

USING FINANCIAL INSTRUMENTS TO FACILITATE THE FORMATION AND DEVELOPMENT OF A STOCK MARKET IN VIETNAM

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In developed countries, the stock market is second only to the banking system as canal for flows of funds. The stock market not only facilitates flows of capital but also provides the public with investment opportunities. In this aspect, the stock market seems more convenient than the banking system because it allows investors to decide where to put their money in and know how their money is used, it provides companies with an appropriate means of mobilizing capital and it keeps the government well informed about current developments of the economy through day-to-day stock indexes and averages.

In Vietnam, when the economic reform was carried out and the market economy under the government's management came into being, capital deficit units have been allowed to raise funds by all possible means. In other words, in the new eco-

nomic conditions, capital is allowed to flow both vertically and horizontally and this situation leads to a need for a stock market. However, the stock market in Vietnam has just come to its first stage of development as an issuing market with many shortcomings of its own: prices of stocks aren't decided by supply and demand forces, there is no professional organizations that could undertake new issues or sell and buy stocks and shares in large quantities, most shares issued in Vietnam are registered ones therefore it's hard to exchange them for cash when there is no organized stock market.

Thus, capital in Vietnam is supplied mainly as short-term loans through banks and the public have no chance to make long-term investment because of the lack of a stock market. Meanwhile, the shortage of capital for development and the backwardness of existing technology have become worrying problems. In addition the need to transfer

shares and stocks has become increasingly urgent and an unofficial stock market is taking shape in Vietnam and showing unhealthy signs. Therefore, the establishment of a stock market is really necessary. It not only helps to solve the shortage of capital in the industrialization process, but also meets objective requirements posed by the development of the market economy. However, a well-organized stock market couldn't come into being overnight, and many efforts are needed to create necessary conditions and a suitable environment.

On Nov. 28, 1996, the PM issued Decree 75/CP to form the State Securities Commission directly responsible to the Government. At present, there have been certain conditions needed for the formation and development of a stock market: the growth rate has stayed high (over 8%) for the years 1992-97, the inflation was under control, the system of laws has been perfected (many laws

have been made and come into effect), the Government has issued Decree 48/CP on securities trade, etc. However, these conditions aren't perfect enough to allow the formation of a stock market. For the time being, it's planned that two stock exchanges would come into operation in Hà Nội and HCMC by 2000. They are included in a pilot scheme in preparation for a better organized stock market in the near future. Thus, the project to develop a stock market is included in the development plan for the first decade of the twenty-first century. Among urgent problems that must be solved in order to accelerate the formation of a stock market is the task of making the best use of financial instruments in the coming years. Great importance is attached to this task because of the following reasons:

First, financial instruments could be used for stabilizing the domestic currency and controlling inflation, thereby helping investors feel sure about their business, especially their financial investments.

One of causes of high inflation rates in Vietnam is big budget deficits. The Government should reduce expenditures, increase budget income and use government credits to regulate flows of capital, at the same time, the government has to keep financial reserves in order to deal with fluctuation on the world market, prevent rushes on gold or foreign exchange, thereby stabilizing market prices and struggling against inflation.

In addition, other instruments such as interest rate and reserve requirement should be made more flexible and suitable to changes in market prices.

In the coming years, the interest rate is still one of the most important macroeconomic instru-

ments, however, it must be adjusted to inflation rate and supply-demand relationship with a view to making the basic interest rate offered by the money market (the market for short-term loans) a basis for interest rates on long-term loans, and more importantly, a basis for prices of stocks.

