Financial Deepening in the Banking Sector—Viet Nam

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Executive Summary

Since 1988, Viet Nam has implemented a wide range of reforms to facilitate its transition from a centrally planned economy toward a market-oriented one. Despite fundamental structural changes, resource mobilization and allocation by the banking sector are still limited. At the same time, the banking sector is structurally fragile. Its composition is dominated by State-owned commercial banks (SOCBs) and its credits by State-owned enterprises (SOEs). On the other hand, lack of competition, nonprice-based operation, as well as lax banking policies and regulations have impaired the development of the banking sector. The foreign banking community estimates that nonperforming loans comprise around 20 percent of total loans. As of the end of 1997, the total overdue was D7.5 trillion ($650 million), of which almost 75 percent was held by SOCBs and 33 percent was owed by SOEs. In terms of percent of total credit, the total overdue increased from 9.3 percent in 1996 to 12 percent at the end of 1997. This fragility is due in part to some inherent problems, and in part to the spillover effects of the Asian financial crisis.

To rectify the banking sector problems, the authorities have exerted intensive efforts. The Law on the State Bank of Viet Nam and the Law on Credit Institutions became effective on 1 October 1998, and 24 related decrees were and will be introduced. The State Bank of Viet Nam (SBV) has promulgated a number of provisions for the establishment of financial institutions and enhancement of deposit-taking, loans, and portfolio investment operations. These measures have contributed to securing an effective monetary policy, directing credits to the most productive sectors, and enhancing the soundness of the credit institutions.

In continuation of such efforts, and taking into account the features of Viet Nam—such as a transitional economy and a rudimentary financial system—as well as recent experience with the Asian financial crisis, the following policies are recommended.

- The banking policy has to be designed and implemented in harmony with other economic policies such as setting a monetary aggregate target, interest rate liberalization, and industrial policy. The monetary target must be determined considering not only inflation but also banking sector development. Deposit interest rates need to be liberalized in advance of lending interest rates. The banking sector should be respected as an independent industry and not seen as an arm of the Government.
- In maximizing resource mobilization, it is essential to enlighten the general public and bankers on the roles of banking in economic development, and to inculcate the habit of saving. To recover confidence in financial institutions, the Government must commit itself to the protection of deposits. The habit of using personal checks can be promoted by improving the security specifics of checks and shortening check clearance time. Shortening cashing out time at banks is also necessary. Encouraging people to pay taxes and utilities and make other regular payments through banking institutions, and direct salary payments to employees' deposit accounts will contribute to bringing banks into the daily life. More efforts should be given to financial innovation.
- The role of the banking sector in distributing financial resources also has to be widely disseminated. The development of screening and monitoring techniques is fundamental for the role. At the same time, the efficient distribution of mobilized funds between financial institutions with surplus and the ones with deficit depends on the development of the interbank market. Instruments such as treasury bills, SBV bonds, certificate of deposit (CD), commercial paper (CP), repurchase agreements (RPs), etc. should be developed first. Advancement of the payment system connecting the central bank, headquarters, and their branches is also necessary.

- To promote competition among banks, first of all, SBV could grade each bank according to criteria set up a priori and allow superior banks more privileges for branching, businesses, etc. Many restrictions on foreign banks and joint-venture banks must be phased out. The authorities need to put appropriate procedures in place to ensure that the State-owned banks are run on a commercial basis, and to facilitate careful internal assessment and monitoring of the credit risk. The financing of specific loss-incurring activities undertaken for public policy purposes has to be transferred to the budget and transparently recorded in the fiscal accounts.
- Through improvements in the accounting and auditing standards, a regulatory framework and prudential regulations must be strengthened. With respect to prudential regulations, exact concepts of nonperforming loans, loan-loss provisions, etc. have to be established and calculated consistently. Compliance with the regulations has to be strictly and transparently supervised.
- Clarification of legal concepts regarding property rights is necessary. They include ownership and transfer right of land, and registration procedures; mortgage laws and title deeds; land-use rights; and collateral. Allowing foreign bankers to accept land-use rights as collateral for loans will help, not only to promote competition in the banking sector but also solve the current liquidity problem. The Bankruptcy Law also has to be extended to clarify exit procedures for financial institutions.
- The restructuring of the banking sector has to be designed and implemented comprehensively and promptly. In particular, reforms on SOEs, SOCBs, and joint-stock banks (JSBs) must be implemented simultaneously. For either SOCBs or JSBs with shortcomings in operation, small chartered capital, and low safety level, consolidation has to focus on recapitalization, change in management and administration personnel, and regaining financial soundness in operation. Banks with insufficient legal capital, weak performance, loss-incurring business, and unsafe operation must be dealt with by contracting the operation gradually, enforcing mergers and takeovers, and closing and suspending operation in a manner that will not affect the safety of the whole system and the economy.
- Enhancement of data collection is necessary for correct economic policies based on an exact current economic and financial situation. Meanwhile the Research Department of SBV needs to be strengthened to play a role as a think tank as well as a training center for the financial sector.

Overview of the Banking Sector[1]

Financial Structure

The Government implemented substantial economic reforms during 1988-1992 to facilitate the transition from a centrally planned to a market-oriented economy. A wide range of reforms included banking sector reforms, State enterprise reforms, external trade liberalization, and tax reforms (Appendix 1). In the banking sector reforms, the monobank system that served the needs of the centrally planned economy was split into a two-tier banking system, consisting of the State Bank of Viet Nam (SBV) as the central bank and four specialized state commercial banks, which were later named as the four State-owned commercial banks (SOCBs).[2] In 1990, entry into the banking system was liberalized, and rules on the sectoral specialization of the four banks were removed. However, Viet Nam recently created two more new specialized SOCBs.[3] Aside from the six SOCBs, the banking decrees in 1990 allowed 54 joint-stock banks (JSBs) to be progressively established. Their shareholders are private entities, State-owned enterprises (SOEs), and SOCBs. Twenty of these JSBs are rural in origin and, in many cases, supplanted the failed credit cooperatives.

The expansion of the banking sector made it possible for one banking facility to serve every 20,000 people. The branch network is confined largely to the SOCBs, which now have around 1,200 branches, but these have to service approximately 10,000 wards and communes throughout the country. The banking sector has been diversified in terms of type, size and ownership (Appendixes 2 and 3). As of the end of June 1998, there existed 24 branches of foreign banks, 4 joint-venture banks, 62 representative offices of foreign banks, 68 credit cooperatives, 2 finance companies, nearly 1,000 people's credit funds, and 1 Government-owned insurance company. Regarding supervision, except for the insurance companies under the management of the Ministry of Finance (MOF), the operations of banks and nonbank financial institutions (NBFIs) are supervised by SBV. SBV provides both off-site and on-site inspection, sets prudential regulations on lending, and stipulates minimum capital requirements.

Current Situation of the Banking Sector

Even though the structural changes undertaken in the Vietnamese banking sector in a decade have been far-reaching and very encouraging, Viet Nam's banking system still has a long list of practices to improve or introduce. Overall, the country remains "underbanked," measured by the ratio of the total banking assets to gross domestic product (GDP). Hence financial mobilization and allocation by the banking sector are still limited.

In terms of growth, the banking sector has grown much faster than the real sector. Its net domestic assets expanded from about 11 percent of GDP in 1992 to 25 percent in 1997. Domestic currency deposits increased at an annual rate of 30 percent over the same period, and its share in total liabilities increased from 35 percent in 1992 to 48 percent in 1997. Regarding diversification of credit, the share of SOEs dropped from over 63 percent in 1994 to 47 percent at the end of 1997 (Appendix 4).

Nonetheless, Viet Nam is far from being a financially deepened country. The ratio of M2 to GDP standing only at 28 percent is far below the 120 percent in the People's Republic of China (PRC) and 90 percent in Thailand. Similarly, the ratio of total deposits to GDP is also only 10 percent at the end of 1997, which is not comparable with 47 percent and 100 percent in the Republic of Korea and Malaysia, respectively. On the other hand, the currency-to-deposit ratio exceeded 42 percent at the end of 1997 (Table 1). Among commercial banks, SOCBs dominated others by undertaking 83 percent of commercial bank operations in 1994, although this fell to 78 percent in 1997 (Appendix 4).

The underdevelopment of the banking sector is also reflected in the low resource mobilization. The gross domestic saving rate in 1997 was only 18 percent, which was much lower than that in the PRC, newly industrialized economies,[4] Malaysia, and Indonesia (Table 2). Furthermore, despite its low level, it has not grown fast either. Compared with the PRC, whose economy is also in transition, Viet Nam has room for more improvement.

Table 1: Financial Deepening, End-1997 (%)

Item	Viet Nam	Japan	Hong Kong, China	Singapore	Republic of Korea	People's Republic of China	Thailand	Indonesia	Malaysia
M2/GDP	27.6	143.8	205.7	93.1	48.3	119.6	89.9	57.0	116.9
Deposits/GDP	10.0	103.7	165.0	85.0	46.8	88.5	82.8	40.8	100.5
Currency/Deposit	42.7	11.8	3.7	9.5	7.8	15.1	8.4	12.1	8.5

Source: IMF, International Financial Statistics (tape). World Bank in Viet Nam Website and country sources (downloaded from ADB, SDBS).

Table 2: Gross Domestic Savings (% of GDP)

Economy	1992	1993	1994	1995	1996	1997
China, People's Republic of	38.3	41.5	42.2	41.9	41.4	42.6
Hong Kong, China	33.8	34.6	33.1	30.5	30.7	30.6
Indonesia	35.3	32.5	32.2	30.6	30.2	31.0
Korea, Republic of	35.2	35.4	36.5	36.8	35.2	34.5
Malaysia	36.5	37.7	38.8	39.5	42.6	43.8
Myanmar	12.8	11.4	11.7	13.4	14.0	14.6
Philippines	17.0	15.2	17.0	16.8	18.8	19.2
Singapore	45.6	46.3	48.8	51.0	51.2	51.8
Taipei,China	27.0	27.0	25.8	25.6	25.1	24.7
Thailand	35.2	35.6	36.0	33.6	33.7	31.0
Viet Nam	16.9	17.4	16.9	17.0	16.7	17.7

Source: ADB. *1998 Asian Development Outlook.*

In addition, the banking sector is structurally fragile. Its weakness is intimately related with the economic structure of the country: the industry sector is dominated by SOEs, and 75 percent of total assets of the banking sector are held by SOCBs. Since budgetary support for SOEs was substantially reduced recently, and since the stock market is not established yet, the role of the banks in the provision of industrial financial capital to SOEs has been critical for economic development. In the lending business, not only SOCBs but also the newly created JSBs have relied heavily on the State sector.

