I – 2

Evaluation of Financial Situation of Enterprises (especially state owned enterprises) and Factors Affected their Relationship with Banks and with the Government

Nguyen Duc Tang
Ministry of Finance

Enterprises are backbone of the economy, producing and supplying almost all of goods, services for society, and contributing main resource of state budget revenue.

In renovation process, enterprises have achieved successes regarding growth rate, its share of GDP portion in the economy and budget revenue, etc. However, enterprises have revealed several weaknesses, in which the most outstanding is low business effectiveness. Therefore, evaluation of enterprises' financial situation plays an crucial role in enterprises' reform and development process .

1- Quantity of enterprises: We can describe the development of enterprises within period of 3 years as follows:

Types of enterprise	1995	1996	1997	Proportion 1997 (%)
SOEs	6,052	6,000	6,000	14.7
Private	18,100	22,775	23,500	58
Stock	164	202	225	0.5
Ltd	7,276	9,002	10,100	24.8
Foreign invested	780	801	850	2
Total	32,372	38,780	40,675	100

From the above table, we can see that quantity of SOEs within 3 years from 1995 to 1997 is quite stable. After restructuring SOEs as provided in Decision 388/HDBT, on 31th December 1997, there are over 6,000 SOEs. These enterprises can be divided into 2 types, in cluding enterprises established by Decision No 90/TTg and Decision No 91/TTg of the Prime Minister and independent enterprises belong to Ministries, other government agencies and provincial people committees. SOEs is accounted for 14.7% of the total enterprises of all economic sectors.

Although the number of SOEs has decreased, their total output value as share of GDP has incresed substantially.

At current price level, the contribution of SOEs is accounted for 42.2% and 44.1% of the whole country's GDP in 1995 and 1996 respectively.

The contribution of other enterprises has increased dramatically in the last three years:

- Private enterprises: in 1997 the number of private enterprises was 23,500, which rose by 29% and by 3% in comparing with that of 1995 and 1996, respectively. Private enterprises consist of 58% total enterprises of all economic sectors.

- Stock enterprises: In 1997, the number of stock enterprises was 225, which increased by 37 % in comparing with that of 1995 and by 11% of 1996, took part of 0.5% of total quantity of enterprises in all types of possession.

- Limited enterprises: In 1997, there were 10,100 Ltd enterprises went up by 38% and by 12 % of that in 1995 and 1996 respectively. Ltd enterprise was 24.8% of total enterprises.

- Enterprises with foreign capital investment: the quantity in 1997 was 850 increased by 9% and by 6% of that of 1995 and 1996 respectively, and consist 2% of total enterprises.

2- Capital and asset: We can describe capital situation of enterprise in the period of 3 years as follows:

Unit: Bi VND

Type of enterprise	1995	1996	1997	Proportion 1997(%)
SOEs	80,684	98,122	103,000	43.0
private enterprises	3,856	4,085	4,500	1.8
Stock enterprises	2,082	2,659	2,910	1.2
Limited enterprises	6,156	7,459	9,500	4.0
Foreign invested	77,110	90,376	120,000	50.0
Total	169,888	202,701	239,310	100.0

SOEs only has proportion of 14.7% in quantity but 43% in total capital exposure of enterprises. From the above table, it is clear that currently capital of SOEs has gone up slightly. That was due to the government has limited budget distributed to SOEs and by their low accumulation of after tax profit.

By 31st December 1997, the number of SOEs' capital reached 103,000 bi VND and this number in 1998 was 108,000 bi VND. Capital of SOEs is concentrated mainly in State Corporation (approximately 70% of total SOEs' capital).

About 80% of capital of SOEs is in the form of fixed assets which are mainly old and technological backward. Therefore, effectiveness and efficiency of capital utilization remain low and 50% of current capital is tied up in account receivables or lost.

The exposure of total debts of SOEs to collect and to pay is extremely large. By 31st December 1997, total debt of SOEs was equal to 128% of total capital of government at enterprises and of which short-term and long-term debts are accounted for 64% and 29% of total debts and foreign debt took up 12% of the total debt and short term foreign debt was 1.3%.

The SOEs' debt which must be collected was approximately 50% of the total capital of government at enterprises. Bad debts reached 2.5% of total debt.

* Regarding to other enterprises (Private, stock, and limited company), their financial situation can be described as follows:

Most enterprises have faced with difficulties of capital shortage, causing debt defaults and capital occupation of SOEs. Due to the lack of capital, non state enterprises run inefficiently, goods and service are less competitive and a big number of enterprise goes bankruptcy. This poor performance of enterprises had put the whole economy into difficulty.

Private enterprise has the greatest quantity (57%) but has the smallest capital proportion (1.8%).. On average, each enterprise has only 191 mi VND capital. Its asset is mainly in the form of building, factory, land, machine and equipments (out-of-date things that it bought from SOEs).

- Stock and limited enterprise has the second large number in 4 kinds of enterprises (25.4%) but its capital take up only 5.1%. The average capital level of a stock is 12.9 bi VND and of a limited enterprise is 0.94 bi VND.

On the contrary, enterprises with foreign invested capital has small quantity, but has the biggest capital level. 141.2 bi VND is the average amount capital of foreign invested enterprise. Enterprise with foreign investment has much newer equipments and more forward technology than that of SOEs and other domestic enterprise. Furthermore, its capital is less tied in low quality goods and bad debts as well. Therefore, in most industries, areas SOEs and other enterprises are compete strongly and lose their market shares, especially in tobacco, soft drink, textile, and garment production.

3- Enterprises performance:

In 1997, total turnover of enterprise reached 432,000 bi VND climbed up by 31% and by 12 % of that in 1995 and 1996 respectively, we can describe that situation as follows:

Turnover of SOEs was 310,000 bi VND increased by 27% and by 11% in comparing with figures of 1995 and 1996 respectively. On average, each SOEs obtained 51 bi VND.

Turnover of private enterprise was 24,000 bi VND and went up by 23% and 13% of that in 1995 and 1996 respectively. Each enterprise gained 1.02 bi VND average turnover.

Stock and limited enterprises in total had 42,000 bi VND turnover, increased by 12% and by 10% in comparing with that number of 1995 and 1996. On average one enterprise had 4.06 bi VND in 1997.

Foreign invested enterprises had 56,800 bi VND turnover soared 76% and 22% in comparing with figure of 1995 and 1996 respectively. One enterprise gained 66.8 bi VND on average.

In 1998, despite of catastrophes and affects of regional financial crisis, enterprise continues its stable development. Growth rate of industrial and construction sector was 10.2%; agricultural sector grew by 2.7%; and services sector increased by 4.2%. SOEs increased 7. 9%, non state enterprises grew 6.7%, and foreign enterprise developed 23.3%.

In 1997, Gross profit of SOEs reached 11,341 bi VND equal to 84% and 103% of the figure in 1995 and in 1996 respectively. Most profitable enterprises were general corporation, consisted of 40% in number, of 71.5% in total capital, of 70.8% in total turnover, and of 82.6% budget collection. On the other hand, inefficient enterprises took up 44% in number, 22.9% in total capital, 23.3% in total turnover, 13.5% in budget collection. Less efficient enterprises were 16% in number, 5.6% in capital, 5.8% in turnover, and 3.8% in budget collection.

4- Factors influence to their relation with banks and government:

From the above mentioned situation:

Demand for capital in enterprises' in general as well as in SOEs is very big, especially capital for technology renovation, and equipment purchasing, so that it enhances their competitiveness and enlarges their shares in domestic and international market. However, it is difficult to meet that need.

Capital from budget resource invested into enterprises is limited in spite of great number of enterprises.

- Enterprises capital speculation ability is limited.
- Profit made by enterprises is small. That has bad affect on enterprises' savings to reinvestment for production expansion and renewing technology to improve productivity.
- Capital invested in production is small. Moreover, several finished projects are not effective.

From all these reasons, demand for credit becomes more and more urgent. The government has facilitated capital mobilization of enterprises by promulgating Law on Corporation, Law on State owned enterprises, Law on Banking and credit institution, etc. All these are legal framework for enterprises to mobilize capital. In fact, recently enterprises have mobilized capital from various resources, such as: state owned credit institution, other credit institution, and public, etc. Credit capital has played an important role in developing productions of enterprises.

- Credit mechanism for investment has gradually become a crucial leverage for renovating investment and construction. Capital effectiveness and efficiency in each enterprise as well as in the whole economy have been strengthened;

- Owing to right investment strategy and modern technology etc., many enterprises have gained profit and gradually paid their debts.
- Otherwise, there are some inefficient investment projects caused billion VND losses, that affected badly to the economy. These are some main reasons:

  + Ineffective investment decision, no market for output

  + indiminished investment, invest too much in equipments and/or material, resource.

  + Located in inconvenient site, difficult for supplying resource

  + Old equipment, out-dated technology

  + Purchasing overpriced equipment

Hence, several enterprises are unable to pay maturity loans, reduced credit resource of banks.

In order to meet the capital demand for production of enterprises, it is necessity for bank to reform their operation mechanism, especially state commercial banks follow track removal subsidiary system, reducing administrative interference in credit activities.

Weaknesses of banking system have negative effects on the whole economy, and each enterprise as well, concretely:

- Banking system has not been strengthened and more important, the relationship between bank and enterprise has revealed weaknesses of ask-give mechanism;
- Unfairness treatment between state and private enterprise in relation with bank.
- Solution for strengthening credit activities is not suitable and harmonized.

I − 3 A

Influence Estimation of Vietnamese Currency Decrease on the Foreign Assets and Foreign Liabilities of Banking System and Enterprises

Nguyen Thi Thu
The State Bank of Viet Nam

In the open economy, the economic, financial and commercial credit relations, etc. are increasingly expanded among the countries. Payment, evaluation, comparison, analysis and estimation with regard to economic value and efficiency in activities of foreign economic exchange become much more complicated. The payment units are not only internal currency but also diverse foreign currencies. Therefore, an obvious requirement occurs i.e. the value and purchase in terms of the internal monetary must be compared with the foreign monetary. That is exchange rate. The main rate means that the cost of a country's monetary unit is shown by the other countries' monetary units.

The exchange rate is the most important cost in the market economy. It affects the relative price of the home and foreign commodities, each exported or imported item of goods as well as the price of the domestic items of goods which are competitive against imported commodities. It impacts the commercial balance, output and economic work.

When the country's monetary increases in comparison with other monetary, that country's commodity in the foreign country becomes more expensive and the foreign commodity in that country is cheaper (the domestic price in two countries are still kept). Whereas, when a country's monetary is in the decline, that country's commodity in the foreign countries becomes cheaper while the foreign commodity in that country becomes more expensive. A monetary increase can make manufacturers in that country have difficulties in their commodity sale in the foreign countries and it can increase competition of the foreign commodity in their country because its price decreases.

As a kind of the international cost so the exchange rate is very important, but perhaps, the most important factor is the rate between domestic currency with dollar with regard to many nations in the world. Because after the Second World War, America prevailed as the strongest economy in the world at that moment, the American dollar was considered to be significant one and had its domination. Many countries in the world used dollar for the international reservation. So far, although the EURO monetary has been born, dollar is still strong one which used utmost in the international relation fields and occupies a rather important role in the international payment balance as well as in the general payment terms in many countries in the world. Hence, the rate management between native currency and dollar still plays a specially important part of many nations in the world.

Since June 1997, when a range of the Asian dynamic economies were influenced by the monetary financial crisis deriving from Thailand, then it spread to Malaysia, Indonesia, Philippines, Singapore, Hong Kong, Korea, Japan and presently it spreads nearly globewide. At first, there was the strong fall in ASEAN monetary which made the price increase strongly and it made the foreign investment decrease. The monetary financial crisis has caused the globally significant influences. The consequence of the monetary financial crisis is the big price-break in terms of the regional countries' monetary compared with USD. It makes the investment to this area worse and it also reduces economic growth in the East and Southeast Asian countries the coming years.

In 1997, Vietnamese economy was not impacted by the regionally monetary financial crisis. In 1998, the foreign economic exchange of Viet Nam was impacted worse and worse. The consequence of the financial crisis has indirectly strongly increased Vietnamese dongs in comparison with USD. It disadvantages almost the economic fields in our country and it also reduces export, foreign investment and approach ability with regards to the debts. From this, it makes the foundation of the quick growth decrease quickly.

Coping with the complication of the regional monetary financial crisis, in order to limit crisis's impact on the macroeconomic stability and the Banking systems' activities, meanwhile, in order to make the foreign economic environment convenient, Viet Nam has decreased Vietnamese dongs. The rate is executed actively, closely to the supply and demand of the foreign currency as well as the rate in the international and regional market with a view to reflecting Vietnamese currency value in a relatively real way. It does not only limit the disadvantaged influence from the economic crisis but also play as a "economic push-up" with purpose of export encouragement, import control and foreign investment attraction which strength economy, meanwhile, does not cause the economic sudden changes and not influence the common price.

Rate adjustment in 1997 - 1998

Unit: VND/ USD

Rate	Before Feb. 97	Feb. 97	July 31st, 97	Oct. 97	Feb. 14th, 98	Aug. 6th, 98	Dec. 31th, 98
Official rate	11,055	11,175		11,175	11,800	12,998	12,985
Transaction amplitude	± 1 %	± 5 %		± 10 %	± 10 %	+ 7 %	+ 7 %
Transaction rate	11,154	11,184	11,683				13,894

In 1997, the market rate freely changes 14.2%; the transaction rate was about 11.5%; in 1998 was 9.6%, the official rate: 16%, the transaction rate was 13%.

Vietnamese currency decrease does not only directly foreign assets and foreign liabilities of banking system but also indirectly affect. It will be analyzed as follows:

1. In Terms of the Banking System

a. Direct affect: (table page 8)

* In 1997, Vietnamese currency decrease about 11.5% according to the given transaction rate:

- In terms of the foreign assets and foreign liabilities of banking system :

+ Foreign assets of banking system increases VND 3,500 billion.

+ Foreign liabilities increases VND 1,600 billion.

Thus, net foreign assets increases VND 2,000 billion in comparison with the rate in 1996.

- In terms of the domestic assets: In case of the sending money in the foreign currency of the banks in 1997 is USD 1.5 billion, at the same time, borrowing economy in the foreign currency is USD 1.6 billion. Thus, the gap between foreign currency borrowing and 5 currency sending is USD 0.1 billion and this also benefits VND 100 billion to the Banking system due to it in 1996.

Therefore, it can be concluded that Vietnamese currency decrease in 1997 has benefited the Banking system.

* In 1998, Vietnamese currency decrease 16% in terms of the official rate and 13% in terms of the transaction rate compared with 1997 has made:

- In terms of the foreign assets and foreign liabilities of banking system :

+ Foreign assets of the Banking system increases VND 9,000 billion in comparison with the rate in 1996 and increases VND 5,000 billion in comparison with the rate in 1997.

+ Foreign liabilities of banking system increases VND 3,000 billion in comparison with that in 1996 and increases VND 2,000 billion in comparison with the rate in 1997.

Hence, it can be said that in the two year 1997 - 1998, VND decrease 24.5% has made value of the clear net foreign assest in the Banking system increase 6,000 billion dongs compared with that in 1996; increases VND 3,000 billion compared with that in 1997.

- In terms of the domestic assets, liabilities are calculated in the foreign currency.

