INTEREST RATE LIBERALIZATION IN VIETNAM

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I. INTEREST RATE

In the market economy many financial tools are used, in which credit and interest rate are important ones. Credit activities include lending and borrowing. Lenders and borrowers have relations of using capital in the principle of repayment. Thanks to credit activities, a major part of social capital in cash or in kind is attracted from the surplus place to the shortage one with the aim to meet various requirements of economic sectors.

For the capital surplus entities, credit helps them not only preserve and gain more incomes. For the capital shortage ones, credit contributes to their capital mobilization for their production, business and living.

The indispensable tool and lever to credit activities are just interest rates. They have effects on benefits of entities having credit relations. If there are no interest rates or irrational ones, such relations will be nullified and their positive role reduced in economic development.

As such, the interest rate, as called the credit price, is the percentage based on a particular term (day, week, month, quarter, year) to figure out the borrower's repayment and moderate entities' economic benefits in the credit relations. So what is an appropriate interest rate?

In the theory of capitalist loaning, Marx affirmed that money did not produce money naturally, it could do so only when it was used in production and goods circulation. He added the interest was a part of profits the borrower generated in production and business thanks to using loan capital and redistributed it to the lender. This argument allows us to determine the maximum rate of interest or generally the average profit ratio in the economy, and the minimum rate of interest is the inflation rate, because it helps the lender maintain his capital value. In short, to make the interest rate become an incentive to expand credit activities in the economy, it should be controlled within the following range:

inflation rate ≤ interest rate ≤ average profit ratio

Exceeding the above limit, the interest rate in particular and the credit on the whole will cause negative effects on the socio-economic life and the banking system will fall into chaos.

II. BASIC INTEREST RATE

The basic interest rate affects all other interest rates arising in the market economy. It is a kind of interest rates playing an important role in the market mechanism in general and our market economy in particular.

The basic interest rate is determined by the central bank and announced on the basis of real situation and targets of the national monetary policy.

The point 12, Article 9 of the Law on the State Bank of Vietnam stipulates:

" The basic interest rate is the interest rate announced by the State Bank of Vietnam making a ground for credit institutions to fix their business interest rates".

However, it is argued that the basic interest rate is a broad concept including different rates of capital re-allocation, rediscount, interbank market; maximum rate for loans and minimum rate for deposits.

We claim that the basic interest rate's unique feature is its transparent effects on other interest rates, if not it is no basic interest rate. That feature is indicated by following points:

First, the basic interest rate is determined and announced by the central bank. It shows the will of the management agency but not self-arising in the money market like other interest rates.

Second, when specified, it becomes an obligatory regulation that all commercial, investment and development banks have to respect without another alternative, no matter whether it is determined reasonably or not.

Third, it makes direct impacts on other interest rates in the market, it is thus used as an important instrument to manage the national monetary policy.

In such a concept, we think that the basic interest rate is subjectively fixed by the competent agency (the central bank) in various aspects.

- For example, if protecting the depositors' benefits, the central bank will fix the minimum deposit interest rate.
- If securing the borrowers' benefits (enterprises, economic sectors...), it will determined the maximum loan interest rate.
- If keeping the banking system safe, the central bank will specify the maximum deposit interest rate and minimum loan interest rate.

These above practices indicate the basic interest rate impacts on the market interest rates so clearly: banks and credit institutions can fix their interest rates only within the permitted range of basic interest rate. We have no conditions to mention the advantages and disadvantages of basic interest rate, but we may affirm that when fixing and announcing the basic interest rate, the central bank proves it is a general financial machinery entitled to use financial tools in which the interest rate is an important one to directly impact the banking activities with a view to reaching particular targets in each stage of socio-economic development.

In Vietnam nowadays, the State Bank determines the loan interest rate cap is 0.85%/month. The interest rates of banks and credit institutions are not permitted to exceed this rate. As such, the loan interest rate cap announced by the central bank play a role of our country's basic interest rate.

III.VIETNAM'S CURRENT INTEREST RATE LIBERALIZATION

Like other countries, Vietnam has used three methods to control interest rates as follows:

Method 1: The Government directly controls interest rates by announcing all of them. This is the practice of fixed interest rates.

