is low, the bank will refuse to give loan because this is loan without mortgage.

- To give loan to SOEs, SOCBs have to classify them regularly into prestige and non-prestige enterprise. Based on appropriate criteria SOCBs apply suitable credit policy to eliminate the credit risks. The SOCBs have to analyze, estimate the financial situation of SOEs regularly to retrieve the debts.
- The commercial banks have invested in improving their abilities on fund mobilization, evaluating the credit-risks, the legitimacy of loans, the financial ability and especially the efficiency and feasibility of each loan project.
- The commercial banks have required carrying out the research and analysis on the SOEs and rural market.

- The situational measures were applied in the background, in which the legal framework of banking activities are being supplemented and completed release the situational measures, promote competition, and provide more autonomy and responsibility to credit institutions. Therefore the commercial banks and SOCBs start to be aware their problem, they increased their ability and qualification in business operation and management.

5. Assessment on measures to release ad hoc measures and to set up a stable and effective financial sector

5.1 The implemented measures to release above ad hoc measures

- The government and SBV noticed and applied the ad hoc measures to avoid a broken danger of financial sector, of which the main cause is not the weaknesses of commercial banks. Therefore, several measures were applied to eliminate the ad hoc measures gradually by issuing new policies and mechanism to adjust both borrowers and commercial banks in order to create quick and stable changes. As details:
  - SOE reforms

    In the transition of Viet Nam, the quick reform of SOEs is very important, which affect the elimination of ad hoc measures on banking credit of government. The government promulgated several regulations to require ministries and government offices at different levels to promote rearrangement for SOEs. For example, the Decree No 44 (Jun 1998), set the target to equitize 1000 enterprises to the end of the year 2000, decree No 103 (Sep. 1999). Thereby, the rearrangement of SOEs is going on by the following alternatives: equitization, in contracts, leasing, selling, consolidating the corporations, and consolidating the public-benefit enterprises. The results showed that the restructuring in each SOE and in whole SOE sector is following the positive direction. Therefore, the recent credit regime has eliminated the particular regulation to apply the common regulations SOEs. This has promoted SOEs reform.

- Scheme for development:

  Up to now, Ministries, branches, and local offices have done the scheme for long-term, medium-term development very well for each branch, product and for each region. Therefore, enterprises and commercial banks have opportunities to determine strategies for business development. Thereby, credit regime has eliminated some constraints, increased the autonomy of credit institutions, especially the power to decide, examine, and expand the range of customers.

- Promote the provision of land-use-right certificate, establish guaranteed transaction mechanism:

  In the past 3 years, under the instruction of government, The Land General Office had cooperate with local office to promote the provision of the land-use-right certificate. Up to now, over 90% of farmer households and 17% of household in urban area were given land-use-right certificate. At the same time, the activities of Notary Office is in order and several regulation on guaranteed transaction was issued (however, some regulations were not applied). According to current situation, credit regime required a loan guarantee by land-use-right. It required the landowner to carry out the right order of procedures for mortgage, at the same time the credit institutions were allowed to give loan of VND 20 million without mortgage.

- Administrative reform of government offices:

  Administrative reform closely related to procedures to provide loans. Recently, Government issued decree No 52 (May 1999) on investment procedures, decree No 17 (Mar 1999) on land and Decision of Government rejecting license applied for enterprises. These created opportunities for project, which have demand on loan to approach to the banks, the unnecessary documents, and technical regulations of credit regime were eliminated.

- Export liberalization and import control:

  In recent years, the export activities are expanding toward liberalization and the import activities are under strict management. Therefore, the credit regime has adjusted to expand their customers of foreign currency loans to all export enterprises. The exchange rate management was transformed into floating-managed mechanism.

- Real estate market:

  Together with amendments of the Land Law on the land leasing, land delivering, and new stipulations of government on the rights and obligations, procedures in land transactions, the recent loan-guarantee mechanism defines more detail the auction and give more autonomy to the credit institutions.

- Changes in policy, development credit mechanism of Government:

  The Decree No 43 (May 1999) of government stipulated that, the credit for development investment would be carried by the government's development fund with limitation of the recipients, including the bailouts, interest subsidies after investment. Therefore, the credit mechanism rejected the favor regulations on the priory customers and expanded their customers.

- The government and SBV have promulgated synchronously and implemented efficiently the credit mechanism. The discriminations of transactions and transactional registrations were limited. The credit institutions were given more autonomy. The administration interventions in credit activities were removed.
- Complemented and implemented legitimately the mechanism of risk dealing: the government would consider and deal with the directed loans if their risks happen. For example, the loan to overcome the consequences of natural calamities, the loans to farmers without mortgage etc. The banks bear by themselves about the risks of the loans that they have decided. The risk-provisioning fund is extracted before tax and is used in accordance with certain regulation. This is appropriate with current economic condition of Viet Nam.
- Complement the methods of operating management in order to evaluate credit risks exactly.

5.2 The measures to set up an efficient financial sector:

- Carry out the measures of state control on business activities of credit institutions toward the market mechanism:

  The measures enforced since 1997 up to now had created legal framework for credit activities, minimized the administrative interventions to business activities of credit institutions, and forced the commercial banks to take responsibility in their business activities.
- The main problem that needs to be dealt is how to reduce the overdue debts and to improve the commercial functions of commercial banks. In certain period, the non-commercial loans need gradually to be rejected or classified clearly.
- Using many consistent measures to reorganize the joint-stock banks and retain at appropriate level. the inefficient banks are allowed to disintegrate, to go bankrupt, merge to be stronger for competition. All activities of the SOCBs should be restructured and reform totally
- Improve the owned capital to expand business and avoid the risks efficiently:

  Implementing the Decree 82, in Oct 1998, the government supplemented the charter capital for SOCBs and required joint-stock banks to supplement their charter capital within 3 years at the minimum level of over VND 70 billion for urban ones. Maybe, in the condition of Viet Nam-US commercial agreement, together with the orientation of globalization, it need to increase the owned capital of commercial banks 2-5 folder than the current capital in next few years. To guarantee the ratio of owned capital to assets over 10% needs employ the measures to restructure and increase the owned capital.
- Business Administration:

  The commercial banks had invested in new machinery, equipment, and technology to supply customer new products. Especially, the banks had improved the payment process, information collection to increase the efficiency of business management, to guarantee competitiveness with other commercial banks, and to prepare for regional integration.

- Apply modern business technology:

  Gradually, SBV gave guidelines to and required the commercial banks to apply the modern business technique on foreign currency, exchange rate, interest operations etc.

- Apply the methods of credit risk evaluation:

  Because project appraisal and risk evaluation gradually approach to the international orders, therefore the commercial banks have selected the more suitable loans, and avoided possible risks.

- The government has dealt with the credit risks, mainly the loans to SOEs, farmer households, and cooperatives. Up to now, government has dealt gradually with the bad debts under the subsidy period of SOEs and part of directed loans by debt cancellation and temporal debt carving out. However, the principle capital has not been repaid sufficiently to commercial banks.
- Strengthen the inspection, supervision of SBV, coordinate with internal audit of commercial banks, determine to judge the inefficient banks especially joint-stock banks.
- Require commercial banks carry out regularly the audit system with high level of confidence and declare the business activities of commercial banks.

6. Assessment on the effects of the credit limitation and interest-ceiling instruments to the effectiveness and stability of banking sector

6.1 Credit limitation instrument

Credit limitation instrument is a direct administrative instrument of SBV to control the increase in credit provision of credit institution to the economy. This is a mean to attain the intermediate objective about the growth of payment capacity, to aim the final target of monetary policy about the inflation restrain and control. In developing countries, the financial market is forming and developing, the indirect instruments of market mechanism have not appeared or been strong enough to restrain or control the increase of money supply. In this case, the credit limitation instrument plays a certain role. However, the credit limitation instrument has some constraints:

- This is a direct administrative instrument. It does not accord with the happenings of money market. In the case of low economic growth, deflation, or normal inflation, the credit limitation instrument not only is inefficiency but also is obstacle of monetary policy.
- There is no exact and sufficient foundation to allocate the credit limitation to credit institutions. It is very complex to determine. The credit limitation only controlled about 85% of credit outstanding. The amount of credit of foreign bank branches, joint-venture banks, rural joint-stock banks, and People's credit funds was not controlled by credit limitation. Thus, it is difficult to control the credit growth in accordance with the credit limitation. This induces inequality among credit institutions.

- The loans in foreign currency take about 30% of total credit outstanding. It is not necessary to be subject to credit limitation, because loan in foreign currency was controlled by exchange rate regime.
- The mechanisms of award and penalty and of credit limitation purchasing were not applied in practice. Thus, the effectiveness of credit limitation instrument is not strong and not flexible.

In the case of Viet Nam, the money market is developing toward liberalization but many factors, which may cause high inflation including external factors, have been existence. The indirect instruments were formed but their effects are limited. The credit limitation instrument consists of both positive and negative effects. Therefore, in coming years, the monetary policy will utilize the credit instrument as following:

- In the case that high growth of money is a main factor pressuring inflation at high level, the tightened monetary policy of SBV will employ synthetically all measures including credit instrument to control the growth of money.
- In the case that the money market operates normally, or SBV implements the relaxed monetary policy, the credit instrument is not necessary for SBV to control the growth of money.

These mean that SBV not give up the credit instrument but retain it for necessary cases. This may accord with the management of money market in Viet Nam at present and in few coming years.

6.2 Interest rate instrument

In previous time, the interest rate policy is reformed gradually toward liberalization. The interest regime increasingly becomes flexible and appropriate with the demand and supply of capital market. The inflation was restrained and controlled (from 3 digits to under 10%). The credit institutions are given more rights to determine their operating interest. Thus, the competition in money market has increased but government still possibly controls the interest rate. This was manifested in high growth of fund mobilization and credit to economy of credit institutions (about 15%-25% per year).

The current interest regime continues to reform toward the market-based interest regime, liberalization but retain under the control of government, and accord with the progress of SOE reform, the objectives of monetary policy, and the happenings of macro-economy. Thereby, the mobilization of domestic saving and foreign capital stands at high level, the value of Vietnamese dong is stable, and the annual objectives and long-term targets of government for economic development have been implemented.

After several changes in policy and mechanism, the current interest regime is as following: the deposit and lending interests among credit institutions have been liberalization. the government controls the lending interest only.

- *The regime of basic interest in Vietnamese dong has applied since Aug 2000.* The credit institutions set their lending interest to the customer in accordance to the regulation that lending interest is not over the determined basic interest and oscillation margin of SBV in each period. (In 8-9/200, the basic interest is 0.75% per month, the oscillation margin is 0.3-0.5% per month). The announcement of basic interest based on considering the commercial lending interest to the best customers of the group of credit institutions selected by the SBV governor in each period. The basic interest and oscillation margin are announced monthly. In necessary case, the SBV will announce the adjustment timely. The credit institutions consider adjusting the lending interest to the customers actively and appropriately with the change of basic interest.

- *The regime of interest in foreign currency (USD)*: the short-term lending interest is not over the level of interest of three-month loans in the inter-bank market of Singapore added to maximum 1% per year. The medium-and long-term lending interest is not over the interest of six-month loans in the Singapore's inter-bank market added to maximum of 2.5% per year.

The responses of market, credit institutions, depositors, and borrowers proved the above basic interest and foreign currency interest regimes are relevant to the financial liberalization. However, in the viewpoint of liberalization, the market-based interest both consists of the factors that may induce negative effects on money market and stands the control as details:

- In the one hand, the lending interest is still controlled by maximum level. This may constrain the long-term loans in risky economy. In the other hand, because the inter-bank market has not been organized, the foundation to determine the basic interest is not sure. Simultaneously, because the lending interest is controlled by ceiling, many credit institutions low down their interest to compete. Thus, the round credit circulation happened and credit-risks increased.
- In the cases of liberal deposit interest and unequal competition among banks, the join-stock banks will be vulnerable even fall in insolvency if the depositors withdraw their money massively to put in the others when the money market fails or when any SOCBs increases its deposit interest suddenly.

With the objective that interest liberalization to accord with the condition and happenings of money market and domestic macro-economy, and with the effects of exchange rate and foreign currency interest, the interest regime in coming years can be changed:

- Make domestic inter-market operate, using interest of this market to determine basic interest. When the money market develops steadily, the announcement of basic interest should be cancelled to move to interest management of SBV (rediscounting interest, financing interest, overnight interest).
- Besides, in near future, SBV should consider an alternative to employ again the administrative measure of lending and deposit interests if money market operates extraordinarily.

7. Assessment on elimination of depression of financial sector

In the case of transitional economy, the managerial mechanism, which stands the orders of both old and initial market institutions, is gradually becoming to entire. The inadequate infrastructure, imbalances economic structure, weak competitiveness, non-synchronous legal framework make the financial sector vulnerable and risky. Therefore, implementing the depressive policy to financial sector is suitable with the reforms of many countries in the world especially NIC countries and transitional countries.

In recent years, the government and SBV have removed gradually the depression regime and policy in accordance to the progress of economic reform in general and of banking system reform in particular. The vigorous reforms to promote investment, production, and business of all economic sectors consisted of the followings:

- The laws of State Bank of Viet Nam and of credit institutions, which enacted in Dec 1997 and have been effective since Oct 1, 1998, are very important legal framework to remove the depression of financial sector, and to understand more clearly about banking operation.
- The credit regime and loan guarantee enacted by the decision No 324/ Sep. 1998 and Decree 178, Dec 1999, and regulations on security and security supervision of operation of commercial banks proved no discrimination among commercial banks. These appreciated the legal framework, removed the "acquaintance" and command mechanism, and minimized the interventions in operation of commercial banks.
- The credit regime has developed toward liberalization in recent years. Previous time the interests of deposit and lending are determined by SBV. At present, the deposit interest and lending interest in the inter-bank market are liberalized. In addition, the implementation of current basic interest reflects market interest and orients the money market as well as encourages the competition.
- The reserve requirements have been reduced from 10% to 5% at present. The credit ceiling applied to commercial banks has removed. The SBV expanded their refinancing operation to commercial banks including joint-stock banks.
- Many markets (namely treasury-bond market, inter-bank market of foreign currency, and opening market operations) have formed to help the monetary operate effectively and help commercial banks restructure their assets with higher liquidity.
- The foreign currency surrender reduced from 100% to 50%. The administrative measures to control foreign currency inflow and outflow have been limited. This is relaxed gradually based on the economic restructuring and the foreign reserve of government. The commercial banks are allowed to carry out the foreign exchange activities in both domestic and abroad money markets safely and efficiently.
- The policy, regulation, and law have created an equal playing field for Vietnamese credit institutions and foreign bank branches in Viet Nam in fund mobilization and loans in VND. For example, the foreign bank branches are allowed to mobilize fund by deposits in VND up to 25% of their liabilities.
- The value-added tax on banking credit operation is exempted. The enterprise-income tax is implemented as the same ratio for all commercial banks.

A – 4

Commercial Bank Reform

Nguyen Ngoc Bao

State Bank of Viet Nam

Information collection

The year 1995

- Law on State Enterprise dated May 24, 1995, in which State-Owned Commercial Banks (SOCBs) had been affected by this Law, but there is overlapping with Ordinance on Banking, credit cooperative and financial company.

The year 1996

- Stipulation on mortgage, pledge and loan guarantee for credit organizations issued according to Decision No 217/QD-NH1 dated Aug. 17, 2000 of Governor of State Bank. This stipulation was issued according to the regulations of Civil Law, which came to effect from Jul. 1, 1996, on pledge, guarantee, and mortgage of loan borrowers of credit organizations. According to stipulation, all loans must be guaranteed with property, and all guarantee contracts must be approved by state notary.
- Decision No 381/QD-NH1 dated Dec. 28, 1995 of State Bank Governor has allowed applying lending interest-ceiling mechanism. Thereby, the deposit interest has been floated. The State Bank controls the lending interest ceiling only. In 1996, because Government canceled turnover tax on lending, State Bank has adjusted to reduce the lending interest continuously.
- Decree No 59/ND-CP dated Oct 3, 1996 of Government on financial management for state owned enterprises (SOEs) stated that the financial mechanism of SOCBs are also applied by this decree and state-owned enterprise law.

The year 1998

- Credit Organization Law and State Bank Law dated Dec. 12, 1997 and came into effect from Oct. 1, 1998. These inherit and replace two ordinances on banking dated May 1990 and create legal framework for new developing period of banking system.
- Decree No 82/1998/ND-CP dated Oct. 3, 1998 on the ratio of authorized capital of credit organizations defined the authorized capital of three State commercial banks is VND 1100 billion per bank. That of Bank of Agriculture and Rural Development is VND 2200 billion. The joint-stock banks have to increase their charter capital in three years to be equal with the authorized capital.
- Directive No 08/1998/CT-NHNN14 dated Oct. 3, 1998 defined solutions to deal with the overdue

debts of credit organizations.

