

The Impact of Monetary Policy and Fiscal Policy on Budget Deficit in Vietnam: Based on Ricardian Equivalent Theory

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Abstract. Vietnam is an ASEAN country where it is a Royal country and president as Prime Minister. From time to time when Vietnam's government was controlled by the same party, the Communist Party of Vietnam, it is suspected that the Ricardian Equivalent theory of budget deficit will be in line and positively influential? The study used research data from 2000 to 2018, with independent variables such as deposit rates as monetary policy variables and corporate tax rates as fiscal policy variables. The data analysis method uses multiple linear regression time series. The result is known that independent variables such as deposit rates and corporate tax rates have a significant impact on the deficit in Vietnam, so Ricardian Equivalent theory is evident in Vietnam.

Key words: budget deficit, deposit interest rate, corporate tax rate.

Introduction

Financing for the country's development is obtained from revenues from taxes, non-taxes, state loans, sales of state assets, etc. In development financing, sometimes a country experiences a condition where financing is greater than revenue or is often referred to as a budget deficit; this is a dilemma in determining revenue's priority. Analysis of the budgets of various countries, especially the European Union, where a budget deficit can increase public debt, which will require additional budget expenditures and result in an increase in the budget deficit. Developed countries have impacted the fiscal and financial crisis in 2012, such as Greece, Iceland, Ireland, Italy, Portugal, and Spain in recent years having high levels of government debt (Labonte, 2012: 3). Deficits and surpluses are important budget indicators that help determine the state of public finances (Dubovskyi, 2017: 1). In recent years, for example, Ukraine has increasingly experienced loan problems. As lending increases, the number of loans maturing increases, which increases the need for cash resources and, consequently, leads to an increase in the loan interest rate (Syniuta, 2018: 3). This large amount of loans will have an impact on a country's budget deficit. The issue of the budget deficit has occurred since the new order era. The existence of a deficiency in development financing often causes a country to increase its revenue with foreign loans (Ouanes and Thakur, 1997: 54; Mudayen and Maridjo, 2016: 8238).

The existence of foreign loans will certainly cover the development financing of a country but will also have an impact on increasing interest rates and encouraging private investment so that the burden of government bonds issued in the current period will be transferred at least partially to future generations; deficits can also increase current consumption at the expense of future consumption, and slow down exports and encourage imports through currency appreciation (Hawkins and Turner, 2000: 7-8). The

services have growth of various industrial and commercial companies and organizations, it has been possible to provide international services so that organizations and companies can continue their business can easily use their services and do as much as possible to fulfill this purpose (Badri and Badri, 2019: 1).

Development carried out for the country's progress is carried out by the government by taking fiscal policies that tend to cause a budget deficit (Ascher, 1998: 37-61) regardless of the various impacts caused by the policy. For example, an expansionary fiscal policy in financing the budget deficit can lead to excessive printing of money (Gonzalez-Redin et al., 2018: 1-19) as happened in Indonesia during the 1953-1967 government period (Collins, 2012), where political developments at that time it had tended to create imbalances in the implementation of monetary policy, which was reflected by the printing of excessive money to finance the budget deficit.

One popular view of the impact of the budget deficit is the Ricardian Equivalence Theory. This theory arises because of the difference between economists' predictions and the economic effects that occurred in America in 1982, where economists predict that the budget deficit that occurs in America will harm the economy, namely that the budget deficit will cause high-interest rates, reduce savings, weakening economic growth, and enlarging the budget deficit, but the American economy at that time showed the opposite situation, where real and nominal interest rates decreased, investment spending increased, unemployment decreased, and real GNP growth increased (Afif and Fatturoyhan, 2017: 1-12).

Vietnam's economy is in the 47th position globally by nominal gross domestic product (GDP) and the 35th largest in the world when measured by the balance of purchasing power (PPP). The country is also a member of APEC, ASEAN, and the WTO. Since the mid-1980s, during the DoiMoi reform era, Vietnam has shifted from a centrally planned economy to a mixed economy using indicative planning through a five-year plan (ASEAN@50, 2017). During that period, the economy has experienced rapid growth. In the 21st century, Vietnam is in a period of being integrated into the global economy. Almost all Vietnamese companies are small and medium enterprises (SMEs). Vietnam has become a leading agricultural exporter and an attractive destination country for foreign investment in Southeast Asia. Currently, Vietnam's economy relies mostly on foreign direct investment to attract capital from abroad to support its economy. Foreign investment in luxury hotels and resorts is rising to support the tourism industry (Cuong et al., 2008: 323; Ziegenhain, 2020: 1-18).

