26% in 1997, that led to decrease in foreign currency deposits of economic entities at banks.

In this period, the foreign exchange rate management of the State Bank was harmonized with macroeconomic developments, especially external economic environment (the Asian financial and monetary crisis that started in Thailand has spread its impacts to regional countries that makes currencies in the region depreciating. As a result, the competitiveness of Viet Nam's export was influenced negatively to some extent).

The State Bank adjusted the trading band of the VND against USD exchange rate to +-5%, then +-10% and also adjusted the official exchange rate from 11,005 VND/USD to 11,175 VND/USD at the end of 1997. Again, in 1998, the exchange rate was adjusted twice to the level of 12,998 VND/ USD (down by 16.3% in comparison with that at the beginning of the year) and then the trading band was lowered from +-10% to +-7%.

The depreciation of VND has enhanced the competitiveness of Viet Nam's export to some extent. In addition, the quick recovery of Asian countries from the beginning of 1999 has contributed to the high export growth rate (at 23.1% in 1999). Therefore, the foreign currency deposits of economic entities at the banking system continued to rise in 1999. Moreover, the adjustment of the foreign currency surrender requirement from 80% to 50% of total foreign currency revenue from current transactions has contributed to increase in foreign currency deposits of economic entities (Decision No 180/1999/QD-TTg dated 30, August, 1999).

+ Regarding to the foreign currency savings of individuals, in recent years, Viet Nam has attracted a huge amount of Vietnamese overseas and worker's remittances to their relatives. Since 1995, the fee charged on remittances has been abolished, that led to a remarkable increase in transfers (about more than 1 billion USD/year). In addition, a huge amount of idle foreign currencies accumulated by households in the previous period flowed to the banking system in form of foreign currency savings (the growth rate of foreign currency savings is 115%-135% in 1996-1998 and 35% in 1999). It can be explained by low inflation, Vietnamese Dong's appreciation (due to the State Bank's adjustment as mentioned above) and low lending rate of Vietnamese Dong.

(3) The concentration of deposits at the banking system

The above part mentioned the funds of enterprises flowing to the banking system in the form of deposits. Whether these funds flow concentrately to some banks or spreadly to every bank? This is an important question for considering improvement of the competitiveness in banking activities.

The Vietnamese banking system has been expanded day by day. At the end of 1999, the banking system of Viet Nam included 4 state-owned commercial banks, the Housing Development Bank of Mekong River Delta; The Bank of the Poor; 51 joint stock commercial banks, 4 joint venture banks; 24 foreign bank branches; 960 People's Credit Funds; 2 joint stock finance companies and 8 leasing companies.

Although the banking system has been expanded, the deposits have still concentrated on the state-owned commercial banks. The main reason is that these banks have advantage of capital scale. The state-owned commercial banks accounted for 82% of total financial assets of the whole banking system, so these banks have set up a branches network throughout the country and have traditional relations with many clients. Moreover, from individuals and households' point of view the state-owned commercial banks have bailout from government. So the saving deposits at the state-owned commercial banks are still very high although the deposit interest rates of non-state-owned commercial banks are higher than those offered by the state-owned commercial banks.

Table 4 Deposits structure by financial institutions, 1995-2000

Unit: percent

	95	96	97	98	99	3/2000
Total deposits	100	100	100	100	100	100
GDP	74	73	78	83	86	86
Total deposit/GDP	26	27	22	17	14	14

Source: SBV

Mean while, the joint stock banks have been established recently. They have small capital, narrowed branch network, so their competitiveness is weak as compared to that of the state-owned commercial banks. Some loss-making banks that faced credit collapses and insolvency have been put in special supervision by the State Bank of Viet Nam, constraining the banking system's fund mobilizing. In addition, the foreign bank branches with sound financial situation are still subject to the limitation of fund mobilizing level. The minimum of Vietnamese Dong demand deposits from individuals and legal entities that have no credit relation with these banks equal to 25% of the authorized capital provided by their parent banks (The Decision of the Governor of SBV No 300/QD-NH5 dated 13, November, 1996 on amending of operations scope of the foreign bank branches and the joint venture banks in Viet Nam).

2. Credit of the banking system to enterprises

The credit of the whole banking system to enterprises (including the state owned and private enterprises) has rising trend. The main reasons are as follows: The reserve requirement rate has been adjusted from 10% in 1995 to 5% in 1999 in order to support the liquidity and reduce the operation cost; The state management on the operations of credit institutions are oriented to the market; The regulations promulgated in recent years for replacement of previous regulations according to stipulations in The Law of Credit Institutions has created a legal framework for credit activities, minimized the state administrative intervention in credit activities of credit institutions in order to give more autonomy to them (such as the Decision No 324/1998/QD-NHNN dated 30, Sept, 1998 on issuing the credit rules of credit institutions to customers). The upward trend of credit reflects the increasing role of the Vietnamese banking system in providing funds to domestic business and production investments.

The Vietnamese banking system's role is more clearly seen if its credit to enterprises is compared to the deposits of enterprises at the banking system (see Table 5). The Table 5 shows that net credit to enterprises was rising in 1995-1998. In 1999, net credit to enterprises declined because the credit to enterprises slowed down as a result of domestic investment decrease while deposits of enterprises at the banking system increased thanks to export recovery at high growth rate. Unlike previous period when the banking system had only played an intermediate role between the state budget and the state owned enterprises, the role of banking system in economic renovation has been confirmed. It can be said that the banking reform is considered as a key reform in economic renovation, contributing to increase in domestic investments to reach high economic growth in past years.

Table 5 Credit by the credit institutions, 1994-1999

Unit: VND million

	95	96	97	98	99
Total credits	42,277	50,751	62,200	72,595	86,626
Bank for Agriculture and Rural Development	9,576	11,369	15,154	18,624	23,586
BIDB	7,936	9,121	11,721	15,743	19,873
Incombank	8,601	9,956	12,812	15,726	19,170
Viet combank	7,534	7,873	8,354	8,991	9,812
Other	8,630	12,431	14,159	13,509	14,184
Total deposits of economic entities	16,678	22,717	30,560	31,987	48,257
Net flow of funds to economic entities	**25,599**	**28,034**	**31,640**	**40,608**	**38,369**

Source: The State Bank of Viet Nam

In term of absolute value, the credit to enterprises has increasing trend but the credit growth rate has fluctuated depending on the monetary policy conduction and economic developments.

- During 1995-1997, the credit growth rate declined because the State Bank pursued a tight monetary policy to contain the inflation, stabilize the value of Vietnamese Dong. Since 1995, The State Bank has continued to apply the credit ceilings to the state-owned commercial banks (first implementation was in 1994) and also applied to the non-state-owned commercial banks. In 1996, the State Bank allowed the credit institutions to buy and sell their credit ceilings with each other. In 1997, the credit ceilings were still applied. However, during implementation the State Bank might consider request for increase of credit ceilings by commercial banks if they were appropriate and efficient. In 1998, this instrument was phased out and the credit management was based on lending rate ceilings and refinancing interest rate... In this period, the refinancing interest rate was adjusted close to the lending rate ceiling (even higher sometime) to pursue the tight monetary policy, constraining credit expansion of The credit institutions.

Table 6 Credit growth rate classified by credit institutions 1994-1999

Unit: percent

	95	96	97	98	99
Total credit	36%	20%	23%	17%	19%
Bank for Agriculture and Rural Development	22%	19%	33%	23%	27%
BIDB	23%	15%	29%	34%	26%
Incombank	22%	16%	29%	23%	22%
Viet combank	20%	4%	6%	8%	9%
Other	144%	44%	14%	-5%	5%

- In 1998, the credit growth rate was lower than that of 1995-1997 period. This can be explained by the impact of Asian financial and monetary crisis. Due to the crisis, the economy slowed down; domestic absorption declined, consumption, especially domestic product consumption decreased, that led to decrease in credit demand of enterprises for expanding their production. As a result, the banking system's capacity of granting credit was constrained although in this year the monetary policy was implemented expansionary to simulate demand for investment and consumption.
- In 1999, the economy still faced low economic growth rate, deflation. The State Bank continues to pursue a expansionary monetary policy through reducing the VND maximum lending rate of credit institutions in five times. Refinancing rate was reduced to 0.45% per month and reserve requirement rate also was reduced. The monetary, credit management was harmonized with macroeconomic developments, supply and demand of funds in monetary market with a view to help enterprises to expand their investments. In addition, the Government allow the commercial banks to give credit to consumers to simulate domestic demand.

With the demand simulating measures and credit to overcome the aftermath of flood in the end of the year, the credit growth rate increased but still at low level. The possible explanation is that there are potential risks in business, so opportunities of investment in feasible projects are limited. As a result, many enterprises are not risky to get loans from banks. From commercial bank's point of view, due to the fact that many enterprises are loss-making one, some are cheaters, so bank staff are very prudential and hesitated to give loans. In addition, the stipulation that credit institutions (except for foreign bank branches) have to maintain the minimum of their own capital relatively to their assets[1] (including their contingent commitments) is a constraint to the credit expansion by the commercial banks because their own capital are still at low level.[2] (the Decision No 297/1999/QD-NHNN5 on stipulations of capital safety ratios in the credit institutions' operations).

In the total credit to the economy, the credit growth rate in foreign currencies is not as high as the credit growth rate in Vietnamese Dong. Especially, in recent years, due to the impacts of regional crisis, domestic

[1] Their assets have been adjusted to risk level

[2] Before November of 1998, the state-owned commercial banks with highest own capital reached the own capital to assets at 5.75%. In November,1998, the State Bank transferred VND 2,400 billion from its credit outstanding to the state-owned commercial banks to their own capital. Therefore, their own capital to assets has improved.

consumption declines, so the foreign currency demand for imports (including capital goods for domestic production and consumer goods) increases slowly.

In 1998, the inflation had gradual increasing trend while the VND nominal lending rate was stable, the value of VND depreciated because the exchange rate was adjusted to increase. As a result, the real cost of foreign currency loan was higher than that of VND loan. In such context, enterprises did not want to get loan in foreign currencies. Since the end of 1999, the ceiling of domestic lending rate in foreign currencies has been lower than deposit rate in international market. Meanwhile, foreign currency loans have not been expanded, so rapidly the commercial banks have preferred to deposit with foreign banks abroad to give loans to domestic investment projects. Especially in the first some months in 2000, the foreign currency deposits of commercial banks abroad increase rapidly.

The credit-to-deposit ratio, went up during 1995-1997, reflecting the rise in share of mobilizing funds for credit expansion to the economy. In 1998, this ratio declined, this meant that there was frozen phenomenon in credit activities because enterprises faced many difficulties in terms of consuming markets, product quality..., so the commercial banks were more prudent in providing credit. However, this phenomenon is only temporary, a large increase in credit was attributed to banks' lending to overcome the aftermath of successive national disaster and floods in the central provinces in the last month of the year.

(2) Credit structure by credit institutions

Unlike the general trend of the credit growth rate, the credit of the state-owned commercial banks increases rapidly thanks to their advantages of capital scale and wide branch net work throughout country (see Table 7). The credit share of the state-owned commercial banks is very high (accounted 81.4% in 1998, 83.6% in 1999 and 84.2% of total credit to the economy in the first quarter of 2000).

Table 7 Credit share by credit institutions

Unit: Percent

	95	96	97	98	99
Total credit	100%	100%	100%	100%	100%
	80%	76%	77%	81%	84%
Bank for Agriculture and Rural Development	23%	22%	24%	26%	27%
BIDB	19%	18%	19%	22%	23%
Incombank	20%	20%	21%	22%	22%
Viet combank	18%	16%	13%	12%	11%
Other	20%	24%	23%	19%	16%

Source: SBV

Among the state-owned commercial banks, the Bank for Agriculture and Rural Development accounted for largest share of total credit because the bank has largest charter capital.In addition, the Government has paid attention to agriculture and rural development. The credit to agricultural and rural sector are mainly lending to effective programs and investment projects packing the production cycle from production to purchasing, processing, marketing and export of rice, tea, coffee, cashew nut, rubber, sugar production, fertilizer imports, lending program for "anti - flood house base upgrading and shelter - on - stakes house construction in Mekong River Delta", lending to fishery households. The credit growth rate of the Bank for Industry and Commerce and Bank for Investment and Development also increases in line with the Government's direction of promoting export processing industries and infrastructure projects.

(3) Credit structure by maturity

The Table 8 shows the upward trend of medium and long-term loan. The main reason is that the State Bank issued Regulation on medium and long-term credit (Decision No 367/QD-NH1 dated 25, Dec,1995) under which credit institutions are allowed to use a proportion of short-term deposits for expanding medium and long-term loan. This regulation gives more autonomy to credit institutions in considering loans to medium and long-term projects; In addition, the credit institutions are also allowed to provide syndicated loan and credit procedures are more simplified.

In addition, the share of time deposit increases. The possible explanation is that low inflation makes depositors believe on the banking system. This facilitates to expand medium and long-term loans by the credit institutions.

Increase in medium and long-term loan shows that the banking system has played important role in fund maturity transformation to meet investment requirements for medium and long-term economic development.