In case of the sending money in the foreign currency of the banks in 1998 is USD 1.7 billion, at the same time, borrowing economy in the foreign currency is USD 1.4 billion. Thus, the gap between foreign currency borrowing and foreign currency sending was USD -0.3 billion. It decreases the own property in the foreign currency was VND 800 billion due to the rate change in comparison with that in 1996 and VND 1,000 billion in comparison with that in 1997. It can be explained that in 1998, because of the rate change > 13% so the change from Viet Nam to the foreign currency increased, it made the speed of sending money in the foreign currency more increased than sending in Vietnamese dongs. Meanwhile, because enterprises were afraid of the exchange risks so they did not dare to borrow in the foreign currency. It made the quota of sending the foreign currency into the Banking system increase compared with borrowing fund in the foreign currency.

But in general, foreign currency status (including net foreign assets and net domestic assets was calculated in the foreign currency) of the Banking system was abundant (assets >liabilities) but it was not much so Vietnamese currency decrease in 1998 still benefited the Banking system in general.

b. Indirect affect to the Banking system:

Apart from the direct affect, Vietnamese currency decrease also indirectly affects the foreign assets of the Banking system as follows:

Although Vietnamese currency decrease brings many positive effects such as: influence of the regional monetary financial crisis is limited, export is pushed up, import is controlled, foreign direct investment is encouraged, meanwhile, the Banking system is benefited as analyzed above. The export push-up will bring some necessary foreign currencies for import of the equipment and other manufacture materials, at the same time, the exchange of knowledge and technology is pushed up. In addition, if export is encouraged, the foreign direct investment will be collected because the investors usually like the countries having the convenient conditions for manufacture with a view to exporting and getting benefit to their countries.

However, Vietnamese currency decrease has also brought the certain risks to the commercial banking system through the indirect influences due to several enterprises have more debts, it leads to loss because of the rate adjustment (it will be analyzed concisely in the following part). In the present circumstance, the density of the borrowing capital in the enterprises usually occupies 70-80% of the operation working capital. In which, there is the capital borrowing in the foreign currency in the enterprises, mainly in the ways of borrowing Credit Organizations' credit fund, borrowing from foreign countries, import of the L/C deferred commodity. Therefore, if the enterprises are in the big debt and loss, obviously, it will affect directly borrowing capital payment and these enterprises' loss will disable bank debt payment. It will have a great influence on the foreign currency own property in the Banking system and it also makes the banking profit decrease. Banks, because of this reason, the overtime debt of the Banking system will rise, the credit risk is high which affects the safety of the Banking system.

2. In Terms of the Enterprises

The foreign currency borrowings in the Banking system are considered and the damaged degree of the enterprises are shown out when borrowing the foreign currency of the banks regardless of the amounts that the enterprises borrow directly from foreign countries.

The foreign currency debt surplus to December 31st, 1998 of the Commercial Banks was USD 1.4 billion, VND decrease from January 1997 to December 31st, 1998 was 24.5% which made the enterprises borrowing capital from the banks increase their big debt amount of VND 4,000 billion in comparison with that in 1996, 2,000 billion in comparison with that in 1997. In which, the enterprises borrowing capital in USD for business and the enterprises importing foreign machines, equipment and materials will have the most difficulties expressed in the two following aspects:

Firstly: *The debt will be increased because of the foreign currency borrowing*

- With regards to borrowing the bank credit in the foreign currency: Despite the State management, credit market in Viet Nam still exists 2 together types of domestic currency and foreign currency. The foreign currency is chiefly American dollar, it cannot only meet the payment demand in terms of importing the foreign equipment, materials and community but also meet the inhabitant, internal purchase and payment demand out of the control scope of the State and the borrowing demand of the foreign currency exchanged into the domestic currency. Many years ago, from 1993 - 1996, dollar cost increased 2.75%, monthly average was 0.07%/month, yearly average was 0.91%/year. During this duration, Vietnamese monetary market is ranked in stability with few risks so the International Banks lent Viet Nam with the interest of 7%/year (Libor + 1% = 6% + 1% = 7%). If the enterprises relent from the Vietnamese state commercial banks, the interest was 8 - 8.5% /year. Thus, the real interest of the foreign borrowing the foreign currency exchanged to VND was about 8.91 - 9.41%/year. Meanwhile, the average VND borrowing in 1994 was 18%/year, 1995 was 16.8%/year, 199 was 14.4%/year clearly higher than the borrowing interest in the foreign currency exchanged to VND. Hence, in the enterprise economic efficiency, foreign capital borrowing is more obviously advantaged than domestic monetary without any discussion. Therefore, in the past years, the enterprises wanting to borrow capital usually rush for the foreign currency borrowing while the domestic capital source in the commercial banks, which can meet the demand, sometimes is in the stagnation.

Facing the adjustment of the rate increase, the first challenge is the debt (usually big) which suddenly increases because they must pay a real interest calculated as follows: the interest of the foreign currency borrowing + the speed of the rate change. The interest of the foreign currency borrowing of the enterprises in 1997 was from about 9 - 9.5%, 1998 was about 8 - 8.5%/year; the rate change in 1997 was 11%/year; 1998 was about 13%/year. Therefore, the real interest the enterprises must pay at the moment was about>20%/year, much higher than the borrowing interest in terms of the domestic currency of 13 - 13.8%/ year. If these borrowings are the long-term capital, the debt continuously increases after the rate adjustments. It is regardless of the arising interests from the original interest also caused by the rate adjustments. For a country, this is the worrying problem.

- In terms of the foreign borrowing, L/C is opened, deferred commodity is imported:

The foreign currency borrowing from foreign countries via the credit borrowing or import of the materials and commodities by opening L/C deferred payment in 1996 - 1997 are rather popular with the import enterprises. Therefore, as the same as the banking foreign currency capital borrowing, there were enterprises only after a night, their debt has increased to billions in the next morning. For instance, But Son Cement Company which has the total of foreign borrowing of $ 195 million, when estimated-cost was carried out the rate change was estimated of VND 11,000/$, presently, the rate has been approximately VND 14,000/ USD, has had to pay for the debt of nearly 600 million dongs regardless of the interest and the amortization because the implementation lasts over 1 year. The interest which had to be paid due to the slow speed was over 250 billion dongs. A range of the vertical-kiln and rotary-kiln cement factories, sugar cane equipment, sugar cane machines and other imported equipment, machines are in the foreign currency, obviously, the foreign debt will increase.

Secondly: *Increasing manufacture expenses causes the loss for some enterprises*

The fact shows that the home enterprises which produce the commodity concerning to the imported machines and materials are in difficulty at the different levels.

The rate adjustment has had influence on the input expenses of several enterprises of this type, (because input material, technology and equipment import are in the differed payment). It increases the cost of some products and some imported commodities. When the machinery value rises, the amortization for the product cost also increases regardless of the other imported materials, increasing the price meanwhile the selling price does not increase and the purchase in the market decrease.

The typical example: Some enterprises in the branches:

+ Sugar cane, cement branches: Presently there are 60 rotary-kiln cement factories and about 80 vertical-kiln cement manufacturers, there are 35 sugar factories and in 1999, more 7 projects will be put into manufacture. According to the current and future estimations, these branches hardly pay the foreign currency debt.

+ Branches of petroleum, electric power, telecommunication: The rate adjustment is the clearest in terms of the petroleum branch because its products must be imported in the foreign currencies, when selling in the home country, getting VND without increase in non-selling price, the branches of post-telecommunication, electric power, shipment will have the bigger foreign currency debt because the service fee mustn't increase. Therefore, obviously because of the rate adjustment or the more these branches sell out, the more they lose and the loss has not been stated open; or the collected VND due to the balanced selling do not have the foreign currency created for the next import or without the interest, or big interest decrease. The pressure of the cost increase for these fee and service commodities is big.

Apart from the enterprises which borrow the foreign currency capital are in a big monetary damage, there are the other premises having the sending money in the foreign currency (including the inhabitants' sending money) have collected the not little profit of Vietnamese currency decrease of 24.5% in the two year 1997-1998. Until December 31st, 1998, the foreign currency of the Banking system was USD 1.8 billion gained thanks to the rate change of 5,000 billion in comparison with the rate in 1996, 3,000 billion dongs in comparison with that in 1997. Hence, the number of the enterprises out of the loss and with the interest in the corresponding rate adjustment are the same with the enterprises in loss and in the loss orientation.

Vietnamese currency decrease in the past years was inevitable, beside the good results for the International and Banking system, there are some major difficulty affecting the system's safety. This is the question given for the Banking system with the rational explanation.

Bank of Viet Nam monetary survey. 1996-1998

Economic Research (including 4 Gov't & 24 non-gov't Com.banks)

- In million Dong

- Billion USD

	1996		1997				1998					
	USD	VND bv EX. rate 96	USD	VND bv EX. rate 97	VND bv EX. rate 96	Ch"nh lÖch tû gi, 97-96	USD	VND bv EX. rate 98	VND bv EX. rate	Ch"nh lÖch tû gi, 98-96	VND bv EX. rate 97	Ch"nh lÖch tû gi, 98-97
I. assets		64.60		81.60				101.1				
1. Net foreign assets	*1,3*	*14,2*	*1,7*	*21,0*	*19,0*	*2,0*	*2,3*	*31,4*	*25*	*6*	*28*	*4*
- Foreign assets	2,8	31.2	3,1	37.9	34,4	3.5	3.4	47,8	38	9	42	6
- Foreign liabilities	1.5	17.0	1.4	16,9	15.3	1.6	1.2	16.4	13	3	14	2
2. Net domestic assets		*50.40*		*60.60*				*69.7*				
O/W:												
- Claims to the Economic		*50.9*		*62.4*				72.6				
+ Loans in VND				42.8				52.7				
+ Loans in foreign currency			1,6	19,6	17,8	1,8	1,4	19.9	15,9	4,0	17,6	2
II. Total liquidity	5.80	64.60	6.64	81.60	73.97	7.63	7.3	101.1	81.02	20.09	89.37	11.74
1. Dong liquidity		51,4	5.1	62,9	57.0	5.9		76,1				
2. Deposits in foreign currency	1.2	13,2	1.5	18,7	17,0	1,7	1.8	25,0	20,0	5,0	22,1	3
Exchange rate ...	11.144 ®/S		12.293 ®/S				13.908®/S					

I－3 B

Impact Assessment of Vietnamese Dong's Depreciation on US Dollar-denominated Assets and Liabilities of Banks and State Owned Enterprises

Do Minh Tuan
Ministry of Finance

I. The Process of Vietnamese Dong (VND) Depreciation

The South East Asian financial monetary crisis, which broke out in Thailand (July 1997) and spread to a series of Asian countries, has spilled over the whole world according to econmists' assessment. Currencies of some Countries devalued one after another and suffer ed from substantial fluctuations. This strongly affected the entire global economy and created devaluation pressure on a number of countries including Viet Nam.

During the past many years, the value of Vietnamese Dong (as reflected by the exchange rate between VND and USD) was relatively stable, which usually more or less around 11,000 VND/USD. Despite a lot of pressure, both domestic and external, that Viet Nam should devalue its currency because the Vietnamese Dong was too much overvalued, thanks to the consistant pursue of financial monetary and economic stabilization objective, the Vietnamese Government through State Bank of Viet Nam (SBV) was still active in the management and able to maintain a stable and flexible exchange rate at the above mentioned level. However, in the past 2 years, the State Bank took steps to lower the value of Vietnamese dong by adjusting the exchange rate between VND and USD.

On 27 February 1997, the Governor of SBV decided to widen the bands for foreign exchange trading of commercial banks with clients from ±1% to ±5% around the offical rate announced daily by SBV. With this Decision, exchange rate on the interbank market went up from 11,200 VND/USD to 11,644 VND/USD, meaning that the Vietnamese Dong devalued by 3.96%.

On 13 October 1997, the above trading bands were raised by SBV to ±10%. Immediately, interbank market rate rose from 11,279 VND/USD to 12,287 VND/USD. The Vietnamese Dong accordingly fell 4.76% further.

Besides the adjustment of trading bands, on 16 Feruary 1998, SBV decided to raise the official rate from 11,175 VND/USD to 11,800 VND/USD, an increase of 5.6% With the trading bands stayed at ±10%, the value of Vietnamese Dong continued to depreciate by 5.6%.

Then on 7 August 1998, SBV issued a decision to narrow the trading bands to ±7%, at the same time the official rate was increased from 11,800 VND/USD to 12,998 VND/USD. This adjustment promptly made the trading rate on interbank market go up from 12,980 VND/USD to 13,908 VND/USD. The Vietnamese Dong devalued accordingly by 7.15%.

It can be observed that during the past 2 years, with 4 times of exchange rate and trading bands adjustment, Vietnamese Dong has devalued by 24.18%. The decision of SBV to adjust exchange rate of VND amd USD was necessary in order to have a real value of VND. The depreciation of Vietnamese Dong has had several impacts (both positive amd negative) on the entire social economic life, particularly on the USD denominated assets and liabilities of banks and state owned enterprises (SOEs).

Ⅱ. The Impact of Vietnamese Dong Depreciation on USD Assets and Liabilities of Banks

As the external value of the domestic currency, in the context of economic globalization, exchange rate adjustment has implications to every aspect of the economy, especially the banking system-banking services and monetary business.

1. Immediate impact of the devaluation

The immediate impact of devaluation on banks' assets and liabilities totally depends on the position in USD of a bank.

Why is there the concept of USD positiom?

Banks are not only involved in taking deposits and lending, but they also buy and sell US D. Since the amount of USD bought and sold by a bank do not match, there exist positions in USD at different times reflecting the relationship between assets and liabilites of a bank.

1) Balanced (zero) USD position

In this case, any currency devaluation whether big or small does not affect the financial situation of banks at the time of devaluation. The reason is that the devaluation increases equally both the value of assets and liabilities in USD when converting into VND equivalent. In other words, the benefits obtained from the asset side in devaluation are just enough to compensate the increased obligations in VND equivalent of liabilities.

2) Positive USD position

Positive USD position appears on a bank's balance sheet when the value of USD buying transactions is greater than the value of USD selling transaction. In this case, banks obtain profits promptly at devaluation. The profits are identified by:

The level of USD appreciation × (value of assets-value of liabilities) in USD
(or VND depreciation)

3) Negative USD position

In contrast to positive USD position, negative USD position appears on a bank's balance sheet when the value of USD selling transactions is greater than the value of USD buying transactions. Devaluation will bring losses to banks because obligations increase greater than the increase of assets in USD when converting into Vietnamese Dong. The losses are identified by:

The level of USD appreciation × (value of assets-value of liabilities) in USD
(or VND depreciation)

2. Long term impact of devaluation

Long term impact of devaluation on banking assets and liabilities is very complex, including both direct and indirect impact.

