# Looking Back on the Exchange Rate Policy

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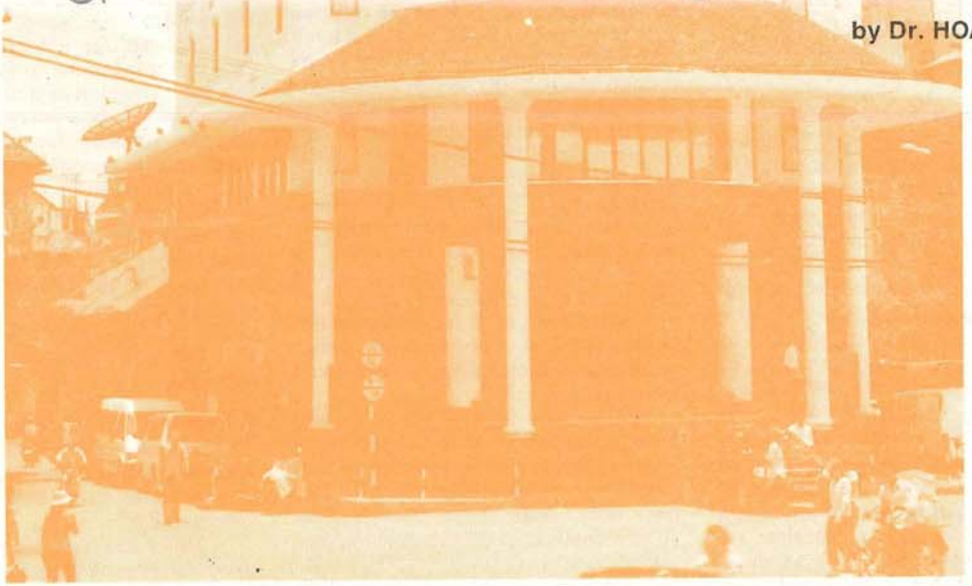

### 1. Under the centrally-planned mechanism (1954-1989)

This mechanism was applied in the North in the years 1954-75 and the whole country in 1975-1989. Main characteristics of the economy in this period are:

- The main trading partners of Vietnam were the USSR and COMECON members.
- The main currency used in trading between Vietnam and its partners was the transferred rouble which was used broadly in the COMECON bloc.
- Other hard currencies, such as the dollar, the sterling and the yen were rarely in use because the foreign trade was seldom extended to capitalist countries.
- Under the centrally-planned economy, the State monolopized many industries and controlled prices strictly with the result that the whole economy relied on subsidies from the State budget.

Under such a mechanism, the establishment of the exchange rate of the VND was as follows:

- The exchange rate of the VND was at first linked with the Chinese renminbi by comparing retail prices of 34 items traded in some provinces or cities in the two countries. On Nov. 25, 1955, the official rate was fixed at VND1,470 to the renminbi.

The Chinese exchange rate then was 0.5 renminbi to the rouble. Thus, the Vietnamese exchange rate was VND735 to the rouble.

In 1959, a reform in the monetary policy was carried out: the new VND equal to 1,000 of the old was introduced, and the new exchange rate was VND0.735 to the rouble.

In 1961, the exchange rate fell to VND3.27 to the rouble because the USSR revalorized its standard currency. From 1977 on, COMECON members agreed to use the transferred rouble as the common currency for all transactions in the bloc.

Besides the official exchange rate, the Vietnamese government also applied an internal rate which was VND5.64 to the rouble since 1958. This rate was used for settlement between banks and companies, and for calculation of national budget income and expenditure when receiving foreign aid and transfer it to foreign trading companies. This rate was adjusted to VND18 to the rouble in 1986, VND150 in 1987 and VND700 in 1988. In March 1989, this internal rate was removed.

In 1987, the Foreign Investment Law was passed, and full attention was paid to the flows of the dollar to and from Vietnam. The exchange rate between the VND and the dollar was based subjectively on the exchange rate betwwen the VND and the rouble, in which the dollar and the rouble was considered equal. Thus, the rate has been VND18 to the dollar and the rouble since 1985. This situation gave birth to the two exchange rates: the internal rate fixed by the State and the market rate. The former was always higher than the latter with the result that the State has to give enormous subsidies to the foreign trade business to cover the difference between the two rates.