Table 8 Credit structure by maturity

Unit: VDN billion

	95	96	97	98	99
Total credit to economy	42,277	50,751	62,200	72,595	86,626
- Short term loan	27,832	33,021	34,566	39,542	48,300
- Medium and long term loan	14,044	17,449	27,242	32,662	37,851
- Capital participation	401	281	392	391	475

Source: SBV

Table 9 Credit structure by maturity

Unit: %

	95	96	97	98	99
Total credit to economy	100%	100%	100%	100%	100%
- Short term loan	66%	65%	56%	54%	56%
- Medium and long term loan	33%	34%	44%	45%	44%
- Capital participation	1%	1%	1%	1%	1%

Source: Calculation from Table 8

However, the share of medium and long-term loan is still at low level because the share of demand deposits is higher than the share of time deposits. In order to ensure the safety of credit operations in the credit institutions, the Decision No 297/1999/QD-NHNN5 of Governor stipulated the maximum proportion of short-term loans to be used for expanding medium and long term loans. The proportion 25% is applied to state-owned commercial banks joint venture banks, foreign bank branches, non-bank credit institutions with 100% foreign capital; 20% for joint stock credit institutions and 10% for cooperative credit institutions.

(4) Credit structure by enterprises

1) Credit to the state-owned enterprises

In the last decade, excess credit to the state-owned enterprises was the main cause of hyper inflation. In this decade, the credit to the state-owned enterprises has left room for expanding credit to the private enterprises, especially since 1995 (see Table 10). It can be explained as follows:

Table 10 Credit structure by enterprises, 1995-1999

Unit: VND billion and %

	95	96	97	98	99
Borrowers	42,277	50,751	62,200	72,595	86,625
SOEs	24,079	26,809	30,980	37,706	41,753
Private enterprises	18,198	23,942	31,220	34,889	44,872
Borrowers	100%	100%	100%	100%	100%
SOEs	57%	53%	50%	52%	48%
Private enterprises	43%	47%	50%	48%	52%

Source: SBV

Firstly, in this period, in order to chock off credit to the state-owned enterprises, the credit ceilings were applied for the commercial banks and for the state-owned enterprises. In addition, the State Bank adjusted the refinancing rate applying to the state-owned commercial banks close to the maximum of Bank's lending rates. As a result, concessional loans given by these banks to the state-owned enterprises have been constrained.

Secondly, the stipulation on the average maximum spread of 0.35%/month was adopted to commercial banks subject to the Decision 381/QD-NH1. This ratio was calculated to meet reasonable cost and profit. However, the state-owned commercial banks and other banks have different deposit structures, different markets of fund mobilizing and allocating as well as different deposit and lending rates, so this regulation limited the competition among credit institutions.

The state-owned commercial banks accounted for largest share in total mobilizing funds as well as total credit, so the above stipulation contributed to decrease in profit from credit operations. Therefore, this discouraged the state-owned commercial banks to expand credit to the state-owned enterprises at low lending rate. As a result, the credit share to the state-owned enterprises declined in 1996-1997.

Thirdly, efficiency of the state-own enterprises is still concerned in the economic reforms. About 44% of SOEs are temporary loss making enterprises and 16% are permanent loss making enterprises. Therefore, the quality of credit should be in question. From the credit institution's point of view, they are prudent in expanding credit to the state-owned enterprises.

Fourthly, since the lending regulations come into effect, all credit institutions have to be subject to the lending conditions. Banks' staff are brought to the court because of credit collapses caused by customers makes bank staff more prudent in the credit expanding to improve the quality of credit. In the 1999, the credit to some big state-owned enterprises that have good creditability was constrained by the Decision 269/1999/QD-NHHNN5 dated 25, August 1999 on maximum amount of credit to one customer. This decision stipulates that credit to one customer does not exceed 15% of the credit institution's own capital. Even when enterprises have high demand of credit, credit institutions discontinue to give loan because credit outstanding of some enterprises exceeded 15% of their own capital. Although credit to the state-owned enterprises has declined, left room for credit to the non-state-owned enterprises, this share is still high. The main reason is that although the SOE sector has been in equitization process, management and supervision is shifted to the direction of giving more autonomy to enterprises, equitization process take places very slowly. Therefore, equitization does not contribute to decrease in credit to the SOEs. In addition, the state owned enterprises have the advantage that they can use assets under their management for collateral loan (According to the law on SOEs dated 24, May 1995). In the context of unfavorable condition due to the impact of Asian crisis, Government took some ad hoc measures to deal with practical hurdles of the SOEs sector, facilitating the economic growth recovery.

For instance, in 1997, some measures was adopted to support the SOEs such as the SOEs have been no longer required to provide collateral for their loans granted by 4 state-owned commercial banks; some loss-making SOEs can get loan if they submit the feasible project for their operations, loans of some SOEs' facing difficulties can be rescheduled. In 1998, the Prime Minister issued the Decision on Implementation of Credit Investment Plan in 1998. This decision allows all projects under the credit investment plan to use assets which are created by use of loans for collateral. In order to promote exports, in 1998-1999, the government required commercial banks to provide sufficient credit to enterprises promptly for buying rice and importing fertilizer. SOEs buying rice for export and importing fertilizer are allowed to use assets which are created by use of loans for collateral.

Although credit rules applied to the SOE sector are relaxed, the state-owned commercial banks still considered the efficiency of the SOEs's business and production as a standard to give loan, avoiding to spread credit to this sector.

For SOEs with profit, stable business and production, sound financial situation, the credit institutions continue to expand credit to feasible and efficient projects in business plan. For SOEs with unstable business and production, unsound financial situation, limited selling market, credit institutions take appraisals every time, supervise closely risk revaluation for each loan and they can reject to give loan to customers who can not pay back the loan.

As can be seen in above analysis, the share of credit to the SOEs has declined to 48% of total credit at the end of 1999. At present, this sector is still rather advantageous in accessing funds from the banking system. The contribution to GDP of SOEs sector (including the foreign direct investment enterprises), GDP is about 50%. However, the fact shows that high economic growth of this sector mainly come from the foreign direct investment enterprises.

Table 11 The share of GDP by enterprises, 1996-1999

Unit: Percent

	1996	1997	1998	1999
Total (percent)	100	100	100	100
State sector	40.2	39.9	40.5	40.2
Non-state sector	59.8	60.1	50.5	50.8
- Foreign investment sector	5.0	7.4	9.1	9.8
- Official private sector	7.7	7.4	7.2	7.1
- Farmer and households	35.8	35.3	34.3	34.0
- Cooperatives	10.1	10	8.9	8.9

Source: GSO

The SOEs are financed by FDI and also by 50% of credit extended by the banking system . However, it contributes only less than 50% of GDP. This reflects an unbalance of fund providing between the SOEs and the non-SOEs. As can be seen in Table 11, farmers and households contribute a large share of GDP. Therefore, the government's redirection to agriculture and rural area in the past years is completely correct under which the banking system has played an important role in widening the network providing credit throughout the country, including remote areas.

Finally, it can be confirmed that the credit balance between to the SOEs and credit to the non SOEs has been improved. The credit share to SOEs declined from more than 90% in 1990 to 50% in 1995-1999 and dropped to 48% in 1999.

2) Credit to the private sector

In the 1990s, especially since 1995, a series of new laws and governmental policies have been issued to foster the private sector, especially small and medium enterprises. The number of newly established enterprises increase rapidly. The private sector's contribution in agriculture, trade and services as well as light industry in the early stage of economic renovation is an evidence that this sector has potential development. However, the output contribution of this sector mainly comes from individual and households and to the less extent from SMEs. The output of SMEs in 1998 accounted for 16% of GDP and 2% of light industry's GDP. The main constraints the private sector's potential development can be seen from following matters:

- Most of private enterprises have small capital, so these enterprises tend to take part in light industry, trade and service that were quick capital recovery industries. The number of private enterprises taking part into international trade is limited because these enterprises are in shortage of capital and staff with appropriate skills and training needed to sign and implement foreign trade contracts.

- While international trade and foreign direct investment is an important engine of the economic growth, the domestic partners of foreign investors are mostly the state-owned enterprises (95%). International trade activities concentrate on industries that the SOEs accounted for larger share of output. Therefore, economic growth of the private sector has not benefited from international trade and foreign direct investment to less extent.

The following section mention on the finance performance of private sector. In this section, this paper considers small and medium enterprises to present the private sector because these enterprises accounted for 33.5% of foreign direct enterprises, 65% of cooperatives and 94.6% of limited liabilities companies.

- **The financial performance of private sector**

According to data of Ministry of Planning and Investment as of 30, June, 1998, there were 25,517 non-state-owned enterprises. Of which, 17,535 are individual private enterprises, 6,400 are limited liability companies, 153 are shareholding and 2,900 are cooperatives. Most of these enterprises are small and medium enterprises. Investment share of the private sector in total domestic investment is very small, so the economic growth rate of this sector is lower than that of the SOEs and foreign direct investment sector. The business households are dominant in the private sector and high potential to transfer into private SMEs.

The efficiency of the private sector is low and unstable. It can be explained that the technology is backward; the professional and managerial skills are very low in comparison to the required demand. All these factors put negative impacts on the profit-making ability of these enterprises.

In order to assess the financial performance, due to unavailable data, one can base on the average turnover per employee and some indicators reflecting enterprises' efficiency (see Table 12 and Table 13).

Table 12 The average turnover per employee by enterprises

	Turnover	Number of establishments	Turnover per establishment	Average number of employees per establishment	Average turnover per employee
SOEs	182,419,363	5,873	31,060.68	151	206
Private Entp.	11,419,661	10,916	1,046.14	12	87
Shareholding Co.	2,742,742	118	23,243.58	111	209
Ltd Co.	19,702,605	4,242	4,644.65	35	133

Source: US/VIE/95/004, 1999, table 1.8.

The Table 12 on turnover per employee shows the average labor productivity of private enterprises is lowest as compared to that of SOEs, share holding companies, limited liability companies. This limit the profit making ability of the private enterprises.

In term of some indicators reflecting enterprises' efficiency, particularly budget contribution versus turnover, one can see that the private sector is less efficient than SOEs. However, this seems to be not correct because in fact there are many private enterprises avoiding tax.

The Table 13 shows that the SOEs invest 0.417 VND of fixed capital for 1 VND of turnover while private enterprises spend 0.197 VND, shareholding companies spend 0.224 VND and limited liabilities companies spend 0.188 VND. This figure sector appears to be the most efficient sector. However, this sector's potential has not been exploited. One of constraints to the potential development of this sector is capital. Let's move to see how the demand for investments of this sector is met.

Table 13 Some indicators reflecting enterprise efficiency

Enterprise	Value of fixed capital vs. turnover	Value of building vs. turnover	Value of machinery and equipment vs. turnover	Investment vs. turnover	Total capital vs. turnover	Credit vs. turnover	Budget Contribution vs. turnover
Total	0.502	0.118	0.325	0.052	0.755	0.276	0.109
Domestic enterprises	0.381	0.098	0.234	0.039	0.611	0.275	0.095
1. SOEs	0.471	0.101	0.261	0.043	0.652	0.302	0.110
1.1 Central SOEs	0.562	0.109	0.370	0.050	0.876	0.432	0.126
1.2 Local SOEs	0.220	0.090	0.111	0.034	0.346	0.126	0.089
2. Co-operatives	0.298	0.089	0.188	0.010	0.358	0.065	0.033
3. Private entp	0.197	0.099	0.088	0.018	0.287	0.045	0.018
4. Shareholding co.	0.224	0.102	0.097	0.010	1.359	0.603	0.047
5. Ltd. co	0.188	0.074	0.103	0.018	0.363	0.147	0.020

Source: MPI survey

- **The demand for investment funds of private sector**

The demand for investment funds of the private sector are mostly funds for start up of their new establishments. Most private enterprises are financed by their owned capital and capital of their relatives and friends to maintain business and production some months after establishing enterprises. Usually, after 1-3 years since its establishing, these enterprises start to borrow funds from banks. In addition, demand for funds to modernize machines and upgrade business and production base is one challenge to these enterprises.

Although credit to the private sector has been expanded, difficulties in accessing credit from the banking system is one of obstacles to this sector's development because credit to the private sector is mainly to farm households and very little to production enterprises. Capital shortage is a character of the private sector, both in rural and urban area. Approximately 25% of households, 32% of private enterprises and 32.5% limited liability companies and shareholding companies in total 500 enterprises surveyed by Ministry of Planning and Investment stated that capital shortage is one obstacle to their development, particularly in rural area.

Looking to the private investment as compared to the state investment and the budget investment

(Table 14), one can see that the private investment has inverse relation with the state investment, this reflects the crowding out of the state investment.

