FOR A BETTER POLICY ON FOREX AND EXCHANGE RATE CONTROL

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It takes only two more months that euro, the world's second strongest currency behind US dollar, will be officially put in circulation. In our country, the Vietnam Bank for Foreign Trade (Vietcombank) has not accepted account opening, loans, and saving deposits in 12 kinds of EU currencies, and shifted to trading in euro...The US dollar faces particular volatility in economic, political and military developments of the U.S., Afghanistan, Middle East and the world. Moreover the Vietnam-U.S. trade pact has been recently ratified by President Bush. Given that situation, how is the country's forex market and exchange rate? Is there any upheaval? This is a big and complicated problem. We need long-term understanding about it.

In January 2001, the exchange rate averaged VND14,520 to a U.S. dollar on the Vietnam's free market and VND14,512 at Vietcombank; then the figures rose to VND15,020 and VND15,516 respectively. According to the General Department of Statistics, the U.S. dollar price index climbed 3.3% in September 2001 as compared to December 2000. The average increase of commercial banks was 3%. Just after the event on September 11, 2001, the domestic exchange rate saw a slight drop to VND14,990/US$1, then inched up recently. There are almost no upheavals in exchange rate as well as in the forex market during the last 11 months.

The forex control policy belongs to the State system of macro-economic policies, aiming at implementing the function of state management on foreign currency used in the country and external economic relations in accordance with the national strategy of socio-economic development.

The exchange rate is a tool to implement the monetary policy. It is managed by the central bank along the Party orientation, the National Assembly's resolutions and the Government's decisions to reach the targets of the policy.

The forex control policy and exchange rate management tool are aimed at securing the national sovereignty in money, spurring economic growth, stabilizing local currency, controlling inflation, generating jobs and improving income of workers.

Over the past years, the State Bank of Vietnam has incessantly renovated and perfected its realization of the Government's forex control policy and made significant contributions to the development of the Vietnam's banking system in line with international common practices and principles of the market economy.

1. Regarding forex control

Before the Law on State Bank of Vietnam and the Law on Banking Institutions took effect (October 1, 1998), the Government and the SBV had determined the forex status for commercial banks; maximum limit of credit balance in enterprises' bank accounts, and provided that the amount of foreign currency which an individual was permitted to carry through the border gate was under US$1,000; and then US$3,000; US$5,000 and US$7,000 without declaration...

However, new regulations have been promulgated from early 1999. Enterprises had to sell their foreign currency within a specific span of time to banks instead of holding a minimum credit balance in foreign currency in their bank accounts, the percentage of sold foreign currency was 100% at first, then reduced to 80% and 40% at present. The maximum amount of foreign currency which an individual is permitted to hold when leaving the country and needs no declaration drops to US$3,000. Other regulations on forex control such as licensing the holding of foreign currency when leaving the country, managing the forex counters, domestic sales of goods and services with payment in foreign currency, enterprises' opening overseas accounts in foreign currency...have been also rectified more clearly, suitably, liberally or tightly.

2. Regarding the mechanism of exchange rate management

Before late 1998, the country's mechanism of exchange rate management was that the SBV had announced the official rate every day, commercial banks which were allowed to trade in foreign currency proactively determined their selling and buying rates within the trading band (from r – r.t% to r + r.t% and r: the SBV's exchange rate). The proportion t% is determined by the SBV in each period. It was first 5%, then 7% and 10%.

Nevertheless, from early 1999 the central bank has abolished its subsidized mechanism of exchange rate management, that is, announced only the average exchange rate on the interbank foreign currency market every day, instead of announcing the official rate as previously. Commercial banks positively fix their exchange rates within the provided band based on the rate already announced by the SBV.

However, the band for commercial banks' trading has continuously changed. In the first stage from 1999 to 2000, the SBV specified the band limits so minutely and the band was very narrow. Therefore it made too deep intervention in commercial banks trading activities. Afterwards, the SBV has widened the band with fewer detailed terms as in the following table:

Term (days)	From Feb 26, 1999 to Aug 30, 2000 (t%)	From Sep 1, 2000 to Sep 17, 2001 (t%)	From Sept 18, 2001 until now (t%)
No term	0.10	0.10	0.10
30	0.58	0.20	0.40
31-44	0.87	0.40	
45-59	1.16	0.40	
60-74	1.45	0.45	1.50
75-89	1.75	0.65	
90-104	2.04	0.79	
105-119	2.33	1.14	
120-134	2.62	1.26	
135-149	2.92	1.38	2.35
150-164	3.21	1.38	
165-179	3.50	1.48	

Another tool of the monetary policy directly affecting the policy on forex control and exchange rate management is the required reserve. Over the past one year, the SBV has step by step raised the proportion of required reserve in foreign currency, from 5% to 8%, then 12% and 15% now; at the same time reduced the proportion of required reserve in local currency – Vietnamese đồng, from 5% to 3%, especially from 3% to 2% for the Vietnam Bank for Agriculture and Rural Development. This has helped control interest and exchange rates better and reduce dollarization in bank accounts.

