SOME IRRATIONAL FEATURES IN BANKING ACTIVITIES

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July of 1992 was the turning-point to the State Bank in the transition from negative interest rate policy to positive interest rate policy. It put an end to the subsidy through credit and the policy on interest rate of the State Bank operated under influence of the market mechanism from then on. Bank interest includes:

- Bank deposit interest comprises real interest (basic interest) plus price index.

- Bank loan interest is bank deposit interest plus bank charges.

However, what existed in reality is different from what are mentioned above. Some irrational features have made their appearance:

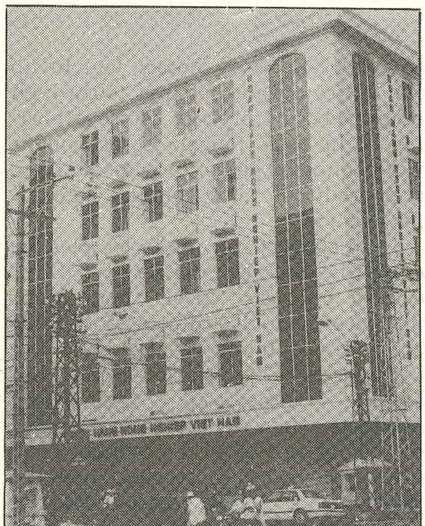
+ The State bank has intervened in commercial banks' decision on interest rate. Many different fixed interest rates were given by the State Bank and commercial banks can't operate according to common practices and couldn't compete with one another fairly for their reasonable profit.

In foreign countries, the State Bank only fixes discount rate and ceiling lending rate. The commercial banks are allowed to fix interest of their own, because they should bear full responsibility for their business. The Vietnam State Bank can adjust the interest rate of capital allocating to commercial banks to market lending rate, and inspect commercial banks regularly in order to prevent any violation of ceiling rate.

+ Regulations laid down for term loans aren't appropriate to international practices. Fox example, interest rate of long and medium-term loans is lower than that of short-term ones. One more irrational feature is that interest rate of long and medium-term deposits is higher than that of short-term ones. We should know that the longer the term of loans, the higher the interest rate because of their high degree of risk.

+ There is a great difference between interest rates of loan in foreign currency and loan in domestic currency. This policy didn't encourage customers to deposit foreign exchange into the banks but encouraged businesses to borrow foreign exchange. This can lead to social evil, to circulation and transaction of foreign currency instead of using VN Đồng as a unique legal tender. This difference should be reduced as soon as possible. The government could allow commercial banks to trade, but not loan, in foreign currency.

+ The present rate of interest regulated by the State Bank on Oct 1,1994 is of 2.1 per cent a month at most (that is 25.2 per cent a year). This interest rate is higher than that in foreign countries by 250 to 300 per cent (the average rate of interest in foreign countries is between 6 and 8 per cent a year). This interest rate isn't appropriate to the increase of price index. In foreign countries, interest is adjusted to changes of market price. This interest rate isn't appropriate to average profit-margin of businesses at present. This made businesspersons hesitate about borrowing money from the banks in order to develop their businesses. As a result of this, production cost of locally-made products is so high that they can't compete with imported goods.



Thus, determining the current rate of interest, the State Bank wanted to maintain equilibrium in money market, but only succeeded in losing it.

+ One more problem needs to be studied is the relation between interest rates of bank deposit and Treasury bond, or in other words, it's the problem of issuing the Treasury bond.

Although the interest rate was agreed on by Ministry of Finance and the State Bank, but the Treasury has gone back on its word. Recently, The Treasury has paid interest to its customers in advance. This made real interest rate of 6-month bond increase to 2 per cent a month, while the announced interest rate of this kind of bond was 1.7 per cent a month. As for 12-month bond, there was the same thing, the real interest climbed to 2.6 per cent a month. In order to prevent a bank run and attract more customers, commercial banks had to raise the interest rate of bank deposit to the same rate of the treasury bond, so this rate became higher than the ceiling rate fixed by the State Bank. Thus commercial banks had to adjust their interest rate to the rate offered by the Treasury, and the Treasury, in reality became interest rate maker. Intentionally or not, there were two rate makers in Vietnam: the State Bank-official institution-who makes policy on the interest rate, and the Treasury-a de facto state bank - who executes this policy under influence of profit motive.

Facing these irrational features we had tried our best to struggle against them, but sad to say, we only struggled against consequences of these features instead of striking at the roots of them. One bad consequence leads to other disastrous one and when can we see the light at the end of the tunnel?

The best solution is to have Treasury bonds issued by tender, the State Banks will act as an issuing house and commercial banks as applicants, thereby avoiding losses to the public funds and controlling the interest rate more effectively. This is a common practice in foreign countries♣