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The Vietnam's Transition Economy and Its Fledgling Financial Markets: 1986-2003

Vuong Quan Hoang

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A few noteworthy points found in the next section are: (i) No evidence of financial markets existence was found before *Doi Moi*. The reform has generated a bulk of private-sector financial companies. New developments have roots in the 1992-amended constitution (*x*3.2); (ii) The need to reform the financial started with the *domino* collapse of credit cooperatives in early 1990s. More stress is caused by the 'blow' of banking deficiency in late 1990s; and (iii) Laws on SBV and credit institutions, and the launch of the stock market are bold steps. Besides, the Asian financial turmoil forces the economy to reaffirm its reform agenda. Our findings also indicate, through empirical evidences, that economic conditions have stabilized throughout the reform, thanks to the contributions of the FDI and private economic sector. Private investment flows continue to be an eminent factor that drives the economy growth.

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Keywords: Vietnam; Financial economy; Transition economies; Financial time series; Economic evolution.

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1 Introduction

Located in the Southeast Asia region, Vietnam is the main economy of the Indochina peninsula. The Indochina, comprising of Vietnam, Cambodia and Laos, was geopolitically defined by the French when they occupied the peninsula in the Nineteenth Century. Vietnam currently has the largest population of the three, approximately 80 million, and covers a total area of over 330,000 sq. km.

The start of Vietnam's contemporary economy dates back to 1946 period when the nation's independent status was regained from the French. Not long after the Independence Declaration on September 2, 1945, the newborn Viet Minh-led interim government had to start building its own industries, historically to (i) strive for the economic independence, proving its own leadership; and (ii) prepare for an upcoming resistance war, anticipating the return of the French troops to Indochina in late 1946.

The military victory Dien Bien Phu over the French in mid-1954 marked the complete independence of the Northern Vietnam. Almost instantly, Northern leaders replicated the Soviet command economy model, blended with some Soviet modification, based on a Resolution of the Communist Party Congress III in 1959. Most of the fundamental components of the later Vietnamese centrally planned economy were laid down in the first 5-year Economic Program 1956-61, following the Soviet and Chinese 5-year plan model, as the economic cornerstone. In contrast, the South followed more or less the American market economy until the collapse of the American-backed Saigon regime[1] in spring 1975; at the same time the reunification of Vietnam's separated parts.

In 1986, ten years after the reunification of Vietnam, an extensive reform program, known as Doi Moi was initiated in the context the nation had undergone extreme hardship and economic crisis. The key ingredients of the Doi Moi program launched in 1986 remain the core of today's continued reform process of Vietnam, and their concepts are worth discussing now before we move on. From the economic perspective, the first ingredient should be the recognition of legitimate existence and rights of the non-state economy. This helps to have generated a formally established private sector consisting more than 120,000 companies and hundreds of thousands of family-owned uncorporatized enterprises; the spectacular change we would not have thought of had we lived in Vietnam early 1980s. A large part of financial and human resources have been freed up and turned into overall economic growth, wealth of the society and new productive engines.

Second is the departure from the Soviet-type centrally planned economy, a conceptual dismissal of its optimality and uniqueness. This change has led to a compromise of the Vietnam-defined 'Socialist-oriented market economy with the State's intervention.' The phrase simply means a legitimate capitalistic economic model, with the political power uniquely gripped by the Communist Party. The Party continues to control and lead off the State apparatus. However, despite the political retention, as the economic concept develops, the market issue gradually evolves to be of the primary concern and the major

[1]In this particular period, the Northern Vietnam was named Democratic Republic of Vietnam, and the Southern Republic of Vietnam. Few years after the defeat of the Saigon regime, the reunified Vietnam was given its existing name of the Socialist Republic of Vietnam.

focus.

The third ingredient is the State's re-defined functionality. A modern concept of the State is formed, which defines the State as an administrative apparatus rather than a supreme economic player. The view is significant in the sense that based on this the government should spend time on the policy issues, and only acts upon the society's call as the player of last resort. It is the de facto change of its working modality. To this end, the government is forced to learn from the advanced western concepts and models, and to restructure itself.

The above ingredients are not exhaustive, but seen as critically important in shaping the current Vietnam's economy. The current agenda of advancing the reform process is basically to address these aspects at 'newer spirals'. This round of reform involves a difficult assignment of restructuring and re-engineering the Vietnamese financial markets, which have not inadvertently failed to address the economy's need thus far. This work is devoted to thoroughly exploring the evolution of the Vietnamese financial markets, with an emphasis on developments after the launch of *Doi Moi*. To undertake the exploration, the paper will be structured as follows. We introduce the Vietnam's economy succinctly, mainly to provide a comparative description following the time, in section 1. Section 2 follows with a clear emphasis on a chronological evolution of the country's financial markets. This section could easily span over many pages; however, we will concentrate on substantive events and developments, which have substantially affected the financial economy of Vietnam over the past 15 years. Finally, section 3 lends an analysis to the structure and salient characteristics of Vietnam's current financial markets, as well as some macroeconomic considerations.

The overall objective of this paper is to provide for an in-depth introduction of the Vietnamese economy, in general, and financial markets, in particular, chronologically and operationally. This introduction will be the guide for us to form a research discipline on Vietnam's financial markets and other issues of financial economics.

2 An Overview of the Vietnamese Economy

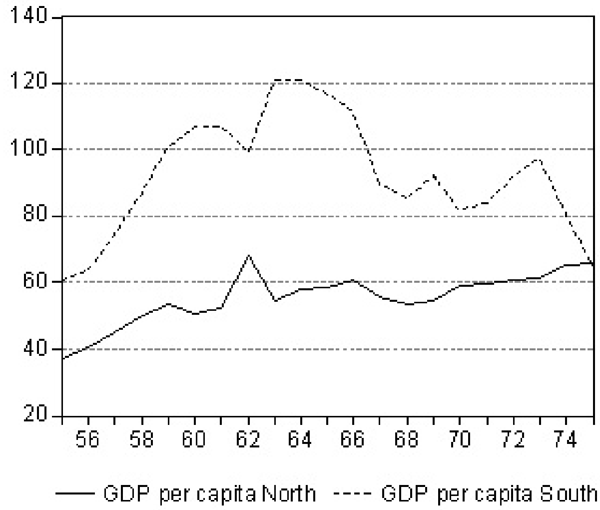
Vietnam has a complicated contemporaneous history with several lengthy and detrimental wars. Its economy has thus been affected adversely, and also had specific attributes that are not necessarily identical to other regional economies. In this section we intend to present important discussion about Vietnam's economy in general. We believe that the understanding of Vietnam's economy should consist of (1) temporal GDP statistics, including all the surges and plunges over time; (2) watershed foreign investment inflows in 1990s; (3) vibrant resurgence of the formal (corporatized) private sector; and (4) the gradual formation of the formal financial economy, functioning even though to a limited extent. The section is structured in this order intentionally.

2.1 Pre- and post-Doi Moi GDP growth; The warning flag of decline in late 1990s

A historical review may help facilitate the perception about the Vietnamese economy's genuine growth over time. Below is a nonparametric way of summarizing the GDP growth of Vietnam, the period 1955-99. In this review, it is our purpose not to split up the northern and southern parts of Vietnam during the wartime, so that one can judge the economic evolution of Vietnam as a whole. A comparative picture between the two parts during the American war follows to provide for a more comprehensive understanding of economic evolution during this critical period of the country.

The following chart in figure (1) indicates different levels of *per capita* GDP in the North and South during the wartime (1955-75). It was clear that the South had experienced substantially higher GDP figures before 1975. Many attributed this to the abundance of aids from the United States. One may find it interesting to note that the gap in per capita GDP between the North and South was almost crossed out in 1975, the year of reunification of Vietnam. It is not obvious as until 1975 the two parts of the nation had still been distinct economies by political and geographical definition.

Figure 1: Comparative per capita GDP of Vietnam 1955-1975



Note: GDPN-per capita GDP in the North; GDPS-the South. Vertical axis: unit indicates value in USD per annum.

The fact worth articulating here should be that Vietnam experienced different stages of evolution. The first period is 1955-63, when Northern Vietnam experienced the first stage of reconstructing the economy in peace, while its Southern counterpart started building up the tie with the United States and following an opposite political economy. The second is the 1964-75, when the two parts of the nation encountered an escalating warfare, with American troops involved until the Paris Peace Accord 1973. The reunification was in April 1975, and in the next period 1975-85, the country started rebuilding the economy, with supports from the former Soviet Union based on a complete cooperation accord between the two countries.

However, the two wars with Khmer Rouge Cambodia in 1977 at the southwest border, and with the Chinese in 1979 at the northern border made the nation plunge into a new period of crisis. The 1980-85 economic crisis was attributed to the rigid and inappropriate economic management at macro levels, which led to hyperinflation in late 1980s and early 1990s.

The extensive reform launched in 1986 brought about many positive changes to Vietnam's economy. The following macro indicators presented in the table (1) will in part substantiate the point.

Year	Real GDP	Annual Growth	Consumption	Savings	Trade Balance	Gov't Spending
		(*Numbers in billion of VND,*	*except percentage*)			
1986	109,189.0	2.838%	108,736.0	16,136.0	-13,121.0	7,841.3
1987	113,154.0	3.631%	110,693.0	19,858.0	-16,356.0	6,535.0
1988	119,960.0	6.015%	115,036.0	20,505.0	-15,348.0	6,897.2
1989	125,571.0	4.677%	118,642.0	20,434.0	-12,050.0	7,074.5
1990	131,968.0	5.094%	123,406.0	20,148.0	-12,766.0	8,912.5
1991	139,634.0	5.809%	127,895.0	22,366.0	-8,742.0	9,972.0
1992	151,782.0	8.700%	133,321.0	27,086.0	-5,992.0	14,115.8
1993	164,043.0	8.078%	139,122.0	39,862.0	-14,036.0	24,118.7
1994	178,534.0	8.834%	148,037.0	45,483.0	-16,866.0	20,293.3
1995	195,567.0	9.540%	158,893.0	53,249.0	-17,877.0	23,257.0
1996	213,833.0	9.340%	173,072.0	60,826.0	-20,183.0	30,522.4
1997	231,264.0	8.152%	182,975.0	66,529.0	-17,752.0	38,077.6
1998	244,596.0	5.765%	190,923.0	74,931.0	-20,530.0	40,793.3
1999	256,269.0	4.772%	194,350.0	72,678.0	-9,225.0	48,720.5
2000	273,669.7	6.789%	199,292.4	–	-12,567.4	–
2001	292,525.5	6.886%	–	–	-12,371.5	–
2002	313,119.3	7.038%	–	–	-30,193.0	–
2003	335,784.4	7.238%	–	83,946.1	-56,086.0	–

op.cit. General Statistical Office, Vietnam: [18, 19, 20, 22, 23] *op.cit.* Tho *et al.*, 2000:[31](for converting to 1994 constant prices and growth rates), and Intellasia periodical surveys 1994-2004. Statistics computed against 1994 constant price levels (VND 10,965 exchanged for USD 1.0 on average.)

Table 1: Macro-economic statistics of Vietnam-Doi Moi period

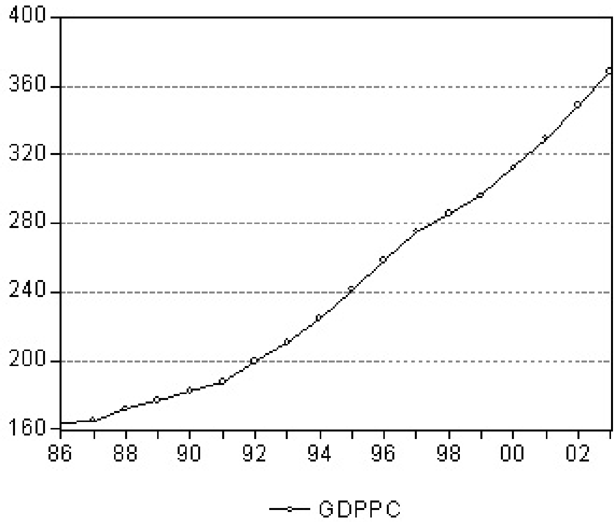
Next, we consider below a graph describing a steeper learning curve of per capita GDP of Vietnam in USD for the period 1986-2003. The *per capita* GDP has doubled after 17 years of reform, the self-explanatory fact.[2] However, this level of GDP per head is still too low, and not even close to that of its ASEAN counterparts, e.g. the Philippines or Indonesia, despite the far-reaching effect of the GDP doubling.

Another useful look at Vietnam's economic growth after Doi Moi initiation should be the relative growth (in percentage) rates of national GDP and per capita GDP as described in the table (2) below. Figure (2) presents relative changes in real absolute and *per capita* GDP of Vietnam period 1986-2003.

In most cases, we observe that the annual *per capita* GDP grows at a slower rate than the real GDP. Comparative standard statistics also support this comment, all the values of

[2]N.B. the vertical axis represents unit in USD per annum.

Figure 2: *Per capita* GDP of Vietnam in reform time



Vertical axis: unit indicates value in USD per annum.

Table 2: GDP Statistics 1986-2003 (Doi Moi period)

	GDP growth	GDP/H growth	GDP growth	GDP/H growth	Indicator
			Statistics		
1986	2.838%	0.756%	6.518%	4.687%	Mean
1987	3.631%	1.403%	5.912%	4.778%	Median
1988	6.015%	3.894%	9.541%	7.390%	Max
1989	4.677%	2.985%	2.838%	0.756%	Min
1990	5.094%	2.779%	2.219%	2.235%	Std.Dev.
1991	5.809%	3.403%	-0.0572	-0.2997	Skewness
1992	8.700%	6.146%	1.5549	1.6725	Kurtosis
1993	8.078%	5.611%			
1994	8.834%	6.606%			
1995	9.540%	7.390%			
1996	9.340%	7.319%			
1997	8.152%	6.234%			
1998	5.765%	3.944%			
1999	4.772%	7.148%			
2000	6.789%	5.524%			
2001	6.886%	5.623%			
2002	7.038%	5.771%			
2003	7.238%	5.783%			

mean, median, maximum and minimum of growth rates of per capita GDP are significantly lower than those of GDP. One possible reason for this is the rate of population increase in Vietnam, which is still fairly high, approximately 2% p.a., given the current population of approximately 80 million in mid-2003.

The figure (22) in the Appendix will exhibit rates of change of GDP, consumption, and investments as key macro-economic indicators of Vietnam over the 1986-2003 phase.

Vietnam's economy remained stable throughout most of the 1990s, with GDP growth rates ranging from 8-9%, except the last three years when the Asian financial turbulence worsened the regional economic situation. The raw statistics above are self-evident about the impact of 'Doi Moi' on the national macro-economic performance in general. In an empirical framework, Nghiep and Quy (1999:[14]) established a measure of impact that *Doi Moi* program produced towards changing Vietnam's GDP. This presented some empirical evidence that GDP growth of Vietnam in 1990s can mostly be explained by intensive investments and some productivity improvement under *Doi Moi* policies, in line with our descriptive statistics and not a surprising remark.

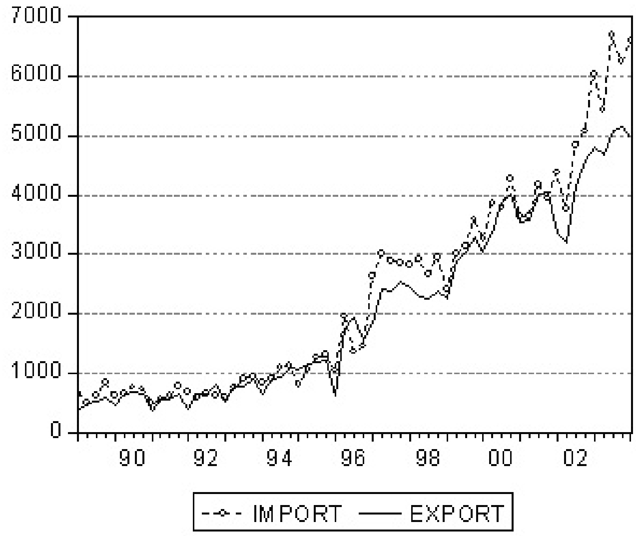


Figure 3: Import and export

After a long struggle with economic stagnation in the 1980s, Vietnam started enjoying a more rapid economic growth in the 1990s. Although slowdown was observed in the last few years, when the notorious financial turmoil overran the East and Southeast Asian economies, its adverse impact on Vietnam has been thus far much less (see the table (3)), compared to the devastating influences the 1997-1999 Asian financial crisis has caused other regional economies, e.g. Thailand, South Korea, or Indonesia.

In reality, the Vietnamese economy had not waited for the notorious 1997-99 financial turmoil to impact on it. A few signals of economic growth deterioration had been identified and warned of since mid-1990s. Of the most critical factors identified then were:

- deteriorating investment climate and rocketing business risks as seen by key foreign investors, such as Japan, Singapore, South Korea, Hong Kong,...;

- strategic-mandatory dominance of the state-run economic players, supported by State funding plethora and non-financial preferentialism-favoritism;
- relatively small scale of the corporatized private economy, even though the growth rate was impressive; and
- malfunctioning financial systems, which failed to satisfy the corporate sector's finance needs when they were most needed, not in this sequencing of importance.

These endogenous issues could be cited as the source of risks for GDP growth sustainability. The stagnation that followed the peak growth in mid-90s substantiated the worries of economists until these days. In our previous citing of risks to sustainability, the last point enumerated above will be the single most emphatic issue of this paper as presented in following discussions.

2.2 Foreign direct investment inflows

Another milestone in Vietnam's reforming path was the passing of the original Law on Foreign Investment in 1987, which encouraged and legitimized the foreign direct investments (FDI) into Vietnam. Since 1988, FDI has become a major economic force that drives the economic reform of Vietnam (World Bank, 1997). The FDI inflows help create a new economic momentum. The factor serves as a stimulus, which enables the subsequent growth of the private economy, and in parallel the divestiture of the state-owned enterprise (SOE) sector through formulating hundreds of joint venture businesses with the SOEs. One of the resultant recognition has been the consideration of the emerging factor of financial performance versus control grip, while in the past the control power had definitely outweighed any others. The table (4) summarizes the FDI inflows since the start of Vietnam's economic reform:

Consequently, the international capital to Vietnam, following the path of FDI, also flows to the banking and financial industries. During the period 1992-97, 24 foreign bank branches and five joint venture banks were established. These foreign-invested banking

Table 3: Comparative GDP growth rates of ASEAN + China nations

Economy	1995	1996	1997	1998	1999	2000	2001	2002	2003
Indonesia	8.22	7.82	4.70	-13.13	0.79	4.92	3.44	3.66	4.95
Malaysia	9.83	10.00	7.32	-7.36	6.14	8.33	0.45	-0.72	10.40
Philippines	4.68	5.85	5.18	-0.58	3.40	4.01	3.40	5.54	4.92
Singapore	8.04	8.15	8.51	-0.86	6.42	9.41	-2.37	2.25	1.10
Thailand	9.24	5.90	-1.37	-10.51	4.43	4.64	1.80	5.43	7.22
Vietnam	9.54	9.34	8.15	5.76	4.77	6.79	6.89	7.04	7.24
China, P.R.	10.51	9.59	8.80	7.80	7.11	8.00	7.50	8.00	9.10

Note: Major sources of statistics for the discussion uptil now have come from [31, 3, 4, 18, 19, 20, 22, **?**], IMF's http://www.imfstatistics.org statistics sources, and other sources such as the US CIA reports, and regional media statistics releases (for those missing official statistics, such as China's 2001, 2002, 2003 GDP generations).

