EXCHANGE RATE, EXCHANGE CONTROL AND IMPROVEMENTS IN GROWTH RATE

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Besides the GDP, many other indicators are also used for estimating the economic growth, such as the balance of goods and services, balance on current account and balance on capital account. Of the capital account, a close watch should be kept over foreign assets in a country and local assets abroad (or the capital inflows and outflows). To keep a close watch over these assets, the government uses the exchange control policy and the exchange rate.

The balance of goods and services is the first thing to take into consideration when estimating the economic growth because it reflects rather exactly the strength of the economy. It tells us about the supply of, and demand for, certain essential goods and services (food, consumer goods of various kinds, capital goods and raw materials; and some common and professional services). Imbalances between the supply and demand certainly lead to fluctuations in prices, including prices of foreign currencies.

1. Exchange rate and exchange control

Deficit and surplus in the balance of goods and services have great effects on the balance of trade. When the demand for certain goods is bigger than the supply (because the supply is poor or local goods are too expensive), local producers can increase the output or reduce the production cost by applying new technology and management methods. These efforts, however, require time and money. To meet the demand quicker, importers can buy these goods from foreign suppliers and these goods can flood the market after one week or two. However, the second approach requires a lot of foreign exchange and easily leads to a deficit trade balance. Thus, the trade balance is very sensitive to deficits or surpluses in other balances and it affects greatly the demand for and supply of foreign exchange, and the exchange rate as well.

Besides the capital outflows (including payments made to foreign parties), there are capital inflows and both of them are reflected in the balance of payments. The main part of capital inflows comes from export earnings, foreign loans, ODA capital or foreign aid, and foreign investment. In Vietnam, immigrant remittances and tourist receipts constitute an important source of foreign exchange, especially after 1990 when the economic reform was introduced. However, this source doesn't come in through the banking system. Many foreign parties are also ready to make unofficial investment in Vietnam by selling goods under deferred-payment terms or supplying short term and high- interest loans.

In the 1980s, the main trading partners of Vietnam were the USSR and the East European bloc. The trade between Vietnam and these countries were done according to agreements between governments, and state-owned companies undertook the task of realizing these agreements. Therefore the balance of payments reflected well all international transactions by Vietnam.

In the trading with the socialist bloc, everything was done according to agreements, then the exchange rate had no important role. The exchange rate fixed at VND18 to the ruble existed for a long time, from the 1950s to 1990s, although Vietnam suffered two long wars (1945-75) and its currency was depreciated seriously after the war.

At present, Vietnam has established the trading relations with many developed countries and the business was done by companies, including private ones; and there is no trading agreements between governments about the exchange rate so it could move up and down according to the conditions of supply and demand.

Thus, all deficits and surpluses in the balance of goods and services affect greatly the market prices and lead to deficits and surpluses in the balance of payments. For example, Vietnam enjoys surpluses of rice, crude oil, aquatic products and clothing and suffers deficits of fuel, machinery and high-quality consumer goods. These surpluses and deficits determine the volume of capital inflows and outflows.

As for the capital inflows, the government can control foreign loans, aid and investment, and part of immigrant remittances and tourist receipts; companies control export earnings in foreign exchange; and private persons hold part of immigrant remittances and tourist receipts. The central bank can take various measures to enhance its control over capital inflows. The following are some of them:

- Asking companies to sell all foreign exchange to banks after obtaining export earnings and buy it from banks if need be.

- Requiring all immigrant remittances to be made through banks, and all foreign tourists to exchange for domestic currency before entering Vietnam: the banks can offer different exchange rates to persuade, or force, private persons to sell foreign exchange (from immigrant remittances and tourist receipts) to banks. The exchange rate could be higher or lower than, or equal to, the market rate. The banking authorities could decide on the rate after examining the supply and demand forces. However, a wrong decision could cause great damage: the Ministry of Finance has once taxed immigrant remittances with the result that this source of foreign exchange stopped flowing to Vietnam until this tax was revoked.

- Adopting different exchange control policies:

(a) Allowing the foreign exchange to move freely in the market: In this case, all foreign currencies are used as legal means of exchange, payment and a store of purchasing power. The exchange rates of the VND to other currencies are used in international transactions while the domestic currency is floated. All foreign exchange transactions are done freely in the foreign exchange market organized by the banking system. The central bank doesn't try to set the price of any currency.

(b) Adopting a strict exchange control policy: Under this policy, only banks have the right to store and trade in foreign exchange. Companies and private persons can sell foreign exchange to banks without being required to inform the bank of its origin, but if they need to buy and use foreign exchange, they will have to get permission from banking or some foreign exchange authorities. These authorities only grant permission according to annual plans made by the Ministries of Planning and Investment, of Trade and of Finance. All companies and private persons aren't allowed to keep foreign exchange or use it as legal tender. Thus, all sources of foreign exchange are concentrated and the government could make optimal plans for using them.

The central bank can fix various exchange rates used as regulating instrument when selling foreign exchange to , or buying it from, companies and private persons.

(c) A moderate exchange control policy: In fact, both the strict and loose exchange control policies have their own disavantages. That is why a moderate one is preferable. When foreign exchange is allowed to move freely, exchange rates will fluctuate widely, and changes in prices of imports and exports will upset the market. But the strict exchange control is hard to carry out because no measure could prevent private persons from keeping foreign exchange. In addition, the use of compulsory measures is never a good way to manage economic activities.

Theoretically, the supply of and demand for foreign exchange move freely at their will. But in fact, citizens have no right to use foreign exchange at will and they should obey the law (they shouldn't import goods banned by law for example). Thus, the official demand for foreign exchange includes needs approved by the banking and foreign exchange authorities; others who need foreign exchange (smugglers for example) should get it from the free market at higher exchange rates. The central bank can fix the exchange rate by taking some indirect measures:

- Only supplying foreign exchange to those who get permission from the foreign exchange authorities, including mainly importers and organizations with foreign debts.