1) Direct impact of devaluation on banking activities through the following channels:

- Deposits (liabilities) : due to devaluation and expectations of devaluation, deposits in USD rose sharply while VND deposits declined. "Within nearly 9 first months of 1998, funds mobilized in VND reduced by 800 billion, while savings in foreign currency increased by 100 million USD"[1]
- Loans (assets) : Contrary to developments of USD deposits, lending in USD in the economy reduced strongly due to fears of debt burden when devaluation happened. In fact, lending turn-over in USD during the past time was very low. Most USD deposits were redeposited or put into trading activities in international market.
- USD trading : Because of rumors that VND was being overvalued, most of the VND devaluation adjustments created expectations of further devaluation of the domestic currency. Foreign exchange holding and speculation were, therefore, very high, even in the banking system. It means that demand for foreign exchange in the economy was very big while supply was small. In reality, all of the past adjustments, either through widening the trading bands or raising the offical rate, led to a decrease in the volume of foreign exchange trading, as follows:

[1] Saigon Economic Times, 24 September 1998

	21 Nov 96	27 Feb 97	13 Oct 97	16 Feb 98	7 Aug 98
Exchange rate adjustment	Increase official rate and widen trading bands from 0.5% to 1%	Raise trading bands to 5%	Raise trading bands to 10%	Increase official rate to 11,800, meaning 5.6% devaluation compared with USD	Increase official rate to 12,998, trading bands reduced to 7%
Developments in inter-bank market	Volume of trading reduced compared with Sept and Oct 96	Volume of FX trading reduced from about 3 million USD/week to 1 million USD/week	Volume of FX trading in inter-bank market declined sharply	The market was nearly frozen, weekly average volume of FX trading not exceeding 200,000 USD	2 days after the adjustment, some banks even did not quote USD selling rate. After that, volume of transactions increased but again reduced sharply when E/R reached

According to Saigon Economic Times dated 27 August 1998, FX buying turnover of some banks were as follows : (unit : million USC)

	17 Aug 1998	18 Aug 1998	19 Aug 1998
VCB (HoChiMinh)	...	4.77	2.55
ACB	2.44	0.72	...
DEUSTCH	1.00	0	...
VBARD (HoChiMinh)	1.60	0.033	...

- Foreign borrowing and repayment of banks : as the USD always in appreciation, interests on foreign borrowing of banks increased, and demand for new loans of the banking system reduced.

Along with changes in USD deposit taking, lending, buying and selling volumes, bank charges also had obvious changes

- Firstly, interest expenses incurred on USD deposits and foreign borrowings increased while interest incomes from lending decreased.
- Secondly, buying and selling fees reduced.

2) Indirect impact:

The indirect impact of a devaluation on banking assets and liabilities depends on its influence on economic activities.

- Export-Import : improved exports owing to devaluation increase FX buying turnover of banks from export incomes. On the contrary, higher price of imports because of devaluation effectively controls import turnover. The result is that demand for FX used in import payments reduces. In fact, due to depreciation adjustment of E/R, the economy's trade deficits decreased continuously in June, July, August, and September of 1998. Net USD selling turnover of the banking system to export-import activities, therefore, also declined.

- Enterprise foreign borrowing, repayment and guarantee fees : increased debt burden due to devaluation results in lower demand for foreign borrowing of enterprises, leading to a decline in guarantee fees. On the other hand, devaluation also brings about doubled losses to enterpises that operate with imported inputs both USD debt service and cost of inputs increase therefore, past-due debt may occur. Then either banking assets value reduces (if risk adjusted), or banks may have to pay USD debt instead of enterises.

In summary, devaluation has complicated affect, particularly long term one, on the asset-liability structure of the banking system. However, since Viet Nam is still in the transitional period, there is no basis for a stable domestic currency, the banking system in rudimentary, to deal with unavoidable fluctuations of exchange rate (i.e. external value of currency), SBV has issued regulation on net open position of the banking system with a view to limiting overly open positions of banks which could incur losses that can not be responded.

3. Impact of Vietnamese Dong devaluation on USD assets and liabilities of SOEs

A devaluation of Vietnamese Dong affects the assets and liabilities through impacts on production and business activities of enterprises in general and SOEs in particular. Specifically:

1) Import activities

The impact on import activities is obviously negative. Since exchange rate changes, the value of VND decreases, enterprises incur higher import expenses, increased input costs, higher production costs and less profits.

Almost enterprises suffer from this impact, among them some have input costs depending on imported component like machines, technology, others import raw materials and fuels for production like in cement, electricity, iron & steel, fertilizers and sugar plants.... Many enterprises are even strongly affected because their imported input expenses account for a major part of the product's cost.

For example, Viet Nam Cement Corporation has imported inputs accounting for 15% of production cost. During the last 3 months of 1997, the Corporation imported 21.9 million USD of raw materials, equipment, spare parts for cement plants ...and this increases the cost by 34.3 billion Dong due to exchange rate fluctuations.

The petrolium sector not only has no resources to pay profit tax of 350 billion Dong as targeted for budget revenue in 1998, but also suffer from losses. It is estimated that with the exchange rate of 14,000 VND/USD, the production and business sector will incur a loss of 1,948 billion Dong.

As for the steel sector (steel foil is imported in 60% of domestic steel production), with the exchange rate of 14,000 VND/USD, production cost increased by 4,95 million Dong/ton, total cost increased by 194 billion Dong.

Viet Nam Paper Corporation imported 32 million USD worth of paper pulp, when exchange rate changed by 1,000 Dong per USD, the Corporation lost 15 billion Dong.

Textile and Garment Corporation had an increase in production cost (imported cotton) of nearly 61 billion Dong in 1997 due to changed exchange rate.

2) Export activities

As for export, the depreciation of VND was basically an advantage. The change in E/R clearly helped export enterprises be able to lower export price to compete with similar export items of other countries like rice, coffee, rubber... , at the same time compensated for export enterprises when the price of exported goods declined in international market.

Enterprises operatng in gas and oil sector were almost not affected by VND devaluation since they export crude oil by long term contracts, a majority of their clients are permanent one with long-lastng relationship and payment in USD.

The devaluation of VND also affected coal enterpises (Coal Corporation) because export market is vital to their operation, if there are no longer profits earned from coal exports to compensate for losses in domestic consumption, after 2 years the Coal Corporation's capital will be depleted.

3) Borrowing activities

The change in VND/USD rate affected significantly borrowings of enterprises. To service debt in USD, enterprises have 2 ways : (1) if the enterprise has FX revenues from exports, it is rather advantageous but rarely the case; (2) the enterprise uses VND to buy USD for debt service at the exchange rate at the time of principal and interests repayment. However, if E/R increases, the enterprise will incur losses. The extent of loss varies among enterprises depending on each's specific operations.

The Coal Corporation's debt service capacity was not affected by E/R fluctuations because of their small amount of FX borrowings and large annual FX revenues from coal exports which doubles the borrowed amount.

The Electricity Corporation (EVN) had debt outstanding of 538 million USD as of 31 July 1998. With the devaluation of VND against USD from 12,300 to 13,960, that outstanding amount increased by 335.375 billion VND.

According to the calculation of General Department for Management of State Capital and Assets in Enterprises, total loan outstanding of SOEs was about 3 billion USD as of early 1998 (of which more than 80% is medium and long term). With the 19% change in E/R (compared with the former rate of 11,700 VND/USD), the increase in debt service was 7,000 billion VND.

Apart from this, the depreciation of VND against USD had impact on investment, joint venture projects, especially on the payment for goods purchased by installments of Vietnamese enterprises.

Thus, the devaluation of VND greatly affected assets, liabilities as well as operations of SOEs. Export trading or export producing enterprises were not much affected, but enterprises that use imported inputs or involve in import trading will suffer considerably. Besides, devalued Vietnamese Dong increased debt burden of enterprises buying goods on installments and particularly enterprises that borrowed FX from local and foreign banks for investments and joint ventures.

I－4 A

Assessment of Objectives and Impact of the Contextual Solutions of the State Bank and the Government of Viet Nam in order to Reduce Financial Difficulties of State-owned Enterprises (SOEs) and Banks

Nguyen Ngoc Bao
The State Bank of Viet Nam

Solution for State-owned Enterprises

Present situation for the state-owned enterprises

Structure and adjustment of structure of the GDP by economic sectors in the current price:

Economic sectors as percent of the economy (in recent years)

	1995	1996	1997
-State-owned economic sector	50.3	49.3	48.2
-Cooperative economic sector	0.6	0.6	0.5
-Private sector	2.2	2.4	2.4
-Individual economic sector	17.6	16.1	14.8
-Mixed economic sector	4.2	5.0	5.5
-Foreign funded economic sector	25.1	26.7	28.5

Looking at the real situation, we have seen that in the structure of the economic sectors, the state-owned sector still account for high ratio and it is increasing, even though the number of the state-owned enterprises has been reduced. The reason is that the state-owned enterprises accounts for high ratio in industry, construction, transport, credit, having taken most of the Viet Nam counterpart role in the joint-venture with foreign counterparts; taking important position in the key economic sectors, ensuring to provide greater part in infrastructure, social services, responsible for supplying a number of essential goods for society and for export.

Through adjustments made in line with the Decision No.315／HDBT, Decree 388／HDBT, instruction No.500／TTg, about 3,000 enterprises and other enterprises relating to technology and market and liquidate about 3,500 enterprises. As a result, by the end of June 1998, there are about 5,800 state-owned enterprises. Difficulties in production of the state-owned enterprises have been reflected in some aspects:

In general, the process of reorganizing SOEs is still bearing the administrative nature, not paying adequate attention to economic effectiveness and ability of SOEs to integrate into the world. Planning by sectors have not met the requirements, sectional structure is still irrational, duplications in a number of sectors and localities have not been overcome, the number of SOEs is still great and in small scale. More 25% of enterprises have capital less than VND 0.1 bill, and 60% enterprises with the capital less than VND 0.5 bill. Some indicator of increasing effectiveness of using capital, productivities have not met the requirements. Therefore, almost enterprises, including the state general companies organized under the Decisions No.90/TTg and 91/TTg are still weak in term of competitive ability, therefore, they are operating mainly in the country. They are not strong enough in term of finance and management ability to operate successfully in foreign countries.

- SOEs are seriously short of capital; general technological situation is backwards and slowly improved. From 5,800 SOEs, there are 3,997 local SOEs. Scale of SOEs are still very small; real financial position is still very weak, about 85%-90% of their capital is loan. A lot of SOEs have loans which is 4 to 10 times higher their own capital; production efficiency and profit per business investment capital is low. There are about 30% of SOEs are loss-making. According to the report of 51 Department of Capital Management which manages 59% of SOEs in the country, the efficiency of activities is very low.

Following is the detailed figures:

Total number enterprises: 3528
Total capital: VND 31,293 bill.(30.4% of total capital of SOEs).
Profit: VND 2,800 bill.
Profit ratio(in 1997):9%.

Accumulate losses and bad loans to be paid by the end of 1997 is VND 3,046 bill.(9% of S OEs' fund).

SOEs are divided into the following groups:

- Number of real efficient SOEs are 1,301, accounting for 37% of total SOEs.
- Number of SOEs which are inefficient and facing temporary difficulty is 1,634, accounting for 46.4% of total SOEs
- Inefficient SOEs are 588, accounting for 16.6%.

The good consumption market is still limited, not taking fully domestic market potential in to play, ability to expand market to foreign country is still limited a lot. Goods produced are less competitive.

- SOEs' mechanism to manage finance and wage is still not in time. In the training activities, there are not enough policy, allowances to ensure keeping and strengthening good managers and skilled workers to met the requirements of the economic development in the severe conditions of the market mechanism.
- Structure is reformed slowly. There are small number of enterprises that operate in the

key sectors that require high quality products and high-technology. At the same time, in the ordinary production and service sectors, the number of SOEs still accounts for large percentage, they are not socialized broadly to bring into play internal power of the whole society.

- System of legal documents are not comprehensive, legal documents needed to be adjusted, amended are made slowly and there are many duplications causing great impacts and big bottlenecks to the productions and business of enterprises.

The above-mentioned emerging problems have shown the low effectiveness of SOEs. Number of inefficient enterprises is high, the situation of loss of capital due to bad debt, loss-making businesses is widespread. If including the losses due to the reduction of price of assets, so the situation is still more serious.

Credit relation between the commercial bank and SOEs

Credits for SOEs has tendency to reduce gradually, which is in line with the changes of economic structure toward the commodity multi-sector economy and in fact the quality and efficiency of production and business activities is still low, about 50% of SOEs have not met conditions to be given credit. Credit is shifted to be given to rural households and non state-own enterprises. Following is the specific figures.

Year	Percentage of SOEs' loan outstanding in the total loan outstanding
1992	92.3%
1993	63.7%
1994	62.7%
1995	56.8%
1996	52.6%
1997	49.6%
1998	53.0%

Based on the present situation of SOEs and in order to achieve the objective to stabilize and increase economic growth at high rate, following the Government and the State Bank of Viet Nam have implemented the credit measures for SOEs:

+ The Government temporarily stops implementing the article 11 of the decree No 59/cp dated October 10/96; total mobilized capital of SOEs should not surpass its legal capital at the latest declaration...".

In the real situation of poor production and weak business of a great number of SOEs and in order to ensure safety for credit amount within ability and permissible conditions, the State Bank of Viet Nam has instructed commercial banks as follows:

+ Those SOEs with total loan outstanding from the Bank (including loan outstanding guaranteed by the bank) and other investors, they should be classified and settled by appropriate measures:

Class A (including those SOEs that operate well, paying debt in time); class B (facing difficulty in doing business but this situation can be overcome), class C (including SOEs that operate poorly, loss-making, having a lot of overdue debt).

+ For state-owned enterprises of class A: commercial banks continue extend loans and revoke debts normally, but the enterprises must enhance their charter capital themselves.
+ For SOEs of class B: commercial banks will revoke outstanding loans steadily. However, new loans may be extended for essential demands; but the amount of loan that will be extended must be smaller than the amount of revoked loans.
+ For SOEs of class C: commercial banks will provide new loans and only focus on revoking the debts.
+ For enterprises that have just been established or have a credit relations not so long: commercial banks apply the ratio of 1/1 between bank loans and enterprises' own capital.
+ Commercial banks should check, readjust records, procedures and conditions of the current loans in order to complete the legal records.
+ Commercial banks implement the regulation that the total outstanding loans extended to a single customer shall not exceed 15% of the own capital of the credit institution (the ratio formerly war 10% of the own capital). Commercial banks should revoke their debts actively. In cases where the loans required by a single customer exceeds 15% of the own capital, commercial banks must be allowed by Prime Minister.
- The lending conditions to enterprise in general and to SOEs in particular that regulated in the lending rules accompanied with Decision No. 324/1998/QD-NHNN1 dated September 30,1998, accord with the current laws, make contribution to enhance autonomy of the credit institutions and facilitate opportunities of borrowing money for SOEs' feasible and efficient investment projects, namely:

+ Help SOEs to have civilian legal ability.
+ Help SOEs improve their financial capability in repayment their debts within duration that mutually agreed upon by the parties.
+ Help SOEs to use bank loans legally.
+ Help SOEs to get feasible and efficient business plans.
+ Help SOEs to implement the regulations on securing for loan in line with regulations issued by Government and directions of State Bank.
- SOEs can borrow short-term and medium- and long-term loans as regulated in the credit rule. However, in order to facilitate development business and production of SOEs, commercial banks also could expend loans to SOEs, only base on efficiency of operations and capability in repayment of SOEs as well as feasibility of investment projects without collateral and charter capital requirements (as said in the document No. 417/CV-NH14). In addition, aim to help ailing SOEs resulted from the losses of operations in previous years, loans may will be extended to the, if they have efficient business plans that are able

to recover the losses. These business plans must be permitted by ministry (for central enterprises); or by City People Committees for local enterprises (as said in the Document No. 417/CV-NH14, Instruction No. 09/Ct-NH1 and Decision No. 199/QD-NH1)

- According to Decision No. 49/Cp-m dated May 6, 1997 issued by Government and Document No. 417/CV - NH14 of State Bank, in special cases of implementation economic task entrusted by Government, SOEs can borrow money from credit institution to satisfy essential demands without charter and own capital requirements, namely:

+ Credit institutions extend medium- and long term loans to SOEs in accordance with state plans.

