

As from Oct.27,1995, the turnover tax on banking service was abolished, so the Vietcombank reduced the lending rate by 0.2%. But according to Vietcombank staff, such an interest rate is still too high in the eyes of businesspersons.

According to banking experts, the current return on capital of a business varies on average from 12% to 15% while the banks have to charge a lending rate of 25.5% in order to break even. This situation leads to disinvestment and divestment because businesspersons think that to deposit their retained profit in banks in order to receive an interest rate of 16.8% per year is safer than to do business.

# DISINVESTMENT DUE TO HIGH INTEREST RATE?

by MEcon. BỬU THÙY

Thus, the bank interest rate is still an unsolved problem. How much should the lending rate be reduced? What will happen if both lending and borrowing rates of the banks are reduced? Maybe the Vietnam State Bank is still chewing over these questions and hasn't decided on reduction of interest rate regardless of the pressure of public opinion.

Is the current lending rate high and an obstacle to business activities? Or is there any other reasons?

When businesspersons decide on disinvestment and putting money into banks, they want to gain some interest which is larger than net profit they could earn by doing business.

This is reasonable and understandable, because no one wants to do anything if they can earn a bigger sum from interest paid by banks. Everyone, from a tycoon to a retailer, will do so. Therefore, if the potential net profit seems smaller than interest paid to banks, everybody will

think that the bank interest is too high.

It's worth noting that, a low interest rate is essential to economic development. In the market economy, however, the interest rate is influenced by the demand and supply relationship. In home countries of foreign investors in Vietnam such as England, France, the USA, Hong Kong, Singapore, Thailand, etc. the per capita income varies from as high as US\$37,561 for Japan to US\$2,134 for Thailand as the lowest. When the per capita income is high, so are their savings. The source of savings supplied is abundant, therefore, the lending rate is naturally low. In Vietnam, the situation is different. The per capita income is low (around US\$200

per year) so the source of savings supplied become scarce and expensive. The lending rate is certainly high. We can't compare foreign and domestic lending rates because this comparison is unreasonable.

Moreover, the current borrowing rate of banks is 16.8% a year, when the inflation rate is around 12% a year, thus, the real interest rate is only 4.8% (16.8 - 12). This borrowing rate is not high. This is the reason why the banks can't attract some VNĐ20,000 billion of dead money from the people. As for businesspersons if they have to borrow money from banks, they should know how much money they will pay for bank interest every year, whereas the net profit is not a constant. It could increase by 2 or 3 times if the working capital is turned over two or three times during a year. So, as for businesspersons, interest paid to banks is only high or low in relation to the net profit.

Another matter is that both in-

terest and net profit should be the real ones, that is, the real values after taking away the inflation rate. We can consider the following examples:

- At present, the current lending rate is 25.5% a year while the inflation rate is 12%, that is, the real interest rate is  $25.5 - 12.0 = 13.5\%$  a year (or 1.12% a month).

- If the average return on capital of a business is 12% a year. After taking away the inflation rate, we see that the real return on capital is  $12 - 12 = 0\%$ .

We come to the following conclusions:

- + If the capital turnover of a business is 1, its return on capital will be nil. It's profitable to deposit its capital with a bank for a real interest rate of 4.8% a year.

- + If a business operates with loan capital and its capital turnover is 1, its return on capital is nil and it has to pay a real interest rate of 13.5% a year for its debt, that is, it suffers loss.

Thus, a business operating with its own capital (or ordinary-share capital) and having capital turnover of 2 times or more will be considered as profit-making one in theory (because incidental expenses - or nameless expenses - in Vietnam is very high now). If the business operates with loan capital, its capital turnover should be 3 times or more in a year, then it can hope for some profit after paying taxes. In short, the bigger the capital turnover, the smaller the relative burden of interest payment, and vice versa.

At present, the capital turnover of a commercial bank is 2.5 times, then in theory, the capital turnover of a business will be only half of this figure, that is, it will be somewhere between 1 and 1.5 times a year. Thus, we see that the interest rate seems too high because the business performance is too bad. In ordinary conditions, the capital turnover of a business is usually from 3 to 4 times, and this is none of banks' business.

Vietcombank and Bank for Commerce and Industry have reduced their lending rate. It's an encouraging sign because not all banks can do this. However, all businesses still meet with difficulties if their capital turnover is only 1.5 times at most.

To solve this problem, it's necessary to increase the capital turnover by taking many measures such as reforming tax policy, struggling against contraband goods, renovating administrative and legal infrastructure, attracting dead money from the public to banks, etc.■