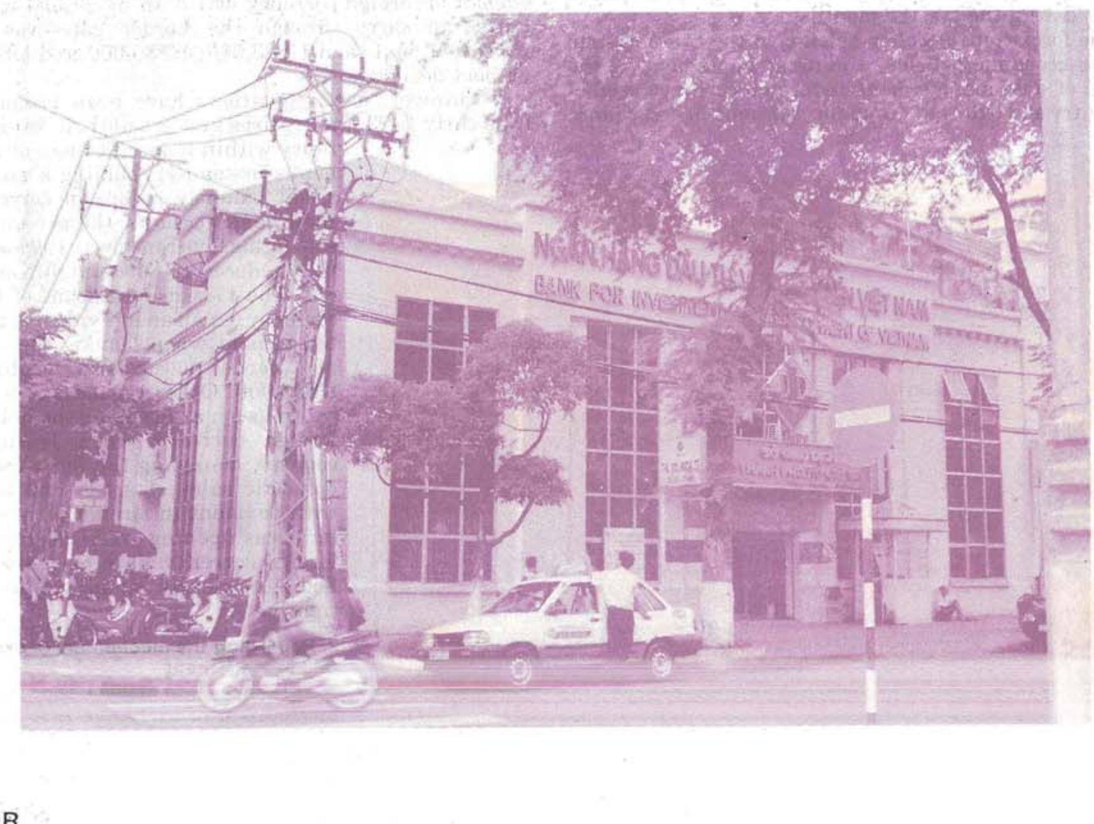
The interbank forex market is the place in which the SBV is ready to intervene to set an appropriate exchange rate in line with the Government's monetary policy.

There has been a surplus in foreign currency and shortage in local one – Vietnamese đồng in commercial banks from mid 2001. Therefore the SBV has used swap facilities to meet the commercial banks' short-term demand for Vietnamese đồng. These facilities have been gradually perfected.

The exchange rate used by the SBV when swapping currency with banks is the SBV's spot exchange rate on the day of signing the swap contract or the day of swap confirmation via Reuters network plus addition rate for each term as follows:

Term (days)	% of spot exchange rate	
	From July 17 to Aug 15, 2001	From Aug 16 to October 2001
7	0.80	0.30
15	0.85	0.40
30	1.00	0.50
60	1.35	1.00
90	1.70	1.50

In addition to intervention in the interbank forex market, the central bank also trades in foreign currency such as buying foreign currency from crude oil export reve-



nues, and selling foreign currency to the Ministry of Finance and selected commercial banks for importing petroleum...Especially the SBV also manages the national fund for foreign currency and gold reserve and the fund for forex market stabilization.

The regulations on overseas remittance have been modified step by step. The local beneficiaries are now allowed to receive foreign currency instead of Vietnamese đồng only as before.

