Chapter 5

CONCLUSION

A study of the banking sector in Vietnam suggest that banking reform is for the purpose of maintaining the power and authority of monetary Control and for sustainable economic growth.

The goal and target of monetary policies consist of overall and intermediary objectives. The overall objective is to promote economic growth and the intermediary goal is to control inflation through the control of money supply (total payment facilities). Vietnam is at initial stage of banking reforms. The SBV and the Commercial banks are aimed at creating a sound banking system. The banking reform is for the purpose of maintaining the power and authority of monetary control and for sustainable growth. Suitable measures are taken so that the banks prove an effective instrument in controlling inflation at a low and stable rate contributing to sustainable economic growth.

Since 1986, the SBV (Central bank) has modified and adjusted the monetary policy (money demand and supply) to control the inflation rate. This proved to be effective in stabilization of the Vietnamese currency and contributing to economic growth. The SBV has applied many market instruments such as inter bank market and compulsory reserve requirement. From 15 July 2000, open market operation has come into existence and from 2 June 2001, interest rate has been partially liberalized— that is negotiable interest rate (managed float interest rate). However, these market instruments are still operating in the form of direct management instrument. Compulsory reserve requirement remains unchanged. The reserve does not introduce re-lending method like the model of the Reserve Bank of America. Borrowing by commercial banks could be permitted only on a case by case basis. Reform could permit borrowing for all commercial banks by rediscounting method as general
banking practices. Thus, in capital management and fund absorption through sale of government treasury bond, auction becomes ineffective.

In the near future, the improvement and shifts of the monetary instruments from direct to indirect management would make monetary policy management more flexible and more effective, avoiding negative impact to the economy. This is the foundation for the SBV to control monetary market and contributing to higher economic growth in Vietnam.

The interest and exchange rates are two “important prices” because they have great impact on the whole socio economic life. When applying the direct instruments under market oriented economy, there is a close linkage among monetary instruments and between other instruments as well. From August 2000, the SBV has applied a new mechanism for interest rate management – fundamental interest rate and recently negotiable rate. This is an advance in the process of interest rate liberalization. The interest rate liberalization creates favorable conditions for monetary market development. During past two years, SBV’s policy for liberalizing interest rate both lending and saving also encouraged both saving and investment.

Nevertheless, it is insufficient to depend entirely on interest and exchange rate policy. Many other integrated policies are required in order to improve long term domestic investment environment. The weakness of the local currency VND and its non convertibility has led to greater dollarisation in the Vietnamese economy. However, due to positive policy on interest and exchange rate, the share of the local currency VND has increased. The share of the USD in the total currency has decreased from 41 percent in 1990 to 30 percent at present. This percentage can be measured by the total USD deposit in the total deposit. This percentage could be higher due to the fact that Vietnamese people still hold a great volume of USD in cash.

At the end of 2000 and at the beginning 2001, the dollarization process was increased. Reform should be directed to maintain VND interest rate higher than USD rate so as to aim at monetary stability and enhancing people’s confidence in VND. The fact has shown that at the end of 1980s, by maintaining high interest rate, then Vietnam could
decrease inflation rate. For effective performance of the banking system, the higher VND rate that has been maintained in the past, should be continued and adopted by the SBV.

The exchange rate must be managed flexibly and appropriately in order to remove foreign currency holding among population, and help local entrepreneurs escaping from foreign exchange exposure. "Managed float" of exchange rate along with gradual devaluation have showed an useful lesson for local entrepreneurs to get used with domestic currency depreciation on both aspects: foreign exchange exposure and export promotion.

It can be stated that Vietnam is cash based economy and therefore very high rate of cash are transacted in the market. Cash accounted for 40% M2. So the payment system reform for the whole banking system is very significant in term of present management. A safe, accurate, modern and fast payment system allows the signals of monetary and financial markets to be reflected sufficiently and rapidly. Owing to this, the SBV can react effectively through its monetary policies and monetary instruments. Moreover, modern payment system will consolidate monetary control and inflation control ability of the SBV.

It is required to have a close link between monetary policy and Government debt management (including domestic and external debt) for the purpose of inflation control, state budget balance and sustainable economic growth. During recent years, this linkage has been very loose. The late emergence of the open market has also reflected this character.