Banks and credit institutions has to respect this regulation absolutely. This practice occurred in Vietnam's centrally-planned economy many years ago.

Method 2: The Government fixes no interest rates, but the interest rate cap and floor, or an interest rate range for banks and credit institutions to determine their interest rates.

We call this is the practice of limited interest rate.

This practice is not so fully rigid as the method 1, but still helps maintain the Government's role of controlling interest rate.

Our country applied this practice from 1992 to 1996. The central bank previously ruled the maximum and minimum interest rates but in early 1996, it determined only maximum interest rate, not minimum interest rate, at the same time stipulated the difference between average loan interest rate and average deposit interest rate was 0.35%/month. Then since early 1998, it has abolished this regulation and practiced the interest rate cap until now.

Method 3: The Government controls no interest rates and allows them to arise in line with the market mechanism. The banks are permitted to determine and announce their interest rates in lending and borrowing money. We call it the practice of interest rate liberalization. Then what is it?

Interest rate liberalization is to let interest rates be freely applied on the basis of (1) capital supply and demand; (2) saving rate; (3) earning and spending of individuals and other factors.

In the practice of interest rate liberalization, if the Government makes no intervention in the market interest rate system, it is the completely floating system. If the Government makes indirect intervention based on a predetermined plan, it is the controlled system of interest rate liberalization. Interest rate liberalization is considered as the core of financial liberalization in which the government control over credit line and interest rate is removed or reduced. This practice will make all flows of capital smooth.

In my opinion, the interest rate liberalization needs following conditions:

(1) Stabilized macroeconomic environment.

(2) Integrated and perfect legal system.

(3) Firm and effective banking system.

(4) The financial market (including money and stock markets) has already taken shape and operates efficiently.

(5) Local resources are distributed and employed reasonably.

(6) Economic entities are all sure to use capital well.

The Party's viewpoint of developing a multisectoral economy under the Government's management and socialist orientation plays a key role in the country's financial system. At the same time, open policies for the integration and globalization trend become essential to speed up socio-economic development.

In such a situation, the financial liberalization on the whole and interest rate liberalization in particular in Vietnam is an inevitable trend suitable for the Party and the Government's policies.

However, if the systems of fixed or rigidly controlled interest rates, the efficiency of banking system, saving and investment will be lessened and growth hindered. In contrast, if the interest rate is floated completely, it will cause bad effects. The competition between banks will increase, medium-and small-sized banks cannot avoid bankruptcy.

As a result, I think interest rate liberalization is essential in Vietnam, but it should be implemented carefully and cautiously and not hastily in order to eliminate its adverse impacts on the socio-economic development.

Regarding this issue, we have two major remarks as follows:

First, the process of liberalization and integration is a step-by-step transitional one to prevent fluctuations. Vietnam has realized that by its revision of interest rate mechanism, especially many times in 1999. Although these revisions have not produced all good effects (even bad effects) but they are necessary to implement the interest rate liberalization.

Second, the conditions for interest rate liberalization in Vietnam are not sufficient (inflation was not curbed actively, GDP growth rate increased unsteadily, the national budget still faced deficit, the banking system revealed many deficiencies...). The interest rate liberalization thus cannot be carried out immediately.

The State Bank should continue to control interest rates by determining the loan interest rate cap as at present, but should rectify it (it need not reduce it to the international level) to harmonize benefits between depositors (earning more income) and borrowers (making profits but not using capital carelessly) and at the same time secure efficiency of the banking system.

When meeting all above conditions, we will shift to the system of interest rate liberalization, but not full liberalization. The State Bank with its role to manage the national money policies will use interest rates of rediscount and capital reallocation to indirectly moderate market interest rates for the country's socio-economic progress.

Interest rate liberalization is a trend to boost up global integration but its steps and implementation should be cautious and reasonable to attain good results as expected.

In short, with its current conditions, Vietnam should applies flexible system of interest rate based on the basic interest rate (interest rate cap) announced by the State Bank. When meeting the conditions, we will shift to the system of interest rate liberalization but still under indirect rectification of the central bank with a view to securing Vietnam's banking activities on the track. This is the trend of interest rate management in Vietnam today■