+ Credit institutions extend or issue guarantees for importing fertilize.

+ Credit institutions extend loans for buying rice to export.

- Where a credit institution have not be able to satisfy borrowing requirement of a customer, or the requirement exceeds the maximum limit stipulated for the customer, credit institutions may syndicate the loan, in accordance with Decision No. 154/1998/QD - NHNN14.

- Duration of lending is determined in line with business cycle of SOEs.

- The SOEs that operate in needy economic areas (high mountain, island...), will receive lower interest rate than interest rate applied to SOEs in good-condition areas.

- **Dealing with the debts:**

+ Due to varying reason, the SOE that are subject to regulations of medium- and long-term lending, gets short-term loans. To create good conditions for SOEs to seek sources for repaying debts in time, the short-term loans may transfer into medium- and long-term loans, in accordance with Instruction No. 09/CT-NH1.

+ Credit institutions may transfer medium-term loans with duration of 1-3 years as stipulated in clause 7, Article 1 of long and medium-term credit rule and Decision No. 367/QD-NH1 into medium-term loans with duration of 1-5 years (as said in Decision No. 200/QD-NH 1) for SOEs if the loans are not revoked or SOEs are not able to repay in time after credit institution have made extending the debts or transferred them into overdue debts.

+ In many cases, where SOEs used short-term loans as medium- and long-term loans, credit institutions may transfer theses short-term loans, event debts that become overdue debts, into medium- and long-term loans, according to Instruction No. 09/CT - NH1, if SOEs operate effectively.

+ Adjustment of interest rates, in line with new duration after rescheduling debts, creates good condition for SOEs on interest rate because adjusted interest rates is lower than previous interest rates.

- According to Document No. 433/CV-NH1, in special case where performance of ailing SOEs must be maintained in order to implement requirements of economy or local, credit institutions will reschedule the debts in order to enhance SOEs' business activities and to help SOEs to find out sources to repay their debts.

- According to Official Letter No. 433/CV-NH1, credit institutions may request Governmen t to write off the unrecoverable overdue debts resulting from storm and flood and SOEs' bankruptcy after recovering partly debts, in accordance with the bankruptcy law.

- According to Official Letter No. 433/CV-NH14, credit institutions may put overdue debts resulting from mechanism changing or suspending SOEs' activities into block-accounts. Credit institution also extend new loans to ailing SOEs if they have efficient business plans, but the plans must be allowed by SOEs' administration organizations. The new regulations have made contribution to facilitate restoration and development operations of SOEs.

- Dealing with SOEs' unrecoverable overdue debts (in accordance with Instruction No. 08/1998/CT-NHNN14 dated October 3, 1998):

+ Dealing with overdue debts before June 30/1998:

If SOEs have really difficulties in their business, credit institutions are allowed to revoke firstly the principal of loans and then revoke the interest.

If SOEs are only capable of repayment the principal and normal interest rate, credit institutions may revoke the principal of loans and the interest in normal interest rate, not in overdue interest rate.

Credit institution also may sell the collateral assets of overdue debts to revoke debts if they have a complete record and legal ownership on these assets. Credit institutions will perform accounting separately to the collateral assets relating to the cases are coming to trial based on credit records. After sentence of the judge, credit institution will solve the debts.

If SOEs don't repay debts in time intentionally, though having a good financial condition, credit institutions will force SOEs to repay the debts.

+ Regarding to overdue debts caused by the losses of operations of SOEs, commercial banks can resolve the debts by extending loans based on Decree No. 09/CT-NH dated August 27,1997 issued by the Governor of the State bank). In addition, commercial banks could review loan maturity suitable for repayment by enterprises.

Regarding interest rate policy, due to state-owned enterprises (SOEs) operate inefficiency, average profit rate is lower than 10%, thus the interest rate policy of the State Bank of Viet Nam has to be step by step eased toward liberalization, in line with renovation process of the SOEs. In fact, now commercial banks apply low interest rates in order to facilitate operations of the SOEs. Maximum lending interest rate is 1.1% per month (for short-term loans) and is 1,15% per month (for medium- and long- term lending). The credit ceilings are 0.1% per month lower than those in rural sector respectively.

- Annually, the State provide a major amount of budget capital for investment projects in important sectors, products, areas and economic programs of SOEs with concessionaire interest rates (0.81%/month), maximum lending maturity amounting to 10 years and other priorities.

- SOEs that have implemented equitization process can still borrow and deal credit capital like the other SOEs.

Above-mentioned temporary solutions have removed timely and fundamentally obstacles in borrowing and lending for SOEs and commercial banks. Those solutions have been also considered as major measures making contributions to stream immediately credit capital flows, prevent reduction of outstanding debts of the SOEs, promote economic growth, reduce unemployment rate, make financial assistance to equitization process of the SOEs and improve financial situation of the SOEs.

SOLUTIONS TO COMMERCIAL BANKS

Many difficulties still exist in banking system, such as:

- Minimum capital adequacy ratios (the ratio of own capital to total assets) of commercial banks fell below the international level required by the Bank for International Settlement (8%).
- Overdue debt ratios of commercial banks are higher than 10% of total outstanding loans.
- Spread between lending rate and deposit rate of commercial banks are lower than 4% per annum, that 2% per annum lower than that applied by other regional commercial banks.
- Provision for risks in the banking activities are still limited.
- Annual profit of commercial bank are still low.
- Commercial banks lack cash to invest in modernization of banking technology and expanding business.
- Many commercial banks have a big amount of staff.
- Commercial banks have to face up to high credit risk and low liquidity because their major business is lending.

Solutions of the Government and the State Bank to overcome hurdles in activities of commercial banks.

- Commercial banks have been supplemented by further addition of charter capital. So far, current average charter capital of commercial banks has exceeded 80% of the required charter capital level, namely:
- Vietnamese Bank for agriculture and rural development: 97%.
- Industrial and Commercial bank of Viet Nam: 73.5%
- Bank for foreign trade of Viet Nam: 72.8%.

- Bank for investment and development of Viet Nam: 70.3%.
- Bank for the poor: 100%.
- Housing Development bank of Mekong River Delta: 67%.

- Join-stock commercial banks shall have to amend capital aimed at obtaining minimum charter capital level of VND 70 million. Nowadays, the joint-stock commercial banks have been implementing program of selling equities to domestic shareholders, some of them are allowed to sell equities to foreign shareholders. While commercial banks amend their charter capital, must enhance their capability in business expanding.

- The Vietnamese Government has issued Decision No. 3449 dated July 12, 1997 and the State Bank has published other decisions on allowing commercial bank to account risk provision to the operating expenses. Formerly, credit risks of commercial banks were set-off by the fund created from their after-tax profit, but in fact, the funds were not enough. The new regulations of the State Bank are suitable with international custom, safe for banking activities, at the same time they reflect appropriately banking operations.

The implementation of the regulations will lead to change expenses composition and income distribution of credit institution. In order to have enough provision for risks, the credit institution themselves have to operate more efficiently. At the same time, the State Bank should reconsider the credit ceiling system aimed at achieving more suitable credit ceilings, facilitating provision for risks of credit institution.

- Allow state-owned commercial bank to resolve their overdue debts based on Multi-ministries Circular No.03/1997/TTLT/NHNN-BTC dated January 22, 1997 issued by the State Bank and Ministry of Finance. This circular focuses on dealing with overdue debts and bad debts caused by objective causes in order to make financial assistance for those banks and help them classify clearly the quality of credit.

- Allow commercial bank to deal overdue debt based on Decree No. 03 as said in 11/I. This Decree focus on help those bank reclassify outstanding loans aimed to evaluate appropriately quality of credit in terms of accounting as well as help them set relevant measure to revoke their debts.

- Allow commercial bank to borrow foreign capital for modernization of payment technology, collection information and improvement efficiency of business (like the industrial and commercial bank of Viet Nam has done)

- From August 1, 1999, commercial banks will perform its accounting based on new system of accounts, of which, many operations that were formerly accounted outside balance sheet will be accounted inside balance sheet (as matured loans have not been revoked). This move will cause sharply effects to capital management and lead to increase assets of the commercial banks.

- Decisions that issued by the Government and the State bank on implementation of credit and interest rate policies that cause little effects to external activities and foreign exchange management should be regulated in the form of legal framework in order to enhance autonomy of the commercial banks, in line with the current laws.

I－4 B

Assessment of the Purpose and the Influence of the Stopgap Solutions of the State Bank of Viet Nam and the Government to Minimize the Financial Difficulties of State-owned Enterprises and Banks

Nguyen Van Sau
Ministry of Finance

In order to implement the economic renovation process over the previous years, The Government and the State Bank of Viet Nam have got the stopgap solutions to minimize the financial difficulties of the banks and state-owned enterprises.

I、The Stopgap Solutions on Minimizing the Fianancial Difficulties of Banks

1. About the taxation policy : From 1st January 1999 income tax rate for the banking system is 32%

According to the provisions in the Tax Code for enterpises (effective from 1st January 1999), income tax rate for the banking system is 32% instead of the previous income tax rate 45%. Thus the gross income after tax of the banks increases similary by 13%.

2. About enlarging the regulatory funds : Government's Decision No. 859／QD-TTg dated 24th September 1998 on providing more funds to the State-owned Commercial Banks (SOCBs)

The purpose of this measure is to correspond to the regulation on regulatory fund for state-owned commercial Banks, also to strengthen the competative possibility of the SOCBs. In the last years, SOCBs have made important contributions to the social-economic development of the country and are recognized as the wealthy banks in the banking system. However, the strength of the SOCBs expressed by capital ratios is not correspond to the size and quality of the banks' activities. Regulatory fund for this type of banks is relatively large, but in fact the fund provided by the Government before the approval of the above Dicision has amounted only to 30-40% of the total fund required. In the same time, the regulatory fund required for foreign branches in 15m. dollars, which activities almost are in one branch in Viet Nam, while SOCBs' operations spread with their branches over the whole country. Therefore, it is necessary to provide SOCBs with enough fund. Moreover, the providing enough fund for SOCBs has influenced to the fund mobilization of the banks. According to the previous regulations in the Decree on Banks, Credit farms and Finance Companies, the limit for the banks' mobilization is 20 times over the banks' owned capital (including fund provided by the Government and fund increased by themselves).

3. About the solution to overdue sums of the commercial banks

The Circular No. 03/1997/TTLT/NHNN-TC dated 22nd November, 1997 signed by the State Bank of Viet Nam and Ministry of Finance togerther indicates the solution to overdue sums of the SOCBs in the corrective action process for banking activities after examinations.

Implementing the indications of the Prime Minister, State Bank of Viet Nam and Ministry of Finance have issued together the above Circular in order to solve problems and overdue sums due to objective causes after examinations, in the same time to purify the financial strength of the banks. The overdue sums due to objective causes could not have been collected by the banks are permitted to be rolled over, rescheduled or written off. These are the stopgap measures to solve the credit risks of the banks while the regulations on provision for credit risk do not exist. Due to the new regulations, the banks must balance their overdue sums from the provision resources by themselves, but not to wait for the State assistance.

- The Official Letter No. 188/TB-VPCP dated 31st October, 1998 indicates conclusions of the Vice-Prime Minister Nguyen Tan Dung about the solutions for the overdue sums due to the objective causes in the State-owned enterprises: they are solved under the spirit of the Circular No. 03/1997/TTLB/BTC-NHNN, dated 22nd, November 1997.

The joint-stock commercial Banking system in Viet Nam is young, but in the latest social-economic development period has made certain contributions to the proccess of mobilization of fund from public as well as widening credit activities to the economic elements. In their activities, many joint-stock commercial banks (JSCBs) have faced with high overdue scale, while have been influenced by regional financial crisis and the difficulties inside the country, therefore they cannot solve the overdue sums by themselves. For that reason, when there is lack of the regulation on the risk provisions, in order to solve most financial difficulties for the JSCBs, the Government has permitted to solve the overdue sums of the state-owned enterprises due to the objective causes under the spirit of the Circular No: 03, e.g. the overdue sums of the state-owned enterpises due to the objective causes will be rolled over, rescheduled or written off if they have met the requirements.

4. About the policy creating the resources to solve the risks of the credit institutitons

The official Letter No. 3449/KTTH dated 12nd July, 1997 signed by the Government has permitted commercial banks and credit institutions (state-owned and non-state-owned) to culculate the credit risk as the cost of the banks.

The purpose of this measure is to express exactly the result of the banks' activities, to create fund resources for covering the credit risk in appropriation with the international practice. The important feature of banking activities is an existence of the credit risk e.g. the banks cannot collect the credits provided to the customers. It is important to solve the credit risk of the banks, otherwise, it will lead to the loss of banks' fund (including owned fund and funds mobilized by themselves). At the same time, the figures of banks' activities do not indicate the actual result of banks: many banks cannot use their profit to cover bad debts; they have profit, but have lost their owned capital.

The credit risk of the banks before was covered by sources estabished after tax profit, but in fact it is not enough to cover the credit risk. Credit risk in banking activities is a certain factor. Some are due to objective causes: natural calamity, flood, the death of the customers, the disappearance of assets...

Due from the above practice and to correspond to the international practice, the Govenment has permitted commercial banks and credit institutions (state-owned and non-state owned) to account the credit risk to the loss. The above Decision of the Government is specified in the Decision No. 48/1999/QD-NHNN5, dated 8th February, 1999 signed by the Governor of the State Bank of Viet Nam on the issuing Decision on the Assets classification, establishment and the usuance of provisions to solve the risk in credit institutions' activities. The credit institutions must classify the assets, establish the provision resources from the cost, use provisions to solve the risk in banking activities.

5. About the foreign exchange policy

Decision No. 173/1998/QD-TTg dated 12 September 1998 said: The units which have income in foreign currencies to sell to the banks, have the right to be provided with foreign currencies when needed.

The Prime Minister's Decision had been issued to implement the purposes of the State: to unify the foreign exchange management, to use only Vietnamese dong in Viet Nam. The banking system has had the concentration of foreign currencies. When economic units have demand on foreign currencies, they must show appropriate documents and could have been provided by banks. Therefore, the banks will minimize the cost to find the foreign currencies sources to serve the customers.

In short, under the management of the Government and State Bank of Viet Nam, the banking system in Viet Nam in 1998 has achieved significant success in competition with the figures in 1997 as follows:

- The capital provided for the state-owned commercial banks by the State increased by 2 times;

- The mobilization fund increased by 25%;
- Credits-investment increased by 19%;
- 40% of the total credits are medium and long-term loans;
- The overdue rate is decreasing;
- Have a profit in banking business.

II. The Stopgap Measures to Decrease the Financial Difficulties of the State-owned Enterprises (SOEs)

1. Tax policy: Abolishment of the income tax from banking credit activities

Before the abolition of the banking credit activities' income tax the income tax is the element of the banks' interest rate. Because the income tax is the indirect type of tax, so that the customers borrowing from banks must pay the tax. Thus, the abolition of the credit income tax means the decrease of the interest rate provided by banks and helps the banks to widen the credits to enterprises which have more conditions to approach banks' fund to service the production business.

In implementing abolition of banks' credit income tax, interest rate has been decreased from 2.1% per month in 1995 to 1.75% p.m in 1996 and stopped at 1.2% p.m today.

2. Investment policy and policy of providing additional funds for the State-owned enterprises (SOEs)

The official letter No. 309/KTTH-Tym dated 8th September 1997 signed by the Govenment on providing the basic investment fund for building and additional working capital to the SOEs.

