

The mechanism for controlling the exchange rate in Vietnam has experienced many changes since 1989 when the economic reform was started. From a multi-rate system, the SBV and the Government have developed a new exchange rate control mechanism that is more sensitive to the supply-demand relationship and laws of the market economy.

Studying these changes after the Circular 33/NH-TT issued by the SBV on March 15, 1989 directing the implementation of the Exchange Rate Control Regulations included in Decree 161/HDBT promulgated by the Council of Ministers on Oct. 18, 1988, we realized the mechanism for controlling the exchange rate experienced three development stages.

1990 to 333 million in 1993, reform in the exchange control, opening of the foreign exchange trading center in August 1991, etc.) have helped reduce speculation in the dollar and make the supply equal to the demand. At the end of 1992, the foreign exchange market became more stable.

In the years 1993-95, however, the Government made no adjustment to the exchange rate control mechanism although on the world market many hard currencies (DEM, JPY and GBP) rose strongly against the dollar in late 1994. This shortcoming made the difference between official and unofficial rates wider and wider, especially in September and October 1996. On Oct. 11, 1996, the rate was VND11,180 to the dollar, increasing

supply frequently, especially during the last months of the year when companies bought foreign currencies to import consumer goods. (See Figure on the next page)

To deal with the shortage of foreign exchange and fluctuation in the exchange rate, the SBV took many measures: controlling more strictly the opening of deferred payment L/Cs, increasing the band for official exchange rate from $\pm 0.5\%$ to $\pm 1\%$ and $\pm 5\%$ on Feb. 27, 1997, raising the official rate gradually, making regulation on SWAP dealings and on sales of foreign exchange through accounts of economic concerns, etc.

However, the shortage of foreign exchange wasn't improved, both companies and banks tended to keep the dollar reserves when profitable, the difference between official and unofficial rates was still wide. Adjustments made by the SBV to the exchange rate or its fluctuating band always led to unfavorable changes in the foreign exchange market (see the Figure 1). Many people felt confused and decided to withdraw their savings in domestic currency to buy the dollar with the result that the bank deposit reduced drastically (a bank saw its deposit reducing by some VND3 billion within a week from August 6 to 12, 1998). There was almost no transaction of foreign exchange in many banks. In the Vietcombank, the big bank for foreign trade, daily transaction of foreign exchange fell from 1.5 million to 0.8 - 1.2 million. Volume of transaction in most banks and exchange offices fell by 50% in comparison with days before Aug. 6, 1998. At the same time, changes in the exchange rate also made the gold price rise.

Thus, the SBV interventions in this period weren't far-reaching and long-lasting enough. Unreasonable

PROBLEMS WITH CONTROL OVER EXCHANGE RATE IN VIETNAM

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1. From March 1989 to 1992

Although the Government affirmed strict exchange control, the exchange rate started floating. The exchange rate of the VND to the dollar changed continuously, producing many fevers and reached a peak in late 1991 when the rate was VND14,400 to the dollar. The Government and SBV tried to intervene but their efforts ended in failure because of many reasons (great deficit balance of payments, serious budget deficit, huge foreign debt, high inflation rate, small foreign exchange reserves, etc.). The domestic currency kept on losing its value over time and the banking system couldn't control the movement of foreign currencies.

2. From 1993 to February 1999

As the economy developed, stronger government interventions (increasing the foreign exchange reserves, increases in realized foreign investment from US\$120 million in

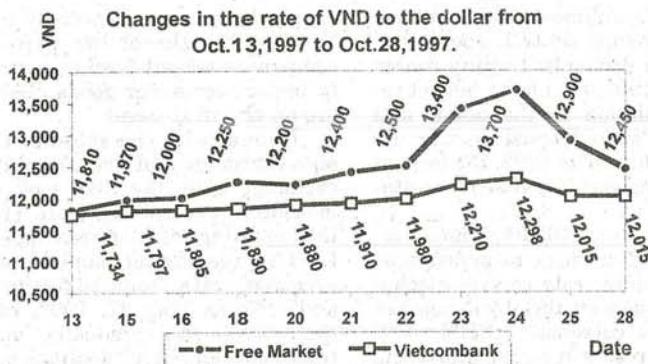
by 15% in comparison with ten days before. This situation forced the SBV to intervene more vigorously.