The intimate relationship between SOEs and the banking sector, which characterizes any transitional economy, brought about a weak banking sector in three ways. First, the low profitability of SOEs caused the balance sheets of the banking institutions to deteriorate. In a centralized economy, the traditional management strategy for SOEs, which lack incentives for profit taking, has worsened the SOEs' profitability, and directly affected the profitability of the banking sector. Second, the credit concentration on SOEs exposed the banking sector to a high credit risk. Third, assuming government guarantee on credits to SOEs, financial institutions did not put much effort on exercising their fundamental role in screening and monitoring borrowers. The lax banking policy and regulations that fall short of international standards and norms have impaired the soundness of the banking sector.

The main problem of the domestic banks is manifested in the high percentage of their nonperforming loans (NPLs). Accurate data are not disclosed, but the foreign banking community estimates the NPLs in Viet Nam to be around 20 percent, compared with the official ratio of only 5-7 percent.[5] Accumulated NPLs put those banks in need of recapitalization, a situation that has developed into a major problem in the whole banking sector. Given the lack of public confidence in the banking system, the banks are able to primarily mobilize deposits of less than one-year maturity, while at least 20 percent of their lending have maturities of more than one year. This has resulted in a growing mismatch of asset/liability structure for a number of banks.

As of the end of 1997, the total overdue was estimated at D7.5 trillion ($610 million). Of this total, almost 75 percent was held by SOCBs and 33 percent was owed by SOEs. The private sector's share of overdue credits rose to 67 percent in 1997 from 41 percent in 1994, with the bulk concentrated in Agribank. The recorded overdues, however, are regarded as understating the precariousness of the SOCBs' financial conditions, and probably underestimating the level of nonperforming assets. The total overdue over total credit was 11 percent. By borrower, the ratios of SOEs and the others were 8 percent and 14 percent, respectively. By lender, the ratios of SOCBs and the others were 11 percent and 14 percent, respectively. The asset quality of SOCBs has been generically weak, but that of other banking institutions also worsened substantially in 1997. As a source of overdue loans, SOEs and non-SOEs have shown a similar trend (Appendix 5).

At the end of September 1997, banks classified about 12 percent of total loans as overdue, compared with less than 8 percent at the end of 1995. While the increase in the proportion of overdue loans reflects partly the loss of impetus in the reform process and a one-time adjustment due to the stricter implementation of the loan classification criteria since the beginning of 1997, overdue loans have continued to rise subsequently. State commercial banks frequently roll over credits that cannot be repaid, especially to State enterprises, and the upward trend in NPLs of JSBs is equally worrisome. Given the banks' weak capital base, these developments raise concerns in the event of a slowdown in economic growth or additional adverse economic shocks.

Banks are almost certainly in a worse condition than indicated by their financial statements. The problem of rising overdues may be overshadowed by still deeper problems because banks are allowed to roll over past-due loans without limit, especially for State enterprises, and can provide loans to State enterprises on an unsecured basis. More specifically, several factors make the figures so incomparable with foreign country data based on international standards, namely:

- The different and nonstandard definition of when a loan is classified as NPL. In Viet Nam, up to now, the cutoff period is six months of not receiving interest payments. NPLs do not include estimates of substandard or doubtful assets.
- The accounting system is not transparent and auditing is not yet compulsory.
- The loans' exposure to troublesome companies might be ignored when the NPL ratio is calculated. The State-directed priority loans might be missed out as frozen loans.
- There are no clear cutoff time and procedures for declaring loans as nonperforming and problematic.
- By recording interests on bad debts as accrued profits on their financial statements in some cases, commercial banks tend to conceal their truly bad financial situation.

Tight prudential regulations prevent banks from being directly exposed to foreign exchange risk. However, since State enterprises have in most cases used foreign currency loans for domestic operations without having access to instruments that would allow hedging of the exchange risk, they are greatly exposed to the risk. Roughly one third of total credit is extended in foreign currency, of which over 70 percent is to State enterprises.

The SOCBs are in a particularly bad situation, with 90 percent of capital at risk under the assumption that half of their NPLs can be recovered. Recent government actions allowing banks to extend the maturity of loans at risk, eliminating collateral requirements for loans for SOEs, and transferring budgetary resources to SOCBs for the write-off of NPLs have served to mask the problem.

The collapse of the so-called credit cooperatives in the late 1980s and the restructuring of these troubled entities into small JSBs, mostly in Hanoi and Ho Chi Minh City, enabled the banking system to develop smoothly for a while. However, JSBs were exposed to high competition and high risk due to their characteristics: family-run small banks, focus on serving their communities and local businesses, and concentration in two host business centers.

The questionable soundness of the banking system was further exposed in the recent problems with letters of credit (L/Cs). A number of JSBs and the SOCB Viet Nam Industrial and Commercial Bank (ICB) delayed payments, and in some cases defaulted on L/Cs issued in respect of transactions by a number of SOEs. Some $65 million of L/Cs are reported to be outstanding. Attempts by overseas parties to the transactions to have the L/Cs honored exposed serious problems in both the level of sophistication and reliability of the Vietnamese legal system.

In addition to the problems in L/Cs, recently JSBs started to face serious problems in loans directed to real estate and troublesome companies. The collapse of the property market in Hanoi and Ho Chi Minh City in early 1996 and the collapse of many trading companies a little bit later in 1996 struck the JSBs. The low and almost separated business activities of the JSBs and SOCBs from late 1996 and early 1997 have been driving these banks into more serious problems. In addition, loose supervision of their activities due to political interference of local governments intensified the problems. Another factor contributing to their weakness is the low human capital in these banks. Their small size and simple traditional banking operations prevented them from paying sufficient attention to recruiting experts and training staff. Currently many JSBs are on the verge of collapse and bankruptcy.

Other developments over the past year raise additional concerns about the soundness of the banking sector. Two of the four big SOCBs were caught up in highly publicized fraud-related scandals and there have been several cases of defaults on L/Cs and payment delays by the JSBs and the State-owned ICB. While the authorities eventually directed banks to regularize the situation and further tightened regulations to prevent a recurrence, these incidents have had an adverse impact on creditor sentiment.

On the other hand, the current average capital/asset ratio of SOCBs is 5.5 percent and that of non-State banks is 16.5 percent, but these ratios are likely to drop substantially following the introduction of international standards of loan classification and risk-based assessment of capital adequacy.

Recent Developments in the Banking Sector

Urgent banking policy measures have been required by the unique features of the Vietnamese economy, such as a rudimentary financial system, a bank-centered economy, fragile banking sector, and recent contraction in foreign direct investment inflows. Some of them were designed by internal necessity, but many of them were introduced by external pressure in the wake of the financial crisis in the region.

NEW LEGAL LEGISLATION

To define the roles and functions of SBV and lay the ground rules for financial institutions, respectively, the National Assembly approved the laws on the SBV and credit institutions in December 1997. The new legislation became effective on 1 October 1998.

The law on SBV defines the role of the central bank to provide it more autonomy in the conduct of monetary policy and the banking regulation and supervision system. On the other hand, the law on credit institutions has provisions to ensure the safety of the activities of deposit- and nondeposit-taking institutions (including legal capital, restrictions on asset/liability management, deposit insurance,[6] and limits on credit institutions' investment in fixed assets) and special controls and special loans. More specifically, they include regulations on the following items:

- improvement of credit rules;
- strengthening of the legal framework for bank loans' collateral, mortgages, and guarantees;
- loan-loss provision;
- credit lines for clients;
- external debt management; and
- encouragement of overseas remittance.

In relation to the two laws, 24 decrees (Appendix 6) will be either revised or introduced, 10 of which will be effective from the same day and the rest will be gradually issued later on. Their main goals are to

- provide quantitative regulations on funds mobilization and utilization by commercial banks to make them more autonomous within certain limitations;
- define responsibilities, obligations and rights of related parties in a credit relationship, namely: depositor, borrower, and bank. The responsibilities and obligations of the borrower to make repayments will be further specified in the laws and proposed decrees; and
- provide adequate measures to enforce the fulfillment of the borrower's repayment obligations, thus ensuring full recovery of bank loans.

However, considering the current stage of legislation to prepare the legal foundation, it is too early to evaluate the efficiency of the legal system. Any inconsistency among laws and decrees is yet to be investigated carefully.

PRUDENTIAL REGULATION

SBV has promulgated a number of provisions on setting up deposit-taking, lending, and portfolio investments to secure an effective monetary policy, direct credits to the most productive sectors, and enhance the soundness of the credit institutions. They include the following:

- increase of the statutory capital and reduction of equity transfer;
- minimum ratio of the equity to asset (5 percent minimum);
- liquidity ratio (covering at least three days of business repayment);
- limits on deposit-taking (not to exceed 20 times of equity and reserve fund);
- limit on lending to a single client (less than 10 percent of equity, but this limit has been increased to 15 percent in the Law on Credit Institutions);
- limit on lending to 10 biggest clients (not to exceed 30 percent of outstanding credit); and
- equity holdings in companies (not to exceed 10 percent of the company's issued capital).

On the other hand, entry barriers for banks have been greatly relaxed to promote competition. The latest developments include permitting foreign banks to open branches and to establish joint ventures by streamlining the banking operation procedures (1992).

However, supervisors appear to encounter difficulties in enforcing prudential regulations. Excessive lending to shareholders—primarily State enterprises—is a particular problem for JSBs, as regulations limiting credit to a single borrower can be easily circumvented. There have been delays in conducting international standard audits of the major banks. Audits are crucial to provide an accurate assessment of the banks' financial positions and facilitate the formulation of restructuring plans.

Currently, the regulatory framework does not impose adequate requirements regarding loan classification and loan-loss provisioning, making it difficult to determine with confidence the extent of problems in the banking system. It appears, for example, that banks are required to maintain provisions against losses as noninterest-bearing deposits at SBV, thus presenting a strong disincentive in prudent treatment of loans. Major items are as follows.

SBV issued a loan classification regulation in November 1996, which grouped loans into four categories based on their past due status. Grade 1 is for loans where payments are current, while Grades 2, 3, and 4 are for loans where the principal and interest payments have been due for 180 days, one year, and over one year, respectively. To develop a better understanding of the nonperforming portfolios, the banks are now segregating loans overdue because of willful defaults or improper utilization. These debt liabilities will have to be borne by the borrower or the bank. The Government plans to write off loan losses stemming from exogenous factors such as natural disasters. Meanwhile, liabilities associated with defaults on loans provided to SOEs will be restructured or rolled over.

Regulations for the provisioning of loan losses were introduced in October 1998. Under these regulations, banks are required to provide for loan losses that occurred prior to January 1997 as follows: 25 percent for dues up to 180 days, 50 percent for dues up to one year, and 100 percent for dues beyond one year.

