THE BANKING SYSTEM AND FISCAL POLICY IN THE NATIONAL INDUSTRIALIZATION

SHORT- AND LONG-TERM OBJECTIVES

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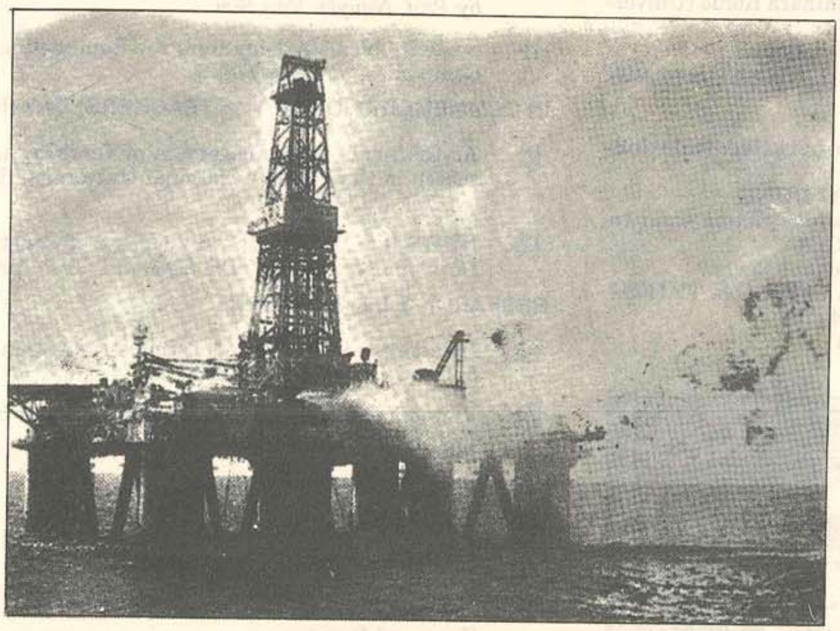
The renovation process has been realized for over 10 years in Vietnam, and the banking system has innovated itself for five years, and up to now, the role of the task of making and controlling finance-monetary policies has caught the attention of both local and central authorities. It's worth mentioning that the improvements aiming at making qualitative changes; responding to orders given by the market in the tasks of making and controlling policies on money supply, credit, foreign exchange... and the skillful and flexible employment of monetary instruments in a market economy at its first stages of development, had helped a lot to stabilize and fortify the national monetary system, reduce the inflation rate successfully and accelerate the growth rate. Moreover, encouraging indicators of economic growth, inflation control, budget deficit control, trade balance control, capital accumulation, saving and investment rate... in recent years have showed that policies adopted by the Government and Party on economic development were right, and put stress on the coordination of macroeconomic policies, including fiscal and monetary policies. All these achievements now assume even greater importance when our nation comes to a stage in which the industrialization is accelerated in order to prepare for the next century.



However, according to overall estimates of the Vietnam economy made by the Government and the Party (after referring to estimates made by international financial institutions and by both local and foreign experts in finance and banking), progress made by the Vietnam economy in recent years wasn't great enough, and it is still facing many challenges and dangers. In short, this economy has just been stabilized and come to the developing stage. In 1996, it must be kept stable and make faster progress in order to maintain achieved results, improve its strength and keep the society from falling farther behind other countries in the region. In the previous stages, the main aim was to stabilize the economy but in the period 1996-2000, the economic growth is considered as the main target and as the basis for economic stability.

In order to obtain a high and stable growth rate, the demand for more capital must be satisfied. The Party's Strategy for the Socio-economic Development in the Period 1996-2000 stated that: "The fiscal policy must aim at accumulating and employing capital more effectively, increasing GDP and national income, and raising saving rate in comparison with spending...". The only way to meet the demand for capital is to attract foreign source of finance and develop domestic one, therefore, more special emphasis has been given to the role of fiscal and monetary policies in developing and maintaining the balance between reasonable exploitation and combination of external and internal resources; taking advantage of being a late-developer; and avoiding dangers of economic crises occurring here and there.

The banking system is trying its best to develop achieved good results and overcome shortcomings in order to make the best use of all possible conditions to attract foreign investment and develop domestic source of finance. To achieve this aim, the Vietnam State Bank has made the monetary prediction and the strategy for capital accumulation for the year 2000 and the following years. This prediction and strategy serve as a basis for the task of developing the monetary policy together with the fiscal policy. In short, the main objectives of these macroeconomic policies are:

I. The central bank is one government body responsible for managing, combining, supervising and regulating the process of accumulating and employing capital in the banking system for the industrialization:

Firstly, the central bank uses the monetary policy to encourage saving and investment in the national economy; control and employ foreign investment (including external commercial loans); prevent the increase in external debt (in comparison with GDP and export turnover) which could lead to dependence on foreign powers or socio-economic crises.