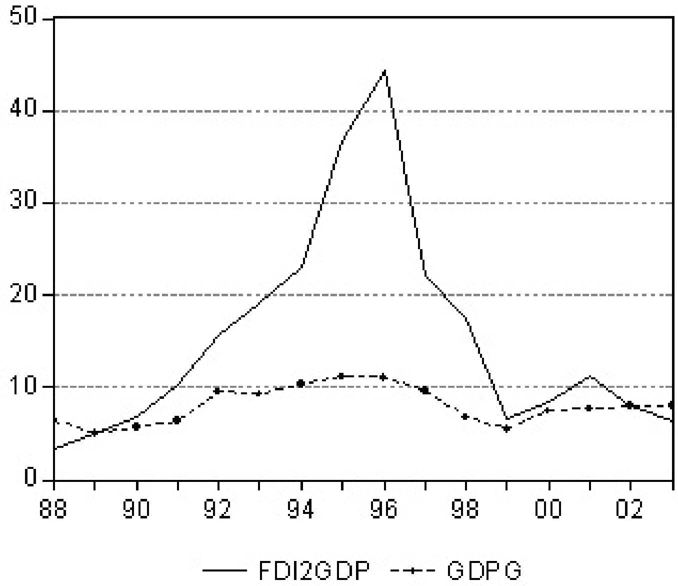
Table 4: FDI Inflows to Vietnam: 1990-2003

Year	(1)	(2)	Growth rate	(3)	(4)	Growth rate
	In USD million, except percentages					
1988	372	372	–	–	–	–
1989	583	954	156.7%	–	–	–
1990	839	1,422	87.9%	–	–	–
1991	1,322	2,744	93.0%	–	–	–
1992	2,165	4,909	78.9%	351	351	–
1993	2,861	7,770	58.3%	1,027	1,378	292.6%
1994	3,766	11,535	48.5%	1,500	2,878	108.9%
1995	6,531	18,066	56.6%	3,048	5,926	105.9%
1996	8,640	26,706	47.8%	2,932	8,858	49.5%
1997	4,659	31,365	17.4%	3,137	11,995	35.4%
1998	3,897	35,262	12.4%	2,364	14,359	19.7%
1999	1,568	36,830	4.4%	2,179	16,538	15.2%
2000	1,973	38,803	5.4%	2,228	18,766	13.5%
2001	3,016	41,970	7.7%	2,305	21,071	12.3%
2002	2,318	44,288	5.5%	2,340	23,411	11.1%
2003	3,100	47,388	7.0%	2,200	25,611	9.4%

Note: (1) FDI commitments refer to registered capital pledges by investors in each year, although not actually implemented. (2) Accumulated commitments: Total FDI commitments since 1988. (3) Implemented FDI capital: the FDI actually put in projects and implemented. (4) Accumulated FDI disbursement: Total implemented FDI capital since 1988. (The figures include the committed and implemented capital by domestic partners.) Both growth rates of FDI commitments and implementation refer to year-on-year relative increases, in percentage. Sources: [20, 22]

operations have become operational in the major urban economic hubs, such as Hanoi, Ho Chi Minh City, and gradually grown up to be a major player in the financial sector of Vietnam since then. In the comprehensive FDI survey (*ibid.*[4]), the risk appreciation and deteriorating investment climate are cited as the source of worry for existing and prospective investors. A combination with higher business-doing expenses in Vietnam has played down Vietnam as an attractive place for FDI flows. This situation further threatens the Vietnamese economy, as the domestic capital is considered insufficient and difficult to leverage. The financial market is thus given more attention as an overall solution.

The relative importance of FDI inflows to Vietnam's economy has so far been profound. The interaction between FDI capital and economic growth of Vietnam is known. FDI inflows brought up the productive capacity of the economy, and generated new income sources. By examining the comparative ratio in the figure (4) below we can have an intuitive relation between the portion of FDI in the economy, and the corresponding growth rate.



Note: FDI2GDP-FDI to GDP ratio; GDPG-Annual growth rate of real GDP. These are computed using 1994 constant price.

Figure 4: FDI in relation to real GDP growth

In turn, the raised level of income and GDP pulled along levels of consumptions and reinvestments, whose impacts are profound to foreign investors that seek to expand markets and growth-oriented opportunities.

In summary, by the end of 2003, Vietnam has attracted approximately USD 47.4 billion in FDI commitments over 15 years of the FDI law implementation. The actual disbursement has been much lower than the commitment, about 54%. The number of enterprises set up under the FDI law by the end of 2003 is 4,324, after substracting the number of FDI enterprises that went bankrupt, dissolved or had their licenses invoked over the past 15 years (the exact number is unknown). The statutary capital commitment made by those dissolved FDI enterprises is estimated at USD 6.588 billion, so the total current FDI commitment that is still valid at the end of 2003 is USD 40.8 billion.

The structure of sectoral investment flows at the end of 2003 can be summarized as follows:

1. Industries and construction: 2,885 enterprises, USD 23.2 billion;

2. Agriculture, forestry, and fisheries: 596 enterprises, USD 2.89 billion;

3. Services: 843 enterprises, USD 14.68 billion

In terms of ownership, the structure of FDI flows can be summerized as:

1. Join-ventures: 45%;

2. Wholly foreign owned: 42%;

3. BOT and partnerships: 13%.

Now that we have noticed in the graph (4) a rapid growth in FDI capital commitment before 1996, and a sharp fallout after. There have been the following reasons, *inter alia*, for the sharp increase of FDI inflows in the first half of 1990s:

1. A high expectation of uncovered lucrative market of an ex-Soviet style economy, that had before considered by prospective investors as the last closed border after China, P.R.

2. The curiosity of what behind the scene in Vietnam's economy, which did not collapse, as many might had expected, after the fall of the former USSR, and the whole Eastern European Soviet bloc. Both the French and American were also interested in the land after years of war in the past.

3. The reasonably large population of approximately 75 million could also be considered as a potentially lucrative market, after years of queuing for basic goods before the state-run old-styled shopping windows.

4. Besides being a market in itself, Vietnam could well become a gateway to another huge markets, China, P.R.

However, after several years in operation, many investors have realized that there had no such upbeat scenario from this market, due largely to:

1. Rampant corruptions and red tape throughout the nation, caused mainly by a huge administration staff that had not been able to transform itself from a control mode to market-economy service one. Most Western businesses were not tolerable to corruptions, thus were quicly turned down by the administrative system.

2. The curiosity ended quite quickly when the primary concern of business efficiency came in the mind of investors. Very few businessmen are willing to spend huge bulks of greenbacks for only sightseeing.

3. The large population turned out in truth a population of the poor, with low savings and about 80% of them lived on farming, which usually brought back little economic wealth, not only in Vietnam, but everywhere else in the region and over the world.

4. High business costs caused by corruptions, poor service quality, infrastructure in bad shape after years in wars and economic hardship, and diseconomies of scale in most industries were also a big impediment to profit making.

5. And, there were opportunities elsewhere in the region, especially China, where labor costs, intellectual capacity, geographic positions, etc. were almost the same as in Vietnam. So why stick to Vietnam?

Besides, there might be one more reason: the Asian financial crisis in the 1997-98 period. Although there has been little economic and empirical evidence, academically qualified, that indicates a link between the regional financial crisis to the further droppage of FDI in Vietnam, facts may have still suggested so. Many large construction projects were delayed and even jittered during and after the 1997-98 Asian financial crisis, such as Hanoi Sheraton Hotel, with the main reason that the investors and hotel management company had been financially distressed by the crisis. So one could hardly reject the impact of such a regional crisis on the local economy, even though we could assume that the economy of Vietnam itself was by then half-closed.

2.3 The rejuvenation of the private economy

The re-emergence of the genuine private sector of Vietnam probably plays the most important role in the *Doi Moi* era economic evolution of the nation. A large number of formal private sector companies, in the form of both privately held and more public shareholding firms have been legally established since the introduction of the former Laws on Companies and Private Enterprises in 1990.[3]

Having implemented for almost a decade, the Law was re-engineered to grasp new changes and more contemporaneous demands in 1999, and became the Enterprise Law, effective from 1-Jan-2000. If in early 1990s, Vietnam's private enterprises were just a small group of 'pioneering entrepreneurs' and limited to a narrow range of business activities, today they have become a large population of businesses as indicated by the statistics below. Private enterprises are now entitled to most fields of business, except only those particularly specified by the authorities to be critically important or off-limits areas, e.g. weapons manufacturing, money production, telecom, to name a few. Nonetheless, the off-limits list of important business activities also gets shorter over time. For instance, the telecom sector would likely be the next on the governmental agenda for *equitization*. Currently, the mounting pressur on equitization speed-up will likely increase the non-state business population, and further the private economy's resurrection.

The above statistics show that the private sector has for a short period grown up to a population of more than 120,000 formal enterprises, not to mention nearly 1,500,000

[3]We will now use the general term 'private enterprises' to refer to all types of private-sector companies, including privately owned, shareholding firms, limited partnerships, and sole proprietorships.

Table 5: Statistics of the private economy

Year	(1)	(2)	(3)	(4)
1990	1,000	1,000	497	–
1991	1,259	259	201	–
1992	4,959	3,700	1,497	–
1993	13,024	8,065	2,593	–
1994	17,442	4,418	1,202	–
1995	21,937	4,495	–	33,758
1996	32,713	10,236	–	36,003
1997	38,821	6,108	–	37,528
1998	39,040	1,019	–	39,032
1999	–	–	–	–
2000	–	12,100	–	–
2001		21,500		
2002		26,000		
2003		28,000		
4M-2003	120,000*	10,000	142,000*	

Note: Statistics refer to formal private enterprises, which were either incorporated or registered legitimately. (1) Total number of enterprises; (2) New startups; (3) Statutory capital (in billions of VND); (4) Current-price GDP generation (in billions of VND). The rule of thumb for calculating the equivalent amount in US Dollars term is VND 1 billion is about USD 60,000. (*) indicates the estimated total over the period.

household and entrepreneurial micro-enterprises.

2.4 SOEs reform via dissolving, merging, and equitization

2.4.1 Reforming the SOEs

We have stated earlier that the nation has shifted its economic model to the mixed socialist and market economy. Still, in the theory of socialism, the state-owned enterprises (SOEs) play a pivotal role in supporting the Vietnam Communist Party's, hence the government's, political mandates. Their presence has still been trong through the numbers that we will go through shortly. However, their diseases also exhibit serious economic health problems, namely:

1. Low efficiency;
2. Waste and corruption of public assets, economic resources;
3. Persistent loss making process; and
4. Very weak competitiveness due to various reasons, not excluding the above three.

We now briefly discuss the historical background that led to the current reform of SOEs. By agreed definition, an SOE is "*an economic unit established by the State and the State's capital. Its business activities or public utilities have to be run and managed by the State, to fulfill the socio-economic missions granted by the State.*" By the administrative measures, the two main types of SOEs are (i) central government SOE, and (ii) local government SOE.

Given those apparent (and very common) problems of SOEs as stated above, after the consensus from the top leaders of the Central Committee of the Vietnam Communist Party, the government made a ground-breaking official decision to pave the way for the *privatization* process in the country. The Decision was numbered 143-HDBT, passed on 10-May-1990, three years after the lauching of *Doi Moi*, by which the *equitization* was possible in a pilot scheme.

However, the pilot scheme was fruitless. During the 4-year pilot scheme, from Jun-1992 to May-1996, only a handful of SOEs were *equitized*:

1. Transport Union (Ministry of Transport)
2. Hiep An Shoes Company (Ministry of Industries)
3. Poultry Feed Processing Company (Ministry of Agriculture)
4. Refrigeration Electrical Engineering (People's Committee of Ho Chi Minh City)
5. Long An Export Food Processing Company (People's Committee of Long An province)

Clearly, this dismal result upset irked the government a lot, and an overhaul was needed. A more comprehensive plan on reforming the SOEs was implemented by which several ways of reforming these SOEs have been introduced, namely dissolving, merging, selling, leasing, and equitizing. We have the following information about the result of this overhaul over the past few years, although the process is far from the final end.

- In 1990, total number of SOEs nationwide was 12,231; 5,571 at the end of 2000, and 4,479, at the end of 2003.
- Approximately 3,100 SOEs disappeared because they were merged to others.
- About 3,350 SOEs were dissolved.
- About 950 were leased, or sold off.
- Some larger corporations were established to house many member enterprises. By statistics, at the end of 2001, 17 such large SOEs housed 1,605 member enterprises, occupying approximately 65% and 61% of State's capital and workforce of all SOEs, respectively.

Still, the process has still been considered slow, especially when Vietnam faces the threats of low competitiveness while commitments with respect to memberships of international organization such as APEC, ASEAN, AFTA, and the upcoming WTO have emerged to be very apparent. Once again, the equitization bell rings, and the government continues to look at equitization as the chief vehicle to speed up the SOE reform.

2.4.2 The *equitization* process

Besides the formation of new private enterprises, the equitization process also adds more non-state enterprises to the private-sector population. In theory, calling the process as privatization has been *politically incorrect*, although it is, *de facto*. Rather, to soften the tone the government defines equitization as the process to make SOEs public assets that the people can be entitled to ownerships.

Below is a summary of equitizing process since the inception of this important economic reform scheme in Vietnam.

Table 6: Process of *equitizing* state-run firms

	8-Jun-92 6-May-96	7-May-96 27-Jun-98	28-Jun-98 31-Dec-98	1-Jan-99 31-Dec-99	1-Jan-00 31-Dec-00	1-Jan-01 31-Dec-01	1-Jan-2002 31-Dec-2002	1-Jan-2003 31-Dec-2003
Quantity	5	25	86	249	212	198	139	537
Equity*	38.5	19.0	61.2	552.5	1,042.0	850.0	*1,211.9*	6,059.5

Sources: Synthesized from various publications, including Vietnam Investment Review, Dau Tu-Chung Khoan, Vietnam Economic Times, data from National Enterprises Reform Committee, Hanoi Institute of Soci-Economic Studies, and self-estimates in *italic*; (*) Initial valuation, in billions of VND.

Although the recent numbers of equitized SOEs may look more impressive, the actual situation has not been that promising, when we note that the total value of these equitized SOEs is only 2.93% of the GDP, or 5.2% of total State's assets value at all remaining SOEs. The root of this is because large SOEs have not been reformed, and they are currently the major cash-generating (not necessarily profit-generating)[4] engines to the government coffer, namely Vietnam Airlines, 4 large state-run banks, Vietnam Telecom, Vietnam Petroleum Corp., and so on.

Increasingly, the social and economic costs SOEs incur to the economy have been unveiled through public media, such as spending tax-payers' money on unproductive assets, explosive corruptions, higher direct costs to consumers due to monopolistic powers (in the case of Vietnam Airlines, Vietnam Post and Telecom, state-run pharmaceuticals distributors, etc.). Especially, the problem of financial mismanagement that becomes rampant over the reform period, has not only reduced the productiveness of the SOEs, in particular, and the whole economy, in general, but also caused possible social unrest. In fact, despite the reiteration by different generations of Party's leaders that SOEs continue to serve as the economic pillar of the country, the common perception is SOEs have been in reality more of a liability than asset to the Vietnam's economy. One of the big problems they cause has direct impact on the development of this work's main theme of study, the problem of SOEs' bad debts, which will be discussed in the subsection dedicated to the banking system.

2.5 A historical account of domestic inflation

Although playing a crucial role in both the economics and the normal economic life, inflation had not been a formal recognition of the Vietnamese government while in the command economy. This situation was similar to other socialist economies, where the major economic doctrine negates the existence of the inflation evil, same as unemployment. However, the computation of consumer price index remained in the past, although received very modest attention compared to things like plans, orders and accomplishment of orders. One of the major reasons for use of CPI in this study is data availability. This although can only be obtained after some painstaking effort is the only inflation data one can have in Vietnam.[5]

However, immediately when facing a more open world economy, the inflation notion has quickly become so real that everybody could feel it constantly. One of the notable periods is that of 1986-1992, when many striking changes were initially implemented. In this period, Vietnam dropped its long-standing Soviet-style distribution through food stamp and rice book. This represents a vibrant shift together with a large-scale layoffs of state budget salary earners. Inflation started rocketing in 1986 and this trend continued through end of 1992. The highest actual inflation, gauged by year-on-year CPI change, was recorded in late 1986, when inflation level increased nearly 8 times on an annual basis. We call this period the 1986-92 hyperinflation (figure (**??**) unveils the wild moves of consumer price index as proxy to the notion of inflation.)

[4]Loss-making SOEs can still be generating cash. An example is a loss-making state-run bank that can still raise funds through public deposits. When such a bank buys government bonds, it actually supply cash to the government, although in an unproductive way, more or less.

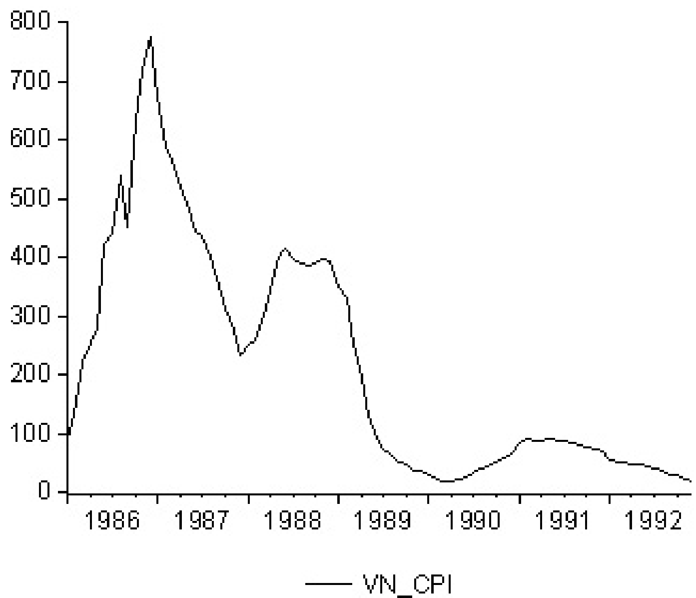
[5]Data availability is a known issue and largest obstacle to any economic researchers who wish to study Vietnam's economy. Financial data is even a harder object to acquire, as agreed by all concerned economists.

Some statistics of the high inflation period (1986-1992) unveil a difficult period for an average Vietnamese, whose living standards dropped quickly as purchasing power of the their income diminished. The highest annualized inflation is 774.7% in December 1986, and the lowest 17.43% in April 1990. Mean level of annualized consumer price is 215.73% for the total period, and the median 91.56% per annum. We also note that this period sustained for about 60 months, nearly one third of the total length of time since the beginning of Vietnam's reform.

Inflation stabilizing period: The high inflation trend was only stopped when new growth engines, i.e. private and foreign-invested sectors, came into efficient production. FDI inflows initialized manufacturing, agricultural production and services industries efficiently in the first half of 1990s. FDI level itself picked up fast, with record registered FDI capital in 1996, standing at annual USD 8.6 billion. In economic sense, capital investment and cash inflows (from both FDI and domestic entrepreneurs) helped alleviate financial distress and improve inhabitants' income. GDP growth rate picked up, too, representing better production output and purchasing power. Positive economic trends and settings contributed to have stabilized the consumer prices. The figure below indicated that level of deviation from 'tractable' level of key economies' inflation has gone down dramatically and constantly in the following period of 1993-2002 to acceptable levels.

Inflation levels of selected countries: Jan-1993 to Dec-2002 are shown in figure (6) below.[6]

[6]The most varying CPI line is Vietnam's; Comparative CPI levels are of the USA, UK, Japan, and the European Union (shorter line). CPI data have been monthly price levels, annualized to possess integrity; stated in percent p.a. Data for developed economies come from IMF international macroeconomic statistics; data for Vietnam from national sources: General Statistical Office, VN Economic Times, and the author's



Sources: GSO Statistical Yearbook, various years; Vietnam Economic Times Annual Summary, various years.

Figure 5: Vietnam CPI growth rate

Nonetheless, as generally agreed among economists, despite the danger of hyperinflation, a '*reasonable*' positive inflation level should by no means be denounced. We now understand that an affordable inflation has several, but important, positive impacts on Vietnam's economic growth. First off, some inflationary gap is desirable for achieving GDP growth. Second, to this agriculture-based economy, inflation would likely push price levels of agro-products up, generating more income and purchasing power for a majority of the domestic population. When this understanding gets clearer to economic agents, economists and businesspeople realized a worrisome deflationary trend happening, at some time lags (about 12 months), after the well-known 1997-98 Asian financial crisis. One can get a sense of deflation in Vietnam's economy by observing the national CPI level in the aforesaid chart, in which first time since its reform in 1986, the country was facing downward general price trend, causing new headache of economic downturn and stagnation.

Not unexpectedly, in this period, FDI level in Vietnam dropped drastically to around USD 1 billion per annum, compared to the peak of nearly USD 9 billion in 1996. Literally in figures, for the 24-month period (2000-2001), the Vietnamese economy experienced 23 months in deflation, with the most serious drop in price is -2.60% (YOY) in July 2000, and the only improvement seen a year later, in July 2001, +0.09%. Average CPI level is -1.114%, with median almost identical -1.104%. Given an estimated growth rate of GDP at about 7% during 2002, inflation also picked up positively, standing at +4.06% (YOY) at 2002-end.

databases.

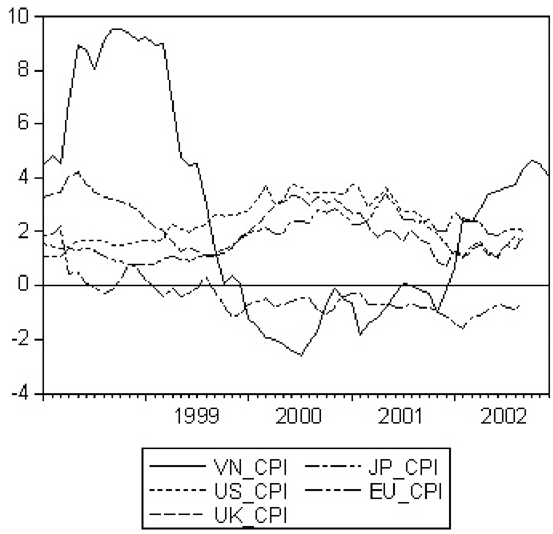


Figure 6: Comparative national CPI levels

2.6 Why financial markets

Given our foremost concern, the private sector economy directly relates to the evolution of financial markets in two evident fashions. First off, private sector financial institutions have been growing very fast, becoming a direct study object in this regard. Second, non-financial private enterprises are driving the genuine growth of financial markets by posing their demand for short- and longer-term capital supplies. In brief, the emerging private economy is substantive. This generates new source of growth and promotes economic sustainability by implementing the 'commercial viability' principle to operations and management.