According to PricewaterhouseCoopers forecasts in February 2017, Vietnam may be the fastest growing economy in the world. The potential annual GDP growth rate is around 5.2%, making the country's economy the 20th largest in the world by 2050. The government system in Vietnam The President is responsible for appointing the Prime Minister and Cabinet from among the National Council members. Its decisions are based on directions from the Council itself. The president also serves as commander of Vietnam's military and as head of the National Defense and Security Council. The president is also a prominent member of the ruling Communist Party in Vietnam. The National Council elects the President for a term of five years. The President is always elected from among the members of the Council himself. This presidency was created when the Socialist Republic of Vietnam was formed in 1976. Since then, Vietnam has had six presidents (not including Nguyen Huu Tho, who was only Acting President). Since July 4, 1981, the term of this position was changed from President to Chair of the State

Council but later returned to President again since September 22, 1992 (PwC Japan, 2017).

Manufacturing, information technology, and high-tech industries make up a large and fast-growing part of the national economy. Vietnam is a relatively new player in the petroleum business, but now it is Southeast Asia's third-largest oil producer with a production value of 400,000 barrels per day. Vietnam is one of the Asian countries with the most open economic policies; the trade balance accounts for about 160% of GDP, more than twice the ratio that China has and more than four times the ratio of India (Australian Trade and Investment Commission, 2017). In general, Vietnam is still classified as an emerging country with a US \$280.2 billion (2006 estimate). This represents a purchasing power of ~ US \$ 3,300 per capita (or the US \$726 per capita based on the market exchange rate). The inflation rate was estimated at 7.5% per annum in 2006. Public purchasing power is increasing rapidly. Poverty, based on the number of people living on under \$1 a day, has decreased dramatically and is now less than in China, India, and the Philippines. Some data from the Vietnamese government budget for 1995-2019 (Fig. 1):

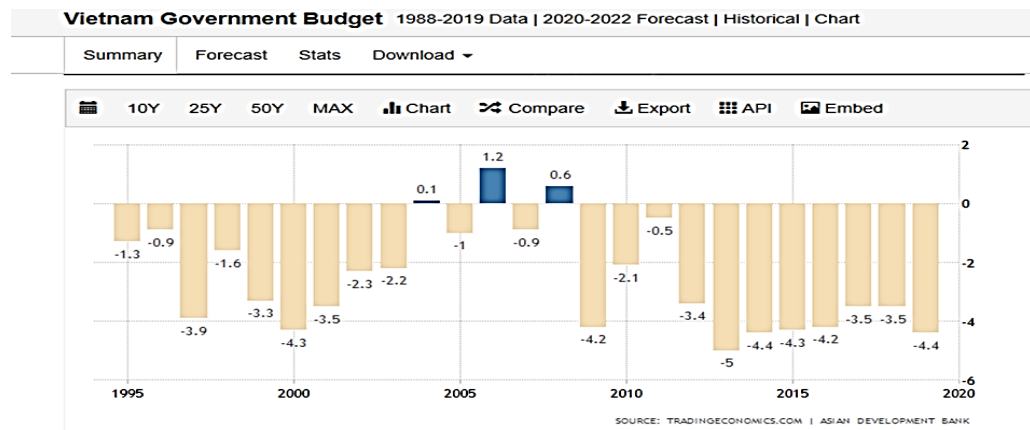


Fig. 1. Vietnam Government Budget

Monetary policy, one of which is the deposit interest rate, which in Vietnam has the following values from 1997-2018 (Fig. 2).

