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Financial intermediaries in Vietnam: current performance and directions for improvement

Background

Let take a grasp of the entire economic picture of Vietnam. Nearly 70% of the labor population is reported to engage in agricultural sector, which accounts for only 23.6% of the total GDP. This simple fact alone can reflect an utter need of Vietnam to quickly promote the process of industrialization if her citizen was to break away from poverty. Among a huge number of challenges, the issue of capital mobilization and its utilization, which fatally depends on the functioning of the financial system, is obviously the one of utmost importance. Then, one of the challenges comes to be the issue of developing an efficient financial system.

Statistical data shows that capital resources for industrialization of this country over the past 5 years from 1995 - 2000 was formed almost equally by domestic and foreign capital, with a slight overweight of the former. According to estimation of the Ministry of Planning and Investment of Vietnam, during the 2001-2005 period, at least VND 840,000 billion (or about US$ 60 billion) will be mobilized for development investment, of which one third is planed to come from the foreign sources and the remaining two thirds from the domestic ones. Needless to say, whether the highly expected proportion of domestic capital mobilization is attained, depends almost solely on whether the financial intermediaries function well enough. It is this rather obvious but critical point that stirs my interest to take an insight into the performance of current financial intermediaries in Vietnam.

Objectives, Scope and Methodology of the Study

Thus, the main purpose of this paper is to grasp an insight of the current functioning of financial institutions in Vietnam, identify the problems and find directions for further improvement of the system in light of the problems observed. Based on the perception that Vietnam's financial system inherits legacies from previously planning mechanism where the capital and securities markets were absent, and consequently banks are taking the dominance not only in the present but also in near future, this paper puts emphasis on bank sector' intermediary functions. While understanding that the long-term development of a financial sector depends on many important issues including of industrial development and FDI attraction policies, this paper in its scope will not expand arguments further to these issues but focus on the performance of current financial sector and how to improve intermediary functions to attain high mobilization and efficient allocation of domestic capital. The study period is mainly from 1995 to 2000.

Regarding the methodology, primary information of the research is obtained from annual reports and official releases of the State Bank of Vietnam, the Ministry of Planning and Investment of Vietnam, the General Statistic Office of Vietnam, specialized magazines and newspapers, and international institutions that include Japan International Cooperation Agency, Asian Development Bank, World Bank, and the IMF.

Structure of the Paper

The paper is organized from three sections. To make the premise for following arguments, first section tries to draw a bird's-eye view of the entire financial sector of Vietnam, reviewing the overall performance of the system's individual part inclusive of banks, the inter-bank market and the bond and securities markets. The section at the same time tries to figure out the existing overall problems. Second part seeks to dig down into concrete problems existing in the both side of resource mobilization and allocation through analyses of available data. It aims to reveal the poor performance of the financial intermediaries through providing insights into the current situation of deposits at financial institutions, saving practices of people in urban and rural areas regarding mobilization function. As for the latter function of allocation, analyses were provided to point out the bad lending practices that result in difficulties for private sector to access funds, and above all, the huge stock of non-performing loans that burden the entire economy. After taking a review of reforms already underway by the government under assistances of international organizations, the third section, which is the core, tries to put forward some directions for the development of an efficient financial sector in light with so far analyzed implications. Conclusion remarks provide summaries of previous arguments and directions for future.

Main Conclusions

Vietnam's financial system faces the intertwined problems of instability and inefficiency. Inefficiency is due to the problems, in a sense, commonly seen in the low developed market economies. Regarding the banking sector, these problems include poor capital and reserves, low level of management, improper accounting practices, lack of transparency and furthermore, the excessive intervention of the government. Bond and securities market is still on its infant period and its functioning of intermediary role is extremely limited, as discussed in section one of the paper. The inefficiency is yet accelerated by discouraging banking policies inclusive of policies concerning interest rate and tax that leaves banks least margin to afford their infrastructural or technological improvement. Policies that bring about privileges on behalf of the state-own sector are discouraging either.

Section two of the paper illustrated the facts that these bad practices necessarily lead to moral hazards in the financial activities that in turn result in the low mobilization of domestic funds, failures to fulfill the long-term capital demand for industrialization, to be more precise, for private enterprises in spite of the growing importance of this sector; above all, huge amount of non-performing loans that cost vastly to be resolved manifests the prolonged bad lending practice in banking sectors. This section strongly suggested that along with the human resource as the basic factor behind the current problems, it is systematic issues inclusive of corporate governance, ownership structure and financial system design that do matter.

In light of these theoretical issues, section three tries to shed a light on directions for improving the performance of financial intermediaries in Vietnam. In addition to the uncontroversial needs of sufficient legal and regulatory frameworks, adoption of international laws and practices, improvement of supervision bodies, enforcement and disclosure, and the need of auditing and accounting reform, this paper strong suggests for introduction of incentive measures for banks including of tax concessions and interest rate policies. Incentives by these mean should be considered to encourage financial institutions to set aside a greater proportion of their profits to develop their infrastructure. This will lead not only to higher mobilization of domestic savings, but also to the more efficient of the overall financial operations.

Regarding structural issues of corporate governance and ownership, the paper tried to allege that, while private ownership, free foreign ownership and excessive competition in a weak regulatory environment may lead to crisis and undermine the financial instability, the gradual privatization of current state-owned commercial banks and appropriate introduction of foreign ownership seem to be inevitable direction for recent future. Role of commercial and long-term credit banks working in tandem with each other, as well as the utmost importance of developing capital markets in the long term also were reaffirmed in section three.

There must be other problems existing in the current financial intermediaries, which this paper failed to deal with due to lacks of statistics. I wish to further contemplate these in following studies.