To facilitate bank lending, SBV issued a regulation in August 1996 allowing individuals and companies to pledge land-use rights as collateral for loans. Under the new regulation, almost all loans will require some form of collateral. SBV has been trying to improve bank loan quality. Besides land-use rights, other items that may be pledged are houses, factories, vehicles, equipment, gold, and other precious metals or stones.

SUPERVISION

Regarding on-site examination of banks, SBV carries it out on a bottom-up approach at the branch or subbranch level. SBV still has offices in 53 provinces, each with its own contingent of bank examiners. To a large extent, this organizational structure drives the examination schedule, and the tendency has been to visit all banking offices. Hence, the approach is more in the nature of a rigorous internal audit rather than a bank examination. The Banking Supervision Department of SBV employs around 500 staff nationwide, some 9 percent of the central bank's total workforce. Because of the importance attached to bank supervision, the department has been able to recruit a high proportion of college graduates accounting for as much as 80 percent of its total staff.

SBV's off-site surveillance system was developed with technical assistance from the International Monetary Fund (IMF). Monthly reports submitted by banks are automated and used to produce standard forms via the two information centers in Hanoi and Ho Chi Minh City. Based on the evaluation of the off-site reports, a written monthly report on each institution assigns it a rating ranging from "A" (best) to "C" (worst or problem bank). Banks rated "C" may have their licenses withdrawn.

Policy Issues in the Banking Sector

Coordination Among Economic Policies

MONETARY TARGET AND DEVELOPMENT OF THE BANKING SECTOR

The monetary policy in Viet Nam is implemented on the basis of the M2 target that is set every year after consultations with IMF. Since the development of nonbank businesses is very limited, the growth rate of M2 automatically constrains the growth rate of the banking sector. Until recently (1993-1997), the M2 growth target has been volatile and remained at a high level over 20 percent. The major concern about the high monetary target is the high inflation, which also induces the excessively fast external growth of banks causing them to exceed their capacity. On the other hand, an excessively tight monetary policy to prevent inflation could hamper the moderate expansion of the banking sector and constrain financial deepening.

INTEREST RATE POLICY AS INCENTIVE TO THE BANKING SECTOR

SBV has substantially streamlined and liberalized a complex interest rate structure. Currently, twofold interest regulations remain. First, the maximum lending rates are set at 1.2 percent per month (14.4 percent per year) on short-term loans and 1.25 percent per month (15 percent per year) for medium- and long-term loans. On the other hand, the interest rate margin—average lending rate minus average deposit rate—is regulated at 0.35 percent per month (4.2 percent per year).[7] Advances for special projects and activities can be offered at preferential interest rates. There is no direct regulation on deposit rates.

The traditional process of interest rate liberalization is to liberalize loan rates first and then deposit rates. This is to provide a pecuniary incentive for the rudimentary banking industry to invest in research and development by guaranteeing a certain level of profits for the banks. Instead of the traditional sequence, Viet Nam has adopted the opposite direction (Appendix 7). In 1995-1996, the yield of treasury bills was high. Believing that it would contribute to bank profits, MOF cut down the interest rate margin to induce more efficient banking practices. However, these heavy financial repression taxes, from the bank's point of view, hampered banks rather than encouraged them to operate more safely and efficiently. On the other hand, the lower-bounded deposit rate retarded financial deepening and raised a potential for curb markets.

In effect, the banking sector was not provided a sufficient incentive to pursue profits. This interest rate policy squeezed banks' profits and transferred a part of banks' profits to SOEs, the banks' major customers. This encouraged the SOEs to get excess liquidity beyond proper investment opportunities. At the same time, this led banks to lose motivation for profit-taking businesses, leaving them to manage conservatively and stay complacent.

UTILIZATION OF THE BANKING SECTOR FOR THE INDUSTRIAL POLICY

The banking sector has been utilized as a credit window of the Government. The Government normally selects projects of SOEs complying with the national industrial policy, and asks SOCBs to allocate mobilized resources. This practice deprives bank management of autonomy in decision making for profit maximization. And it makes it difficult for the bank to detect problem loans and to fix them properly at the early stage. Furthermore, it is difficult to distinguish between private sector and sovereign problems. All of these phenomena were pointed out as a common major root cause of the Asian financial crisis in Indonesia, Korea, and Thailand.

Resource Mobilization

Domestic resource mobilization is a major driving force for economic development. However, the domestic saving rate in Viet Nam is very low compared with that in other Asian countries. Low income can be a partial explanation, but financial markets also have not functioned well for the purpose. Behind the slow financial deepening are some crucial factors, and the Government needs to redouble its efforts for resource mobilization.

First, Viet Nam experienced hyperinflation in the late 1980s. The inflation was very volatile, reflecting the high weight of food (65 percent) in the consumer price index (CPI). Second, the financial sector failed to get the confidence of the public mainly because of the massive and nationwide collapse of credit cooperatives in the early 1990s. Third, the banks' resources had been dependent on the Government budget, and the banks did not have sufficient incentives for promoting financial savings.

In addition and more fundamentally, there is no clear distinction between profit-taking and the social duties of banking, and the uniqueness of banks as financial intermediaries is not well recognized in Viet Nam, possibly due to the past practice in the pretransitional period. Even though the banking sector's share in the financial markets is absolutely dominant in Viet Nam, a bank is regarded as either a safe or a broker, or a distributor of government funds. There is no clear distinction between financial intermediation and social duties. A bank's intrinsic functions such as risk sharing, screening, and monitoring have not been sufficiently acknowledged or emphasized. Therefore its contribution to economic development has been commonly neglected. These factors together led households, a financial surplus sector, to prefer real assets to financial assets, and kept them from forming the banking habit. They also dampened the bank's motivation to initiate financial innovation, leaving deposit products simple as shown in Appendix 8.

The banking system in Viet Nam is so bank-centered that NBFIs are not well developed. As mentioned earlier, there are nearly 1,000 people's credit funds, and 68 credit cooperatives, which outnumber the branches of the SOCBs and JSBs. However, the NBFIs capital does not reach 5 percent of that of the SOCBs. In addition, there are two finance companies, and one Government-owned insurance company. The development of NBFIs is important to expand formal financial markets, cover the niche financial market, and expand the scope of the banking sector through universal banking in the future.

Resource Distribution

In resource distribution as well as mobilization, the banking system is still far from performing its key roles in accordance with a market-based system: processing information about investment opportunities, spreading risk through asset diversification, and providing liquidity services through asset transformation. This inability is largely due to the fragmented money market and an adverse yield curve that discourages long-term credit.

The efficient distribution of mobilized resources requires expanded capacity on two levels. First, financial institutions should be able to select the most productive investments. Second, idle funds among the financial institutions should be minimized. The second component can be satisfied when money and capital markets exist, and sophisticated and sufficient instruments are developed in the markets.

The first component concerns the screening and monitoring functions of the financial institutions. The starting point is for each financial institution to adopt profit maximization as a criterion for lending. SOEs have played a fundamental role for the industrial policy to achieve high economic growth. As compensation for full support to the real sector focusing on SOEs, the banking sector was utilized as an agency for allocating funds according to Government's decisions. Major decisions on credit allocation were made by the Government, and the banks had to comply with those decisions, sometimes against their independent profit maximization.[8] Such a Government-led resource allocation mechanism left no room for both SOEs and banks to adopt a market mechanism.

Viet Nam shares with other countries in financial turmoil the fact that improper prudential regulation and a State-led loan policy weakened the banking sector. However, the real sector surrounding the SOEs is much more responsible for the financial difficulty in Viet Nam than in any other countries. When the SOEs turn to be less productive, banks cannot avoid getting fragile. Therefore restructuring of the SOEs and strengthening of the banking sector are almost twin issues that need simultaneous attention.

Competition in the Banking Sector

Fair competition is the surest way to improve efficiency. To promote competition, first the playing field should be leveled and sufficient incentives for accountability given to the players. However, markets for SOCBs and JSBs are completely separate in terms of depositors and borrowers. In particular, although privileges given to SOCBs for each particular sector have already been removed, each SOCB tries to keep its own specialty. Due to the segmented financial markets, competition is not a great concern to SOCBs. Even the seemingly stronger competition among JSBs is restricted only to interest rate competition. This business environment has limited the internal and external expansion of the banking sector.

Competition between domestic banks on one hand, and foreign banks and JSBs on the other hand is also blocked. The regulation explicitly prohibits the latter from accepting land-use rights, which excludes them from loans to domestic firms for which collateral is needed. Foreign banks are allowed to mobilize only 25 percent of their capital in dong.[9]

Of course, the starting point in promoting competition is to apply equal treatment in tax,[10] regulation, subsidy, etc. across different types of banks and credit institutions. However, this tends to make the economic agent forget its competitors, and deprive the market of dynamism. Therefore, incentives to lead the market have to be developed simultaneously.

Regulatory Framework and Prudential Regulation

REGULATORY FRAMEWORK

A well-established regulatory environment can ensure sound and convenient banking activities, and can prevent political constraints in the banking sector. A good legal system can help recover depositors' confidence in the banking sector and strengthen the efficiency and sustainability of funds mobilization.

The regulatory framework in Viet Nam's banking sector includes laws, decrees, and decisions. Even though two laws and 24 decrees became effective on 1 October 1998, the framework is still rudimentary. According to conventional practice, the authorities are more respected than the market mechanism that requires fair and transparent regulation and standards. Compared with the old decree, the new law on SBV was supposed to guarantee more autonomy for SBV in achieving the monetary target. However, contrary to its initial intention, this law does not grant independence and autonomy to the central bank in the conduct of monetary policy and the banking regulation and supervision system, both of which remain subservient to Government intervention. Because of lax coordination with other government agencies such as MOF and MPI in carrying out economic policies, the autonomy of SBV is limited. In particular, the new law requires the central bank to seek National Assembly approval for monetary policy and the Government will continue to interfere with the credit allocation mechanism to serve the multiple socioeconomic objectives of the economy.

PRUDENTIAL REGULATIONS AND SUPERVISION

Together with the restructuring of the banking system and further liberalization of monetary and banking policies, it is important to improve the ability to monitor the banks and deter or detect the emergence of further problems. Adopting stringent prudential regulations, strengthening banking supervision, and improving accounting standards in accordance with internationally accepted standards are also critical.

The current loan classification system does not conform to the international standard since loans overdue for 90 days are not classified adequately. The classification system also does not reflect the credit risk based on the borrower's repayment capacity, collateral coverage, and other factors. Aside from the frozen bad loans of about D2 billion segregated in 1996 from SOCBs account but not written off as yet, under the old system of classification the overdue loans were estimated at D8.1 billion in 1997. The frozen bad debts and overdue loans exceed the aggregate capital base of the banking system estimated to be close to D8.1 billion (equivalent to 9.8 percent of total assets). Over half of NPLs have been overdue by more than 180 days.

