

SIGNIFICANT STEPS IN FINANCIAL MARKETS LIBERALIZATION IN VIETNAM

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ABSTRACT: *This paper is aimed to outline the timelines and important milestones of the financial markets' regulation process in Vietnam. Such typical types of financial markets as money markets, capital markets, foreign exchange markets, derivatives markets and the key factor in these markets – interest rates are taken into account in order to conceptualize significant steps in financial markets liberalization in Vietnam. Such steps are not what the government actually planned but sketched out based on objectively external observations from the reality. However, they should systematically show the plan of the Government in the liberalization process. Otherwise, the government may need to consider the gaps in their next plan.*

The development of Vietnam's financial markets has been regulated for a best fit to Vietnam's economic growth as well as to reduce risk. Then, deregulation is required to ease the financial flows, both in and out flows, and to comfort the investment environment. However, it is noticed that deregulation is not a "must", better regulation is more important.

INTRODUCTION

Globalization of financial markets appears to be inevitable to emerging economies as Vietnam. When the country removes legal and regulatory barriers to international investment, then the country's financial market is globalized. This movement should be two ways: foreign financial flows into Vietnamese markets and vice versa. Therefore, the Government of Vietnam has adopted a comprehensive financial reform program (Vu, 2003) that included:

- (i) Reforming the **banking system**, which covered not only bank restructuring but also improvement of prudential supervision and regulations and corporate governance in banking;
- (ii) Building up foundation for **financial stability**, with measures taken to reform the corporate sector, maintain the soundness of macro fundamentals of the country; and
- (iii) Designing a prudent and gradual timetable for international integration that includes measures to **liberalize the domestic financial markets**.

Although there are still many for and against arguments about globalization, one has to admit that this is the obvious trend anyway (Miller (a), 1998). Vietnam should prepare for this trend. The liberalization of financial services, including the presence of foreign financial institutions, can help reduce distortions and damage to sources of investment and facilitate the economic stability. The liberalization also makes domestic and foreign capital movements effective and active channels for fund mobilization. From social perspectives, liberalization of financial services creates really new jobs (it's true in Vietnam since 1994) such as accounting (CPA), auditing (CRA), legal advisory and computer-related services, brokers and dealers, forwarders, etc. and demand more skilled labors.

It'd better to firstly look at this process based on milestones of legal documents announcement, and see whether Vietnamese financial markets are really moving along this trend. This study does not include the banking system reform which was already studied separately in other researches. The banks mentioned below are put in the consideration of the whole financial markets whereby they are a kind of key players. The scope of this study is financial markets liberalization, not financial liberalization (too broad discussion). Also the unregulated/informal financial markets are not in this scope.

OVERVIEW OF VIETNAMESE FINANCIAL MARKETS

In the 1990s when the market economy started to develop in Vietnam, financial markets (FMs) came into being and developed. The money markets provide the State Bank of Vietnam (SBV) with instruments for implementing the monetary policy and smoothing the flows of capital, especially short-term one, between economic sectors. The capital markets are still "gloomy" in the organized one (as just 24 listed companies) while more and more transactions in the OTC markets (e.g. the OTC trading center of Vietcombank Securities Company has 114 companies "listed" regularly there). Derivatives markets in Vietnam have just emerged in recent years, mostly in options, forward, and swap. The interest rates in Vietnam were really liberated in June 2002 when the lending rate was based on agreement between related parties.

The role of SBV is critically important in this system. However, there is still the gap and less transparency between policy making and policy implementation. The volatility in the markets is not only characterized by changes in interest rate, or inflation, or credit (default) of players, but also by changes in regulations (including the disparities among Decrees, Government Decisions, State Securities Commission or SBV's disciplines and guideline documents).

TIME LINES AND MILESTONE REGULATIONS

Money markets

After two banking ordinances were issued in 1990, the two-level banking system took shape and allowed banking and financial institutions to flourish. At the same time, sub-markets of money market were also emerging:

- **Market for short-term credits:** this is the traditional market for banking services as depository institutions.
- **Inter-bank market for domestic currency:** this market was established in 1993 by the Decision 136/QD-NH2 to smooth the flow of capital among commercial banks before they resort to the SBV.
- **Market for SBV bills** services as a basis for open market operations by the SBV.
- **Market for T-bills.**

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Capital markets

In the past few years, the capital markets involve mainly the supply of credit through banks.

