The 1988 Vietnamese Banking Reforms: Its Developments and Prospects

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Ⅰ. Introduction

Sound financial industry and institutional framework are one of the fundamental bases for successful economic development in the capitalistic market economic system where decision makings are dispersed to each and everyone of economic agents, because efficient operations of financial system, especially banking system, are one of the prerequisites to mobilize fund for working capital in the short run and investment fund in the long run. Also it retards the development of non-bank financial institutions. Specially in the transitional economies, industrial reforms cannot be expected to proceed without financial reforms(Borish, Long and Noel 1995, 23).

The 1988 banking reform which was one of the on-going economic renovations called 'Doi Moi' has also brought revolutionary changes in the financial industry. It has restructured the entire financial system and

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changed the financial environments, strengthening its operation. The past mono-banking system was dismantled and two-tier banking system had been adopted, thereby having separated the commercial banking activities from the central banking. Interest rates have been adjusted to inflationary rates, and discrimination of interest rates to different economic sectors began to be minimized and the entry into the financial industry was greatly liberalized(World Bank 1994, 1).

In this paper, we would like to review the development and prospects of the 1988 banking reforms in Vietnam. The main purposes of the research are to study the Vietnamese experiences of financial reform and to obtain some implications on the South Korean banking industry which is contemplating to enter the Vietnamese financial market.

After this introduction, we would like to review the 1988 financial reform in Vietnam, its contents and outcomes in Section II. Then we will investigate the limits and further tasks of the financial reform in Vietnam in Section III. Then directions of the future financial reforms will be searched. In the last section we will conclude with the brief assessments of the Vietnamese financial reform and their implications to the South Korean banking industry which expects to enter the Vietnamese financial markets. Even though the 1988 banking reforms cover not only banking fields but also monetary policies, we will confine our discussion mostly on the banking reform.

II. The 1988 Banking Reform: Contents and Outcomes

1. The Banking System Prior to the 1988 Banking Reforms

The contrasts between the banking systems under the centrally command economy prior to 1988 and those of the market economic system after the 1988 banking reform would reveal more clearly the major changes and further tasks to pursue. One of the most contrasting difference between the two periods is the change in the system from mono-banking to two-tier banking system. Before the 1988 banking reform, there were 3 banks. The

State Bank of Vietnam(SBV) had engaged in both central banking and commercial banking activities during her 40-year history. SBV had issued currency, and taken deposits and offered short term loans and provided clearing system. When the government was lack of tax revenue, SBV had provided the fund with issuing currency. In a sense the main function of SBV was the fiscal agent for the government as the bank for the government. SBV had not engaged in the macroeconomic monetary policies for stabilization or increasing production activities which are routinely performed by the central bank in the market economic system(World Bank 1994, 15).

Thus SBV had a branch network according to the government administrative units, and its capital was provided by the government and its loanable funds were arranged as a part of the national budget planning. Thus SBV had to achieve the national targets set by the government without independent discretion. The workers of SBV behaved more or less like government bureaucrats. Interest rates were also regulated by the government, not by the central bank. The level of interest rates were determined by subjective judgement of the government officials and discriminated by the sectors. Thus the imbalance in financing did exist from region to region and sectors of the economy, and even among branches of the same bank.

There were two other specialized banks: the Bank for Foreign Trade of Vietnam(Vietcom Bank or BFTV) dealing with foreign exchange business. It was similar to the Korean Foreign Exchange Bank in 1960's and the Bank for Investment and Development(BIDV) for long-term loans for building infrastructure and public utilities. It was similar to the Korea Development Bank. After reunification in 1975, the banks in the former South Vietnam had become the part of the State Bank of Vietnam.

2. The 1988 Banking Reforms

(1) Basic Principles of the Banking Reforms: The Vietnamese government had set out some basic principles for the structure and roles of

the banking system(Lao Quang Thuc 1994, 5). First of all, two-tier banking system should be adopted by separating central banking and commercial banking activities. According to this principle, the function of the central bank, the monetary management and that of the commercial bank, the circulation of money had been assigned to different organization. Secondly, the central bank should assume roles for price stabilization and strengthening of the purchasing power of its currency. It demonstrates with very clear terms that the main aim of the central bank should be the price stabilization, delegating the central bank an independent role as the main guard for stabilization. It is a far cry from its past role as a mere fiscal agent of the government.