Table 14 Some tax and investment indicators of private sector, 1995-1998

Unit: percent

Year	Private sector's tax/GDP	Private sector's tax/ private sector's GDP	State investment (a)/GDP	Budget investment/GDP	Private investment/GDP
90	2.3	3.4	6.1	5.1	5.9
91	2.2	3.4	5.7	3.5	7.7
92	3.0	4.7	7.4	5.8	6.3
93	3.4	5.8	8.6	6.8	7.7
94	3.2	5.6	7.7	6.6	8.6
95	3.5	6.3	7.4	5.4	8.8
96	3.79	7.3	9.8	6.0	7.6
97	3.9	7.3	12.2	5.9	6.4
98	4.0	8.0	11.6	6.7	5.8

a: includes budget investment, state credit and SOEs' investment

Source: MPI

The survey' results also show capital sources of the non-state-owned enterprises in rural and urban area as follows:

Capital of the non-state-owned enterprises come mainly from their own capital, accounted for 90-91% while credit from banks accounted for small part. Since 1991, the banking system has been expanded, setting up a wide network to offer banking services (including joint venture banks, foreign bank branches, joint stock banks and credit cooperatives). The private enterprises and households have more chances to access credit from banks. Therefore, credit of the banking system to the private sector tends to increase. However, of total funds at the time of establishing, credit from banks contributes a small proportion owing to bottlenecks in credit activities, including constraints by enterprises, constraints by banks, loan secure mechanism and other constraints.

Table 15 Capital sources at start up establishing of private enterprises (In rural and urban areas)

Unit: Percent

	Urban area	Rural area
- Own capital	91.2	90.3
- Non interest loan	3.1	3.8
- Banks credit	0.8	1.9
- Credit cooperatives	0.0	1.0
- Local authorities	0.0	0.3
- Worker contribution	2.2	0.1
- Borrowing from individuals	1.3	2.3
- Others	1.5	0.3

Source: MPI, 1998

- **Constraints by enterprises**

  - Most private enterprises have small capital as compared to that of the state-owned enterprises, these enterprises was established since the early of 90s, so their creditability is still low. As a result, it is difficult for them to access bank credit.
  - Complicated procedures and high transaction cost also make loans to the private sector less desirable from banks' point of view because a small loan required the same procedures as a big loan.
  - The private enterprises met difficulties in accessing bank credits because bank credit is usually provided to the enterprises having sufficient authorized capital, pledges of the owner and feasible business plan. Sometimes, the enterprises have not sufficient legal documents related to real estates for collateral. Some owners of enterprises have limited knowledge, so they are not able to formulate efficient business plan and their abilities to build up medium and long-term business plan to pursuade banks to give loans are limited.
  - Some owners of the non-state-owned enterprises are hesitated when borrowing from banks because they have to submit their accurate reports on financial situation, profit and loss statement, the thing that many owners do not want to submit due to different reasons.

Table 16 The average capital of enterprises by ownership

Unit: million VND

Year	Private enterprise	Limited liability companies	Shareholding companies	State-owned enterprises
1991	175	754	19,650	3,909
1992	213	1,416	16,526	4,359
1993	185	917	14,225	9,070
1994	159	789	49,629	40,103
1995	204	810	11,492	66,895
1996	179	818	10,978	26,865
1997	128	1,032	10,412	11,688
1998	275	1,141	8,064	12,589

Source: MPI

  - Most the non-state-owned enterprises were newly established in recent years, so the owners of these enterprises have not been trained for management and business administration. Approximately, 48.7% of private enterprise's owners have no specialized certificates or bachelors. Only 31.2% of them have at least bachelor.
  - Some non-state-owned enterprises lose their creditability as a result of cheating, so bank staff often have prudent attitude in providing loans. Lack of a good accounting standard, low confidential level of report of these enterprises makes bank staff more prudent to expand credit.

- **Constraints by banks**

The credit institutions have prudent attitudes when pouring investment in the private sector because this sector is very risk due to lack of government bailout. In addition, the discrimination against the private sector is rather popular, so bank staff seem not want to give loans to this sector.

- The foreign banks branches are banks that can support this sector efficiently. However, most credit extended by these banks are for foreign direct investment enterprises. Therefore, capital constraints to small and medium enterprises could not be overcome. According to an official survey on foreign bank branches, large share of credit is trade finance, short-term loans, guarantee. Major customers are joint venture enterprises and 100% foreign capital enterprises.
- From the credit staff's point of view, if the credit is efficient, profits belong to the banks but in case of bad loan, personal responsibilities are very serious. As a result, the bank staff is very strict in appraising projects to give loans.

- **Constraints by collateral regulations**

The private enterprises always met difficulties in getting loans from banks because they have to provide their pledge or mortgage collateral for such loans according to the credit rules. It is not easy for then to obtain the land use right (including notary procedures and procedures for evaluation of collateral and mortgages) be cause documents illustrating land use right and asset ownership have not stipulated by law. In addition, the stipulation that enterprise's collateral has to be located nearly credit institutions is also difficult faced by enterprises. Vice versa, the SOEs have been no longer required to provide collateral for their loans. This is one of constraint to credit to the private sector.

Particularly, the economic enterprises, especially the private enterprises have difficulties in obtaining the land use right certificates. Although some administrative reforms have been carried out, difficulties in resolving complicated procedures related to land use right are still major obstacles. In order to obtain the certificate of land use right, certificate of house ownership, individuals and households have to declare the house location, land use right at city and provincial people commitments together with other appropriate documents proving the origin of asset and land use right. Even with difficult documents, entities have to pay a lot of fee, that cost about 25% of total real estate value. Owing to complicated procedure, the number of individuals and entities having sufficient documents are not numerous. However, credit rules stipulate that individuals and entities can borrow funds from banks only with their appropriate document such as certificate of assets and land use right. Therefore, it is difficult for the private enterprises to get loans from banks.

- **Other constraints**

Beside reasons from enterprises, reasons from banks and some matters relating to collateral of loans, some following reasons also constrain credit to the private sector:

- In term of general policy to the private sector (small and medium enterprises): Although the Law of

Domestic Investment Promotion are in force but in fact, it is not implemented yet because many public offices still have beaurocratic attitude, less understanding, cooperating, serving the private enterprises' requirements subject to the Law.

- Administrative reforms in the public services such as licensing the land use right, notary, investment appraising took place slowly. These are constraints to the enterprises when completing procedures of credit from banks.
- Some state polices for expanding credit to the private sector have come slowly into effect, particularly The Fund for Credit Guarantee to small and medium enterprises.

A – 2

Financial Situation of Some Major Customers of the Banking System[1]

(The Second Step: Innovation of the Financial Sector—Bad Debts)

Le Viet Duc

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To analyze and clarify with persuasive rationale the real financial situation of Vietnamese banking system and of Vietnamese businesses is an extremely hard work since no individuals and organisations have so far been willing to publicize information on their financial situation. In some cases, when being forced to do so, individuals and organisations try to hide real information and announce only information that has been modified according to their own target in each period of time. Due to these reasons, this report will compile general information on the overall financial situation of economic components to satisfy the demand Project's Director Board in case of lack of data. This report is comprised of two parts:

- The financial situation of businesses through anlnalyzing the real financial situation of the commercial banking system.
- The financial situation of economic components.

Part 1 Financial situation of banking system

In the two-level banking system, commercial banks, acting as one level, are also customers of and under State admistration of the Central Bank. In additition to information about major customers in economic sectors, it is necessary to have information about the financial situation of commercial banks because the financial situation of business customers is reflected in the financial situation of commercial banks.

A) Bad debts of banking system in the early 1990s

Bad debts in Vietnamese banking system are classified into 3 main categories: credit arrears, delinated debt for settlement and delineated debts . Compared with countries in the region, in the early 1990s, the total bad debts of Viet Nam are not considerable in terms of value, but very dangerous because the total arrears and bad debts account for a big propotion in the total credit balance and a considerable ratio compared with the registered capital and working capital of banks.

Bad debts have been blocking many banking activities and the flow of bank capital, preventing banks from expanding credits of commercial banks and credit objectives of the Central Bank. Even in 1990, the

[1] By Le Viet Duc, Department on General Economic Issues, Ministry of Planning and Investment

too high overdue debt propotion created a crisis in all the corporate commercial banks system and credit cooperatives in Viet Nam, causing a distrust in this system in all the 90th decade. In late 1990s, thanks to some in-time adjustments, bad debt problem was kept under control and did not cause a banking crisis and macroeconomic instability like that in 1990.

Debt situatation of banking system in the period before 1995 can be summarized as followed: After the credit crisis in 1990, banking system and credit funds were restructured, resulting in an increasingly sound growth of the banking system in the period 1992-1994. Bad debts accounted only 6% of the total credit balance in late 1994. However, the balance sheet of the banking system worsened since 1995 as shown in the following table.

Table 1 Bad debts in Viet Nam (%)

% compared with	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**
Total credit balance	19.7	13.7	11.1	6.0	7.8	9.3	12.3
In which:							
- State-owned enterprises	19.7	13.7	11.6	10.2	8.9	11.0	11.9
- Private enterprises						4.2	13.5
Total capital of enterprises	106.7	88.1	95.5	85.5	61.9	75.8	93.5
In which:							
- State-owned enterprises	106.7	109.0	125.6	121.0	105.5	128.4	128.5
- Private enterprises						17.5	51.4

Source: Viet Nam economy 1998, research program on Asian financial and monetary crisis and its effect on Viet Nam's economy. Director: Do Hoai Nam, Center of Social Science and Humanity, Economic Institute, Hanoi, 10/1998. According to the State Bank, the arrear ratio of the total debt balance by 31/12/1997 was 13.3%, by 31/7/1998 was 13.6%.

The data in the above table shows that after the debt crisis in 1990, the ratio of bad debts in the restructure of the banking system remained very high in 1991 and 1992 (19.7% and 13.7%). The total bad debt in comparison with the total credit debts decreased to the lowest rate in 1994 but increased again in 1995. Particularly, bad debts of state-owned enterprises kept remaining at a higher rate than that of private sectors, proving that business activities and financial situation of the former was more difficult.

To settle businesses' debts that seem unrecoverable, Vietnamese Government has considered the solution of delineating and wiping out the debts. According to the State Bank's data, the total arrear of businesses in state-owned banks permitted to be delineated before 1995 to be settled in the 2nd phase of the totat debts liquidation was 2233.2 billion VND.

- Debts in Foreign Commercial Bank is 1,606 billion VND
- Debts in Industrial Commercial Bank is 472 billion VND
- Debts in Bank of Investment and Development in 117 billion VND
- Debts in Bank for Agculture and Rural Development is 38.2 billion VND

In the second general debt liquidation, the State Bank estimated that the debt eligble for wiping out of 4 state-owned commercial banks reached 1,116.7 billion VND, accounting for half of the total bad debts mentioned above.

Table 2 Arrears delineated for settlement until 31/12/1995

Banks	The total debts in the second phase in the payment net	% compared with the mobilized capital	Total debt value eligible to be wiped out	% compared with the total debts in the payment net	Total value of debts ineligible to be wiped out
Foreign Commercial Bank	1606	18.2	570	35.5	1036
Industrial and Commercial Bank	472	3.6	421	89.2	51
Bank for Investment and Development	117	7.1	87.5	74.8	29.5
Agriculture	38.2	0.2	38.2	100.0	-
Total	2233.2		1116.7	50.0	1116.5

Source: Report from the Central Economic Committee.

The derivative debts not subject to being wiped out are mostly under the following categories:

- Debts of enterprises that are in constant losses and subject to adjustment by the Law on Bankruptcy.
- Debts of enterprises that have reorganised their production and have potential for development to pay the debt later, according to to the guide in the Interministerial Finance and Banking Circular No 03/1997 dated November 22, 1997.

However, the situation of bad debts in banks keeps going worse. According to table 1 and updated data of the State Bank, in the recent years, the ratio of bad debts in the total capital of state-owned enterprises remains very high and tends to go up. By the end of 1997, the ratio of bad debts compared with the total credit balance reached 12.3% and increased to 13.1% by the end of 1998, 13.7% by the end of 1999. It can be said that due to worse financial situation of enterprises, bad debts ratio becomes too high and make direct impact on the financial situation of banks.

According to Table 1, if 50% of the above mentioned debts could be recovered, the financial loss of commercial banks is still very big. The financial situation of banks in the public sector is even more worrying. In 1997, with the bad debts accounting for 12.3% (or 13.3% according to the State Bank) of the total debt balance and 128.5% of the total capital, if only 50% of arrears is recovered, the banks will lose 65% of their capitals. In such a situation, the long-term arrears and small register capital make the bank more vulnerable in case of economic sudden changes.

Bad debts of East Asian countries before the crisis accounted for about 10-20% of the total credit debts while this ratio in Viet Nam has exceeded 12% since 1997 up to now. In the the 1990 decade, bad debts keep constantly higher than the capital of the state owned enteprises. The situation is very worrying because it means a great propotion of state owned enterprises remains unable to pay debts, especially when their business has just overcome a decline and is hardly to recover. The debt ratio in the total capital of private enterprises is lower, but in comparision with the total credit granted, it is also alarmingly high (13.5% in

1997).

The debt structure tends to get worse, too because the short-term debts and debts in foreign currency also increase. In 1997, in the total arrears, short term debts accounted for 51.8%, debts in foreign currency accounted for 40.7% while the long-term arrears accounted for only 6.5%.