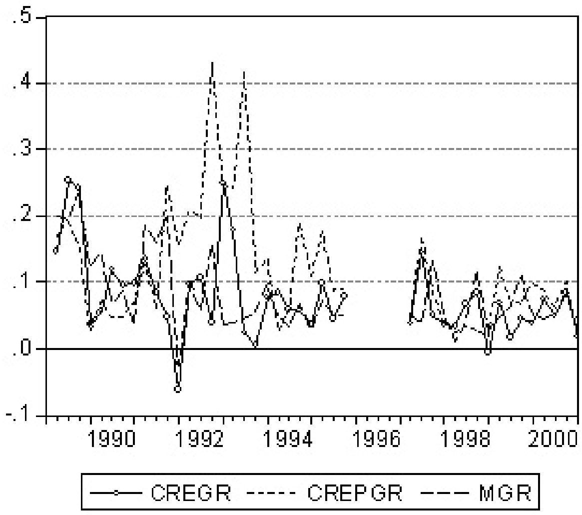


Figure 7: Money stock and credit extension

The financial market is a fundamental component of the modern economy of the world. It is not only the major vehicle to facilitate the flows of idle funds to where they are needed, but also the overall mechanism for an economy to efficiently allocate scarce resources, whose concept is what economic activity is all about. Arguably, developed financial markets are a good metric and knowledge of the stage of development of the economy. It is because the development of such a market will certainly require:

1. A reasonable degree of legal and regulatory development;

2. Policy shifts to recognize the privately-owned businesses;

3. An enabling and incentivizing environment for market economic activities; and

4. The freedom in economic choices and decisions of the market participants.

By tracing back to Vietnam's evolution of the financial market in the contemporary context, one can gain a thorough understanding of not only advances of the economy in the reform, but also how far it has gone toward catching up with other market-driven economies, perhaps with those in the Asian-Pacific region.

Having appreciated the necessity of such knowledge and limitations on a detailed study, the upcoming section of this paper will examine the chronology of the Vietnamese financial economy, summarizing important events of the evolution. Subsequently, section 3 will expand to a thorough diagnostics of its financial system over the past two decades. This is taken on with a clear emphasis on the former system's structural and operational legacy affecting the current. To this end, the analysis will allow for a deeper knowledge of the functional efficiency. In addition, section 4 will try to reiterate the recent events that remarkably affect and pressurize the functioning of Vietnam's financial machinery and the performance of the financial market, that is the existence of the equity and debt markets.

3 The Chronology of the Vietnamese Financial Markets

The financial market of Vietnam has just emerged following the overall reform program of Vietnam's economy. In fact, the evolution of the financial sector began with a lag of time, approximately four years compared to other economic sectors such as manufacturing and production related services. According to some published works (World Bank, 1995:[3]; Shimomoto, 1999:[28]; Oh, 1999: [24]; Riedel, 1997:[25]), the financial sector in Vietnam was assessed to be among sectors with the slowest pace of change and to have had many potential problems. Despite this fact, the financial sector of Vietnam has grown up significantly compared to the ancestor in the centrally planned time. The following summarize the important events of its evolution in a chronological order, together with showing major achievement associated with them, leaving the critical reasoning and discussion of issues until the diagnostics section subsequently.

3.1 Before the start of *Doi Moi* in 1986

One thing that should be stated up front and clearly is that virtually no financial markets had existed before the 1986 Doi Moi startup. The only three financial organizations that had been operating before 1986 were the National Bank of Vietnam (NBV), Bank for Investment and Development of Vietnam (BIDV), and Bank for Foreign Trade of Vietnam (VCB). Given the unique characteristics of the highly subsidized and centrally planned mechanism, the NBV had the most critical role in the financial system in the pre-Doi Moi period, thus deserves to in-depth exploration before moving on to the new economic settings.

One of the important milestones is the establishment of the National Bank of Vietnam (NBV), the predecessor of the current State Bank of Vietnam, in May 6, 1951. In the World Bank's review (*ibid.*[3]), the major attributes and roles of this NBV are identified as follows: (a) Functioning as a central bank, with a limited scope of activities such as money production; and (b) Funding the needs of a centrally planned and highly subsidized economy in war times, by executing the commands and decisions of the government. The resources of the newborn People's Democratic Republic of Vietnam then were so limited, thus the this Bank would only allocate the scarce financial resource to a few selected sectors, with priority for the need of defense expenditure.

The main focus of the NBV in credit activities was to provide 'soft' loans to State-owned economic entities, which were serving the direct consumption and expenditure of the war-resisting government in the war stronghold in the North of Vietnam until the defeat of the French troops in Dien Bien Phu. Soft loan is the expression of low-interest or non-interest bearing debt instruments, whose working modality had been very popular and widely accepted in Vietnam. This type of financing instrument has been considered quasi-subsidies or grants, and had significant departure from normal commercial nature of debt financing. The NBV *de facto* played a dual role of central and commercial banking, and this situation continued until the legal changes from late 1980s through 1990. There existed virtually no formal financial market. Only did the so-called the 'black market', which was an informal credit process taking place among individuals and at tiny scales. Black markets by definition had been an illegal economic process until reform concepts were adopted.

After the regaining of independence in 1954, the Northern Vietnam, now following the Soviet-type command economy, set up the Bank for Investment and Development of Vietnam in 1958, and subsequently Bank for Foreign Trade of Vietnam in 1963. These were wholly owned by the State and served specific needs of reconstructing the economy in the peacetime. They were normally referred to as the "policy banks", created to accomplish the economic plan set out by the government in each period, such as the planner and monitor of funds, in compliance with predefined schemes, to the Soviet-modeled heavy industries, focal projects of developing strategically geopolitical urban areas in the North, or as the supporter of the import and export needs of the nation. These were not commercial banks, by and large. The salient feature of this period of Vietnam's financial history is its highly centralized financing process, in which everything should be planned. Thus the banks, be it NBV or policy bank, worked as the State agent strictly following the predefined credit plans set forth by the State.

3.2 The introduction of *Doi Moi* and the 1992-amended Constitution

In the National Party Congress VI of the Vietnam Communist Party (VCP: [7]) , a comprehensive and extensive reform program was initiated, which marked a departure of Vietnam's economy from the centrally planned and heavily subsidized model (see Appendix A.5). The Doi Moi program has been an influential appeal to the building of an open-market economy and the recognition of Vietnam's private economy. Naturally, Doi Moi has simultaneously institutionalized new concepts and changes in the then old-fashioned and poorly performing financial sector. The reform put an end to the autarky era by appreciating the contribution and the vital role of private domestic and international capital flows as one of the major growth engines for Vietnam to take off. The Doi Moi shakeout created a need to revitalize all political and economic concepts at the national level, and led to the notable amendment of Vietnam's Constitution in 1992. Remarkably, this Constitution legitimize the existence and rights to develop of the private economy, and thus of the capitalistic economic model, together with the State sector:

> "... The aim of the State's economic policy is to make the people rich and

> the country strong, satisfy to an ever greater extend of the people's material and spiritual need by releasing all productive potential, developing all latent possibilities of all components of the economy-the State sector, the collective sector, the private individual sector, the private capitalist sector, and the State capitalist sector in various forms..."
> — The 1992 Constitution of the Socialist Republic of Vietnam, Article 16.

The new legislation has enabled vital translations of Doi Moi concepts into almost all areas of the society's econo-political activities, and by that way greatly influenced the birth and growth of Vietnam's financial economy. Doi Moi has in effect revolutionized Vietnam's financial economy, and paved the way for its most important activities today, viz. domestic private investments; the building of diverse financial markets (not just bank); central bank's open market operations; and most recently the launching of the symbolically capitalistic stock market in 2000. Perhaps, the most noticeable and meaningful shake-up of Doi Moi to the development of the market economy, in general, and the financial economy, in particular, was the legitimizing of the individual ownership of the productive assets, and the shift towards a market-oriented economic model. These innovations were reflected, again in the Constitution 1992 (loc. cit. Art. 15), explicitly and fully:

> "The State promotes a multi-component commodity economy functioning in accordance with market mechanism... The multi-component economic structure with various forms of organization of production and trading is based on a system of ownership by the entire people, by collectives, and by private individuals"
> — The 1992 Constitution of the Socialist Republic of Vietnam, Article 15.

3.3 The central bank, two-tiered banking structure, and non-bank financial institutions

The State Bank of Vietnam (SBV) was created upon the new legislation provided by Ordinance on the State Bank of Vietnam, passed on May 23, 1990. The new SBV is the successor to the NBV predecessor and was restructured to accommodate new functions of a more modern central bank in a two-tiered banking system as well as to stay away from commercial banking activities, which the NBV predecessor had assumed. The new economic model, largely based on the market economy concepts, requires the SBV fulfill the following jobs:[7]

1. Developing strategy and plans for socio-economic development, policies related to monetary operations and laws relating to operations, currency, credit payments, foreign exchange, and banking;

2. Issuing rules and regulations under its authority and reviewing the implementation of laws and regulations relating to these matters;

[7] See Article 3, Ordinance on the State Bank of Vietnam, May 1990.

3. Being a lender of last resort, and a banker of bankers, and ensuring the professionalism and integrity of credit organizations;

4. Taking care of currency matters, i.e. the printing, casting and reserving of currency. This job also includes the managing of currency circulation and anticipating the economy's need of currency;

5. Participating in treasury activities with the State Treasury (Ministry of Finance), foreign agencies and international institutions. It may provide loans to the State where necessary;

6. Managing the reserves of foreign currencies and gold; monitoring the balance of payment, foreign exchange matters; ....

This represented a significant departure from the previous functional duality of the NBV ancestor. Following the move, the two other pillars of the banking sector nowadays were spun off from the SBV to become strategic State-owned Commercial Banks: Bank for Agriculture of Vietnam and Industrial and Commercial Bank of Vietnam, in 1992. The two previously founded policy banks, Bank for Investment and Development and Bank for Foreign Trade, were modified and restructured to become commercial banks. These four commercial banks, classified as State-owned commercial banks (SOCBs), have since then dominated the banking system, and become the major players in the Vietnamese financial market.

The two-tiered banking system started taking its shape. From 1992, there had been a new wave of establishing a new type of bank, termed as Joint Stock Commercial Bank ('JSCBs'). JSCB is a type of commercial bank, with its equity held legitimately by SOEs, SOCBs, individuals and private enterprises (also see Appendix). A typical JSCB functions as a private-sector bank. It operates retail and wholesales banking activities using the equity base, and an allowed maximum equity multiplier for JSCB, currently 20 times of the shareholders' equity. A JSCB should normally be allowed to take deposits, except when facing special legal imposition or moratorium by the SBV for serious reasons. Within the short period between 1992 and 1997, 56 JSCBs were founded. They operate in both urban and rural areas. The birth of JSCB newborns officially marks the introduction of financial economy in Vietnam, in which banks, for the first time, compete and strive to achieve better economic performance.

In addition, the new legislation allowed for the birth of non-bank financial institutions, namely finance companies, credit funds, financial leasing companies, etc. Until 2000, there are *ca.* 70 credit funds established and operational, plus a total of 16 financial leasing and finance companies throughout Vietnam.

3.4 The People's Credit Cooperatives chain collapse and the historical shakeout

Alongside the formation of the mentioned banking system, new People's Credit Cooperatives (PCC) mushroomed in late 1980s, forming part of the financial market. PCC is the type of deposit-taking institution, which performs similarly to commercial bank, except its smaller operation scale, limited geographic coverage of one PCC, equity size. A PCC initially could be just a group of people who contributed a certain amount of cash for operation. By nature a PCC was not a company, and had unlimited liabilities plus personal charges. The critical attribute was these institutions were allowed to mass mobilize capital from the public, while the legal framework for governing their operations had not been in place. The nomenclature 'mobilizing funds' of a PCC was actually interpreted fairly freely. The mobilizing in the painstaking period included trust-based borrowings, mass chains of deposit-taking outlets, borrowings from SOEs that had idle cash 'out of the State control', etc. They all had a common feature, virtually non-existent equity. In brief, a PCC was far less regulated than a normal bank. The number of such PCCs had grown fast to thousands throughout the nation, mobilizing thousands of billions of VND.

The performance of the credit cooperative system as a whole was questionable, but was left unaddressed until the collapsing chain-reaction in 1991-92 period. In this shaking period, thousands of PCCs shut down operations just over the time of week. Many factors can be thought of as the major reasons for this mass collapse, however, the most frequently referred factors are:

1. Risky capital structure, with no sufficient risk cushion of equity;
2. Weak professionalism and integrity of these cooperatives;
3. Limited number of investment opportunities for the public;
4. Inappropriate and inefficient monitoring of the authorities; and last but far from the least,
5. Underdevelopment of both financial system as a whole and sophisticated finance concepts in the economy.

While the first three can be and have been improved and fixed over the past ten years, the last factor proves to be intellectually and financially challenging. One possible underlying rationale for that difficulty may well be the long-standing centrally planned perceptions, which generate the bias when the public and policy makers embark on adopting new market concepts. In parallel with this, there existed in the past the mobilizing of funds in Ponzi scheme, where mobilizers used proceeds from subsequent depositors to pay preceding ones, without productively investing the funds for financial returns. This situation was rampant in late 1980s and early 1990s, contributing the shake-up of the whole system. One serious consequence of this has been the lack of confidence of the public in the overall finance system. Today, putting money in banks always reminds one of the devastating collapses in the early 1990s, which made thousands of people live in hardship for a while.

3.5 The entry of foreign-owned financial institutions

One landmark event in the reforming of the financial sector in Vietnam was the open-up of the banking system for foreign investment. The first foreign bank in Vietnam is Australian and New Zealand Banking Corp. (ANZ), which was established as a foreign wholly owned operational branch in 1991. This event triggered an influx of foreign bank representatives and full-fledged operational foreign-owned banks to Vietnam. Foreign-owned banks operate primarily on their registered equity. These foreign banks typically have the equity size of USD 15-20 million, and were initially licensed to operate for 20-30 years. Foreign banks can take deposits from foreigners, and also, partially, Vietnamese. However, the total deposition of local currency funds in an operational foreign bank has been capped by the SBV. Today, the regulation was relaxed somehow, but a foreign still cannot take more than 50% of its total deposited funds in local currency, i.e. Vietnamese Dong. One major source of funds for operation of these banks is from the parent firm, while an alternative might be the mobilizing of idle funds from FDI firms. Except a few banks, for instance, ANZ Banking Corp., that have targeted the retail banking, most foreign banks focus on commercial corporate and wholesale banking activities. These banks usually opt to fund FDI projects, and in most cases, stay away from the domestic private sector companies.

Foreign-owned banks introduce a wide range of products to the Vietnamese market, although thus far, those products have been delivered primarily to FDI-related clients. However, there appeared to have been a shift in lending policies of foreign-owned banks recently. Before, when seeking to diversify the portfolio, the only targets these banks looked at were the large SOEs. Until 1997, the number of foreign bank representatives present in the nation quickly proliferated to more than 80, from over 30 different nations and territories. More importantly, 24 full-fledged operational branches and five joint venture banks have been up and running in the marketplace. By the end of 2000, this foreign-invested financial component accounts for 8% of the total assets of the banking sector and ca. 10% of the economy's lending portfolio. In fact, despite the growing importance of the foreign-owned banking operations in the nation, this sector has still been outweighed by the SOCBs and looked like a small fraction of the country's financial system. With the promulgation of the temporary Prime Minister's Decree 64-CP by the government in 1994, the foreign-invested finance companies also started doing business in Vietnam in the form of joint venture financial leasing operations.

Table 7: A snapshot of foreign-invested financial institutions in Vietnam

	1992	1997	2000	2003
Full-fledged foreign bank branches	4	22	24	27
Operational joint-venture banks	0	6	4	4
Offshore investment funds (dedicated to Vietnam)	3	7	4	6
Onshore investment funds (dedicated to Vietnam)	0	0	0	2
Foreign bank representatives	51	85	70	42
Total Equity Base (USD million)	420	700	*590*	*530*

Sources: [15, 16, 17, 32, 33, 26, 12, 21], and self-estimates, in *italic*.

As such, these developments further advance the scale and diversity of Vietnam's financial markets, in which the commercial banking sector operates almost to the full swing.

3.6 Banking deficiency detected in late 1990s

The banking sector had grown up quickly over the first half of 1990s, in both asset size and lending portfolio. However, the second half experienced disappointing performance of it. The public and authorities detected various banking scandals in both SOCBs and JSCBs. In several fraudulent scandals detected in the period 1996-1998, the monetary loss exceeded many JSCBs capital base. Such scandals include the striking case of Tamexco, a Ho Chi Minh City-based Communist Party-owned SOE, about VND 500 billion (approximately USD 40 million) had been misappropriated and siphoned off the operations; the Minh Phung-Epco case, another Ho Chi Minh City-based privately-owned consortium, about VND 4,485 billion (USD 330 million) assets of the banking sector were stuck in illiquid and speculative real properties. These shook the financial system violently. Since the detection of the first few cover-ups, hundreds more were uncovered, with the average loss of bank being millions of dollars. In addition, a question about the integrity and professionalism of banks comes back to the public. The more investigated, the more non-performing loans are detected. The reported number of bad loans skyrocketed. And most of defective and fraudulent transactions had the involvement of the bank's personnel (in most cases, senior bank executives) as collaborators. Hundreds of bankers were arrested and several bank executives sentenced to death. Again, the safety of depositors' money and the soundness of the banking system have become a serious question.

Having identified the reason of malfunctioning as the unqualified banking sector, since 1998, the SBV produced a watch list of banks and insisted all banks on meeting new operating requirements. Of those most restrictive requirements are: (a) raising the minimum equity base of bank to VND 70 billion (or USD 5 million); (b) reducing the overdues-to-assets down to below 10%; and (c) following the prudential regulations in conducting the credit activities, e.g. auditing and accounting, building reserves for credit loss provisions, deposit insurance participation, etc.

In parallel, the SBV put several problem JSCBs in moratorium, and subsequently handed down the verdicts of bank mergers and acquisition on some of these, namely Vietnamese Bank for Private Enterprises (VP Bank, Hanoi), Asia Pacific Bank (Saigon), Nam Phuong Bank (Saigon). Other ten JSCBs have been now undergoing a total financial restructuring and senior management reshuffle (SBV, Econ. Research Dept.: [15, 16]). While these actions taken by the SBV have enabled JSCBs to reform and raise performance standards, they have not produced more positive impacts on the financial market genuinely because no such serious effort was made to the overshadowing SOCBs. The modus operandi of SOCBs remains, and thus, so do their intrinsic problems. One of the major intrinsic problems that caused theorists and practitioners a great concern is the non-transparency and not observing best practices in many operational areas, e.g. financial and managerial accounting, public disclosure and corporate governance. Any improvement in the modus operandi of the financial market must really come from solving out this concern (Farber, 2000:[9]).

3.7 The Asian financial turmoil and its impacts on Vietnam

While the grassroots problem of the Asian financial turbulence has come from the economic and investment structural issues, and the region's capability of matching a variety of financial obligations, its most evident symptom were the foreign exchange and capital flights. In this context, the unconvertible Vietnamese Dong, the officially legitimate domestic currency, did not fluctuate in high correlation to other regional currencies depreciation. This has been attributed to the half-opened (or half-closed) foreign exchange policies postulated by the government, and effectively run by the SBV.
The SBV posed a few restrictions that, in the short run, helped constrain needs of foreign exchange to avoid the pressure on devaluing the local currency, most importantly:

1. Foreign exchange earnings by exporters have to be sold to commercial banks, at adjustable proportions of 100%, 80%, or 50%, at the discretion of the SBV (Circular 107, SBV);

2. The offshore borrowings by domestic business-borrowers have to register the loans with the SBV and must receive necessary approvals from both the Governor and the SBV's Department of Foreign Exchange Management prior to any proceeding;

3. As to the approved offshore borrowings with medium to long-term maturity, the interest rate is capped at 6-month Libor (or Sibor) plus 3% per annum;

4. Until 1999, the trading of foreign exchange, mainly the United State Dollar, on the official markets (interbank market and authorized commercial banks) was strictly governed by and referred to the official rate announced by the SBV's Department of Foreign Exchange Management (see Appendix a.6 for details) within a thin fluctuation band of -0.25 to +0.25% of the previous trading day's rate. Since early, the strict announced rate has been replaced by the interbank-defined previous-day closing price. Still an upper limit of +0.5% per day is imposed on any rising of the foreign exchange price.

It is now useful to get some telling statistics about the historical macroeconomic indicators of Vietnam's financial health.

Table 8: Selected statistics of the macro level financials

	1996	1997	1998	1999	2000	2001	2002	2003
	In millions of USD, except percentage							
Current account balance	-2,431	-1,664	-1,067	-1,285	-307	-1,135	-2,770	-5,115
National reserve[8]	1,573	1,738	1,615	2,546	3,115	*2,815*	*3,081*	4,814
Total external debt	9,800	11,000	10,900	10,900	13,500	*15,419*	*16,377*	–
Debt-service ratio (paid)	6.7%	5.9%	9.1%	10.1%	9.3%	6.0%	6.6%	6.0%

Sources: *Economic Intelligence Unit*, 2001; International Monetary Fund Vietnam Country Reports, Statistical Appendixes 1995, 1998, 2001, 2004; World Bank Country Data Profile; and Intellasia news clipping services.

The foreign exchange (and equivalent) reserve is of our interest. The national reserve has not been affected a great deal over the crisis time. In general, the Asian financial turbulence has impacted the speed of growth in Vietnam, but not significantly undermined the financial system's stability, being an externality, as the economy is still half-open. The destabilizing factor is believed to lie inside the economy; increasingly cited to low efficiency and mishandling limited financial resources available.