In fact, in the previous years, the capital of the enterprises provided by the State to manage and use in the production business is too limit, so the total borrowings from banks of these enterprises are large, amounted to 80-90% of the total fund used for their own business and much larger than their own capital. To help the enterprises, in August 1997, the Government had issued the official letter No. 309/KTTH-Tym on providing the investment capital for building and additional working capital for the SOEs.

3. About Policy of borrowing from banks

Usual Government's Summit Decision in April 1997 (No. 49/CP-m dated 6th May 1997) : The SOEs while borrowing fund from SOCBs do not need to take the collaterals. It is not limited to the regulatory fund rate but based on the effectiveness of the production business of enterprises. As regards the units that have made loss in previous years but have not had been solved, if they have the effective production plans approved by the Ministry and the People Committee of the town or province, then they will be provided further funds by the banks.

The actual problem of SOEs is small amount of the funds provided for them by State Budget. They have to operate based mainly on the borrowings from banks. Due to the lack of provided fund, the assets that enterprises can use to mortgage is a few. One more problem that enterprises have to face with is that they do not have enough legal documents in any time for collateraliztion of assets. Thus, problem of the SOEs is: they need fund from banks, but do not have assets for collateralization.

Due to above practice, in order to ease provisions to borrow from banks for SOEs to serve the production process, the Government has permitted SOEs to borrow from SOCBs without collateral, without limit to the capital ratios, only based on the effectiveness of theenterprises' production business. As regards to the units that have made lost in previous years but have not had been solved, if they have the effective production plans approved by the Ministry and the People Comittee of the town or province, then they will be provided further funds by the banks.

The credit policy to create the appropriate conditions for the SOEs in the production business:

- In order to strengthen the financial posibility or effectiveness of the SOEs activities, in the case of high economic feasibility of the production plan, while one credit institution has not enough fund to meet the customers' requirements or requirement is more than borrowing limit for one unit, than credit institution can provide the credits under the regulation on syndication.

- About the borrowing limit in one credit institution:
  The Government allows not to limit by the capital level of the enterprises, 10% of the owned capital and reserves of the credit institution (under the previous Decree on Banks, Credit farms and Finance Companies) in the following cases: Medium and long-term loans by State indications, loan or guarantees for fertilize import, loan provided for purchasing rise to export.

Thus, the difficulties in widening loans to the SOEs have been decided basically.

- As regards the SOEs taking their operation in the difficult social-economic regions such as mountains or islands... they have the advantages in decreasing to 30% of the interest rate provided for the same type of enterprises taking business in flat country.

- As regards the SOEs that must have been provided with medium and long-term loans, but due to many causes have been provided with short-term loans, in order to create sources for these units to repay the loans in time and to correspond with the producing schedule, State Bank of Viet Nam has allowed enterprises and credit institutions to transfer to long-term loans if credit institutions realized the effectiveness of the enterprises' operations.

In short, the SOEs system is in the process of renovation and restruction, therefore it is necessary to have the help from State with policies in order to find out the right way for SOEs development. The stopgap measures of the Government and State Bank of Viet Nam to solve the financial difficulties of the SOE are with the same purposes: to strengthen and develop the SOEs, also to promote the capitalization process of the SOEs. The results of the SOEs system's operation in 1997 are expressed in comparison with the previous years data as follows:

- Fixed assets increased by 12%;
- Working capital increased by 15%;
- The operational result increased more than 3%;
- The total payment to the State Budget increased by 2.3%.

I－5

Assessment of the Purposes and Effects of ad-hoc Solutions Made by the State Bank of Viet Nam to Strengthen Foreign Exchange Management

Chu Thi Hong Minh
The State Bank of Viet Nam

From 1988 to Aug. 1998, all foreign exchange transactions were governed by the Decree No.161-HDBT on Regulation on foreign exchange management in the Socialist Republic of Viet Nam issued by the Committee of Ministers. During the course of implementing this Decree, in response to the changes in economic management mechanism, many different legal documents were issued by the Government, which was aimed at adjusting some of articles of the Decree to the new economic conditions. In general, the legal framework for foreign exchange management in that period had covered all aspects of foreign exchange management.

After the regional finance and monetary crises, changes in foreign exchange market tend to be more complicated. Besides that, trade management mechanism also experiences massive changes towards liberalization and funds movements become globalized. In that context, the existing foreign exchange management mechanism becomes unsuitable. In waiting for the new foreign exchange management mechanism to be completed, many temporary measures were made by the State Bank of Viet Nam to strengthen foreign exchange transactions management. They are the followings:

I. To Improve the Enterprises' Foreign Debt Management

Besides the locally mobilized funds, the externally borrowed capital plays an important role in the economic development of Viet Nam. Before 1997, foreign debt management was governed by the Government's Decree No. 58/CP dated 30th Aug. 1993 on promulgation of the Regulation on foreign debt management. External borrowings by enterprises are carried out in accordance with the public sector's foreign borrowing limit agreed between the Government and IMF in framework of ESAF. During the course of implementing Decree No.58, the State Bank of Viet Nam had step by step researched the borrowing needs, managed the enterprises' external borrowing and payment, and assisted them in getting loan with more favorable terms, thus reducing loans with terms inconsistent with the Government's foreign debt management requirements.

However, foreign debt, in particular short-term one, management was still ineffective due to the fact that the controlling and supervising over the above mentioned Regulation's implementation by banking system was not carried out in such a regular manner that any violations could be found out and dealt with in time. There were cases where state-owned enterprises borrowed money from abroad without registration with the State Bank of Viet Nam. Some other enterprises failed in having a reliable feasibility study of external borrowing project, the consequence of which is ineffective use of borrowed funds. Besides, complicated administrative procedures and the lack of a synchronic and consistent legal framework on enterprise's foreign debt management have triggered difficulties for both banks and enterprises in implementing the Regulation. Moreover, there are no specific measures in dealing with acts of violations of the Regulation.

In these circumstances, since 1997, the external borrowings and payment by enterprise are managed by the Government through approving of total limit of external borrowings and payment. State Bank of Viet Nam has the responsibility to establish and submit to the Government the total annual limit of external borrowing by enterprises for approval, as well as to manage this approved total limit. This total limit is defined based upon the borrowing needs of enterprises after considering the social-economic goals set by the Party and the Government and on other macroeconomics criteria, such as external borrowing and payment by the Government, projected balance of payment, commitments made by the Government with the IMF and WB. The approval of external borrowing and payment by enterprises will be given within the framework of this total accepted by the Government limit.

To strengthen the controlling over foreign short-term debt, especially deferred payment L/C opening by commercial banks and external borrowing by state-owned enterprises, in 1997, State Bank of Viet Nam required commercial banks to follow short-term foreign debt limit which is in no case could be higher than the total outstanding short-term foreign debt and total less than 1 year guarantee issued in foreign currencies as of 30th June 1996 (Governor's Official letter No. 434/CV-NH7 dated 5/8/1996). After that, State Bank of Viet Nam managed short term foreign debt by setting a ceiling of total outstanding short-term foreign debt (included short term debt, short-term loans guarantee issued, short-term deferred payment L/C) which is not in exceed 3 times of the bank's own capital. Besides that, State Bank of Viet Nam had Decision No. 207/QD-NH7 dated 1st July 1997 to promulgate Regulation on deferred L/C opening, in which it stipulated specific conditions for commercial banks and enterprises to comply with if they wish to open deferred L/C ; as well as the maximum deferred payment term in case of less than 1 year L/C for material and consumers good import in order to minimize borrowed funds misuse. The Circular No. 07/1997/TT-NHNN dated 4th Dec. 1997 was issued by State Bank of Viet Nam, giving guidelines to implementing of the Prime Minister's Decision No. 802/TTg dated 24th Sept. 1997 on dealing with remains of L/C opening, in which clarified that at maturity, importer, who is guaranteed by the banks to open a L/C is responsible for making payment to foreign parties. In case it defers or is temporarily lacking in payment capacity, issuing bank has the responsibility to make payment on behalf of the importers to ensure its prestige in international payment, and the importer is considered as a bank's compelled borrower.

After implementing a number of measures as mentioned above, the foreign short-term debt situation in general and deferred L/C in particular have changed positively. The deferred L/C amount reduced gradually, the import of non-essential consumer goods is limited, and at the same time, the deferred payment import of other goods which are not locally produced or insufficiently is also remained. The total short term external borrowing balance (includes direct external borrowing, banks guarantee and deferred L/C opening by commercial banks) as of 31st Dec. 1997 was reduced by 42% in comparison with the balance as of the beginning of the year. Short-term external borrowing in 1998 is equal to only 36% of the 1997 figure.

Concerning external medium and long term borrowing: in implementation of the Government's Decree No. 58/CP on foreign debt management, State Bank of Viet Nam has step by step known the needs, as well as the actual foreign debt situation of enterprises. The enterprises' external borrowing and payment is gradually improved, emphasizing their responsibility to make payment at maturity.

In order to attract and manage foreign capital effectively for economic development, 7th Nov. 1998, the Government issued Decree No. 90/1998/ND-CP concerning Regulation on foreign debt management.

According to this Decree, from 22nd Nov. 1998, the foreign debt management all over the country will be carried out solely by the Government. Moreover, based on the practical requirements of the foreign debt management, the Prime Minister can consider to form an inter-ministerial mechanism to conduct the foreign debt management task. In respect of foreign debt relating to investment and development projects, it is stipulated in the Decree No. 90 that: for the highly recoverable projects, the Government will lend or get and transfer payments amount to Debt Servicing Fund managed by the Ministry of Finance in order to have sources to repay debts when matured. In case of foreign borrowing by the Government itself, Ministry of Finance has the responsibility to repay as agreed between the Government and foreign parties.

With respect to commercial borrowings, enterprises of all economic sectors have the right to borrow directly from abroad. In that case, they have to perform their repayment duty, and "in no case are permitted to transfer their debt burden to the Government, except loans guaranteed by the Government". The Decree emphasizes that before getting in any loan agreement with foreign parties, enterprises should hold consultation with the State Bank of Viet Nam. The loan disbursement and debt servicing by enterprises should be done through Viet Nam's banks that are licensed to carry out foreign exchange transactions. In case the volume of external borrowing project is beyond the banks' guarantee competence, the Government can issue guarantee, provided that the project is important for economic development or it is a prioritized export-producing project etc. and the beneficiaries are state-owned enterprises or credit institutions. The Decree also determines the Government's maximum annual guarantee limit, included guarantee issued by Ministry of Finance and State Bank of Viet Nam, which equals to 10% of the total budget revenue in the given year.

The new Decree has amended and replaced some of the articles in the Decree No.58, thus creating a legal framework of foreign debt management for enterprises and banks.

II. Increase Foreign Exchange Management

Despite the fact that the Prime Minister has Decision No. 396/TTg dated 4th Aug. 1994 on amending some regulations on foreign exchange management in new circumstances, the foreign exchange use by the local economic units is still not monitored closely. According to the Decision No. 396/TTg, enterprises are permitted to retain a part of their foreign exchange revenue for their daily expenditure purposes, the remaining amount should be sold out to banks. But in fact, there is almost no enterprise to follow this requirement. After foreign exchange rate fluctuation in the market, enterprises have tendency to hoard foreign currencies, causing ineffectiveness in foreign exchange market. Banks' foreign currencies exchange agents are not controlled in a proper way so that they can take advantage of being "state-owned" to speculate for their own benefits. Banks are not able to buy many foreign currencies through this channel, thus eliminating the ability to control the foreign exchange circulation in country.

Measures to attract foreign exchange into banking system are not taken so successfully. There is large amount of foreign exchange circulated outside banking system, kept or deposited in personal saving accounts or organizational accounts, but not used to support economic development.

In this situation, in 1998, the Government had taken some administrative steps to strengthen foreign exchange management and release standstills in interbank foreign exchange market. These are Decision No. 37/1998/QD-TTg dated 14th Feb. 1998 on foreign exchange management measures and Decision No. 173/1998/QD-TTg dated 12th Sept. 1998 on the institutional resident's duty to sell and right to buy foreign currencies.

Under Decision No. 37, enterprise that has revenue in foreign currencies has to put all received foreign currencies in an account opened with a credit institution after deducting amount needed for its next month's estimated expenditure purposes. Besides, each enterprise is permitted to open only one foreign currency deposit account in one credit institution. It is required to register with the State Bank of Viet Nam if enterprise wish to have more than one foreign currency deposit account. Whenever there are needs to make payment transactions in foreign currencies in compliance with foreign exchange management regulation, institutions and enterprises have the right to buy forward from credit institutions. Within 6 months, counting from the day enterprise sells foreign currencies to a credit institution, it has the right to buy foreign currencies back from the same credit institution with the minimum amount equal to the sold amount, provided that this foreign currencies be used for purposes in compliance with foreign exchange management regulation.

The Decision No. 37 aims at managing foreign exchange supply and demand, increasing foreign exchange circulation speed in the economy, preventing foreign exchange speculative activities and stabilizing foreign exchange market, accommodating export-import settlement.

After 3 months of implementing Decision No. 37, foreign exchange trading activities between banks and customers have improved positively, making contributions to satisfying enterprises' foreign currencies needs. Foreign exchange trading in interbank market has been normalized; the bought in foreign currencies amount by commercial banks is higher than sold amount, creating good conditions for banking system to increase their foreign exchange reserves. In March and April 1998, the total foreign exchange trading volume of banking system had nearly doubled the volume of two preceding months.

According to Decision No.37, each enterprise is allowed to maintain only one deposit account and if this enterprise has the need to open more than one account, it has to register with the State Bank. In addition, this enterprise has to submit monthly reports regarding the foreign exchange receipt and payment operations of its accounts in different banks, in different localities. This practice enables banks to take initial efforts in detecting enterprises that have unused foreign currencies and requires them to sell the foreign currency surplus to the banks. This aims at attracting foreign currency into banks, preventing speculative hoarding and inappropriate use of foreign currency.

However, the enforcement of Decision No.37 faces some difficulties. For instance, the concerned enterprise willfully overestimates the amount of foreign currency needed for its demand in the incoming period because it fears that it will have to pay a high premium when buying back foreign currency from banks.

Given this circumstance, following Decision No.37, in September 1998, the Government issued the Decision No.173 on the obligation to sell and the right to buy foreign currency of institutional residents. This Decision specifies that after 15 days, enterprises have to sell 80% of their amount of foreign currency received from current account transactions. Besides, this Decision affirms the right to buy foreign currency of institutional residents when there is a demand for foreign currency to facilitate current account transactions and other allowable transactions. Then, on December 1st 1998, the Government issued Decision No. 232/1998/QD-TTg to modify sub-articles 1 and 2 of Article 1 of Decision No.173 in the sense that the institutional residents have to surrender foreign currency to licensed banks as soon as foreign currency is transferred to or paid to their foreign exchange accounts with the banks.

The State Bank has required and instructed the uniform implementation of Decision 173 by commercial banks in a vigorous and complete manner and thus some remarkable results have been achieved, contributing to the development of the inter-bank foreign exchange market operations: bank-customer transactions in the last three months of 1998 increased considerably, monthly average transaction volumes in these last three months increased faster than those of the remaining 9 months by 80%.

In addition to such administrative measures, the State Bank has issued regulations permitting credit institutions to conduct foreign exchange forward and swap transactions with the view to diversify transaction instruments in the inter-bank foreign exchange markets, enhance the flexibility of credit institutions in trading in the market.