- **Market for long-term credit:** in 1990, there were only four state-owned banks for the whole economy (now, they still occupy about 70% of this market). In 2002, there are 7 state-owned commercial banks, 39 joint-stocks banks, 4 joint-venture banks, 25 foreign bank branches, 1 People's Credit Fund system, 1 social policy bank, finance companies, and 8 financial leasing companies¹. The policy on interest rate was adjusted to the mechanism. This market now is well connected with the market for short-term credit. Decree 72 dated June 8, 1992 on *issues of government bonds*. Decree 23/1995/ND-CP dated Mar. 22, 1995 on *issues of bonds in foreign markets*. Decree 01/2000 dated Jan. 13, 2000 revised and more on issues of government bonds. Decision No. 182/2003/QD-TTg signed on Sept. 5th, 2003 on *fund mobilizing* by bond issuance for the purpose of national infrastructure improvement. The bonds market seems to be regulated and then liberalized before stocks market. But up to now they just once appeared in the primary market, then were listed in the secondary market but... nearly no trading.

¹ State Bank of Vietnam, Annual report 2002

- **Market for financial leasing service** was formed in 1995 by the Decision 64/CP dated Oct. 9, 1995.
- **Stock market:** the legal infrastructure for the stock market has been developed by decrees. Decree 120 dated Sept. 17, 1994 on *issues of bonds and shares* by state-owned companies. The equitization of state-owned enterprises (SOEs) provides more securities to the markets thanks to this Decree. Decree No. 78/1996/ND-CP dated Nov. 28, 1996 on *the establishment of the State Securities Committee* (SSC). Decree No. 48/1998/ND-CP dated Jul. 11, 1998 on *securities and securities market*. Decree No. 127/1998/ND-CP dated Jul. 11, 1998 to *establish the Stock Exchange Center*. Decision No. 172/1999/QĐ-TTg dated Aug. 19th, 1999 on *the establishment of securities companies and listing policy* on the stock market. Then, the State Securities Commission provided Document No. 109/1999/UBCK2 dated Aug. 11, 1999 to give guidelines for listing on the Securities Trading Center. Decree No. 64/2002/ND-CP dated June 19, 2002 on *transformation of SOEs into joint stock companies*. However, foreign investors have to wait until Mar. 11, 2003, when Deputy PM signed the Government Decision No. 36/2003/QĐ-TTg on promulgation of *the Regulation on the capital contribution and purchase of shares by foreign investors* in Vietnamese enterprises. This Decision rules that the rate of foreign capital shall be equal to 30% at maximum of the charter capital of Vietnamese enterprises. And quickly then, the Decree No. 144/2003/ND-CP dated Nov. 11, 2003 *revise a lot on securities and securities markets* (in comparison to Decree 48). Many foreign investors said that this Decree removes more restrictions on the foreign indirect investment in Vietnam. Also this Decree loosens the required conditions for companies which want to give first issuance in the organized securities markets: 7 conditions decreases to 4 conditions, minimum required charter capital reduces from 10 billion VND to 5 billion VND, 2 years of profitability lowers just 1 year. However, this Decree allows one type of securities to be listed in one securities market. It means that if a company already lists its securities in the HCMC Securities Center it will not be allowed to list them in foreign markets.

Foreign exchange markets

Since 1999, the SBV has decided to expand the forex-trading band of credit institutions (for most terms) 4 times (!). The recent decision was announced in July 2002.

- **Inter-bank market for foreign exchange:** this market came into being in November 1994 after the Decisions 146 and then 203/QĐ-NH13 to regulate *the supply and demand of capital in foreign exchange among commercial banks*, particularly spot rate, thereby establishing the market exchange rate used for determining the official rate. Till 2003-6/2004, the interest rate on deposits in foreign exchange by banking institutions with the SBV was also lowered according to changes on the market. The SBV also allowed commercial banks to enjoy more autonomy in trading in the foreign exchange.
- **Forex trading market:** credit institutions are permitted to trade foreign currency with customers who are mainly enterprises. Forex trading in free market is much more flexible (Tran, 2002). Exchange rates there change many times a day. Under Circular 49 of the SBV, foreign investors must conduct stock transactions in VND. The conversion of VND into foreign currency, stock custody and money repatriation abroad must be done via foreign custody banks in Vietnam. In 2003, the SBV reduced the required sale of foreign exchange by companies to the SBV to 0%. This means that companies were allowed to sell the foreign exchange to commercial banks or send to their bank accounts at will.

Derivatives markets

When the stock exchange has just come into official operation (2001), the State Securities Commission was afraid of speculation with its usual unpredictable consequences, therefore it banned

all the future markets. Actually, such derivative products as currency options, forward and swap contracts have already been in transactions since 1990s. Hence, forex derivatives market is the most emerging one in comparison to the other derivatives markets.