3.8 The introduction of laws on the central bank, and credit institutions

The situation forces the public and government to revise their plans with regard to the pace of reforming the financial sector. The issuance of standard and modern banking laws had thus been pressurized tremendously. In 1997, the National Assembly gained the consensus to let legislators pass the two first laws governing the banking sector in Vietnam: Law on the State Bank of Vietnam, and Law on Credit Institutions (21-Dec-1997), superceding the previous decree-laws. These laws have enabled the legal and regulatory framework for the banking and financial institutions to operate to the generally accepted industry standards. More market concepts and best practices are dealt with and encouraged in the legislation. The passing of these banking laws marked a step forward from the previous ordinance, and by the introduction of which the government hoped to improve the long-run performance of financial institutions significantly and in a sustainable fashion.

3.9 Launching Vietnam's first stock market

The financial economy of Vietnam had long intended to build its own stock market. For over seven years, the government had put the establishment of the first Vietnamese stock market on the annual agenda. However, the serious preparation only took place since the launch of a dedicated organizing panel, the State Securities Commission (SSC), headed by Mr. Le Van Chau, a former Vice-Governor of the SBV, specified in the Government Decree No. 75-CP, in November 1996.

Following advances were the Prime Minister's Decision No. 127/1998/QD-TTg and Decree No. 48/1998/ND-CP, both passed on July 11, 1998, governing the establishment of Stock Trading Centers, and Securities and Securities Markets, respectively. Pursuant to the legislation, the SSC had pushed the preparation forward by coaching and preparing for the key regulatory framework for such a stock market to exist and function. The preparation was concentrated on the establishing of the first securities trading floor located in Ho Chi Minh City - the nation's economic powerhouse, called Ho Chi Minh City Securities Trading Center (here after, 'HSTC'.) The subsequent task would be another center in Hanoi, which is planned to open in the third quarter of 2001. These two trading centers will then be joined under the umbrella Vietnam Stock Exchange as a whole.

These efforts led to the launching of Vietnam's first securities trading floor, located in the financial and commercial center-Ho Chi Minh City, on July 20, 2000. This long-awaited stock market is still in its infancy, and operating on a pilot basis. As to the pilot scheme, the government and the authorized governmental agency in the deal, the

SSC, have imposed a great deal of restrictions and control measures, as we will sum up in the following diagnostic review. In short, for this early stage of the stock market's life, the government first off prioritizes the safety for prospective investors, leaving its growth, efficiency, liquidity, and other attributes of a model capitalistic stock market to be second imperative needs.

3.10 Banking deficiency re-detected in early 2000s

The reemergence of the banking sector's problems in early has a close connection to piled-up bank bad debts, poor-performing SOE borrowers, and rampant corruptions. After the banking shakeout in the period of 1998-99, in which information on doubtful debts and extremely dangerous health of Vietnam's banking system was unveiled, a number of reactionary responses were devised to defuse a possible financial crisis *ab intra*. We can point to the following as those that attract most attention by the population, financial professionals, policy makers, international donors community, and the public media.

1. Establishing Deposit Insurance Corporation Sept-1999 by Government Decree 89

2. SBV Decision 297 in Aug-1999 on requirement of bank capital adequacy, which requires equity to be equal to 8% of total assets, and restrict the capability of mismatched funding by allowing to use maximally 25% of short-term deposits to provide medium- to long-term loans.

3. Establishing and channeling funds to the *superbank* Development Assistance Fund (DAF), established 2001, whose predecessor is the General Department of Investment.

4. Government's Decree 100-1998-ND-CP on 10-Dec-1998, SBV Decision 171-2000-QD-NHNN on 8-Mar-2002 that stipulates regulations on establishment, management and use of SBV Risk Reserve (provision). By this, the established risk reserve is set at 10% of SBV's total revenue. The reserve is used to offset losses arising from credit, payment and treasury operations. The operation of this reserve has to consult with the Ministry of Finance, and the Prime Minister Office in many special circumstances.

5. SBV Decision 1627-QD-NHNN on 31-Dec-2001 to classify categories of doubtful and bad debts, in domestic standards. Terms of this quickly became irrelevant as the classification had significant difference from the international norms, and was vague in many circumstances. A revision or even new promulgation on this issue is proposed on agenda in 2004.

6. Recapitalizing SOCBs, by rerouting the doubtful debts to DATC, cleaning the books, and pouring more statutory capital funds to them.

7. Allowing SOCBs to write-off, write-down much of the SOE borrowers' uncollectibles.

8. Establishing the Debt and Asset Trading Company (DATC) in Feb-2004 to deal with banks' bad debts and assets. The first crop of SOEs' bad debts involved 20 noisy

SOE cases, where uncollectibles by banks mounted upto VND 615.7 billion (USD 39.5 million), while equity of these had evaporated over years in red.[9]

However, these measures have not solved the problems, not to mention creating more. The problems remain with SOEs, as the borrowers, and SOCBs as lenders. In many cases, bad debts, poor performances, and corruptions are connected as due to the absence of transparancy in most banking deals. The situation gets worse when we look at some statistics reported by both government offices and mass media. By the end of 2003, through sample statistics the reported bad debts and uncollectibles of SOCBs is approximately VND 35 trillion (equivalent to USD 2.235 billion). This number is horrible, as the total collective equity of four largest SOCBs, which account for 72% of lending market, and 78% of mass funds mobilization nationwide, only stood at USD 425 million at the end of 2003. Moreover, the actual figure is predicted to be much higher, if many types of financial supports from the State are doffed off, and the whole population of SOEs is surveyed seriously. Most of this huge amount is at SOEs of all types, through what is called 'directed loans[10]'. The consequence of 'directed credits' has been very eminent because those who have the power to 'direct' credits to SOEs usually have little responsibility in terms of the state-run banking system. In one of the eminent cases, very recently, that brought two deputy ministers at Ministry of Agriculture and Rural Development (MARD), and two other ministerial department heads to prison in 2003, the concerned governmental officials simply sent correspondences in the form of suggestions, guarantees, requests, etc., to SOCBs, in order to enable the SOE, called Marketing Company, to obtain the loans. The firm by establishment date had only USD 60,000 equity, but in a very short period of time, less than two years, has borrowed VND 129 billion (USD 8.27 million). Reported at the court, this firm immediately used USD 1.24 million in direct bribery to concerned officials. The total loss amount of funds that banks could not recover from this deal solely was VND 77.4 billion (USD 4.96 million), or 60% of the loans! Similar problems happen almost everywhere in Vietnam, and through the Vietnam banking system. To address this issue in detail, we will continue in the section discussing the current banking system as the major component of the Vietnam's contemporary financial system as a whole.

3.11 Observations of and commitments to multilateral organizations

The list of commitments and important dates that help mount up the pressure on further reforms follows.

1. ASEAN Framework Agreement on Services on 15-Dec-1995 in Bangkok, when Vietnam became the full-fledged member of the regional organization.

[9]The DATC itself was inaugurated on 6-Feb-2004, with initial chartered capital of VND 2,000 billion, or USD 129.2 million. Its major task is to assist restructuring debt-laden SOEs. DATC's capital for operations is from the budget expropriation. The first disbursement was made in early Feb-2004, mounting to VND 500 billion (USD 32.3 million). The remainder of VND 1,500 billion (USD 96.9 million) will be disbursed fully by the end of 2005, using two major sources of funds: (a) reserve funds for SOEs restructuring; and (b) government budgets under Ministry of Finance's supervision.

[10]Interventions into the SOCBs' operations, in particular the lending process, are common. The forms of interventions are diverse: guarantee, directions, high-ranked opinions, etc.

2. US-Vietnam Bilateral Trade Agreement on 13-Jul-2000 in Washington, D.C., with which Vietnam has to observe many conditions and terms with respect to the financial markets mechanism. One example is to remove all restrictions on local currency (VND) transactions by 2008.

3. WTO's General Agreement on Services, which Vietnam has been in a bid to become a member in 2005. Many conditions impose the country to liberalize banking and nonbank financial sector, and cut off financial subsidies to SOEs, including SOCBs.[11]

Besides these extremely influential commitments, many others also add up to the list, such as conditions to work on lending scheme by the World Bank, International Monetary Fund, Asian Development Bank, Consultative Donors Group (representatives of donor countries to Vietnam), EU Mission, Japan's bilateral schemes, and so on. Given the existence of these agreements, and the wish to re-integrate into the world's economy, the need of reforming the financial economy has become not just Vietnam's own wish, but also the obligations for the nation to observe common rules.

Having reviewed its chronology, we next move to discuss the current structure of Vietnam's financial system, after many changes over the past 15 years. This picture is naturally important to our understanding of the country's financial economy in the transition.

4 Current Structure of the Vietnamese financial system

Those major financial components of Vietnam's economy include:

1. The banking sector, which is the largest, and dominent, as we will see shortly.

2. The nonbank financial institutions. These include non-deposit-taking finance companies, leasing companies.

3. People's Credit Funds, which are deposit-taking institutions, but do not belong to the category of banks.

4. Securities companies, including broker firms.

5. Investment funds.

6. Policy bank, development funds and the rest.

In terms of organized markets, those that operate frequently are: (a) the bank credit market; (b) interbank money market and foreign exchange market; (c) the equity market; and (d) the bond market. Since the equity market will be analyzed in detail in other work, in what follow we focus on the bank credit market, interbank market, and the bond market. Some elaboration on interest rates is also provided.

[11] We note that SOCBs are simply SOEs, but with huge size, to Vietnamese standards, and extreme power in dealing with national financial flows.

4.1 The bank credit market

4.1.1 The picture of the banking system

The banking system is the most important, and also the most long-standing one in the national economy. Several important findings have been documented and summarized in previous studies of the Vietnamese financial market and its reforming process, particularly those undertaken by the World Bank (*ibid.*[3, 4]); Asian Development Bank (1999). One major finding is the system's serious structural issue. This issue in practice can be considered to have several variations, as the structural notion itself is manifold.

For example, in ADB analysis (Shimomoto, 1999:[28]) the most eminent variation of it is the centering of the financial sector around the banking sector. In this regard, whereas the total assets of the financial system in Vietnam is estimated VND 157.46 trillion (or, USD 11.25 billion), of which the banking sector collectively holds approximately 80% (*ca.* VND 125.97 trillion, or USD 8.98 billion) as of Dec-1999. Not surprisingly, the total financial assets of the banking sector stands at VND 72.3 trillion (USD 5.2 billion) in aggregate, accounting for *ca.* 80% of the total national capital flows to all economic sectors. The findings (*op. cit.* Word Bank:[3]; Shimomoto, 1999:[28]) indicate that the banking sector outweighs financial institutions of other forms, both in terms of assets holdings, mobilization, financing scale.[12]

Table 9: The banking sector by form of ownership

	Number of banks by ownership						
	1991	1993	1995	1997	1999	2001	2003
SOCBs	4	4	4	5	6	6	6
JSCBs	4	41	48	51	48	39	36
Bank JVs	1	3	4	4	4	4	4
FOCBs	0	8	18	24	26	27	27

Sources: Various business press issues of Vietnam Economic Times, Vietnam Investment Review, Banking Review, etc.

Five years since the reports [3, 4, 28], several changes have taken places as we have seen in the previous discussion of §3.10, but the important questions still linger on:

1. Any actual and major changes in the financial structure of the nation took place?

2. Any major shift in strategic dominance of the state-run banking sector?

3. Has the performance of debt borrowers improved to bankers' eyes?

To address the first two questions, the following table (10) has been estimated using official statistics on capital adequacy and total assets, estimates of equity base. The table has three points in times, 1993, 2001, and the first quarter of 2004. This table together with table (12) will present a fairly clear comparative picture of the banking sector in Vietnam over time, in terms of its lending performance and financial adequacy.

[12]Data sources: compiled and synthesized by the author from sources of ADB (*op. cit.* 1999); (*op.cit.*[3, 4]; IMF (*op.cit.*1996, 1998, 1999) and self-estimates.

What we have seen is the financial adequacy of the banking sector has decreased over comparative points in time. However, JSCBs, FOCBS/JVBs, and NBFIs have shown better adequacy. Banking assets have expanded quickly over time since 1993. The outstanding level reaches out to over VND 330 trillion (VND 21 billion). This amount is not large to international standards, but quite substantial to the Vietnamese standard, if we compare it to the realized real GDP of the nation for 2003, just about USD 31 billion (USD 383/per head). This shows that the credit market has grown up significantly over time, as it stood at only USD 3.39 billion in 1993.

The state-run banks have the lowest level of capital adequacy because its debt financing has increased faster than its equity. Overall, the number of bank population decrease after the mergers happening among the joint-stock banks after late 1990s problems. Two more SOCBs are added to the market: Mekong Housing Bank and Bank for the Poor. Several foreign banks closed down operations due to inefficient performance or small size of the market, e.g. ING Bank and Bank of America.

Over the years, JSCBs have made great efforts to restructure and re-position themselves in the banking market. The reduction of the number of JSCBs down to 36 is a clear example of the restructuring. Among JSCBs, there exist natural classifications based on performances and sizes. Top national JSCBs include larger ones, with promising business results and growth, namely Asian Commercial Bank (ACB), Saigon Commercial Bank (Sacombank), East Asia Bank (EAB), Phuong Nam Bank, Vietnam Export and Import Bank (EIB), Techcombank (TCB). As these banks are in fact shareholding companies,

Table 10: Structural issue dimension at time snapshots

			1993 snapshot	
	SOCB	JSCB	FOCB/JVBs	NBFI
Capital adequacy	6.0%	14.0%	25.0%	13.5%
Total asset	85.0%	8.0%	6.0%	0.5%
Equity base	510	8.7	64.0	13.5
Institutions	4	32	11	2
			2001 snapshot	
	SOCB	JSCB	FOCB/JVBs	NBFI
Capital adequacy	4.5%	9.0%	16.0%	12.0%
Total asset	78.0%	11.0%	8.0%	3.0%
Equity base	1,341	83.9	165.8	103
Institutions	6	39	31	10
			2004 snapshot	
	SOCB	JSCB	FOCB/JVBs	NBFI
Capital adequacy	3.8%	8.0%	16.0%	10.0%
Total asset	75.0%	14.0%	8.0%	3.0%
Equity Base	2,063	109.8	177.0	107.0
Institutions	6	36	31	12

Capital adequacy: Equity-to-Asset; Total asset: percentage of the total profit-generating asset of the component over the total market; Equity: average equity of the sector measured in VND billion; Institutions: the number of operational institutions in the financial structure.

they have the capability of raising more equity via public mobilization. The race started in 2003, with some statistics in (11) below.

Table 11: Top JSCBs equity increase and 2004 plan

	1999	2003	2003 Earnings	2004 Plan
	Unit: VND billion			
Asia Comm. Bank	354	424	185	557
East Asia Bank	85	253	100	350
Sacombank	71	505	125	650
Eximbank	250	300	*60*	500
Techcombank	70	110	36	180

Sources: State Bank of Vietnam summary; Banks' report and planning; and self-estimate (in *italic*).

In reality, well-performing JSCBs equity raising plan has been backed by their promising earnings in 2003, together with safe ratio of overdues over total loans, with 30/37 banks experience this ratio of $\leq 5\%$.

4.1.2 The dominance of state-run banks

At the microstructure level, the SOCBs outweigh all other non-state banks, including both JSCBs and those with foreign capital, in terms of assets portfolio. Literally, in 1999, SOCBs accounted for 81.5% of the total financial assets portfolio of the market, or VND 59 trillion (*c.a.* USD 4.3 billion) as of 1999 yearend. The 'critical mass' problem of JSCBs is also widely known, i.e. leading to the current scheme to restructure and resize those 46 non-state banks from this cramped population.

Table (12) indicates that the story has had little change. The SOCBs still dominate the bank credit market. Operationally, Vietnamese banks mobilize funds from the public, including individuals, companies, administrative agencies with idle cash. Mobilizing from the individuals becomes increasingly important when the confidence in the banking system starts returning to depositors. Not many Vietnamese have transactional accounts, but most have the so-called 'savings book'. A savings book is similar to a certificate of deposits, but is non-transferable, and can be demand or term book. Savings book usually generate a higher interest than transactional account. Vietnamese are also allowed to deposit funds in USD at selected and authorized banks, of which the most active bank is VCB.

As to bankers, the savings book appears to be more reasonable mobilizing vehicle. This source of funds is stable and abundant. The larger banks, especially SOCBs, even enjoy much lower cost of funds than JSCBs. The major dilemma the banks face now is the foreign exchange exposure. While low interest means less expensive cost of funds to the bank, it could easily force depositors to convert VND to USD on the black markets and re-deposit with banks. This tactic proved to be very safe when some unexpected change in foreign exchange is suspected. It is a months-long paradox that a safer and stronger USD savings book provides the depositors more interest than its local currency counterpart, with more forex exposure and lower real interest. In this highly bank-centered financial sector, non-bank financial institution (NBFI) sector is notably underdeveloped, although

Table 12: The dominance of SOCBs in commercial lending

	Total Lending	SOCBs:	VCB	ICB	BARD	BIDV	JSCBs and FOCBs
1990	10,053	9,505	2,192	3,032	2,851	1,430	548
1991	15,093	13,867	3,618	4,190	3,999	2,060	1,226
1992	23,179	21,016	4,976	6,189	6,126	3,725	2,163
1993	29,768	27,138	6,237	6,670	7,855	6,376	2,630
1994	42,277	33,647	7,534	8,601	9,576	7,936	8,630
1995	50,751	38,879	8,046	10,318	12,161	8,354	12,431
1996	56,926	43,742	9,052	11,609	13,682	9,399	13,184
1997	62,201	48,042	9,942	12,750	15,027	10,323	14,159
1998	72,597	59,087	12,228	15,681	18,482	12,696	13,510
1999	112,730	76,559	*13,659*	*21,905*	*22,968*	*17,991*	36,171
2000	*186,268*	*141,654*	14,421	26,224	39,393	34,420	*44,704*
2001	*205,442*	*152,027*	16,476	39,594	51,472	44,485	*53,415*
2002	*259,325*	*197,087*	29,295	47,121	66,399	54,272	*62,283*
2003	*330,121*	*247,591*	–	–	–	*69,845*	*66,024*

Source: the State Bank of Vietnam Annual Reports; IMF Country Reports; SOCBs audited annual reports, various years; self-estimates in *italic* by synthesizing numerous public data, on both mass media and private sources.

(*) Note: From 2000 onward the figures are estimated by the author using various public statistics, including commercial banks' reports. The figures provided by IMF in their official country reports from this year on show critical departure from the actual performance of the market, for many reasons. One of such reasons has been the inaccuracy of data from the SBV, which later caused a noisy dispute between IMF and the Vietnam banking authority. IMF ended its PRGF lending scheme in Apr-2004, and stated to possibly close down its office in Vietnam. We also notice the superficially balanced numbers in IMF's statistics with the fact that when computing past IMF data on Vietnam's banking system the proportions of total loans out to the economy of four state-run banks have been *exactly* the same for four consecutive years (1996-99), which are totally made up, hence, unreliable.

it already outnumbers the banking one with over 70 credit cooperatives, 170 People's Credit Funds (a type of savings-and-loans institution), eight finance lessors, plus eight domestic finance companies. The underdevelopment of NBFIs is reflected by its much smaller size of total assets, capital base, and investment portfolio. On the other hand, NBFIs performance seemed[13] questionable with no finance lessors making profits, most credit funds and cooperatives having overdues of over 20% of assets, and finance companies in the wait-and-see mood.

The super-weights of SOCBs come from the fact that they own large equity funded by the state. The best-performing SOCB is Bank for Foreign Trade of Vietnam (VCB), made a pre-tax profit of approximately VND 451 billion (USD 28.9 million) in 2003, representing ROE of 17.9%, compared to that of the non-state ACB VND VND 185.5 (USD 11.89), with pre-tax ROE standing at 43.8%. However, SOCBs have great advantages compared to other commercial banks, both domestic joint-stock and foreign-owned banks:

1. Large network of branches, transaction offices. The network has been established over the past 50 years, at the cost of the State, thus, currently no other banks can compete in this sense.

2. They receive direct funds from the government to increase equity. More recently, on 6-Jun-2003, The Ministry of Finance injected VND 1,900 billion (USD 123.04 million) into the big four SOCBs. The amount this time was split by the portions provided by table (13).

3. When their business has trouble, especially with shortage of funds and growing bad debts, SOCBs are usually able to seek financial supports from the government. An example is the DATC treatment of bad loans from SOCBs caused by poor-performing SOEs (see §3.10 above), SOCBs get rid off these problems by transferring them to DATC, after approved by the MOF.

4. Sizable operations bring back more funds. With huge size, SOCBs can establish commercial activities much more easily than smaller JSCBs. Also the 'reputation' of being backed by the State is another asset.

5. Lower cost of funds. Economies of scale help SOCBs reduce funds, as they can reach depositors and corporate entities throughout the nations. Also, in many cases, SOCBs serve as banking agents for State organizations and large international pool of funds, in which case, SOCBs can make use of funds with marginal cost.