In recent years, the state budget deficit has not been covered by issuing bank notes. Foreign loans, individual deposits and savings have been the main sources. However, the State treasury bond rate often exceeded the fund raising rate of the commercial banks. This induced the commercial banks to increase their fund raising rate to match that of treasury rate. This led to increasing the lending rate of commercial banks to borrowers causing a great burden on the investors and which affected the economy negatively. The leveling of the treasury bond rate with the fund raising rate of the commercial banks is necessary to ensure the level playing ground for mobilizing resources for development of the country in the long run. The dependence of the state budget on foreign loans and
external debts also affected the international balance of payment negatively while creating pressure for VND devaluation. This led to country risk, increasing the pricing of foreign commercial loans in turn.

The reform in the commercial bank system is to maintain its function as intermediary to transfer capital from savings to investment for sustainable economic growth and acting as main channel of SBV’s monetary policy. The SBV can perform better macroeconomic management including inflation control through banking reform. In the process of international integration, Vietnam requires external capital inflows equitably among different sectors of the Vietnam economy. In this context, the banks can help to establish contacts between local investors and international agencies for financing. It can provide import & export financing to entrepreneurs in different sectors for balanced development of the economy.

Reform of State owned enterprises and private enterprises are also necessary to maintain the success of the banking sector reform. The commercial bank system is a mirror to reflect the enterprises performance. The commercial banks could not be sound and healthy if their customers - enterprises always generate losses and pile up additional debts. The reform would enable enterprises to absorb perfectly the investment capital from banking system in order to maintain sustainable economic growth. The state owned enterprises reform can restrain bank credit to SOE and also create their autonomy and effectiveness, reducing considerably state budgetary support to them. The reform also restrains the pressure of preferred interest applicable to SOE in obtaining commercial loans from the banks under direct government guarantee. State enterprise reform has an important role to play not only with regard to banking sector reform but also with regard to private enterprise development. In fact, only financially viable enterprises can improve their behavior by responding to economic incentives. By improving efficiency of state enterprises, further reform of this sector would thus contribute to development of a sound and healthy banking system in Vietnam.

The Government of Vietnam has come to recognize that the heavily regulated environment and lack of financial infrastructure would constrain effective performance and management of enterprises. In the past, reforms have succeeded in restructuring the banking system in terms
of modernizing, fund raising, lending activities and banking services to the enterprises. Specifically, banking reform has also helped to reduce non-performing loans (NPLs), improve liquidity, lower the share of policy-lending and re-orient bank management to view all loans on their commercial merit, including loans to the private sector. Continuing reform of the banking sector is likely hinge on the reform of the SOE.

Due to globalization, economic performance and demand for development, international integration is a strong requirement of Vietnam economy. Vietnam’s low exchange reserve means a great demand for external financing sources. International integration of the financial and banking sector would bring to Vietnam many financing sources and technology for development. However, the integration also exposes the country to many risks if the enterprises and the banking system are still weak, legal environment is unhealthy and information system is unreliable. In order to be successful in the process of international integration of the financial and banking sector, Vietnam is required to develop a sound and healthy financial and banking system.

During 1993-1997, foreign direct investment (FDI) inflow to Vietnam was relatively great. There remained no great changes in turn but many risks and exposures were seen as FDI was accounted for 95% of current account deficit in 1996. Vietnam’s commitment in AEDAN Free Trade Area (AFTA), Vietnam’s partial commitment in World Trade Organization (WTO), and increased participation by Vietnam in the Association of South-East Asian Nations (ASEAN), Asia-Pacific Economic Cooperation (APEC) and America – Vietnam trade agreement have also helped to improve financial and banking sector and to boost trade. Ho Chi Minh city stock exchange center entered its operations from 20 July 2000. There remains many restrictions in this issue as foreign ownership in a listed Vietnam company is not more than 20% in which a foreign entity can purchase maximally 7% of its stocks, whereas an individual can purchase maximally 3% of its stocks. However, this implies an open policy for Vietnam joining international financial banking community. The routes for financial and banking integration are only appropriate upon Vietnam’s active management in its integration process.
In the context of international integration, the issues involve flexible exchange rate management, effective management of international capital inflow, gradual liberalization of capital inflow, and external debt management for both public and private sectors. This requires the government to formulate an action plan on debt monitoring and debt management. Issuing supporting decrees and regulations on external debt helps to clarify of different agencies in external debt management, and gain support from donors with technical assistance for debt management. These are functional issues of Government authorities such as The SBV, Ministry of Finance, and State Securities Commission aiming at controlling inflation and sustaining economic growth.

