Pollution of the Vietnamese Financial Environment and Preventive Measures

by Dr. NGUYỄN THỊ LIÊN HOA

1. Signs of financial pollution

Pollution of financial environment could be interpreted as disorders and limitations of financial and monetary policies that produce bad effects on the public finance and the economy as well. Signs of such pollution are as follows:

- Finance market becomes unstable and investors tend to focus on short-term investments causing a shortage of long-term ones. In addition, misuse of derivatives also leads to more disorders on the market.

- If fiscal, monetary, tax, exchange rate and interest rate policies are implemented well, they could encourage investment, production and economic growth, otherwise they could lead to unfavorable changes in the economy and the finance market as well.

- System of financial institutions doesn't function well leading to danger of bankruptcy. This sector is venerable to risks. A small disorder in this sector could cause a domino effect in the whole economy.

- Unstable and hot economic growth involves many risks and discourages investors. The economy could be open but attract no visitor.

- Discrimination against certain classes or sectors will be a barrier to foreign investment making the business climate less healthy.

Photo by Huỳnh Thơ

The financial pollution could be divided into three levels:

+ Low level includes minor changes in price index, inflation rate, and unemployment rate, etc.

+ Medium level happens when inadequacies of macroeconomic policies produce remarkable changes in the economy and offer chances for speculators to make easy money and cause disorders on the monetary market.

+ High level of pollution could cause disastrous consequences that are not limited to a country. It is financial and economic crises.

The situation can go from this level to others because they are successive stages. When a change takes place at the low level it can make progress and develop into a crisis if relevant policies fail to prevent or adjust it.

(1) Financial factors of macroeconomic level (exchange rate, inflation rate, monetary policy, etc.) (2) Financial factors of microeconomic level (finance market, business finance, etc.) (3) Financial environment (4) Pollution of the financial environment (5) Pollution of low level: changes in financial indexes (6) Pollution of medium level: manipulations by speculators, disorders on the monetary market (7) Pollution of high level: financial crisis (8) Inappropriate financial policy (9) Unstable finance market (10) Dysfunctional financial institutions (11) Unstable and hot economic growth (12) Unequal investment climate

2. May the Vietnamese financial environment show signs of pollution?

Let's have a look at some indexes.

- Inflation rate: This rate in 2004 was 9.5%. To prevent the CPI from reaching a two-digit figure, the government had to give a subsidy of some VND16,000 billion to importers of fuel and used administrative measures to stabilize prices of some essential goods, which made the inflation rate in 2005 stayed at 8.4%. High inflation rate partly come from poor productivity and competitiveness, dear imports used as raw materials and high production costs.

- Exchange rate: the exchange rate couldn't be floated because the banking system is weak, the domestic currency is overvalued causing bad effects on export, and the economic growth isn't stable.

- Monetary policy: The implementation of this policy isn't flexible and effective enough. The required reserve ratio tends to rise high causing difficulties for banking business and investment. The interest rate was kept low in the years 2001-04 while the money supply increased, which forced banking institutions to change their rate remarkably although the exchange rate was strict under control and sources of long-term loans and deposits were limited. The following table show interest rates set by the SBV in 2005-06.

use of the dollar beyond the government control.

- Fiscal policy: Source of budget income is not stable. The tax system is complex and unreasonable, and unable to encourage the business circle. Use of budget expenditures is ineffective and wasteful. In the years 2001-05, the government had to accept a higher budget deficit (5% compared with 4% in 1996-2000).

- Operations of financial institutions: Competitiveness of commercial banks is poor. The stock exchange fails to act as a channel for long-term capital because its scale is small (total value of stocks traded is only VND4,200 billion equaling some 0.6% of the GDP), sources of commodities are limited and most investors are only interested in short-term investments.

The situation allows us to notice some pollution of low level of the financial environment. Signs of pollution will become more worrying when Vietnam integrates fully into the regional market.

Interest rates	Rate	Set by Decisions	Effective as of
Basic rate	8.25%/ year	311/QĐ –NHNN dated Feb. 28, 2006	March 1, 2006
Refunding rate	6.5%	1746/QĐ-NHNN date Dec. 1, 2005	Dec. 1, 2005
Discount rate	4.5%	1746/QĐ-NHNN date Dec. 1, 2005	Dec. 1, 2005

In addition, the Vietnamese basic rate is higher than what offered by foreign banks, the flow of foreign exchange leads to common

Currencies	Basic rate	Currencies	Basic rate
VND	8.25%	NZD	7.25%
AUD	5.5%	GBP	4.5%
USD	4.75%	CAD	3.75%
SGD	3.25%	EUR	2.5%
CHF	1%	JPY	0.0%

3. Preventive measures

- Maintaining a stable growth rate by promoting export in order to reduce trade gap, and allowing a higher degree by which the invisible hand decides the market price instead of resorting to government interventions.

- Developing a healthy finance market by perfecting the mechanism for controlling risks, reducing state subsidies, and allowing various ways of mobilizing capital from home and abroad instead of depending too much on a sole source of finance.

- Perfecting economic and financial policies: The monetary policy must allow a freer flow of capital. Control over the exchange rate must be less strict. Discrimination of all forms in taxation must be removed. Budget deficit must be kept at a reasonable level.

- Encouraging competition between banking institutions in order to diversify sources of capital. Insurance against risks in banking business must be open to all classes.

- Protectionist barriers must be removed in order to ensure a level playing ground and all investors are treated equally by the same law with a view to make the business climate healthier and more stable.■