The provision against bad debts is barely 1 percent of the total loans. Recent legislative changes have restricted banks to provisioning of up to a maximum of 2 percent of the total outstanding loans and to adjust provisioning if loans are backed by collateral. No instructions have specified whether loan reserves are counted as capital. In the calculation of the capital adequacy ratio, adequate weights to the degree of risk exposure associated with the assets are not assigned.

SBV's surveillance of banks and inspectors' assessment of asset quality and credit review are significantly hindered by lack of a comprehensive loan classification, as well as of provisioning and capital adequacy regulations, and unreliable financial statements of the banks and the borrowers. SBV is restructuring its supervision department, improving on-site and off-site inspection, and devising intensive training of supervisors over the next few years.

ACCOUNTING AND AUDITING STANDARDS

The accounting system is in need of a review, as it is very difficult to determine the financial standing of borrowers from their financial statements. The financial sector suffers from lack of technical infrastructure and skilled staff. Underdeveloped accounting systems and unfamiliarity with independent auditing make it difficult to evaluate financial histories.

At present, banks are not required to submit to independent audit. SBV acts as auditor to the local banks, while JSBs and foreign banks are given the choice of independent audit. Local banks are not required to disclose their financial statements although most provide financial summaries in their annual reports. Three JSBs (VP Bank, Asia Commercial Bank, and Maritime Bank) have submitted to independent audits as required by foreign investors prior to the latter's purchase of equity stakes.

The World Bank is providing MOF with technical assistance on public accounting to improve the Government's ability to keep track of and monitor the macro economy and public finance, as well as to make clearer the basis for assessing and collecting taxes from companies. The European Union is providing technical assistance to improve private accounting through the establishment of accounting and auditing guidelines. The two-pronged program is expected to be completed in two years. In a related move, the Government has a program to have the four SOCBs plus two major JSBs audited by international firms. The agriculture bank was the first to be audited by Coopers & Lybrand in 1996, the three other SOCBs were next in 1997, and the two private banks were scheduled for 1998.

Other Banking-Related Regulations

Considering that the banking sector is in a state of flux, the legal environment for the sector is not well established. The enforcement of laws is generally weak because of cumbersome procedures and a complicated and ambiguous legal framework. Each authority can loosely and widely interpret the laws in different ways.

Ownership and transfer right of land are not clearly stated, and the registration procedures are not clearly set down. These can be obstacles to the future development of the banking system. The development of property markets in Viet Nam is slow and likely to be hampered by the laxity of the land-use rights as well as registration problems.

Mortgage laws and title deeds are still ambiguous, which makes lending to the retail-housing sector a risky business. Legal shortcomings pose serious obstacles to investment and lending. Recent decrees on land-use rights have temporarily cast doubt over the possibility of using land as a mortgage tool for Vietnamese companies. A decree in February 1995 in effect defined land-use rights in such a way that owners of land-use certificates have become tenants of the land and obliged to pay rent. The decree can also be read as imposing tight restrictions on circumstances under which the lease can be mortgaged to banks. Recent legal changes might bring some improvement, but the severely gray areas in the law need to be clarified before any real progress in financial services can be made.

Viet Nam does not have any unified legislation on collateral. The subject is dealt with in a fragmentary and noncohesive way. This is, in part, due to the fact that loan agreements may be treated as civil or economic contracts. The definitions of four forms of collateral are available only under the Ordinance on Civil Contracts dated July 1991. The Ordinance on Economic Contracts dated September 1989 merely provides that performance of this type of contract may be secured by mortgaging property or by guarantees in accordance with the law. It does not define the type of property that can be mortgaged or the applicable law regarding guarantees. The establishment of a mortgage and, in the event of default, collection against the mortgage therefore constitute a very complicated process. Hence, most banks resort to out-of-court methods, instead of initiating legal proceedings.

SBV's ruling is largely a consequence of a civil code passed by the National Assembly in 1995. The civil code required SBV to clarify certain rules governing borrowing and lending. The new regulation is intended to be more liberal than the previous guidelines on the subject. In Viet Nam, the State owns all land; hence, land can never be pledged as collateral for a loan. Land-use rights, however, can serve as a surrogate. In particular, foreign bankers have long contended that lending for infrastructure and other large industrial projects in the nation would be accelerated if they could accept land-use rights as collateral for loans. They are currently able to accept little of genuine value as collateral.

Finally, the Bankruptcy Law that was introduced in 1993 does not adequately address the bankruptcy of financial institutions. In preparation for the anticipated restructuring of banks, including the possible liquidation or merger of some of the 54 JSBs, it is necessary to revise the law to include the cases of financial institutions.

Restructuring and Consolidation of the Banking Sector

Confidence in the banking sector, unless addressed now, will further be eroded, given that the capital base of a few key banks could be wiped out in the process of adoption of international prudential standards. In addition, some of the banks are highly leveraged in foreign currency terms and their profitability is, among others, affected by continued ad hoc lending to SOEs, and the asset and liability maturity mismatch.

The current weakness of the banking sector is reflected in the weak balance sheets of banking institutions (Appendix 9). In turn, these reflect lack of soundness, low profitability, and inefficient financial intermediation. Therefore, the banking sector requires both stock measures to improve soundness and flow measures to improve profitability. Stock improvements emanate chiefly from financial restructuring operations, while sustainable flow improvements result from operational restructuring measures. Moreover, intermediation capacity has to be enhanced and an appropriate level of banking services relative to the real sector should be developed.

In many ways, the SOCBs in Viet Nam share the same problem of high NPLs with other countries' commercial banks in financial crisis. In particular, State-directed loans were the main reason for the weakness of the banking sector. However, the Vietnamese banking sector problem is distinguished from others in that it is due more to domestic problems than to exposure to foreign investors. Therefore, without exact understanding and tremendous efforts from the Government, easy resolution of the problem cannot be expected.

The many mergers of collapsed credit cooperatives increased the number of weak JSBs from 4 in 1990 to 15 in 1997. The JSBs are weak in terms of capital, expertise, and performance. They are concentrated in two business host centers—Ho Chi Minh City and Hanoi. Most of them are family/relative-connected and -run businesses of Chinese Vietnamese nationals. They have been diversified by their ownership structure and their local business requirements; however, they are not sufficiently diversified in a practical sense. If the economy continues to slow down, which is seriously felt in the two sectors—real estate sector and trading/business financing—JSBs will be definitely exposed to the systematic risk.

Data Collection and Knowledge Dissemination

Lack of accounting standards and lack of experience in data analysis make it difficult to realize the importance of data. As the economy and the financial system develop, optimal policy decision making cannot be expected without wide, exact, and timely information. In particular, an indirect monetary policy that requires analysis of the relationship among numerous variables is not possible without sufficient data sets and their analysis. The General Statistics Office of the Government currently produces major macroeconomic data such as GDP and CPI. Credit Information Centers of the SBV located in Hanoi and Ho Chi Minh City collect other information related to monetary policy. However, the data are not collected systematically. Analysis, storage, and dissemination are also limited.

Since the economy of Viet Nam is in transition, building human capacity is much more urgent than in any other country. Viet Nam has to catch up on the constantly developing financial markets, adopt best practices in banking, and strengthen prudential regulation and supervision. Currently, the Research Department in SBV is carrying out two crucial functions: research on economic issues and direct involvement in the implementation of monetary policy. Striking a balance between these two functions is easier said than done. As long as the Research Department makes policy decisions, it is hard to expect its research to be carried out in an objective way.

Policy Recommendations

Coordination Between Economic Policies and the Banking Policy

MONETARY TARGET AND DEVELOPMENT OF THE BANKING SECTOR

To set a growth rate of monetary aggregate, consistent with price stabilization as well as the development of the banking sector, the trend in income velocity of money has to be investigated carefully. The target of M2 needs to be improved from end-of-period basis to average basis to mitigate undue fluctuations at the end of a period. Development of NBFIs is necessary to bring hoarded financial assets into the system. However, such development can at the same time enlarge the gap between liquidity in the economy and M2. This will, in turn, make implementation of the monetary policy difficult. Therefore, an adequate balance between banking institutions and NBFIs needs to be maintained.

INTEREST RATE POLICY AS INCENTIVE TO THE BANKING SECTOR

Taking into account the importance of financing through banking institutions, all interest rates cannot be liberalized at the same time, because doing so can lead to higher levels. However, it is necessary to change the current interest rate regulation structure. In Viet Nam, borrowers are known to be very sensitive to interest rate differentials in contrast to depositors who are more concerned about the safety of their assets. Therefore, it will be desirable to liberalize lending rates first. Under the assumption that the Government continues to influence banks' credit allocation, banks can discipline borrowers through differentiation of interest rates according to credibility. This new policy complies with the standard sequence of interest rate liberalization. On the deposit side, it is recommended that interest rates be liberalized sequentially:long-term time and saving deposits first, short-term demand deposits next, and demand deposits last. The regulation on the interest rate margin needs to be removed to provide banking institutions with adequate profits.[11]

SEGREGATION OF THE BANKING POLICY FROM THE INDUSTRIAL POLICY

In establishing a transparent and sound financial system in Viet Nam, direct lending and subsidies to SOEs have to be rationalized. This issue entails three agendas: (i) separation of budget-based lending from the purely bank's own-resource-based lending, (ii) injection of funds for frozen projects, and (iii) sharing of information on SOEs. The first agenda needs significant management and legislative commitments. Unless the central and local governments, respectively, clarify their portions and their obligations to use funds wisely, the issue will continue to aggravate the banking sector problem. Fortunately, this may change along the process of the SOEs' restructuring scheme.

The second issue, which is more difficult and technical, requires the Government to design and implement a bigger and more serious funding program for improving the balance sheets of the banking system. The large portion of bad debts of SOCBs is known to be attributed to the legacy of the State-led system in the past, and the recent collapse of large corporations.[12]

The third agenda is about asymmetric information between SOCBs and other smaller financial institutions. Giving the big SOCBs the right to manage a part of the Government budget would provide them with significant informational advantages over the small banks in selecting customers, getting sectoral and market information, and so on. However, with the committed SOEs equitization programs from this year onward, the Government might end up with a dramatic cutdown on its subsidies for SOEs, which will lead to further and better competitive operating environments in the future.

Promotion of Resource Mobilization by the Banking Sector

To maximize resource mobilization and to improve resource allocation through banking institutions, it is essential to educate the general public and bankers about the roles of banking in economic development, and to promote the saving habit. Only when these conditions are satisfied can genuine solutions to many fundamental problems in the banking sector, such as lack of confidence and fragility, be obtained.