B) Arrears in lending and guarranteeing of banking system until June 30 , 1998

The East Asian economic and financial crisis has made a great effect on the potential of banking system and its customers, making it more urgent than ever to reform the banking system. Arrears increased very quickly in 1997-1999 as mentioned above. This dangerous financial situation is attached with risks in potentially fast increasing exchange rate because from one third to 40% of the total bank loans are foreign currency while most enterprises only have income in local currency obtained by selling goods imported by the above mentioned loans in the domestic market.[2] The risk in payment also increases because the total capital mobilized by the banks keeps constantly higher than the lending capital, reaching 112% by the end of 1997, equal to that of crisis-hit countries in the East Asian countries.[3]

However, according to official report, the financial situation of the banking system in June 1998 was still rather low compared with the assessement of many economic specialists. Particulary, international auditing companies insisted that the total value of non-profitable loans of Viet Nam is much higher than the official figure announced by the State.[4]

Table 3 Debts of enterprises in banking system (%)

Order	Banking system	Total debts until 30/6/1998	Total arrears			
			Total	% compared with the total	Bad debts alone	% compared with the arrears
I	State commercial banks	78819	7,431	9.4	4332	58.2
1	Industrial and Commercial Bank	22387	4,165	18.6	2479	59.5
2	Foreign Commercial Bank	9771	1,414	14.4	898	63.5
3	Bank for Agriculture	24302	1,319	5.4	698	52.9
4	Bank for Investment and Development	19884	480	2.4	249	51.8
5	Bank for Poor People	2475	53	2.1	8	15.0
II	Corporate commercial banks	11471	1,909	16.6	1012	53.0
III	Corporate financial companies	246	19	7.7	9	47.3
IV	Foreign banks branches	17794	139	0.78	54	38.8
V	Joint-stock banks	1515	229	15.1	213	93.0
	Total	109845	9,727	8.8	5620	57.7

Source: the Central Economic Committee, "Report on settling bad debts in the banking system and financial institutions", September 12, 1998

2 the Word Bank (1998) and the Institute of Central Economic Administration (1998)

3 the Word Bank (1998) "Viet Nam - Strategy for national support in 1999-2002", page 12, Vietnamese version.

4 World Bank (1998) "Viet Nam - Going to take off?", Economic report in the Conference of Consultation group of Vietnamese sponsors, Hanoi, 14 - 15 May 1999, page 8

According to the above table, by June 30, 1998, the arrears compared with the total credit debts of state-owned banks were only 9.4% while this ratio of domestic corporate commercial banks reached 16.6%. The arrears of the corporate bank sector and joint - venture banks are the most worrying. In contrast, the safety level of loans in foreign bank branches seems to be very high. However, due to the fact that these banks are permitted to operate under a full market mechanism, not under any pressure from Viet Nam economic, political and social organisations they only make loans to foreign companies and joint-venture enterprises, their safety is higher.

Taking bad debts of the total arrears into consideration, we find the same danger as above: about 58% of the total arrears of the banking system is considered hardly recoverable, even unrecoverable, equal to 5620 billion VND. Especially, regarding this criterion, the state bank sector seem to be weaker than the corporate bank sector. In the joint-stock bank sector alone, despite the low credit loans, 93% of the arrears is hardly recoverable.

Another significant point is that the arrears and bad debts of banks for agriculture sector and farmers are much less than that of more luxurious banks which specialize in external economic activities (Foreign Commercial Bank) or industrial and service enterprises (Industry and Commercial Bank). Through this fact, it is possible to make an indirect assessment that agriculture and rural sector have better financial situation than the urban sector.

In some corporate commercial banks , the arrears ratio in the total credit balance gets very high, for example, debt ratio in Long Xuyen Quadrangle Bank reaches 98.21%, in Nam Do Bank - 94.27%, in Hai Phong Bank - 62.11%, in Gia Dinh Bank - 47.41%, in De Nhat Bank - 39.08%, in Viet Hoa Bank 29.06%, in Sai Gon Industrial Commerical Bank - 28.36%, in Viet Hoa Bank - 29.06%, in Phu Tan Bank - 25.75%, in Dai Nam Bank - 21.31%, in Eximbank 17.16%, Hanoi House Bank 17.76%...[5]. More than half of the above mentioned arrears is 6 month overdue, a sufficient long time that commercial banks no longer make loans to enterprises.

The potential Vietnamese banking system is still very weak, thus easy to be in turmoil when encountering difficulties. 4 state commercial banks accounted for 80% of the money mobilized, but in early 1998, the ratio of captial of the total asset and the ratio of capital of the total credit were only 5.3% and 8.9% respectively.

Besides the banks, people's credit funds' activities are not always safe and frequently encountering with problems at different serious levels in different periods. In early 1990, there were about 470 people credit funds in the whole country, mobilizing the total capital of 21.7 times as high as the registered capital, 90% of which was short-term capital and at a very high mobilizing interest rate, at the same time using 93.8% of the total capital for lending, resulting in 73% of the debts overdue. As a resutl, from mid 1990 to the end of

[5] Le Dinh Thu, Central Economic Department, "Report on dealing with arrearss in the banking system and credit organisations" 12 September 1998.

the year, 100% of the lending capital became overdue and mostly all people credit funds went bankrupt, causing chain reactions that a series of corporate banks went bankrupt as a sequence.

The recovery of the people credit fund system went cautiously in the 90th decade along with the promulgation of regulations to control it. By February 1999, there were 975 people credit funds all over the country operating in 53 of 61 provinces. Although the crisis threat in this system is not very high, in about 5 years from 1996 to 2000, there were several negative signs in the activities of the system, leading to increasingly worsened financial situation . By February 1999, in People credit fund basis, arrears accounted for 4.2% the total credit debt balance; financial balance of People credit fund basis is low, about 30% of the people credit fund basis could not cover the cost with the gain. The operation of people credit fund in the central and regional sector is better but there remains a high ratio of arrears in some places.

In 1999 and 2000, the Central Bank had to take many measures to structure and rearrange and reorganize credit funds to conform with regulations provided in the Law on credit institutions, at the same time tp strengthen the examination, instructions and support in time to decrease the debts in credit funds and prevent a new crisis. By March 2000, the ratio of arrears of the total debt balance of credit fund basis system in the mountainous and midland area in the North was 2.1%, in Red River Delta was 4.2%, in the former 4th Region was 1.5%, Central Coast:2.8%, Highland:3.0%, South East Region:2.0% and the Mekong River Delta:5.7%. The arrears on the total debt decreased o 3.88%.[6]

To settle the increasing debt situtation of enterprises in the banking system, Ministry of Finance, Banks have issued the circular to provide guideline on solutions. The interministerial Financial and Banking circular No. 03/1997 dated November 22, 1997 allowed the use of some capital source for compensation. Then, in the Decision No. 95/1998/QD dated 19 May 1998, the Prime Minister provided solution to settle delineating debts and arrears of state commercial banks .

In the second debt settlement, for debts eligible to be wiped out, it is possible to use the following capital sources if agreed by the Ministry of Finance and approved by the Prime Minister:

- Discount from the debt that State owned banks borrowed from the State Bank.
- State commercial banks distract from the fund providing against risk.
- Settled partly to the bank administration cost or used partly the profit to be contributed to Government for liquidation.

Debts that are already on payment net but not subject to being wiped out will be subject to the Law on bankruptcy for eligible enterprises. Enterprises who have arrears in state owned banks due to subjective reasons will be assigned responsibility to individuals or organisations and subject to legal settlement, if the arrears are due to objective reasons, the enterprises will be settled according to the directions provided in the current legal documents

[6] Nguyen Khai, the State Bank: "Some assessments on the activities of People credit fund basis". Financial Market magazine, No.10, May 2000.

In October, 1998, the Government granted capital to state-owned enterprises to wipe out the delineated debts left by the former subsidizing mechanism.

C) The situation of bad debts in the recent two years.

By the end of 1998, Vietnamese banking system consisted of 4 state-owned commercial banks (accounting for 82% asset of the banking system), 51 corporate banks with state-owned and private enterprises as their share holders (accounting for 10% of the asset) and 23 foreign bank branches, 4 joint-stock banks (accounting for 8% of asset). The total asset value of the banks is equal to 38% of GDP, the total loan value equal to 22% of GDP and the total deposit equal to 20% of GDP. In the two year 1999 and 20000, 2 corporate commercial banks were merged and 4 other were close, decreasing the number of corporate commercial banks to 46. In contrast, in 2000, a joint-stock bank was added to bring theo total joint-stock banks to 5.

The situation of bad debts in the banking system in the recent two years could be described as followed:

Table 4 Movements of bad debts in the banking system in 1999-2000

	31/12/98	30/04/99	31/8/99	31/12/99	30/6/2000	31/8/2000
Bad debts of the total debit balance (%)	13.6			13.7	13.4	13.1
- Arrears	6.0			6.6	5.9	5.8
- Debts to be settled	4.8	4.6	4.5			
- Delineating debts	2.8	2.6	2.7			
Debts to be settled and delineating debts	7.6	7.2	7.2	7.1	6.5	6.3

Before April 1999, delineated debts were settled in the account "debtors", therefore they were not settled to the loan balance of the economy. Since April 1999, according to the new economic statistic system, delineating debts have been settled in the account "delineated loans" and not in the loan balance of the economy. *Data source: State Bank.*

Table 4 shows that the arrears situation in the banking system has reached its peak by the end of 1999, coinciding the bottom of the GDP decline of the country. However, the financial improvement of the banking system is going at a pretty low speed in the year 2000. There is concern that the practice of lending for paying the debts (debt swapping) may continue, making the real arrears even higher. By the end of 1999, many Western economists still thought that the banking debts of Viet Nam were similar to that of China, but China often announced much higher figure of bad debts than Viet Nam's data. Even in early 1999, a highly prestigious monetary organisation said that the financial situation of Vietnamese banking system was only better than Russia's and Ucraine's.

The improvement of the financial situation of the banking system is mainly based on the economic recovery and new policies and initiatives of the Government, the State Bank of Ministry of Finance. The economic recovery in 2000 is resulted from the increasing foreign demand, increasing income thanks to a sudden high increase in oil price during 2000, the investment and comsumption stimulation of the

Government and people's increasing income thanks to a strong increase in domestic demand. Since demand increases, enterprises increase their sales, continue their reproduction and get income to pay for the banks.

Regarding the debts to be settled and delineated, thanks to Government's initiatives, mainly in terms of wiping out and equitizing the debts, the ratio of these debts in the total credit debt balance constantly decreased in the recent two years. Thanks to the above measures, by the end of 2000, Viet Nam has made the first improvements in the two weakest aspects of the banking system, namely the vulnerability to internal and external shocks and the low capacity in mobilizing savings and transfering savings to highly effective investment projects.

In brief, the financial situation of the Commercial Banking system in Viet Nam has made a lot of progress in the early 1990s after the banking crisis in 1990. Nevertheless, from 1995 to 1999 there went a contradictory trend, resulting in bad consequences, especially that international financial and monetary institutions rated the prestige of Vietnamese banking system one of the lowest in the region. This made a very bad impression in foreign investors about the investment environment in Viet Nam.[7] The situation has gradually been improved since 2000 thanks to the proactive economic recovery.

Part 2 Financial situation of the main customers in the banking system

The financial situation of Vietnamese banking system is closely related to the financial situation of its main customers. Mostly all the big borrowing customers are the General Company 90, 91 of the State which have a lot of member enterprises. Periodical reports of these general companies to the Government authorities often have little information on the financial situation but a lot of information on the production and sale of products under the plan. Most of the information relating the financial situation of the state-owned enterprises and non-state enterprises is insufficient and inobjective, let alone the fact that it should be audited by responsible authorities. It is, therefore, hard to say exactly and clearly about the real financial situation of those enterprises.

To prepare for the following content of the report, we must base ourselves on various information sources from the relevant authorities of the Government to magazines and newspapers on economic research.

A) Customers from the state-owned enterprise sector

By August 2000, the state sector has 5280 enterprises, accounting for about 42% of GDP, over 50% of export turnover, 15% of non-agricultural employment, nearly 40% of the state budget, 98% joint-venture projects with foreign invested enterprises, but accounting for more than 50% of the credit debt balance of

[7] In general, international corporations specializing in rating the health of banking systems catergorize 3 criteria for sound banking operations to 4 levels of trust from high to low namely A, B, C, D. In Viet Nam in late 1996 and 1997 we had two criteria at B and one at C. But after the Eastern Asian financial and economic crisis in July 1997, we had only one B and two C. In the early and mid 1998, we had only 3 C.

the whole banking system.[8] In 1998, 200 biggest state-owned enterprises alone accounted for 60% of the total capital of the State and 40% of the total banking debts.[9] Most of the debts of the state-owned enterprises are from over 1000 big enterprises.