Generally, the exchange rate in this period to all foreign currencies was fixed subjectively by the State with a view to serving the centralized planning and wasn't based on the supply and demand for the foreign exchange. Therefore, the exchange rate didn't reach its full potential and produce intended effects on the economy. This is also one of features of the centrally planned economy. When Vietnam adopted the market economy, the exchange rate became inappropriate.

### 2. Under the market economy (from 1989 till now)

In the transition to the market economy, Vietnam's relations with foreign countries were expanded, especially in trading. The landmark in changes in the exchange rate policy was the Circular 33/NHTT issued by the

SBV on March 15, 1989 providing guidelines on the implementation of Decree 166/HĐBT on the exchange control. The Circular "introduces regulations on the trade in foreign exchange, removes the fixed exchange rate system and the internal rate, and develops an exchange rate based on market forces and under the State control."

**a.** In 1989-1992, there were two exchange rates in Vietnam, official and unofficial ones.

**b.** In 1992-1997, the State adopted many changes in the exchange control:

+ Removing the fixed exchange rate applied to catergories included in settlements between the State and import-export companies and introducing the official rate fixed by the SBV.

+ An allowed band on either side of the official rate was publicized on a daily basis by the SBV, and companies with sales in foreign exchange was forced to sell it to the SBV at a fixed rate.

+ The State beefed up the supply of necessary information and publicized timely and precisely important indicators: official rate, unofficial rate, price index, gold price, etc. and strengthened reserves in foreign exchange and gold in preparation for government intervention when necessary.

+ A network of foreign exchange offices was developed to facilitate the trade in foreign exchange with agreed prices, thereby creating favorable conditions for the supply force meet the market demand. In this effort, the inter-bank market for foreign exchange was established on Sep. 20, 1994 by the SBV Decision 203/QĐ-NH. The presence of this market has helped stabilize the exchange rate since.

**Table 1: Exchange rate to the dollar in 1989-1992**

| Indicator | 1989 | 1990 | 1991 | 1992 |
|---|---|---|---|---|
| Official rate (VND) | 3,900 | 5,133 | 9,274 | 11,179 |
| Unofficial rate (VND) | 4,750 | 5,610 | 9,546 | 11,334 |
| Difference (%) | 21.7% | 9.3% | 2.9% | 1.4% |

Source: SBV

**c.** In 1997-1998, the Asian financial crisis broke out and produced disastrous effects on regional economies, including Vietnam. In July 2, 1997 Thailand had to float the exchange rate, putting an end to its 14-year-old fixed exchange rate system. Facing such a situation, the Vietnamese exchange rate policy experienced no changes.

From 1997 on, the exchange control policy changed from aiming at stabilizing the exchange rate to focusing on the task of ensuring the value of the VND by adopting a flexible control.

On Feb. 26, 1999, the SBV decided to publicize the average rate on the inter-bank market instead of publicizing the official rate. Banking institutions were allowed a narrow band of 0.25% on either side of the average rate adopted by the inter-bank market (this band replaced the previous 0.1% band as from July 1, 2002.)

As for other currencies, commercial banks were allowed to adopt any exchange rate. With this regulatory mechanism, the nominal exchange rate was based on market forces and did reflect the spending power of the VND in comparison with the dollar.

Since the introduction of the new mechanism, the exchange of the VND to the dollar was frequently adjusted to changes in the market forces at home and abroad. To introduce measures to reduce exchange risks, the SBV allowed application of options operation to the Eximbank. At present, this operation is adopted by many commercial banks.

In fact, there is still a difference between the inter-bank rate and the market one. The SBV has tried its best to develop the inter-bank market in order to make its rate to meet the market one, thereby stabilizing the exchange rate and facilitating the economic growth.

In the future, the exchange rate policy makers must consider the following problems in order to help the financial market integrate into the world economy:

- Allowing a wider band on either side of the inter-bank rate, for example, 0.5% instead of the current 0.25%.
- To take a further step, the SBV could stop fixing the band and exchange rate but it could intervene when wide fluctuations take place.■