For the next steps—to overcome current difficulties and to utilize the banking system as a major channel of resource mobilization—the following measures need to be considered. First, to recover and strengthen the extremely weak confidence in the financial institutions, the Government needs to commit itself to the protection of deposits. These factors prevent market discipline from working well. However, introducing an explicit deposit insurance scheme in Viet Nam is indispensable.[13] At this moment SOCBs are not only owned by the Government, but also too big to fail. On the other hand, JSBs and other banking institutions are allowed to protect the secrecy of the related information.

Second, the traditional ways of financing, such as credit pooling in rural areas and relatives lending/support, are difficult to break down. Unless the overall environment is changed persuasively, the general public will not shift their idle funds to the banking system. People are not used to transaction by check or credit. The habit of using personal checks could be fostered by improving the security specifics of checks and shortening check clearance time. Simplification of cashing out steps at bank counters will also encourage the public to visit banks more frequently. The encouragement to pay taxes, utilities, and other regular payments through banking institutions, and direct salary payment to employees' deposit accounts will contribute to bringing banks into the daily life.[14] The development of NBFIs, each of which holds its own specified and more customer-friendly market, can contribute to bringing hoarded financial assets into the system. People's credit funds and credit cooperatives could be merged or capitalized to be more solid institutions in filling the gap between banking and self-sufficient financial behavior. Some of them could be developed into merchant banks.

Third, the authorities have to develop saving instruments that provide incentives for saving for households and deposit taking for banks. From the household point of view, keeping real interest rates stable is as important as keeping them positive. This condition is intimately related with the stable CPI. Since around 65 percent of total weight in the CPI is allocated to the agriculture sector, which is very unstable due to weather dependence, the CPI is also very unstable. On the other hand, the Vietnamese households' preference for gold[15] is very high compared with that in other countries. Recently the price of gold in the world market has been on a sharp and consistent downward trend.[16] The domestic price of gold also has decreased dramatically: since early 1997, the Government has stopped issuing quotas for imports of gold when the supply already exceeded the demand. In contrast, the real interest rate remains at over 3 percent, which is sufficient to motivate people to deposit. Therefore, authorities and banks need to widely advertise these facts and utilize this opportunity to collect gold in the closets and transform it into financial assets. Worries over the volatility of the CPI (i.e., real interest rate) can be mitigated by developing long-term time deposits with loose penalty for canceling the deposit contract. Apart from the real interest rate, traditional financial cooperation through credit pooling, strong offspring caring, and available services attachable to banking services could be sought and incorporated in the new deposit products.

Enhancement of Resource Allocation by the Banking Sector

The efficiency of resource allocation depends on the governance of banks. In the case of Viet Nam, it also relies on the soundness of SOEs. Therefore, SOE reforms should be directed toward reducing the number of firms through mergers and liquidation, rationalizing them through equitization, eliminating virtually all fiscal subsidies, and sharply reducing the size of the labor force. These will result in large productivity gains and strong output growth, as well as much increased net transfer from SOEs to the Government or other sectors.

Another important issue related to recovering the profit-based management of banking institutions is the time horizon for calculation of the gross discounted profit of a project. In particular, since Viet Nam is in an economic development stage that needs to launch a long-term development plan, it is important to keep in mind that the time horizon should be longer than that in the more developed countries. The role of banks has to be further emphasized due to the underdevelopment of the capital markets. In that sense, good practice regarding market discipline and governance in the banking sector cannot be transmitted in Viet Nam as they are in the more advanced countries, and Vietnamese banking institutions are deemed to have a special duty. But it is equally important that banking institutions' decisions must be transparent and justifiable by predetermined standards. It is equally true for the allocation of funds from the budget for project funding.

The efficient distribution of mobilized funds between financial institutions with surplus and those with deficit depends on the development of the interbank market. Sufficient instruments such as treasury bills, SBV bonds, certificate of deposit (CD), commercial paper (CP), repurchase agreements (RPs), etc. should be developed first. The development of a wider payment system connecting the central bank, headquarters, and their branches is also necessary.

Promotion of Competition Among Banks

The restrictions on JVBs and foreign banks need to be relaxed. First, the restriction on deposit taking by JVBs has to be phased out. Second, after clearly specified criteria applicable to all banking institutions are prepared, JVBs and foreign banks must be allowed to establish branch offices according to the criteria. Third, JVBs must be allowed to make equity investments in local enterprises not exceeding 10 percent of the capital of the companies or enterprises as local banks are currently allowed.[17]

In the issue of specialization of SOCBs, removing the business wall is recommended. Competition among SOCBs over the same businesses—international businesses, development investment projects, and agricultural and rural development projects—will enhance efficiency.

Many other obstacles have to be removed gradually. Legal and regulatory reforms should be enacted. The authorities have to put appropriate procedures in place to ensure that the State-owned banks are run on a commercial basis, including procedures to facilitate careful internal assessment and monitoring of the credit risk. Financing for specific loss-incurring activities undertaken for public policy purposes has to be transferred to the budget and transparently recorded in the fiscal accounts. This separation of banking from quasi-fiscal activity will contribute to promoting competition among SOCBs. From the fiscal point of view, without complete elimination of this type of quasi-fiscal activity, structural improvement of the fiscal sector would not be possible. The Government has to set up short-term and long-term action plans for these reforms and must be steadfast in their implementation.

Regarding incentives for active competition, SBV can grade each bank according to criteria set up a priori. The criteria can include soundness, profitability, growth, productivity, etc. Superior banks can be given privileges for branching, businesses, etc., usually given to tier-1 banks in the two-tier system.[18] Taking into account international experience, bank size should not be given too much weight in evaluation.

Improvement of the Regulatory Framework and Prudential Regulation

The new law on SBV fell far short of the initial expectation in enhancing the autonomy of the central bank. The law needs to be revised to allow SBV to implement monetary policy independent of politics. Since Viet Nam is in the process of establishing good practice, the law has to make sure that the SBV policy decisions are made according to transparent standards and discussion, and that they are announced openly through the proper channel. SBV, on the other hand, should be fully accountable for its decision.

The law on credit institutions also needs to be supplemented to level the playing field for foreign banks and JVBs vis-a-vis the domestic banks. The following items are of primary concern: foreign banks are subject to special capital requirements, deposit restrictions, and collateral rules; they have no access to the SBV refinance facilities. At the same time, the credit law does not provide a regulatory framework for the foreign bank branches that have thus far been governed by the operating licenses. Equally of concern are stipulations regarding the directed and subsidized lending, which specify that the Government can direct banks to provide subsidized loans for SOEs. Already over 50 percent of SOCBs lending is directed to SOEs and is not secured.

Prudential regulations and loan-loss provisioning have an important role in limiting credit expansion to problem enterprises in the State-owned and private sectors. Improvements need to be made to the management information systems of individual banks to provide good quality data. There is also a pressing need to clarify the guidelines on nonperforming or problem loans.

First, SBV has to adopt a risk-based loan classification regulation and segregate the loans overdue beyond 90 days and those with high credit risk. These steps are prerequisites for establishing an adequate loan-loss reserve for the loan portfolio. Second, as soon as possible, regulations have to be issued to provide for mandatory pretax loan-loss provisions by all banks and credit institutions, and there should be no upper limit to loan-loss provisioning. Third, capital adequacy rules have to be strengthened into risk-based ones. Other prudential regulations also have to be revised to bring them into close conformity with international practices. Financial institutions unable to comply with these new regulations should face curbs on their lending activities and even exit. International accounting standards have to be adopted by the banking system, with equivalent emphasis on on-balance and off-balance sheets. For the implementation of a good regulatory framework, examiners' capacity is crucial. Strong emphasis has to be placed on training bank examiners and on improving SBV's capacity for on-site and off-site bank examinations.

Regarding supervision of the implementation of prudential regulations for the banking system, beside monitoring and supervision by the credit institutions, there are also supervision and monitoring by SBV, by the line ministries and Government agencies, and by People's Committees. Too much fragmented and overlapping supervision impairs the efficiency of management. The supervisory scheme has to be streamlined so that banking is separated from political interests, and supervision is carried out by an autonomous agent.

The Government should prepare audit regulations to improve the assessment of the financial standing of borrowers based on their financial statements. At the same time, the activities of foreign banks and accounting firms should be encouraged to increase expertise and competition. Good accounting is also important for improvement of the profit of financial institutions. If banks have to pay taxes before adequate provisions are made for bad debts, they would be overtaxed and decapitalized. As mentioned earlier, many efforts have been put in this area. Their outcomes have to be reflected in practice without generous compromise with political excuses.

Refinement of a Banking-Related Legal Framework

In banking perspective, the focus of legal reforms should be on the clarification of legal concepts. These include ownership and transfer right of land, and registration procedures; mortgage laws and title deeds; land-use rights; and collateral. Allowing foreign bankers to take land-use rights as collateral for loans will not only promote competition in the banking sector, but also solve current liquidity problems. To facilitate financial institutions' proper exits, the Bankruptcy Law has to be extended to cover financial institutions.

Restructuring of the Banking Sector

For optimum benefit, restructuring has to be designed and implemented comprehensively and promptly. Regarding comprehensiveness, reforms on governance, accounting, legal and regulatory framework, and supervision have to be carried out simultaneously so that they can cover all issues on stock and flow improvement as well as operational efficiency. These reforms can be considered at three economic agency levels: SOEs, SOCBs, and JSBs. First, the State-led lending to SOEs, backed by Government implicit guarantee, has damaged banks' incentives to screen and monitor borrowers. Therefore, the resolution of the banking sector problem necessitates restructuring of SOEs, reestablishment of the relationship between banks and SOEs, and resolution of NPLs to SOEs. Second, for the four large SOCBs, the first steps are the completion of audits and the implementation of restructuring plans to address recapitalization and write-off of bad loans, independence of management from political pressure, the possible breakup of each bank into smaller and more viable entities, and partial or full privatization. Finally, for JSBs, early action to merge or close nonviable institutions is essential. In the case of viable JSBs, their shares should be allowed to be sold to foreign partners. Among the three economic agencies, SOCBs and JSBs are our major concern in this paper.[19]

STATE-OWNED COMMERCIAL BANKS

In restructuring SOCBs, efforts should focus on three points: (i) immediate rationalization of their structure and consolidation of operation to establish competent institutions, (ii) restructuring of NPLs and inefficient investments to help SOCBs recover investors' confidence, and (iii) recapitalizing them by utilizing budget funds to enable them to emerge and maintain their leading role in commercial banking.