Secondly, the central must regulate and control flows of foreign investment which tend to change recipient countries into markets for foreign products and supplies of cheap raw materials and labor. This is a way to keep our natural resources from being exhausted, our ecosystem from being destroyed and our economy from depending on foreign parties.

Thirdly, the central bank must expand international relations and gather knowledge and experience (especially experience of making and regulating monetary policy) in order to avoid suffering losses when Vietnam integrates into international fiscal and monetary system, and enhance Vietnam's position in international trade, finance market and investment market. This is the best way to bridge the gap between Vietnam and other developing countries.

Fourthly, the central bank must cooperate with finance authorities to find out the best ways to solve problems of budget deficit, regulate the supply and demand relation, and employ properly foreign sources of finance. This task aims at controlling both ODA and NODA sources of finance with a view to avoiding bad effects caused by the difference in purchasing power between domestic and foreign currencies. Many developing countries (such as the Philippines, Indonesia...) had to bear heavier burdens of external debt because hard currencies had recently risen against their domestic currencies. Lack of knowledge of the nature of foreign investment has made these recipient countries receive and use it carelessly with the result that the burden of external debt becomes heavier.

Many local and foreign experts in finance have warned us against "hot" development which is very difficult to

avoid when we want to speed up the industrialization. Intentionally or accidentally, the increase in investment beyond the control always leads to disastrous consequences. Recently, a survey carried out by a Swiss organization of international economic strategy research showed that two-thirds of Vietnam factories had bought obsolete equipment and machines at high prices. This fact showed that a mistake in making policy and controlling foreign investment would produce bad effects on the economy. However, for the time being, Vietnam has no choice but to depend on foreign resources for its first stage of development and at the same time, Vietnam has to pay attention to the other side of the coin. This consideration reminds us of the role of government bodies responsible for making and directing macroeconomic policies, and the central bank is one of these bodies.

II. The strategy for mobilizing foreign and domestic sources of capital is one of important parts of the fiscal and monetary policies which are considered as the most important tasks of the central bank.

Acting as an advisor to the Government and taking part in the tasks of making the strategy for socio-economic development for the year 2000, the central bank has to know what resources are essential to the national development strategy and how to cooperate with the Government and other government bodies in exploiting these resources. One of the most important resources is capital. In order to secure a source of capital which is more plentiful, cheaper, stabler and quicker to get, we have to form the relation between domestic and foreign sources of finance. This relation will determine the measures we take to accumulate capital over different stages. By making and controlling the monetary policy, the central bank will present its views and take appropriate measures to realize the capital strategy. In its turn, this strategy will affect the success of the monetary policy taken by the central bank in this period. No other body could take the place of the central bank in the tasks of stabilizing external and internal value of the domestic currency, stabilizing the market prices and controlling inflation. The strategy for capital accumulation, in medium and long terms, will change considerably the relation between the supply of and the demand for capital, and this change, in its turn will require the monetary policy to be adjusted.

The consistent feature of the process of mobilizing foreign and domestic capital is the agreement between the making and the controlling of the monetary policy. The monetary policy taken by the central bank must create both short- and long-term conditions for the realization of the capital strategy of the banking system and the capital strategy for the industrialization as well.

The Government and the Party's views on the industrialization constitute a basis for the monetary policy. The development of science and technology must be considered as a task of the whole society, of all social classes, and as a long, difficult and overall process.

Therefore, directions of the monetary policy must be as follows:

- to rely on domestic source of finance and exploit foreign source effectively by expanding international cooperation.

- to diversify the structure and location of sources of capital for the industrialization.

Capital today includes cash, labor, fixed assets, natural resources, economic geographical advantages and other kinds of tangible and intangible assets. As for Vietnam, proper attention must be given to the human resources, or grey matter of the army of scientists and managers. Human resources act as the decisive factor in making the best use of all sources of capital, selecting the most appropriate technology, applying effectively new scientific achievements to the industrialization and building techno-scientific infrastructure for the country.

- to cooperate with related bodies in all tasks from making to controlling policy in order to make all decisions on capital accumulation more feasible.