- Decision No 324/1998/QD-NHNN1 dated Sep. 30, 1998 on the lending regulation of credit organizations to customers in accordance to the credit organization law replaces the former unsuitable regulations

The year 1999

- Decision 48/1999/QD-NHNN5 dated Mar. 8, 1999 on classifying "assets", on extracting and using the provisioning for using in operation of credit organizations.
- Decision No 435/1999/QD-NHNN2 dated Feb. 12, 1999 on accounting system of credit organizations.
- Decision No 296/1999/QD-NHNN5 dated Aug. 25, 1999 on the loan limitation to a customer of credit organizations
- Decision 297/1999/QD-NHNN5 dated Aug. 25, 1999 on guarantee ratios to ensure safety in operating of credit organizations

The year 2000

- Decree No 178/1999/ND-CP dated Dec. 29, 1999 and Circular No 06/2000/TT-NHNN1 dated Apr. 4, 2000 on solutions of loan guarantee with and without mortgage.
- Decree No 20/2000/ND-CP dated Jun 15, 2000 on administrative penalization relating money and banking activities in order to prevent the violations in operating of commercial banks.
- Decisions No 241/2000/QD-NHNN1, No 242/2000/QD - NHNN!, No 243/2000/QD-NHNN1, 244/ 2000/QD-NHNN1 dated Aug 1, 2000 on basic interest mechanism removed interest ceiling instrument to apply basic interest mechanism.
- Decree No 89/1999/ND-CP dated Sep 1, 1999 and Circular No 03/2000/TT-NHNN1 dated Mar 16/ 2000 on deposit insurance defined all credit organizations and other institutions that mobilized capital legitimately have to participate to deposit insurance with the fee is 0.15% per year.

Commercial bank reform

1. Economic situation from 1995 to present

In decade 1990s, Viet Nam's Economy had escaped from social-economic crisis. GDP grows as double as previous time, the average growth is about 8.7% per year. The inflation had been restrained at around 10%. Budget deficit had been reduced. Domestic accumulation from national economy was 25% of GDP. Development investment increased to 28% of GDP. Export stood at high level. The foreign investment increased with high rate and large scale. Balance payment had been changed from deficit to surplus. All economic sectors had high jump, but state sector still plays the leading role. Market institutions had been formed and developed. Financial system develops fast in size and variously in forms.

Since 1997 to present, the economy continuously develops but its growth had been slow down because of regional financial crisis and continuous natural disasters. Deflation is going on through the year 1999 and the first seven months of the year 2000. Purchasing power is low. Development investment tends slowdown. The efficiency and financial performance of enterprises become worse. The competitiveness is weak. The banking sector stay in crisis danger, the bad debts is high rate and tends to decline very slowly. The economic structure exposes conflicts, the market institutions establish and develop unevenly. The money and exchange rate markets contain many risks.

2. Overview of long-term structural reforming policy implemented by government and SBV since 1995

- Determine and manage monetary policy's instruments to create and develop the factors of money market synchronously, to promote competition among commercial banks.
  i) Since the beginning of 1996, by removing deposit interest ceilings, liberalizing deposit interest and inter-bank interests, and moving from interest-ceiling to regulatory regime of basic interest in Aug. 2000 had made a progress of interest policy toward liberalization. Particularly, foreign currency interest had been applied by managed floating regime. Refinancing interest rate had raised to higher level than interest ceiling in 1995-1997 by tightened monetary policy but declined dramatically in 1998-2000 by expansionary monetary policy.
  ii) Exchange rate policy operates flexibly and properly with the demand and supply of the foreign currency market to promote export, to control import, and to increase official foreign reserve. Especially, from the Aug. 1997 to beginning of the 1999, State Bank had adjusted exchange rate or its fluctuation marginal five times (actually that is the devaluation of Vietnamese dong). This helps to prevent bad impact of financial-monetary crisis in Asia. Since Feb. 1999, exchange rate has been applied the managed floating mechanism. Particularly, State Bank only informs average exchange rate in the inter-bank market of VND against USD. This exchange rate is determined based on actual average exchange rate in the inter-bank market of latest previous operating day. Credit institutions, which were allowed to purchase foreign currency, determined spot rate of VND against USD not over 0.1% compared with the average exchange rate in the inter-bank market.
  iii) Required reserve has been adjusted from rigid regime to flexible regime. It means that the required reserve account is merged to payment account of credit institutions at the state bank and is allowed using more flexibly.
  iv) Open market instrument has been applied since Aug. 2000. This marks a progress of monetary policy in transformation from direct to indirect instruments.
  v) Credit limitation, which was used from 1995 to 1998, was cancelled due to its direct intervention to the credit activities of credit institutions.
- Increase the owned capital of commercial banks to ensure its ratio to assets is over 8% as international

orders, to expand business scale, and to ensure operating safety by using decree No 82/1998/ND-CP on the authorized capital of credit institutions in Oct 1998. According to this decree, four state commercial banks were supplemented charter capital with VND 2400 billion, other commercial banks have to raise the charter capital to be equal with the authorized capital within three years since Oct 1998.

- Employ all necessary solutions synchronously to reduce bad debts at acceptable level, to ensure operating safety by improving capacity of credit evaluation and internal audition, and continuing to apply the strict credit procedure.
- The two new laws, which were issued in Dec 1997, had created necessary legal framework for banking system reform. These laws defined bank guarantee regulation, banking supervision and legal framework. According to new regulations, the autonomy of credit institutions was appreciated. Non individual or organizations are allowed intervening illegally to the operation of credit institutions; all rules are applied equally among credit institutions, there is non-priority for SOCBs or SOEs. More rules were issued to create open policy, encourage fair competition, and strengthen financial ability of commercial banks such as: extracting provisioning, managing "assets" and liabilities guarantee, monitoring indirectly etc.
- Apply new accounting system appropriately with international rules and regulations.
- The deposit insurance organization has been established and operated
- The State bank of Viet Nam has presented the proposal and prepared to form the debt purchasing company. This is basic solution to help the commercial banks restructure their "assets" account and strengthen the financial system. In addition, some commercial banks establish subsidiary company to deal with the collateral, mortgage.
- The operating structure of commercial banks has been changed toward wider network, higher managerial qualification, diversified services and products (foreign exchange business, financial leasing companies...). Some commercial banks, which satisfy the necessary conditions to form stock company, have participated to the capital market.

3. The Medium and long-term plans to reform SOCBs and joint-stock banks

3.1 General orientation to reinforce, rearrange, strengthen and improve competitiveness of banking system:

- Reassess the assets and liabilities of each commercial bank exactly and properly with international standards for its restructuring. Because the accumulated assets and liabilities of banks, especially of SOCBs, have not yet been estimated exactly for many years and the actual value these items may be much lower than their values on books.
- Increase owned capital and managerial capacity of credit institutions based on ownership restructuring, merger, or refinancing depending on particular situation of each one.
- Rearrange joint-stock commercial banks, People's credit funds including disintegrating or merging the inefficient banks, which can not restore and develop healthy.

- Consolidate and strengthen the finance of the SOCBs by rearranging debts, resolving bad debts, and separating the policy functions and the directed loans from activities of SOCBs. Establish special banks to carry out the policy-loans. Create opportunities and pressures to promote competitiveness of SOCBs under the market principles.
- Improve managerial qualification of assets and liabilities of commercial banks, clearly define the nature and risk level of each asset, reinforce interior supervision and loan-retrieving management, improve customer policy and credit condition, form special fund to compensate the capital leakage.
- Minimize operating costs especially administrative costs, personnel costs and costs for branches. Lower down the ratio of transactional costs to assets approximately with the average regional level (2-3%) to retain and expand market, to improve profit ability and competitiveness in new phenomenon.
- Concentrate on training to improve skills of bank staffs and managerial board to be equal to regional level. Improve basically banking technology, develop new services appropriately with open route of financial market that government committed in bilateral and multilateral agreements on trade and services (Vietnamese-American commercial agreements)
- Implement the route to open market of financial-banking services as government's commitments. Thereby, gradually lift the constraints on operation of branch of foreign banks locating in Viet Nam, and simultaneously expand the operations of Vietnamese banks on the regional and international financial markets.
- The government considers establishing an organization to classify independently on merit of credit activities considering experiences of countries in the region and in the world, to support domestic and foreign investors, to promote competitions, and to pre-warn the risk possibilities.

3.2 Supporting conditions for successful commercial bank restructuring:

For Viet Nam, banking system is an intermediary for capital mobilization and allocation to economy. The troubles of the banking system are not only originated from themselves but from other causes at different grades. Therefore, the restructuring of banking system can be successful only if it consists of following conditions:

- The banking reform has to implement at the same time as enterprise restructuring especially SOEs.
- The macroeconomic environment must be stable.
- The accountancy standards must be clear.
- The legal framework on financial technique need to be promulgated.
- The incentives for private sector's development and competition need to improve.
- The bank staffs need to become skillful.
- The interior banking supervision and inspection must be effective.

3.3 The solutions:

a. Market-based solutions:

In general, market-based solutions have been considered the most efficient and less expensive. When applying these solutions, the depositors are protected by deposit insurance so two major solutions can be employed:

- Liquidation: Usually, after supplementing fund for re-operation the banks are allowed to liquidate. Banking liquidator has responsibility to compensate and distribute the remained assets following the legal rules. If these rules are adjusted by law, depositors of broken bank have to surfer losses out of insured deposit. This solution may be applied for joint-stock banks in each particular case.
- Selling or merging: this solution does not require the support from government. The banks, which are broken danger, will be merged or sold to other banks even considering selling to foreign banks. However, in case of merger, it requires new institution has enough capital and ability to survive after merger. Two weak institutions should not merge. Because this merger will create a weaker institution.

In Viet Nam, within 5 or 10 coming years, the SOCBs play an important and leading role. Therefore, selling or merging joint-stock commercial banks to SOCBs are proper solutions. In special cases, liquidation may be necessary.

b. Governmental supporting solutions:

Main reasons for applying the supporting solutions from government:

- Market-based solutions may be fail because of many causes of market failures, which include inefficient macroeconomic policies and inappropriate monitoring and evaluating.
- The broken banks relate to thousands of debt and deposit contracts.
- Commercial banks are both public money keeper and payment operator. The bankruptcy of bank usually brings about systematical risks then induces unstable economy and confidence losses of banking system.
- Depositors believe that government will ensure the value of their deposit. Despite perception of high moral risks, government still engages in most difficult cases of banks.

Detail solutions:

- Banking nationalization: this is to transform losses of banking sector to debts of government sector. Thereby, banking system continues mobilizing fund due to people is no longer afraid of safety of deposit.

- Direct supports and policy adjustment:

  This solution is applied if fiscal capacity of government is rather good. In this case, government strengthens commercial bank's assets and sells them to larger banks even considering selling a certain portion to foreign banks. The debts of SOEs are strengthened by guarantees of restructuring organization. All these guarantees are re-bailed by government. Result, commercial banks can operate with out suffering former bad debts of performing debts, which were controlled by market rules.

  i) Government adjusts policy by requiring a high level of charter capital to restrain the expansion of banking activities.

  ii) Government subsidies investment capital and lends to enterprises, which no longer can access to banking credits due to the banks contract their credit provision when them face to difficulties. These subsidies include direct lending, bailing, and assisting after investment interest rate of the state fund of investment development assistance and the support fund of SMEs. Thank these subsidies enterprises continue their operation and can make profit to pay their banking debts.

  iii) Commercial banks are encouraged to follow the financial rules, to keep outside losses, to reduce income tax to lowest level, to allow using profit to eliminate bad debts.

- credit and payment assistance and balance payment sheet strengthening:

  i) Credit and payment assistance: this solution can be used effectively for difficulties of most banks in non-serious cases. This is liquid assistance of Central Bank by subsidiary interest rate for refinancing to domestic banking system. This solution is high cash costs because of supporting liquidity to unprofitable banks. This is only implemented in case of expansionary monetary policy and requires a strict management of Central Bank to ensure policy's objectives are implemented independently and objectively.

  ii) Relaxed management allowed commercial banks participating to activities outside of the traditional ones namely insurance and stock markets. Business diversification usually carries high costs of training and fixed-asset investment. Thus, Central bank should implement an appropriate monitoring regime to remain an acceptable risk level.

3.4 Particular solutions:

a) For SOCBs:

- Build a long-term business plan toward modern bank, defining main duties, targets, and financial and operating plans.
- Separate and defining clearly the functions of commercial banks and central bank.
- Equitize a certain portion of SOCBs.
- Develop the human source.

- Modernize the technology.
- Diversify the products and services.
- Improve credit qualification, evaluation capacity, bad debt management, and policy's debts.
- Reform operating management.

b) For joint-stock commercial banks:

- Reorganize the operating management activities such as changing managerial board, determining business plans, and improving internal accounting and auditing processes.
- Restructure the overdue debts.
- Improve the competitiveness of regular banks.
- Consolidate weak banks and banks that have authorized capital shortage.
- Restructure or disintegrate the banks that lose payment capacity.

4. Assessment on solutions to split the bad debts out of the banks and to refinance to banks in structural reform

a) Bad debt performance of commercial banks:

According to SBV, amount of bad debts in overdue debts of Vietnamese commercial banks up to 31 Dec. 1999 accounted for VND 5,000 billions approximately USD 500 millions. This amount is nearly 2% GDP and over 4% of total credit liability balance at that time. In comparison with average rate of over 13% and 10-20% respectively in most regional countries, the rate of bad debts in Vietnamese banks is not high. However, this is very anxious because of weak and vulnerable financial capacity in Vietnamese banks, especially in joint-tock banks.

The causes of bad debts are followings:

- Situation of serious capital shortage of enterprises, especially of SOEs that play leading role in economy. In these enterprises, the banking loans accounted for 70% of their total assets. This is difficult for banks to control credit risks. The number of inefficient and non-profitable enterprises amounted to 60% of total SOEs. This makes banks face to difficulties to retrieve their loans.
- Central and local government interventions to banking loans for investment projects especially to projects of SOEs make appraisal and risk evaluation become less objectively.
- Non-synchronous and inappropriate policy and mechanism have deterred development of investment, production, and business and have distorted enterprise's efficiency and operation.
- A portion of credit has used to invest in the risky real assets (Minh Phung-Epco company, Huy Hoang company...) while price of real assets decreased sharply and can not increases again in few coming years.
- The economy continues being backward situation, low purchasing power, and negative impact of financial-monetary crisis. This added foreign-debt burden to domestic banks that guaranteed L/

C and to enterprises that borrowed foreign loans.

- Laws on banking credit management are insufficient, inconsistent, and rigid.
- Commercial banks lack of managerial capacity and relax their management

b) Solutions for splitting bad debts:

- *Solutions for economic development*: the economy should be continuous growth based on deeper development, technology innovation, and productivity increase, export encouragement, economy's competitiveness improvement.

  Foster the financial and structural reforms. Particularly, reform the SOE sector deeply, wholly, and strongly by equitizing, disintegrating, selling, contracting, and leasing and bankrupt the weak enterprise. Consolidate the state corporations in the essential industries to make them stronger. Reevaluate and monetarize the assets, and applying a relevant distribution for all enterprises.

  Simultaneously, support and encourage to small and medium enterprises especially to new established firms, which are facing financial difficulties in initial period. Implement synthetically solutions of investment in rural and agricultural areas to foster the process of hungry elimination and poor reduction and to develop rural infrastructure and markets for sustainable development.

- Market-based solutions:

  Gradually financial liberalization and stabilization: determine and implement the process of financial liberalization, create the transparency and clarity in operation of commercial banks and financial institutions, raise gradually operating standard to be equal to international level within 7-10 coming years.

  Form up the real estate market with increasing scale and under control and management of functional institutions to ensure its quality and to limit the risks to investors. This is very important and significant for banks to solve their bad debts. For this objective, government has to guide the provision of land-use-right certificates to all entities who are using land, establish and employ the real estate's transactional registration system and the real estate's evaluation and advisory institution, consider to abolish the regulation on land-use-right evaluation based on central or local government's decision when land use right is used as collateral for loans in credit institutions. Law should give the rights to person, who received collateral, to solve their collateral following their initial agreements.

- *Legal framework solutions*: complement urgently legal framework for credit activities toward diversification of credit provision. Require the credit institutions tighten their credit's provision procedures, improve their capacity of credit's risk evaluation, apply loan security by assets, create legal framework for person who has collateral loans, mortgage and for credit institutions to auction quickly.