- Decision 65 dated Fed. 25, 1999 concerns about the buying/selling *the currencies forward and swap*.
- Decision 289 dated Aug. 30, 2000 concerns about the buying/selling the currencies forward and swap (*revised* Article 1 of Decision 65)
- Decision 198 dated Sept. 18, 2001 *revised* Decision 65 and Decision 289.

Interest rates

- *Before 1995: both deposit and lending rates* were fixed by the SBV. It set the interest rate ceiling and stopped discriminating in favor of the public sector in terms of lending rate, thereby helping commercial banks gain full autonomy in attracting deposits.
- *1995:* the gap between rates on loans in domestic and foreign currencies was reduced.
- *1996-1999:* the SBV *set the lending rate ceiling*, then was reducing many times (5 times just in 1999). The government issued a Decision allowing banks to *trade their credit ceilings*. However, such transactions were not made until 1998.
- *From 2000 up to now:* the SBV *only fixed the base rate* and got prepared for liberalization of interest rate (Nguyen, et. al., 2002).

In short, Vietnamese financial markets are still in the threshold: small, less diversified, few both in number of players and instruments, not efficient (insider trading, asymmetric information), focused on capital markets, dominated by crowd psychology and noise trading. The government continues to publish more regulations. Beside HCMC Securities Trading Center launched in 2001, Ha Noi Securities Trading Center is expected to open by the end of 2004. There is little foreign investment in these markets, and also outflows to international markets are even fewer. Investors expect more dynamic stock market, less restrictions to foreign investors as well as to Vietnamese stocks going abroad in the near future. Let's look at the implied steps in VN financial markets' development in order to realize whether we can forecast about the liberalization in the future.

FINANCIAL MARKETS LIBERALIZATION

The first attempt at financial markets liberalization in Vietnam was shown in the Decision of the Council of Ministers dated March 9th, 1988 allowing all business organizations, including private sector, to borrow and raise funds publicly. In the process of financial markets liberalization, Vietnam has initially lifted its controls on interest rates, leaving its determination in the hand of market forces. This step was a positive development in increasing the operational independence of commercial banks. In following steps, the SBV is expected to gradually liberalize foreign exchange control. This must be a big challenge to the government because by the regional standards, the money markets in Vietnam is still underdeveloped characterized by a poor portfolio of products and limited number of seasoned participants. In addition, the SBV's intervention to other banks, especially state-owned commercial banks, is still too much weighted. The SBV organized and regulated the inter-bank markets (with about 40 members) and still has high control over them. By observing the delivery of regulations on the timelines as above, there must be some explanations for the Vietnamese government's plan to develop and then liberalize the financial markets for international integration. Such plan can be interpreted as steps following:

Significant steps

- *Step 1 (1988-1995):* developing inter-bank financial markets, supported by the SBV. The government started with its most favorable institutions: state-owned commercial banks. The regulation focused on shaping the money markets and the foreign exchange markets (inter-

bank). This period was also the time for piloting equitization (the 5 first equitized companies) in order to restructure the SOEs sector and prepare products for the coming stock market. This step is aimed at *building up both some potential players and instruments for both OTC and organized financial markets*. This period was in initial years of Vietnam's economic reform ("Doi Moi" policy).

- **Step 2 (1996-2000):** developing capital markets, removing regulations on deposit interest rates. The bond market has been regulated and then partially liberalized first (e.g. being allowed to issue in foreign markets). The government kept track of the stocks' OTC markets in order to prepare for an inauguration of organized stock exchange center. The trend of liberalization presented more clearly in interest rates terms, both domestic and forex. The focus of regulation was more on primary markets. This step is aimed at *adding and diversifying financial players and instruments in the organized markets*. In this period, there were many reforms in export-import policies that have effectively stimulated export-import activities as well as the development of export processing zones and industrial parks. It is resulted in increasing in foreign direct investment. The economic reform has encouraged the flow of immigrant remittance (Viet Kieu) for investment. However, those activities that would support exports such as export credit, market information, etc. still stayed less effective.
- **Step 3 (2001-2004):** developing organized securities markets (HCMC and Ha Noi Securities Trading Centers), attracting more foreign investors, putting free derivatives markets into regulations, nearly finishing liberalization of interest rates (except forex rates). The focus is boosting secondary markets. This step is aimed at *consolidating and starting to open the markets to foreign indirect investment*. Consolidation is in terms of revising regulations. "Open the markets" is in terms of more favorable regulations and selective deregulations (by continuously reducing the restrictions to foreigners in stock transactions, foreign exchange, and business operations in financial markets). The previous steps were in the line with many changes, even fluctuations, of other macro markets of the market economy such as scientific & technological markets, real estate market, labor market, etc. Their changes have left considerable effects to this step as a synergy effect among these markets and uncertainty from the environment (SARS, bird flu epidemic) which particularly fail to control the fluctuations in consuming markets (price index increasing), gold market, foreign exchange market (affected by market demand for gold), etc. Especially the fast but asynchrony development of real estate market, scientific and technological markets (IT), labor market have made the liberalization process of financial markets in this step to face more obstacles.