The August of 1998 marked an important milestone in the foreign exchange management as the Government promulgated Decree No.63/1998/ND-CP on foreign exchange management, replacing the Decree No.161. This new Decree includes the following amendments and additions that fit the actual situation:

First, it introduces a new concept of foreign exchange by incorporating electronic cards, SDRs, Euros, single currencies in international and regional transactions into the concept of foreign exchange.

Second, it classifies the governed objects vis-à-vis foreign exchange management into 2 types: residents and non-residents. On the basis of this classification, the authorities apply different treatment of foreign exchange management for different types.

Third, it officially provides for the right to use foreign currencies of individuals, both residents and non-residents: they have the right to store, bring, deposit in banks or sell to credit institutions or foreign exchange bureaus on the voluntary basis.

Fourth, it classifies transactions under foreign exchange management into 3 major transactions that were not clearly specified in the old regulation on foreign exchange management. These transactions include: current account transactions, capital account transactions and foreign exchange transactions of credit institutions.

Fifth, it only recognizes gold of international standard as foreign exchange so that it has one separate chapter on the regulation of gold.

With these new features, Viet Nam's foreign exchange management policy have been established in a more comprehensive and systematic manner in order to achieve the objective of gradually making Vietnamese Dong convertible in foreign exchange transactions, promoting economic growth and improving the balance of payments.

Ⅲ. Flexible Adjustment of Exchange Rate in Accordance with the Supply of and Demand for Foreign Currencies

In 1997, Viet Nam's economy began to reveal the following negative signals that may threaten the stability of the macroeconomic environment: slow improvement of the balance of payments; the slowdown and decline in export growth rate, the sharp fall in foreign direct investment; more difficult and less favorable terms and conditions for external borrowings; in addition, the external debt service obligations was on the rise because the grace period of enterprises' debts has lasted and they have to start paying the principals; the operation of the inter-bank foreign exchange markets was perfunctory and sporadic, the trend of hoarding foreign currency increased. The VND-USD exchange rate reached the maximum allowable level almost all the time; the gap between official market and black market grew very large; the official foreign exchange reserve held by the State Bank was threatened to fall as a result of demand-side pressure in the inter-bank foreign exchange markets.

These tendencies were taking shape more clearly since the outbreak of the Asian financial and currency crisis in July 1997. There was a massive devaluation of domestic currencies in the region: Thai Baht, Philippine Peso, Malaysian Ringit, Indonesian Rupiah, Singaporean Dollar, Korean Won, Japanese Yen devaluated 46%, 40%, 38%, 60%, 18%, 53% and 14%, respectively.

These facts must be taken into account seriously and requires necessary and timely adjustment in policies, particularly foreign exchange management policy so that Viet Nam could enhance her adaptability and brace for adverse effects of external shocks while still securing the control of the State. Given such international and domestic changes, the foreign exchange management policy would not be inclined to stabilize the value of the domestic currency vis-à-vis foreign currency but aims at the long-term objective: stimulating production, encouraging economic growth, limiting the large fluctuation and any socio-economic disruption, focusing on encouraging exports, controlling imports and increasing foreign exchange reserve. In achieving this policy objective, the State Bank has 4 active adjustments of the exchange rate since 1997:

- First adjustment on 27 February 1997: the State Bank widened the trading band around the official reference rate stipulated by the State Bank from ±1% to ±5%.

- Second adjustment on 13 October 1997: the State Bank kept on widening the trading band around the official reference rate stipulated by the State Bank from ±5% to ±10%.

- Third adjustment on 16 February 1998, the official reference rate was raised from 11,175 VND/USD to 11,800 VND/USD (increase by 5.6%).

- The fourth adjustment on 7 August 1998, trading band was narrowed from ±10% to ±7%

and at the same time the official reference exchange rate was raised from 11,815 VND/USD to 12,998 VND/USD. It is noted that the official reference rate stipulated by the State Bank on 7 August 1998 is the closing rate of the inter-bank foreign exchange market on 6 August 1998. It means that the State Bank has established the official reference rate on the basis of buying and selling exchange rates in the inter-bank foreign exchange market, reflecting the demand-supply relationship in the foreign exchange market fairly well.

With policy objective mentioned above, 4 adjustments of the exchange rate have the following impacts:

a) Positive impacts:

* With regard to banking activities and the regulating ability of the State Bank:

- Exchange rate is adjusted to a level more suitable with demand-supply relationship and thus enhance the official exchange rate's ability to regulate the market, narrowing the gap between daily official exchange rate and the actual trading exchange rate.

- Taking initial step in addressing the freezing situation in the inter-bank foreign exchange market; trading volumes of commercial banks tend to increase; the supply of foreign currency is stimulated as a result of a more appropriate and attractive exchange rate.

- The adjustments of the exchange rate lessen the downward pressure on the official foreign exchange reserve; the State Bank has not to sell foreign currencies to maintain the desired exchange rate as previously.

* With regard to the economy and enterprises:

- Improving the balance of payments of the whole economy: as of July 1998, the exports increased much less than projected (the actual rate of 7% in comparison with the projected rate of 25-26%), imports was still very large, the overall balance of payments of the economy in 1998 was likely to be deficit. Thanks to the adjustment of exchange rate in August 1998, the overall balance of payments had a surplus of USD 73 million.

- For the domestic exporters, the newly-adjusted exchange rate helps to ease difficulties for producers of exports, contributing to slow the decline in exports of Viet Nam.

- The exchange rate that was adjusted to a higher level has helped to enhance the competitiveness of Vietnamese export commodities in the world market. Notably, the adjustment of exchange rate has positive impact on a number of exporting items as: rice, coffee, marine products.

In addition, the adjustment of exchange rate has helped to improve the performance of some loss-making export enterprises, some of them, such as those dealing in rubber, crude oil or coal, etc. become profit-making or less loss-making.

- The adjustment of exchange rate has the role of controlling imports: The exchange rate that was adjusted to a higher level than before has forced importers to make more carefully decision prior to importing and thus limiting the import of non-stable goods. The falling importation will encourage the use of available and substitutable raw materials and domestically-produced goods due to the rising cost of imports.

b) Negative impacts:

Adjustment of exchange rate is always accompanied by adverse effects, therefore prior to any adjustment, the Government and the State Bank already had careful forecasts and due consideration in order to have measures to mitigate these effects:

- The adjustment of exchange rate leads to the surging cost of some production enterprises engaged in such products as sugar, cement, power, steel, fertilizer.
- The adjustment of exchange rate results in the increase of external debt obligation; for enterprises that have external borrowings, the adjustment of exchange rate makes their external debts go up. Such situation is popular for importing enterprises.
- As to psychological element: there is certain mix-up in the market perception following the adjustment of exchange rate. This psychological phenomenon caused the demand for foreign currencies in the black market increase sharply at some points, leading to the rise of the black market exchange rate.

  However, after State Bank's adjustment, the market exchange rate has step by step come into stability, the gap between black market exchange rate and the inter-bank foreign exchange market became negligible.

In summary, in the face of the world and regional economic crises, these *ad hoc* measures of the State Bank has brought about considerable results, contributing to maintain the macroeconomic stability in 1998 which is represented by: an economic growth rate of 6%, an inflation rate of 9.2%, a decline of 3% in imports, an increase of 1% in exports (though not reach the projected increase).

The external debt management is gradually enhanced. External debt continues to be controlled in accordance with the annual overall maximum level approved by the Government, exchange rate is actively managed to keep up with foreign exchange demand-supply evolution, the exchange rate movement in international and regional markets, reflecting appropriate alignment of the exchange rate between VND and foreign currencies, mitigating the adverse impacts of the regional financial crises. And the foreign exchange management recently not caused any disruption of the economy.

However, these are only some *ad hoc* measures of foreign exchange management that have been carried out before the implementation of Structural-adjusted Facility and Industry Policy for the period 1999-2001 as agreed with the IMF on the following issues: flexible management of the exchange rate and efficiency enhancement of the foreign exchange market; liberalization of the current account; amendment of foreign exchange management regulations and streamline of guidelines on foreign exchange management with regard to commercial banks.

I－6

Review the Solution Adopted to Restore and Consolidate the Financial Sector

Duong Thu Huong
The State Bank of Viet Nam

Part I

I. Overview of Viet Nam Economic Situation During the Financial-Monetary Crisis in the Asian Region (July1997－December31, 1998)

The crisis firstly derived from Thailand in July 1997, had a heavy adverse impact on Asian region such as the Philippines, Malaysia, Indonesia...etc. and became the crisis in the whole Asian region. For Viet Nam, the economy is lightly effected from the crisis. The economy still grew at 8.5%, inflation was kept at 3.6%, exports increase by 22%. However, at the beginning of 1998, Viet Nam's economy exposed clearly adverse impacts of the crisis. In addition, we was highly damaged by the nature disasters such as storm or drought for a long time together with the weakness inside the economy, so the economic picture showed many nagative signs, Foreign Direct Investment (FDI) downed, export hardly increased, good sales was low, the competitiveness was low. Thanks to Vietnamese Government efforts, through synchronous macroeconomic solutions, especially the exchange rate policy, interest rate policy, export management, the "bringing into play the internal force" policies of the Government, limiting of foreign currency spending, limiting of the state budget, have limited effects of the crisis as much as possible. The economy grew at 5.83%, industry grew at 12.1%, agriculture at 3.6% and export at 0.9%, import reduced by 3%, inflation was kept at 9.2%. These results were lower than targeted but still better than that of other countries in the region.

However, the weakness of the economy, the low capacity of production in some sectors have affected significantly to the restoration and consolidation of the banking system. With only the decline in FDI due to effects of the crisis, 19 representative of foreign banks in Viet Nam had to close of which 9 offices of Korea, 2 offices of Japan, 1 of United Kingdom and 1 of Russia. The investment in foreign currencies of foreign bank branches reduced from 90% of total capital to 70%.

In short, it can be stated that in 1998, Viet Nam had to overcome many difficulties to obtain the above results. In 1999, besides these results obtained from the economic renovation, we still have to face many difficulties such as effects of the crisis, overcome damages caused by storms and drought and the weakness inside the economy. They were also difficulties to the banking system

Part II

Review the intermediary role of the banking system of Viet Nam from July 1997 to December 1998

1. Since the reform the banking system in 1991, the Vietnamese banking system has developed significantly both in quantity and quality. In general, the renovation of banking system met requirements of the economy. In details, they were:

- Effectively implementing stability objective, controlling inflation and limiting the negative effects of the crisis through the improvement in execution and adoptation monetary policies of the State Bank.

- The financial intermediary role was modestly enhanced and developed. This was reflected in following data:

- The legal framework for banking activities were re-established to create condition for raising the effectiveness of banking system and to develop the financial intermediary role.

2. However, in general, if we considered all aspects of banking system activities, the banking system still had a lot of weaknesses, the mobilization and investment effectiveness were still limited because:

- Capital of banking system was small. The legal equity capital and own capital was small, financial depth increased modestly, M2/GDP in 1997 was 27.5% in 1998 it was estimated at 27.4%.

- The outstanding debt (in arrears) still high (although it is derived before 1997). Banking system transactions was still in risk situation because of the enterprise still faced difficulties in production expansion and seeking markets.

- The banks' accounting system were not relevant to international standards, have reduced the capacity of supervision and execution. There for, it has made difficulties to have timely solutións enhancing the quality of the banks' activities.

- The management system of banks were still weak due to the limitation of capacity and education of staff, especially the executive staff. Beside, there was no regulation to execute and supervise sufficently activities of the banking system.

- The legal framework for banking system although were improved but still not completely and synchronously.

- Deposit mobilization through banking system increased but still lower than the financial intermediary role, savings in long-term was still limited.

- Execution of monetary policies through direct instruments such as credit line, lending rate ceiling had limited the distribution of financial resources and the sound development of the banking system.

II. Review the Indicators Include the Applied Solution which Limit the Development of Banking System as a Financial Iintermediary

In the economic reform process and development of the banking system in Viet Nam, many policies and solutions were applied. In general, these policies obtained main objectives of monetary policies such as stability in currency, controlling of inflation, high economic growth rate, enhancement and creating soundness of the system. However, these policies and solution more or less limited the development of banking system as a financial intermediary which reflectd in following details:

1. Interest rate policies

From the real conditions of low development level of the monetary market, the limitation of the execution and supervision capacity of the State Bank, an uncompleted anti-risk framework, Viet Nam could not apply the policy of liberalizing interest rate and it was necessary to have direct management of the State Bank in interest rate mechanism. It limited the relevance of lending rate to the current actual conditions. At present conditions, the regulation of interest rate ceilling was relevant with the condition of commercial banks. However, their lending rate applicable to customers based on this policy was not closed to the level of risk of borrowing. It limited the business capacity of commercial banks, limited the financial intermediary of commercial banks, limited the development of monetary market. In other side, in order to encourage the development of production for obtaining high economic growth objective, we had to lower the lending rate ceilling (short-term borrowing is 1.2% and long-term-borrowing is 1.25%; with state owned commercial banks: 1.1% in short-term lending and 1.15% in long-term lending) which benefited to the borrowers but did not benefit to the lenders or depositors. Therefore, in 1997 and 1998, the banking system began to face difficulties in capital mobilization in term of VND. If interest rates for three month, six month 1 year in 1995 were 1.4%, 1.5%, 1.6% respectively, then in 1997, 1998 they were respectively 0.65%, 0.8%, 0.95%. While interest rates were low in the condition of exchange rate adjustment, it created difficulties for commercial banks to mobilize capital, especially long-term capital. In addition, the regulation of difference of 0.35% per month between lending interest rate and borrowing rate in 1997 highly limited the competitive capacity of commercial banks. From 1998, this regulation was erased .

Credit line:

The disadvantage of regulating the credit line of commercial bank was that it limit the investment expanding capacity of commercial banks, hence limited the financial intermediary role. The credit/GDP increased modestly in 1994, 1995, 1996, 1997 (see above table). The credit line was one of reasons for this. However, in 1998, the State Bank of Viet Nam did not applied this regulation, but credit in 1998 was not expanded significantly due to the decline in production in some sectors.

It is can be said that the application simaltanuosly interest rate ceiling for lending and credit line had created resistant forces for appropriate capital allocation of commercial banks. It made the price of the credit did not reflect the supply and demand relation in the market, the competitive capacity between banks are limited, and hence affected negatively to the sound development of the banking system. However, these were necessary steps in the trasition process of Viet Nam' banking system.

2. Management of opening deferred L/C

Although the Government had issued the Decree No. 58/CP dated 30th August 1993 on management of foreign loans granted to, repayment of foreign loans (at present, it was replaced by the Decree No. 90/1998/NDD dated 7th November 1998), but regulations on management of foreign loans and repayment of foreign loans made by enterprises, especially the regulation on deferred L/C opened by enterprises were still loosen. In 1997, deferred L/C payment were used popularly by most enterprises. Many enterprises agreed to buy goods at high price with deferred payment method and then sold goods at zero or loss price in order to have capital to do business cycle in domestic. In the following cycle of doing business, many enterprises faced risks. It leads to the loss situation, therefore, they had no money to repay the debt to the foreign lenders. It forced the guaranteed banks to pay the debt for them. In fact, some bank did not settle the foreign loans in time have impacted to international reputation of Viet Nam and fragile belief of inhabitants in banking system.

The loosen management of deferred L/C was one reason for high overdue debt of commercial banks. Facing this situation, the Government promulgated Decision number 802 /TTg dated 24th September 1997 on solvement opened deferred L/Cs in which regulated the responsibility of guaranteed banks to pay the debt in time when the enterprise can not pay the debt to maintain the international reputation. This decision also solved some issues related to the mortgages amd collaterals of banks to help banks to restore lent capital, reduced the overdue debt.