We also note the fact that government injection of funds to SOCBs is not unique in the case of Vietnam. The same had been done in China, P.R., where the economic structure and banking system are very similar, except the huge scale. On 26-Nov-2003, the Chinese government also decided to save big four SOCBS (bearing the names very

[13]N.B.: Lacking systematic data, figures presented in this Section throughout are those accessible by the authors, provided in a range instead of specific values. Although they are not necessarily comprehensive for the overall market, the data is relatively corresponding to public reports by various agencies.

similar to Vietnam's big four), by injecting RMB 2000 billion (RMB 8= USD 1) into their equity. The same practice had been done in 1997, when the Chinese government poured RMB 270 billion in these four, plus moving their non-performing assets, piled up to about USD 1,600 billion to the Central Asset Management Co. (similar to Vietnam's DAT).

In fact, there are a lot more advantages that we could count to show the absolute advantages over the other commercial banks. However, their major weakness is also very fundamental: the actual capability of generating profit. It is extremely hard in Vietnam to obtain statistics on banking system, especially the SOCB system, as the information is categorized as one on the list of National Secret Information.[14] Even in public address, the Governor of SBV only stated the growth of the system, in percentage, and most addresses were uninformative.

But, we can still sketch the a draft picture of actual profitability level of SOCBs through the weaknesses of the operations. They can be summarized as:

- Weak security. Cases of embezzlement, corruptions, conspiracy with borrowers, etc. happen rampantly with SOCBs. A typical case, most recently, is one treasurer of the best SOCB (VCB) was arrested for embezzling USD 4 million. The problem was, he had done that frequently over 9 months, but the bank could not detect the problem. The case and the amount were unveiled only after the police arrested him. In fact, actual loss was still in question.

- Bad debts linger on. All SOCBs have big problems with bad debts, and the lack of information was part of the reasons that IMF stopped its PRGF lending scheme with the government. The statistics has always been too little, too late, thus could not help any efficient policy modeling in the SOCBs reform. In a rought estimates, the following banks might even have equity close to zero or negative, if bad debts counting follow international standards and now such 'debts freezing practice' was introduced to help SOCBs: ICBV and VBARD. Situations are better, but not optimistic with other big two. For instance, BIDV's income statements in 2000 stated pre-tax profits of VND 285 billion, to Vietnam Accounting Standards. But Price-WaterhouseCooper stated its figure of VND 139 billion. Similarly, the after-tax profits showed by BIDV was VND 200.6 billion in 2000, while that of PWC was the

[14] Violators can be treated as committing fellony, and be imprisoned.

Table 13: SOCBs equity injections in 2003

	6-June-2003 injection		Total first phase injection	
	VND billion	USD million	VND billion	USD million
VBARD	700	45.33	1,500	97.10
VCB	400	25.9	1,000	64.76
ICBV	400	25.9	1,000	64.76
BIDV	400	25.9	1,200	77.70
Mekong Housing Bank	–	–	200	12.95

Sources: MOF and State Bank of Vietnam summary; Banks' report and planning.

mediocre VND 13 billion.

- Inappropriate loan loss provisioning. The bank lending activities always face up loan losses due to borrowers' risks. Clients risks also vary over over time. However, the loan loss provisioning has not been done appropriately at SOCBs. Very commonly, when borrowers are SOEs (and they are SOEs most of the time), SOCBs try to seek some special treatments as the lending has some 'policy factors'.

In brief, SOCBs are giants in the banking market of Vietnam. But these giants have been sick of bad debts, client poor performances, unsafe equity multipliers, and weak management skills. The government gradually realized this fact, and have tried to find the way out. However, the results have thus far been very limited.

4.1.3 Bad debts, corruptions: Eminent sources of risk

By statistics, and nature of the low development of the financial economy, we have known that the banking system is dominating the economy, with huge asset size. Further, we know that SOCBs are dominating the bank credit market, but they themselves are contracted a big diseases of weak performance and bad debts. We discuss a little more here the problem of bad debts, and the sources of bad debts.

When looking at JSCBs or FOCBs, bad debts are a natural credit risk. However, with SOCBs, the nature has the characteristics of policy risk. It is because SOCBs usually follow some directions in practicing the lending. An *ad hoc* survey in late 2003 with one SOCB took up a random sample of 692 loans, with substantial amount of credit, a little over VND 16,000 billion (38% of total outstanding loans of this SOCB at the time of the survey), bad debts by international definition increased to 46%, a quantum leap from the Governor's re-iteration that bad debts in the banking system is only around 7%. IMF also stated the actual bad debts ratio to outstanding loans of Vietnam banking system is around 40%. By the weight of SOCBs asset in the economy, we can imply easily that SOCBs cause the bad debts problems. Given this information, the central bank (SBV) simply stayed quiet, with its Head of Bank Strategy Department commenting that the bad debts are still unknown.

Huge bad debts should come from some sources that are easy to see. And in Vietnam, they are SOEs with very poor performances, government projects that went belly-up, and other State sector. In my recent survey, by doing random collection of data from newspapers[15], the SOEs and State-funded projects have caused huge losses of funds and credits to the economy, with some striking figures as follows:

- A fractional sample of SOE populations, comprising of about 160 SOEs, made a loss of VND 1,452 billion in the period of 2000-03 (approximately USD 93.1 million).
- 14 surveyed SOEs have a huge equity multiplier, even higher than the banks! This simply means that they accessed loans too easily, somehow, and created assets almost purely from borrowings. In the small sample, the lowest equity multiplier is already

[15] I did the job using only public sources, that do not violate the National Secret Information regulations

at 16 times (almost of a bank, 20 by law), and the highest is 89 times! The average is 40.7, twice as much as the actual asset mobilization of a normal bank. Needless to say, debts have turned them all to financial distress.

- Corruptions are also rampant. In a small sample, running on news-clips, I found about 90 famous corruption cases, many dealing directly with banks' borrowings, for the period 2000-04, mostly concentrated on the period 2001-03. The amount surveyed already reached VND 7,808 billion (approximately USD 488 million).

- No observation of best practices in bank lending activities. SOCBs broke all the rules and safety requirement when dealing with large loans. Such rules usually impose percentage limit for industry, individual firm, and credit characteristics that banks should not exceed. However, directed lendings show the following extreme loans of large size that I survey recently: Sugar production VND 3,881 billion (USD 259 million); cement factories VND 2,900 billion (USD 193 million); paper mills VND 746 billion (USD 50 million); Iron casting VND 896 billion (USD 60 million); Fertilizer production and trades VND 858 billion (USD 57 million); Locomotives VND 224 billion (USD 15 million); Offshore fishing boats manufacturing VND 1,600 billion (USD 107 million), and so on.

One should notice that these figures are way below the actual level, as I did this with only noisy cases, and appeared on mass media after a strict censoring practice by the government. Still the figures are shocking to any Vietnamese. We have seen that the banking sector, and SOCBs being the main players, is the biggest creditor to these SOEs. Hence, there is no difficulty to see that when the SOE sector makes it bad, SOCBs struggle with the uncollectibles, and their equity are wiped out very quickly, despite government continuous injection of capital.

4.1.4 Vulnerability of the banking system

The bad debt has caused the banking system, especially the SOCB sector, vulnerability to further crises. In recent announcement, the government stated that following international rules of the integration game, it can no longer subsidize SOCBs after 2005-06 period. And the SOCBs will have to find way to deal with shrinking equity base if writing off bad debts. And this will clearly be a problem as the SOCBs have to be on their own.

Following this, first two SOCBs have submitted their *equitization* plans to partially privatize their assets, as well as raise more equity through the public and stock market, which are VCB and Mekong Housing Bank. These plans have been approved in principle by the government in Apr-2004. However, whether such plans will actually reduce the vulnerability caused by poor performance and huge dependence on the State over the past 50 years or not is still a question.

Another aspect of vulnerability is in the slipping confidence of the public in the banks. We have mentioned earlier that the nation experienced chain collapse of credit cooperatives, and banks' problems. Despite the struggle, that image has changed much, even with top JSCBs, considered more sound and safe. Once again, the public experienced the fresh case of ACB in Oct-2003, where tens of thousands of depositors rushed to withdraw money from this best-performing bank of the country following the rumor that both president and managing director of the bank fled the country. It took the ACB and the central bank 3 weeks to persuade and guarantee in the best faith, together with a critical emergency monetary assistance of VND 900 billion (USD 57.7 million) to help calm the market down.

4.2 The interbank market and some elaboration on interest rates

4.2.1 The interbank market and VNIBOR

Our analysis now moves on to discuss the situation of one of the most important factors recently in terms of a more market-determined interest rates: the interbank market. The interbank market is nothing special, but the mechanics with which legally-registered full-fledged commercial banks, both domestic and international, can lend, onlend and do other types of commercial banking transactions. Many foreign bank branches operating in Vietnam participate in these transactions, and in fact have played a critical role since the market establishment in 1995. The interbank market has since been closely monitored by the State Bank of Vietnam.

We will in the subsequent review look into the level of interest rates offered among banks, under the official term: Vietnam Inter-Bank Offered Rates, or for short VNIBOR. VNIBORs are quoted every transactional day, and we obtain the data from Dow Jones Telerate. These have also been organized into our own databases since Nov-2002, when we established formal contact with Telerate. In daily transactions, we observe that the most frequent terms for VNIBOR quotes are O/N (overnight), 1-week, 2-week, 1-month, 2-month, 3-month, and 6-month. Thus far, all the offerings have been made in the local currency, i.e. Vietnamese Dong (VND). This fact indicates that most banks are not ready for making longer-term loans in Vietnam, appreciating the risks, together with foreign banks' high provisional rates. In fact, the majority of corporate transactions occuring at domestic commercial banks, belong to the 3-M type of loans. Typical banks that frequently participate in interbank operations are: (a) Vietnamese: Asian Commercial J-S Bank (ACB), Bank for Foreign Trade of Vietnam (VCB), Bank for Investment and Development of Vietnam (BIDV); (b) Foreign and JV Bank: Citibank, Deutsche Bank (DB), Standard and Chartered Bank (SC), Hong Kong and Shanghai Banking Corp. (HSBC), ABN Amro Bank (ABN).

We present below graphs showing three pairs of VNIBOR quotes over the past 13 months for a view of price formation process in the interbank market (see figure 8, 9, 10). These three pairs are formed between two typical domestic commercial banks: VCB (most power state-run) and ACB (most efficient privately-run); Citi (most active foreign-owned) and Standard-Chartered; and the comparative view between VCB and Citi as two representatives of domestic and international banking powers in Vietnam. The rates shown in the graphs are quote for O/N transactions, the most frequent type of dealing. Unit for measure (vertical axis) is per cent (%) per annum.

In pairs, the VNIBOR quote rates move in the same trend, as seen in the graphs, over long enough time period, let say 4 to 6 weeks. However, in the short run, some large deviations occur in the case of VCB and ACB. The rather transient deviations could be attributed to different sources of fundings between these two. As a privately funded and managed bank, ACB could hardly enjoy abundance of low-cost finance or obtain immediate availability, but in majority of situations rely on its own financial positions, considering the balance of inflows and outflows of finance. It is understandable that this particular bank, although regarded as the *giant* among nearly 50 domestic privately run banks, their reaction to changes in environmental settings is different from that of VCB.

In the pair of Citibank and Standard-Chartered, two worldclass banking players, the difference has been quite minimal. Except for the fact that SC is less active than Citibank in the marketplace, including interbank, they appear to have found consensus in deter-

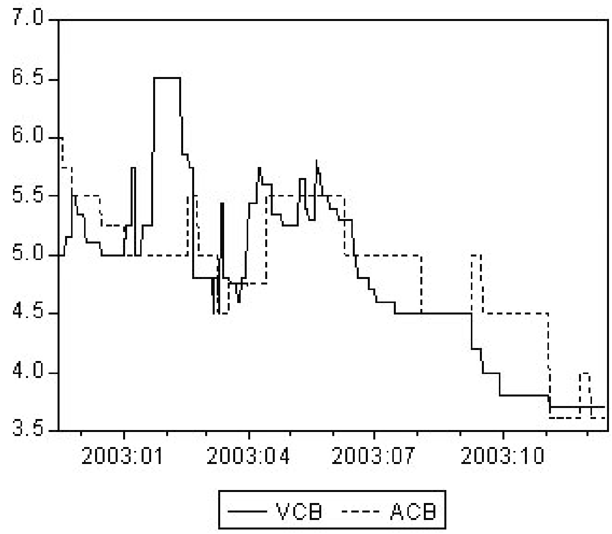


Figure 8: VNIBOR quotes: VCB and ACB

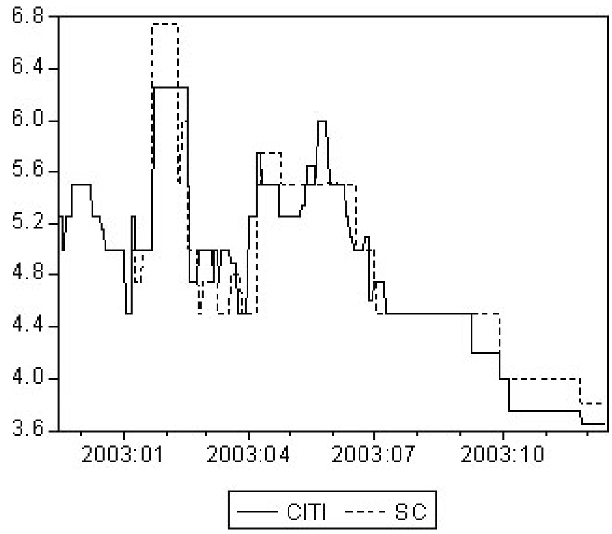


Figure 9: VNIBOR quotes: Citibank and Standard-Chartered

mining the VNIBOR rates through what we see in (10). This point can be confirmed later with further statistics on comovements of quote rates among these two in table (14).

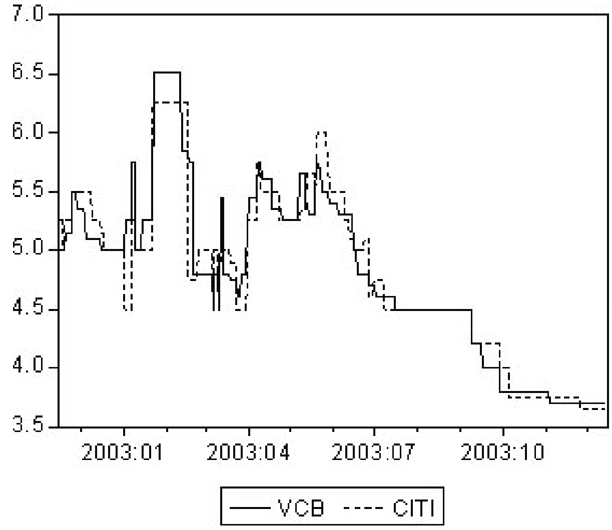


Figure 10: VNIBOR quotes: VCB and Citibank

Similarity in comovement is found between VCB and Citibank as two representative of major banking players in Vietnam, one national the other international. Their reactions to the market changes reflected in VNIBOR quotes have been quite similar. The two lines almost go identical in the majority of the timeline in our sample. Deviations when present were almost immediately adjusted. In general, all deviations appear to have been negligible, and disappeared in a short while. We must note that VCB is the only that can be considered of the regional quality in banking muscles (strongest equity base), and is the oldest bank in Vietnam.

The table (14) below provide us with a more complete view about the interbank rate determination and comovements among banks. Although they appear to be highly positively correlated in price, most foreign banks reach almost complete consensus in interest rate trends(!), while domestic banks appear to have possessed larger differences. The private bank ACB is perhaps the single most deviated from the general trend of bigger banking players, including two state-run giant, Bank for Foreign Trade of Vietnam (VCB) and Bank for Investment and Development of Vietnam (BID).

In this discussion on interbank market and VNIBOR as one type of price, price for the capital borrowings, we have in reality looked into the issue of price formation in the money market. Fluctuation in interest rates has gradually influenced the economy much more than early 1990s. The interbank market operations and the statistics on VNIBOR nowadays reflect the changes in the financing settings of many financial institutions, especially with active participation of foreign-owned banks. Forming an important part of the capital base for banks, VNIBOR acts as a reference to other wholesale and retail finance products.

4.2.2 Interest rates

Interest rate is defined as the cost of capital that the user of funds pays for true owner to compensate the time and risk involved. That concept has not really been adopted in Vietnam's financial markets. The interest rate level was highly regulated by SBV before 2001. Before, the SBV set the ceiling that no banks were allowed go above, unless they wanted to be fined. In 2000, the SBV introduced a new method of controlling, less direct but conceptually the same, that is this central bank announces a 'base rate' and some spread limits periodically, and commercial banks are allowed to build their interest policies, so long the interest rates stay within the range of basic rate plus and minus spread limits. The main problem with this is to be on the safe side, the SBV announces a very small spread limit around the already low basic rate. For instance, the current base rate is 0.5%/month for VND, and spread is 0.5%/month, so the max interest rate a bank can go for is only 1% per month. Similarly, the basic rate for USD loan is SIBOR or LIBOR p.a. plus 2.5%. Thus 2.5% is the maximum compensation for the bank's money, no matter however long the maturity and risky the transaction.

Since 2001's Decision 1627, the basic rate was made irrelevant by the fact that it would become only a reference. However, in the business life, there has been little change, as faced by the issue of interest rates, banks have the tendency to rate in the same range. And the funding decision is only yes or no, not the matter of how high interest rate for different levels of risk involved.

Table (11) shows a clear downward trend in interest rate (in this we use the most commonly used 3-month commercial lending rate), following the declining inflation levels of Vietnam over the past decade.

A comparative view on national interest rates It is quite problematic to obtain a complete set of interest rates for the purpose of a comprehensive analysis on the situation in Vietnam in the reform period. We have gone over thousands of pages of domestic studies, reports without succeeding in getting the data. The data we use for this analysis is a combination of the IMF's international statistics on macroeconomic data for a number of economies, our self-organized database for Vietnam, and some minor adjustments to make the data consistent.

Table 14: Correlation Coeffs. Matrix for VNIBOR

	ACB	ABN	CITI	VCB	BIDV	DB	HSBC	SC
ACB	1	0.7027	0.7333	0.7099	0.7634	0.8125	0.7780	0.6908
ABN	0.7027	1	0.9556	0.9554	0.8836	0.8877	0.9641	0.9255
CITI	0.7333	0.9556	1	0.9664	0.9200	0.9374	0.9756	0.9356
VCB	0.7099	0.9554	0.9664	1	0.9016	0.9031	0.9586	0.9328
BIDV	0.7634	0.8836	0.9200	0.9016	1	0.9452	0.9108	0.8293
DB	0.8125	0.8877	0.9374	0.9031	0.9452	1	0.9273	0.8631
HSBC	0.7780	0.9641	0.9756	0.9586	0.9108	0.9273	1	0.9396
SC	0.6908	0.9255	0.9356	0.9328	0.8293	0.8631	0.9396	1

In this discussion, Vietnam's interest rates in level will be compared to a number of selected economies, so that one can have a better view of the differences. Those economies included for this purpose are the United States, the European Union as a whole, Thailand, and China (as usual being a neighbor with similar socio-political conditions). Below we provide two graphs (12, 13) that show the trends of commercial lending rates, both of which contain Vietnam's rate, being a main focus for the comparative view.

Given the graphs in figure (12), some noteworthy points can be made. Only in the case of Vietnam, could the annualized interest rate be inflated to very highly levels in between of 50 to 60% per annum, in the first six months of 1989. This period of time could be

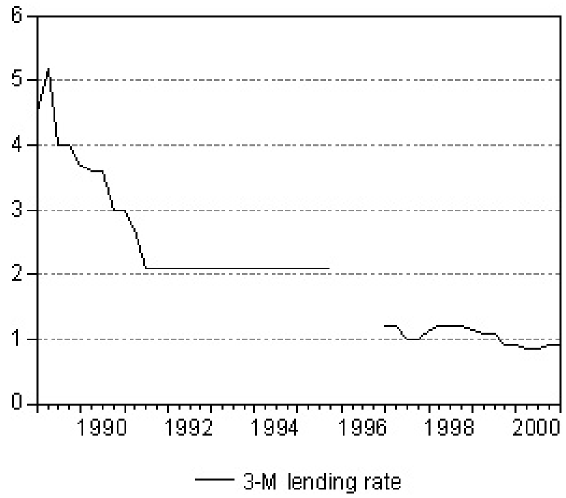


Figure 11: Short-term lending rate decline

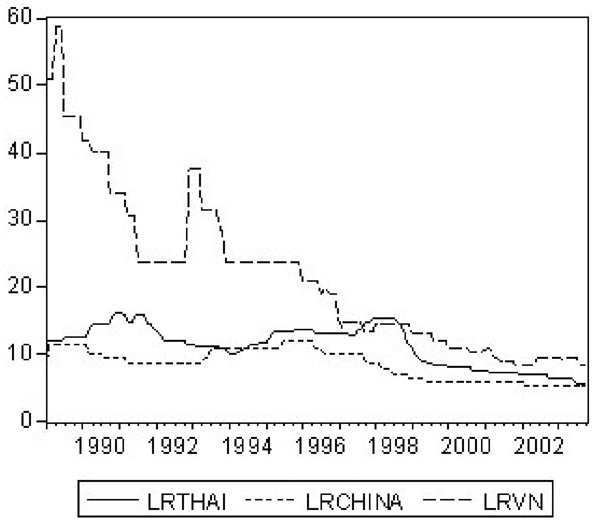


Figure 12: Comparative commercial lending interest rates: Vietnam, China and Thailand

considered one of the single most serious financial crisis of Vietnam in the contemporaneous economic history, with the extremely high inflation, sudden fall of aids from the former Warsaw Treaty Soviet-bloc member nations, including the mighty Soviet Union, loss of traditional export markets, etc.[16] as have been indicated in the preceding discussions.