Thirdly, commercial banks should play main roles for fund mobilization from domestic and foreign sources. In principle, no more discrimination is allowed to charge different interest rates to different sectors. Interest rates should be determined by the market pressure of supply and demand for fund. Loan rates should be higher than deposit rates. This principle had made it clear that the commercial banks are the main player in the financial markets, and no more preferred treatment to certain sectors of the economy. And it made it clear that no interest rate subsidy would be allowed. This principle allowed commercial banks to operate according to profit maximization rule.

Fourth, all banks should cooperate the stabilization policy and financial policy of the government. This principle had set up the limit in the behaviors of the banks. It limits the independence of the central bank and commercial banks, having indicated that the banks would not be totally free from the government. Also it implies that the government could exercise some stabilization policy, even though the central bank is assigned to play a role for price stabilization.

Fifth, the monetary expansion should be the outcome of the credit supply to the government in order to compensate for the budget deficit and to the commercial banks and of an increase in net foreign assets. This principle made it clear that the central bank should be charged for exercising the monetary policy. However, it opened a channel to provide funds to the government to finance budget deficits. In many developing countries, this channel has often been misused, having resulted in excessive inflation.

In the market economy, these principles have been adopted as a matter of fact, because they are theoretically quite proper to make the banking industry and institution fulfill their expected roles. Thus these principles Vietnam had adopted indicate that the banking reforms have been based on solid theoretical basis.

(2) Major Measures of of Banking Reforms: With the principles set forth as we have studied in the preceding section, the Vietnamese government had adopted a two-tier banking system, having separated the central banking and commercial banking to be performed by two different financial institutions. Now the State Bank of Vietnam(SBV) was assigned to play a role of the central banking, having been charged to play monetary and credit policies for stabilization(Lai Quang Thuc 1993, 157). The industry and commercial department of the State Bank of Vietnam including its branches in the cities had become the Industrial and Commercial Bank nick-named as Incom Bank. Also the credit department of the State Bank of Vietnam including its branches in the rural areas had become the Agricultural Development Bank nick-named as Agribank(World Bank 1994, 17). These two new and two existing banks, four in total, are the state-owned commercial banks(SOCB) and their budgets have been provided by the government, they are expected to operate based on commercial basis. In addition to the SOCBs, tens of shareholding banks have been set up in the urban areas such as Hanoi, Haipong and Ho Chi Minh City. Some of them are state-owned, some are owned both by the state and the private sectors, and still some owned entirely by the private sectors.

From 1996, Vietnamese banks have introduced various type of new financial products. For example, saving deposits were introduced with the terms of 3-month, of 6-month, 9-month and 12-month, respectively. Even though time deposits were withdrawn before the final term, penalty rates in its interest payment have been modified to some reasonable level. Also transferable bank debentures had been allowed to be issued.

It is indeed a far cry from the behaviors of the hey days of the State Bank period. The central bank has been allowed larger room to set interest rates according to the state of the fund markets. During 1966, there have been adjustments of the interest rates four times, and that would prove that the interest rates became flexible and responsive to the market conditions. Even savings deposit with lottery have been created. When the large deposit is made, the bank clerk even visits the customers(Vu Manh Thuan 1997, 24). It shows that the Vietnamese banking industry is undergoing tremendous changes from the seller-oriented stage to the consumer-oriented stage. It also implies that bank marketing started in Vietnam.

Ⅲ. The Outcome of the 1988 Banking Reforms

1. The Structure of Financial Industry

As we see from <Table 1>, by the end of 1994, six years after the 1988 banking reforms, there were 4 state-owned commercial banks, 46 joint-stock banks, 3 joint-venture banks, 69 credit cooperatives, 13 foreign bank branches(licensed, 9 operating), 153 People's Credit Funds(licensed). Also there were 2 finance companies and 1 insurance company. Therefore, one of the most significant phenomena in the Vietnamese banking industry during the reform years was the lowering entry barriers into the financial industry. Of course still the state-owned commercial banks are dominant player in the field.