The Vietnamese state-owned enterprises were always the biggest customer of the banking system during the 90th decade although the propotion of banking credit granted for this sector gradually decreased. If in 1990 and 1991, the banking credit for this sector reached the high rate of 90%, it fell to 54.5% in 1998. However, the problem existing during 90th century was how to settle bad debts and arrears in Vietnamese banking system when most debtors were state-owned enterprises.

While many state-owned enterprises are in constant loss and unable to pay the banking debts, they still get credit loans from state-owned commercial banks without any mortgage. This has worsened the debt situation of state-owned enterprises, threatening the banking system with a crisis if they are not supported by the Government. The delineating, wiping, capitalizing or equitizing the debts in enterprises just have low and short term effects. financial situation of state-owned enterprises are still difficult due to their constant losses in business. Since 1997, many state-owned enterprises have been supplemented with working capital. The Government had to require state-owned commercial banks to supplement credit capital for state-owned enterprises.

Compared with other sectors, state owned sectors enjoy a lot of priviledges in policy, such as easy access to scarce resources, especially banking credit capital, preferences in land, in international trade, in opportunity and ability to make joint-venture with foreign enterprises. A state-owned enterprise even losing in their business may obtain bank loan if they have a feasible business project no matter whether or not the project is really feasible. However, the work efficiency of state-owned enterprises is low, resulting in weak financial situation . According to the General Department of Statistics, in 1990, 80% of state-owned enterprises lost in their business 89% of which were local state-owned enterprises under provincial control.[10]

The General Department of Statistics also estimated that the production cost in Viet Nam was often higher than the international standards. For example, in the early 1990s, the energy and material cost in ure production in Viet Nam was 2.35 times and 1.89 times as high as the international standards. For chemical products, the above mentioned costs were 1.38 and 1.44 times as high. Considering the energy cost alone, the Vietnamese cost price compared with the international one was 1.26 times as high in paper production, 2.04 times as high in tyre production, 1.31 times in pottery production, 1.75 times in coal production, 2.46 times in fan and 1.95 times in paint prodution.[11] It is clear that production difficulty will lead to very poor financial situation of the state owned sector in the early 1990s. The Government, therefore, reapplied the

[8] The World Bank (1999) and the Central Department on Enterprise Management Reform (2000), "Project on continuing structure and reform of the state-owned enterprises"

[9] World Bank (1998) "Viet Nam - Going to take off?" Economic report in the Conference of Consultation group of Vietnamese sponsors, Hanoi, 14 - 15 December 1999

[10] Ta Thi Xuan (1992): "Inflation in Viet Nam". Viet Nam Social Science Publishing House.

direct subsidizing policy from the state budget for state-owned enterprises in 1990-1992.

By the end of the 90th decade, the situation was much improved. However, this improvement was not enough to reverse the situation. The cost price of many major industrial products remained higher than the international standards, resulting in higher ex work price than the price of the like improted products (see Table 5). Particularly, some domestic industries such as raw sugar have the price 70-80% higher than the import price. Therefore, these industries must rely completely on the government protection. In some cases such as cement, sugar cane, sugar, textile fibre, machine, electric equipment, chemicals, paper, beverages...there were overspreading invesment which not only resutled in low efficiency of the investment capital but also in long term harms.

Table 5 Comparison the domestic and foreign prices, USD/ton

Products	Ex work price	CIF imported price	Difference (%)
Cement	50-60	40-45	30-50
Sugar RS	360-400	260-300	20-50
Construction steel	300	260-280	10-12
Ure fertilizer	160-180	115-125	30-40

Source: The Government Pricing Deparment, quoting in Vu Minh Khuong "Improving the efficiency and international competitiveness of our economy", Economic Studies Review, No 254, July 1999.

The production and financial situation of the state-owned sector was also improved quickly in the early half of the 90th decade. In 1995, the ratio of enterprises losing in business decreased to 10%. However, since 1996 there was an opposition trend: according to the Ministry of Finance, the ratio of losing enterprises increased at a rather fast rate. In 1996, 22% of the total enterprises lost in their business. Before the financial and monetary crisis in Eastern Asia, only about 40% of enterprises made profits while the other 32% of enterprises continued being in loss. However, according to the Central Department of Business Innovation, the ratio of losing enterprises in 1995 was only 16%, in 1996 - 16.5% and in 1997 was 22%. The total creditors of state-owned enterprises was 100577 billion VND, 119000 billion VND in 1997 while the total debtors were only 64141 billion and 56000 billion VND respectively.[12]

Eastern Asian crisis has increased the number of entepises losing in business, the ratio of losing business reached 50% if fully calculated.[13] By the end of 1997, the 'weakest" 'inefficient" enterprises (categorized

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[11] Tran Hoang Kim and Le Thu (1992) "Economic sectors in Viet Nam - Situation, trend and solutions". Statistics Publishing House, Hanoi. Duong thu Huong (1995) "Innovation in monetary policy and banking system", in "Innovation in financial and monetary policy and inflation control in Viet Nam", the National Politics Publishing House, Hanoi

[12] The Central Department of Enterprise Innovation, "xxx report to enhance and reorganise production and strenthen the equitization of the Central Department of Enterprise Innovation". 9/1998. Vietnamese information sources are different, we just put here for your reference.

[13] Nguyen Minh Tu (1998) "Vietnamese economic growth seen from the point of a two regions' economy". The Economic Studies Review No. 242, 7/1998.

based on the profit rate and banking debt rate) had nearly 20 thousand billions amd 43 billions VND banking debts respectively, equal to 1.4 and 3 billion USD. Following is the financial situation of these enterprises. (see Table 6)

The group of weak state-owned enterprises had the average debts twice as much as the value of state capital. 50 enterprises in this group had debts that many times as high as the value of the capital granted by the government (that is the capital of the enterprises). Because most of these enterprises lost in doing business, they were unable to pay the debts. In addition, since 1998, the demand pressure was released while the competitiveness of the imported goods increased, resutlting in even worse production efficiency and financial situation of state owned enterprises in 1998 and 1999.

Table 6 The financial situation of weak state-owned enterprises

Criteria / Types of state-owned enterprises	Weak	Inefficient operation
Number of enterprises in the group	711	1989
Number of laborers (thousand people)	183	583
Total debts (thousand billion VND)	19.5	42.5
Mere banking debt (thousand billion VND)	14.0	29.0
Government capital (thousand billion VND)	10.2	52.5
Pre-tax profit (thousand billion VND)	-0.25	5.0

Source: the Ministry of Finance and the Central Department of Enterprise Innovation, quoted in the report of the World Bank in the Conference of Vietnamese sponsors, 12/1999

Table 7 Operation situation of state-owned enterprises in industries

	Unit	1995	1996	1997
I- Total number of enterprises	Unit	1958	1880	1858
1- Public service enterprises	Same as above (sa)	77	69	73
2- Productive and trading enterprises	Sa	1881	1811	1785
3- Businesses making profit	Sa	1582	1417	1498
4- Businesses recovering in their capital	Sa	109	119	69
5- Businesses making loss	Sa	267	344	291
Ratio of businesses in loss/total enterprises	%	14.5	19	16.3
II- Capital sources	Billion VND	59798	71469	80911
1- Owner's capital	Sa	40631	43660	46327
2- Borrowing capital	Sa	13098	18897	34584
III- Business result	Billion VND			
1- Turnover	Sa	63680	76440	86435
2- Pre-tax profit	Sa	3031	3851	4406
+ Profit of profiting businesses	Sa	3196	4151	4711
+ Loss of losing businesses	Sa	-165	-300	-305
IV- Total contribution to the state budget	Billion VND	7896	8491	10357
1- Consumption tax	Sa	3080	3537	5963
2- Profit tax	Sa	1136	1463	2230
3- Tax and other charges	Sa	3680	3491	2164

Source: The Central Department of Enterprise Innovation, the Report on contiuous innovation and equitization of state-owned enterprises, 9/1998.

The above data table shows that the ratio of losing businesses in 1996, 1997 increased very quickly compared with that in 1995. If compared with the whole state owned sector, the ratio of losing businesses in industry in 1996 was higher, but in 1997 was lower. In addition, it can be seen that the ratio of losing enterprises in the General Company 91, 92 was lower than all the industrial sector in particular and all the state-owned sector in general.[14] This can be explained with the fact that general companies enjoyed more preferences than other sectors, especially they nearly enjoyed the status of monopoly.

Table 8 The operation situation of state-owned enterprises in trade

	Unit	1995	1996	1997
I- Total number of enterprises	Unit	1805	1778	1755
1- Enterprises making profit	Sa	1355	1209	1184
2- Enterprises recovering their capital	Sa	39	76	75
3- Enterprises making loss	Sa	171	221	267
Ratio of losing enterprises/Total enterprises	%	*9.5*	*12.4*	*15.2*
4- Enterprises that not identifying profit and loss	Sa	240	272	232
50% Enterprises that not identifying profit and loss + Losing enterprises / total enterprises	*Sa*	*16.1*	*20.1*	*21.8*
II- Total capital	Billion VND	22	36.5	46.3
1- Owner's capital	Sa		10	8.9
2- Borrowing capital	Sa	22	26.5	37.4
III- Business result	Billion VND			
1- Turnover	Sa	94.3	127	140
2- Pre-tax profit	Sa	1.0	1.1	1.2
IV- Total level of contribution to the state budget	Billion VND	8.2	9.3	11.5
1- Turnover tax	Sa	1.1	1.2	1.4
2- Profit tax	Sa	0.5	0.5	0.8
3- Import and export tax	Sa	4.7	5.6	6.0
4- Excise tax	Sa	0.01	0.3	0.4

Source: The Central Department of Business Management, the report on continuous innovation and equitization of state-owned enterprises, 9/1998, the date not accounted for joint-stock with foreign partners.

For state-owned enterprises in trade sector, the ratio of losing businesses increased constantly in the period of 1996-1997. Particularly, suppose that 50% of the state-owned enterprises which were not identified loss or profit were losing, the ratio of losing enterprises would be 21% in those two years. The situation was even worse in 1998 and 1999 because the economy was declining greatly and the worst decline was happening in the service sector (GDP growth rates in 1998 and 1999 were 5.8% and 4.8% respectively compared with 9.3% and 8.2% in 1996 and 1997)

Some additional information in the efficiency of state owned enterprises can be put in as followed: According to the General Department of Captial and State Asset management under Ministry of Finance, in 1998, of nearly 5800 state-owned enterprises, only 37% effectivly operated while 46.4% were in difficulty with the banking arrears reaching 1135 billion VND and 16.6% of enterprises were losing with the arrears

[14] According to the Department of Business Reform, the ratio of losing state-owned enterprises in the General Company 90, 91 was 16.9% in 1996 and 13.2% in 1997.

of 1763 billion VND. The ratio of profit out of capital of state-owned enterprises decreased constantly, from 19.1% in 1995 to 14.5% in 1996, 10.8% in 1997 and 8.0% in 1998. Other criteria such as profit/ turnover, profit/fixed asset...also constantly decreased.[15] According to the Central Department of Business Management Innovation, the member enterprises of the General Company losing in business in 1999 accounted for 14% the total member enterprises of government general companies.[16] General Companies 91 of the Government accounted for 58.8% of the government's capital but created only 37.7% turnover and 52% contribution to the state budget of all the state-owned sector[17] although their loss rate is lower than other sectors.

The weakness of the state-owned sector led to its difficult financial situation, orginating from the management mechanism of the state-owned enterprises which didn't create the impetus for the enterprises to actively improve innovatives in production and business. Enterprises find that the government can still financially support and enhance the protection, thus they want to rely on the government. The management and organisation of state-owned enterprises is too cumbersome, less efficient compared with private and foreign invested enterprises. In the same industry and with the same production scale, labour in state-owned enterprises is twice or three times as much as in private enterprises. With the same fixed assets, labour in state-owned enterprises is 10 times as much as in foreign invested enterprises. Actually, after one year of equitization, the resutl of production and business, work productivity, tax to contribute to the state budget, post-tax profit, profit rate of equitized enterprises increase by 2 or 3 times compared with the period before the equitization (see table 12). This is an clear evidence of the very low production efficiency of state-owned enterprises.