In the context of strong development of international banking, the renovation must be closely linked to banking modernization and human resources development so as to quickly integrate international banking system. Renovation is a difficult and complicated process, particularly in the banking reform. In the past, the banking reform has been successful in creating two tier banking system from monolithic one tier banking structure. This has involved the separation of the central banking function from the commercial banking operation with the approval of two banking laws in November 1997. Previously, the entire banking system was state owned and under state control. With the emergence of the two tier banking system, private entry and participation in commercial banking has been legitimized.

Both domestic and foreign enterprises and companies operating in Vietnam have come to expect that the heavily regulated environment and lack of financial infrastructure would inhibit effective cash and treasury management. In the past, several of the innovative banks have worked hard to actively address this issue, recognizing that in a cash-based economy with numerous systemic inefficiencies, opportunities still exists. Although much has been accomplished in the reform of the banking sector, a number of challenges remain. Business transactions are generally conducted on a cash basis. The authorities are concerned that a large share of foreign exchange earnings bypasses the formal banking system, and recognize that central control over monetary supply and currency transactions needs to be further strengthened. Bank supervision, accounting standards and financial and technical skills are being improved to raise confidence among prospective users of banking services.
It is felt that Vietnam must do more while trying to mobilize resources. To achieve this, existing enterprises, whether state-owned or private, must use resources more efficiently and additional resources should be channeled to more efficient activities. Efficient enterprises, especially private Small and Medium Enterprises in rural economy and exports must get more of that credit. Efforts to mobilize more savings, domestic and foreign, must be pursued in parallel, though attracting more foreign investment will be more difficult than in past years.

A vigorous private sector (consisting of farmers, household enterprises, private and foreign-invested enterprises) will need more freedom to operate and better services from a modern banking sector and other service sector firms to contribute to the above imperative. Reform of state enterprises, private investment, trade and banking, is expected to address both imperatives. Measures in each area compliment and reinforce attempts to encourage all existing enterprises, private and state, and to increase efficiency. Similarly, faster expansion of the private sector is likely to increase employment and exports as well as the overall efficiency of the Vietnam economy because it uses more labor than capital and uses both more efficiently.

Private sector's potential can be harnessed not only by reforms that deregulate and encourage private investment but also other reforms. Trade reform helps the private sector by enhancing its access to imported inputs and to open export outlets. SOE reform, in the form of equitizations and divestitures, could jump-start the private corporate sector, by adding quickly to the number of private SMEs. Restraint on bank credit to SOEs, aimed at instilling more financial discipline, can reduce "crowding out" of credit to the private sector. Bank restructuring and reform will help to reduce non-performing loans, improve liquidity, lower the share of policy lending and re-orient bank management to view all loans, including loans to private firms, on their commercial merit.

These reforms are also expected to improve performance of existing enterprises including the commercial banks. Liberalized trade as well as easier domestic and foreign private entry would increase competition and create incentives from increased efficiency. Trade reform – that phases out import licensing restrictions, and reduces both implicit and explicit export taxes – not only increases transparency and competition, but also raises return to export and encourages investors to move into more productive
areas. SOE reforms, that shift ownership of SMEs to the private sector, restructure and downsize large SOEs and subject them to the discipline of harder budget constraint, help to limit waste and to generate pressures for more efficient performance. Banking reform – aimed at restructuring, at improving prudent regulations and supervision, at leveling the playing field and at improving governance in SOCBs – will reduce the banks’ liquidity crunch, increase competition among banking services, create incentives for prudent banking and reorient banks’ management to move towards the private sector.

Many of the reform implemented in the past have begun to show results. Liberalization of trading rights and the approval of the Enterprise Law have expanded private firms’ participation in import and export activities of the economy. Various export promotion measures – allowing private rice exports, auctioning garment export quotas, providing financial incentives to exporters, removing restrictions on foreign invested enterprises to export, eliminating many export taxes have led to a significant pick-up in export volume. Similarly, simplification of the equitization procedures have accelerated actual equitizations.

In 1999 and 2000 various ministries, in consultation with international financial institutions have drawn up three-year reform plans in the areas of trade, state enterprises and banking. This period is to be used very effectively to analyze relevant data on state-enterprises, banks and trade policies, as well as to access external experts for discussions about possible solutions, and learning from other developing countries’ experiences. Many steps were taken by individual ministries to internationalize the specific programs and to agree on the key reform measures.

However, it is felt in retrospect that further renovation in banking sector will be delayed due largely to shortage of fund. Greater the delay in reforms, higher will be the loss in term of foreign investment. Investors and exporters are delaying their investments in view of impending reforms. Finally it can be stated that reforms in the banking sector have contributed to modernization and economic growth of Vietnam.