The international-standard audits, together with the strengthened loan classification system that was put in place in 1996, will provide the basis for reform plans for the four big SOCBs. The plans will address possible recapitalization; independence for bank managers and internal reforms; the possible breakup of the bank into smaller, more viable entities; and partial or full equitization. Committees were established for the restructuring program of the Viet Nam Bank for Agriculture and Rural Development (VBARD), ICB, and the two other banks. Equitization of partly State-owned credit institutions, excluding BIDV and other policy banks (banks assigned certain social duties), is the Government's policy to be implemented during 1998-2000, within the SOEs' enhanced equitization program (Appendix 10). It will substantially contribute to rationalizing the banking system and improving the competitiveness of weak SOCBs with lower capital adequacy ratios than the international level of 8 percent, and high and increasing rate of overdues (over 10 percent).

For the restructuring of banks through liquidation, merger, etc., there are two more related issues. It is necessary to revise the Bankruptcy Law introduced in 1993 so that it can adequately address the bankruptcy of financial institutions. The establishment of an asset management company is also necessary for efficient disposal of bad assets of financial institutions. Considering the lack of human resources and the small scale of the financial sector, one agency would be sufficient to collect and dispose of bad assets from all financial institutions.

JOINT-STOCK BANKS

The objective of restructuring the JSBs is to allow some of them with sound development capacity to expand their scope into large-scale private JSBs and attain regional level. Consolidation for JSBs will be encouraged through the establishment of explicit and timely procedures for merging and for closing nonviable banks. For the larger JSBs (with capital of at least D50 billion), a plan for international-standard audits had been set up. Public resources—including budgetary transfers and equity, and other cash infusions from SOCBs—should not be provided to bail out JSBs of any size. For the small JSBs, lack of experience and therefore lack of confidence are major problems. In addition to mergers, a clear exit policy needs to be prepared.[20]

For either SOCBs or JSBs with shortcomings in operation, small chartered capital, and low safety level, consolidation has to focus on recapitalization, change in management and administration personnel, and regaining financial soundness in operation. Those banks with insufficient legal capital, weak performance, losses in business, and unsafe operation have to be dealt with by contracting operation gradually, enforcing mergers and takeovers, and closing and suspending operation in a manner that will not affect the safety of the whole system and the economy.

As a related issue to banking sector restructuring, two government agencies can contribute to shorten the process. They are deposit insurance and asset management corporations. Deposit insurance was mentioned earlier. The asset management corporation can help financial institutions dispose of NPLs and concentrate on the banking businesses only. It can also be utilized as a government window for the recapitalization of financial institutions. Taking into account the scale of Viet Nam's financial sector, one institution can start to carry out the functions of both corporations.

Enhancement of Data Collection

Budgetary as well as human resources have to be guided toward handling of data that are up to international standards and comparable with other countries. The credit information centers need to be expanded and forced to upgrade currently available databases to make them user-friendly, and to develop new sets of data. SBV must require all information on loans/credits extended by financial institutions to be submitted in the standard format. The reports must contain not only basic credit information, but also an evaluation of the credit. Crucial information has to be approved by appropriately designated authorities within these financial institutions and must be available for audit by SBV when deemed necessary.

Strengthening of the Research Department of SBV

For a more efficient monetary policy and management of SBV, the Research Department should be separated from the Monetary Policy Department so that it can concentrate on in-depth research separate from daily operations and provide balanced policy recommendations. This change requires the incorporation of credit information centers into the arms of the Research Department. This measure can be taken in line with the restructuring of the central bank.

This change will allow the Research Department to function as a think tank of SBV, and provide objective policy recommendations. Specifically, the department will undertake the following responsibilities: (i) carry out an in-depth study on long-term as well as current economic policies; (ii) provide objective views on the monetary, banking, and exchange policies (balance and check); (iii) introduce new information on economics and economic policies; (iv) develop statistics on economic policy (incorporation of data collection and analysis); and (v) train staff. Subsequently, prudential regulations regarding NPLs and a single party limit, and implementation of monetary policy need to be transferred to the relevant departments.

To study and adopt advanced knowledge within the shortest time period, it is necessary to establish a well-organized training system. For a while, two offices of SBV—headquarters in Hanoi and a branch in Ho Chi Minh City—can be utilized as training centers. Later on, the bankers association can consider establishing a special institute to train bank staff to be experts in banking.

Viet Nam lacks financial and human resources for the costly restructuring of the financial sector. Therefore, SBV needs to more actively solicit assistance from international institutions or foreign central banks in designing a legal and technical framework as well as restructuring procedures for banks.

Notes

[1]The final revision of this paper was made in November 1998.

[2]The four SOCBs are the Bank for Foreign Trade of Viet Nam (VCB), Viet Nam Industrial and Commercial Bank (ICB), Bank for Investment and Development of Viet Nam (BIDV), and Viet Nam Bank for Agriculture (VBA). The last one was recently renamed as Viet Nam Bank for Agriculture and Rural Development (VBARD).

[3]Bank for the Poor (1996) and Bank for Mekong Delta (1997).

[4]Hong Kong, China; Singapore; Korea; and Taipei,China.

[5]Viet Nam: Deepening Reform for Growth, An Economic Report, World Bank Report No. 17031-VN (1997) reports that at the end of June 1997, banks classified over 15 percent of total loans as overdue, and estimated that, even under optimistic assumptions, loan losses could wipe out over half of the system's total capital.

[6]The Asian Development Bank (ADB) is reviewing the deposit insurance scheme that has been introduced.

[7]As of 11 September 1998, 7.5 percent per year is the ceiling rate of foreign currency lending. For deposits, ceiling rates for demand deposit, six- month deposit, and over six-month deposit are 0.5 percent, 3 percent, and 3.5 percent, respectively.

[8]Annually, ministries and industries prepare investment plans to be submitted to the Ministry of Planning and Investment (MPI), and subsequently to the Government, for final decisions on funding. Once the plans are approved, State banks have to provide them with loans at low interest rates. At present, banks pay deposits at an annual interest rate of 12.25 percent while under State orders, they must provide State-approved investment projects with loans at a rate of only 0.81 percent per year. In many cases, local authorities have made investment decisions without consulting banking experts, forcing bank officials to invest in unprofitable enterprises.

[9]From 10 percent, it was liberalized to 25 percent of registered capital in November 1996. SBV attempted to further increase the ratio to 50 percent; however, that was not approved by the Government.

[10]Paradoxically, foreign banks and JSBs are enjoying a more favorable tax treatment.

[11]In fact, the current actual interest margin is quoted as smaller than the legal margin. The current regulation is therefore irrelevant.

[12]This refers to the commercial bad debts in the 1970s in the VCB balance sheet and some SOCBs' involvement in recent corporate scandals in Viet Nam.

[13]The decree and proposed organization for deposit insurance were expected to be ready in the first quarter of 1999.

[14]There was confirmation of payroll usage first tested and implemented in the Treasury system and then at several SOCBs.

[15]The savings structure of the population is as follows: 44 percent in gold, 20 percent in housing, 10 percent in idle funds, 7 percent in savings deposits, and 18 percent in other assets.

[16]In New York, gold price per fine ounce dropped from \$387.45 at the end of 1995 to \$290.20 at the end of 1997.

[17]A circular is being prepared to give effect to this policy measure, but the circular will be completed only after the proposed 24 decrees have been finalized. This measure is significant since by the end of 1998 a pilot securities trading center had become operational. The objective of this measure is to enlarge the domestic demand for securities by creating institutional sources of investment in parallel with the Government's program of equitization and development of a domestic capital market, given the limited investor base.

[18]In Malaysia, for example, tier-1 commercial banks have the following privileges: (i) issuance of negotiable instruments of deposit up to five times of their capital funds; (ii) participation in equity derivatives; (iii) participation in the share borrowing and lending activities; and (iv) for domestic banks, regional expansion of operations through the establishment of branch offices, representative offices, and joint-venture or subsidiary companies.

[19]The main issue on the restructuring of SOEs is equitization. As of 1 August 1998, the Government had planned the restructuring of 2,280 SOEs (56 percent of the total number of SOEs): 1,768 were to remain unchanged, 307 were to merge, 768 were to be equitized, 101 were to be

incorporated, etc. The Prime Minister signed a decision to equitize 178 SOEs in 1998. For details on the equitization policy, refer to Appendix 10.

[20]SBV announced in July 1998 that JSBs under special control (banks unable to pay back debts) will be merged, taken over, or sold to other banks. Other JSBs can voluntarily apply for merger, takeover or sale. However, mergers, takeovers, or sellouts must be proposed by local branches of SBV, agreed upon by shareholders, and approved by local authorities. If the banks on the verge of insolvency refuse to apply these solutions, SBV will revoke their licenses, force them to merge or designate banks to take them over. Within 15 days from the date of receiving applications for merger, takeover or sellout, SBV's local branches must consider them and report to the SBV Governor.

Appendix 1

Milestones in the Reform Process, 1986–1998

1986

- Renovation or "Doi Moi" formally endorsed

1987

- Difference between free market price and official prices reduced, ration system abolished for many commodities; internal trade liberalized
- Enactment of a Foreign Investment Code, followed by by-laws and regulations, and establishment of the State Committee for Cooperation and Investments

1988

- Farmers given user rights for land for at least 15 years, and allowed to take initiative in farming activities and benefit from surplus production
- Increased autonomy given to State enterprises
- Initial reform of the banking system, including separation of the functions of the State Bank from those of commercial banks

1989

- Wide-ranging price reform. With few exceptions (electricity, accommodation, medicine), the distinction between official prices and market prices was abolished, interest rates raised to yield positive real rates
- Devaluation of the official exchange rate close to the market rate
- Trade liberalization was intensified. Private sector allowed to produce export commodities and trade with foreign partners, import-export quotas were significantly reduced, export subsidies were terminated, and foreign exchange restrictions were relaxed.
- Fiscal reforms introduced, including a broadening of the tax base and equal tax rates applied to all economic sectors

1990

- National Assembly adopted the Law on Private Business and the Law on Companies, allowing the establishment of private businesses.
- Initial restructuring of State enterprises; merging or dissolution of loss-incurring enterprises
- Entry into the banking system liberalized and rules on the sectoral specialization of the four SOCBs removed

1991

- Broadening of trade relations caused by reduced markets with former Soviet Union and Eastern European countries
- Socio-Economic Stabilization and Development Strategy to the Year 2000 approved
- Establishment of foreign exchange centers, utilization of exchange rates established at these centers as basis for formulating official exchange rates
- Elimination of the practice of increasing money supply to finance budget deficit

1992

- Series of decrees concerning reorganization of State enterprises, including provisions for lease, sale, merger, or liquidation, and policy vis-à-vis surplus labor
- Tight fiscal and monetary measures, sharply reducing the rate of inflation; introduction of real positive interest rates
- Adoption of a new Constitution, introducing changes to democratic freedoms and property rights, and right to free business activities in line with law