Due to business loss, the chain debts among state owned enterprises and their bad debts to commercial banks have been increasingly serious. After the first phase of debt general settlement, the debts of state-owned enterprises increased very quickly. If in 1996, the total debtors and creditors of state-owned enterprises are 159.1 thousand billions VND, they increased to 170 thousand billion VND in 1997 of which 75 thousand billion was debtors and 95 thousand billion was creditors.[18] The debts continued growing, in 1998 reached 175 thousand VND and in 1999: 199.1 thousand billion. In 1999, the debtors accounted for 62% while the debtors equaled 109% the government capital granted to enterprises.[19] Almost all the above debts would be unable to be paid because many debtors have disbanded, gone bankrupt or merged, and it is the government

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15 The data were surveyed on the 1200 enterprises under General Companies 90 and 91

16 The Central Department of Business Innovation and Management (2000) "Project on continuous organisation, innovation and development of state-owned enterprises"

17 The Central Department of Business Innovation and Management (2000) "Project on continuous organisation, innovation and development of state-owned enterprises"

18 The Central Institute of Economic Management Research (1998) "Report on Viet Nam's economics in 1998" Hanoi 3/ 2000

19 The Central Department of Business Innovation and Management (2000)

who has to suffer mostly all the loss.[20]

To lessen the financial difficulty of the state-owned enterprise sector, in 10 year period from 1991 to 2000, the Government has invested an additional capital of 41 535 billion VND in state-owned enterprises in which 8000 billion VND was invested in 1997-1999 period (2016 billion was supplement to working capital, 1464 billion was compensation for loss) to help enterprises with financial difficulty. Also in the last 10 years, the Government has granted preferential credit of 70 thousand billion VND, in 1997-1999 alone 8685 billion VND. In addition, during the last 3 years, the Government also exempted tax of 1351 billion VND, wiped out the tax debts of 1088 billion VND, delineated debts of 3392 billion VND, slackened debts of 540 billion VND, discounted the depreciation of 200 billion VND.[21]

Along with the above supportive measures, to basically settle the long debt situation, the Prime Minister has issued the Decision No 95/QD on settlement and liquidation of public debt phase two. The restucture and reorganisation of the prodution, disintegration, mergence and bankruptcy of state-owned enterprises alone made the banks unable to recover 1400 billion VND in phase two of the settlement and liquidation of debts. However, the financial situation of state-owned enterprises by the end of 1999 was not considerable improved because a significant number of enterprises in this sector kept doing loss in business. Only since 2000, thanks to growing foreign demand, increasing oil price and the demand stimulation policy of Government, the economy recovers and the financial situation of state-owned enterprises started being improved.

Corporate company	Year			Capital (billion VND)			Compared with the time before equitization		
	Equitization	In equitization	After 1 year	Proportion of Government capital	Turnover	Profit	Contribution to state budget	Labour	Labourer's income
Transportation coliation Agent	1993	6.2	65.0	18.2	980.1	898.5	784.0	411.8	400.0
Refrigerating and Electrics Company	1993	16.0	150.0	25.0	950.0	560.0	1100.0	240.0	131.3
Hiep an Shoe company	1994	4.8	4.8	30.0	108.8	2488.9	829.6	92.0	163.5
Long An Export processing Co.	1995	3.5	6.5	30.1	165.3	956.3		155.6	232.6
Viet Phong Co.	1995	7.9	12.0	30.0	297.4	145.7	136.3	133.7	
Bee honey Co.	1996	2.5	2.5	30.0	117.6	837.5		100.0	133.3
Binh Dinh Ship building Co.	1996	1.15	1.15	50.7	638.8	816.6	463.3	106.3	
Sai Gon Hotel	1997	18.0	17.2	40.0				100.0	
Minh Hai sea products export processing Co.	1996	10.0	12.8	51.0				69.4	114.3
Hai Phong bus Co.	1996	1.8	1.8	40.0	121.0	120.0	120.0	100.0	116.6
Dong Giao Rock Co.	1996	3.2	3.2	39.3	183.1	194.0	94.7	101.7	
Hanoi woodware Co.	1996	0.4	0.5	0.0					

Source: Central Department of Business Management Innovation, 8/1998.

[20] The Center of Social Science and Humanity, Economics Institute (1998) "Vietnamese economy: 1998's problems, 1999's prospects and some policy recommendations". Hanoi 10/1998.

[21] The Central Department of Business Innovation and Management (2000)

B) Private sector

In this report, private economic sector includes farmers, households and domestic private enterprises. Although a number of researches on its activities have been carried out, systematically information regarding the financial situation of this sector is still limited. Therefore, this report is only intended to give a general assessment of this sector.

In Viet Nam, private sector accounts for more than 40% GDP in the period of 1996-2000. The majority of this sector, making up 34 % of GDP, consists of household businesses, mainly those in agricultural production and service provision. Other private economic entities, mainly small and medium sized enterprises, accounts for only 7%.

The above figures show that private sector plays a no less important part than state sector in the national economy. In 1990s, however, the financial situation of this sector was much more difficult than that of other sectors, as it had lower economic potential and competitiveness while receiving little support from the Government.

One of the biggest financial problems facing private enterprises was that they often lacked capital to meet their own need. Back to early 1990s, up to 95% of their capital was contributed by friends and relatives free of interest. Capital borrowed from commercial banks and through other form of mobilization accounted for a small proportion. Thus, private businesses owed little debt to banks and other financial organizations. Most of them owed almost nothing to banks. However, in 1989-1990, a small number of private enterprises borrowed large sums of capital from credit funds while their operation was not efficient. This situation led credit funds to crisis in mid 1990s.

By 1991-1992, only 8% of private enterprises in cities and 2 % in rural areas had access to capital sources at banks and credit cooperatives, but most of these loans were of small value, not more than USD 300 each. Structure of capital sources accessed by private enterprises in cities was almost unchanged, with self-finance accounting for 76%, contribution from staff 13.5%, non-interest loans 5%, loans from banks and credit cooperatives 0.6%, from private sources 1.6%, and capital from other sources 3.3%[22] Fortunately, the proportion of bank loans extended to the non-state sector increased every year from 10.1% in 1991, 18.2 % in 1992, 31.5% in 1993, and 37.5% in 1994. At the same time, credits extended to farmers also mounted: VND 359 billion in 1991, VND 1579 billion in 1992, VND 4246 billion in 1993, and VND 8526 billion in 1994.[23]

With little capital from external sources, private sector businesses do not have the serious problem of heavy debts. The debt-to-asset ratio of private enterprises in cities was just around 3.6% in 1990 and 4.7% in 1991, being 3-4 times higher than that of the households. However, these figures were much lower than

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[22] Statistics from a survey on SMEs in Viet Nam by Ministry of Labor, Invalid, and Social Affairs in cooperation with the International Labour Organization

[23] Pham Ngoc Long (2000) "Money Policies and the Reform in Viet Nam"

that of state-owned enterprises in the same period: 25.7% in 1990 and 23.4% in 1991. In recent years, bank loans extended to private sector (including foreign invested enterprises) have increased: 44.9% in 1995, 48.2% in 1996, 50.3% in 1997, 48.1% in 1998 and 50% in 1999. The majority of these loans were granted to farming households: VND 10375 billion in 1995, VND 12000 billion in 1996.[24] Loans granted to non-agriculture sector accounted for a lower percentage but tended to increase in the following years.

Working capital of private enterprises made a large growth in the period 1991-1996. The average working capital of each small private enterprise established under Law on Private Enterprises increased 2 fold. Capital of limited companies were 10 times more than that of the above private enterprises, but the total of capital shrank from VND 2 billion in 1991 to VND 1.6 billion in 1996. Capital of privatized enterprises also increased. Generally, the growth of capital in private sector increased 17% over the period 1991-1995. The increase in the number of enterprise and in the average capital of each enterprise resulted in large output growth of this sector.

General estimation based on revenue and contribution to the state budget, small sized private enterprises are the most effective, then come limited companies, and privatized companies and cooperatives rank third.[25] Based on the improved performance and financial situation of privatized companies as compared with state-owned enterprises, it can be concluded that private enterprises can achieve a sound financial record. Table 1 shows that their overdue debt was only 4.2% of total debts by 1996.

If private sector was not recovered in 1991-1995 and its financial situation was not improved by the open-door deregulation policy, the general growth rates have even declined at faster pace with less of their contribution. In order to improve the competitiveness in the increasingly difficult stages of development, private enterprises are in a desperate need for capital in order to enlarge their production scale and capacity, modernize their equipment, machinery and technology, and develop human resources. However, the sad fact is that capital growth rates of this sector have been minus for 4 consecutive years 1996-1999, even –10 % in 1999.

The banking and financial system of our country is still under-developed. Complicated collateral and examination procedures, together with corruption, bureaucracy and immorality have mushroomed during 1990s, forcing 20% of small and medium sized enterprises (SMEs) to mobilize their own capital. Banking loans extended to this sector is also very limited. On the one hand, this is because banks are not willing to lend private investors for their low reliability and high cost involved. On the other hand, strict regulations in granting loans also discourage investors. The waiting time, which used to be 3-6 months, sometimes up to 1 year, now has been shorter, but still too long for investors to seize their business opportunities. In 1990s, the Government set up a number of investment-stimulating funds to provide soft loans to investment

[24] Pham Ngoc Long (2000), as mentioned above

[25] Nguyen Huu Dat (2000) "The development situation of private economic sector in Viet Nam in the period 1990-2000", Economic Study, Vol 262, March 2000

in underdeveloped areas and industries. In principle, private enterprises could benefit from these funds. In reality, almost soft loans were granted to state-owned enterprises and only 10% of them were for private enterprises.

By now, access to medium and long-term sources is still a big challenge for private enterprises because most of them can not meet bank's requirements regarding collateral. A survey by World Bank shows that 53% of small and medium sized private enterprises in Viet Nam consider capital shortage as the biggest obstacle to their business. Lacking capital, private enterprises are unable to modernize their machinery and equipment or enlarge their production. The Government's instruction for commercial banks to continue providing loans for loss-making state-owned enterprises without requiring collateral has also further limited the accessible capital for private enterprises. In addition, complex and vague regulations on land use rights cause a lot of difficulties to private enterprises in enlarging land area for their production. The result is that many private enterprises have to operate with outmoded machinery and equipment in cramped factories. Thus, their products can hardly compete in the international market. The competitiveness of our products is presently based on low cost price, not on quality.

The common trend in recent years is that investors have unpeaceful mind and wait for new changes in policies while delaying the implementation of their projects. Particularly, investors have even found themselves being discriminated when they are put under increased supervision by the Government to cope with the impact of East Asian economic crisis (e.g. the proportion of bank loans extended to this sector in 1998-1999 deceased as compared with that in 1997). As a result, during 1990s, despite the continued growth in general production, a large number of private enterprises had to terminated their business or declared bankrupt, another considerable number were facing serious financial situation with increasing overdue debts, bad debts and illegal capital appropriation.

The general outcome was that production growth rate of private enterprises decreased sharply since 1996-1997. GDP also descended from 8.5% in 1995 to 4.2% in 1998 and continued its way down in 1999. Their competitiveness also decreased in comparison with that of state-owned enterprises and foreign invested enterprises. It is becoming increasingly difficult for private enterprises to sell their products because their prices are high and their quality is not up to customers' expectation. Most of the inputs and outputs for private enterprises' business come from the domestic market, which has been stagnant in recent years. And most of these transactions have been conducted via personal relationships (only 20% of private enterprises sell their products in big cities and 33% products from this sector are sold to state-owned enterprises[26]).

Stagnant production and decreased revenue have led private sector to more serious financial situation. According to Table 1, the proportion of overdue debts to banks made up by this sector soared from 4.2 in 1996 to 13.5 of the total debts in 1997, and continued its way up in 1998, 1999. It is expected that this figure may gradually decrease in 2000 on the background that the national economy will be rehabilitated

[26] Executive Summary of Survey on small non-state enterprises by the Ministry of Labor, Invalid and Social Affairs

and that the State Bank has taken some steps to solve this problem.

A more general outlook shows that the private sector and the foreign invested sector is more effective than the state-owned sector though these sectors are in a more disadvantaged position. In the long run, the state-owned sector will pursue the import-substituted policy, depending heavily on the Government's capital and protection, while the later two sectors will follow the export-oriented policy. Considering the ratio between export turnover and total revenue of different sectors in 1997, the state-owned sector's figure is estimated at 17.2%, while the private sector in the processing industry and the foreign invested sector can achieve 46.6 and 46.2 % respectively.[27]

In the manufacturing industry alone, there have been 600,000 private enterprises of very small size and 5,600 small and medium sized enterprises (SMEs) by 1999, producing a total of 28% in the industry's GDP. On the other hand, many SMEs, especially enterprises of relatively large scale, have taken the lead among exporters. For example, 457 SMEs employing 100 workers in the areas of textiles, footwear, aquatic products, leather products, foodstuff and drinking, wood processing, non-metal processing, have exported an average of 75% of their products.[28] Furthermore, private enterprises also play an important part in creating jobs for the society.

On the other hand, table 13 shows that all privatized state-owned enterprises after 1 year in operation have produced increased working efficiency despite many difficulties at the early stage. Particularly, profit, budget contribution and wage on an average worker of these enterprises have been much improved. This can prove the fact that all enterprises will be more active in exploring opportunities for their own business and developing themselves when they have to exist in a competitive environment with little, if any, support from the Government. And private sector consists of such enterprises.

In summary, the situation of private enterprises regarding their business, production, finance, and debts was gradually improved in the first half of 1990s, and then reached the best level in 1995-1996. After that, growth rates of production, revenue and profit decreased sharply causing a lot of difficulties for this sector. The proportion they account for in banks' overdue debts also went up. However, the general situation has got slightly improved since the beginning of 2000.