- *Banking solutions*: establish state's debt purchasing company to buy overdue debts from commercial banks. However, the company should buy overdue debts with collateral. State-owned commercial banks allowed buying overdue debts from SOEs. Other overdue debts are dealt by debt purchasing company. This way could solve mostly bad debts, avoid dependence of commercial banks, and force them mention to credit-risk prevention of new loans and actively deal with the remain overdue debts.

Government should eliminate non-retrievable debts due to natural disasters by enterprise's fund of risk compensation.

Secuiritize the overdue debts with collateral, mortgage, or sell to other commercial banks, government, enterprises, individuals, and foreign organizations or individuals.

Establish SOE's debt-purchasing company to repurchase overdue debts that are mainly banking loans, from SOEs.

c) Refinancing to commercial banks:

For objective to establish the banks that operate safely and provide good services and high competitiveness the refinancing for commercial banks requires following solutions:

- For SOCBs:

Firstly, sell bad debts to state's debt-purchasing companies. SOE's debt-purchasing company will be established and came to operation in near future. This solution refinances the capital, which is interrupted or is kept in real estate investment. Besides, the improvement of the assets " to refine the asset balance sheet."

Secondly, the government supplements charter capital from its budget capacity or issues long-term government bonds to refinance capital to SOCBs.

Thirdly, equitize a certain portion of SOCBs to sell them to local and foreign companies and individuals.

Fourthly, reduce service tax, enterprise income tax, and fees of using capital from state budget to possible lowest level (0%-2%) to create opportunities for SOCBs to supplement their charter capital by the annual accumulated profits. Establish fund of provisioning and fund of fixed assets reinvestment.

- For joint-stock commercial banks:

Firstly, sell the bad debts to the debt-purchasing companies of government or of SOEs like doing with SOCBs.

Secondly, merge the urban and rural joint-stock banks from 50 banks at present to 6 or 8 banks.

Thirdly, sell the shares of joint stock bank to government, SOBs, or foreign institutions to increase their operating capacity.

Fourthly, continue increasing charter capital by selling the shares to domestic and foreign organizations and individuals.

Fifthly, government through the SOCB injects temporarily capital and points out a new manager board to restructure the weak joint-stock banks then sells them to others even foreign banks.

Sixthly, implement purchasing debts to diversify their maturity.

Seventhly, auction collateral assets and mortgages to retrieve loans.

d) The efficiencies of solutions for separating bad debts from bank and refinancing to SOCBs and joint-stock banks

The experiences of financial reform in many countries and bad debt performance of commercial banks at present prove that separating bad debt and refinancing to SOCBs and joint-stock commercial is feasible and efficient solution. This is significant for success of commercial bank reform.

Overall, the bad debts of commercial banks are considerable. The commercial banks need a long time to compensate (may be 10-15 years) or cannot resolve by themselves but need government supports to deal with these debts. Bad debt separation help commercial banks restructure the assets, refine the balance sheet, reduce the risk ratio, increase solvency.

By restructuring assets and refinancing to commercial bank, the danger of financial crisis, which may cause the economic-political crisis, has been prevented. After that, if the State bank supervises and monitors the operation of commercial banks strictly and the risk avoiding solutions certainly, the commercial bank system of Viet Nam will be sound, strong and more competitiveness.

The urgent requirement for success of economic reform in next period is to have strong and competitiveness banking system. By refinancing and dealing with the bad debts, the financial ability of SOCBs and joint stock banks increase significantly. Thereby, the banks can improve the capacity of credit provision to economy, diversify services and products to customers, and modernize technology, train personnel.

5. Cost evaluation for commercial bank reform

The reform of commercial banks required calculating totally costs to balance resource capability and efficiency of banking reforms to adopt measures and a process appropriately.

For commercial bank system of Viet Nam, the costs of the reform include:

- Costs of restructuring non-performing loans which are mostly in state-owned commercial banks (SOCBs)
- Cost of restructuring the former high-risk loans to SOEs and to farmer without collateral under the Government's guidance, even they have been not overdue.
- Cost of supplementing charter capital to both SOCBs and joint stock banks (JSBs).
- Cost of training and re-training human resource and developing banking technology.

According to 4 items above, total costs of restructuring Vietnamese commercial bank system under real conditions is about USD 1.5 billion approximately 6% of GDP. Within this total, the costs of resolving the current non-performance loans (NPLs) and loans of SOE reform account for USD 700 million, the costs of raising the charter capital to SOCBs and JSBs are about USD 700 million, and the amount of training banking staff and investing in technology is USD100 million.

6. Assessment on finical measures to reform financial sector

As above presentation, measures to finance the costs of financial sector reform are required about USD1.5 billion equivalent to 6% of GDP. With current deposit interest rate of 6 % per annual, if the Government issues its bonds at the yield equal to the deposit interest rate, the required cost would be about 0.36% GDP (6%x6%GDP) at least. This also means that, budget revenue would increase 0.36% of GDP or budget expenditure would reduce by equivalent level to cover the interest-payments of government bonds. If comprise the payments of principal debts at 6% of GDP with the suppose that "new debts to pay old ones" while foreign debts ODA debts begins come to the end of their maturity, clearly the government financial capacity is not enough to finance the costs of commercial bank reform.

Therefore, there is only application of a comprehensive set of measures at least within present to year 2005 as following:

- Government issues the bonds and through the debt purchasing company to restructure bad debts worth USD 700 million during 4 years (2001-2004), about USD 150 million per annual.
- Government issues bonds, establishes reserve fund, uses ODA to refinance to SOCBs an amount of USD 300 million per year within 5 years (2001-2005)
- The commercial banks make profits in future to re-supplement their charter capital and raise shareholder capital, liquidate their own collateral assets to self-refinance their charter capital estimated USD 400 million in 5 years (2001-2005).
- Commercial banks have to mobilize capital by themselves from domestic, abroad or from their future profit to invest USD 100 millions in training and re-training their personnel and technology development.

7. Assessment on positive effects of measures to reform SOCBs and JSBs, especially financial measures

a. The objectives of SOCBs and JSBs reforms are to build the banks, which operate soundly, provide good services to create infrastructure for economic development. So, there are following positive measures:

- Implementing synchronously financial sector reforms or considering as soon as possible the financial supporting measure to SOCBs and JSBs is the best solution to prevent the possibility of regional financial crisis that may induce negative effects on economic development and political and social instability like experiences of other countries.
- Promote sequential steps of Vietnamese economic reform toward favorable direction, particularly SOEs reforms. Create favorable conditions for SMEs develop, foster the modernization and industrialization in rural area, where takes 80% of total area and nearly 76% of the population.

Restructure the economy to become a multi-sectoral one with high competition and export orientation.

- Provide credits with reasonable interest rate to the economy, which is growing at high level (over 7% per year), and to the goals of hunger elimination and poverty reduction to promote sustainable economic development with underdevelopment capital market.
- A modern and healthy system of commercial banks will ensure Vietnamese economy to integrate into region and world steadily and successfully; as well it prevent the risk and negative impacts of possible regional or global economic crisis.
- Create the fair playing field for all banks, promote competition and development of domestic commercial banks relevant to the pace of opening economy when the Vietnamese- American agreement come to effective and Viet Nam becoming full-member of AFTA in 2006.

b. After enacting two Banking laws in Oct. 1998, the Government and State Bank of Viet Nam (SBV) have issued a lot of regulations to require commercial banks implementing safety rules or to supervise them strictly, make them assess credit risk more exactly and allocate capital more efficiently as following details:

- Overall, there is no discrimination of operating regulation between SOCBs and JSBs, and between SOEs sector and non-state sector. Therefore, these banks are freely to choose efficient loans under consistent criteria.
- Credit regulation, loan guarantee are consistent, create legal framework and autonomy for SOCBs doing their activities.
- Moving from interest ceiling to basic interest rate has promoted competition and allocating capital efficiently.
- Regulations on safety of assets, on raising authority capital, on administrative punishment, on organization and financial mechanism of SOCBs, on exchange rate management, deposit insurance, extracting provisioning...

8. Assessment on effects of credit limitation and interest ceiling on efficiency and stability of banking sector

a. Credit limitation instrument

In developing countries where financial market has been emerging and developing, indirect instruments of market mechanism have not been appearance, or not strong enough to control and monitor additional money supply, the credit instrument plays a certain and flexible role.

In case of Viet Nam, money market is developing toward liberalization but consisting of inflationary factors including external factors, indirect instruments has been established but their impacts has still been limited, credit limitation has both positive and negative effects. Therefore, monetary policy in coming years, the credit limitation will be applied as followings:

- In case of money supply expansion inducing high inflation danger, to implement tightened monetary policy SBV uses measures synthetically to control money supply including credit limitation for SOCBs.
- In case of implementing expansionary-monetary policy or money market operating normally, and other instruments are available for SBV control money supply, credit instrument is not necessary.

This means that SBV should not give up credit instrument but retain it for using in necessary cases. This point of view is appropriate with the control of money market in Viet Nam at present and several coming years.

b. Interest instrument:

At present and in future, interest mechanism continues to reform based on market principle, to liberalize gradually but it is still under the control of the government and suitable with the SOE reform, with macroeconomic objectives and monetary proceeding (inflation, economic growth, employment, balance payment...). This makes domestic saving and foreign investment stay at high level, domestic currency stable and implements social-economic objectives of annual and long-term plans of the government and Party.

Up to now, after several changes of policy and operating mechanism, deposit and lending interests among credit institutions has been liberalized. The government controls lending interest only. This is applied to Vietnamese dong by operating mechanism of basic interest and to foreign currency by managed-floating mechanism.

Based on objective of interest liberalization in accordance with domestic money market proceedings and macroeconomic context, impacts of exchange rate factors and foreign currency interest, the interest mechanism in coming years may be changed as followings:

- Operating domestic inter-bank market to determine basic interest rate. As far as money market develops steadily, the basic interest determination will be canceled to move to interest management of SBV (rediscount rate, refinancing interest rate, overnight interest...)
- Remove interest ceiling for foreign currency deposits of legal entities.
- Besides, in near future, if the market operate irregularly, SBV considers an alternative of using administrative intervention to lending and deposit interest rate.

9. Assessment on eliminating gradually situational solutions and establishing an efficient and stable financial sector

The major objective of monetary policy is to stabilize money, contribute to economic growth, and increase official foreign reserve. Therefore, central bank continues reforming the management of monetary policy toward basic principles of market mechanism and appropriately with its functions.

In Viet Nam, the law stated that central bank is government's bank. Money market factors are underdevelopment, small scale, vulnerable by effects of regional or international money markets. So, situational solutions were and are being applied to financial sector, as followings:

- Use credit limitations, control interest ceiling of deposit and loan.
- Lend to SOEs and farmers directed by government's policy and request.
- SBV controls each time of capital mobilization by issuing bills of commercial banks.
- Surrender current foreign deposit.
- Control exchange rate marginal.
- SBV issues legal and compelling regulations on credit provision.

Medium and long-term strategy of financial sector reform and liberalization will gradually cancel situational solutions, as following details:

- Credit limitation will not be used if it is not necessary. Interest liberalization will be implemented relevant to money market development.
- In near future, the policy bank is going to establish to separate policy credit from commercial credit.
- SBV relaxes gradually credit regulation to abolish "acquaintance" mechanism and it only issue regulation on credit guarantee and remove regulation on professional technique operations.
- It is able to remove regulation on surrender of foreign currency and control exchange rate marginal when domestic market of foreign currency tends to develop steadily, foreign reserve grows enough to intervene in the exchange rate market.

10. Assessment on possibility to eliminate restrictions of financial sector

In case of economy, where market economic institutions emerges initially and growing up step by step, the infrastructure is weak, economic structure exposes imbalances, the efficiency and competitiveness is low, legal framework for economic operations is non-synchronous. This makes financial sector be vulnerable and high risk. Therefore, applying tightened policy to financial sector is obviously.

However, the government and SBV will lift gradually this tightening relevant to the pace of economic reform in general and achievement of banking system reform in particular. However, there are vigorous reforms to promote scales and speeds of investment, production, trading of all economic sectors. In medium and long-term strategy of banking system reform, these following constraints will be considered to remove:

- Lending interest liberalization may be conducted within 5 to 10 coming years when macro-economy and financial market develop steadily, inter-bank domestic currency market forms maturely and operates daily, indirect instruments of monetary policy come to effect and influence to money demand and supply effectively.
- Remove regulation on surrender of foreign currency and eliminate administrative measures of

controlling foreign currency inflow and outflow. This is relaxed gradually based on relevant restructured economy and official foreign reserve can deal with the causes, which make Vietnamese dong unstable.

- Participation of private sector including foreign organizations and individuals to SOCBs to absorb modern banking technology and to encourage efficient management and competitiveness.
- Create fair playing field of policy, regulation, and legislation for foreign banks in mobilizing and lending by Vietnamese dong.
- Removing government intervention to autonomy of credit institutions by existing operating regulation exposes clearly at lending regime and loan security.
- Develop synchronously money markets (inter-bank market, Treasury bill biding ...), help credit institutions participate to these markets, access to and enjoy benefit from monetary policy instruments fairly and sufficiently.

A－5

Restructuring of Joint-Stock Commercial Banks in Viet Nam

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Over the past 15 years, the economic reforms in Viet Nam have gained considerable achievements for the economy. Substantial contribution to this has come from the banking sector with the establishment of firstly state-owned commercial banks (SOCBs) and later joint-stock commercial banks. The number of joint-stock commercial banks has increased rather fast since 1990 and has reach 51 banks in 1999. However, despite this development the quality of these banks has been a grave issue over the recent years for Viet Nam especially after the outburst of the Asian financial turmoil in 1997. The rate of non-performing loans in these banks in 1999 was 16.6 percent which is the highest among banks in Viet Nam (this rate in SOCBs was 12.3%, in joint-venture banks was 15,5%)

The banking sector is highly sensitive to the healthiness of the economy and for that reason is highly vulnerable when there is economic fluctuation. Conversely, changes in the healthiness of the banking sector has immediate impacts on the stability of one economy, each failure or close-down of one bank in general and of a joint-stock bank in particular not only cause contagious damages to the economy but also affect badly people's psychology and socio-politic stability. Aware of the seriousness of the problem of the JSBs, Vietnamese government has prepared an action plan for comprehensively restructuring the JSBs first in 1998 for Ho Chi Minh city and later in 1999 for the whole Viet Nam. This action plan aims to address the weaknesses of these banks which comprises low capital base, insubstantial capital adequacy, inefficiency and low profitability, bad management with loose internal inspection and also to strengthening external factors like inadequate supervision from managing State organizations especially from the State Bank of Viet Nam (SBV) and unclear regulatory framework.

1. The deficiencies of the JSBs in Viet Nam

Due to the fact that the JSBs have been newly established these banks have rather little experiences in their operation and weak management which have led to a wide range of deficiencies in the banks. These deficiencies can be categorized into 3 major ones including size of capital, organization and operation.

(1) The most conspicuous weakness of JSBs in Viet Nam is their weak capital base with much of their capital consists of borrowed funds. Inspite of the stipulated regulation of the government on the minimum

charter capital requirement many JSBs in Hanoi and Ho Chi Minh city have not been able to increase their capital over the level of 50 billions of VND. With the new capital flow from the government, the SOCBs have received capital up to the required level by the government decision, which make the competitive pressure even more severe for the JSBs. More seriously, certain part of the capital contributed to the JSBs has deceitful sources and in many cases is illegal or prohibited.

(2) The second weakness of JSBs is about the management and personnel. This weakness can partly attributed to the loose control on the personnel with the short sighted way of doing business which create an environment for moral hazard to develop (including defrauding in capital mobilization and in lending and guaranty operation).

Certain number of shareholders have a history of doing other business and just moved to banking sector with the capital they contributed have been raised though doubtful business and in some cases by illegal businesses or they just unlawfully using money of other people or entities to contribute to the banks. They sometimes just set up the joint stock banks but did not for the objective of doing banking business. Conversely, they try to take advantage of the banks to mobilize capital for their own business, which are against the law. This is why they paid little attention to the organization of the banks. The management therefore is often loose with low capacity in controlling, executing and supervising. Personnel in these banks are very weak at professional capacity and for a large part are untrained on banking operations and regulatory principle.