1993

- Relicensing of all State enterprises; all forms of subsidized credit to State enterprises effectively terminated
- Continued fiscal reforms, introduction of land-user tax with the tax rate reduced by one half of

the previous rate, introduction of new salary for public and State enterprise workers
- Passage of Land Law, granting land-use rights and right to construct and use fixtures on land to private Vietnamese entities and individuals. Farmers granted flexible landholding rights over farmland for 20-50 years depending on use
- Passage of Law on Disputes and Resolutions

1994
- Adoption of Bankruptcy Law (passed on 30 December 1993) that governs all enterprises
- Establishment of an interbank foreign exchange market
- Establishment of economic courts to hear economic and bankruptcy cases
- Comprehensive legal framework for the protection of the environment
- Adoption of a Labor Code containing labor contracts, wages, collective labor agreement
- Law on Promotion of Domestic Investment

1995
- Law on State Enterprises
- Law on Copyright
- Civil Code
- Establishment of 18 General Corporations
- Reorganization of Small Enterprises
- Continuation of Equitization

1996
- Budget Law
- Law on Cooperatives
- Mining Law
- Completion of public expenditure review
- Preparation of Public Investment Program
- Preparation of Action Plan for State Enterprise Reform

1998
- Law on the State Bank of Viet Nam and 12 decrees
- Law on credit institutions and 12 decrees

Appendix 2

Structure of the Financial System[a]

State Bank of Viet Nam (Est. 1951)

Total Assets	D64,051	$5,810
Cap.	D809	$73
Employees	4,945	
Branches	53	

State-Owned Commercial Banks Total

Total Assets	D58,041	$5,264
Cap. & Res.	D1,508	$137
Income (net)	D452	$41
Employees	39,200	
Branches	674	

Bank for Investment & Development of VN (BIDV; Est. Mar 57)

Total Assets	D10,954	$994
Cap. & Res.	D269	$24
Income (net)	D58	$5
Employees	5,200	
Branches	90	

Bank for Foreign Trade of VN (VIETCOM Bank; Est. Apr 63)

Total Assets	D18,162	$1,647
Cap. & Res.	D359	$33
Income (net)	D157	$14
Employees	2,000	
Branches	17	

VN Bank for Agriculture (VBA; Est. Jul 88)

Total Assets	D13,462	$1,221
Cap. & Res.	D618	$56
Income (net)	D26	$2
Employees	21,000	
Branches	474	

Industrial and Commercial Bank of VN (INCOM Bank; Est. Jul 88)

Total Assets	D15,463	$1,402
Cap. & Res.	D262	$24
Income (net)	D211	$19
Employees	11,000	
Branches	93	

Shareholding Banks (50 banks) Total

Total Assets	D9,278	$842
Cap. & Res.	D844	$77
Income (net)	D247	$22
Employees	2,711	
Branches	54	

Urban (Ho Chi Minh based) (17 banks total as of Apr 94)[a]

Total Assets	D3,776	$342
Cap. & Res.	D519	$47
Income (net)	na	na
Employees	1,794	
Branches	45	

Urban (Hanoi based) (6 banks total as of Apr 94)[b]

Total Assets	D159	$14
Cap. & Res.	D103	$9
Income (net)	452	na
Employees	162	
Branches	2	

Urban (Other based) (8 banks total as of Apr 94)[a]

Total Assets	D748	$68
Cap. & Res.	D101	$9
Income (net)	452	na
Employees	405	
Branches	6	

Rural (19 banks total as of Aug 95)[b]

Total Assets	D416	$38
Cap. & Res.	D113	$10
Income (net)	D48	$4
Employees	350	
Branches	1	

Source: Consultant report for rural finance project.

Joint Venture Banks Total

Total Assets	D3,893	$353
Cap. & Res.	D717	$65
Income (net)	D52	$5
Employees	52	

Indo Vina Bank (Est. Jan 91) INCOM/Dagang National Bk (Indonesia)

Share	50%	50%
Total Assets	D924	$84
Legal Cap.	D165	$15
Income (net)	D22	$2
Employees	61	

VID Public Bank (Est. May 92) BIDV/Public Bk (Malaysia)

Share	50%	50%
Total Assets	D786	$71
Legal Cap.	D165	$15
Income (net)	D18	$2
Employees	72	

First Vina Bank (Est. Feb 93) VIETCOM/Korea First Bk/Daewoo Securities

Share	50% / 40%	10%
Total Assets	D2,007	$182
Legal Cap.	D221	$20
Income (net)	D12	$1
Employees	58	

Vina Siam Bank (Est. Aug 95) VBA/SCB/CP Group (Thai)

Share	50% / 25%	25%
Total Assets	D176	$16
Legal Cap.	D165	$15
Income (net)	D0.1	$0.01
Employees	32	

Foreign Bank Branch Total (19 banks with 21 branches)

Total Assets	D4,168	$378
Cap. & Res.	D1,068	$97
Income (net)	D31	$3
Employees	605	

Bank	Licensed
Amro Bank (N)	Sep-95
ANZ Grindlays Bank (N)	Jun-92
Bangkok Bank*	Apr-92
Bank of America (N)	Dec-94
Banq. Franc. Com. (H)	Jun-92
Banque Indosuez (H)	Apr-92
Banque Nat'l de Paris (H)	Jun-92
Chinjon Bank (N)	Apr-93
Citibank (N)	Dec-94
Credit Lyonnais*	May-92
Deustche Bank (H)	Jun-95
Hong Kong Bank (H)	Jun-95
ING Bank (N)	Mar-95
Keppel Bank (H)	Mar-95
May Bank (N)	Mar-95
Shinhan Bank (H)	Aug-95
Standard Chartered Bank	Mar-95
Thai Military Bank (H)	Sep-92
United Overseas Bank (H)	Mar-95

H = One branch in HCM
N = One branch in Hanoi
*Two branches in HCM and Hanoi

Foreign Bank Rep. Office (62 banks with 67 offices)

HCM	39 banks
Hanoi	28 banks

There is one insurance company under direct control of the Ministry of Finance.

People's Credit Funds (596) (As of Apr 1996)

Total Lending	D4,168	$378
Cap. & Res.	D1,068	$97

Credit Cooperatives (69) (As of Aug 1995)

Total Lending	D14.5	$1.0
Cap. & Res.	na	na

Bank or Poor (Est. Aug 1995)

Total Assets	D1,480	$134.0
Cap. & Res.	D210	$19.0
Income (net)	D2.7	$0.2
Employees	na	

Finance Companies (2)

Total Assets	D241	$22
Cap. & Res.	D40.5	$4

Gold & Gems Company (47)

Total Assets	na	na
Cap. & Res.	na	na

Minimum Capital Requirement

Commercial Bank	D20	$2.00
Shareholding Bank		
Urban Bank		
Hanoi Base	D50	$4.00
HCMC Base	D70	$6.00
Others	D20	$2.0
Rural Bank		
w/o branches	D1	$0.09
w/ branches	D3	$0.27
Joint-Venture Bank	D110	$10.00
Foreign Bank Branch	D165	$15.00

Data as of December 1995 unless otherwise indicated; Exchange rate used: $1 = D11,025; D = billion; $ = million; na = not available.

[a] Branches include subbranches, which can do the same operations.

[b] Latest available figures.

Appendix 3

Banking Institutions

At the end of 1996, Viet Nam's banking system included four State-owned commercial banks (SOCBs), 52 joint-stock banks (JSBs), 23 branches of foreign banks, four joint-venture banks (JVBs), 62 representative offices of foreign banks, and 68 credit cooperatives. There were also close to 900 people's credit funds, two finance companies, and one Government-owned insurance company.

STATE-OWNED COMMERCIAL BANKS

- Industrial and Commercial Bank of Viet Nam (ICB), whose operations include mobilizing funds, making local and foreign currency loans, trading in foreign exchange, processing local and international payments, trading in gold and silver, consulting, and providing computer services.
- Bank for Foreign Trade of Viet Nam (VCB) dominates trading in foreign exchange and offers the following services: financing trade, letter of credit operations, making bank guarantees, processing international payments, offering credit card facilities, and making loans and accepting deposits.
- Bank for Investment and Development (BIDV) is responsible for mobilizing funds for development investment projects, providing equity participation in development projects, dealing in foreign exchange, and providing medium- and long-term lending.
- Bank for Agriculture and Rural Development, whose operations are generally limited to the agriculture sector. It also operates the Bank for the Poor, a Government-funded, low-income credit scheme.

JOINT-STOCK BANKS

Shareholders of JSBs are SOCBs, State-owned enterprises, and private entities. Most of the JSBs were established during 1991–1993.

FOREIGN BANK BRANCHES

Foreign bank branches operate mainly in foreign currencies, especially in the area of trade finance, as they may accept only a limited amount of domestic currency deposits.

JOINT-VENTURE BANKS

The four JVBs—which are partnerships between a state commercial bank and a foreign bank—are subject to the same restrictions on deposit taking as foreign banks.

Source: Viet Nam: Selected Issues and Statistical Annex, IMF Staff Country Report No. 98/30, April 1998.

Appendix 4

Distribution of Credit, 1994–1997

Item	1994	1995	1996	1997
		In billion dong at end of period		
Total nongovernment credit	33,345	42,277	50,751	65,691
To state enterprises	21,004	24,079	26,810	30,979
To other sectors	12,341	18,198	23,941	34,712
Of which: foreign currency loans	12,873	16,350	18,564	20,825
Credit extended by State-owned commercial banks	27,610	33,647	38,320	51,484
To state enterprises	18,604	20,855	22,030	26,382
Of which: foreign currency loans	8,648	9,886	10,493	10,032
To other sectors	9,006	12,792	16,290	25,101
Of which: foreign currency loans	681	1,020	771	2,560
Credit extended by other banks[a]	5,735	8,630	12,431	14,208
To State enterprises	2,400	3,224	4,780	4,597
Of which: foreign currency loans	1,812	2,589	3,582	3.315
To other sectors	3,335	5,406	7,651	9,611
Of which: foreign currency loans	1,732	2,855	3,718	4,918
		In percent of total nongovernment credit		
Total nongovernment credit	100.0	100.0	100.0	100.0
To state enterprises	63.0	57.0	52.8	47.2
To other sectors	37.0	43.0	47.2	52.8
Of which: foreign currency loans	38.6	38.7	36.6	31.7
Credit extended by State-owned commercial banks	82.8	79.6	75.5	78.4
To State enterprises	55.8	49.3	43.4	40.2
Of which: foreign currency loans	25.9	23.4	20.7	15.3
To other sectors	27.0	30.3	32.1	38.2
Of which: foreign currency loans	2.0	2.4	1.5	3.9
Credit extended by other banks[a]	17.2	20.4	24.5	21.6
To State enterprises	7.2	7.6	9.4	7.0
Of which: foreign currency loans	5.4	6.1	7.1	5.0
To other sectors	10.0	12.8	15.1	14.6
Of which: foreign currency loans	5.2	6.8	7.3	7.5

[a] Include joint-stock banks, joint-venture banks, and branches of foreign banks.
Sources: State Bank of Viet Nam, and staff estimates.