By the end of 1994, among the aggregate banking assets, SBV, the central bank shared 47.4%, while commercial banks, 52.6%. The state-owned commercial banks shared 47.0%, while non-state owned commercial banks, 5.5%. It also means that the state-owned commercial banks occupied 89.4% of the aggregate commercial banking assets, with far better branch networks than the non-state-owned commercial banks. However, the share of the total deposit of commercial banks, the non-state-owned commercial banks had increased to 11.5% in 1993 from 6.5% in 1991(World Bank 1995, 9).

<Table 1> Banking Structure(December 31, 1994)

	Asset(trillion D*)	No. of Branch	Capital & Reserves
Central Bank:			
SBV	D32 Trillion	53	D 476 Million
Commercial Bank:	D38.8		Minimum D20 Bil
SOCB	D35		D2,688 Bil
Vietcom bank	D13.8	14	D 519 Bil
Agribank	D7.5	56	D 438 Bil
BIDV	D5.6	53	D 583
Incom bank	D8.3	50	D 393 Bil
Other banks	D3.7	16	D 755 Bil
Joint-stock banks(35 operating)			
Joint-venture banks(2 operating)			
Foreign bank branches			
Others			
Credit cooperatives		63	D 300 Mil
People's Fund		10	
Finance company		2	
Insurance company		1	

* D = dong
Sources: World Bank, 1995, *Vietnam Financial Sector Review*(March 1), 9.

There have been some changes in the deposit composition of the banking industry. The share of foreign currency deposits had been reduced from 62% in 1991 to 41% in 1994. This is due to the higher nominal deposit rate for Dong deposits and the reduction of inflationary pressure which has stabilized the exchange rate.

In the past, bank loans had routinely been financed by the government budget or subsidy in the commercial banks, now a new directive was made: 'to borrow in order to lend' or 'borrowing for lending.' It has resulted in reduction of the dependency ratio on the central bank funding from 30% to 5-10%. There are some banks which have stopped utilizing central bank funding entirely. This indicates that the commercial banks began to operate on commercial basis and that shows the Vietnamese banking industry approaches to the commercial banking principle in the market economy.

The state-owned commercial banks began to increase credits to the non-state sector. The share of the total bank credits to the non-state sector was 4.3% in 1989; however, it has increased to 14% in 1992, 26.6% in 1993 and 28.3% in 1994(World Bank 1995, 96). The Agribank could provide loans to the private sector from 1991 and it was only 2% of the rural farmers who had received any types of loan from the bank; however, in August 1993 the ratio had increased to 56%. Even though the number of people who have a bank account in the state-owned commercial banks is increasing rapidly, only 6% of the total population utilize bank services. It indicates that the banking reform has a long way to go and the future prospects of banking business is immense in Vietnam.

2. Outcome of the Banking Reforms

(1) Financial Deepening: One of the measures for financial development is the ratio of broad money relative to GDP(M3/GDP). In Vietnam, it was 27.8% in 1989 when the banking reform began. This ratio reduced to 24.6% in 1992, 23.6% in 1993 and 23.3% in 1994. It is still relatively low. Among the ASEAN countries, the ratio for Malaysia was 139.8% and Indonesia, 46.8%. The ratio for Korea was 40.5%(World Bank 1995, 99).

According to some survey of life style of the Vietnamese people, the main forms of savings are currency holdings, gold and precious stones which are outside of the banking system. Thus one of the main tasks of the banking industry is how to mobilize these types of savings into the banks(World Bank 1994, 11).

(2) Concentration of Finance(World Bank 1995, 96-97): Concentration of finance in Vietnam has two distinct characteristics. First of all, financial fund is concentrated mainly to state-owned enterprises. In the total credits provided by the banking system, the ratio of the credit to the state-owned enterprises were 90.2% in 1990, 90.0% in 1991, 81.8% in 1992, 66.9% in 1993

and 63.0% in 1994. Considering the relative share of the state-owned enterprises in the national economy, it is not unnatural. The share of the state-owned enterprises in the fixed capital assets is around 80% and employ 90% of the skilled workers. However, during 1986-90 period only 33.4% of GDP is contributed by the state-owned enterprises. Therefore, the high concentration of financial fund to the state-owned enterprises seems to be too excessive.