Clearly, as seen from the data, the high interest rate period continued through to the middle of 1991. In this period, the interest rates ran from 30 to 60% p.a. Unlike Vietnam, the neighbors China, P.R. (mainland) and Thailand did not experience these problems. We can easily observe that their interest rates, although did move over time, never went so wild as in the case of Vietnam. In light of the Asian financial/currency crisis ignited in Thailand in mid-1997, we observed the trend of lower interest rates among the three regional nations. However, we also learn that the interest lowering trend in Vietnam started even before the actual occurence of the crisis in Thailand, that is in early 1996, and the slope of the lowering trend has almost as steep as that of Thailand, in our visualization, over the longer period of time. Among the three economies in this consideration, China appears to have been most stable, probably with a great deal of intervention of the central governmental agencies, such as the central bank, and the big-four state-run commercial banks. (Some valuable source of discussion and technical analysis on the central bank intervention can be found in [6, 5].) It is very likely that with strict financing policy throughout 1980s-90s, the interest rate levels in China could been kept artificially stable, despite known problems of bad debts and uncollectibles as in Vietnam.

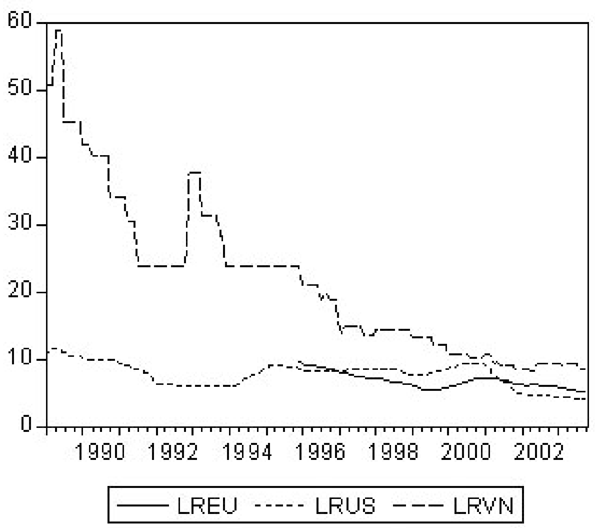


Figure 13: Comparative commercial lending interest rates: Vietnam, the U.S. and E.U.

In the figure (13), we note the shortest data line belongs to the E.U., where the data started only in 1996. (13) unveils the fact that without considering the hyperinflation

[16]Another rarely cited reason for this crisis period is the double warfare with the Khmer Rouge after Southwest border conflicts leading to Vietnam's invasion of Cambodia in 1978, and then the Northwest war with China, P.R. known as Deng Xiaoping's strategic intent to stop Vietnam from expanding influence to the southwest nation Cambodia. Both wars cause the economy huge costs of casualties, loss of long-standing economic supporter, that is China itself, military expenditures, and economic stagnation.

period of early 1990s, the lending rates in Vietnam have constantly been significantly higher than those of the more developed economies, in this situation, the United States and the European Union. The situation only changed very recently when with some lags in time, the domestic economy of Vietnam started digesting the devastating effects of the Asian financial turmoil, leading to slow business doing and poor bank performances. Interest rate then started declining significantly to some comparable level, althouhg still in easy-to-see magnitude of deviation. In this cited period, the local economy experienced many months consecutively in deflation.

For a general view, the following tables (15, 16) will allow us to summarize basic statistics of interests for the five economies we just mentioned. The statistics confirm what we feel from the graphs. The two developing economies, Vietnam and Thailand experienced higher mean levels of lending rates, followed by China. The United States and E.U. show lower interest rates. The lowest level of lending rates in the minima belongs to the U.S., 4.00%, whereas the highest belongs to Vietnam, 8.46%. The least fluctuating in loan rates is the E.U. with standard deviation of 1.101%, while the record still belongs to Vietnam, approximately 12%(!).

Table 15: Statistics on Comparative Lending Rates

	China, P.R.	E.U.	Thailand	the U.S.	Vietnam
Mean	8.546	6.791	11.256	7.747	21.578
Median	8.640	6.610	12.000	8.250	21.000
Maximum	12.060	9.590	16.250	11.500	58.900
Minimum	5.310	5.240	5.500	4.000	8.460
Std.Dev.	2.294	1.101	3.021	1.838	11.987
Skewness	-0.113	0.781	-0.301	-0.355	1.033
Kurtosis	1.544	2.899	1.854	2.416	3.516
Observations	178	95	178	178	178

On the other hand, table (16) presents a set of statistics for the deposit rates, comparable between economies. The situation has been quite analogous to the loan rate shown in table (15). All the records belong to the economy in question, i.e. Vietnam, with maximal deposit rate is around 41%, far exceeding the one right after, which is Thailand, 15.5%. The lowest high level of deposit rates belongs to the E.U., less than 5%, whereas the U.S. rate had once peaked to above 10% over the sample period.

Next, table (17) gives some insight about the co-movement trend among national lending rates, to show a typical picture for costs of funds in these economies. The different correlation coefficients are indicated in the table. Vietnam and China again shows a very close situation in interest rates over time, despite the late 1980s crisis situation in Vietnam.

Now that we have been equipped with a comparative view about interest rates of several economies over the 1989-2003 period, we extend our effort to look more deeply into the subject within Vietnam, starting with exploring the highly likely connection between deposit and loan rate, in a more or less qualitative reasoning.

Connection to deposit rates in Vietnam In the economic theory for commercial banking business, the moves of deposit rate and lending rate can be highly correlated. The reasoning of it is quite straightforward: the deposit rate is the single most important factor contributing to financial costs of a typical bank in Vietnam. Therefore, its moves should in some way be reflected in the move of actual lending rates. But here comes the difference in Vietnam's financial economy. The theory of business economics acknowledges that lending rates, netting the effect of capital costs including inflation, should be positive to make financial institutions, such as banks, alive. But this has only been the case after the banking reform in Vietnam took place in early 1990s. In reality, before the banking reform, there had been long-standing situation in which no connection between capital costs and lending rates existed, simply because the denial of fundamental capitalist financial concepts in the highly centralized command economy, where the notion of '*costs*' only existed for the *matter of completeness.*

Taking into account this fact, our considering of the correlation of the moves in deposit and lending rates below is by no means trivial because it could track whether or not a basic economic principle in the banking sector has been re-established since the start of the reform. The figure (14) below visualizes a somewhat correlated moves between the two, before we go into factual statistics to confirm it.

Apparently, we learn from (14) that in the recent reform period, deposit and lending rates have a similar tendency of negative growth. The reduction in interest rates can be attributed to two major facts observed in the economy. On the one hand, the inflation has been stabilized (see the relevant discussion in this paper) over time, with some negative inflation in the post-Asian currency crisis, period 1999-2000. On the other, the central

Table 16: Statistics on comparative deposit rates

	China, P.R.	E.U.	Thailand	the U.S.	Vietnam
Mean	6.736	3.151	7.966	5.063	14.655
Median	7.560	3.250	9.500	5.410	15.790
Maximum	11.340	4.930	15.500	10.090	41.053
Minimum	1.980	1.730	1.000	1.040	3.540
Std.Dev.	3.563	0.686	4.019	2.094	8.937
Skewness	-0.137	-0.016	-0.259	-0.017	0.805
Kurtosis	1.495	2.689	1.876	2.695	3.049
Observations	178	95	178	178	178

Table 17: Lending rates correlation coefficients

	LRCHINA	LREU	LRTHAI	LRUS	LRVN
LRCHINA	1	0.888749	0.820207	0.482543	0.913484
LREU	0.888749	1	0.660579	0.501829	0.805648
LRTHAI	0.820207	0.660579	1	0.599855	0.808939
LRUS	0.482543	0.501829	0.599855	1	0.542964
LRVN	0.913484	0.805648	0.808939	0.542964	1

government has relaxed many previous restrictions to cope with credit demands caused by continuous economic growth inside Vietnam. These two factors prevent interest rates from growing, and rather force them down steadily over the recent period.

Further into the issue of deposit versus lending rates, we can also see the interest spread from the statistics, represented by the figure (15) below.

What we note from the figure is that the spread between the two rates in Vietnam reduced significantly over the past years. In contrast, those of Thailand and China, P.R. remained fairly stable and even gew up a little bit after the Asian currency crisis. In the present time, the spread in Vietnam is in fact the lower level of the three. The

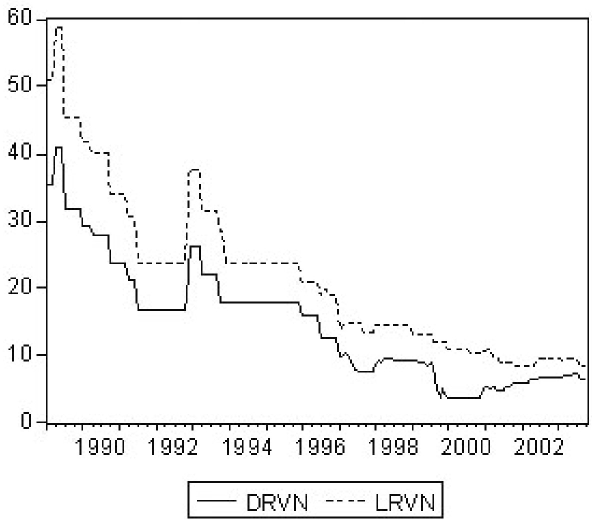


Figure 14: Observing the moves deposit and lending rates in Vietnam: the reforming period

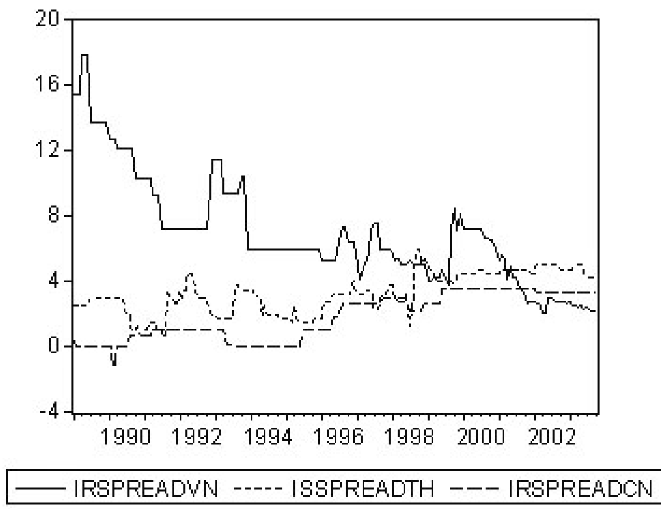


Figure 15: Comparative interest spreads: Vietnam, Thailand and China

comparative view for Vietnam, the U.S. and E.U. show similar situation. The other two developed economies exhibit stable interest rate spread over time. And very recently, that of Vietnam has come down lower. In both graphs, we note that the level of spread in Vietnam crosses other economies in around 2001 (see figs. 15, **??**).

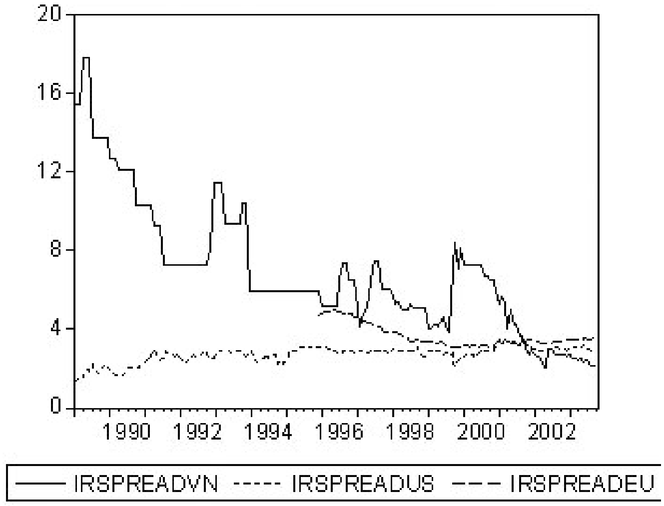


Figure 16: Comparative interest spreads: Vietnam, the U.S. and E.U

The next table (18) summarizes basic properties of the spreads among the economies in study.

Table 18: Basic statistics on interest rate spreads

	China, P.R.	E.U.	the U.S.	Vietnam	Thailand
Mean	1.810112	3.639895	2.683483	6.923461	3.289326
Median	1.8	3.41	2.83	5.91	3.25
Maximum	3.6	4.91	3.43	17.8467	6
Minimum	-1.26	3.03	1.3	2.07	0.5
Std.Dev.	1.413567	0.563223	0.415660	3.408665	1.251214
Skewness	-0.059176	1.157710	-1.256507	1.039129	-0.161655
Kurtosis	1.464428	2.897095	4.263678	3.903416	2.034698
Observations	178	95	178	178	178

Records of the highs in mean, median, maximum and dispersion belong to Vietnam, according to these statistics. The dispersion from the mean level is quite substantially higher than other nations, most likely caused by the interest rate policy during the 1990s crisis and anti-inflation campaign, which the government has been praised by the international financial community for efficient methods.

On the one hand, higher interest rates were the result of hyperinflation, caused by huge gap between the societal consumption demands and limited economic production forces, as have been by economists. Of course, lower rates could hardly satisfy both population and financial institutions in terms of economic efficiency. However, on the other, the government also sought after a proactive high interest rate policy to limit the money in circulation for the critical period of time. It is like using antibiotics for a patient in the first time, the remedy had shown clear and strong effects, but would unlikely remain as strong in later times. However, the tool of interest rate has been used well to successfully tackle the illness; a praiseworthy effort.

4.3 The bond markets

4.3.1 On the corporate debts/bonds

The public corporate debt is virtually non-existent, the fact which can be attributed to the habit of sticking to simple and straightforward financing vehicles; and the low standards of domestic enterprises and accounting-reporting practices, as raised in [9]. The only 'renowned', and yet risky, mode of corporate debt has been borrowing from employees, companies' good friends, and sometimes suppliers and purchasers. Some more formally established methods of corporate debts, such as corporate bonds and quasi-equity (like convertibles) were only introduced by FIEs very recently. Several typical features of the business environment that impede the proliferation of this financial instrument follow:

1. Unusual type of finance for enterprises;
2. No liquidity;
3. Simplistic and non-sophisticated nature, which limits the possibility of enriching the range of assets available to investors;
4. Unclear and incomplete, while prohibitively strict, legal ground;
5. Newness of corporate debt instruments and limited knowledge of the public about them;

Another type of near-corporate debt is 'project bond' which was introduced by national-level project undertakers in early 1990s, such as those for the notorious projects of Trans-Viet 500KV power grid and Yali hydropower plant, etc. However, given the specificity and importance of these government-backed projects, the business nature and commercial viability of any issues are reduced substantially much less emphatic of. A few of these not very common quasi-corporate bonds are researched by and tabulated below (Vuong, 2000:[33] and [34]).

Notwithstanding, over the past 3 years, firms have started looking to leverage the use of a variety of debts. Although no common practices have been in place, the high likelihood is that corporate debts will become more accepted. This tendency is natural, in the context of limited long-term capital for operation, not only in Vietnam, but even in more developed economies (see Adam and Farber, 1994:[2].)

4.3.2 Government bonds

The government of Vietnam also participates in the financial markets, in many cases through issuing its own debt instruments. The government debt instruments have the most common form of a State bond, an equivalent to the US T-Bond. The governmental agency that is charged with the issuing of these bonds in Vietnam is the State Treasury Department, part of the Ministry of Finance. The government bonds in Vietnam have the following features:

1. Longer term to maturity;
2. Less emphatic on financial returns computation-as most of the times, the coupon rate is calculated without taking into account the real situation of inflation and local currency depreciation;
3. Relatively large-value issues;
4. Sometimes creating anomalies in pricing practices, as the 'safest' government debt instrument sometimes carrying higher coupon rates than a much riskier corporate bond with the rest of conditions being identical.

In the sense of the financial market, the government bond represents a type of asset that the populace can consider to hold as part of their portfolio. It might not be appropriate now for the investors to think of an exciting bond market, but very appropriate to think about ways to diversify the personal portfolios, and even institutional. In Vietnam, the period 1997-99 witnessed hundreds of large corporations flooded the bond bidding sessions with their idle cash in hope for a fair and safe exchange of their temporary discontinued use of funds for some desperate returns right in the financial panic tide. This trend reemerged in 2003-04 with banks, insurers purchasing government bonds despite a little problem with liquidity. We next go in detail discussing several important aspects of this market.

History, patterns of issues, investors The history of Vietnam government bonds has not been long. We marked the year of 1997 as the launch of this new concept. In 1997, the bond had the maturity of 2 years only, and for the whole year the issue was standing at VND 132 billion (about USD 11 million). In 1998, the issue size was VND 275 billion,

Table 19: Selected issues of corporate and quasi-corporate bonds

Project	Issuer	Unit	Value	Year	TTM	Coupon	Type-Remarks
500KV power	EVN	VND	334.0bn	1992-94	3	3.8-5.0%	Bond/MOF-guaranteed; gold-indexed
Cement mfg.	Hoang Thach	VND	44.3bn	1994	3	21.0%	Bond/State Treasury-guaranteed
Cement mfg.	Anh Son	VND	7.5bn	1994	3	21.0%	Debenture
Air-con eng.	REE	USD	5.0mn	1996	2	4.5%	Bond/Convertible; Redeemable.
Steel casting	SouthSteel	USD	0.46mn	1995	3	5.5%	Debenture.
Power plant	Yali Hydro	VND	200.0bn	1995-96	4	8.5%	Bond/State Treasury-guaranteed
Hotel	Khanh Hoa Tour	VND	25.0bn	1998	5	8.0%	Debenture
Cement mfg.	Phuc Son	VND	63.0bn	1997-98	3	14.0%	Bond/Local Treasury guaranteed
Finance service	VILC	VND	10.0bn	1999	5	11.0%	Debenture/SOCB-backed
Finance service	BIDV	VND	1000.0bn	2000	5	7.5%	Debenture/SOCB-backed
		USD	65.0mn	2000	5	5.2%	
ISP	EIS	VND	60.0bn	2001	5	10.0%	Debenture
Petro	PetroVietnam	VND	300.0bn	2003	5	8.7%	Corporate bond

and no issue in 1999. In recent period 2002-04, more types of maturities were introduced to the market, so now the government can have the maturity typically running from 5 to 15 years. Unlike in the past centrally planned financial model, government bonds have increasingly played critical roles in the socio-economic bigger picture. We have seen that in a short period of time, just over 26-Jan-2000 to 19-Mar-2004, 130 issues of different bonds, with different terms and conditions, were implemented through almost all possible channels of distribution. Over 160.4 million bond units, with present capitalization of over USD 1,028 million have now been held in both corporate and public sectors. This single number is not very large in Western term, but quite substantial if we note that total GDP of the nation in this time period is still below USD 32 billion, and total FDI inflow in 2003 is approximately only USD 3.1 billion. This situation represents a shift of government budget sources to public borrowings. We should note that this is just the start of the story because the strategic intent of the government is to continue further issues with longer terms in the years to come. The plan of bond issues has gradually become high on permanent agenda of the cabinet. In the medium term view, issues will continue to increase over the next 10 years, showing an upward trend of government indebtedness to the society.

Government bondholders are also diverse, individuals, corporates, banks, insurers, investment funds, etc. However, the largest investors in government bonds are banks and insurers. The norm of issue is each government bond certificate has the face value of VND 100,000, or about USD 6.3. The bonds issuing modality can be: (i) working out bids with major market players on the primary market, and the bid winners redistribute in their retail system. (ii) selling directly to individuals through a system of distribution of the State Treasury Department, and sometimes with local government units.

Given specificity of the economy, we move next to discuss the coupon rates on government and government-instructed bonds, simply because they represent a twofold power. Firstly, government bonds can be very large (in Vietnamese terms) in size, thus moving the finance around the economy in a big way. Secondly, given large volume of transaction, and supranatural economic power of the central State, their determined coupon rates can heavily impact the economic settings that other commerciall-based financial institutions have no choice but to observe closely.

Technical details of government bond issues over time For a comprehensive view of the government bond issues, we provide in this paper a long series of all bonds currently available for trading and investment. The tables (21, 26, and 27) enumerate their basic properties in each issue: size or volume of the issue, the coupon rates deemable to bondholders, the term of bond or the time from issue date to maturity, and corresponding specific maturity dates for reference. We note that all the bond codes in these tables start with "*CP*", a short-hand writing of *Chinh Phu*, i.e. government to clearly state the status of the bond. Several of them have been listed on the HSTC, namely instance CP1-0100, CP1-0102, CP1-0200, CP1A0103, CP1C0101, CP4A0903, CP4A2003, among those that experienced actual trades on HSTC.[17]

Table 20: Summary of issues Jan-2000 to Mar-2004

Type	Issue size (units of bond)	Coupon range (% min-max.)	Value (USD million)	No. of issues
2-year	8,080,000	7.7-8.1	51.79	10
5-year	66,084,080	6.5-8.7	423.62	49
7-year	150,000	8.0-8.1	0.96	2
10-year	10,160,000	8.1-9.3	65.13	16
15-year	7,593,000	8.59-9.99	486.73	53

Sources: State Securities Commission; Ministry of Finance; and public media.