Appendix 5

Overdue Bank Loans, 1994–1997

Item	1994	1995	1996	1997
		In billion dong		
Total overdue	3,152	3,337	4,726	7,512
State enterprises	1,854	1,658	2,088	2,501
Other borrowers	1,298	1,679	2,638	5,011
State commercial banks	3,004	3,052	4,209	5,600
State enterprises	1,754	1,519	1,852	2,181
Other borrowers	1,250	1,533	2,357	5,011
Other commercial banks[a]	148	285	517	1,912
State enterprises	100	139	236	320
Other borrowers	48	146	281	5,011
		In percent of total overdue		
Total overdue	100.0	100.0	100.0	100.0
State enterprises	58.8	49.7	44.2	33.3
Other borrowers	41.2	50.3	55.8	66.7
State commercial banks	95.3	91.4	89.1	74.5
State enterprises	55.6	45.5	39.2	29.0
Other borrowers	39.7	45.9	49.9	45.5
Other commercial banks	4.7	8.6	10.9	25.4
State enterprises	3.2	4.2	5.0	4.2
Other borrowers	1.5	4.4	5.9	21.2
		In percent of total credit		
Total overdue	9.4	7.9	9.3	11.4
State enterprises	8.8	6.9	7.8	8.1
Other borrowers	10.5	9.2	11.0	14.4
State commercial banks	10.9	9.1	11.0	10.9
State enterprises	9.4	7.3	8.4	8.3
Other borrowers	13.9	12.0	14.5	13.6
Other commercial banks[a]		3.3	4.2	13.5
State enterprises	2.6	4.3	4.9	7.0
Other borrowers	1.4			
Memorandum item:				
Nongovernment credit outstanding	33,345	42,277	50,751	65,691

[a] Include joint-stock banks, joint-venture banks, and branches of foreign banks.
Sources: State Bank of Viet Nam, and staff estimates.

Appendix 6

List of Decrees and Decisions to Be Issued Under the New Banking Laws

LAW ON THE STATE BANK OF VIET NAM

Decrees

- Decree on foreign exchange management
- Decree on organization, responsibilities, and powers of the management of SBV
- Decree on organization, responsibilities, and powers of the National Advisory Council on Monetary Policy
- Decree on financial regime of the State Bank
- Decree on printing, minting, safekeeping, transport, and destruction of Vietnamese currency
- Decree on the issue, redemption and replacement of Vietnamese currency
- Decree on development of international balance of payment
- Decree on management and use of State foreign exchange reserves
- Decree on organization, responsibilities and powers of bank supervision
- Decree on information operation of SBV
- Decree on formulation and conduct of national monetary policy
- Decree on settlement of administrative violations in monetary and banking operations

Decision of the Prime Minister

Decision on the list of confidential documents in monetary and banking operations

LAW ON CREDIT INSTITUTIONS

Decrees

- Decree on organization and operation of financial leasing companies
- Decree on organization and operation of policy banks
- Decree on operation of cooperative credit institutions
- Decree on organization and operation of finance companies (including finance companies of State corporations)
- Decree on organization and operation of foreign credit institutions in Viet Nam
- Decree on financial regime of credit institutions
- Decree on banking operations of other institutions
- Decree on loan security
- Decree on organization and operation of commercial banks
- Decree on organization and operation of banks for investment and development
- Decree on deposit conservation or deposit insurance organization

Decision of the Prime Minister

Decision of the Prime Minister on capital level of credit institutions

Appendix 7

Selected Interest Rates, 1992–1997 (in percent per annum)

Item	1992	1993	1994	1995	1996	1997[a]
Deposit rates[b]						
Demand deposits	na	na	na	8.4	6.0	4.8
Households	12.0	8.4	8.4	na	na	na
Economic units	3.6	1.2	1.2	na	na	na
Three-month savings	na	na	na	16.8	8.4	7.2
Households	24.0	16.8	16.8	na	na	na
Economic units	18.0	9.6	0.8	na	na	na
Six-month savings	na	na	na	20.4	9.6	8.4
Households	na	20.4	9.6	na	na	na
Economic units	18.0	12.0	12.0	na	na	na
One-year savings	na	24.0	24.0	24.0	10.8	9.6
Lending rates[c]						
Working capital (short term)	32.4	25.2	25.2	25.2	15.6	12.0
Fixed capital (medium term)	21.6	14.4	20.4	20.4	16.8	13.2
Foreign currency loans[d]	na	90.0	108.0	114.0	114.0	102.0
Memorandum items:						
Interest rate spread[e]	8.4	8.4	8.4	8.4	6.0	4.8
Inflation[f]	13.2	3.6	16.8	1.2	8.4	3.6
Real interest rates:[g]						
Three-month savings deposits (households)	10.8	13.2	0.0	15.6	0.0	3.6
Lending:						
Working capital	19.2	21.6	8.4	24.0	7.2	8.4
Fixed capital	8.4	10.8	3.6	19.2	8.4	9.6

na = not available.
[a] Based on September 1997 figures.
[b] Mandated deposit rates through 1995; average of 4 state commercial banks thereafter.
[c] Maximum lending rates through 1995; average of 4 state commercial banks thereafter.
[d] Annual rates.
[e] Difference between interest rates on working capital and households' three-month savings deposit.
[f] Average monthly inflation during the quarter; not seasonally adjusted.
[g] Measured with respect to nominal interest rates at the end of each quarter and average monthly inflation during that quarter.
Sources: State Bank of Viet Nam, and staff estimates.

Appendix 8

Deposit Products of State-Owned Commercial Banks, as of March 1998

Depositor		Products	Period	Interest Rate	Remarks
Deposits from corporate customers including credit institutions		Demand deposits	On demand	0.4%	
		Time deposits (T/D)	Mainly 3 mo 6 mo 1 year	0.6% p.m. 0.75% p.m. 0.80% p.m.	0.4% p.m. before maturity
Deposits from population	Savings Deposit	Demand deposits	On demand	0.3% p.m.	
	Savings Deposit	Savings in connection with housing loans	Over one year	Deposit 7% p.a. Loan 10% p.a.	Introduced in 1994
	Savings Deposit	Time deposits	1,2,3,6 mo 1 year 13 mo 2 years	3 mo 0.6% p.m. 6 mo 0.75% p.m. 1 year 0.80% p.m.	0.4% p.m. before maturity
	Certificates of deposit (C/D)	Ordinary C/D (1) Interest paid in advance (2) Interest paid semi-annually (3) Interest paid at maturity	3 mo 6 mo 9 mo 1 year 13 mo	Higher than ordinary time deposits	0.3% p.m. before maturity
		C/D secured by gold value	Same as above	Lower than ordinary T/D, i.e. 6 mo.=5.5% p.a.	Introduced in 1992
		C/D secured by US dollar	Same as above	Same as above	Introduced in 1995; more popular than C/Ds secured by gold
From corporate and population		C/D with certain purpose	1 year to 5 years	Not fixed	To finance a specific project
		Bonds	13 mo 36 mo 60 mo	-0.85% p.m. -0.85% p.m. -0.90% p.m.	

p.a. = per year; p.m. = per month; mo = month/months.
Source: Bank for Investment and Development of Viet Nam (BIDV).

Appendix 9

Consolidated Balance Sheet of Deposit Money Banks, 1992–1997[a] (in trillion dong, end of period)

Item	1992	1993	1994	1995	1996	1997
Net foreign assets	7.15	2.97	0.38	(0.15)	(0.12)	1.60
Foreign assets	9.27	5.84	7.29	9.57	10.69	12.28
Foreign liabilities	2.13	2.86	6.91	9.72	10.81	10.68
Net domestic assets	16.26	24.34	36.50	44.28	50.44	60.71
Credit	12.46	23.03	33.91	43.76	47.51	62.62
Government (net)	(2.63)	(0.16)	0.54	1.45	(0.59)	0.37
State enterprises	12.35	15.51	20.46	24.08	26.11	30.98
Other sectors	2.74	7.67	12.88	18.20	21.96	31.22
Claims on NBFIs	0.00	0.00	0.02	0.03	0.03	0.05
Reserves	3.45	3.71	5.09	7.61	8.10	9.45
Other items (net)	0.35	(2.40)	(2.50)	(7.10)	(5.16)	(11.36)
Liabilities	23.41	27.31	36.88	44.13	50.32	62.31
Dong deposits	8.09	10.59	14.80	21.98	26.27	29.88
Demand deposits	3.97	4.80	5.01	6.87	8.56	14.68
Time and saving deposits	4.12	5.79	9.79	15.11	17.71	15.19
Import/restricted deposits	1.71	1.51	2.14	2.14	1.85	3.08
Foreign currency deposits	6.51	5.89	7.39	8.92	10.63	15.61
Credit from State Bank	4.75	6.62	7.86	5.79	5.56	5.56
Capital and reserves	2.35	2.69	4.69	5.29	6.02	8.18

NBFIs = nonbank financial institutions.
[a] Data for 1993 are based on an incomplete monetary survey and are not strictly comparable with other years. Negative values are enclosed in parentheses.
Sources: State Bank of Viet Nam, and staff estimates.

Appendix 10

Decree No. 44/ND/CP on Equitization, 29 June 1998

1. The equitization program aims to enhance the effectiveness and competitiveness of State-owned enterprises (SOEs). Equitization is a Government order and is not done on a voluntary basis.
2. The assessment of the value of SOEs should be based on the current market prices. Shareholders should include enterprises employees, Vietnamese overseas and foreign companies, and people who want to buy shares.
3. In enterprises categorized as “wholly” equitized, people can buy shares without limit. In enterprises in which the Government dominates, an entity can buy a limited share of 10 percent and an individual 5 percent. In enterprises in which the Government does not have a dominating share, the corresponding rates are 20 percent and 10 percent.
4. The equitized enterprises should secure jobs for all employees. A part of the share-selling capital should be spent on further training the redundant workforce. Employees are entitled to buy shares at preferential prices, 30 percent lower than nominal prices. The total value of preferential shares must not exceed 20 percent of the value of State ownership. If the self-accumulated capital of an enterprise accounts for 40 percent of its total value, the value of preferential shares will increase to 30 percent. Low-income employees can buy shares at preferential prices on ten-year credit without paying interest.
5. Enterprises, excluding those providing the State with monopolized products or services and those dominated by the State, will be subject to equitization. The Prime Minister will only consider equitization plans for enterprises worth over $800,000. Decision on those worth less than $800,000 will be made by ministers or chairpersons of People’s Committees.