Secondly, financial fund are provided mostly by the state-owned banks. The credits of four state-owned commercial banks in the total banking credits were 94.6% in 1991, 91.9% in 1992, 90.7% in 1993 and 89.5% in 1994. Considering that the majority of financial fund was provided by the government budget to the state-owned enterprises

(3) High Cash Preference: One disturbing sign is unusually high currency ratio in Vietnam. In 1989, the ratio(currency/M3) was 31.7% but it has risen to 39% in 1992, 44.0% in 1993 and 45.0% in 1994. This ratio is far higher than that of ASEAN neighboring countries. For example, in 1994 the ratio was 14.7% in Philippines, 10.8% in Indonesia, 8.2% in Singapore and 8.0% in Thailand. It was 9.5% in Korea. Even in transitional economies, the ratio was 22.9% in Hungary, 20.7% in Rumania and 9.0% in Bulgaria. Only in Albania, the ratio was 36.5%. This facts are due to the lack of efficient payment system and lack of public confidence on banking institution, and some incidence of cash shortage experiences(World Bank 1995, 99). Thus it indicates the future tasks of the banking reform and show the future prospects of the room for development of the banking industry in Vietnam.

(4) Government Intervention in the Banking Industry: In the past, the government had de facto managed the banking industry; however, the government intervention is subsiding. Banks can make decision on the loans without much intereference from the government. The current constraints are the maximum loan rate and the minimum deposit rates. Interest rates are announced by the central bank with the permission of the government. As more discretionary power is endowed to the banks, they allow more

loans to non-state sectors. In 1989 loans to the private sector was only 4.3% of the new loans made during that year; however, the ratio increased to 14% in 1992, 27.1% in 1993 and 28.3% in 1994(World Bank 1995, 96). Most of the subsidies to the state enterprise sector by the state-owned commercial banks had been stopped.

(5) Banking service to the Private Sector: Even though it is said that there is no rules to discriminate loans to the private sector from those to the state-owned enterprises, the former seems to be relatively constrained more than the latter. Private businessmen complain the discrimination of the state-owned commercial banks in their credit policy. Before the 1988 banking reforms, financial fund were mostly allocated according to the budgetary process to state-owned enterprises and so the state bank did not pay much attention to the profitability of each project it financed. It means that the government officials should have made appreciation of investment projects. Unfortunately, the government officials were not in a good position to make appraisal of the various funds allocated to commerce, agriculture and industry. Only it had allocated fund to produce public goods and services as much as possible. Now it is time that the financial fund be allocated based on market principle. Thus the continuation of the non-performing loans to the state-owned enterprises should better be discontinued.

Recently, banking services for the private sector are increasing. Especially, the shareholding banks or joint stock banks, which are founded by the private sector, are successful in their endeavor in providing services to the private sector. These banks make efforts to increase deposits and engaging in marketing activities, and compare relative risk for loans. These banks attempt to provide loan services to the private sector which has not been much exposed to banking at all. The loans are mostly 3-month terms and for trade-related credit. Even though the interest rates are higher than the government has set, it is very significant that these banks are providing banking services to those who have never before benefited from financial institutions(World Bank 1994, 1). Thus these joint stock banks become a model for future development of the private banking institutions.

IV. Further Tasks: Building Infrastructure of Banking Industry

Even though successful outcomes of the 1988 banking reforms during the first half of 1990s, Vietnam is still under-banked country. Total financial asset over GDP is mere 28.4%, and most of which is shared by the state-owned commercial banks. The intermediation cost seemed to be relatively high, and distribution of fund inefficient(World Bank 1994, 21). Thus the banking industry does not lead the manufacturing industry, and cannot keep up with the development of the real sector. The followings are some of limitations and further tasks the banking sector would face.

(1) Legal Framework: Even though lots of efforts have been made and achieved great deal in various aspects in Vietnam, the framework of laws and regulations are still deficient with regards to operations of the banking industry as in other transitional economies. Non-performing loans are accumulated due to the lack of legal protection that results in long and delayed process of disposing collaterals. Out of court settlement system has not been established. There is no independent court to settle property right disputes. The liquidation and bankruptcies process are long and complicated. It takes long time to settle through the court process(Borish, Long and Noel 1995, 25). Therefore, it is recommended that the government should set up more extensive and sufficient legal and institutional framework on definition of property rights, the laws of contract, and a system for adjudicating disputes. They require not only the property laws but also legal infrastructure to enforce them such as courts and lawyers.