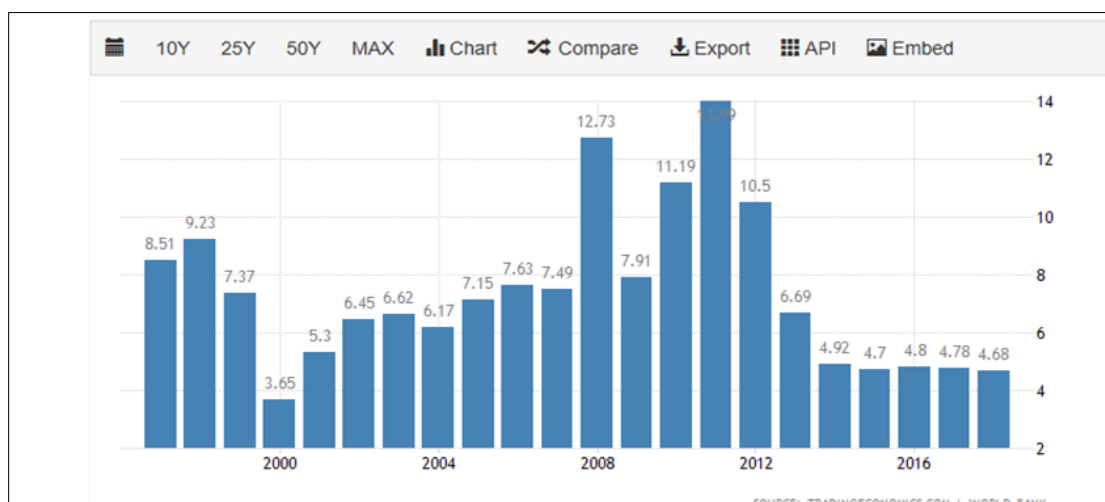


Fig. 2. Vietnam's Deposit Interest Rate

One of the fiscal policies is the corporate tax rate, which in Vietnam has the following values starting in 1997-2020. Fiscal policy is a policy undertaken by the government to control the economy by varying its revenue and expenditure budget. Monetary policy is a policy of controlling monetary quantities such as the money supply, interest rates, and credit by the central bank (Juhro and Goeltom, 2013). In its development, Kydland and Prescott found new theories about fiscal policy, monetary policy, and the business cycle. This theory emphasizes the existence of a factor of public expectations, which policymakers tend to ignore. In fact, public expectations are often the cause of time inconsistencies and failures in government policies and will result in a budget deficit.

Literature Review

The equivalent Ricardian Theory questions government financing decisions' ability to influence the level of aggregate demand and, consequently, its current accounts. It states that the substitution of debt for taxes does not affect aggregate demand or interest rates for a given expenditure line. The reasoning of this theory is as follows. The government's inter-temporal budgetary constraint implies that a tax cut for unchanging government spending levels now implies future tax increases (Handa, 2008: 409). Therefore, as government borrowing only delays taxes into the future, consumers, who are simultaneously taxpayers, fully anticipate future tax increases, do not consider current tax cuts and the consequent increases in disposable income as permanent. Therefore, consumers' inter-temporal budgetary constraints are left unchanged by government financing decisions. As a result, the consumption path is also not affected: the increase in disposable income resulting from tax cuts is completely saved (Haug, 2016).

Under the Ricardian equality, Robert J. Barro (1989: 37-54) states that consumers react to tax cuts by increasing their savings. This increase in private savings used to purchase newly issued government bonds has the resources to pay for future tax increases. Therefore, as private saving increases by the same amount as the budget deficit, national saving remains unaffected. This, in turn, leaves the interest rate unchanged. Besides, the deficit does not affect current account balances in an open economic manner because the increase in personal savings originates sufficiently to avoid the need for (additional) external financing. As a result, the deficit does not include crowd capital or worsens the current account balance. In this way, public debt does not affect private sector wealth, or in other words, consumers do not perceive government bonds as net worth. Hence, and for expenditure, it is the equivalent of public expenditure by debt or by taxation: the tax time does not affect private consumption (Shamsi et al., 2016: 14-23).

With the quantitative theory of money, the pattern of real economic activity requires a certain desired level of real money balances, and the price level is controlled by the nominal money supply. The reason is very easy. Given a nominal money supply - exogenously determined by the monetary authority - the price level is determined as the unique rate of the price which will make the purchasing power of the money supply equal to the level of real balances desired (Palley, 2017). From an operational perspective, central banks seek to ascertain the desired number of money agents for their transactions. Given the price level, if the nominal money supply differs from the desired real balance, it will change at that price level. Therefore, the price level must be completely flexible and determined exclusively by the exogenous nominal money supply.

Concerning fiscal policy, the nominal money supply may change due to seigniorage as the main financing source for public spending or as an open market operation. The central bank buys interest rates on government debt. Since these two money expansion mechanisms may have different effects on taxes and the government debt stock, they can affect prices / or interest rates.

