ON THE EXCHANGE RATE

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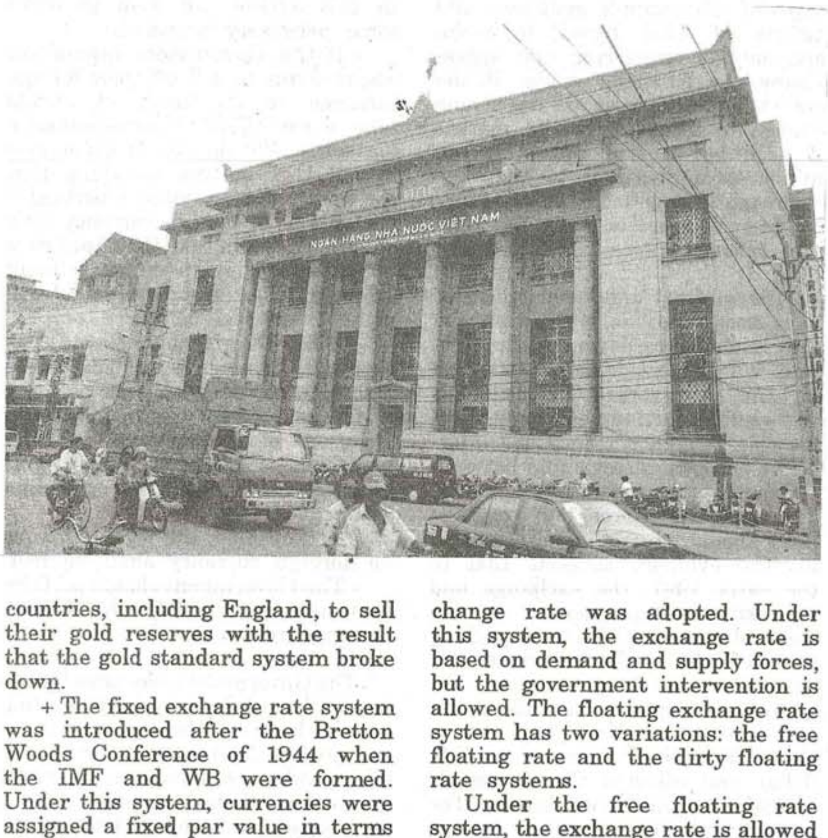
The exchange rates in the world have experienced three stages of development:

+ Under the gold coin standard which was widely adopted in the nineteenth century and operated down to the 1930s, exchange rates were rigidly fixed in terms of gold and many currencies were freely convertible into gold. Under the gold standard system, the exchange rate between currencies could vary between two points, called gold points, one just below and one just above the par rate, the difference being fixed by the costs of transporting the metal from one country to another. Financial difficulties after the World War I forced many countries, including England, to sell their gold reserves with the result that the gold standard system broke down.

+ The fixed exchange rate system was introduced after the Bretton Woods Conference of 1944 when the IMF and WB were formed. Under this system, currencies were assigned a fixed par value in terms of other currencies, especially the U.S. dollar, by comparing their values in gold. Exchange rates were allowed to vary within a band of 1% of the official rates registered at the IMF. If the exchange rates fluctuate by more than 1%, the central banks will sell or buy a certain amount of the dollar. In the years 1958-61 when the American balance of payments deficit reached US$56 billion and foreign debt amounted to US$62.2 billion, the devaluation of the dollar was so serious that most IMF members couldn't stabilize their exchange rates. Everybody exchanged the dollar for other hard currencies.

In August 1971, the American Treasury decided to stop exchanging gold for the dollar from foreign central banks, and the fixed exchange rate system broke down.

+ After the fixed exchange rate system collapsed, the floating exchange rate was adopted. Under this system, the exchange rate is based on demand and supply forces, but the government intervention is allowed. The floating exchange rate system has two variations: the free floating rate and the dirty floating rate systems.



Under the free floating rate system, the exchange rate is allowed to move up and down according to the conditions of supply and demand in the foreign exchange market. It is also affected by changes in prices, interest rates and growth rates.

Under the dirty floating rate system, or controlled floating rate system, the government, through its central bank, could deliberately engineer a depreciation or appreciation of the exchange rate in order to gain an advantage over trading partners or stabilize the growth rate by (1) acting as a buyer or seller of foreign exchanges; (2) neutralizing short- and medium-term fluctuations caused by sudden or accidental happenings; and (3) preventing changes in the exchange rate irrelevant to supply and demand forces.

In the past, the Vietnam's exchange rate experienced many changes, from a multi-rate system before 1989 to the fixed exchange rate system after 1989. The official rate based on the PPP principle proved to be inexact and failed to mirror changes in demand and supply forces.