(3) Another deficiency of the JSBs is their ineffective operation. Two obvious evidences to this are the low levels of safety and profitability. Firstly, the JSBs have insufficient liquidity, which is resulted from first from the maturity mismatch, and second the high level of non-performing loans. One of the reason is that many banks just invest their money in real estate (most are land) which are of low liquidity and are very risky. In recent years, JSBs have provided guarantee and guaranteed for opening L/Cs in a lax manner and not in compliance with the regulations. Large amount of foreign debts has occurred due to this operation. Of these debts many are costly with short maturity and high interest rate. The high level of NPLs is created since credits by JSBs often provided on the basis of acquaintance not on the loan feasibility analysis. These loans most of the times do not satisfy credit conditions and have enough required documents.

Due to the bad business practices, profitability of JSBs are unstable and low which does not ensure the growth and development of the banks. In addition, information system in these banks is not precise which are partly because of bad accounting system and partly because of immoral business. Many banks have more than one systems of accounting in order to fraudulently recording illegal transactions. Bad information system makes the analysis of JSBs meaningless and increases the riskiness of JSBs ' operation.

The consequence is that until the beginning of 2000, despite the certain contribution of JSBs to the economy, the level of overdue debts of JSBs has reached the highest point unprecedentedly observed in the development process of the banking system in Viet Nam (24%). This might very well ignite a contagious collapse of JSBs in Viet Nam. To prevent this possibility, the Political Bureau has required the government to have a comprehensive restructuring programme for the banking system in general and for the JSBs in particular. An action plan therefore has been set up in the government agenda and the Governor of SBV has been implementing it.

2. The process of restructuring JSBs in Viet Nam since 1999

(1) Changes in the government's awareness

Confronting with the problems and deficiencies of credit institutions in Viet Nam especially of the JSBs, since 1997, the government of Viet Nam has taken certain steps to combat with the situation. The operation licensing for new JSBs have been limited and a number of new regulations have been promulgated to form a legal framework for the banks to adjust in right direction. (For example, The directives no. 227/VI-m dated 15/7/1997, Document no. 2910/KTTH dated 10/6/1997 on the temporary cessation on issuing license for establishment of JSBs). In 1998, the government submitted to the Standing Committee of the Political Bureau the Action Plan for restructuring JSBs in Ho Chi Minh City and gained approval from the Committee. Based on this pilot plan, in 1999, the Prime Minister did endorse a more comprehensive programme for JSBs restructuring for the whole Viet Nam.

In fact, the government of Viet Nam and the SBV did recognize the problem of the JSBs and wanted to have a plan to strengthen JSBs even much earlier (since 1993- the Directive no. 93/TB-TW of 9/1993). However, only until 1998 regulatory writings related to this issue have been promulgated in an expansive way. This reflects a long lag of decision making after some issue has been recognized.

Up to presence, though the regulations have been set up rather ample, the implementation of those is very sluggish. This can be attributed to a wide range of reasons but above all is the obstacles in the controlling mechanism, which is apparent, rather loose and not clearly distinguished between macro and micro-level. On the other hand, the cooperation between concerned government organs in the process of finding solution for problem assets and thus clarifying the JSBs financial statement is still under requirement.

(2) Rehabilitation of the deficiencies of JSBs

1) Recapitalization of JSBs

As pointed out, JSBs largely are undercapitalized with a low level of registered capital, which is not sufficient for the banks to expanding their businesses both in terms of areas and activities. This is the target of Decree no. 22/1998/ND-CP dated 3/10/1998 on the requirement of minimum charter capital. The JSBs have only one choice is to raise their capital otherwise they would be merged or withdrawn of their licenses.

In order to ensure the capital raising to performed without delay, the SBV have promulgated that those banks of low capital base are not allowed to expanding their areas of operation. The deadline regulated in Decree 22 for JSBs to manage to raise their capital to the required level is October 2001 before their licenses would be withdrawn.

In addition, the SBV have directed the JSBs to mobilize capital contribution from SOCBs and SOEs (which is specified in the Law on credit institutions). This in one hand would help the banks to quickly increased their capital and in other hand to upgrade management capacity. Another effort is to strive to withdraw capital from illegal or regulation violating investment especially those investments made by the managers of JSBs.

Despite all these efforts, the Recapitalization is mostly carried out by some large JSBs. Major parts of JSBs (70%) still do not have the required amount of capital.

2) *Improving organization and management in JSBs*

The second issue the rehabilitation efforts aim to attack is the organization and management in JSBs. The first step has been taken is that each JSBs is required to revise its charter in accordance with the current regulations. Through this task, each bank has the opportunity to rationalize its organization structure, to secure the list of shareholders and to rearrange the three functions of management, inspection and steering.

By the rehabilitation process, the SBV has stepped in to take out members of management board that are not proper in terms of moral, professional experiences and knowledge in banking (such as those in Viet Hoa JSB, Nam Do JSB, Vung Tau JSB...). At the same time, some others in the management board, internal inspection and executive board that violated the provision no. 36, 37, 38, 39, 40, 77, 78 stipulated in the Law of Credit Institution have been temporarily dismissed from their position (Phuong Nam JSB, Nam A JSBs, Phuong Dong JSBs, Housing Development JSB of Ho Chi Minh city, VP bank, §a Nang JSB).

Along with the rearrangement of personnel, other strict administrative and legal actions have been carried out to punish the violation of laws in Nam Do JSB, Me kong JSB, Que §o JSB, Viet Hoa JSB, Vung Tau JSB...

3) *Increasing the effectiveness of JSBs' operation*

The first step to restore the effectiveness of JSB is to base their business-expanding plan on the specific condition of each bank. The capital mobilization has been limited to reduce future risks of insolvency.

The SBV continued to direct JSBs to reexamine all the credit files to make quality analysis.

Cooperating with other administrative organization to make every efforts economically, administratively of even legally to solve the problem of bad debts in order to recover as much as possible the capital for JSBs. Strict measure of maintaining provision for loan loss, keeping safety ratios required by regulations and to join saving insurance. Up to presence the provision of the banks has been increased to 600 billion VND.

In some cases the SBV have authorized SOCBs to take charge of solving JSBs. The SBV also coordinate with the banks and foreign lenders to settle the problem of high stock of over due L/C. SBV have been taken part in the process of revising every guaranteeing contracts and have been supervising the repayment of JSBs. It also supports the JSBs to renegotiate with foreign lenders to restructure loans and reduce

(3) Supports from the government

To support the process of restructuring the JSBs the government has decided to set up a special committee for this task since early 1998 which is led by one Deputy Governor of the SBV. A fund called The Fund for Rearranging Joint Stock Commercial Banks was also set up with the started capital of 1,200 billion VND. The fund has been actively used to help the rehabilitation process. However, compared to the size of bad loans and debts of JSBs the fund is rather insufficient.

Another important measure to help the rehabilitation of JSBs is to set up and clear regulatory framework for the sector. Series of legal documents have been promulgated such as the regulation on the special supervision to JSBs, the regulation on merging, taking over and buying back JSBs, Decision on classification of assets, provision for banking risk maintaining and using of JSBs... These documents have contributed to fulfil the gap in the legal framework and create the basis for the rearranging and rehabilitation of JSBs in particular and of the whole banking system in general.

(4) Some specific steps taken so far in the restructuring process

To orderly carry out the above measures, in the Action Plan, JSBs have been categorized into 4 groups including the JSBs that operate normally, the weak JSBs that need supports, the unsound banks that have the danger of insolvency and the insolvent banks. For the group 1 and 2, rehabilitation measures like charter amendment, recapitalization, credit quality improvement, reduction of debts and profitability enhancing should be taken to strengthen the capacity of the banks. For the group 3 and 4, the restructuring efforts should be taken which consists of first limitation on the expansion of business and second putting under special supervision of SBV (or an authorized SOCBs). If the operation of the banks is not improved then the license should be revoked.

In 1999, basing on the classification, The State Bank of Viet Nam implemented the reconstruction of JSBs as follows:

- Withdrawing business licenses and completing liquidation of Vien Dong joint stock commercial Bank.
- Withdrawing business licenses and implementing liquidation of Mai Phuong Joint stock commercial Bank.
- Merging Dai Nam Joint-Stock Commercial Bank and Phuong Nam Joint-Stock Commercial Bank.
- Allowing the International Joint-Stock Commercial Bank to purchase assets of Mekong Joint-Stock Commercial Bank and preparing necessary documents to withdraw business license of Mekong Joint-Stock Commercial Bank.
- Assigning Viet Nam Investment and Development Bank a job of taking part in restructuring NamDo Joint-Stock Commercial Bank and preparing documents to withdraw business license of NamDo Bank.
- Assigning Viet Nam Foreign Trade Bank a job of taking part in restructuring VungTau Joint-Stock Commercial Bank and completing necessary documents to withdraw business license and implement liquidation of NamDo Bank.
- Allowing Tay Do Joint-Stock Commercial Bank to transform to TayDo Rural Joint-Stock Commercial Bank.
- Placing joint-stock commercial banks of Viet Hoa, Vung Tau, Me kong, Nam Do, Mai Phuong, Quang Ninh into a special control and joint-stock commercial banks of Que Do, De Nhat, VP, Gia Dinh export-import, Tu giac Long Xuyen under supervision of The State Bank.
- Submitting to Prime Minister a project of special control and restructuring plan for some other banks.

3. Conclusion

Strengthening, consolidating and rearranging joint stock commercial banks is a very important condition to strengthen Viet Nam banking system and be prepared to integrate into regional financial market in forth-coming time. In order to push up the progress of restructuring SOCBs, the following tasks should be done as soon as possible:

Firstly, to make joint stock commercial banks clean through rescheduling overdue debts in banks and supervising strictly banks with seriously bad debts.

Secondly, to inject capital into joint stock commercial banks and restructure ownership of those banks.

Thirdly, to strengthen risk management in banking business of SOCBs through reorganizing and training staff.

Fourthly, to dissolve or merge too weak joint stock commercial banks who are facing high bad debts and low credit quality.

Fifthly, to create favorable conditions for joint-stock commercial banks to modernize their banking technology, train their staff.

Sixthly, to consolidate internal inspection in SOCBs as well as inspection of the State Bank of Viet Nam to help SOCBs find and cope with problems.

A－6－1

Reforms of State-Owned Commercial Banks

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1. Review on operations and necessity to consolidate and restructure state-owned commercial banks in Viet Nam

(1) Up to now, Viet Nam has 4 state-owned commercial banks (SOCBs) including Viet Nam Foreign Trade Bank, Viet Nam Industrial and Commercial Bank, Viet Nam Bank for Agriculture and Rural Development, Viet Nam Bank for Investment and Development.

Their operation scopes are quite large with a wide range of branches located throughout the country. Currently, these 4 banks have about 230 branches and a range of more than 1,000 affiliated sub-branches covering all provinces and cities. The number of employees who work in SOCBs is nearly 40,000 including 36% graduates and post-graduates, 43% trained at high schools and 21% untrained.

While playing a leading role in Viet Nam credit institution system, during the past 15 years of renovation, SOCBs have really made an indispensable contribution to the broad-based, high economic growths and stable development.

Currently, the state-owned commercial bank sector is still playing an important part in credit and monetary markets in the country.

By the end of December 1999, the total credit outstanding of SOCBs accounted for 73% of that to the economy. The total amount of mobilized funds of SOCBs reached 75% over the total of all credit institutions in Viet Nam. This showed their good capability of mobilizing funds.

(2) Over the past years, the banking industry has made a positive contribution to the successful accomplishments of our "Doi moi" course and of which the important role of SOCBs could not be neglected. The performance of the banking sector in carrying out and supervising monetary policies and promoting banking credit operations help spure economic growths and socio-economic development.

Economic growth rate, inflation rate in the period 1995-1999

	1995	1996	1997	1998	1999
Growth rate (%)	9.5	9.3	8.2	5.8	4.8
Inflation rate (%)	12.7	4.5	3.6	9.2	0.1

Despite SOCBs' efforts in obtaining some important achievements along with the whole banking sector, there still have been many problems and shortcomings in their organizations and operations. They are now facing many challenges arising from their operational environments. Follows are main remarkable weaknesses of SOCBs:

- Low credit quality
- High overdue loans and insolvent loans
- Violations of banking principles and regulations

(3) The urgent tasks in coming years is to consolidate and restructure SOCBs in the direction of promoting their good sthengs, overcoming their weaknesses and conforming with the 2 banking laws (The Law on the State Bank and the Law on Credit Institutions issued in October 1998). This task also aims at clearly separating market operations and policy ones, improving banking technology and financial heath in order to meet practical requirements and create new instruments and mechanisms supporting credit and currency markets.

Along with restructuring systematically and comprehensively banking system, the above task also aims at getting the following goals:

- To develop the SOCB system and enable it to take the key role in banking industry as well as to ensure its effectiveness and safe operations.
- To consider SOCB consolidation as a strategic job of the banking sector in order to push up capital mobilizations and investments for the industrialization and modernization of the country.
- To improve the prestige and competitiveness of SOCBs in domestic and international markets and facilitate Viet Nam's international economic integration.

(4) SOCBs' mobilizing and lending performance

1) Fund mobilization

By the end of December 1999, SOCB's total amount of mobilized fund represented 80% of that of the whole banking system. It was about VND 106.5 billion, of which 82% was mobilized (VND 87.3 billion) and 18% was borrowed from other credit institutions.

The above structure of that fund clearly reflected the SOCBs' scale and capability in mobilizing fund. This is a very important source for industrialization and modernization.

However, this amount can not meet the increasing capital demand for economic development in Viet Nam financial markets. Moreover, a major part of this is short-term fund (over 80% is under 12 months). This makes SOCBs difficult in providing medium and long-term loans for businesses.

Regarding mobilized fund (deposits, savings, time-certificates, bonds) in 1995-1999 period, we can realize that the notable success of these banks was the high growth rates of mobilized fund. The follows show the annual averaged rates of mobilized fund:

- Viet Nam Bank for Agriculture and Rural Development 22%
- Viet Nam Bank for Foreign Commerce 23%
- The Viet Nam Bank for Investment and Development 54%
- The Viet Nam Bank for Industry and Commerce 18%

This was the major fund source of SOCBs. By the end of December 1999, the ratio of mobilized fund over the total amount of fund as follows:

- BARD 78%
- VCB 86%
- VIDB 80%
- VICB 82%

The equity includes statutory capital, bank's retaining, profits and reserves. By the end of December 1999, the ratio of SOBCs' equity over the total assets as follows:

- BARD 8%
- VCB 5%
- VIDB 5%
- VICB 4.4%

According to experiences of many banks in the world, the reasonable ratio of equity over the total assets of bank must reach 8% or more. This ratio of SOCBs is far lower compared with the internationally accepted standard. Therefore, in the beginning of 1999, the State Bank capitalized SOCBs to help add registered capital of theirs and nearly reach the appropriate ratio.

2) *Use of funds*

At the end of 1999, the SOCBs' credit outstanding was about VND 70,000 billions, increased by 12% over the same period last year. The reason of this lower growth rate (compared with some previous years) was the slow economic growths in the period of 1997-1999 and SOCBs were paying more attention to improving credit quality.

However, over long period of time (many years) the average growth rate of SOCBs' credit outstanding was as high as follows:

(1995-1999 period)

- BARD 23%/year
- VCB 7%/ year
- VIDB 33%/year
- VICB 24%/year

The structure of credit has changed in the positive direction since medium and long-term credit has risen rapidly. Its proportion was up by 40%.

The ratio of credit for SOEs over the total lending was 53%. This ratio was higher than that for non-state enterprises because their actual financial situations didn't meet requirements to apply for loans from banks. Meanwhile, the borrowing procedure was simplified for SOEs.

SOCB's total lending for credit institutions also rapidly soared in 1995-1999 period. This could mean that SOCBs had had difficulties in providing direct loans to custormers, especially loans in foreign currency. This was partly due to banks' lending mechanisms. The other reason was the limited absorption of businesses in using loans, especially loans in foreign currency with highly- risky exchange rate.

The ratio of overdue debts and non-performing loans accounted for 15% of the total credit outstanding. However, after addressing SOCB's debt problems by State Bank (debt restructuring) (Decision 445 of the State Bank's Governor issued 5th November 1998), the nominal overdue debts of SOCBs accounted for 6% by the end of 1999. The overdue debts arising from new loans were curbed but overdue debts arising from old credit still need to be addressed.

3) *Business results*

Pre-tax profits of the 4 banks reached VND 907 billion on 1996, in 1997-526 billion, in 1998-556 billion, in 1999-650 billion (accounted for 60% of total profits of credit institutions as a whole).

If bad debts were not included in total costs of SOCBs, all SOCBs would work at profit and make big contribution to state budget. However, if bad debts were included in total costs, all SOCBs would work at loss.