Besides, the State Bank also issued some regulations on management of deferred L/C. Deferred L/C were calculated in short-term borrowing limit of commercial banks. Since these regulations were applied, commercial banks could not guarantee deferred L/C unlimitedly. In other side, from the experiences, the risk from this kind of payment was large, it caused the banks were more careful in guarantee this kind of payment. Therefore, in 1998, deferred L/C decreased, the balance of deferred L/C of commercial banks reduced by nearly 50% as compared with that in previous years when this regulation was not promulgated. At the same time, there were no more overdue debts derived from guaranteed deferred L/C .

3. Credit policy

In general, the present credit policy created a relative efficient legal framework for commercial banks to expand their investment credit activities to all aspects of the economy and all sectors based on the efficiency of investment and were not limited by any regulations (in 1998, we scraped the credit line). However, main reason for constraining financial intermediary role of commercial banks were preferential credit policies are increasingly expanded

The preferential credit mechanism were applied in two sides:

+ Lending with lower interest rate as compared with normal interest rate set by commercial banks based on the interest rate ceiling set by the State Bank.

+ Lending to pointed projects, programs of the Government.

At present, the preferential credit policies has been applied in following fields:

- Lending to the poor (the bank for the poor with interest rate of 0.8%)
- Lending to students (0.7%)
- Lending to overcome damages of nature calamity such as storm, drought ... (0.5-0.6%)
- Lending to the construction of focused projects (0.7%-0.8%)
- Lending to promote export with certain exports with interest rate of 0.2% lower than normal interest rate
- Lending to the outlying and remote areas with interest rate lower than 0.2% per month
- Lending to pointed projects by the Government for infrastructure projects, programs of export buying and rice reserve and other economic program.

The application of preferential credit policies in the present conditions were very necessary to enhance the economy and limit adverse effects of the financial crisis. However, this policies were applied in too much aspects, it reduced the competitive capacity, profit and the seeking effective projects of commercial banks as well as enterprises. It did not create the fare environment between banks and enterprises. Theses reduced the finacial intermediary role of commercial banks.

With regard to the credit policies, it was necessary to make clear with international institutions. They misunderstood the regulation 417/CV-NH14 dated 31st, May, 1997 on guidelines the solution of government to credit activities of banking system and Directive 09/CT-NH1 dated 27th, August, 1997 on solving some credit conditions and procedure. International institutions such as IMF, WB understood that these were solutions of Vietnamese government to hide its outstanding debt and the way to expand preferential credit. Therefore, they suggested the Vietnamese Government erasing the above two regulations and preferential credit policy. However, in practice, regulation 09 and regulation 417 were policies to solve the real difficulties in credit mechanism between enterprises and banks. Reasons were: previous tight policies about conditions of borrowing applicable for commercial banks and inexactly estimate the time to repay the loans. These created difficulties to enterprises to repay in time. The practice shown that these regulations did not make the quality of credit worse, but help commercial banks become closer to enterprises in borrowing relation. Commercial banks itself increased their capacity to estimate the value of projects, borrowings, expand the capacity for enterprises to seek borrowings.

4. Other factors impacted to the financial intermediary role of commercial banks

Besides above negative effects to the financial intermediary role of commercial banks, in recently, there were other factors that limited significantly to the developing of banks as a financial intermediary such as:

(i) The undevelopment of monetary market: So far the monetary market has developed significantly, but this market was still weak in flexibility, financial instruments were not diversified and the liquidity of these instruments were still low because of the secondary market was simple at first step, interest rates in the market were not closed to the demand and supply of capital. From these limitation, they limited the role of commercial banks in moving capital from surplus areas to shorten areas:

(ii) During the reform process, the created information system did not meet in time and effectively for analysis, estimating monetary situation, interest rate, credit and enterprises' business situation. They impacted negatively to the developing and implementing the business strategy of commercial banks. In other sides, when information are not update and at low exact level, they create difficulties for the state bank change the way to execute the monetary policies from direct instruments to indirect instruments.

For example the application of open market operations to replace direct monetary instruments such as credit limit: there were many factors which prevent to apply open market operations in which not update and inexact information was one factor. In order to estimate surplus or shorten liquidity situation of commercial banks for making division of the state bank in buying or selling securities to supply sufficiently capital for market, it required exact and update information. If not, it will make capital imbalance in the market, then create unstable interest rate and currency.

At present, usable capital management, information selecting are at simple way, therefore most information are not updated and this is difficulty for adjustment of error for the next estimate.

The difficulties in information limited a lot the capacity to change form direct execution instrument to indirect one, therefore, it impacted on the financial intermediary role of commercial banks.

(iii) The capacity of information analysis and estimate as well as the management capacity of commercial banks were still weak. Therefore, most of commercial banks had no long-term business strategy and did not estimate long-term interest rate for expanding capacity of mobilization in long term as well as long-term investment. In other sides, the limitation in information and in estimation affect a lot to seeking effective projects of commercial bank; the weakness in management capacity, especially with managing staffs caused capital flight in joint-stock banks.

(iv) Technology in banks have been reformed but still not updated, therefore, it did not create technical base for diversifying instruments, payment services and modern money remittance. The withdraw from deposit account and payment account were still inconvenience, take time for customers. Therefore, it limited the extraction inhabitants using banking services. At present, there are nearly individual 120,000 accounts while the population of Viet Nam is 78 millions people. The application of credit card, such as Master Card, Visa Card are still strange to Vietnamese people.

(v) Own capital of joint stock commercial banks was small as compared with requirement of reform and development of banking system. Small scale of initial capital do not allow these banks to expand their capital mobilization and lending. At the same time, the technical reform also faced difficulties. Therefore, it can be considered as a reason to constrain the development of bank as a financial intermediary.

(vi) Another objective factor putting banks into overdue-debt situation is the weakness of enterprises, especially after the monetary crisis swept across the region. Many enterprises fell into loss-making situation and couldn't give back loans to banks. The fact that having too much overdue debt have made banks facing no less difficulties in the process of innovation and development.

In the present circumstance, it could be said that beside many favorable factors for developing the banking system as a financial intermediary to actively help the development of the economy, many obstacles facing us such as policy framework implemented to achieve the final object of monetary policy, factors that exist indispensably in the transition process from a central planning economy to a market-orient economy. And those limitations certainly be solved in the time to come.

Ⅲ. Review on Medium and Long-term Solutions to Recover the Banking Sector

Those have been mentioned above are the limitations of the Vietnamese banking system. To overcome the current problems, Vietnamese Gorverment have implemented many policies and solutions. The State Bank of Viet Nam, who is the direct responsible body, have made medium and long-term solutions to restore and develop the banking sector as follows:

1. Step by step to complete the legal environment for banking activities:

The realization of the Law on State Bank and the Law on Credit Institution(took effect from October 1, 1998) marked a turning point in the process of innovating the legal framework for banking activities. This is an important basis for State Bank to build a regulatory and supervisory framework, which ensuring the safety of the system. Against the background of the Banking Law, as of the end of 1998, a system of legal documents has been enacted such as the Decree on foreign exchange management; Decree on Foreign Borrowing Management; Decree on legal capital of institutions; Decree on functions, authorities and organization of State Bank; regulations on banking activities of institutions, Regulation on institution's lending to clients and other documents to create the legal framework for correcting the organization and activity of institutions in the past and the time to come.

The main direction in making legal documents to guide implementing the Law is the accuracy, enhancement of self-reliance, initiative on business of institutions and create a clear and detail legal framework for auditing, supervising the banking activities which ensuring the safety of the system.

2. To make and implement an all-sided reform strategy the banking system:

a. Beside solutions step by step to enhance the credit quality of commercial banks such as making regulation on credit safety, to coordinate with ministries, especially the Ministry of Justice step by step overcome the limitation on auction procedure, mortgage procedure helping the commercial banks having legal background to settle mortgage to retrieve loans. In recent time, the State bank was making a scheme to consolidate and dress the joint-stock commercial banks(the first experimental place was chosen is Ho Chi Minh city) and the system of state-owned commercial banks.

The arrangement and consolidation are implemented in the direction that the shortcoming and small capital banks will be consolidated by raising capital, changing the managing personnel, allowing merge and taking initiative to adjust within legal framework. The joint-stock commercial banks which are lacking legal capital, bad performed, loss-making and breaking the laws will be closed up. For State-owned banks, beside innovating organization, the legal capital will be raised.

b. For State-owned banks, in the recent time, the State bank have completed the organization, changed managing personnel and Government have also provided supplementary capital. The State bank has moved forward to make a scheme to consolidate and re-organize the state-owned commercial banks with a long-term objective to the year 2010 and under the light of Law on credit institutions.

3. Implemented the enhancement the regulatory and supervisory regulation:

a. Estimates the actual activities of Vietnamese banking system before the Banking law came in to effect has revealed that the legal framework to manage banking activities is still weak. The regulatory and supervisory framework is still limited due to lacking the clear criteria of a smooth and safety banking system; the accounting system is complicated and inspectors are not well trained. Therefore, it is necessary to build a regulatory and supervisory framework immediately.

Currently, the State bank is drafting new regulations to implement the Law on credit institutions. The regulations to consolidate joint-stock commercial banks and safety regulation have been enacted as follows:

The Decision No. 48/1999/QD-NHNN5 dated February 8, 1999 of Governor issuing regulation on credit assets classification, attraction and use of provisions to settle risks in the institution's activities. This decision took effect on February 24, 1999, in which credit assets are classified into 4 groups. Group 1 with the provision ratio is 0%; group 2 is 20%; group 3 is 50%, group 4 is 100% and clarify the risky circumstances and the ripe to settle risks by those provisions.

Regulation on credit institution classification, in which stipulate specific criteria to classify institutions and create conditions for supervising its activities.

Regulation on special control over joint-stock credit institutions(Decision No. 215/1998 /QD-NHNN5 dated May 23, 1998).

Regulation on integration-merger and repurchase of joint-stock credit institutions (Decision No.241/1998/QD-NHNN5 dated July 15, 1998) in which stipulate conditions required to be allowed merger, integration and re-purchase and procedures to implement.

In addition, the Governor also required forced auditing to joint-stock commercial banks with legal capital over 3 billions Dong. So far, all state-owned banks and a number of joint-stock commercial bank were audited.

The Governor also issued a new international standard accounting system for credit institutions.

Therefore, it could be stated that the State bank had made great efforts to enhance the regulatory and supervisory framework to control institution'activities. This is an import ant and necessary step to implement a program to innovate and recover the banking sector.

Thanks to timely issuance of the above regulation, the consolidation and rearrangement joint-stock commercial banks in Ho Chi Minh city have gained desired targets, laid the foundation for consolidating and rearranging all joint-stock commercial banks in Viet Nam.

b. Begin to lose the restrictions on foreign branch' VND deposit mobilization:

The Vietnamese Government has issued an official letter allowing losing restriction on joint-venture banks' VND deposit mobilization. According to this letter, the lose will be implemented in 2 steps, the second step will take place in 2000 as detail as follow:

Step1: (implemented in 1999) Allowing the joint-venture banks to raise VND deposit ratio from clients having no credit relation with the bank, from 25% to 100% against legal capital, to receive VND time deposit from every clients at the rate of 50%.

Step 2: Deregulating restriction on joint-venture bank' VND deposit mobilization

The allowance of join-venture bank' foreign currency deposit mobilization from every clients only take place once their capital is transfer to VND and the tax favor for those banks is scrapped.

The mentioned regulations are appropriate to the current development of Vietnamese banking system, ensuring an equal competitive environment for banks and protecting the development of domestic banks.

c. To achieve the objective of completing banking system, raising credit quality in 1999-2000, a number of banking policies need to be completed for early applied such as to establish deposit guarantee fund, deposit insurance body, to make regulation on risk management; to establish an assets managing body to settle loans and restructure debt enterprises; to restructure the overdue debts as well as state owned enterprises; to rebuild a training program for professional and managing staffs, raising the inspection quality in the system, transferring to a inspection system against risks; to rearrange credit activities; to overcome the losing control situation of lending without sufficient conditions, without paying attention to effectiveness, leaning on mortgage; to limit lending according to high-up' decision, limit the subsidy in form of credit activities to enhance business capacity of state-owned banks; to complete an initial estimate of financial situation of urban joint-stock commercial banks, move forward to finish restructuring of 51 joint-stock banks; the granting business license also need to be recompleted, ensuring necessary conditions required.

4. To innovate the monetary instruments from direct to indirect:

This is an important move to create conditions for banks to allocate capital appropriately, price(interest) reflects actual supply and demand. This innovation will be implemented actively in 1999 and 2000 in the direction as follows:

Quickly move from current direct monetary tools(for example credit line) to indirect monetary tools(ex. open-market tool). In order to put open-market tool into operation in the time to come, the State bank coordinate with the Ministry of Finance to make more regular T.bond auction, simultaneously to issue bank note to have more market instruments for more active operation and to expand the rediscount operation. The State bank will complete agreements with Ministry of Finance on developing short-term T.Bond market, issuing regulations of open-market operation for deploying the operation of primary market of Government'Bond and beginning open-market operation.

In other side, for raising the effectiveness of reserve requirement tools, creating more flexibility of this tool to regulate the money supply effectively, from January 1,1998 the reserve requirement management was implemented more flexibly, which not manage according to monthly average. Since the Banking law took effect from Oct. 1, 1998 those tools will be more completed and flexible, the refinancing tool will also be completed in the direction of raising the regulatory effectiveness of this tool, helping the open-market operation, raising refinancing ratio in form of value paper rediscount, reducing lending ratio under hight-up'decision. The State bank will step by step to self-adjust to gradually deregulate the interest upper limit and adopt a more flexible interest structure.

To improve the information system and enhance the forecast ability: A credit information center under the State bank has been established and put into operation. This center collect information about enterprises, commercial banks and international monetary and credit news. This information center now step by step is being completed to respond to the demand of State bank and commercial banks.

The enhancement the ability to forecast and analyze is helped by a training program and its content is gradually updated and developed to respond to innovating requirements of the system.

IV. Estimate the Effects of the Credit Mechanism Adopted by Government to Limit the Negative Effects of Asian Regional Monetary Crisis to Vietnamese Enterprises

The Asian regional monetary crisis had made a numerous blow to many economies in the region in 1997 and 1998, which many economies grow at a modest rate and even at a minus rate. For Viet Nam, we also are affected by the crisis but in a smaller degree due to objective and subjective causes and it should be mentioned that the policies adopted by VN Government have work effectively to minimize effects to VN enterprises. Within the context of this subject, we only analyze the credit, interest and exchange rate policies to limit the crisis'effects.

a. The credit policy:

The regional crisis has directly effected the ability to attract foreign investment, and therefore reduce the capital available for domestic investment. Facing this problem, Vietnamese has promoted policy of "bringing into play the internal force" to mobilize every sources domestically, especially the idle capital kept by citizen. A capital mobilizing scheme which attracts 6000 billions VND (in VND, USD and gold) has been approved by Government for financing the focus investment projects and counterpoising the ODA sources.

Currently, the Ministry of Finance is submitting to Government to issue National T. Bond with total face value about 4000 billions with period of 10 years for supplementing the capital reduced due to foreign investment decline.

Beside the policy of "bringing into play the internal force", to help the export enterprises to reduce input expenditures and then reducing production price for having international competitiveness, increasing export, the Government has laid down as a policy establishing an export supporting fund which is responsible for financing export enterprises and ones carrying on business commodities made from domestic materials, financing for export to new market and focus market; for enterprises export new products, the products encouraged.