Because of the fact that the Government should regulate flows of capital and orient them towards fields of top priority, the future stock market should combine all factors of both open and

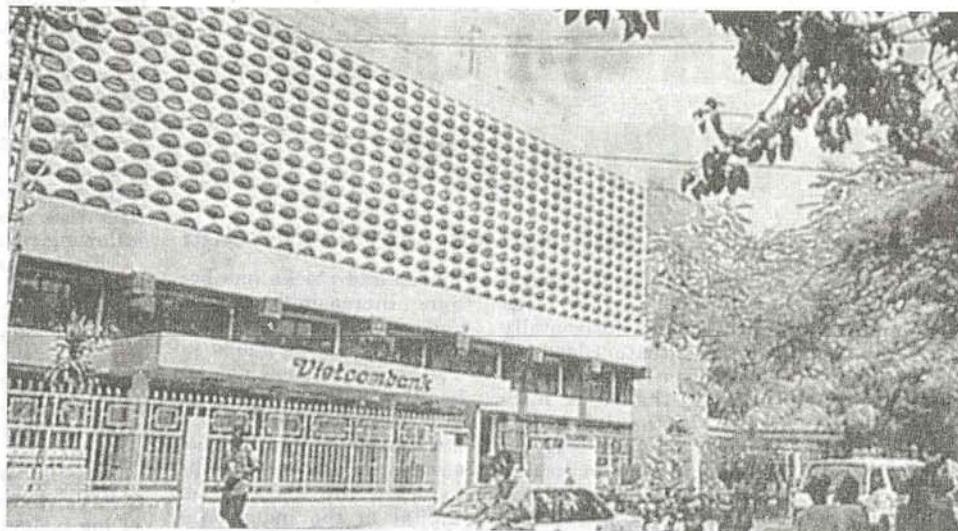
favorable for the formation and development of a future stock market.

Second, financial instruments could be used for stimulating the supply of securities. Two main commodities in Vietnam stock market are bonds and shares but the supply is limited. Up to July 1998, only 29 state companies have been equitized, but they aren't attractive companies, the value of issued shares is small, and many of them aren't listed securities. To increase the supply of securities, it's necessary to

equitization. Article 13 of Decree 44/CP issued on June 29, 1998 on equitization allows equitized companies to enjoy a 50% reduction of company income tax for two years after the equitization. In our opinion, it's difficult for companies to make some profit after equitization, so the government had better allow them to enjoy this reduction for three or four years and offer more tax reduction to companies that plan to go public.

Third, financial instruments could be used for increasing the demand for

banks to form brokerage companies, and foreign brokerage companies to work in partnership with local ones. Thus, in the near future, the State Bank should invest in formation of Vietnamese brokerage companies and allow commercial banks to increase their legal capital in preparation for establishment of their brokerage companies or joint ventures with foreign partners. In addition, certain preferential treatment, in terms of tax for example, could be given to these companies.



closed markets. In other words, the future stock market in Vietnam will be opened step by step according to the development of the capital market. This practice attaches great importance to the exchange rate because it is the most sensitive financial instrument in an open market. If the exchange rate isn't stable, effects of the financial crisis will be multiplied because foreign shares will be traded in the open stock market and foreign investment could be withdrawn when the exchange rate falls. This is what happened to Thailand in previous years. Thus, a stable and flexible exchange rate system will help to create conditions

accelerate the equitization, especially for companies in key industries such as oil, electricity, telecommunications, cement and aviation.

Other financial instruments, such as government credit and taxation, could also be used for increasing the supply of securities.

In the first stages of development, the government investment is of great importance, and moreover, issue of government securities can help to reduce budget deficit. The government should make feasible investment projects that allow the issuance of low-interest project bonds.

The taxation could be used for accelerating the

securities. In recent years, the banking system and the Treasury have succeeded in selling some thousand billions worth of bonds and bills. This fact shows that the value of idle money held by the public is very big, therefore it's necessary to form brokerage companies to facilitate the relation between the supply of and demand for securities. In current conditions, these companies could undertake five activities: buying and selling securities for themselves, supplying broker services, providing advice on securities trading, managing portfolios and underwriting new issues of securities. The Government had better allow certain local corporations and

In the first stage, the Government had better not impose tax on dividend or income from securities trading. The commercial banks could supply soft loans to workers who are allowed to buy securities on credit and pay in instalments as ruled by Decree 44/CP if they are assisted by the Vietnam State Bank by lowering the reserve requirement and offering discount on securities sent from commercial banks.

In addition, the State Bank can manipulate interest rate in order to regulate flows of funds between short-term money market and long-term investment market.