4) *Other problems*

- The high ratio of unrecoverable loans over the overdue loans

  As above-stated, by the end of 1999, the ratio of overdue debts and non-performing debts of SOCBs accounted for 15% over the total credit outstanding. Especially, the ratio of non-performing debts in the 4 banks represented 35% of total overdue debts. This proves the low credit quality and high credit risks in SOCBs.

- Frozen debts

  By the end of December 1999, the Government has permitted SOCBs to cycle debts for some customers with a sum of VND 4.9 billion. Those are non-refundable debts caused by force majeure causes.

(5) Solutions to strengthen SOCB's financial positions

1) *The main causes leading to existing weaknesses of SOCBs*

(a) Regarding to SOCBs side

- All 4 SOCBs have had lack of a long-term business plans. Therefore, many business decisions were made only on the basis of short-term interests. And, when business environment changed (for examples, the changes in prices of real estate, cement, steel...) such a big bad debts would occur in

SOCBs.

- Professional and administrative staff's skills didn't met the requirements to ensure safe and efficient operations in such a highly risky and fast developing market as in Viet Nam.
- The decentralization of credit procedure has been a reasonable solution but unable to be implemented if requirements of centralized supervisions on the basis of an update and transparent financial information system were not satisfied.
- Some solutions such as encouragement of outstanding, separation of interest collection from principal one, heavy dependence on some security, guarantee and administrative regulations... were big obstacles for credit risks management—the most important function of SOCBs.
- Severe competition among bank branches in a specific small area caused by opening too many branches led to an unsafe customer policy, higher costs for employees in almost SOCBs.
- Moral hazards resulting form heavy dependence on state subsidy (banking service has been considered as a public service) were also a regular risks in Viet Nam banks in general and in SOCBs in particular. The lack of legal transparency, the confusion between business functions and policy-served functions drove banks into a passive situation. Especially, some administrative clerks have intensively violated regulations on credit mechanism for corruption causing tremendous losses to SOCBs.
- Bad internal inspection, lack of autonomy, backward information and accounting system were also big obstacles in the way of improving administrative quality and applying modern technology.

(b) Regarding the State Bank of Viet Nam

- In some cases, the State bank's legal documents interfered too deeply in SOCBs' activities including credit, guarantee, custody, accountancy, using of reserve funds... This lessened their autonomy, self-responsibility and created dependence of SOCBs. The legal framework to ensure safety for SOCBs was inadequate and inconsistent.
- The State Bank's inspection activities were still overlapped, in lack of independence, violations of banking regulations... could not timely be detected and treated. Especially, regular inspections by the State Bank at SOCBs branches instead of inspections at SOCBs' central headquarters has weakened the responsibility and power of their internal supervision and auditing sessions such as board of management, board of director... in SOCBs.
- Lack of institutions specialized in analyzing, appraising SOCBs' financial heaths and forecasting their development trends made it impossible to timely correct supervising regulations and methods. Especially, it hasn't paid enough attention to work out development strategies for the whole banking industry in the context of international competition and integration.
- Monetary instruments were backward, heavily administrative and unexpected changeable. After 10 years of "Doi moi", the establishments of secondary financial market as well as monetary markets

haven't been done. This created negative impacts over SOCBs on building a sustainable and firm business strategy.

- The systems of statistics, accounting, auditing and financial information were in bad conditions and not in line with international standards. These were important instruments for the State Bank to supervise the whole banking system, but they didn't function well.

(c) Regarding clients of banks

- Most of SOCBs' clients have been SOEs with quite low business efficiency. And the number of customers who was the private sector was increasing but some of them were badly aware of law, in lack management skills and had business moral hazards. The phenomena of subsidy, speculation, fraud in credit relations as well as in trade performance were still popular.
- SOEs and SOCBs are all under the ownership of the State and their operations still reflected the greate subsidy.
- Some SOEs operating in the field of import-substitutes such as cement, sugarcane, fertilizer, steel... may work at profit at present because of trade protection. However, in the long run, they would be easily vulnerable due to cut-down of tarriffs barriers and increase in non-tarriffs measures. Therefore, it was possible that the long-term lending and guarantees for such SOEs were very risky and would cost SOCBs in the near future
- Business and investment environment in Viet Nam have been unstable and risky.
- Tradable collateral assets have been small that caused difficulty for SOCBs in recovering debts.

(d) Regarding state policies and mechanisms

- The policies on compensation for policy-based interest rates, cycled debts and write-off were unreasonable causing losses to the bank's capital and lessening SOCBs' efficiency.
- For bank's operation, subsidy mechanism have still existed (especially in rural credit policy, credit for SOEs and State budget). There was no clear separation between commercial lending and policy-based lending in both practices and model.
- In many cases, changes in macro-economic policies directly caused bad debts for SOCBs but the compensation by budget hasn't been timely and fully made.
- The model of organization and management of SOEs in general and SOCBs in particular have not been clearly specified and defined including actual rights and responsibilities of the Board of management and the Board of Executive, the issues on personnel, finance, investment, penalty... These were main reasons weakening the engine of growth of SOCBs.
- Too many agencies involving in banking inspections and supervisions helped loose people's confidence in banking system creating difficulties in business operations of SOCBs.

2) *Measures copping with overdue debts in SOCBs*

- Up to now, besides case solutions for debt treatment of the Government, The Government issued 2 main legal documents consisting of Decision 95/QD-TTg of PM issued on 18th May 1998 on second-stage debt solutions and Circular 03/1997TTLT/NHNN-BTC of Ministry of Finance and the State Bank of Viet Nam issued on 22nd November 1997 on guidance of solutions on overdue debts in SOCBs after banking inspection mission completed. The appropriate measures would be applied for each kind of bad debts on the basis of each specific circumstance:

(a) Overdue debts caused by the violations of credit mechanisms.

Whether the violations made by banks or by clients and the debtors were defined, the following solution should be applied:

- Using all means to recover as much as possible including enforcement, duty assignment or introduction of instance if necessary....
- Remaining overdue debts were classified by causes and submitted to the State Bank of Viet Nam and Ministry of Finance for doing examination and finding solutions.

(b) Overdue debts caused by uncontrolled risks.

- Overdue debts caused by objective reasons could be divided into three main categories:

a) Force majeure causes

These causes included act of god, debtor's bankruptcy or insolvency or missing or death... In these cases, after the Central Mission for debt solutions and concerned bodies did their best to recover debts, the remaining debts would be compensated from 2 main sources: state budget and fund for risks of the bank.

b) The objective causes (besides force-majeure causes)

- Overdue debts were considered to be frozen for 3-5 years.

The debtors were SOEs who were not capable of repaying debts to banks because of direct effects caused by the changes of mechanisms, policies, business environments (closed businesses, food security, market losing...) ; rearrangements of businesses, policy - lending....

In principles, fund sources for compensation for these kinds of debts would be taken from banks for themselves. In foreseeing, banks had to bear annual non-refunded interests over those debts. The Government would issue a mechanism on buying and selling debts in banks and those cycled debts would be taken out of total overdue debts of banks.

- The overdue debts would be considered to be rescheduled for 3-5 years.

The debtors were SOEs who worked at loss or were in the progress of making profits or needed for future development .... Those debts were rescheduled from short-term to long-term loans, from overdue debts to normal ones and in those cases, debtors had to pay interests during valid agreement time.

2. Restructuring of SOCBs

Principles for restructuring SOCBs

- To strengthen SOCBs in the direction of sufficiently big scales, safe operations, high competitiveness satisfying the requirements of industrialization and modernization.
- To separate the functions of doing market banking business and policy-based credit activities.
- To improve SOCBs' management skills and financial facility.
- To restructure SOCBs with ensuring not to constraint businesses of banks.
- To reform SOCBs in parallel with to rearrange and enhance efficiency of enterprises in the economy.
- To speed up SOCBs' integration into international financial markets.
- To take appropriate steps for each plan.

The solutions for restructuring SOCBs:

(1) Establishing the Bank for the poor

1) *The aims of establishing the Bank for the poor*

Separating policy-based credit activities from the functions of SOCBs aims to better implement State and Party's social-economic policies, especially policies on hunger eradication and poverty reduction. On the other hand, it helps SOCBs really operate towards markets. It's also easier for the State Bank to inspect and supervise commercial banks and helps SOCBs strengthen management capacity, especially risk management.

2) *The main functions and tasks of the Bank for the poor*

(a) The key long-term tasks

- Providing preferential loans to policy people who need funds to do business and production to overcome difficulties and integrate into social community.
- The Government in each period of time must specifically target (the beneficiary).
- Providing loans to right people, collecting principal and interests in line with state regulations.

(b) Foreseeing tasks

- Taking over the Bank for the poor currently belonging to the Bank for Agriculture and Rural Development in order to establish an independent bank with a head quarter located in Hanoi and 20-25 branches (under 7 areas and the remaining branches should be opened in areas with highest poverty rates).
- The first customers to be served are poor households, especially in rural areas and poor students who can not afford for their study at university.

3) *Organizational apparatus and operating mechanism*

(a) Apparatus

In the short-term, a policy bank will be established on the basis of the current Bank for the poor and other proposed sources. A specific plan for this bank's organization will be worked out and submitted to Government and State Bank for consideration.

The main contents of organizational plan include:

- Board of Management: including 5-7 competent and prestigious people who can work independently within the legal framework.
- Board of Directors: in the long-term, the Board of management will appoint them.
- Board of Supervision: an affiliated part of Board of management but independently in term of professional responsibility from the Board of director.
- System of departments in headquarters and branches (specific plans)

(b) Capital sources

- Equity: being once granted by the State and annually supplemented according to specific development plans.
- Mobilized capital:
  + Issuing 1-year, 2-year, 3-year deposit certificates.
  + Issuing medium and long-term debt instruments.

  The Government will guarantee (the two above forms)
  + Aid provided by domestic and foreign donors such as Government organizations, non-government organizations, and benefactors.
  + Re-lending funds from other commercial banks in respect of negotiations receiving time deposits form other banks.
  + Time deposits and deposits for payment from population and organizations.

(c) Head quarter and working means.

Head quarter: in short time, leasing is still used for headquarter and branches as approved plan.

Working means: in short-term, the policy bank will use working means of BARD.

(d) Operating mechanisms

- Because it is a policy bank, its operating mechanisms will base on administrative decisions.
- Wages and basic income mechanism bases on this for the State Bank. Budget-based income is earned through various channels: compensation for interest rate differences, capital tax exemption, other non-commercial supports.
- The local authority's decisions and the bank's evaluation set the concrete list of people who enjoy preferential loans. The bank will decide ceilings and terns for lending.
- Paying commission to agent banks for disbursements and debt collections.

- The bank is under the ownership of the Government. It has legal entity and under the State Bank's direct inspection and supervision.

4) Establishing an independent policy bank.

After 3-4 year's operation, when the Bank for the poor has obtained the entrusted targets of efficient and stable performance, a National Policy Bank will be officially established on the foundation of the Bank for the poor.

(a) The main functions of the national policy bank

- To provide preferential loans to the poor,
- To provide preferential loans to housing programs in Cuulong delta.
- To provide preferential loans to poor students
- To provide preferential loans to other policy-based finance programs of the Government such as lending programs for people in mountainous areas, islands, Kho-me minority areas, calamity areas and for activities of culture, arts, social studies....
- To provide some banking services and financial facilities.

(b) Capital sources and operating mechanisms

Capital sources:

- Granting initial budget capital and annually supplementing.
- Mobilizing from issuing bonds guaranteed by the Government.
- Aid from domestic and foreign financial institutions, non-finance institutions.

Operating mechanism:

- The bank is not allowed to mobilize savings from population in order to ensure the transparency of the policies and the equality, safety and efficiency of the whole banking system.
- The bank is under the State Bank's supervision and inspection as a commercial bank.
- The bank can entrust commercial banks to disburse, collect debts, basic accounting... for it.
- The preferential lending activities will gradually shrink in line with economic growth and development and substantial progress of hunger eradication and poverty reduction program. (until the GDP growth rate should reach the level of over 1,000 USD per head).
- After finishing the historical role as a preferential policy bank, this bank will be planned to convert to a commercial bank or a national strategic policy bank (no loans with preferential interest rates).

(2) Restructuring and consolidating SOCBs.

1) The bank for housing and infrastructure development in Cuu Long delta

- This bank has the amount of statutory capital about VND 600 billion funded by the State. It has operated accordingly to the Decision 769/QD-TTg of Prime Minister issued on 18th September

1997 and the Decision 1121 of Prime Minister issued on 14th December 1998. Under these 2 decisions, the bank works as a SOCB with the 2 main functions:

+ Operating as a commercial bank following market principles.
+ Operating as a policy bank with the targets of developing accommodation and infrastructure in Mekong delta.

- The bank is permitted to retain capital tax, mobilize saving deposits and provide preferential loans.
- However, in order to reach the main goals, the bank's capital management skills and operating mechanism need to be strengthened. Therefore, it's necessary for the bank to convert from a policy bank to a commercial bank specialized in developing house and infrastructure in the area. The State bank is now instructing and advising the Bank to work out a plan for converting to an SOCB and at the same time implementing a research for equitization of the bank. The equitisation of the bank needs a specified plan. In principles, the following requirements must be followed:

+ To increase capital and expand business scope.
+ To improve management and supervision skills.
+ To mobilize more funds in form of shares and stocks from many different partners such as state-owned banks, joint- stock banks, finance institutions, businesses, banking clerks and citizens in the same area.
+ Only 30-40% of total share value is owned by the State.

2) *The leading state-owned commercial banks:*

After transferring the function of policies financing to the policy bank and development assistance fund, SOCBs who will do business under market principles are:

+ Viet Nam Bank for Industry and Commerce
+ Viet Nam Foreign Commerce Bank
+ Viet Nam Bank for Investment and Development
+ Viet Nam Bank for Agriculture and Rural Development

- Based on the approved development strategy, SOCBs will continue implementing fixed development plans and programs to restructure, reorganize and rearrange management apparatus as well as the system of affiliated branches.
- Proposing the Government to make plans of raising registered capital of 3 SOCBs including Viet Nam Bank for Industry and Commerce, Viet Nam Foreign Commerce Bank and Viet Nam Bank for Investment and Development up to the registered capital of Viet Nam Bank for Agriculture and Rural Development

3. Some strategic tasks aiming to basically renew management mechanisms over SOCBs

After the Government approves the master plan of reforming SOCBs, the State Bank will hurriedly instruct SOCBs to work out and implement given restructuring plans in conformity to actual situations of specific bank. Basically, the concrete plans will focus on:

(1) To further clearly specify the functions, rights and responsibilities of the Board of Management and Board of Executive to the SOCB's operations. To build and renew the operational regulations of SOCBs and submit to the State Bank Governor for approval.

(2) To improve SOCBs' operational and organizational model In short-term, some operational procedures of each bank will be renewed on the basis of international experiences in regulating modern commercial banks and actual conditions of Viet Nam, especially, regulations on risk management, internal supervision and audit, credits.... In principles, the reorganization has to ensure decentralized administration on the professional basis stead of the current administrations on the geographic basis.

(3) To increase SOCBs' autonomy in finance.

Expanding the SOCBs' autonomy in finance will create an engine of growth as well as increase the productivity and management efficiency. The Decree 16/ND-CP of the Government issued on 19th November 1999 on financial mechanism for Credit institutions still hasn't had a guiding document. According to the decree, the SOCBs' autonomy in finance is limited in formulating and using reserve funds for risks, using revenue on state capital, ... This problems should be considered for amendment in order to support SOCBs' restructuring process.

(4) To expand SOCBs' autonomy in human resource management.

Because SOCBs' branches are located in provinces (they are considered as a bank of each area), local authorities always interfere in their decision making in arrangements of staff. The situation is the same in central level. This creates negative impacts on SOCBs' plans and business results.

Therefore, consolidating SOCBs should be implemented in parallel with rearranging the network of branches, unifying power in workforce management, and specifying responsibilities of bank and employees. This is a prerequisite condition to improve management skills, strengthen competitiveness and increase productivity of SOCBs.

(5) To have a reasonable investment strategy for technology development.

Technology has increasing decisive meaning for bank strengths but it is the weakest point of SOCBs in Viet Nam. It is necessary for the State Bank to hurriedly build a general strategy for modernizing technology in this sector. The foreseeing task is to concentrate in improving current service quality, creating conditions for opening new services.

On the other hand, the State Bank and relevant bodies should remove some policies hampering technology modernization process such as policies on accounting, statistics, and documents management....

(6) To eliminate and reduce overlapped legal documents to facilitate SOCBs' autonomy.