The policy on forex and exchange rate control is a big issue, including control over currencies of countries having the same frontiers, payment in border trade, licensing of transferring foreign currency abroad, provisions on local sales and services with payment in foreign currency, regulations on opening deferred payment L/Cs, etc. Some following issues need distinct views:

a. The exchange rates of exports and imports

In early 1990s, it was argued that the official exchange rate should be based on the exchange rates of exports and imports in the process of managing the monetary policy.

In my opinion, that method is only suitable for the centrally planned economy and the period in which Vietnam established trade relations mainly with socialist countries in compliance with government agreements. At present, the Vietnam economy develops in line with the market mechanism and integrates into regional and international economies, that view is no longer appropriate. The structure of Vietnamese exports and imports changes rapidly, the selling prices are dependent on specific markets, the cost prices of the same kind of commodities are different by countries and the exchange rate between currencies always fluctuates. As a result, the exchange rates of exports and imports cannot be figured out exactly. The official exchange rate is affected by market factors with the SBV's intervention in accordance to the planned targets.

b. Devaluation of Vietnamese đồng for export stimulation

To boost export does not depend only on exchange rate, but on other factors including competition edge, marketing competence, quality, design, price and so on. So the local exporters should not expect currency devaluation.

The devaluation of Vietnamese đồng will produce an immediate effect on imported goods, increase input costs for commodities made of imported materials, and promote selling prices of imports while Vietnam is now facing a serious trade deficit. In particular, devaluation will augment the country's burden of foreign debts which are currently estimated at US$15 billion. Although China has been consistent with exchange rate stabilization for many years, its export turnover always grows fast.

c. Fact of dollarization and utilization of only Vietnamese đồng

According to the International Monetary Fund (IMF), dollarization is a common event in developing economies which are in the transition period when they cannot control smuggling, face regular deficits in current balance of payments, their local currency remains weak and unstable, the banking system is underdeveloped, and the people get used to hoarding dollars and gold. The problem is which degree the dollarization is at and whether it can be controlled or not. However, the dollarization in Vietnam is at a normal degree and can be controlled according to international experts. We have to temporarily acknowledge it, tap its advantages, reduce its bad effects, and attract overseas remittance, foreign investment capital and the people's foreign currency. We temporarily accept dollarization in bank accounts rather than in the society.

When the Vietnam stock marker is gradually integrating into the international market, local banks mobilize the people's foreign currency and deposit it in overseas banks to earn income. This is actually appropriate to the market rules and beneficial to the entire economy, as well as banks and the people. It also helps the country have a large reserve of foreign currency, the banks earn income, the people gain profits and finally the foreign currency do not float on the market.

3. Solutions to a better policy on forex and exchange rate control

- It's necessary to take solutions and specific measures to create necessary and sufficient conditions and factors for Vietnamese đồng to be soon convertible. Vietnamese đồng is the only currency permitted to be circulated and used in Vietnam. The competent agencies must bring smuggling under tight control. The range and objectives allowed to sell goods and services domestically with payment in foreign currency must be narrowed. Instead they will collect local currency. There should be a general investigation, review and evaluation to specify responsibilities of each agency in the implementation of regulations on domestic sales with payment in foreign currency.
- To continue carrying out the decision on flexible exchange rate control in accordance with market fluctuation and make intervention when need be: The SBV cannot replace the forex market in the trend of integration, and avoid upheavals and shocks. It should soon liberalize exchange rate, first keep on easing regulations on the trading band of exchange rate and finally abolish these administrative regulations. It is also required to listen and adopt commercial banks' specific proposals on exchange rate management. The interbank forex market performance should be improved and more flexible when the Ministry of Finance expands the selling of foreign currency from crude oil export revenues to the SBV; and the SBV is also willing to sell foreign currency to commercial banks with a view to meeting strategical requirements of the economy.
- The SBV continues to enhance administrative reform, reduces deep intervention in forex activities of commercial banks, minimize procedures and time of swap dealing. It should review legal documents on forex and exchange rate management and cancel inappropriate or overlapping regulations.
- It is explained that the SBV increases the proportion of required reserve for deposits in foreign currency to 15% so as to raise the cost of capital mobilization and restrict dollarization in bank accounts and transferring foreign currency abroad. At present, the situation has changed, the interest rates of US dollar in the world and local markets have dropped sharply. To attract the people's foreign currency to banks for loans or deposit money in overseas banks are beneficial to the economy and in compliance with law. As a result, the proportion of required reserve for deposits in foreign currency must be lower than or equal to that for local currency. Moreover, the mobility of foreign currency is not similar to that of local currency when ruling high proportion of required reserve.
- The SBV's role in the interbank forex market needs be promoted. It should make more effective intervention in this market when acting as the last trader.

The country's foreign currency demand and supply is currently improved, the reserve fund of foreign currency regularly strengthened, especially from crude oil export earnings and the SBV's exchange rate control increasingly effective. Just because of these factors, there will be no upheaval in the domestic forex market ■