In the next period, from 1996 to 1998, the exchange rate in both official and free markets fluctuated widely. The demand exceeded the

Table 1: Some facts about Vietnamese economy in 1990-1993

Indicators	1990	1991	1992	1993
GDP growth rate (%)	4.9	6.0	9.0	8.0
Inflation rate (%)	60.0	67.5	17.6	5.2
Budget deficit/GDP (%)	-8.8	-4.4	-4.9	-5.2
Realized foreign investment (US\$ mil.)	120	165	333	832
Immigrant remittance (US\$ mil.)	50	36	59	70
Foreign exchange reserves (US\$ mil.)	24	27	465	404
Balance of payments (US\$ mil.)	-142	50	267	-1,055
Nominal exchange rate (VND/US\$)	5,789	9,643	11,283	10,990

Source: SBV, IMF, WB and *Kinh Tế Việt Nam và Thế Giới 1999-2000* ("The World and Vietnamese Economy")



features of the mechanism for controlling the exchange rate remained unchanged.

3. From February 1999 till now

The most basic feature of the SBV exchange rate control before February was the dependence on the fixing of official rate and fluctuating band. These instruments helped the SBV control and regulate the foreign exchange market easily. The fixed fluctuating band seemed effective in that period and made the rate of the VND to the dollar rather stable.

However, reality shows that the official rate failed to reflect correctly the value of the VND, and the exchange rate tended to reach the permitted limit. Thus, the control over exchange rate through the fixed official rate needs improvements.

Facing this situation, the SBV issued Decision 64/1999/QĐ-NHNN7 on Feb. 25, 1999 stating that "the SBV publicizes everyday in mass media the average rate of the VND to the dollar applied to the inter-bank foreign exchange market, instead of

publicizing the official rate, or buying and selling rates offered on the inter-bank foreign exchange market." On the same day, the SBV issued Decision 65/1999/QĐ-NHNN7 setting the method of determining exchange rates applied to banking institutions that are allowed to trade in foreign exchange. According to this Decision, the difference between the rate of the VND to the dollar used for spot exchange and the official rate offered on the inter-bank foreign exchange market on the immediate previous trading day mustn't exceed 0.1%.

These two decisions, and the Circular 01/1999-NHNN7 issued on April 16, 1999 providing guidelines on the implementation of Decree 63/1998/NĐ-CP changed basically the mechanism for controlling the exchange rate in Vietnam.

Generally, reforms in the mechanism for controlling the exchange rate in recent years have produced good results, helping maintain the purchasing power of the VND and contribute to the economic growth.

There are, however, many shortcomings in this mechanism.

- The official rate isn't kept flexible enough.

- The official and unofficial rates still exist side by side with the result that the dollar is increasingly used as a second legal tender.

- Instruments for adjusting the exchange rate aren't employed effectively.

- The exchange rate control mechanism isn't strict enough.

4. Solutions

To deal with shortcomings in the exchange rate control mechanism, in our opinion, the SBV can take the following measures:

a. The SBV should distinguish its function as the banker of the government from the function of stabilizing the foreign exchange market. As the banker of the government, it performs dealings for the government and increases the foreign exchange reserves according to the plan set by the government, while its function of stabilizing the foreign exchange market aims at adjusting the exchange rate based on the supply-demand relationship. The failure to distinguish those two functions has reduced its managing and regulating performance.

b. The SBV had better refrain from using administrative measures to intervene in the market and intervening too much in technical operations in the market. Reality shows that the SBV sometimes has intervened too much in technical or professional operations and services, such as issuing Decision 65/1999/QĐ-NHNN7 on Feb. 25, 1999 setting the

(continued from p.3)

its 10-year history, the PTKT has carried some 7,000 articles either in Vietnamese or English. The PTKT in Vietnamese was included in the website of the HCMC University of Economics since 1996 while readers could get access to the Economic Development Review, the PTKT's English version, at the website of the Financial Times since 1995. On the occasion of its 10th anniversary, 120 contents pages of 120 PTKT issues and 75 contents pages of all EDR issues will be put in the Internet.

The happiest thing in its development is the fact that the Magazine has attracted more and more contributors from all walks of life. They have, on this Magazine, presented worthy studies and arguments helpful to the economic reform and development. It's only the Magazine that has failed to develop this army of contributors.

It's very difficult to survive a 10-year period, but it's more difficult to face new challenges ahead. The PTKT personnel always bear in mind that they should try harder to become a forum for a university in its incessant reform and effort to integrate into the world and develop.

For this purpose, the Magazine must attract more authors and contributions with scientific and persuasive arguments.