These conceptual steps are described in the framework **Figure 1**.

Comments

Beside the improvement in the legal system over time, regulations on Vietnamese financial markets have been *revised and changed too frequently*. In average, there are about 200 decrees issued by the government and 500 decisions signed by the Prime Minister or his Deputy per year (!). This fact increases *the volatility of the legal environment* in Vietnam that frustrates foreign investors.

As observed above, we can experience the low "durations" (not maturity!) of those Decrees and Decisions from the Government when the latter ones come to revise the previous ones just after one year, or even within the year. In addition, there are still a lot of *contradictory guidelines and mis-implementation* of these legal documents. Thus, the government does not need to give too much restrictions to foreign investors because just given the two vulnerable facts from the legal environment they will be more hesitate to put their money in Vietnamese markets. If these problems still remain for long time, the liberalization will get stuck at step 3 for long time. There will be less foreign investment (so called "exit" investment) as well as no capital outflows to foreign markets. It is not the unique

issue of Vietnam, there are many researches agreed that emerging market countries have high standard deviations and low betas (Stulz, 1999).

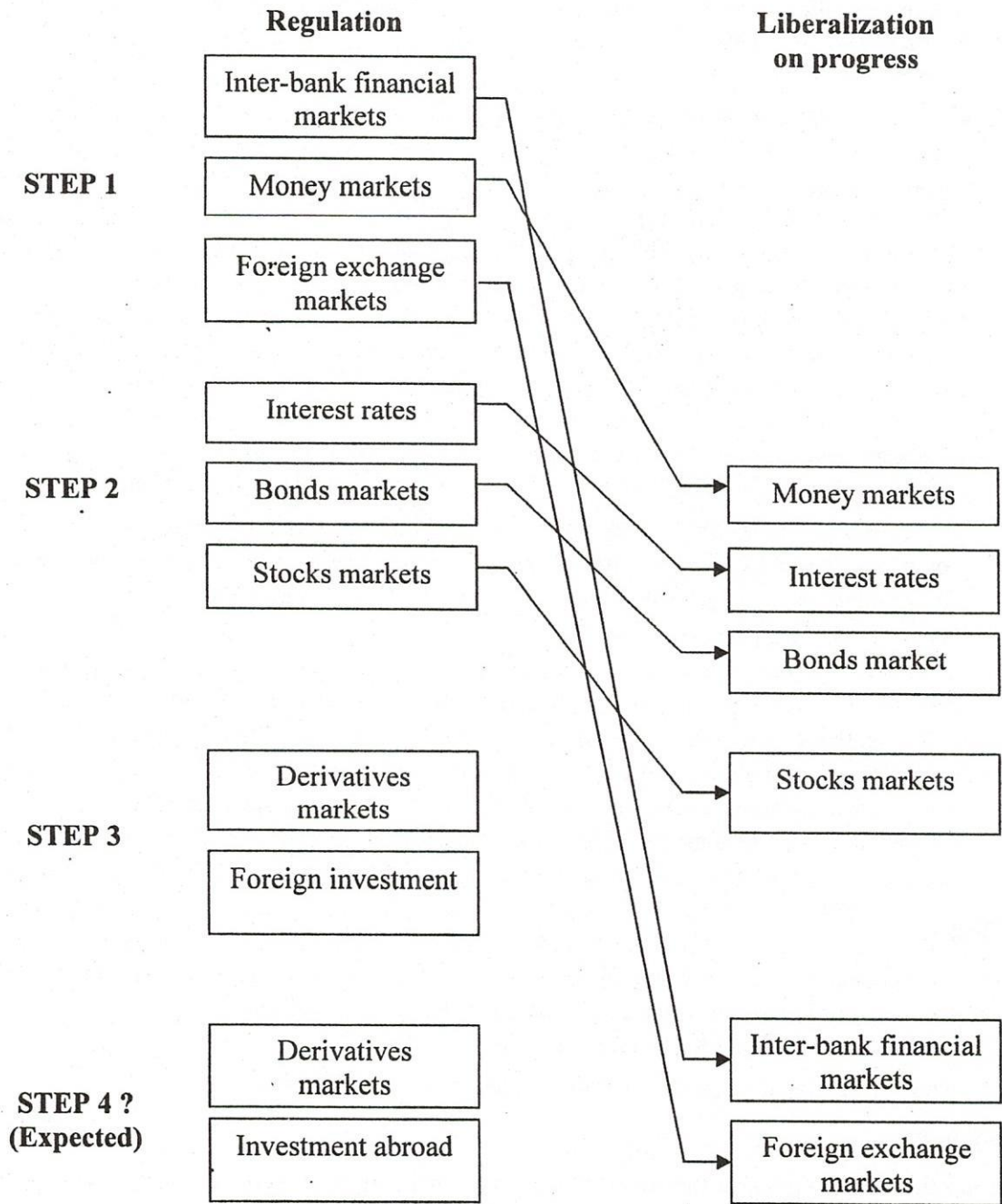


Figure 1: The process of financial markets liberalization

Anticipation

To date, more than 1,000 SOEs have been equitized and could list their shares. In addition, more than 30 foreign-invested enterprises (FIEs) have applied for conversion into shareholding companies since the Government issued Decree 38/2003/ND-CP on the conversion of FIEs into shareholding companies, and more are expected.

There are expectations on the development of bonds market (which is still “on the shelf” up to now) for more dynamic products, derivatives markets for sharing risk, and investment flows will be in two ways. This is called step 4.

How many steps are there in the plan? I leave the answer for the government because it's their plan. The figure above is just what I have observed and conceptualized for comprehensive understanding about the legal environment in Vietnam. And these steps above are just drawn from the legal side. There must be gaps or lags between the legal steps and the practical steps. The slow development of bonds market is a typical example.

CONCLUDING REMARKS