It is noted immediately that there have been some properties to watch given of this bonds population. These points were raised in Farber (2004:[10]), and the following will embark on each of these in more details.

1. The frequency of issues. Beyond the fact that 5-year and 15-year term bonds are most frequent in the marketplace. Their issues at times were somewhat disorganized. Sometimes, it appeared that the government rushed to issue for funds, sometimes more relaxed. Let us take the count of days in the given sample, which is 1081, on average each issue was organized every 8.33 working days. And Farber [10] argued that the actual issue frequency was too high. In considering that, graph (17) indicates the actual time location of bond issues, and is even more telling that, the frequency in recent 6 months even increases much more compared to the past. (Note: the upper line with triangle indicates 15-year bond, the lower 5-year.)

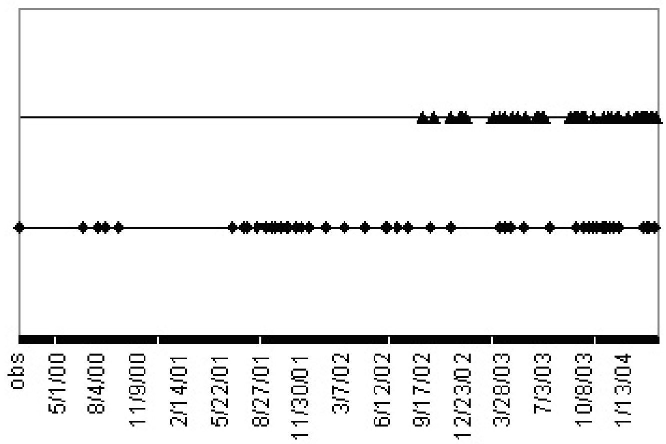


Figure 17: Visualizing the frequency of 5-year and 15-year bond issues

2. The second property, which was also taken on in [10], is that the coupon rates appear to have fluctuated wildly. Two unexpected characteristics of the bond coupon rates

[17]We will later have an opportunity to look more deeply into the situation of bond trading in the centralized secondary market HSTC.

are: (a) the difference between 5-year and other longer-term, 10- or 15-year does not seem to be enough to consistent and appropriate. The upward trend in 5-year one is clear. But the trend of 1- and 15-year is unclear, if not chaotic (see graph (18) for this observation, in which upper and shorter cluster indicates 15-year; lower and longer one 5-year.); (b) Observing the 1-year bond coupon rates alone, the fluctuation in a 17-month period, from Apr-2002 to Sept-2003, was chaotic, see graph (23). There was no justifiable reasoning for why it should behave in such wide range of abrupt and inconsistent changes, provided that no significant economic events took place during the period.

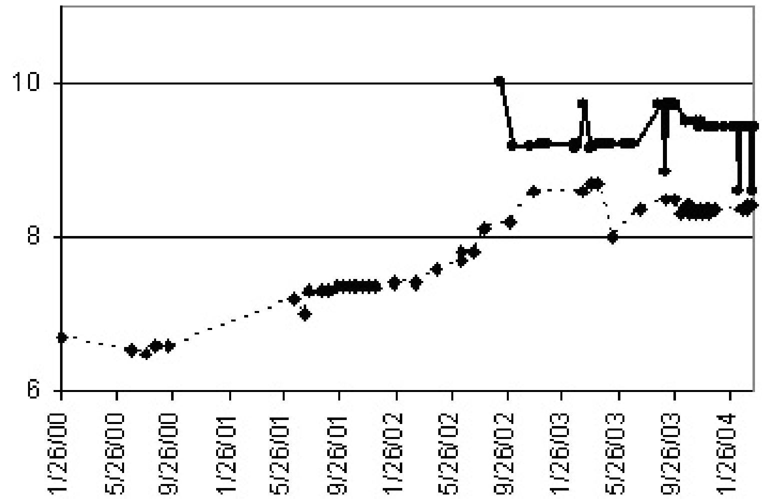


Figure 18: Inconsistency in coupon rates among 5- and 15-year over time

3. The third striking property is the changing size of issues. Suddent jumps and drops in the size of issues can be observed very clearly in the graph (19). [10] reasoned that the possible cause could be that the issuing policy and planning process may not have been done well enough. This clearly affected the liquidity of the bonds negatively.

From the data given by the table (21, 26, and 27) we could easily find an indication of the current size of total issues of government bonds.

Returning to the main point of coupon rate, we look at the mechanism of price determining process. The governmental agency that plays a single most powerful role in the game is the Ministry of Finance, and its financial arm, the State Treasury Department under MoF. In theory and principle, the job of determining a *reasonable* coupon rate for a particular bond is straightforward. But in reality, it has not been the case. Under the pressure of meeting deadlines and required finance volumes from each issue, the MoF has to pay attention to the fact that economic benefits from holding such government bonds should be ‘attractive’; the factor that has almost solely been set by the coupon rate satisfactory to the society. For this reason, there had been cases in the past in which government bonds carried a higher interest rate than even risky bank’s deposit rates. This

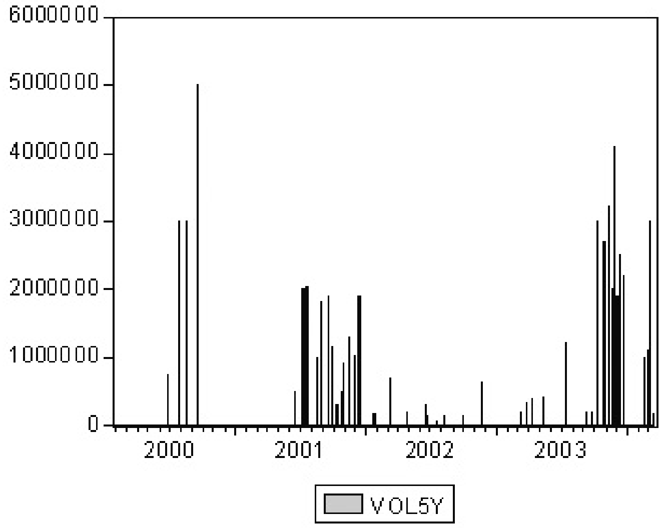


Figure 19: Size differences of 5-year government bonds 2000-04

Table 21: 5-year maturity government bonds 2000-04

Issue	Coupon	Size	Value	Value	Issue	Coupon	Size	Value	Value
	rate %	(uob)	VND bn.	USD mn.	rate %	(uob)	VND bn.	USD mn.	
1/26/00	6.69	830700	83.07	5.9	10/1/02	8.2	150000	15	1.0
6/26/00	6.55	746350	74.635	5.3	11/19/02	8.6	650000	65	4.2
7/28/00	6.5	3000000	300	21.3	3/12/03	8.6	200000	20	1.3
8/17/00	6.6	3000000	300	21.3	3/27/03	8.7	350000	35	2.3
9/15/00	6.6	5000000	500	35.3	4/11/03	8.7	380000	38	2.5
6/15/01	7.2	486330	48.633	3.3	5/13/03	8	400000	40	2.6
7/11/01	7	2000000	200	13.4	7/11/03	8.35	1230000	123	8.0
7/19/01	7.3	2050000	205	13.8	9/10/03	8.5	200000	20	1.3
8/16/01	7.3	1000000	100	6.7	9/26/03	8.5	200000	20	1.3
8/30/01	7.3	1800000	180	12.0	10/10/03	8.3	3000000	300	19.5
9/20/01	7.35	1900000	190	12.7	10/24/03	8.4	1240000	124	8.1
9/28/01	7.35	1150000	115	7.7	10/29/03	8.3	2700000	270	17.5
10/12/01	7.35	300000	30	2.0	10/30/03	8.4	2300000	230	14.9
10/24/01	7.35	500000	50	3.3	11/12/03	8.3	3200000	320	20.6
10/30/01	7.35	900000	90	6.0	11/20/03	8.35	2000000	200	12.9
11/15/01	7.35	1300000	130	8.6	11/26/03	8.3	4100000	410	26.5
11/29/01	7.35	1030000	103	6.8	12/4/03	8.35	1900000	190	12.3
12/13/01	7.35	1900000	190	12.6	12/10/03	8.3	1300000	130	8.4
1/24/02	7.4	160000	16	1.1	12/11/03	8.35	2500000	250	16.1
3/8/02	7.4	700000	70	4.6	12/24/03	8.35	2200000	220	14.2
4/26/02	7.6	200000	20	1.3	2/19/04	8.35	1000000	100	6.4
6/18/02	7.7	300000	30	2.0	3/2/04	8.4	1100000	110	7.1
6/20/02	7.8	150000	15	1.0	3/3/04	8.35	3000000	300	19.2
7/16/02	7.8	50000	5	0.3	3/16/04	8.4	180700	18.07	1.2
8/8/02	8.1	150000	15	1.0					

Sources: SSC; Ministry of Finance; and public media. uob: units of bond.

is a truly paradox in the reform time. What we learn from the coupon rate determining is quite simple: there is no clear rules about this critically important exercise.

We now mention another noteworthy fact about the investors in these government bonds. As mentioned above, they are mostly state-run banks, such as VCB, Agribank, nation insurers, such as Bao Viet, Bao Minh, Prudential, etc. Except the case of insurers, investments by banks in government bonds have been for long debatable. On the one hand, it could now be a lucrative investment as 8-9% return from safe bonds compared to 9-11% from very risky lending exercises is a 'peanut-butter deal.' On the other hand, the existence of government bonds to a certain extent jeorpadizes the efficient allocation of scarce funds to effective sector. It is not difficult to answer decisively about the precedence in lending to the government with safety net and lending the private sector, which bears a lot of risk, while the interest rate policies have been quite rigid. The situation could in fact be more dangerous when we note that most bondholders in this case are state-run entities. So it can be said as the government can take the money at its discretion with little effort from moving its hand between left and right pockets.

More information on an emerging bond market We now pay some more attention to the organized bond market in Vietnam. In terms of organization, the bonds that are listed also follow rules set out by the governmental decree governing securities in general terms.

Bond trading, as in the case of stocks, has two major types: (a) normal transaction through centralized matching system; and (b) negotiating method. The bond trading has so far been not very active with type (a). To see this point, we examine the history of trading as follows fig.(20).

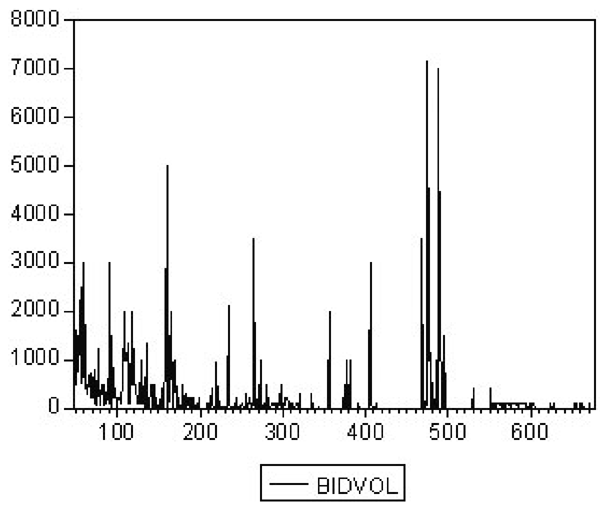


Figure 20: BIDV's BID1 bond trade volume

BID1 is the trading code of a bond issue by the SOCB BIDV. This is the first bond active in the marketplace with trading. However, we can see very clearly that the actual trading is very very thin. In fact, we can consider it inactive asset with almost no trading.

And, surprisingly enough this is the single 'most active' bond in trading on HSTC, among nearly 100 types of bonds listed on HSTC over the past 3 years. The thin trading leads to a typical situation that on the official floor, the price moves sometimes to the middle of nowhere as seen in the figure (21) below.

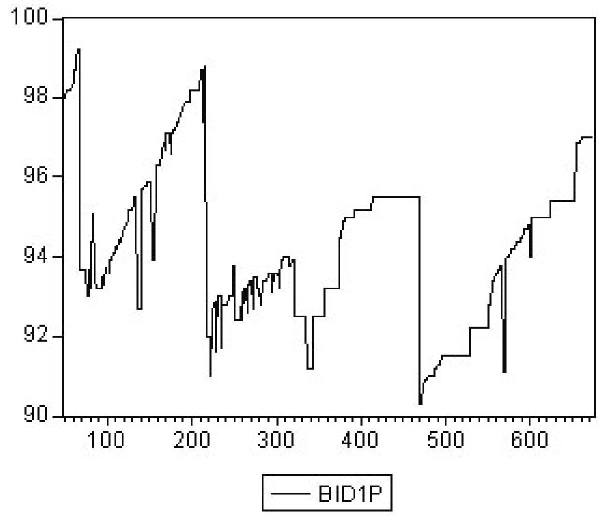


Figure 21: BIDV's BID1 bond price

It is noticeable that the drops and peaks in the prices have nothing to do with the economic or market settings. Simply because after long period of dull trades, some tiny amount of bonds can be thrown to the market and matched with a very surprising closing price. (Some insiders of BIDV itself even unveiled the fact that the parent-bank request operational departments to offer and then buy their own shares to make the transaction happen. This is something called a 'face-saving' practice.)

However, the situation of bond trades through negotiations can be a big surprise. It is not surprising in terms of much better activeness, because according to our statistics, total number of bond transactions through off-floor negations is only 89. HOWEVER, the number of bonds that has been exchanged this way is approximately 22,672,368 bonds from 1/1/2003 to 1/1/2004. the total value traded through in 2003 through this negotiation method has reached over USD 143.854 million. Compared to 51,120 bonds of all types that were traded during 2003 on the official floor, with value of USD 0.304 million, the above trading volume and value of bond negotiaton are an enormous difference. We notice that nearly 23 million units of bonds were negotiated over only 64 distinct trading sessions, while the tiny official bond trade was made over 247 sessions. 1,260,370 bonds were negotiated in 2002, with total value of USD 7.647 million.

So what are behind the surge in bond negotiations, that cause 19 times increase in value, or 18 times in volume? Several factors can be described below:

- Over the past two years, about 130 new bonds have been listed on the HSTC, most of them government bonds;
- The interest rates are going down, but the government financing need is still on the

rise, thus leading to a paradox that the coupon rate levels on government bonds are quite appealing and lucrative to fixed-income financial institutions such as life insurers;

- Many SOCBs and nonbank financial instituations are struggling with improving portfolio quality, and taking advantage of lower deposit rates and reasonably high government bond coupon rates clearly represents a lucrative opportunity.

The bond market has gradually become familiar with the people and institutions in Vietnam. However, transactions are in general not very active, although individual deals, negotiations may be done with a single large sum of money. However, in the very near future, this market will certainly develop and grow up to cover a large portion of the securities trading. We do not have an opportunity to look further into the bond market, due largely insufficient data and the actual situation of thin trading, thus stop here to move on the conclusion of the paper However, when the data become available and sufficient for analysis, many more insights of the bond markets can be drawn upon the market statistics.

5 Concluding Remarks

5.1 General points of observation

Given the review, we realize that within a short period of time, the financial market of Vietnam has evolved through different stages and will continue to change, alongside the fast-changing Vietnam's economy. This evolution is noteworthy as the contemporaneous economy of Vietnam started only 50 years ago. Clearly, the economy lags far behind other regional economies, e.g. ASEAN-4, and the financial markets in general remain underdeveloped. However, given the deterministic route of reforming the economy and reintegrating to the regional and global economy, Vietnam has little choice but to continue to leverage the limited resources, including building on a better functioning financial economy. The far-reaching influence of financial markets in the modern economy is well articulated, thus learning from substantive lessons is invaluable.

The critical issue is the lack of comprehensive and in-depth understanding about the functioning of a standard financial market as well as with regard to the specificity of Vietnam. By reviewing the situation thus far, the authors propose further research on the recent development of the financial market, most importantly the continuous reform of the banking system and the structuring of the securities markets, regulatorily and functionally. One serious problem that faces the policy makers and businessmen in Vietnam is the shortfall of guiding knowledge about the genuine mechanism of the economic machine, articulated in more scientific and quantitative ways. In light of this, our proposal to develop a narrow discipline of research on selected topics of Vietnam's financial markets will fit to need. Naturally, the influence could be not only the specific understanding about the researched issues, but also unveiling of uncharted territory of research issues in relation.

Moving from the above more general remarks, in particular, given early signs of speculation, the Vietnam's fledgling stock market will need further adjustments and thorough knowledge to operate efficiently and economically, being an asset not the liability to the national economy. The limitation of knowledge of both administrators and populace about the functioning of financial markets and asset prices is now an impediment to both future growth and the safety of investment mechanism. We would like to also propose to develop a discipline of quantitative analyses on the financial markets of Vietnam to provide for insightful understanding of its features, ranging from stock price behaviors, return distribution to time series properties. One of the useful methods is to test the theories and qualitative conclusions empirically, based on the formulated and established models. The alternative is obviously the theoretical modeling route, which imposes the same degree of rigor to derive scientific conclusions.

Going down the empirical route, we can truly benefit from a rich literature and applied frameworks. In terms of theory, for instance, one can benefit from the applied mathematical statistics, such as Rose and Smith, 2002:[27], Abell et al., 1999:[1], or Terrell, 1999:[30], among many others. Besides, many underlying economic solutions have been aided greatly by the mathematical developments, both applied and theoretical, such as problems in optimization, differential and difference equations, for instance in standard texts and references of Tenenbaum and Pollard, 1963:[29], Hohn, 1973:[11], etc. We should emphatically mention the richness of the applied econometric literature in studying economic and financial problems, for which an overall, but useful, review can be found in Kennedy, 1998:[13]. For a thorough overview of key and forefront problems in financial economics, Cuthbertson (2000:[8]) will be of interest.[18]

This discipline is virtually non-existent in Vietnam by the time this is written. Almost all the scientific and application questions of highly quantitative and mathematical nature have been danced around by the researchers, or more positively transformed to the qualitative fashion. And here comes the rationale of this paper presenting data and statistics as a starting point for researching Vietnam's financial markets, beyond a pure verbal assessment.

5.2 On the further analysis

Our analysis of the key macroeconomic variables in the reform time of Vietnam also provides us with several noticeable insights.

5.2.1 Stabilized economic conditions

The economic conditions in Vietnam have stabilized over time, after the shakeout departing from the previous centrally planned economic model. This has been a proof that the economy has passed the point of no return, enjoying new economic momentum despite difficulty ahead of the road. The growth of key macroeconomic indicators suggest that the economy continues to keep up the growing pace, with the single most prominent indicator of real GDP rate, ranking only second to China in the whole Asian region, in the

[18] Although detailed relevant and related literature reviews have to be delayed until in each topical study, because the citations of those cannot be done here, given the general scope of this paper, these documents are quite accessible and valuable in providing for needed background in researching our related issues. That is why they are mentioned here as recommended reference sources.

wake of recent Asian financial turbulence. In brief, it has succeeded in achieving economic stability, given the overwhelming transition process.

5.2.2 Trends and interrelated factors

Further analysis also shows that not everything is correct in such a growing trend. Financial resources continue to be skewed towards state-run sector, financial and manufacturing, although recent adjustments have contributed to some shifting to a more liberal societal mobilization for private sector investments.

The clear trend we can see is growth, as all log-levels of time series exhibit nonstationary character over the past decade or so. The growth can be seen in all areas of the economy, from import-export, to national money generating dynamics, to national domestic productive energy. Their growth rates are naturally different in magnitudes, and behavior, however, they are mostly positive with some time trend. We can also realize that both FDI and private investment contribute substantially to the growth pace of the economy. On average, they both grow at nearly equal magnitude over time. However, the stability of FDI inflow appears to have been weaker than the private investment, with the worst downward trend is twice as large as that of private investment in slow times. Overall, the dispersion around the average of FDI growth is 31% (standard deviation), while private investment flow is about a half (13%). In the general context, our analysis shows that the growth in GDP tends to be weaker than some other interrelated economic variables. No proof on cointegrating relationship among GDP and money stock, consumption, and domestic private investment. The recent weaker GDP growth trend, possibly due to many unidentified reasons, has been offset by extensive expansionary credit flows within the economy, and equity investment by the private sector. Increased domestic consumption is another important factor that helps keep up the growth. Perhaps, these 'non-state' elements play the most critical role in the revamping of the economic downturn in late 1990s caused mostly by inefficient resource allocations and mismanagement of the giant state-run corporate sector.

One should not ignore the question of how the private sector grows with limited official support within the economy (except what economists called 'the unleashing'). The answer perhaps lies in the private financing system that operates within the sector. The private financing mode was diehard even in the command economy, and has proved to be efficient despite the limited resource of the sector. What missing in the picture is that a growing private sector, and market-economy components of the economy sooner or later require much better organized and commercially viable financial markets to genuinely serve the dynamic private sector. This argument leads us to the role of a better functioning financial system in Vietnam's economy, foreseeing more reforms in the road ahead.