- Allowing the demand for foreign exchange to be met at first by sources of supply outside the banking system: those who possess foreign currencies are allowed to sell them in the free market or to banks without being required to inform the bank of its origin.

- When those sources couldn't meet the market demand that has been approved by the foreign exchange authorities, the central bank will sell foreign exchange from its reserves at a stable exchange rate.

The moderate exchange control has been applied in Vietnam since 1990. The import of contraband goods or banned ones is hard to prevent because as we know, the Government has punished severely this activity but these goods keep on flowing into Vietnam. The moderate exchange control can help limit the supply of foreign exchange in the free market, and thus limiting smuggling operation.

2. Use of foreign exchange

Under the moderate exchange control, the foreign exchange could be found in and outside the banking system. The foreign exchange held by banks comes from official foreign loans, foreign aid, ODA credit, and export earnings (if exporters are forced to sell all foreign exchange to banks). The foreign exchange in the free market comes from tourist receipts, immigrant remittances, illegal export earnings, hidden foreign investment and some export earnings (if exporters aren't forced to sell all foreign exchange to banks). Thus the banking system only controls part of foreign exchange inflow in the same manner that the Ministry of Planning and Investment controls state-owned companies.

In the 1980s, the main source of foreign exchange coming to Vietnam was aid and loan from the USSR, equaling some one billion rubles a year, and export earnings compulsorily sold to banks (equaling some 1.0 – 1.5 billion rubles or dollars a year). Although the foreign exchange inflow was small (some 2.5 billion rubles or dollars a year) but it was well under control of the banking system and most of it was used for importing equipment and raw materials needed for major investment projects (Hoà Bình, Trị An and Phả Lại power plants; Bỉm Sơn and Hoàng Thạch cement plants; VietsovPetrol Company; etc.). These projects were some of the biggest ones in Southeast Asia and started to produce good effects after 1990, but they took a long time to be finished with the result that the inflation rate was high and the living standard was low in the 1980s. In this decade, however, the balance of goods and services was improved gradually: Vietnam could produce enough food, electricity, cement and many other essential goods. These improvements helped the balance of payments become favorable: from a trade gap of millions of dollars a year to a surplus of US$40 million in 1992. In the early 1990, the Vietnamese economy became stable.

Besides investing most foreign exchange in major projects, the government also adjusted the exchange rate with a view to promoting the export business: the exchange rate was allowed to rise from VND18 in the 1980s to over VND13,000 to the dollar in 1991. This made the export earnings rise from some US$500 million to US$2 billion and improved the balance of trade. When the export to capitalist countries rose over years, however, the export to the USSR made no progress because the exchange rate of the VND to the ruble wasn't changed appropriately.

The most noteworthy fact in the 1980s was the good policy to control the exchange rate and employ sources of foreign exchange. This policy helped a lot to make balance of payments more favorable. Shortcomings in this period were the shortage of consumer goods, low living standard and high inflation rate. Due to the said major projects, however, Vietnam could gain high growth rates in the early 1990s (from 8.0% to 9.5%). In the late 1990s, regrettably, Russia couldn't help Vietnam realize some major projects as planned (a steel mill with a capacity of five million tons a year, north-south power line, an oil refinery of six million tons a year, etc.). Vietnam had to build on its own the north-south power line, Hoà Bình Hydropower Plant, and some other projects which helped increase the production in Southern provinces.

In the 1980s, the budget income in foreign exchange was rather small, around 2.5 billion rubles and dollars but in 1999, the Vietnam's export earning topped the US$11- billion mark. Estimates of other sources of foreign exchange are: US$3 billion in tourist receipts (from some 1.5 million tourists coming to Vietnam every year), US$2 billion in immigrant remittances (from some 2 million Vietnamese expatriates), US$3 billion in foreign investment and some US$2 billion in the ODA credit. Thus, Vietnam can get from US$14 to 17 billion a year. Although its expenditures (legal and illegal import, principal and interest of foreign debts, etc.) are also rising, Vietnam, with these sources of foreign exchange, can start some major projects that are much bigger than those were realized in the 1980s if top priority is given to import of capital goods and export.

Certain shortcomings in the 1980s – the shortage of consumer goods and high inflation rate- could be overcome by importing high-quality consumer goods and attracting dead money to banks. Experience from the 1980s shows that the limited import of high-quality consumer goods helped importers make good profits. In recent years, the import of those goods has been done without limit while the market demand made no increases with the result that importers could make small profits only. The Ministries of Planning and Investment, and of Finance had better make plans to reduce the import of luxury goods in order to save the foreign exchange for import of more capital goods. An investment of US$3 to 5 billion is enough for Vietnam to build an oil refinery (some US$1 billion), a long gas pipeline (some US$100 million), a urea fertilizer factory and a big power plant at the same time. In addition, the reduction in import of luxury goods will make them go like hot cakes, ensure better profit for importers (and bigger import duties for the Treasury), and still satisfy those who need and can consumer high-quality imported goods.

As for the tourist receipts and immigrant remittances, experience shows that the best way; especially in the market economy; to attract them to the banking system is to buy them at high prices (that is, to fix a preferential exchange rate for these sources of foreign exchange). In doing so, the banking system can defeat smugglers with their own weapon, because all smugglers get foreign exchange by offering high prices. In other words, this policy allows the banking system to kill two birds with one stone: chasing away all smugglers, and attracting more foreign exchange to banks. The sooner the central bank adopts this policy, the better■