Based on McCallum and Nelson (2015: 565-583), the price level fiscal theory (FTPL) links fiscal and monetary policy through the budget constraint (GBC), which is also understood as a long-term solvency condition for public sector finances. GBC is satisfied when the government's future key surplus's discounted value is greater than (or equal to) the face value of the current public debt. It is important to note that it is included in the government's main surplus - as a source of income -, while nominal public debt considers the monetary base. This is why the relevant public sector consists of the government and central banks. Because GBC is expressed, most often, as a percentage of nominal GDP, the discount rate is determined by the real interest rate ratio to the rate of economic growth (Tala, 2018).

To be more explicit about how the price level is affected by fiscal action, Michael Woodford (1995) suggests first considering positive and exogenous price shocks that reduce the real value of government liabilities and lead to a parallel reduction in the real value of private portfolios invested in government securities. The lower real value of these personal assets results in a negative wealth effect, ultimately reflected in less demand for goods. According to the FTPL, the agent's expectations regarding fiscal policy's sustainability will produce a similar wealth effect. If the market has negative perceptions about the sustainability of public finances; If the discounted value of the government's primary surplus does not include the face value of the liability, that perception will drive up the price level to the extent necessary to restore the GBC equilibrium. The higher price level reduces the real value of the personal portfolio, resulting in a wealth effect. The higher the nominal government liability (nominal debt), the greater the necessary adjustment to the price level (Lozano, 2008: 5).

Methodology and Research Development Models

This type of research is causality to find a cause-effect relationship. Therefore, the requirement for scientific research is that the hypothesis is tested quantitatively, which is a statement of parameters that are temporarily assumed to be true (Supranto and Limakrisna, 2019: 3-33). In general, multivariate analysis relates to the methods used in data processing using statistics to achieve a study's aims using an inferential approach (Santosa, 2019: 3). The regression model used is a multiple linear regression model because this study the relationship or influence of two or more independent variables on the dependent variable. The methods that can be used to estimate the parameters of simple linear regression models and multiple linear regression models are the ordinary least squares (OLS) method and the maximum likelihood estimation (MLE) method (Kutner et al., 2004). The general form of a multiple linear regression model with p independent variables is as in the following equation. The general form of a multiple linear regression model with p independent variables is as in the following equation:

$$Y_i = \beta_0 + \beta_1 X_{i_1} + \beta_2 X_{i_2} + \dots + \beta_p X_{i_p} + \varepsilon_i$$

Note:

- Y_i : Budget Deficits
- $\beta_{0;1-2;p}$: Beta Coefficients
- X_1 : Deposit Interest Rate
- X_2 : Company Tax Level
- ε : *Error term*

Before processing or analyzing data, it is important to formulate a research model to help the researcher's frame of mind to answer the research aims. The model is everything that is build up thru specific parameters that are fathomed both in structure, form, content, number, and meaning with all limitations (Husain, 2019: 1-9). Development of research models with IPO logic (input-process-output) and a combination of causal models to formulate alternative hypotheses (Sani et al., 2020) in regression analysis. Testing the regression coefficient's significance is useful for seeing the validity of the model formed. Sometimes several models fit the data in the sense that they are statistically valid. In such cases, for comparison or model selection, a coefficient significance test alone is not sufficient. Several other measures are needed that serve as benchmarks in comparing some of these valid models. Hypothesis testing in multivariate analysis is carried out in several stages as follows:

1. *The coefficient of determination (R-squared)*

R-squared essentially measures how far the model can explain the variation in the independent variable. This test is intended to determine the difference in the meaning of a path coefficient (Supranto and Limakrisna, 2019: 115). A small *R-squared* score means that the independent variables' ability to explain the dependent variable's variation is minimal. Sometimes the researcher wants to maximize the *R-squared* score to look for a model that produces a high *R-squared* score. This is dangerous if done because the regression analysis aims to get a high *R-squared* value and find the estimated value of the regression coefficient and attract statistical inferences. If getting high *R-squared* is good in the process, but if *R-squared*'s value is low, it does not mean that the regression model is bad (Nau, 2020).

2. *Residual standard error*

The residual standard error is a measure of the stability of the regression model's prediction in question. The smaller the value, the better the model:

$$\hat{\sigma} = \sqrt{\frac{\sum_{i=1}^n (y - \hat{y})^2}{n - k}}$$

Information: n = number of samples; k = the number of predictors in the model including the intercept.

