, when the state budget has not been improved, the physical infrastructure is not stable and Vietnam is still heavily dependent on foreign investment capital flows. The analysis shows that there is an imbalance between savings - investment and an imbalance of roles between economies. Vietnam is also heavily dependent on foreign investment capital, which leads to the CAD increasing the GBD.

In terms of the risk of an economic crisis, although the manifestations are not clear, it is undeniable that the world is facing unstable events from politics to economy. Political instability between Russia and Ukraine also has caused crises in energy prices, gold prices, etc. globally. The bankruptcy of a series of US banks also raises concerns about the threat to the world economy before a global financial crisis similar to 2008. After COVID-19, from the second half of 2022 to the beginning of 2023, Vietnam recorded a sharp increase in economic and social problems, such as unemployment, bankruptcy, bad debts at banks, stock market decline, and bursting of the real estate market. With the general situation of the world and Vietnam in particular, the Government needs to have strong and accurate decisions to minimize the possibility of an economic crisis. This is because if an economic crisis really happens, a TD is more likely to happen.

In the long term, to prevent TD, Vietnam needs to adjust its macro policies towards increasing the efficiency of public investment and encouraging the development of the domestic economic sector.

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