The strategy for capital accumulation aims not only at securing a bigger amount of medium- and long-term capital with a view to increasing this kind of capital from present 8% to somewhere between 13% and 15% of total capital mobilized by 2000, but also at stabilizing the monetary system by controlling the inflation rate, keeping it at a level of 1% or 2% lower than the growth rate.

The stability of the economy (in which the stability of the monetary system is of great importance) will be a basis for the realization of the strategy for capital accumulation. The stability of the monetary system is the utmost precondition for attracting and employing effectively both foreign and domestic investment. In the first three quarters of 1996, the inflation rate was kept low while the growth rate rose considerably. This is a favorable condition for Vietnam to increase saving and capital accumulation and form a source of medium- and long- term capital needed for the industrialization. In addition, the central bank and related ministries are watching changes in international and domestic markets with a view to taking action if need be to prevent inflation from increasing again (the inflation rate increased from 5.3% in 1993 to 14.4% in 1994).

III. For the time being, and in the long run as well, the central bank, in its tasks of making policy serving

the industrialization, must solve the three following problems:

1. To enhance its capability of making and controlling the monetary policy and to make an active and effective monetary policy aiming at expanding all sources of investment and controlling both domestic and foreign sources of investment:

The central bank must try to develop the use of all kinds of financial assets, including capital in cash and commercial papers (or near money). First of all, the central bank had better increase the quantity and enhance the quality of all assets of the banking system.

Up to Dec.31, 1995, the assets of the banking system equalled only 25.4% of GDP, not including other 3% held in non-yielding assets (including overdue and bad debts...). Thus, its assets were too small in comparison with the demand for capital of the economy. Moreover, medium- and long- term loans supplied by banks represented only 29.2% of total debit balance. It's worth noting that all assets owned by the banking system equalled nearly one-fifth of the external debt, or 2.5 times higher than total capital accumulated from GDP every year (if we consider that only 10% of GDP was turned into investment). These data showed that the financial strength of the banking system was very limited. Recently, repayment we made to foreign parties has decreased since 1988, especially in the period 1990-1992 because of successful negotiations with Paris and London Clubs, however the external debt compared with GDP has showed an upward tendency. This makes us realize the urgent need to increase the assets of the banking system by increasing the saving rate and the net accumulation and reducing the external debt in the structure of investment.

To obtain a high saving rate (from 20% to 30% of GDP), the monetary policy must encourage saving, reduce unnecessary spending, attract dead money to production and increase net accumulation. The central bank can realize this by offering an elastic rate of interest higher than the inflation rate favorable to both investors (including depositors and banks) and companies. Interest rate could be used as an instrument for encouraging commercial banks and credit organizations to compete with one another for attracting medium- and long- term deposits. To charge a higher interest rate on medium- and long- term loans than on short-term ones, and offer deposit insurance service are right measures to take.

To make reserve requirements more elastic and to reduce the minimum lending rate to a reasonable level will reduce the cost of capital and increase loanable funds in banks with the result that the interest rate on short-term loans will be reduced. A lower rate of interest charged on short-term loans will make interest rate on medium- and long- term loans more reasonable and attractive to borrowers. Moreover, the exchange rate must be kept stable and reasonable in order to encourage exportation and local production, and attract both foreign and domestic investment. The central bank must adopt a wise policy on interest rate in order to ensure the domestic currency a reasonable level of profitability and stabilize the exchange rate.

In the current open conditions, the exchange rate is not only the price of a currency expressed in terms of another currency, or a means of comparing purchasing power of two currencies, but also an important instrument for attracting investment (if we know how to manipulate it, of course). If the exchange rate only aims at encouraging exportation by devaluating repeatedly the domestic currency, it will make things very difficult for local producers. This isn't the intended result of the regulated floating exchange rate system. On the other hand, if the value of the domestic currency is kept too high, importation will be encouraged, foreign exchange reserves will decrease along with the ability to repay external debts, an as a result, we will meet with difficulties in realizing the strategy for capital accumulation. Besides preferential treatments given by related government bodies (such as taxes, duties, licence, foreign investment control, import and export, land use rights, etc.) we had better enhance the attractiveness of interest rate in domestic currency in order to attract investment more effectively.

When the structure of Vietnam stock of money isn't clear and the monetary system hasn't developed fully, the monetary policy had better aim at introducing financial instruments and commercial papers in order to speed up capital movements (including movements of medium- and long- term capital). This measure not only creates conditions favorable for regulating the money supply (through open-market opertions), but also reduces the inflationary pressure. To introduce near money to the economy is also a way to expand the structure of the stock of money and increase the amount of medium- and long- term investment.