Almost all SOCBs' activities (credit, guarantee, payment, accounting...) are regulated and instructed by too many overlapped and too specific regulations of the Government and the State Bank. The State Bank and relevant bodies should check and replace them by macro-level instruments and reasonable legal framework to improve SOCBs' self-responsibilities. The roles and legal responsibilities of financial auditing should be emphasized as well as financial auditing activities should be strengthened to help SOCBs to easily supervise their operations.

(7) Human resource training.

At present, over 60% of SOCBs' staff have not graduated. A big part of senior managers in SOCBs haven't had access to modern banking management knowledge. This is an obstacle for restructuring and modernizing banking system.

Therefore, the State Bank and SOCBs should give priority to more invest in training workforce, modernizing technology and refreshing talents in order to save time and training costs.

4. Establishing asset management company (AMC)

(1) The necessity of establishing AMC

1) Non-performing assets is an obstacle for the development of credit institutions and the economy

In the context of undeveloped financial markets, credit institutions, especially commercial banks, are major suppliers of funds for the economy. Recent high economic growth rates have been importantly contributed by credit institutions with annual average credit growth rate of 20%.

However, the high ratio of overdue debts shows the considerable quantity of unperformed assets due to many deferent causes. By the end of 1998, the total overdue debts reached about 15% of total credit outstanding, of which a large amount is bad debts (unrecoverable). Of unrecoverable amount, asset value kept by legal bodies for waiting for solutions is quite big and 99% of that owned by SOCBs.

- If non-performing assets are not solved properly, they will exert negative impact on Viet Nam banking system and economic development, because:

+ Banks can not collect enough funds to lend businesses. On the other hand, banks are possible to increase costs, decrease profits, lessen prestige and even take risks of bankruptcy.
+ The economy has a large amount of stagnant assets, which are not deployed and used actively for economic activities.

The situation will be more serious if effects of recent financial crisis do not stop.

2) *International lessons and the solution for banking non-performing loans in the meltdown period*

Many financial and economic crisis has taken place in the world. Many countries had to establish special institutions to settle non-performing loans in banks after the financial turmoil. These institutions had different names and scales in different countries but the same targets of supporting banks in solving non-performing assets, pumping capital to recover and develop the economy through the banking system.

Viet Nam banking system has small scale compared to that of international community but if it is the major lenders in the economy. Therefore, a Government's special organization should be established to help banking system escape from this pressing situation.

According to international experience, if attention is timely paid to solve problems, the financial burden on the economy will considerably lighten.

(2) Characteristics, functions of AMC

1) *Name: Assets management company*
2) *Characteristics*

- AMC is a special state-owned enterprise established by the Prime Minister and its operation is under the SOE Law.
- AMC is a non-profit organization, but it has to do business at market prices in order to minimize losses and rapidly recover capital for credit institutions.
- AMC will stop operating after basically resolving non-performing assets of credit institutions.

(3) Source of fund

Operating capital is estimated about from VND 4,000 to 5,000 billion, and formed from the following sources:

1) *Statutory capital: about VND 1,000 billion financed by state budget.*
2) *Borrowings from credit institutions.*
3) *Aggregated capital.*

There are 4 solutions for fund of AMC

<u>The first solution:</u>

The Government uses budget and borrowings from Government and international institutions to grant statutory capital for the company (about VND 1,000 billion). The company will use this fund to plough back and gradually recover fund for credit institutions.

+ Advantages: the State can timely meet the need for fund of the company.
+ Disadvantages: because of quite small amount of capital, it is impossible for accompany to make the rapid capital recovery. Moreover, long time operations of the company will cost more to the State.

The second solution:

The Government issues bonds in domestic and international markets to form the company's statutory capital (about VND 4,000-5,000 billion).

+ Advantages: the capital recovery for credit institutions can be done rapidly.
+ Disadvantages: It is difficult for the Government to mobilize such a large amount of capital at the same time.

The third solution:

The Government issue bonds to directly grant the company. When buying non-performing assets from credit institutions, the company pays by bonds and credit institutions can use bonds to borrow form the State Bank.

+ Advantages: The Government can actively finance the company and doesn't use state budget.
+ Disadvantages: When credit institutions borrow capital from the State Bank, inflation can occur.

The fourth solution:

The Government can use many sources to grant the company immediately (about VND 2,000-3,000 billion) including:

+ State budget
+ Issuing government bonds to mobilized domestic capital
+ Using other government and institution's sources.

Advantages:

+ It makes less pressure on state budget.
+ The company can help credit institutions recover debts rapidly
+ It's more feasible than other solutions

Disadvantages: It is difficult for the Government to mobilize such a large amount of VND 2,000-3,000 billion in 2000.

(4) Operational organization

The AMC organization is formed as an SOE, including:

- Board of Management: including a president appointed by the Government and 6 members appointed by the President and approved by the Government. They are representatives of Ministry of Finance, State Bank of Viet Nam, Central committee for enterprise reforms, Justice Ministry and Central Committee for pricing. The term is 5 years. Qualifications of the members have to meet SOE law.

- Board of Executive: including a General director, 2 deputy directors and other members. The General director is appointed by the Prime Minister and is a member of Board of Management. The term is 3 years.
- The structure of organization:

A headquarter is located in Hanoi. It has necessary departments and sessions such as asset evaluation department, market research department...

- The company is permitted to establish afflicted company or open branches, representative offices in central provinces and cities. In the short-term, a breach is HCM City will be established with a director and 2 deputy directors.

(5) Company's operations.

1) *The operational principles*

The main function of this company is to buy and sell non-performing loans of credit institutions at market prices. The main principles for its operations as follows:

- Targeted non-performing loans are assets with and without collaterall.
- The value of traded assets is determined at market prices at trading time.
- AMC enjoys tax exemption when trading and processing the traded assets.
- NPL trading activities will be expanded to joint-stock commercial banks after given period of time of AMC's operation.

2) *Asset purchasing.*

- In the first stage, the transactions are made between the company and commercial banks.
- The principles of asset purchase:
  + Purchased assets are collateral for bank loans. Those loans are classified as non-performing loans.
  + The company has the right to buy frozen assets at market prices.
  + For assets with zero-value, the company is allowed to buy those assets at prices equal to value recorded by banks.
  + The company doesn't need to report to debtors when purchasing non-performing assets.

3) *Asset classification.*

- Right after receiving assets, the company conducts classification of assets with different categories convenient for solutions.

- The company needs to supplement and complete the legal file of the purchased assets for solutions because most of collateral is real estates.

4) *Asset processing*
   - The company has the right to conduct production reorganization, construction, repair of assets in order to make them tradable. For the real estates, the company will have the right to own and use assets while the assets are not traded.
   - The company can have other companies do processing assets.

5) *Asset selling*
   - The company is allowed to sell directly, do auctions, entrust and sell through agents, transfer purchased debts and assets at market prices.
   - The company can sell assets through auction centers.

4. Estimation of the SOCBs' whole restructuring costs

Costs of reform of SOCBs cover 3 main components:

- Costs for establishment of a policy bank
- Costs for restructuring 4 SOCBs
- Costs for establishment of AMC

(1) Estimation of costs for establishment of a national policy bank

An independent policy bank should be established on the basis of the bank for the poor. Currently, all operational expenditure including building rent, wage payment, office instrument and vehicle expenses,... of the bank for the poor have been covered by the Bank for agriculture and rural development.

Now we assume that a nation-wide policy bank will be established. It means that the bank will have branches in all 61 provinces and cities and about 500 sub-branches in districts. A number of employees totally will be estimated about 10.000. We also have to build offices including a headquarter, 61 provincial branches and about 500 sub-branches.

In that case, costs will be estimated as follows:

- Costs for wages of employees: 10 million VND/head/year * 10,000 persons = 100 billion VND/ year.
- Costs for capital construction: 600 billion VND
  + A headquarter in Hanoi: about 10 billion VND
  + Provincial branches: 1.5 billion VND/branch * 61 branches = 91 billion VND
  + District sub-branches: 1 billion VND/sub-branch * 500 = 500 billion VND
- Other expenses (including costs for fixed asset depreciation, inspection, training, meeting....):

estimated 200 billion VND. (equal to half of wage payment).

- Interest subsidy: about 500 billion VND/year.
- Working capital from State Budget (supplement): 400 billion VND

Total estimated cost for establishment of a policy bank will be 1,800 billion VND.

(2) Estimation of costs for restructuring 4 SOCBs

Costs for restructuring 4 SOCBs should be cover all subsidies of the State to SOCBs including registered capital supplementation and compenstion for addressing debt problems. But,

- Further capital injection to 3 SOCBs (including VCB, VIDB, VICB): about 3,300 billion VND (1,100 billion VND for each).
- Compensation for addressing debt problems:

Estimated total SOCBs' debts the State should write off:

Total outstanding * overdue debt rate * non-recoverable debt rate =

= 70,000 billion VND * 0.14 * 0.3 = 3,430 billion VND

(Non-recoverable debts include debts made by bankrupt enterprises, debts arised from force-majeure causes and changes in state's policies).

Total estimated costs for restructuring 4 SOCBs will be about 7,700 billion VND.

(3) Estimation of costs for establishment of AMC

- According to the above project of establishment of AMC, 5,000 billion VND needs to be granted inform of registered capital to AMC.

=> Estimated SOCBs' whole restructuring costs:

= 1,800 + 7,700 + 5,000

= 14,500 billion VND.

Ad-hoc Measures Taken by the Government and State Bank of Viet Nam to Reduce Financial Difficulties to State-Owned Enterprises

Positive and Negative Effects of the Measures on Financial Situations of State-Owned Enterprises

Tran Van Son
Ministry of Planning and Investment

Overview

- It is obvious that Viet Nam has achieved a very important economic progress in the process of economic reforms for past 10 years with high growth rates, one-number inflation, stable society and politics, improved living standard, employment and legal framework. The national economy has basically got out of crises and step by step developed to a market-oriented one. Along with developments of various economic sectors, the state enterprises have also had great changes in both sides, quality and quantity, substantially contributing to the progress of the reforms.
- Two basic economic institutional sectors in Vietnamese economy are state business sector and financial sector that have been under reforms. Recently, one of the focused jobs to construct and develop the economy was to strengthen and rearrange state-owned enterprise, make policy reforms and enhance efficiency of state-owned enterprise. SOEs reforms are implemented with prudential policies and plans. However, in parallel with comprehensive and long-term policies, ad-hoc measures have been taken to deal with foreseeing problems of SOEs. For the sensitive economic sectors like SOEs and financial sector, ad-hoc measures are also aimed to support and supplement to medium and long-term policies. But, in general, if policy-makers focus too much on short-term measures and policies on one hand they can not completely solve problems of the sectors and on the other hand consequences in long-term will be unpredictable. With the view, the paper focuses on ad-hoc measures that has been taken by the Government and the State Bank of Viet Nam form 1996 up to now to reduce financial troubles of SOEs and analyzes positive and negative effects on financial situations of SOEs.

Financial situations of state-owned enterprises

- According to Instruction 20/1998/CT-TTg dated April 21, 1998 of the Prime Minister on assignments to ministries, industries and provinces of completing the projects on SOEs rearrangements and Instruction

868/198/CT-BTC dated March 26, 1998 of Ministry of Finance on supplying guidance to local finance authorities to implement the Instruction of the Prime Minister, as for June 31, 1998, there were 51/60 Capital management departments completed SOEs classifications and business assessments. Therefore, the figures of financial situations of SOEs in this paper were covered from reports of 51 Capital management departments. For the 1999 data, it aggregated from reports of Ministry of Finance and Central Committee of enterprise reforms. Thus, difference among some indexes and figures may be unavoidable.

Since 1996, the year of approval of economic renovation including SOE reforms, the Government has taken many measures such as SOE rearrangements, establishments of state-owned big businesses in very important economic fields, SOE ownership transfers, and bankruptcy.... As a result, thousands of billion VND has come to businesses' investments. SOEs have gained some important achievements, but faced difficulties such as labors, finance, management, and technology....

Financial situations of SOEs are showed in details below:

SOEs' capital

According to reports of the Ministry of finance, as for 31/6/1999, basic figures of funds of SOEs as following:

	31/6/1998	31/6/1999
Number of SOEs :	5,980 SOEs	5,280 SOEs
Total budget capital:	102,930 bi. dong	106,900 bi. dong
Average capital per one SOE	17.2 bi. dong	18.4bi. dong
SOE classification by total capital:		
+ Less than 1 bi. dong :	8% of SOEs	14.0% of SOEs
+ Less than 5 bi. dong :	72% of SOEs	65.5% of SOEs
+ More than 10 bi. dong :	20% of SOEs	20.9% of SOEs

The number of SOEs with capital of less than 5 billion. Dong (equal to 370,000 USD) occupied a large proportion. It means that the sizes of SOEs were very small.

- Generally, SOEs are now facing shortage of capital. As estimation of different sources, there are about 60% numbers of SOEs suffering shortage of initial capital, which are regulated in Decree 50/ CP of the Government. Only 50% of working capital were used for business and the remains were in forms of assets, lost materials, low quality materials, bad debts, uncompensated loss.... It is more serious that due to lack of capital SOEs are unable to invest in new technology, new machines that will result in low competitiveness of products.
- In the process of reform implementation, big SOEs were given priority to go ahead. There were 250 corporations throughout the country in 1991. In the reform periods from 1992, they have been reorganized. At present, there are 17 corporations "91" and 76 corporations "92". The number of

members of corporations is 1,392. In comparison with whole SOE sector, corporations account for 24% on number and 66% on capital and 55% on labor. For corporations "91" alone, there are 559 member enterprises with independent accountings, making up 9% of number of SOEs, 56% of operating capital and 35% of labors.

- Although state corporations are given favored conditions and treatments the financial situations are not much improved. In 1998, average budget capitals of corporations "91" is 3,661 billion. Dong (equal to 260 mi. USD). Of 17 corporations "91" there are 14 corporations (82%) with budget capital of less than average level, of which 6 corporations (35%) have budget capital of less than 1,000 bi. Dong for each. That means there are only 3 state corporations having considerably big budget capital.
- For corporations "90", capital situations are worse. More than 20% number of corporations has budget capital of less than 100 bi. Dong for each, of which 13 corporations have budget capital of less than 40 bi. Dong for each.
- If based on budget capital in SOEs it can be said that almost SOEs have rather small sizes. Average budget capital in SOEs is a little bit more 18 bi. Dong. The number of SOEs with budget capital of less than 5 bi. Dong represents more than 65% while SOEs with budget capital of more than 10 billion. Dong accounts for only 20%. Moreover, there are still a large number of SOEs with various industries, areas.

The growth rates of SOEs

	1996	1997	1998
Economic growth rates	9.34	8.1	5.8
SOE growth rates	11.28	9.67	5.48
GDP of SOEs on GDP of the economy		40.5%	40%

Before 1997, the growth rates of SOEs were higher than that of the economy. Three were some changes in the growth trends between SOEs and the economy in 1998 up to now in the context of slow-down economic growth (5.8% in 1998, 5% in 1999...). The growth rates of SOE sector trend to go down compared to the growth rates of the economy.

Business outcomes and contributions to budget of SOEs in 1999

	1996	1997	1998	1999
Contributions to budget	64%	56%	43%	39%
Profits/Capital	0.19	0.11	0.14	
Contributions to budget/capital	0.32	0.21	0.35	

- Although SOEs had to cope with difficulties arising from weaknesses of the economy and negative impacts of the Asian financial crisis SOE sector remains to play an important role in the economy. The following figures will give the details:
    + Contributions to GDP: 40.2%
    + Contributions to export turnover: 50%
    + Contributions to budget: 39.25%
- However, the contributions to budget were far much lower than the inputs. The contribution to budget was different from various SOEs. For many SOEs, contributions to budget were much lower than supports of the Government to those SOEs. Take the example of Hanoi SOEs. In 1997, turnover increased by 12.56% while operating profit decreased by 22%, the contribution to budget went down to 99.7% compared to 1995. In 3 years (from 1995 to 1997) capital granted to local SOEs increased by 43.5% but local SOEs' contributions to budget decreased by 7%.