In 1989, the method of setting the exchange rate according to the PPP theory was abandoned and the State Bank of Vietnam (SBV) based the official rate on many factors including changes in the price index, balance of payments, objectives of the monetary policy and changes in the free market rate. From then on, the exchange rate was adjusted flexibly instead of being fixed for a long time. In 1991, two foreign exchange centers were established in Hà Nội and HCMC. Membership of those two centers includes banks allowed to trade in foreign exchange and important export-import companies. Transactions of foreign exchange in those centers are usually carried out by tender.

Commercial banks were allowed to keep 15% of their legal capital in their foreign exchange funds. The SBV used administrative orders to regulate the exchange rate and beef up its control over foreign exchange market. Many of its decisions and orders (such as ones allowing a company only one foreign exchange account, forbiding free trade in foreign currencies, requiring exporters to sell all foreign exchange to the SBV and allowing them to buy foreign exchange from the SBV when necessary, etc.) helped stabilize the foreign exchange market which had experienced many fluctuations and unreliable supplies.

At first, the SBV controlled the foreign exchange market by setting the price ceiling and floor and publicizing the selling and buying prices offered to commercial banks. As from Feb. 26, 1999, the SBV stopped publicizing official exchange rates between the VND and foreign currencies everyday, and informed instead the average trading rates offered on the interbank foreign exchange market. These average rates were based on the rates on the interbank market on the previous trading day. Thus the exchange rate originated from the market rate although some people questioned the method of working out the average trading rates on the interbank market.

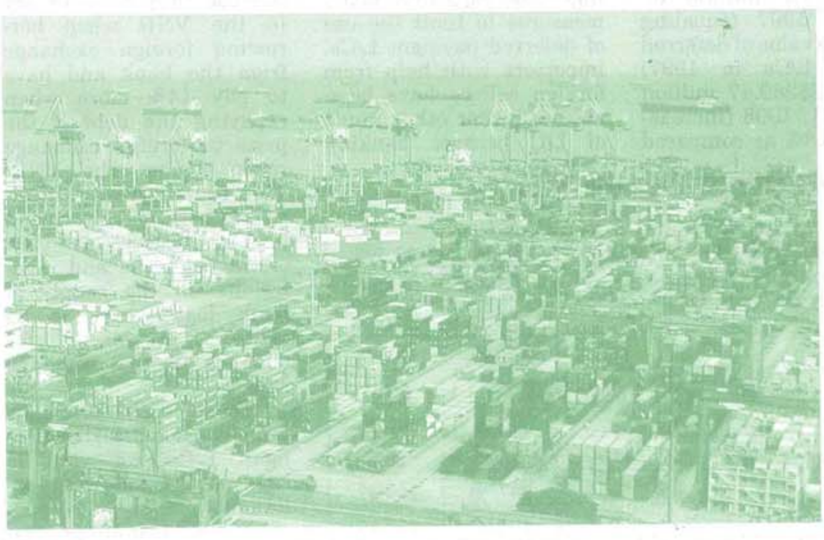
To control the exchange rate and foreign exchange market, the central bank could take different measures but full attention, however, should be paid to the following matters:

+ Necessary researches should be carried out to draw experience of controlling and regulating the exchange rate in the past few years with a view to forming scientific grounds for defining nominal and real exchange rates.

+ Realities show that fluctuations in the international finance market and in prices of hard currencies affect greatly the finance and money markets of the country. So it's necessary to keep a close watch on and analyze systematically these fluctuations, thereby predicting directions of future changes and working out measures to cope with them and ensure smooth operation of the local foreign exchange market.

+ Interest rates on deposits in both domestic and foreign currencies should be controlled properly. Prices on the local market must be regulated flexibly. In addition, the Government should adjust customs duties regularly in order to protect local production reasonably and at the same time, make preparations for the process of removing tariff barriers and integrating into the AFTA as planned.

+ The habit of consuming local goods should be encouraged. Local production could be improved by new technologies and industrialization. Regarding the monetary aspect, the VND should be made the only legal tender in Vietnam. It's regrettable that this policy had long come into effect but it wasn't enforced properly and foreign currencies, especially the dollar, is still traded and put in circulation without punishment.



+ Inflation, as everybody knows, could make the domestic currency fall, that is, the exchange rate rise. Although the inflation could help export increase but a high inflation rate could lead to complex fluctuations in the exchange rates and foreign exchange market and everything could go beyond control. So the inflation rate should be curbed and it can't be allowed to surpass the planned target.

+ Money and finance markets along with the banking system should be formed and developed firmly in order to ensure Vietnam's integration into the world and regional finance markets. The foreign exchange market in Vietnam should operate according to the market mechanism. It could be liberated step by step with a view to integrating into the world exchange market. The local markets (including mainly markets for goods, services, money, stocks, gold and foreign exchange) should be not only deregulated, but also integrated into international markets.

A strict and effective exchange control policy will certainly be a basic condition for stable economic development■