Financial markets liberalization is not a good-smell appetizer and it may cost so much. While financial markets liberalization is proposed as a part of globalization (Miller (b), 1999), there are some arguments that attribute it to an initial stage leading to financial crisis in emerging market countries. These arguments warn developing countries to be much careful in their plans for liberalization. Financial markets liberalization involves lifting restrictions on both interest-rate ceilings and the type of lending allowed and often privatization of the financial system (Mishkin, 2000). This can be inferred that in liberalization process, deregulation is not a "must", better regulation is more important. However, in the case of high unstable legal environment in Vietnam, better regulation does not mean that making vulnerable regulation first and then improve it. The Government should learn more about the other emerging countries' lessons and thinks twice before issuing the regulations.

CÁC BƯỚC CHỦ YẾU TRONG QUÁ TRÌNH MỞ RỘNG TỰ DO CHO CÁC THỊ TRƯỜNG TÀI CHÍNH Ở VIỆT NAM

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TÓM TẮT: Bài viết này nhằm phát họa một bức tranh tổng quát về quá trình thể chế hóa các loại thị trường tài chính ở Việt Nam dựa trên những điểm mấu chốt quan trọng về mặt thời gian của các luật định. Các loại thị trường tài chính điển hình như thị trường tiền tệ, thị trường vốn, thị trường hối đoái, thị trường các sản phẩm phái sinh và cả một yếu tố chi phối trong tất cả các thị trường này – đó là lãi suất, đều được đề cập trong bài nhằm rút ra những bước quan trọng trong quá trình mở rộng tự do thị trường tài chính ở Việt Nam. Các bước này không phải là những bước nằm trong kế hoạch thật sự của nhà nước mà chúng được phát họa dựa trên những quan sát khách quan những gì diễn ra bên ngoài thị trường. Tuy nhiên các bước này hẳn phải thể hiện một cách hệ thống kế hoạch của nhà nước trong quá trình mở rộng tự do. Bằng không, có lẽ nhà nước sẽ phải xem xét những khác biệt này trong kế hoạch tiếp theo.

Sự phát triển của các thị trường tài chính ở Việt Nam đã được thể chế hóa ở mức độ phù hợp với chủ trương phát triển kinh tế của Việt Nam cũng như để làm giảm thiểu rủi ro. Tiếp theo, sự phi thể chế hóa sẽ giúp làm thông thoáng hơn cho các dòng chảy tài chính, cả dòng vào và ra trên thị trường tài chính, và giúp môi trường đầu tư thêm thuận lợi. Tuy nhiên, điều cần lưu ý là việc phi thể chế hóa không phải là điều kiện "bắt buộc" của quá trình mở rộng tự do cho các thị trường tài chính, mà chính sự cải thiện môi trường thể chế hóa cho tốt hơn mới là điều quan trọng hơn hết.

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