While Fund has not been established, the Government has enacted the Decision No. 178 QD-CP on concessionaire lending to some export products and entrust 6 commercial bank the job. The lending interest rate is lower 0.2% than that of commercial bank to the same product. Those products are: Castle meat, fresh and processed poultry, fresh and processed vegetables(except pineapple), software, some devices, electricity engine, bicycle, fan. However, this is only a tactic solution, and this will be invalid when export supporting

Fund is established and come in to operation. In addition, the Government has directed commercial banks to spare sufficient capital for buying rice for export and for reserves. This had contributed to large price export in 1998 (3.9 millions tons).

The foreign borrowing management has helped enterprises in recent time while the exchange rate fluctuate about 18%. The foreign borrowing management is implemented according to the limit approved by government and the procedures to borrow are required closely and through State bank.

To enhance further the effectiveness of foreign borrowing management, the Government has enacted a Decree No.90/1998/ND-CP dated Nov. 7, 1999 in which stipulate specifically the responsibilities of Ministries related in managing foreign borrowing and the responsibilities of enterprises borrowing directly from abroad(without Government guarantee).

This has active effects in considering and taking caution when borrow from foreign that reducing loss caused by regional crisis.

b. Beside the credit mechanism, the interest rate and exchange rate policies also contribute to limiting effect of regional crisis through stabling exchange rate, encouraging exports, stabling macroeconomy:

- The regional financial and monetary crisis has reduce the competitiveness of VN exports due to regional currencies devaluation. In this situation, the exchange rate management need to be considered thoroughly for both maintaining competitiveness in the world market, stabling exchange rate, increasing national reserves. With such an attitude, in 1998, with a closely direction of Government, the State bank has adjusted exchange rate twice(in February, 1998 the trading band was adjusted from +/-5% to +/-10%; in August, 1998 the official rate up to 12,998 VND/1USD from 11,800VND/1USD and at the same time the trading band down to +7% from previous +/-10%).

Along with the exchange rate policy, the State bank has carried out appropriate foreign exchange controls to fend off speculation, enhanced the State bank's role on forex management to reduce the false imbalance between supply and demand, directed to implemented all-sidedly the Decision No. 37/1998/QD-TTg dated Fer 14, 1998, Decision No. 267/1998/QD-NHNN7 dated August 6, 1998, Decree No. 63/1998/ND-CP dated August 17, 1998 and especially the Decision No.173/1998/QD-TTg dated Sep 12, 1998 of Prime Minister in which stipulate forex selling responsibilities and buying rights of residents, the regulation on forex open exposure, regulation on forex buying and selling activities. And those has resulted in stability of monetary market in general and the foreign exchange market specifically, interbank transaction turnover increase(the total transaction turnover between banks in November up by 21,372 billions USD to that of October and transaction turnover between banks and enterprises up by 15,728 billions USD), the difference of exchange rate between official market and black market almost disappears, and at the same time the reserves are kept at the level equivalent to 9.5 weekly imports, meeting the demand of importing essential goods, raising the competitiveness of export enterprises.

And then, on Feb 25, 1999, the Governor promulgated 2 decisions, namely Decision No. 64 /1999/QD-NHNN7 on publication the exchange rate of VND to foreign currencies and the Decision No. 65/1999/QD-NHNN7 on stipulation the principle of quoting exchange rate by institution allowed doing forex business. According to those decisions, the State bank will publish the interbank average exchange rate of the previous day, and with this exchange rate, the commercial banks are allowed quoting their buying and selling rates not exceed +0.1% of the average rate. This is an important turning point, marking a basis change in the process of Vietnamese exchange rate management.

The promulgation of the two above deacons do not intend to change the current exchange rate, it is only the change in managing mechanism to create conditions for VND exchange rate reflects more closely to supply and demand encouraging export activities. Over the past 10 days since the new regime born, the monetary situation is stable, the exchange rate of official market and that of black market are close, foreign exchange market is still as active as it was with the former exchange rate regime. This is a successful signal of new regime.

Together with the foreign exchange rate controls, interest rate policies have also been managed deliberately with a view of encouraging exports, ensuring the harmonization between foreign exchange rate and interest rate so as to reduce the VND-to-USD conversion flows. In 1998, State Bank of Viet Nam had moved the short and medium-term lending rates from 1% and 1.1% to 1.2% and 1.25% per month, respectively; reduced the foreign currency lending rate from 8.5% to 7.5% per annum; and set the maximum rate for USD deposits of enterprises. Such interest rate policies had motivated enterprises to make further bank loans for their investment expansion, as well as reduced VND-to-USD conversion flows. Foreign currency mobilizations increasing level in 1998 (foreign exchange rate affected factor excluded) was a little bit lower than it was in 1997, and was closed to the VND mobilization increasing level.

V. Appraising Regulations on Short- and Long-term Lendings and Indirect Investments

1. Regulations on medium and long-term lendings:

From 1996 to October 15, 1998, medium and long-term lendings were regulated by Decision 367/QD-NHNN1 dated December 12, 1995 issuing regulations on medium and long-term loans. This regulation was the principal legal frameworks for the medium and long-term credit activities of credit institutions, and was considered to be fairly appropriate to the reality. There, however, was some obstacles in implementing this regulation, for instance, 1-to-3 years was quite a short limitation for a medium loan; it was not comprehensive to consider only collateral, mortgage and guarantee as security measures for a loan because there were many other security measures; only lucrative enterprises had chances to access bank loans so it was very difficult for enterprises wishing to improve their businesses to raise capital, especially State-owned enterprises. These incomplete regulations, therefore, had been amended and supplemented by the Decision 200/QD-NH1 dated 28 June, 1997 of the State Bank Governor to conform with the practice requirements.

In addition, some particular medium and long term loans were regulated as follows:

- Loans for science technology applications were regulated by Decision 270/QD-NH1 dated 25 September, 1995 issuing regulations on loans for application of science and technology for productions. This new form of lending had met the practice requirements, and the lending level has been increased years by years. However, it weighed only 0.6% of the total outstanding debts.

- Loans for house building were regulated by Decision 15/QD-NH1 dated 2 February, 1994 issuing regulations on loans for house building.

  This lending form was brand-new in Viet Nam and far from the knowledge of Vietnamese. In addition, incomes of citizens were still so low compared to the value of a house that this lending form was not widely applied, or in other words, it was not feasible. It is now applicable in only the Investment and Development Bank with a small total outstandings which is not worth being reported.

- Loans applicable for students were regulated by the credit regulations on granting loans for students in the Universities, Colleges issued in conjunction with Decision 270/QD-NH1 dated 2 November, 1994.

In general, this form of lending (including short term but mostly medium and long-term loans) was a preferential loan, suitable for students' requirements. It stipulated that credit limite per month for a student was only 120,000VND so that total outstanding of those loans were not significant. However, loans granted for students without security measures always bore high risks, which directly affected expenses of commercial banks.

To solve these problems, on 5 December, 1997, the Governor of the State Bank of Viet Nam issued the Decision 402/1997/QD-NH1 superseding the previous one (decision 270). This new regulation had covered larger applicants, more comprehensive credit terms and conditions, and credit limits decided by Director (General Director) of Commercial Banks so as to meet the needs of students and to ensure the debt repayment ability of students.

The preferential loans for students played important roles in implementing the training and education developing orientation of the Government, thus it is necessary for further expansion of this lending form. Nevertheless, in order to avoid any adverse impact on the businesses of commercial banks, the Government had decided to set up the Training Credit Funds which was supported by the Budget and commercial banks' voluntaries. The Vietincombank was entitled to manage and grant loans from this Funds. Another Lending Statute was issued inconjunction with the Decision 219/1998/QD-NH1 dated 1 July, 1998 renewing the regulations on granting loans for pupils and students.

Basically, this Statute was not much different from the one issued in conjunction with Decision 402 with the exception of clear stipulations on credit limit of 150,000 VND per month, maximum credit term of 15 years, maximum lending interest rate being equal to 50% of the short-term lending interest ceiling rate or of the average lending rate. Furthermore, obligations of Youth Union and Schools/Universities in the procedure of assessing loan applications were also stipulated. Local authorities where the students live and organizations for which the students work after graduating were to coordinate with the banks in restoring the debts.

Such stipulations aimed at reducing credit risks for the operations of the Training Credit Funds.

2. Regulations on short-term loans:

The most important legal basis for the Credit institutions to extend short-term loans is Decision 1997/QD-NH1 dated 18 September, 1994 issuing Regulations on short-term loans to economic organizations. Basically, these short-term loan regulations have met requirements of short-term credit activities of credit institutions with a view to ensure credit safety.

However, there still remained some obstacles in practically implementing these regulations, for example: stipulations of security measures were still incomprehensive; only lucrative enterprises had chances to access bank loans; lacking of provisions on short-term debt selling and buying among credit institutions had limited short-term capital circulation. These obstacles did need to be amended and supplemented.

In addition to the above regulations on short, medium and long term loans, there were some other regulations on, for example, consumption loans, unsecured up-to-5 million USD loans for the poor, collaterizing services, guarantee, leasings. These were all appropriate regulations for practices, and regarded as legal frameworks for credit institutions expanding their credit activities in the principle of security and effectiveness.

3. Regulations on collateral and mortgage. (Decision 217/ QD-NH1 dated 17 August 1996)

This was an important regulation to ensure the security and smoothness of credit activities in credit institutions. Basically, it was considerable legal framework for credit institutions to implement their rights and obligations towards their customers in asking for security measures for loans. However, according to this regulation, there still exists some significant unsettled problem as follows:

- Mortgage of land use rights: credit institutions had no rights to organize an auction of the land use rights but were only entitled to request the competent State agency to do so (Article 33). In fact, it was approximately 50% of the loans being secured by mortgaging land use right. While there were still difficulties in settling the mortgaged land use rights, there would remain more loans unrecovered which consequently resulted in the capital stagnation.

- Collateral by the loan-formed assets: Decision 217, in principle, stipulated that assets for med from a loan were not accepted to be collaterals. But in fact they were in cases of collaterising for projects which were in the interest of the nation, beneficial, and able to cover debt services. Directors (General Director) of commercial banks were fully authorized to make credit decisions. However, there were not detail regulations on such projects so that the above collaterising procedures can hardly be applicable in reality.

- Regulations on mortgage and collateral in this Decision were incomprehensive to cover the matters of settling mortgaged assets which were related to other ministries and levels. Detail guidances on the procedures of settling them had yet been available. Therefore, the effectiveness of this Decision was quite modest.

To solve those problems, a new decree on loan security will be submitted by the State Bank of Viet Nam to the Government as an effort to establish a synchronous legal framework for credit institutions in their credit activities.

4. Regulations on indirect investments:

Up to now, Vietnamese credit institutions are not much interested in indirect investments. Some commercial banks had merely invested in the Government Bonds, Promissory Notes. These investment activities are stipulated in the charters of each commercial banks. The low liquidity of indirect investments due to primitive primary markets has resulted in low level of indirect investments in credit institutions. Most of indirect investments are dealt in the Treasury Bonds Bidding. As of 31 December, 1998, total issued bond oustandings in credit institutions is 3474 billion VND, weighing 5.5% of their total investments.

The regulations stipulated that the interest taken from the bidding is not based on market supply and demand but on the official one set by the Ministry of Finance, so that commercial banks found it unattractive to invest in this field.

Generally, regulations on short, medium and long-term loans, on indirect investments basically meet the practice requirements of credit activities in credit institutions.

However, there were too many legal document regulating these activities.

On 15 October, 1998, a new Lending Statute applicable to credit institutions and borrowers which supersede all of the above-mentioned credit regulations was issued in conjunction with Decision 324/QD-NH1 by Governor of the State Bank Vietnam as a guidance of the Law on Credit Institutions.

This new Statute contains many advantages in applicants, loan purposes, credit terms, forms of lending... (except credit regulations applicable to pupils and students).

- More details applicants stipulated:

1. Credit institutions which are established to lend in accordance with the regulations stipulated in the Law on Credit Institutions.

2. Borrowers which include: Legal persons: State own enterprises, collectives, liability limited companies, join stock companies, foreign invested enterprises and other organizations which meet the requirements as stated in Article 94 of the Civil Code; Individuals; Households; Co-operative group; Private companies.

- Further loan purposes which include value of materials, goods, machinery, equipments and reasonable fees and expenses, especially export duty and interest amount to be paid to the credit institutions during the period when fixed assets are being constructed. These two last loan purposes have never been mentioned in the previous regulations.

- More details credit terms stipulated: maximum credit term for short-term, medium-term, and long-term loans is respectively 12 months, from 12 to 60 months, and over 60 months.

- Interest rate is agreed between the credit institutions and borrowers in accordance with the State Bank's regulations on lending interest rates prevailing at the time the loan contract was signed.

- Credit limit restriction is based on the assets being secured for the loans and must not exceed 15% of the equity capital of the credit institutions.

- The least cumbersome procedures in credit assessment and approval: this Statute stipulates a detail time limitation for these procedures such as within 10 days for short-term loans and 45 days for medium and long-term loans.

- More regulations on the case in which borrowers are in financial difficulties and unable to repay the loan in full due to certain objective reasons, the credit institutions may consider the extension, repayment reschedules, exemption, reduction of borrowing interest rate.

- Further regulating particular form of lendings such as: foreign currency loans, preferred loans, construction loans based on the State Plan, trust loans from a trustee being the Government, local or foreign organizations and individuals.

In comparison with the previous Credit Regulations, this new Statute contains more appropriate and "opened" regulations. For example, customers who are legal entities or individuals all being entitled to request a loan from credit institutions; beside these popular loan purposes, customers can request a loan for a purpose of study, health care, medicine services, education...; lendings and dispute settlement are all based on the agreed loan contracts; credit terms are in accordance with the business cycles or terms of capital return of the projects. Customers having business cycle over 12 months are entitled to have accordingly credit term. Various forms of lendings are available in conformity with the international practices.

VI. Conclusion

This theme has mentioned the basic issues of the Vietnamese banking system since the Asian regional crises. It shows up not only the successes but also disadvantages and weakness of Vietnamese Banking system. It analyses factors (including policy solutions) which had prevented banking system from developing as a financial intermediary system, as well as appraises the implemented and going-to-be implemented solutions to improve banking system.

However, this theme has just given brief analyses on the basic solutions and main factors exerting impacts on the financial intermediary functions of the banking system, thereby suggested necessary solutions in order to enhance the stable development of the banking system. These solutions mainly aim at completing the lagal environment for banking activities; establishing regulation framework of monitoring and supervising banking activities; improving tools of monetary policies, money market; improving management and minitor capacity of the State Bank and commercial banks as well; enhanceing the information systems. These are essential solutions for the process of renovation to establish a developed banking system which gradually integrates into international practices and effectively carries out its intermediary functions.

This theme is also a re-appraisal of the regulations on short, medium and long-term loans, indirect investments so as to make a foundation to complete legal framework for banking activities. To solve the pending issues of these regulations, a new Lending Statute was promulgated by the Governor of the State Bank of Viet Nam in September 1998 to meet the practice requirements with the establishment of necessary legal foundation for the credit institutions effectively expanding their credit activities. Furthermore, the assignment has given a brief assessment on the credit mechanism, foreign exchange rate and interest rate policies which were some of the solutions applied by the Government to ease the adverse impacts of the Asian financial crisis.