C) Foreign invested sector

Before the occurrence of the Asian financial crisis in 1997, most of foreign invested projects were making profits and in sound financial situation. The total revenue of this sector increased from USD 151 million in 1991 to USD 3605 million in 1997 (23.9 times higher). Its budget contribution also rose from USD 128 million in 1994 to USD 315 million in 1997. Overdue debts in banks were fairly low. Foreign invested enterprises usually borrowed capital from foreign bank branches, and as shown in Table 1, overdue

[27] The General Statistics Department, survey conducted on July 1st 1997 on the revenues of industrial enterprises

[28] The World Bank (1999) "Viet Nam – about to take off?"

debts of these banks (1 year after the Asian crisis) was only 0.78% of the overall balance, of which only 38.8 % was bad debts, the lowest level in Viet Nam's banking system.

The regional economic crisis, which broke out in 1997, had strong and spreading influence on foreign invested sector in Viet Nam in two dimensions: implementing the licensed projects and attracting investment. Regarding financial situation, after the Asian economic and financial crisis, most of foreign invested enterprises operating in Viet Nam faced difficulties and loss. Many export producers operated with moderate capacity due to diminished market and competitiveness. For a variety of reasons such as the parent company went bankrupt, foreign currency devaluated, the IMF limited the transfer of capital abroad for investment, banks set up stricter regulations for granting loans, it became more difficult for exports, competitiveness was reduced, "many foreign invested companies operating in Viet Nam faced a lot of problems. Some investment projects even had to slow down their implementation"

According to Viet Nam Economic Times, Ho Chi Minh City had 683 foreign invested projects by December 31st 1997 with a total registered capital of USD 10 billion. The disbursed capital in this area was USD 3.7 billion, accounting for 28.8 % that of the whole country, of which 32.3% was bank loans. The number of loss-making enterprises tended to increase, 188 in 1995, 237 in 1996, 296 in 1997. The proportion of loss-making enterprises was 43.3%.[29]

After the crisis, the exchange rate VND/USD tended to increase to cope with devaluation of many Asia currencies, creating loss for import-substitution producers. Investment projects in restaurants, hotels and offices met a lot of difficulties. A large number of debts nominated in foreign currencies expired when domestic consumer price index and foreign exchange tended to increase, raising the cost of borrowing loans and reducing revenues. According to a report by Ho Chi Minh City's Department of Planning and Investment, nearly 70% of foreign invested enterprises were making loss in 1999. In 1998, foreign invested enterprises did not recruit more employees, they even dismissed 10,000 employees. These enterprises also continued to face financial difficulties in 1999, and only saw a slight improvement since the beginning of 2000.

Foreign investors in Viet Nam are bound by regulations on the minimum proportion of export in their total output, and on self-financing in terms of foreign exchange. However, many new enterprises that have only been in operation for only a few years can not meet the above requirements. Another difficulty is that Viet Nam is a small-scaled market, with low purchasing power which has been continuously diminished since 1996. Many enterprises have come to saturation in areas which used to be very attractive before 1997. Such areas include hotels, offices, car and motorbike assembly, home electronic products, steel for construction, cement, sugar, detergent, Thus, enterprises in this sector faced different problems like slow increase revenues, longer investment return, difficult financial situation.

Difficult financial situation of foreign invested enterprises in key areas can be indirectly reflected through

[29] Viet Nam Economic Times dated June 24th 1998: " Encourage investment from two directions"

the way they use their designed capacity. Figures in table 13 indicate that there is no area where foreign invested enterprises use up their designed capacity. If we consider 70% of the designed capacity as the minimum profit making point, then only 3 out of 30 foreign invested areas (10%) (including crude oil, ceramic tile, and footwear) can see profits and the rest (90%) are making loss. If the above point is 60%, then only the steel industry can be added to the list of profit-making enterprises. On the other hand, there is up to 19 out of 30 areas (63%) where foreign invested enterprises only use 30% of their designed capacity. This analysis can be a good justification for the difficult situation facing this sector.

Table 13 Usage proportion of designed capacity of machinery and equipment in foreign invested sector, as of 31/5/1998

Unit: %

Types of products	Proportion	Types of products	Proportion	Types of products	Proportion
1. Crude oil	78.0	11. Fridge	21.8	21. Wine	14.3
2. Electricity	15.9	12. Washing machines	21.3	22. Beer	26.0
3. Steel	61.5	13. Air-conditioners	12.3	23. Soft drinks	26.0
4. Cement	25.5	14. Video	35.7	24. Cigarette box	13.7
5. Glass for construction	0.1	15. Transformer > 250 Kva	50.0	25. Canned milk	10.0
6. Hygienic ceramics	3.2	16. Fabrics of different kinds	9.0	26. Fertilizers	16.4
7. Ceramic tiles	75.7	17. Cloth of different kinds	23.0	27. Insecticide	57.1
8. Motorbike	28.1	18. Garments	22.5	28. Paint	48.1
9. Automobile	3.0	19. Shoes	76.6	29. Plastic for home products	20.0
10. Television	50.0	20. Sugar and cane	46.2	30. Plastic material	47.8

Source: The Ministry of Planning and Investment, Overview report on foreign investment in 9/1998.

Meanwhile, the international investment community continues to estimate that investment in Viet Nam has not much been improved, taking account of high risks and investment cost involved, incomplete and weak banking and financial system, changeable tax and import-export policies, difficult foreign exchange control, underdeveloped infrastructure, cumbersome licensing and land clearance...

In 2000, although the National Assembly of Viet Nam has revised Law on Foreign Investment in order to meet the aspiration of investors, foreign investors have not yet shown their interest in the Vietnamese market. What they concern most is that laws are fairly open while sub-laws seem to tighten the incentives set forth in laws, and that it is difficult to carry out the rules of laws. Another problem facing foreign investment in Viet Nam is that in recent years, Vietnam's comparative advantages such as cheap labor, low production cost, plentiful natural resources,... are loosing their position due to increasingly harder competition with that of other countries in the regions. However, in the common trend of development around the world, the financial situation of foreign invested enterprises in Viet Nam has been, and will be improved since 2000.

A－3

Ad hoc Measures to Deal with the Banking Debts

Nguyen Ngoc Bao

State Bank of Viet Nam

1. Assessment on the financial performance of financial institutions including SOCBs, joint-stock commercial banks, foreign banks, joint venture banks, and local people's credit funds.

1.1 Present financial performance of credit institutions

- *SOCBs:*

The charter capital of the Bank of Agriculture and Rural Development is VND 2,200 billions equivalent to USD 150 millions. This of other three SOCBs is VND 1100 billions per each one approximate to USD 75 millions. The ratios of the owned capital (charter capital and its supplementary reserve fund) to the assets (including contingent commitments) of SOCBs are lower 8% of international minimum level. The difference between average lending and mobilizing interest rate tends to decrease in recent years. This ratio of 1999 was under 0.2% per month. The profitable ability of SOCBs is weak. The ratio of their profit to the average owned capital is over 5%. The ratio of their operating costs to assets is over 7% while this ratio of the commercial banks of regional countries is only over 2%. The operating productivity is low. The ratio of overdue debts is rather high, it is approximately or over 5%. The retained earning of SOCBs is only enough to pay the fees for using government capital (6% of charter capital). While they have to reduce the lending interest rate to areas II, III-highland, island, Khmer ethnic group according to government policy.

- *Joint-stock commercial banks:*

The charter capital of joint-stock commercial banks is small. This of a few urban joint stock banks has not yet reach to the required level of authorized capital. The claimed legal capital is about USD 3.5-5 millions for a joint stock bank in urban and USD 350 thousands for one in rural areas. There are only 6 among 50 banks attained the ratio of the owned capital to the assets over 8%, the others attained at lower ratio. In comparison with SOCBs, the operating costs of the joint stock banks are rather high and its competitiveness is limited. The ratio of overdue debts in some banks is below 5% while that in most of the others is over 5%. Many banks make losses and fall in insolvency danger. The return of all the banks is diminishing.

- *People's credit funds:*

  At present, there are nearly 900 local People's credit funds in whole country. These funds mobilize capital and lend to their members. Their average owned capital is about VND 1.3 billion. Their credit outstanding is over VND 4 billion and profit is low. Although many people's credit funds have high ratio of overdue debts but in many provinces and cities they exposed high credit quality.

- *Foreign bank branches in Viet Nam:*

  The charter capital of a foreign bank branch is USD 10-15 million. Their credit provisions to a customer are not subject to the limitation of 15% of owned capital. The ratio of overdue debt in these branches is less than 1%. All of them are making profit. The ratio of their profit to the owned-capital is nearly 10% and the ratio of the profit to the assets is about 4%.

- *Joint venture banks:*

  There are four joint venture banks at present. The charter capital is USD 15 million per each. The credit provision to a customer is subject to limitation of 15% of owned capital. There are only two banks (INDOVINA Bank and VIDPUBLISH bank are operating efficiently and providing high-qualified services. The others are operating inefficiently.

1.2 Some general conclusions about financial performance of Vietnamese credit institutions (excluding branches of foreign banks)

- Small operating scale: the owned capital of Vietnamese banks is only equal to 1/6 of that of the regional banks. Therefore, it limited the ability of multifunctional operating expansion and the diversification of banking products and services, as well as the ability of credit provision to the economy.
- The high-risk level is measured by the criteria of low solvency, low ratio of owned capital to assets, and too high ratio of overdue credit outstanding. Additionally, the SOCBs have to make the priorities of capital, interest rate, and lending conditions to some customers directed by government policy. Many reasons bring about this situation of Vietnamese credit institutions but most of them come from the risks of the borrowers.
- Low profitable ability is measured by the criteria of the ratios of the profit to the owned capital and the profit to the assets. The reason of low profitable ability is mainly due to low qualification of credit, partly due to low productivity, backward technology, weak management, as well as mixed commercial and directed credit.
- The SOCBs are operating mainly in credit services. The other banking services especially the services of a modern bank is rarely offered.
- Many SOCBs operate in lager area. Their operating costs are rather high because the small items of fund mobilization and loan provision (USD 50-100) take a significant ratio.
- The technology qualification used in Vietnamese banks is far below in comparison with this in the

regional commercial banks. This depends mainly on the skills of bank staffs to use modern equipment. In many cases, the operating costs grew up because the available modern equipment was used inefficiently.

- In addition, the tax policy on lending services of installment is not clear. Because the tax rate of foreign-borrowing interest is 10% and the fee of government's capital use is 6% of charter capital, the SOCBs and some joint stock banks have no retained-profit to create the functional funds especially the operating-development fund.
- Because the owned-capital is small, the provisioning has just formed I year ago and faced to many challenges, the liquidity of assets is not high even low, the short term mobilized capital is used to make medium- and long-term loans, so high risk of credit in some commercial banks affects the security of credit institution system.
- Vietnamese credit institutions have low competitiveness and integration opportunity, the high return area of money market in domestic is competed by foreign bank branches.

1.3 The causes of weak financial performance of the Vietnamese credit institutions

- Viet Nam's economy in reality has still been in transitional process, low efficiency and competitiveness, improper structure, slow SOEs reform. Therefore, there are many making-loss and insolvent enterprises. This put many banks face to high ratio of bad debts, low revenue, and low profit.
- Insufficient and inconsistent legal framework make commercial banks face to high risks and non-complementation.
- In general, the determination of the operating plans of commercial banks is not clear. Thus, the determination of owned-capital scale is also not exactly in quantitative side. This induces constraints for government in providing charter capital to SOCBs and for commercial banks in supplementing charter capital by themselves.
- The managerial and operating mechanism of commercial banks is initially forming or gradually transforming to the market principle. In which the financial autonomy is limited, the prior credit directed by government is not defined distinctly but increasingly.
- There are too many joint stock banks and local people's credit funds while they by themselves lack the necessary conditions to compete and operate vigorously.
- The operating management of commercial banks has been weak, the qualification of banking personnel has been low, and the operating technology has improved slowly.

2. Review of the ad hoc measures implemented by the government and SBV since 1997 to deal with the banking debts of the enterprises (especially SOEs) and of the farmers

2.1 The year 1997

- Decree No 59/ND-CP dated 3 Oct 1996 on financial management of state owned enterprise in article 12 defined: "the fund mobilization of SOEs is not allowed to be over its charter capital." However, because of not enough condition for applying, government issued the memo No 6755/KTKH dated 31 Dec 1996 to temporarily delay implementing the regulation on fund-mobilizing limitation of SOEs.
- Resolution No 49/CP dated 6 May 1997 of government's annual conference (parliament) defined: *"SOE is allowed borrowing loans from SOCBs without collateral, and without limitation by its charter capital, but with consideration to its operating efficiency. For SOEs made losses since last years, if they present efficient alternatives of operation and agreements of ministries, provincial committee, cities belong to central government, banks continue giving loans to them. For the farmers borrowed bank loans, if they face to difficulties, they may receive the debt relief and new loans to continue their production."*
- The SBV issued the memo No 417/CV-NH14 dated 31 May 1997 on the guidance to implement the urgent solutions of government relative to banking activities.
- Circular No 03/1997/TTTL/NHNN-BTC dated 22 Nov 1997 on the guidance to deal with the remained overdue debts of SOEs and cooperatives up to 31 Dec 1996 in SOCBs stated: *"the overdue debts caused actively by the banks, SOEs, and farmers have to retrieve exhaustedly. The overdue debts caused objectively by non-resistible reasons are considered to cancel or to carve out within 3-5 years. In this time, the borrower has not to pay their interest. In case of non-profitable business, the overdue debts are relieved within 3-5 years but the borrower continue paying the interest."*
- Memo No 959/KTKH dated 3 Mar 1997 on implementation of the investment-credit plan in 1997 stated: *"continue transforming the short-term fund of commercial banks into medium- and long-term loans to planned investments..."*
- The SOCBs continue reducing 30% of lending interest rate for the area III (highland, island, Khmer ethnic group, and the area of natural disaster, where customers are mainly farmers).