3. *AIC and BIC*

The AIC and BIC methods can be used to select the best regression model found by Akaike and Schwarz (Grasa, 1989: 25-29). Both methods are based on the maximum likelihood estimation (MLE) method. To calculate the AIC and BIC values, the following formula is used:

$$\ln AIC = \frac{2k}{n} + \ln \left(\frac{\sum_{i=1}^n \hat{u}_i^2}{n} \right)$$

$$\ln BIC = \left(\frac{k}{n}\right) \ln n + \ln \left(\frac{\sum_{i=1}^n \hat{u}_i^2}{n}\right)$$

Information: k = number of parameter in regression model; n: number of observation and u: residual.

According to the AIC and BIC methods, the best regression model is the regression model that has the smallest AIC and BIC values (Dziak et al., 2017: e1103v3). Data analysis used multiple regression analysis with Statistic / Data Analysis software Stata MP14 Version. Stata is a program that can be used in quantitative calculation analysis and has its own advantages (Santosa, 2020: 1).

Results and Discussion

Tests are performed using multiple linear regression analysis to estimate the magnitude of the regression coefficients, which show the relationship between the independent variable and the dependent variable.

Table 1. Summarized Results

Variable	Mean Score	Deviation Score	Minimum Score	Maximum Score
Y	-2.542105	1.938876	-5	1.2
X1	7.203158	2.845113	3.65	13.5
X2	26.18421	4.180678	20	32.5
<i>Source:</i> Calculated by Author's (Stata App., 2020)				

Based on the above results (Table 1), research data for 19 years starting from 2000-2018 can be seen the standard deviation of the dependent variable, namely the budget deficit of 1.938, while the independent variable (X1), namely the deposit interest rate, has a standard deviation of 2.845. The independent variable (X2), namely, the corporate tax rate, has a standard deviation of 4,180. Therefore, it can be concluded that the independent variable (X2) has the greatest standard deviation among other variables.

Table 2. Summarized Regression Results

Model (R-Squared)	0.4294	F (2;16), Prob.	(6.02); 0.0112
Variable	t-stats	t-table	Yields
X1	2.82	2.1199	Significant 5 percent
X2	1.78		Not Significant 5 percent
<i>Source:</i> Calculated by Author's (Stata App., 2020)			

Based on the results of the linear regression above the time series data were processed from 2000 - 2018, it can be seen that the regression results are as follows:

$$Y = -9,268 + 0,364 + 0,1565 + e$$

This shows that the value of X1, namely the deposit interest rate variable has an influence of 0.364 on the budget deficit. The X2 variable, namely the corporate tax rate, has an influence of 0.1565 on the budget deficit; this is both the deposit interest rate variable. The corporate tax rate variable can affect an increase in government revenue

budget to reduce the budget deficit. Based on the t-test, it can be seen that the results of variable X1, namely the variable deposit interest rate, have the value of $2.82 > 0.05$; this indicates that the deposit interest rate variable has a positive and significant effect on the budget deficit. Meanwhile, seen from the variable X2, namely the variable corporate tax rate, it can be seen that the t value is $1.78 > 0.05$, which indicates that the corporate tax rate variable has a significant positive effect on the budget deficit.

Table 3. Summarized Heteroskedasticity and Multicollinearity Results

Breusch-Pagan (chi2 (1))	0.26	Prob. > chi2	0.6119
Variable	VIF	1/VIF	Mean VIF
X1	1.01	0.993513	1.01
X2	1.01		
<i>Source:</i> Calculated by Author's (Stata App., 2020)			

Based on the results of the heteroscedasticity test, it can be seen that the chi-square test results show a value of $0.26 > 0.05$ and the chi-square probability score is 0.611 so that the data does not occur heteroscedasticity. The VIF value at X1 is $1.01 < 10$ and X2 is $1.01 < 10$, which means that the X1 variable of deposit interest rate and X2 variable of corporate tax rate does not occur multicollinearity.

Conclusion

The From the results of time series regression data, it can be seen that the variable deposit interest rate (X1) and company tax level (X2) have a positive and significant effect on the budget deficit. This shows that there is a positive effect in the Ricardian Equivalent theory if the leadership of a country is led by one understanding. The same time within a certain period. In the research year 2000-2018, there were four periods of government or the presiding president, but all of them were under the same party, namely the Vietnamese communist party, so the policy direction used in a government was relatively the same.

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