5.2.3 The emerging bond market

We have also discussed in detail the bond market in Vietnam. Recently, this market has become more active with 130 government bonds issued over a short horizon. With the government shift to use bonds funding its budget, the market will likely grow even more rapidly.

Nonetheless, we also detect some points that bond issuing agency will need to address to maintain the financial markets in order. The planning of bond issues. Given rather high frequency in issuing, the practice in fact reduces the liquidity, and makes the management of funds much harder. Coupon rates determination is another problem to solve. Currently, there is little ground to reason the small difference between medium-term bond, 5-year, and long-term one, 15-year. Wild fluctuations of rates over short period of time, such as in the case of 10-year bonds, could also send mixed signals to the market, and make the pricing less justifiable. In some cases, there was even no difference between 5-year and 10-year rates. This is clearly a flaw of the pricing system, indeed.

With respect to bond rates, finally we should also note that close government bonds with high interest rates can jeopardize lending operations. By this we do not say that the rates are actually higher, but given banks' current lending rates, risky loans are priced not much differently from a government bond. This in fact led several SOCBs rich of cash investing in the bonds, drawing funds out of the productive sector, such as private manufacturing or services.

5.2.4 Roles of a better functioning financial system

The role of the domestic financial system has always been appreciated. However, such a system has not been available in the Vietnamese economy. Among many critically important roles, which the financial market can assume, we mention here a number of prominent roles for such a system if implemented appropriately:

- Increased extension of credits and equity to the most productive and profitable sector, the domestic private economy of Vietnam;
- Reduced cost of capitals and cost of transaction, which have currently been inflated through artificial shortfalls of capital and weak downstreaming money generating process of the economy; and
- Improving liquidity, and hence risk management tools, for prospective investors. This particular improvement can be done with a great help of a correctly installed (and functioning) stock market.

For the particular recognition of critical roles that a financial system, through financial markets, can take in the Vietnamese economy, we will considering different aspects of Vietnam's financial markets.

6 Appendixes

6.1 Appendix 1: Banking sector data

Table 22: State-run commercial banks: SOCBs

Bank	Scope	Est.Date(*)	Equity(**)	Remarks
Indus.-Comm. Bank VN	National/Hanoi/92	9/21/96	712.8	Commercial
Bank for Agri.-Rural Dev'nt.	National/Hanoi/578	10/15/96	2,122.2	Commercial-Policy
Bank for Foreign Trade	National/Hanoi/18	9/21/96	732.2	Commerical
Bank for Investment-Dev'nt.	Nationl/Hanoi/86	9/21/96	784.9	Commercial-Policy
Bank for the Poors	Rural areas/Hanoi/570	9/1/95	700.0	Policy lending
Bank for Mekong Delta Housing	Mekong delta (South VN)	9/18/97	600.0	Policy lending

Table 23: Joint-stock commercial banks: JSCBs-National and Provincial line

Bank	Scope	Est.Date*	Equity**	Remarks
Maritime Bank	Regional/Hai Phong/3	6/8/91	109.3	(a)
Vung Tau Bank	Provincial/Vung Tau/2	8/28/91	55.5	(a)
Saigon Commercial Bank	Regional/HCMC/5	12/5/91	71.0	(a)
Dai Nam Bank	City/HCMC	12/31/91	23.3	(a)
Dong A Bank	City/HCMC	3/27/92	85.0	(a)
Exim Bank	Regional/HCMC/4	4/6/92	250.0	(a)
Mai Phuong Bank	Provincial/Binh Duong	3/31/92	20.0	(a)
Tay Do Bank	Provincial/Rural/Can Tho/2	4/6/92	7.6	(a)
Hanoi Building Bank	Regional/Hanoi/2	6/6/92	50.0	(a)
HCMC Housing Bank	Regional/HCMC/2	6/6/92	42.1	(a)
Que Do Bank	City/HCMC	6/6/92	10.0	(a)
Gia Dinh Bank	City/HCMC	8/22/92	45.6	(a)
Da Nang Bank	Regional/Da Nang/2	6/25/93	3.0	(a)
Nam A Bank	City/HCMC	8/22/92	29.4	(a)
Viet Hoa Bank	District/HCMC	8/15/92	73.0	(a)
Tan Viet Bank	District/HCMC	8/22/92	70.0	(a)
De Nhat Bank	City/HCMC	4/27/93	38.5	(a)
Phuong Nam	City/HCMC	3/17/93	70.2	(a)
Saigon Comm-Indus. Bank	Regional/HCMC	5/4/93	99.8	(a)
Asia Comm. Bank	National/HCMC/6	4/24/93	353.7	(a)
Techcombank	National/Hanoi/4	8/6/93	70.0	(a)
VP Bank	National/Hanoi/4	8/12/93	174.9	(a)
Vien Dong Bank	Provincial/An Giang/2	12/9/93	10.0	(a)
Nam Do Bank	City/HCMC	12/29/93	27.1	(a)
Me Kong Bank	Provincial/HCMC	12/31/93	50.0	(a)
Hai Phong Bank	City/Hai Phong	3/23/94	5.0	(a)
Bac A Bank	Provincial/Nghe An	9/1/94	20.0	(a)
Military Bank	Regional/Hanoi/2	9/14/94	100.0	(a)
AP Bank	City/Hanoi	11/7/94	70.0	(a)
International Bank	Regional/Hanoi/3	1/25/96	50.0	(a)
Phuong Dong Bank	City/HCMC	4/13/96	70.0	(a)
Thanh Thang Bank	District/Can Tho	4/6/92	4.8	(b)
My Xuyen Bank	District/An Giang	9/12/92	3.0	(b)
Dai A Bank	Provincial/Dong Nai	6/23/93	2.9	(b)
Rach Kien	Provincial/Long An	12/29/93	2.9	(b)
Tan Hiep Bank	Provincial/Kien Giang	6/23/93	2.0	(b)
Ninh Binh Bank	Provincial/Ninh Binh	11/13/93	2.5	(b)
Hai Hung Bank	Provincial/Hai Duong	12/30/93	2.0	(b)
Quang Ninh Bank	Provincial/Quang Ninh	5/28/96	2.7	(b)

Note: Scope refers to (Level/HQ/no.-branches); (*)As to SOCBs, corporatized date means the date on which they were re-established as market-model economic entities, while simply the legitimate establishment date to JSCBs; (**) Equity in billions of VND in 1999; (a) Private commercial; (b) Communal-commercial

Table 24: JSCB: Provincial-district line

Cai San Bank	Provincial-District/Can Tho	4/6/92	10.6	(b)
Dong Phuong Bank	Provincial-District/Lam Dong	10/22/92	1.1	(b)
Co Do Bank	Provincial-District/Can Tho	4/6/92	1.6	(b)
Chau Phu Bank	District/An Giang	9/12/92	2.5	(b)
Dong Thap Muoi Bank	District/Dong Thap	11/13/93	1.2	(b)
Nhon Ai Bank	District/Can Tho	11/13/93	3.0	(b)
An Binh Bank	District/HCMC	4/15/93	1.2	(b)
Tu Giac Long Xuyen	District/An Giang	11/13/93	1.5	(b)
Phu Tam Bank	District/Soc Trang	6/23/93	1.0	(b)
Song Kien Bank	District/Kien Giang	9/18/95	1.1	(b)
Kien Long Bank	District/Kien Giang	9/18/95	2.0	(b)
Hai Phong Rural	District/Hai Phong	11/29/95	2.1	(b)

Note: Scope refers to (Level/HQ); Equity in billions of VND in 1999; (b) Communal-commercial

6.2 Appendix 2: Non-bank finance companies data

Table 25: Non-bank financial institution

Company	Type	Reg. Location	License Date	Statutory Equity
Saigon Finance Co.	Domestic	Ho Chi Minh City	9/12/1991	17.0
Seaprodex Finance Co.	Domestic	Ho Chi Minh City	7/9/1992	10.5
Vietnam International Leasing Co.	J.V.	Ho Chi Minh City	10/28/1996	69.5
Korea Exim Bank Leasing	J.V.	Ho Chi Minh City	11/20/1996	138.9
Vinatex Finance Co.	Domestic	Ho Chi Minh City	8/3/1998	30.0
Petro Vietnam Finance Co.	Domestic	Hanoi	12/10/2000	100.0
VNPT Finance Co.	Domestic	Hanoi	10/10/1998	70.0
VBARD Finance Leasing I	Domestic	Hanoi	8/27/1998	65.0
VBARD Finance Leasing II	Domestic	HCMC	8/27/1998	55.0
Vietcombank Leasing	Domestic	Hanoi	5/25/1998	55.0
BIDV Finance Leasing	Domestic	Hanoi	10/27/1998	55.0
Vinalease	J.V.	Hanoi	12/1/1997	118.0
ICBV Leasing Co.	Domestic	Hanoi	12/1/1997	55.0

Note: Equity in billions of VND

6.3 Appendix 3: Frequented terms and acronyms

There are several terms that are used frequently when describing the current Vietnamese economy. Most of them reflect the recent changes of the economy shifting to a market-oriented model. Those terms used throughout this paper are summarized hereunder.

6.3.1 Doi Moi:

The reform process in Vietnam following the former Soviet's *perestroika* initiated by the former Federated Russia President M. Gorbachev in 1986. In Vietnam, *Doi Moi* was introduced by the late General Secretary of the Communist Party Nguyen Van Linh in the VI*th* National Congress, Nov-1986 (VCP's Central Committee, 1999). It was then vibrant that the concept of Doi Moi for the first time ever recognized the legitimate co-existence of the formal private, and thus capitalistic, economy. The program intended to build a multi-sector, multi-ownership Vietnamese economy. It forced the economy to depart from its previous highly centralized and heavily subsidized operation. However, it took Vietnam almost five years to have translated *Doi Moi* concepts into the practical economic and administrative reform. The actual implementation of the new concepts only took place in early 1990s. The whole economy struggled hard through the early 1990s, where the market concepts took the similar shape as they are now. *Doi Moi* concepts have been enriched and further enhanced through subsequent Party Congresses. The most recent Party Congress was held in Hanoi, April 19-23, 2001. A critical outcome of this Congress is it was able, after lengthy and painstaking debate, to decide to continue and further the *Doi Moi*, by voting for a new senior leadership of younger and better-educated personnel (see [7] for details.) It is commented that the new reforming group of the Communist Part leadership, containing a lot more reform ingredients, outweighs and outnumbers the conservatives. This move promises to deliver more rapid and thorough reform process in the years to come.

6.3.2 Equitization:

The process of privatizing a state-run company, in which the target firm can be sold off to the public, completely or partially. After the process, the firm will no longer qualify as SOE and will then be called an **equitized company**, in effect, a shareholding firm classified as nonstate company. The word equitization is considered 'politically correct'. The process of equitization had been very slow until the end of 1997. For about three years since new incentives and more 'stick-policies' were adopted, the number of equitized firms has increased significantly to over 500 companies. These newborn equitized companies join the non-state sector and become a weight in the government's policy considerations. The equitizing speed is expected to accelerate over the next few years.

6.3.3 FDI:

Foreign Direct Investment. One of the stimuli of Vietnam's economy. FDI was first defined as a possible source of capital for the nation in 1996. Following a series of efforts in making laws and attracting FDI, the FDI influx started flowing to Vietnam in 1991-93. FDI inflow reached the peak in 1996 with committed investments being over USD 8 billion. After this happy year, the FDI investment dropped drastically due to both appreciating risks in doing business in Vietnam, and externalities triggered by the Asian financial turmoil. In 1999, the National Assembly approved the Amendment of the Law on FDI, so as to encourage potential investors to consider Vietnam as FDI destination and to remove several sources of risks. However, many important issues remain and continue to worry existing and potential investors, such as financial mechanism for FDI firms to operate, taxation policy, employees recruitment constraints, project land clearance, customs procedures, etc. One of the key factor, which inflates the cost of doing business in Vietnam and is most frequently cited to, is the rampant corruption at all levels of the administrative system. Vietnam is ranked the most corrupt country (with corruption index being 9.75/10) in 2000 by PERC, Hong Kong, above China and Indonesia. A large campaign has been in place for several years to improve the image and business settings. However, it has not reached the level of expectation by both investors and the public. More should be done, and the corruption problem is also increasingly high on agenda, in part related to the removal of obstacles to FDI.

6.3.4 SBV:

The State Bank of Vietnam. SBV is the successor of the 1951-established National Bank of Vietnam (NBV). The SBV was created after the promulgation of the Ordinances on the SBV and on Banks, Credit Cooperatives, and Finance Companies in 1990. Since this time, SBV has played a pure role of central bank, and struggled to adopt a standard model of the open market economy. The need to reform SBV has emerged vitally together with the flaws of the banking sector as a whole, and continues to be critical until today.

6.3.5 SOE:

State-owned enterprise. Before Doi Moi, an SOE was not really a company, although its name was. For a long time before the market economy and even in the first several years of Doi Moi, SOEs only serve to be an economic tool of the government with too few autonomous rights. The normal practice is that SOEs received capital, expropriating from the State budget, and managed to accomplish the State-demanded or State-planned objectives. Since the introduction of Law on State-owned Enterprises (1995), all SOEs have operated in compliance with this Law. However, the society has realized the many shortcomings and flaws of this Law, and nowadays demands amendments and more radically even a complete rewriting of this. In a politically correct statement, one has to say the SOE sector is the underpinning factor of a socialist national economy and is mandated to show its leadership in all economic operations. However, the Vietnamese SOE sector's actual performance has thus far been very disappointing and its supposed leadership has been critically questioned.

6.3.6 SOCB:

State-owned commercial bank. This concept has emerged since the introduction of the existing two-tiered banking system, and become popular after the birth of the four largest SOCB in 1990s, namely Bank for Foreign Trade of Vietnam; Bank for Agriculture and Rural Development; Industrial and Commercial Bank of Vietnam; and Bank for Investment and Development of Vietnam. The abbreviation SOCB is to contrast JSCB.

6.3.7 JSCB:

Joint-stock commercial bank. This concept has emerged since the introduction of the two-tiered banking system in combination with the State's recognition of existence of the private economic sector. A JSCB is de facto a commercial banking with part or all of equity being held by the public, both individually and institutionally.

The State does not take charge of establishing such a bank, and if there is any equity holding by the State in such a bank, it is rather in the form of capital contribution through a State-owned institution, either banks or SOE. The first JSCB is the Vietnam Bank for Export and Import (Eximbank), with a substantial holding of statutory capital by SOEs, for example Vietcombank, Incombank, Vietnam Maritime Co., Vietnam Container Shipping Co., ...

Having realized many loopholes and weaknesses in bank management practices, the Government and the SBV have signaled a stern message since 1998 that JSCBs of lower quality operations be merged, acquired or restructured to improve the overall quality and creditworthiness. The program has also been firmly supported and hailed by major donor organization to Vietnam, e.g. EU, World Bank and IMF. The actual progress of this restructuring scheme turned out to be so slow, however stern the message was. The more or less important effect was, in reality, the additional supplies of capital to non-target banks, i.e. the four largest SOCBs, who were adversely affected by past credit quality problems.

6.4 Appendix 4: Government Bonds

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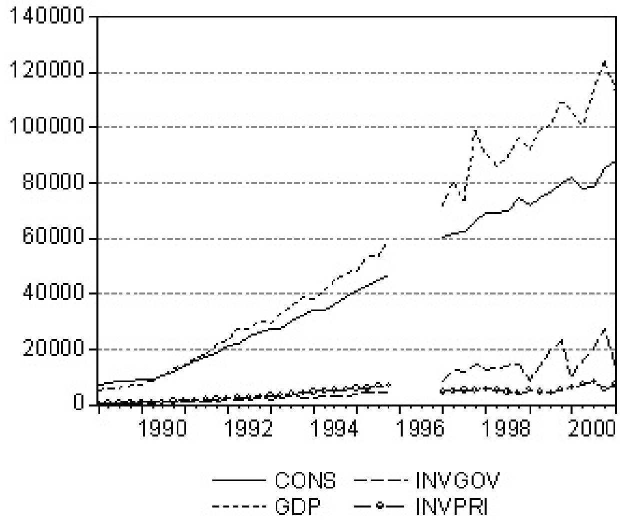

Figure 22: Real GDP and consumption growth

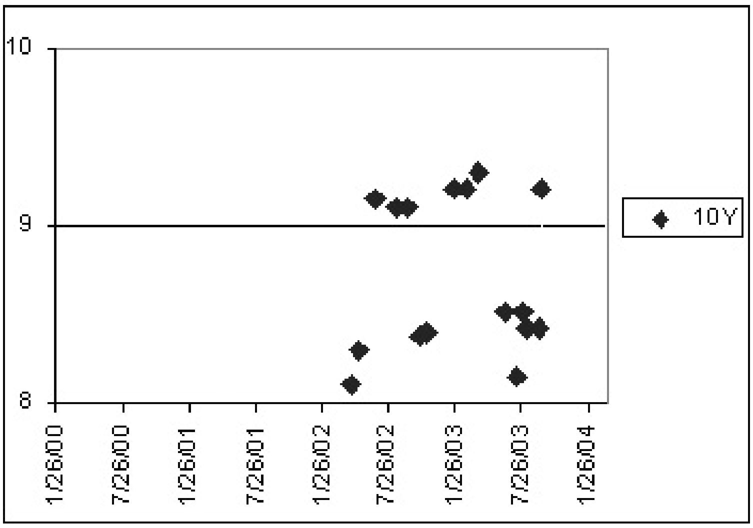

Figure 23: Fluctuation of 10-year coupon rates in 17 month period

Table 26: 15-year maturity government bonds 2000-04

Issue	Coupon rate %	Size uob	Value VND bn.	Value USD mn.	Issue	Coupon rate %	Size uob	Value VND bn.	Value USD mn.
9/12/02	9.99	1000000	100	6.6	10/2/03	9.7	2000000	200	12.9
10/8/02	9.15	1000000	100	6.5	10/24/03	9.5	1000000	100	6.5
11/15/02	9.17	1200000	120	7.8	11/18/03	9.5	2150000	215	13.9
12/10/02	9.18	1000000	100	6.5	11/21/03	9.4	2000000	200	12.9
12/12/02	9.18	700000	70	4.6	11/27/03	9.5	1000000	100	6.5
12/24/02	9.18	800000	80	5.2	11/28/03	9.5	1270000	127	8.2
2/25/03	9.18	1100000	110	7.2	12/8/03	9.4	1000000	100	6.4
2/26/03	9.13	1100000	110	7.2	12/19/03	9.4	1300000	130	8.3
3/14/03	9.7	1000000	100	6.5	12/23/03	9.4	2000000	200	12.8
3/28/03	9.13	700000	70	4.6	12/25/03	9.4	1000000	100	6.4
4/16/03	9.18	1150000	115	7.5	12/26/03	9.4	800000	80	5.1
4/29/03	9.18	1200000	120	7.8	1/15/04	9.4	700000	70	4.5
5/14/03	9.18	1420000	142	9.3	2/3/04	9.4	500000	50	3.2
6/12/03	9.18	1500000	150	9.8	2/9/04	9.4	1000000	100	6.4
6/13/03	9.18	400000	40	2.6	2/16/04	8.59	500000	50	3.2
6/23/03	9.18	700000	70	4.6	2/17/04	9.4	1500000	150	9.6
6/30/03	9.18	5000000	500	32.7	2/18/04	9.4	2000000	200	12.8
8/28/03	9.7	1000000	100	6.5	2/20/04	9.4	1500000	150	9.6
9/9/03	8.84	4390000	439	28.7	2/23/04	9.4	1150000	115	7.4
9/10/03	8.84	1000000	100	6.5	2/25/04	9.4	2000000	200	12.8
9/11/03	9.7	600000	60	3.9	2/26/04	9.4	4000000	400	25.6
9/12/03	9.7	1250000	125	8.2	2/27/04	9.4	1300000	130	8.3
9/15/03	9.7	1200000	120	7.8	3/1/04	9.4	5050000	505	32.4
9/25/03	9.7	2000000	200	13.1	3/8/04	9.4	1000000	100	6.4
9/26/03	9.7	1000000	100	6.5	3/15/04	8.59	500000	50	3.2
9/30/03	9.7	2000000	200	12.9	3/19/04	9.4	1100000	110	7.1
10/1/03	9.7	1200000	120	7.7					

Sources: State Securities Commission; public media. Database: organized and updated by Mezfin. uob: units of bond.

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Table 27: 10-year maturity government bonds 2000-04

Issue date	Coupon rates %	Size units of bond	Value VND bn.	Value USD mn.
4/15/02	8.1	1210000	121	8.0
5/6/02	8.3	900000	90	5.9
6/20/02	9.15	1000000	100	6.6
8/16/02	9.1	1000000	100	6.5
9/18/02	9.1	300000	30	1.9
10/21/02	8.38	650000	65	4.2
11/6/02	8.4	1200000	120	7.8
1/21/03	9.2	550000	55	3.6
2/26/03	9.2	250000	25	1.6
3/28/03	9.3	200000	20	1.3
6/13/03	8.51	600000	60	3.9
7/15/03	8.15	600000	60	3.9
7/31/03	8.51	650000	65	4.2
8/13/03	8.42	500000	50	3.2
9/15/03	8.42	450000	45	2.9
9/16/03	9.2	100000	10	0.6

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