2.2 The year 1998

- Continue implementing the above resolution decided in 1997, excluding the settlement of overdue debts.
- Decision No 52/1988/QD-TTg dated 3 Mar 1998 on implementation of the investment credit plans in 1998 defined that the government's investment projects can use the assets generated from their loans to

guarantee the debts of the loans. The enterprises are not permitted to transfer, purchase, or mortgage the assets belong to planned-credit capital of government if they are being in debt.

- Directive No 08/1998/CT-NHNN 14 dated 3 Oct 1998 on improvement of credit quality to contribute to economic growth and ensure the security and efficiency of credit institutions stipulated: the overdue debts before 30 Jun 1998 from enterprises which faced to difficulties, the credit institutions are permitted to retrieve the principal value first, then retrieve the interest later. The overdue debts over 12 months, the credit institutions can retrieve them at normal interest rate. For overdue-debt confiscation, if the confiscated assets have enough legitimate papers and property rights, the credit institutions can auction or account to reduce debts. The overdue debts caused by natural disasters, the borrower can enjoy the debt relief. For overdue debts of loss making enterprises, the credit institutions can consider to redefine the maturity of loans but this loans is subject to the maximum of 15% of their total credit outstanding.

2.3 The year 1999

- Decision No 67/1999/QD-TTg dated Mar 3, 1999 of Prime Minister on banking policy supporting agricultural and rural development stated: the farmers (including plantation owners) were not required mortgage for a less than VND 10 million loan. The loans of over VND 10 million are required mortgage. The Cooperatives, plantation owners, agricultural cooperatives, SOEs, which works as dealers of rice export and fertilizers import, are allowed to use the assets formed by loans for loan guaranty.
- Decree No 27/1999/ND-CP dated Apr 20, 1999 on revision and addition to regulation on financial and accounting management of SOEs, which accompanied with the decree No 59/CP at article 11 stated: "Besides the state-invested capital, the SOEs were allowed to mobilize capital under the forms of securities, borrowed capital, joint-venture capital, and other forms. The capital mobilization should be in accordant with the legal regulations and not effected on ownership form of enterprise. Issuing bonds, shares to mobilize capital must follow current legal regulations."
- Decision No 13/1999/QD-TTg dated Feb 4, 1999 on investment credit in the years of 1999 stipulated: The unfinished projects has been lent by which credit institutions (SOCBs or Investment and Development General Office), in 1999, that should continue to provide the loan according to the progress of construction and defined capital structure in investment decision. The investor has responsibility of investment efficiency and on-time payment.
- Decision 250/QD-TTg dated Dec 24, 1998 on rice-export and fertilizer-import management in 1999: Commercial banks should provide capital appropriately to the enterprises to buy rice from farmers and to import fertilizer and allow them using assets formed from loans for loan guarantee.
- Decision No 107/QD-TTg dated Nov 17, 1999 on the solutions to overcome disastrous natural calamities in Central Provinces: The Government spend VND 500 billions from the SBV refinancing fund to lend to farmers without collateral. The interest rate of short-term loans is 0.3% per month, medium and long-

term is 0.4% per month. The flood-effected farmers and enterprises, which have loans from credit institution, were considered to relieve, to carve out, or to cancel their debts depending on their losses.

2.4 The year 2000

- Continue to apply credit mechanism stated at decision No 67 and decree No 27 and decision No 107;
- Decision No 237/1999/QD-TTg dated Dec 24, 1999 on rice-export and fertilizer-import management for the year 2000: the enterprises which works as rice dealers were given loans sufficiently and were allowed to use the assets created from loans to guarantee for their debts as above decision 67/1999/ QD-TTg
- Resolution No 11/2000/ND-CP dated Jul 31, 2000 defined seven ad hoc measures to guarantee for loan and directed solutions to deal with the debts of flood-effected farmers in practical situations.
- Circular No 10/2000/TT-NHNN1 dated Aug 31, 2000 of SBV to be guideline for the decree No 10 above.
- Decision No 266/2000 QD-NHNN1 dated Aug. 18, 2000 defines the terms, the limitation for loan without collateral from joint-stock banks, joint-stock financial companies, and joint-venture banks.

3. Assessment on direct effects of the situational measures on the financial situation of the commercial banks

After several reforms, the number of SOEs reduced from 12300 to 5280 but its output took 40% of GDP. The rural area, which takes nearly 80% of total territory, where 76% of population live in over 12 million households, produced over 25% of GPD. This showed the important role and position of SOEs and rural sector in economic stabilization and development in general, and in banking safety and development in particular. Therefore, situational measures of government and SBV on credit policy and mechanism for SOEs and farmers also have direct effects on the finance of the commercial banks at certain period. The SOCBs are under big influences, such as:

3.1 The positive effects of the situational measures in short-term

- The priorities of credit condition to SOEs and farmers are appropriate with article 10 in Law of Credit institutions. Therefore, credit institutions are willing to expand credit without the worry of bad effects on the financial conditions, because the credit risks of these loans mainly originated since before 1997. Practical evidence shows that loans to farmers are efficient, low risk. If credit risks of these loans appear they will be considered and settled by government.
- Delaying the implementation of the Decree No 59/ND-CP and permitting the SOEs borrow loans from SOCBs without collateral had created good conditions for SOEs continue borrowing loans from

Commercial bank (mainly from SOCBs) for investment, production, business, and avoiding possible interruption and crisis. This is very easily to be seen, because in the capital structure of investment, production, and business of SOEs, the owned capital takes a small proportion (only 5% - 20%), the main capital is loan of commercial banks. Most SOEs were allowed to be given more loans to invest in unfinished construction, production, avoiding bankruptcy for several SOEs and for the whole financial system because of chain reaction.

- Limit the increasing bad debts of the commercial banks. The SOEs and the farmers have to mobilize capital equal to 2 - 5 fold of their owned capital but they lack the borrowing conditions. Especially, they can not make profit continuously in many years and their assets used for loan guaranty are unsuitable. If the banks retrieve and lower down their loans immediately, the overdue debts would increase. Thus, based on the ad hoc measures to lower down the amount and proportion of loans of SOEs gradually. When equality among economic sectors were attained, the borrowing quality will be reach easier.
- Because credit outstanding to economy continues increasing, the commercial bank has assistance of government to deal with the bad debts, the income of SOCBs although decreased somewhat but is restoring in 1999-2000.
- These ad hoc measures created the opportunities for credit expansion to farmers, changed credit structure, dispersed the risk, utilized potential of agricultural and rural economic sectors, created opportunities for SOEs and private enterprises to develop. Therefore, the commercial banks have opportunity to expand credit market in the rural area.
- The solutions guaranteed for SOCBs to keep the credit growth rate, to expand business scale, and to increase the scale of customer from 12% to 18% each year in the last three years.
- Allowing the SOEs and farmers to enjoy the debt relief, debt cancellation and debt carving out provided time for SOCBs to restructure their assets, "gradually clean their balance sheet"
- The situational measures had wiped out the doubts of depositor, they continued putting their money in the commercial banks, especially in SOCBs. The lesson on the reasons and experiences to deal with the crisis of Asian countries, which were heavily effected by monetary-financial crisis, is that the role of government is very critical. The government is a supporter for the commercial banks to stand up against the bad effects of unexpected changes on money market.

3.2 The negative effects of the situational measures

- The situational measures mainly deal with the constraints of SOCBs and SOEs. These measures did not create a "fair playing field" for all banks and enterprises particularly for joint-stock banks and private enterprises. These make commercial banks and SOEs continue to depend on these bailouts of government, and deter the incentives to SOCBs and SOEs to compete and develop. In the transition of Viet Nam, this needs to be accepted appropriately with the economic structure and institution.

- These measures created inequality among economic sectors, among commercial banks, and caused the certain doubts about the government's mechanism and policies. The attraction and transfer of customer-SOEs to SOCBs mechanically does not encourage the competition among commercial banks by improving service quality, providing customers with the best, most modern banking services.
- The temporary debt carve-out or debt cancellation for SOEs and farmers are situational measures. It takes not one or two but several last years, but no effective measure was created to replace. Sometimes, SOCB was considered a subsidy measure to get credit, therefore the number of SOEs and farmers have overdue debts increased. This weakens credit ability of SOCBs and it possible causes the deficit of charter capital.
- These measures cause the dependence of SOEs and farmers, when they meet the difficulty in doing business due to objective impacts. On the site of SOCBs, there is a manifestation of easing the lending condition and procedures even they lack caution when doing risk evaluation to decide lending to farmers and SOEs. This makes the credit risk tend to increase. At the same time, the issuing loans to non-state enterprises draw too much attention at asking for property mortgage. The technique of loan evaluation, the legal status and the financial ability of customers, the efficiency, feasibility and solvency of investment projects, production, business and service plans were not considered importantly to evaluate the risks to use appropriate lending procedures.
- Situational measures deterred banks to improve the quality of marketing services and risk evaluation and to research and determine business target of commercial banks.
- Because SOCBs continue to give loan to inefficient SOEs, it attributes to slow down the SOE reform, for example: the bankruptcy according to The Law on bankruptcy happen very scarcely, the evaluation of SOEs is difficult etc.

4. Assessment on positive effects of situational measures on the bank's decision

- The owned capital of SOEs is very small. Their ratio of owned capital to mobilized capital is 1:5. The capital of SOEs is mainly bank loan. It is not easy for the banks to retrieve their loans from SOEs and to reduce bank loan in SOEs. Because if the bank do that, the enterprise will possibly have to stop their working, the overdue debts will be high, and it will affect economic growth and employment. Therefore, delay implementing the ratio 1:1 between the owned capital and mobilized capital according to article 11 of Decree 59/CP is proper. However, this warns the banks that they needs appropriate solution for lending decision to SOEs to avoid the credit risk. In reality, the commercial banks have applied the following solutions:
    - Provided more loans to SOEs, who produce and carried out business steadily and effectively, and have ability of solvency, to help them carry out the investment projects or effective and feasibility

business plans. The number of these enterprises is about 40% of total SOEs.

- Gave loan to SOEs, which do not have losses yet but have unstable business and low financial ability, and face difficulties in selling their product, by each time. Evaluated, controlled and assessed the risk for each loan strictly. The bank also refused to give risky loan.
- The bank refused giving loans to loss-making SOEs, who have insolvency because of any reasons, but applied the solutions to retrieve the debts.

- The regulations of commercial banks on loan guarantee with assets applied for SOEs and other enterprise, including farmers, are detail and adequate. However, in practice there are some obstacles from administrative procedures. Thus, it is difficult for banks to apply these regulations sufficiently, quickly and to meet the operation of enterprises. For example, the value of guarantee assets of enterprises is very small. If the enterprises want to mortgage the main production chain, they need have allowance of People's committee of province or city or allowance of ministry of Finance. The value of land use right has not been defined sufficiently by legal framework. The other forms of guarantee have not allowed by law. Hence, the regulation of government that SOEs can borrow loan from SOCBs without mortgage is appropriate with practical situation. This creates legal framework for SOCBs have autonomy to select, to exam and to decide to give loan and take responsibility to retrieve debts. Because the responsibilities of SOCBs were raised up, they have to establish and apply the mechanism of evaluation, control, and supervision more restrictedly.
- The mechanism of debt relief, debt cancellation, and debt confiscation created opportunities for SOCBs to release non-performing and bad debts, to sell confiscated property to retrieve debts, or to examine the real credit quality, and financial ability to plan appropriate business direction.
- With the giving loan of up to VND 10 million (up to VND 20 million from Sep 2000) to farmers without mortgage, bank can expand its business, simplify borrowing procedures and fees to be appropriate with current weak and slow situation in planning and providing certificate of land use right in rural area in the past time.
- SOEs, which export rice and import fertilizer, rural cooperatives and plantation owners are allowed to use the assets formed by loans for guarantee of short-term, medium and long-term borrowing. That is an effective measure to deal with difficulties for loan guarantee by assets, to increase the loan security.

In the side of historical situation and condition of money market in the previous time, the situational measures have made SOCBs consolidate their positive factors, increase their ability of credit-risk evaluation and manager the operation and financial situation of borrowers more strictly. Because of the following reasons:

- Because the loan guarantee by assets was not allowed, SOCBs had to set up a strict lending procedure. Based on the criteria of the ratio of owned capital to the debts (at least 25%), the solvency, the overdue and bad debts, SOCBs evaluate the risk level of enterprises. If the solvency of enterprise 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.