We had better concentrate all domestic investment in one fund and avoid an interest rate war which is unfavorable to the strategy for capital accumulation. There must be an agreement between the fiscal and monetary policies. In the near future, the central bank can act as the issue house to the Treasury and other government bodies to issue by tender all government bonds and bills. These government bodies had better issue bonds and bills for medium- and long- term capital only.

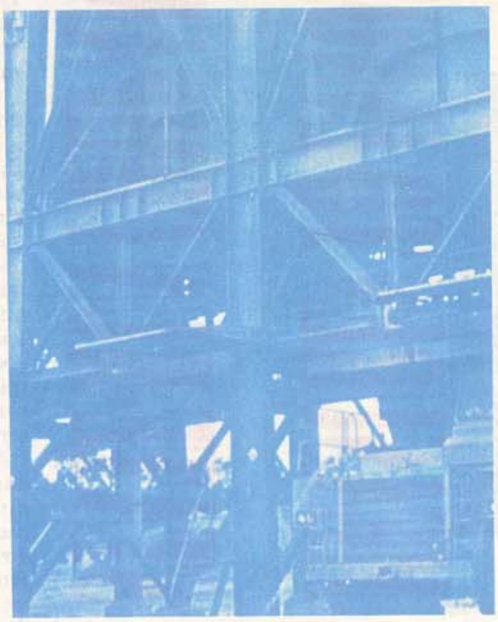
2. To develop a system of financial intermediaries which can form a capital market, supply perfect services to the public, and keep safe all assets of customers and the banking system as well:

- When the capital market hasn't been developed, only a perfect and well-managed banking system can carry out the monetary policy and meet demands posed by the strategy for capital accumulation. In principle, whenever and wherever there is a chance to form capital, the bank must be present.

- To diversify new forms of attracting dead money (forming building society, issuing shares on credit, etc.) besides old forms of banking services, to pay attention to the issue of bonds and bills made by commercial banks in domestic and foreign markets, to favor immigrant remittances... are also good measures to accumulate capital.

- The bank had better diversify its services: providing financial leases, brokerage service, mortgage financing service, pawnbroking, insurance, advisory service, stockbroking, etc. Commercial banks and credit organizations can also buy bonds, shares or go into partnership with companies or with other banks.

To supply a range of diversified services is the best way for the banking system to attract dead money from the public, reduce risk degree, and prepare conditions for the capital market.



To accelerate the formation of long-term capital, the banking system can form subsidiary companies or open branches, banks can merge into big banking groups or finance companies, however, proper attention is required to ensure that the public sector still play the leading role in the banking system.

- Another measure to take is to modernize banking facilities and train banking personnel with a view to supplying services of better quality. This is also a condition, besides the mechanism for inspecting and supervising, for a banking system to integrate into the international financial community.

3. To perfect as soon as possible the money market together with the capital market in order to accumulate more plentiful sources of capital:

- The money market supplying short-term capital could help realize the strategy for capital accumulation, because short-term capital could help companies do their business and make profit, that is, accumulate their capital. From the development of companies the banking system could find chances to form long-term investment.

To develop the money market, the banking system can introduce short-term negotiable instruments (certificate of deposit, T-bills, cheque, credit card, promisory notes, etc.). This can be seen as a necessary drill for the banking system before the capital market comes into being in Vietnam.

At present, T-bill auction is developing in Vietnam, but one of difficulties in this business is that these bills aren't universally negotiable. We need the credit rating service now in order to enhance the negotiability of these bills or bonds. It is the opinion which maintains that T-bill is only a way the Treasury uses to borrow money from the public has lowered the role of T-bills in helping the central bank carry out open-market operations and control loanable funds of the economy, and in developing a stock exchange in Vietnam.

- Investors and companies play the leading role in the capital market while banking system plays only a minor one. But thinking through, the development of a stock exchange (both primary and secondary markets) will accelerate the development of financial assets and productive financial instruments which make the proportion of medium- and long- term capital in the stock of capital larger.

In conclusion, in the process of developing the economy, quantitative and qualitative changes in finance-banking activity are only at the first stage. The banking system, with its four main development strategies for the period from now to 2000 presented by the Governor of the State Bank in 1995 is trying to perfect and improve its activity, especially in its task of making policy.

We hope that, in the process of renovating and developing itself with a view to serving the industrialization, the banking system will receive help, encouragement and instruction from the public, the Government and the Party; and the cooperation of related ministries and business partners from home and abroad■