The forward movement of the country, and of the HUE as well, doesn't allow the Magazine to take a rest, feel satisfied with achievements and fail to overcome its shortcomings. In this spirit, the Magazine expects and welcomes all contributions and help from political and business circles, and especially from readers and contributors who have shown sympathy for our efforts.■

(Speech delivered at the 10th anniversary of the *Phát Triển Kinh Tế* Magazine)

method of determining exchange rates applied to banking institutions that are allowed to trade in foreign exchange, or Decision 18/1998/QĐ-NHNN⁷ stipulating foreign exchange reserves of banking institutions allowed to trade in foreign exchange. In our opinion, it's not necessary to stipulate the foreign exchange reserves of all banking institutions, the SBV can stipulate a percentage of foreign currency deposit kept in reserves suitable to each banking institution, and this per-

supply of foreign exchange. Within over a year, from Feb.14, 1998 when Decision 37/1998/QĐ-TTg was issued to Aug. 30, 1999 when Decision 180/1999/QĐ-TTg was issued, the SBV made four adjustments to the foreign exchange reserve requirements which aimed at setting a higher requirement when the supply of foreign exchange reduced and a lower one when the supply exceeded the demand. This way of management can only deal with fluctuations in the foreign exchange markets and fail to orient operations of the mar-

ent, the control over import and export of gold, especially trade in gold in border towns, isn't strict enough with the result that gold smuggling activities are still widespread. When the price of gold on the domestic market is much lower than the world price, smugglers purchase gold to export illegally for the dollar with the result that the supply of the dollar increases and makes its price fall. In the contrary cases, when the world price of gold is lower, smugglers will buy the U.S dollars to import gold from Cambodia, creating a temporary shortage of the dollar. Apparently, it's gold smuggling that causes wide fluctuations in the unofficial rate and bad effects on the public morale, companies and the banking system as well. In such a situation, the SBV had better cooperate with related governmental bodies to exert stricter control over the trade in gold, especially gold export and import, as required by Decree 174/1999/NĐ-CP issued on Dec. 9, 1999 by the Government.

Besides the above-mentioned measures, the SBV should carry out regular inspections of banking institutions with a view to forcing them to observe SBV's regulations on exchange control and punish severely all violations. The SBV can fine heavily the banking institution that violates for the first time and force it to close down if it repeats the violation. Moreover, the use of the dollar as a legal tender should be prohibited, bank loans in foreign exchange should be limited and then cancelled entirely. In addition, macroeconomic policies should be consistent in order to enhance efficiency in exchange rate control.

The exchange rate plays a very important role in the open economy. It is a bridge between an economy and the world through finance and commodities markets. In other words, fluctuations in the exchange rate affect greatly export, import, production, employment and inflation rate of an economy. That is why the control over exchange rate should be performed carefully. The above-mentioned measures should be carried out consistently and developed into a well-coordinated mechanism with a view to limiting weaknesses of each measure. Implementation of these measures can also pave the way for radical reform in the exchange rate control mechanism and liberalization of the exchange rate when necessary requirements are met. ■

centage could be adjusted over time if need be.

c. The inter-bank foreign exchange market needs improvements: With current organization, the inter-bank foreign exchange market produces moderate effects on the economy. Dealings carried out in this market represent a small percentage of all bank transactions, therefore most banks tend to depend on sources of foreign exchange they could find by themselves. Many companies when exporting goods usually do business with banks that are ready to buy foreign exchange at high prices (even higher than the price ceiling), and choose banks with large foreign exchange reserves when importing goods. In our opinion, the SBV had better develop all operations of the inter-bank domestic currency market with a view to coordinating the inter-bank foreign exchange and domestic currency markets, and moreover, allow larger membership of these markets, including brokers.

d. The SBV should set reasonable foreign exchange reserve requirements in order to ensure long-term

ket toward a healthy state. We think that the reserve requirement should be set on a long -term basis because it needs stability more than flexibility. Realities show that after the requirement is set higher, the supply and demand relation is more favorable and a fall in reserve requirement usually leads to a shortage of foreign exchange that forces the SBV to raise it again.

e. The SBV should control more strictly activities of borrowing and repaying foreign debts. Under current regulations, these activities are under the control of three governmental bodies: Ministry of Planning and Investment, Ministry of Finance and the SBV and each body has its own responsibilities, but realities show that there is no cooperation and agreement between these bodies. The Government had better form an organization including representatives from these bodies and other ministries if necessary to work out plans to control activities of borrowing and repaying foreign debts made by both public and private sectors.

f. Stricter control over gold trade, export and import is needed. At pres-