Business Efficiency and Profits

- Turnover and profit gained on a unit of investment capital is one of important indicators for evaluating business efficiency and profitability of the enterprise. For SOEs, the ratios have recently declined. This trend can be explained by many reasons but the main reason is SOE's weaknesses which have existed for a long time (weak management, cumbersome organization, limited capital, outdated technology...) and increasing severe competitions (competition in domestic markets, in international markets, competitions among economic sectors such as SOEs, NSOEs, FDI....). Following figures will prove this explanation:
    + The year 1995: 1 dong of capital created 3.46 dong of turnover and 0.19 dong of profit.
    + The year 1998: 1 dong of capital created 2.9 dong of turnover and 0.14 dong of profit.
    + For industry sector alone: 1 dong of capital created 0.024 dong of profit.
- General conclusions from SOE business efficiency assessments in 1998 on the basis of reports from 51 capital administrative departments (of which assessments of 3,528 SOEs were completed accounting for 59% SOEs throughout the country, including 757 central SOEs and 2,771 local SOEs); The amount of budget capital in 3,528 SOEs is 31,293 billions dong, accounting for 30.4% total amount of budget capital in all SOEs in the country (Unfortunately, excluding reports from Hochiminh and Hanoi where have a large number of SOEs and majority of big SOEs). The information drawn from the reports as follows:
    + Operating profits reached 2,800 billions dong, The ratio of profit on operating capital in 1997 averaged 9% (central SOE reached 9.4% and local SOE reached 8.4%).
    + Accumulative loss and bad debts was 3,046 billions dong at the end of 1997, making up 9.8% of budget capital in SOEs (central SOEs born 1,006 billion dong, local SOEs born 2,027 billions

dong).

- For efficient SOEs, assessments of the Central committee for enterprises in 1998 showed details:
  + The number of really efficient SOEs (SOEs with conservation of capital, fulfillment of debt obligation, full contributions to budget, full payments of wages to labors and making profits) accounted for 40% of the total number of SOEs (while assessments of the General department of capital administration said the number is 1.301 SOEs, occupying for 37% of the number of SOEs evaluated, of which central SOEs made up 44% and local SOEs made up 35%).
  + The number of SOEs with fluctuate operations, temporary difficulties and poor efficiency accounted for 40% (while assessments of the General department of capital administration said that the number was 1,634 SOEs, occupying for 46% of the number of SOEs evaluated, of which central SOEs made up 42% and local SOEs made up 48%; and total receivable debts and accumulative loss was 1,135 billions dong).
  + The number of SOEs with inefficiency and losses in many years accounted for 20%. (While assessments of the General department of capital administration said the number is 588 SOEs, occupying for 17% of the number of SOEs evaluated; The budget capital in those SOEs was 2,383 billions dong; Total receivable debts and accumulative loss was 1,763 billions dong. It means that the budget capital in SOEs was lost by 75%).
- Shortly, efficiency of SOEs was quite low. The number of inefficient SOEs accounted for 63%, capital losses because of bad debts, doing business with loss were quite high even asset devaluation were not taken into account. The profits after tax of SOEs reached only average 6% over budget capital. State-fixed assets depreciation reached annually 7% - 8%. The number of really inefficient SOEs was very low. The domestic products and services suffered from low competitiveness even some domestic products were from 20% to 40% more costly than the same exported, especially some product's prices were 70-80% higher. That situations caused very big stagnation in some industries such as cement, sugarance, steel, fertilizer...
- Debts of SOEs: Funds for SOEs operations depend mainly on borrowings from banks, accounting for 80% of total operating capital and largely were short-term loans. Therefore, debt obligations of SOEs were very serious. Moreover, sometimes a part of capital of SOEs taken over by the other enterprises also raised total debts of SOEs. Payable and receivable debts of SOEs as for 31/6/1998 were as follows:
  + Total payable was 126,000 billions dong, equal to 124% of budget capital in SOEs.
  + Total receivable was 72,000 billions dong, equal to 60% of budget capital in SOEs.

While total debts of SOEs on 31/12/1997 was:

  + Total payable was 95,000 billions dong
  + Total payable was 75,000 billions dong

Although the Government and SOEs themselves implemented many active measures to cope with debts of SOEs their debt outstanding were increasing. It means that new debts have upward trends. Such serious debts of SOEs made their financial pictures and state financial ones worse barring the process of rearrangements, equitization and restructuring of SOEs

Rearrangements, reorganizations and equitizations and business performance of equitized SOEs

- Since 1990, realizing the Government's initiatives of basic reforms of SOEs, up to 31/12/1999 the number of SOEs was falling to 5,280 from 12,300 in 1990, of which 3,100 SOEs were merged, 3,350 SOEs were dissolved and 370 SOEs were equitized (up to 31/6/2000 there were early 500 SOEs equitized). The implementation of SOE reform policies in general and SOE equitizations in particular were delayed in all levels, industries and SOEs by themselves. Lack of thorough implementations, much dependence on Government, expectations and hesitations have popularly existed. Additionally state assets were wasted by almost SOEs.
- For business results of 40 SOEs equitized for more than 1 year, assessments of the Central committee for enterprise reforms showed below:
    + Average turnover increased by 25%/year, and in some SOEs equitized the turnover growth rates were up to 50%/year.
    + The number of employees raised by 10%/year and it was 20% in some SOEs equitized.
    + Increase in income of the labor averaged 20%/year.
    + Average profit increased by 26%, and in some SOEs equitized it increased by 2-3 times.
    + Contributions to budget was 30% up.

On the basis of basic data and figures on SOEs operations, we can have an overview of financial situations of SOEs as follows:

- Small capital scales, lack of funds for investments in new technology, in independent SOEs and corporations "90" and "91".
- Low business efficiency and effectiveness. The figures on profits and contributions to budget say that about 40% of total turnover were not made clear. If indirect taxes, subsidies from the Government, incentives of land, export supports were separated from the turnover efficiency and effectiveness of SOEs would be much lower.
- It is notable that reports from provinces, cities, ministries, industries and SOEs of business effectiveness of SOEs were untrue and low in quality. 40% of SOEs seen effective in 1998 was covered from reports regarding supplementing working capital to effective SOEs. Even some assessments reflected that SOEs working at profits accounted for only 20-30%.
- Debts of SOE sector were very big and equal to 125% state-owned capital in SOEs. Especially, overdue debts of 16,000 billions dong were a very serious problem deteriorating financial situations of the whole sector.

- Lack of transparency in support policies for SOEs including capital policies (transforming borrowings to grants, rescheduling, cycling, writing off debts, preferential lending...), tax policies, land policies, market policies... For the period from 1997 to 1999, the Government directly invested in SOEs about 8,000 billions dong, of which 6,500 billions dong was subsidized and 1,500 was compensated for losses. Moreover, tax exempt was about 2,300 billions dong, write-off was 1,100 billions dong, debts cycled was about 3,400 billions dong and thousands of billion dong were rescheduled and 8,700 billions was preferential loans.

Value added tax for SOEs

- When implementing VAT law, some industries, SOEs have enjoyed benefits because new tax levels are equal to or lower than former turnover tax levels. But at the same time, some industries and SOEs suffered a lots from losses due to higher levels of tax while prices of products are stable and even are going down. That made finance of some SOEs more difficult, especially in industries of coal, steel, paper, marine, and railway... (Each corporation in those industries suffered average loss of 50 billions dong/year compared to turnover tax law; SOEs who enjoyed benefits of thousands of billion dong are cement corporation).

Are supervising mechanisms of the Government to SOEs effective?

- Under law on SOE, (promulgated in June of 1995), the Government has a common mechanism to control, manage and supervise SOEs through:
  + Issuing policies, mechanisms for managing each kind of SOEs. Making special policies for supporting SOEs who enjoy favored policies such as policies of incentives, subsidies, price compensations or giving priority to public activities of SOEs.
  + Making decisions of protections and supports to SOEs who play an important roles in the economy.
  + Making strategies and plans of development of SOEs in master strategies and plans of development of industries and regions.
  + Inspecting and examining SOEs in executions of laws, policies and regimes of the State.
  + Decentralizing in SOEs management under assignments of the Government.
- However, SOEs have increasingly been more active in operations and more independent on finance against the managing ministries. Therefore, supervisions by the Government against SOEs though enforcing tax laws, banking system, informing, reporting, and auditing... are increasing.
- At present, establishments and management against SOEs are classified into 3 levels: SOEs belong to the Government, SOEs belong to ministries and industries, and SOEs belong to local authorities. Those

levels have the function of "state management" to SOEs who were established by the relevant levels. In addition, many organizations and agencies with their functions and responsibilities also supervise SOEs such as General department of state assets and capital in enterprises, General department of Tax, Customs Office, State Auditing....

- Since the introduction of SOE law, the Government made many efforts to construct a system of legal documents to provide guidance for law implementation and this really created favored conditions for operations of SOEs as well as improved supervising mechanisms for SOEs. However, some policies and regulations to SOEs have not come to effective. Shortcomings and problems of policies for SOEs not only obstructed operations of SOEs but also caused troubles to management performance.
- Decree 59/CP dated 3/10/1996 on issuance of the regulation on financial management and business accounting for SOEs is an important step in financial management mechanisms for SOEs. In recent years, financial mechanisms for SOEs resulted in independence and autonomy of SOEs in businesses contributing to improving effectiveness. Nevertheless, the regulation has faced problems that limited mobilization of funds, initiatives of many SOEs.
- Decree 27/1999/ND-CP dated 20/4/1999 on amendment and supplementation of "the regulation on financial management and business accounting for SOEs" has some changes towards giving more autonomy to SOEs, enlarge mobilization and use of funds of SOEs, strengthening supervisory responsibilities of Board of Management for business operations in SOEs with the same model as "state corporation".
- Decree No. 39/CP dated 27th of June, 1995 on organization and operation of stated-owned corporations regulates relations between the state corporations and their members of which members of the Board of Management and general directors are appointed by the Government. So, the Board of Management has no responsibilities for finding executive managers in the corporations.

- Law on state-owned enterprises dated 30th of April 1995 defines two types of SOEs including public work and business operation. Decree 56/CP issued on 2/10/1996 regulates on SOEs servicing public work. But in fact, the classification of SOEs to public and business has faced some problems because of its complications.
- Legal framework for SOEs was abundant but incomplete and unrealized. Contradictions and overlapping among legal documents made both regulators and SOEs hard to implement.
- The regime of managing ministries for SOEs: At present, of 5,300 SOEs there are 4,430 SOEs belonging to local authorities, 417 SOEs, 17 corporations "91" and 74 corporations "90" belonging to ministries, ministerial agencies and the Government. So, the number of SOEs belonging to ministries and ministerial agencies accounts for quite big percentage (over 10% of total number of SOEs). Ministries do the function of "state management" to SOEs who are under their establishments and play an important part in providing

orientations for SOEs operations. However, recently, the functions of the ministries have decreased and SOEs have been more active and independent in their business operations.

- One of the most shortcomings in policies and mechanisms for SOEs is that there have been too many clue agencies supervising and managing SOEs. Inspection and supervision of SOEs performance are very necessary to help find and resolve problems for SOEs, but the overlapped supervisions and inspections also made SOEs trouble and inconvenience. So, in some cases, SOEs didn't know exactly the right agencies that were responsible for problems of the SOEs. Furthermore, making solutions usually took a long time for regulators because of passing many branches and levels.
- Shortly, regulating and supervising SOEs over years have made valuable contributions to development of SOEs, especially to recovering and solving problems of SOEs. However, the regulations on supervising, controlling, examining SOEs by governmental agencies till faced some unreasonable issues as follows:
    + Too loose regulation and management that lead to irresponsibilities of SOEs and cause wastes and losses of state assets, or
    + Too much intervene in business activities of SOEs that make troubles to SOEs and unclear responsibilities between regulators and SOEs, or
    + Overlapped management that lead to inefficiency and inconfidence of SOEs in regulators.
- To consolidate management, supervision for SOEs and step by step strengthen financial positions of SOEs is necessary and urgent. What should be done in long- term is constructing an effective and valid legal framework to regulate SOEs aiming at creating a favorable conditions for their operations as well as enhancing analysis of financial positions of SOEs and supervisions of credit activities to avoid, prevent and restrain risks. And what should be done in short- term is conducting inventory and reassessment of assets, capital and finance in SOEs aiming to have comprehensive understanding about business performance, capital and effectiveness of SOEs as well as carrying out solutions for strengthening performance capacity of SOEs. Meantime, implementing amendments and improvements of law and instructions on SOEs needs doing.

Ad-hoc measures taken by the Government and the State Bank of Viet Nam from 1996 up to now to mitigate financial troubles of SOEs

- We only have a strong and effective economy once both the finance sector and the business sector are strong and effective. Weaknesses in business sector will cause and make weaknesses and difficulties of the finance sector more serious and the contrary is the same. Two economic sectors have mutual interactions in both short and long terms. The Government realizes that to gain success in economic reforms it is very necessary to simultaneously restructure both sectors, finance and business. So, to deal with weaknesses and shortcomings of the economy, from 1996 up to now, the Government and the State

Bank of Viet Nam have made many policies and taken many measures including ad-hoc measures to reduce current financial troubles of businesses and banks and long-term measures to address fundamental and key weaknesses of the economy. However, it seemed to be that ad-hoc measures were more preferred in past few years and focused on SOEs who have done business inefficiently and released untrue data on financial situations. This part of the paper will focus on ad-hoc measures implemented by the Government and State Bank of Viet Nam to reduce financial difficulties of SOEs. Measures can be classified as follows:

+ Ad-hoc measures relating to budget subsidies and supports.
+ Ad-hoc measures relating to credits and debts.
+ Ad-hoc measures relating to foreign exchange transactions.

Budget subsidies and supports

- In order to raise funds to SOEs, Document 309/KHTH dated 8/9/1997 decides to grant capital investments and supplement working capital to SOEs. Actually, equity of SOEs granted by the Government is quite small, so most of the working funds of SOEs come from banks. The amount was estimated about 80% of total funds. The decision gave SOEs opportunity to finance for business plans.
- According to the budget expenditure plans in the year 1998 and 1999, budgets for supporting SOEs relatively were estimated about 500 billions dong and 200 billions dong and mainly for granting working capital to SOEs.
- Decision No. 178/1998/QD-TTg dated 19th of Sept., 1998 of Prime Minister on supporting some exported products with banking preferred interest rates. The decision allowed banks to lend exporters and exports producers at interest rates 0.2%/month lower than normal ones. The supports would be finished when an export-supporting fund was established. This measures along with other finance, market and tax policies for rice exports contributed to reaching over 1 billion USD for rice exports, 0.6 billion USD for coffee exports... in each year 1998 and 1999.
- Decision 859/QD-TTg dated 24/9/1998 of the Prime Minister on supplementing registered capital to SOCBs. The registered capital has not been fully granted to the SOCBs and accounted for only 30-40% as fixed. The decision gave Agricultural and Rural development banks 97% of the fixed registered capital, Commercial and industrial bank 74%, Foreign Trade bank 73% and Development and investment bank 71%. The measure strengthened financial situations of SOCBs.
- Decision No. 195/1999/QD-TTg dated 27th of September, 1999 of Prime Minister on establishment of the export supporting fund in order to support, promote exports, to expand export markets and strengthen competitiveness of Vietnamese exports.
- From 1997 to 1999, according to unofficial data the Government directly invested about 8,000 billions to SOEs, of which budget grants were about 6,500 billions dong and loss subsidies were about 1,500

billions dong.

Ad-hoc measures on credits and debts

- Document No. 433/CV-NH1 NH1 dated 4th of August, 1996 allows banks to restructure debts of SOEs in case the SOEs play important roles to the economy and face financial difficulties. Accordance with the document, banks are allowed to write off overdue and impossibly repaid debts caused by objective reasons such as calamity, bankruptcy as well as to circle overdue debts caused by changes in policies against SOEs.
- Decree No. 49/CP dated 6th of May, 1997 and Document No. 41/CP-NHNN14 dated 31st of May, 1997 (on prudential regulations of banks) remove some prudential regulations that have ever been effective to banking lending. Under the new regulation, state owned commercial banks can lend SOEs without securities and also give new loans to SOEs even the SOE's debts on equity is over 100% and SOEs made losses if the loans are used for efficient business plans or investment projects with efficient business and feasible repayment plans. The regulation also says that main criterion to evaluate efficiency and feasibility of production plans is approval of leaders of ministries or provincial people committees. An assessment criterion like that may cause credit misallocation in a changing environment toward market oriented.
- Circular No. 417/CV-NH14 dated 31st of may, 1997 on guidance of implementing urgent Government's solutions related to banking credits minimizes compulsory regulations on securities for SOE borrowings. When borrowing form the banks SOEs don't need to have collateral and don't depend on their registered capital and base only on their business efficiency, project feasibility and repayment possibility.
- Instruction No. 09/CT-NH1 dated 27th of August 1997 on allowing banks to set up repayment conditions for SOEs. The banks are able to shift SOEs' short-term loans to medium and long-term ones, medium-term loans to long-term ones if SOEs can not repay as scheduled but they have prospects in short-term.
- Circular No. 03/1997/TTLT/TC-NHNN/TC dated 22nd of November 1997 on guidance of dealing with overdue debts of SOCBs after banking inspections. According to the Circular, banks are allowed to revert, restructure or write off debts if their customers are unable to repay because of force majeure reasons such as floods, droughts...
- Document No. 471/VPCP-KTTH dated 30th of January, 1998 of the Government Office on allowing deal with overdue debts that is not included in Circular No. 03/1997/TTLT/TC-NHNN/TC. The State Bank of Viet Nam, Ministry of Finance and State inspection Agency would conduct examinations and considerations of writing off, cycling and scheduling debts of dissolvent SOEs, debts cycled by inter-ministries in 1995, debts borrowed for repayment purpose, debts targeted by the Government...
- Decision No. 95/1998/QD-TTg dated 18th of May 1998 of Prime Minister on dealing with debts phase II. The solutions and settlements of corporate debts would be made under different creditors

(Government, banks, enterprises, and guarantor...).

- Instruction No. 08/1998/CT-NHNN14 dated 3rd of October 1998 on improvement of credit quality to strengthen banking operations. Many solutions are set out to reduce debt burden of SOEs. SOEs with financial troubles are allowed to delay interest payments. They will also not requested to pay penalty interests for overdue debts if their repayments of principal and common interest are made. Moreover, if SOEs are making loss and impossible to repay as scheduled banks can reschedule the debts.
- In addition, Document 456/CP-KTTH dated 27/4/1998, Decision 1078/QD-TTg dated 1/12/1998, Document 864/CP-KTTH dated 28/7/1998, Decision 547/QD-TTg dated 14/5/1999, Decision 180/QD-TTg dated 5/3/1999 make decisions to write off, cycle and reschedule debts to SOEs facing difficulties and risks in business.
- Decision 250/1998/QD-TTg dated 24/12/1998 and decision 67/1999/QD-TTg on 30/3/1999 allow SOEs who are main rice exporters, main fertilizer importers including food corporation's members to use assets come from borrowings as securities. Those decisions have partly made contribution to addressing fund matters of SOEs to serve agricultural productions and stabilize market prices.
- Decision No. 140/1999/QD-NHNN14 dated 19th of April, 1999 on issuance of regulations on buying and selling debts of credit institutions. The regulation covers debt buying and selling activities in order to diversify credits, enlarge bank lending and support banks and companies...
- Circular No. 06/1999/QD-NHNN14 dated 02nd of December, 1999, Document No. 850/CV-NHNN14 dated 9th of September, 1999, Document No. 1136/CV-NHNN14 dated 7th of December, 1999, Document No. 1194/CV-NHNN14 dated 7th of December, 1999 on guidance of dealing with losses caused by natural calamity, floods under guideline of Prime Minister.
- Decision No. 05/2000/QD-TTg dated 5th of January 2000 on amending and supplementing some points of debt accounting phase II.
- Circular No. 23/2000/TT-BTC dated 27th of March 2000 on guidance of implementing Decision No. 05/2000/QD-Ttg. The circular stipulates the responsibilities and authorities in addressing SOEs' debts. Accordingly, Board of Management, general directors, directors have responsibilities of treating payable and receivable sums of SOEs under specific principles. In case that debts are taken into account for several years makes SOEs work at loss or decrease in profit relatively, the SOEs still enjoy good things such as borrowing from banks, staying at classified corporate conditions and deducting welfare and rewards funds. Recording credit and debit will also treat two living SOEs with debts among themselves.

Lending interest rate policies for credit institutions

In the year 1999, in context of economic recession due with low economic growth, slowdown production and frozen credit markets, the State Bank of Viet Nam has taken measures to reduce bank lending interest rate ceilings aiming at promoting credit markets and economic growth. The measures gave incentives to

SOEs to borrow money from banks for investments.

- Decision No. 189/1999/QD-NHNN1 dated 29th of January 1999 on adjustment of lending interest rate ceiling of credit institutions. The decision allows credit institutions to reduce interest rate ceilings form 1.2%/month for short-term lending and 1.2%/month for long-term lending to unique interest ceiling of 1.15%/month. The interest ceiling is applied for all credit institutions operating in both rural and urban areas (excluding people credit funds).
- Decision No. 266/1999/QD-NHNN1 dated 30th of Junky, 1999 on adjustment of lending interest rate ceiling of credit institutions reduces lending interest rates to 1.05%/month.
- Instruction No. 05/1999/CT-NHNN1 dated 1st of September 1999 adjusts VND-lending interest rate ceiling of SOCBs to urban clients down to 0.95%/month. The interest rate ceiling applied for rural customers is staying at 1.05%/month.
- Instruction No. 383/1999/QD-NHNN1 dated 22nd of October, 1999 on adjustment of lending interest rate ceiling of credit institutions continues to reduce VND lending interest rates (not effective to rural joint-stock commercial banks and people credit funds) from 1.05%/month to 0.85%/month for urban customers and 1%/month for rural ones.
- Decision No. 50/2000/QD-NHNN1 dated 3rd of February, 2000 on adjustment of lending interest rate ceiling of grass-root people credit funds makes funds lend members at maximum interest rate of 1.35%/month (past ceiling is 1.5%/month).
- Decision No. 241/2000/QD-NHNN1, Decision No. 242/2000/QD-NHNN1, Decision No. 243/ 2000/QD-NHNN3 dated 2nd of August 2000 on announcement of basic interest rate mechanism. Under the new mechanism, credit institutions' lending interest rates are determined on basis of basic interest rate stated by the State Bank of Viet Nam. That is an important step to completely liberalize interest rates. The policy helped banks as well as enterprises to be more active in planning business, accounting losses and profits and correcting operations with market signals.

Measures to reduce foreign exchange risks

- A range of policies and measures have been issued in order to recover and maintain transactions in official foreign exchange markets and limit illegal transactions and strengthen controls of foreign currency keeping. Those decisions are Decision No. 37/1998/QD-TTg dated 14th of February 1998, Decision No 267/1998/QD-NHNN7 dated 6th of August 1998, Decision No 173/QD-TTg dated 12th of September 1998 and Decision No 232/1998/QD-TTg dated 1st of December 1998. Regulations on foreign currency keeping for enterprises are increasingly tight, of which:
  + Decision 37 requires that enterprises with foreign currency revenue must immediately put received amount to an account at bank after deducting estimated expenses in foreign currency for next month.

+ Decision173 requires enterprises to sell 80% of foreign currency revenue received to banks after 15 days from the receiving date and affirms the enterprise's right to buy foreign currency at banks.

+ Decision 232 (Decision 173 amendment) forces enterprises on list of foreign currency balancing to sell foreign currency amount right after the money comes into account.

- Controlling L/C issuance by banks: Due to increasing deferred L/Cs (foreign short-term borrowings of enterprises) in 1996, of which many matured but enterprises were unable to pay, banks had to pay in replace of enterprise by their money. The Government took may ad-hoc measures to control more strictly issuance of L/C and deal with problems:

  + Document No. 434/CV-NH7 dated 5th of August 1996 on foreign short-term borrowing quotas of commercial banks. According to the document, total foreign short-term borrowings of banks must be less than total foreign short-term outstanding and up to 1 year foreign currency-based guaranteed outstanding on 30/6/1996 as well as 3times less than equity of the bank.

  + Decision No. 207/QD-NH7 dated 1st of July, 1997 on regulations on opening deferred L/Cs for imports requires specified conditions to banks and enterprises for opening deferred L/Cs.

  + Decision No. 802/TTg dated 24th of September, 1997 and Circular No. 07/1997/CT-NHNN dated 4th of December, 1997 on addressing problems caused by deferred L/Cs includes responsibilities of related parties (banks and enterprises) of deferred L/C guarantee and issuance.

- Exchange rate management: To reach long-term objectives of encouraging production, pushing up the economy, avoiding social-economic uncertainty, giving incentives to exports, controlling imports and increasing foreign reserves while the current foreign exchange mechanism has not been flexible and Vietnamese currency has been appreciated, from beginning of 1997 the State Bank of Viet Nam had step by step devaluated Vietnamese currency for 4 times:

  + 27/2/1997: expanding margin for permitted foreign currency transactions from +/-1% to +/-5% of official exchange rates stated by SBV.

  + 13/10/1997: expanding margin for permitted foreign currency transactions from +/-5% to +/-10% of official exchange rates stated by SBV.

  + 16/2/1998: increasing official exchange rate from 11,175 VND/USD to 11,800 VND/USD (increase by 5.6%).

  + 7/8/1998: reducing margin for permitted foreign exchange transactions from +/-10% to +/-7% and meanwhile increasing official exchange rate from 11,815 VND/USD to 12,998 VND/USD.

- Decision No. 64/1999/QD-NHNN7 and 65/1999/QD-NHNN7 on new mechanism on exchange rates. The State Bank of Viet Nam daily announce yesterday's average exchange rates in inter-bank market and with reference of the stated exchange rates commercial banks will decide business exchange rates with a band of +/-1%. That is a strong step of exchange rate mechanism in Viet Nam.

- Decision No. 118/1999/QD-TTg dated 4th of May 1999 on USD-lending to target projects. The decision allows some commercial banks to supply medium and long-term loans to specified projects targeted by the Government in 1999. The borrowers are not required securities for loans.

Positive and negative effects made by ad-hoc measures to SOEs' financial situations and performance

Positive effects:

- Majority of the above ad-hoc measures created favorable conditions for commercial banks and SOEs to reduce their financial troubles, especially SOEs. Banks were allowed to restructure overdue debts of SOEs and classify them as normal debts. For short-term, these measures made financial situations of banks and SOEs seem to be better.
- In general, through the measures, difficulties in borrowing and lending have been addressed. It can be said that those measures helped banks and enterprises to break-through fund flows preventing trend of credit outstanding reduction of SOEs, preventing unemployment and speeding up SOE equitization process.
- That the prudential regulations for credit institutions are tightened while SOCBs' registered capital is small and less than legal levels has limited bank performance. Moreover, Asian financial crisis had negative effects on bank financial picture. The Government's decision giving capital supplement to SOCBs was seen as a strong action to strengthen financial situations of the Viet Nam biggest credit institutions. However, for the long-term, those banks need to grow by themselves.
- For SOEs with overdue debts, the solutions of rescheduling, cycling and writing off debts lightened financial pressure on SOEs as well as gave SOEs time to reform and find fund sources for repayment.
- For credit institutions, debt restructuring helped them to actively govern and make decisions, prevent credit risks, enrich economic forecasting capability and motivate banks to participate in economic-social development programs.
- Foreign currency surrender requirements resulted in stability of foreign exchange markets and success in exchange rate policies. After implementation of surrender requirements, foreign currency markets no longer suffered pressing as they did ever before and foreign currency transactions in banks substantially increased.
- The management of deferred L/Cs made foreign short-term borrowings including deferred L/C opening decline and hampered unnecessary consumption imports and ensured importing goods which has not domestically produced yet or not fully supplied. Foreign short-term outstanding (including foreign short-term borrowings and deferred L/C guarantee) on 31/12/1997 decreased by 42% compared to that at the beginning of the year.

- Exchange rate management policies reduced difficulties to exporters and increased competitiveness of Vietnamese goods in international markets. In particular, VND devaluation made exports of rice, coffee, sea-products... go up and helped some exporters who were making loss make profits such as exporters of rubber, crude oil, coal....

Negative effects to SOEs, especially to highly debted SOEs

- Besides positive effects improving current financial situations of SOEs and bank, there would be negative effects those could cause serious problems in long-term if the SOE reform process was not sharply carried out and made progress.
- The lack of transparency in budget subsidy policy for SOEs including transformation of borrowings into subsidies, capital supplements, writing off, tax exempts, tax reduction... led to dependence on and waiting for supports from the Government. Finance mechanisms in which the Government was seen as a "milk cow" only make economic renovation process slowdown and make SOEs hesitate to implement reforms.
- In market economies, creation of a equal playing field for all enterprises is very necessary and is a motive for economic participants. That is a policy target of Viet Nam in the transition period towards a market-oriented economy. Nevertheless, the above ad-hoc measures of the Government and the State Bank of Viet Nam seemed to create an unfair playing field between SOE sector and NSOE sector.
- Although the measures helped SOEs to tackle some financial difficulties, maintain and expand business activities in one hand they were only temporary and on the other hand opportunity costs were very high. Credits for the non-state sector became limited. Banks who have suffered troubles were pushed into "no forwards and no backwards". Banks, especially SOCBs carried very high credit risks because SOEs' borrowings were bigger and bigger although in short-term the overdue debt ratio decreased thanks to debts restructuring.
- A dangerous factor of the ad-hoc measures is the criterion used to assess efficiency of investment and production plans. The pity condition to apply for bank loans is that leaders of ministries and provincial people committees agreed and approved of efficiency of business plans. That must only cause delay in investment activities, abuse of powers and bribes because responsibilities of leaders of ministries and people committees are not clearly specified.
- Cycling SOEs' overdue debts seemed to make bank's financial reports better by reducing bad debts on total outstanding (banks usually separate cycled from bad debt list). But, in the eyes of banks, the burden banks have to bear is not lighten due to very limited fund sours for addressing debts. Most of the cycled debts are exempted from interest payments in waiting time for completion while banks have to mobilize fund sources from people to lend and they have to pay interests. That means income of banks fell. From 1991 to 1999, credit institutions have cycled debts of enterprises, individuals and households

(of which majority are of SOEs) with amount of 3,900 billions dong while fund availability to support banks is only 2,000 billions dong. The remain of nearly 2,000 billions dong and interests from cycled debts has not been settled to banks.

- Most of the cycled debts are under policy-based finance programs or target finance programs of the Government and unable to be repaid due to force majeure reasons such as calamity, disasters.... Participatory financial institutions that mainly are SOCBs appeared to be secured for loans because finally risks come to the Government. Have the banks filled their jobs when they conducted evaluations and approvals of the loans?
- For foreign currency surrender requirements, banks didn't have foreign currency available at anytime to meet demands of enterprises. Moreover, the procedure to buy foreign currencies at banks is rather complicated. The exchange rates are always fluctuate harmful to enterprises. That also made enterprises less active in doing business.
- The Vietnamese currency devaluation raised costs of imports of some enterprises with importing goods and services (especially sugar, cement, electricity, steel, fertilizer, gasoline...) as well as increased costs of external debts of enterprises with foreign borrowings (especially electricity, telecommunications..).

Scenarios to phase out ad-hoc measures and establish an SOE sector on the basis of budget constraints

- For ad-hoc measures relating to budget subsidies and supports.
  + Speed up equitisations progress: To conduct amendments and supplementation of Decree 44/ CP on equitisations of SOEs. The amendments will be made in orientation of ensuring equality and encouraging SOE participation.
  + Implement assigning, selling, contracting, leasing SOEs: To build instructions for implementing Decree 103/1999/ND-CP. Instructions will be constructed with the principle of making easy for implementation.
- For ad-hoc measures relating to credits and debts.
  + Prepare and issue the regulation on solutions to cope with overdue debts and support finance to participatory credit institutions. The regulations will be applied for all enterprises including SOEs. SOE overdue debts will specifically be dealt with.
  + Establish assets management companies (AMC): To prepare necessary conditions to establish an AMC belonging to the Government and to promote establishments of AMC belonging to commercial banks.

- For ad-hoc measures of lending interest rates
    + Implement the mechanism of basic interest rates.
    + Building a mechanism of interest rates for policy-based finance towards a really flexible one.
- For ad-hoc measures relating to foreign exchange transactions.
    +
- Decree No. 59/CP dated 3rd of Oct. 1996 attached by the Regulation on financial management and accounting for SOEs.
- Decree No. 27/1999/ND-CP dated 20th of April 1999 on revising and supplementing the Regulation on financial management and accounting for SOEs.
- Decision No. 859/QD-TTg dated 24th of September 1998 of Prime Minister on additional subsidy of registered capital to SOCBs.
- Decision No. 250/1998/QD-TTg dated 24th of December, 1998 and Decision No. 67/1999/QD-TTg dated 30th of March, 1999 on allowing SOEs who are main exporters of rice, main importers of fertilizers to use assets from borrowings for securities.
- Circular No. 10/2000/TT-NHNN1 dated 31st of August 2000 on guidance of implementing solutions on securities for borrowings of credit institutions.
- Decree No. 44/ND-CP dated 29thh of June, 1998 on privatization, Decision No 177/1999/QD-TTg dated 30th of August, 1999 on organization and operation of the Fund for supporting SOEs' privatization.
- Decree No. 103/1999/ND-CP dated 10th of September 1999 on assigning, selling, contracting and leasing SOEs.
- Decision No. 150/1999/QD-TTg dated 8th of July 1999 on re-evaluation of state-owned assets at SOEs.