With regards to the regulation of the banking industry, it is recommended that the government should make utmost effort to reduce the risks banks and the banking system take. The government should strengthen the capital adequacy requirement, and specify in detail the range of permissible bank operations, clarify the responsibilities of management and ownership more clearly, and set up elaborate monitoring system with more detailed reporting requirements on the state of bank operations. Loans should be classified in detail according to their performances. Different weights should be applied to the different risks of bank operations. Allowances should be made for non-performing loans. International standards of calculating interest rate income and restructuring of the non-performing loans should be introduced. Concentration of loans should be avoided by limiting large loans to one person or enterprise, and those to bank stock owners and to bank managers.[1)]

(2) Public Confidence Building on Banking System: First of all, bank institution should have complete public trust and confidence in order to mobilize domestic fund for economic development. People will have confidence on banks when they believe for certain that the bank will keep the information on their financial assets such as magnitude of their bank deposit secret. Some of the former South Vietnamese people had an experience to have been suffered when they revealed the information on their wealth to the government during the transitional period. Those who have successfully hided their wealth were less suffered. Thus it is believed that the people should be assured the secrecy of their deposits. Secondly, the real value of the deposits should be assured. It can be achieved by consistent macroeconomic stabilization policy. Thirdly, bank deposits should be guaranteed liquidity on the spot and unconditional. In certain instances, it is said that depositors had to wait a few days to withdraw deposits from their bank. It would be feasible when the banks learn how to manage proper liquidity.

Bankruptcies in one bank due to insolvency can be very contagious due to the special nature of banking and would threaten the public

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1) Due to the deficiency of legal framework, banks may not easily dispose the collateral when loans are defaulted. A Korean bank branch in Hanoi has some difficulties in recovering advance payment when the letters of credit guaranteed by Vietnamese banks are defaulted due to the bankruptcy of importers. It indicates that there would be a great deal of danger from accumulating large non-performing loans.

confidence on the entire banking system. Thus the government should make it certain that there should be no bankruptcies in the banking industry. The central bank should constantly check soundness of bank operations and ability of risk bearing through supervision and monitoring. The central bank should play the role as the lender of last resort(Sumihide Jinnouchi 1993, 102).

Some suggest to set up an introduction of orderly bank liquidation process, because it will allow a bankruptcy of one bank without risking public confidence for the entire banking system(Borish, Long and Noel 1995, 25). In the market system, it makes a good sense in unit banking system consisting of many small and large banks; however, in Vietnam where the public confidence on the banking system is still very weak and the banking system is consisted of large banks with branch banking system, bankruptcy of one bank, a very important national institution, would certainly threaten the public confidence on the entire banking system and may lead to bank-run and bank panic. Therefore, it would not be wise for the government to take a position of laissez faire in the banking industry.

Of course, the government attempt not to allow bankruptcies of banks could invite what is called 'moral hazard' problem. The banks would take more risks than otherwise they would without such government protection. This problem should be dealt with pre- and post-supervision.

Fortunately, the domestic savings ratio has increased from 2% of GDP in 1989 to 11.2% in 1992 and 16.6% in 1994(Adam Florde and Anthony Goldstone 1995, 136). It seems to indicate that the domestic banks began to gain public confidence.

(3) Indirect Financial System and Development of Security Market: In the full fledged market economy, balanced development of direct and indirect financial systems would be desirable; however, indirect financial system based on commercial banks should be developed first in Vietnam where the financial system seems to be an infant stage and the credit society is yet to be built. It is because banks have better public confidence because it is heavily regulated by the government and so does not require depositors

much searching cost to find a credible financial institution. Since the per capita income is still relatively low in Vietnam, it would be easier for the people to transact the bank products of which the minimum unit is relatively smaller than the direct financial market products such as bonds.

Indirect financial system can promote efficiency of investment, because feasibility and profitability of investment projects of firms would be investigated by the professionals of banks before loans are made. Of course it presupposes that the banks should be able to evaluate the feasibility of investment projects based on its profitability, not relying blindly on collateral.

In Vietnam, savings products are not sufficient, and thus savings are apt to be made in forms of physical entity such as precious stones and physical commodities. It will lead to shortage of investment fund and retard the economic growth. Moreover, the investment projects in Vietnam would be relatively smaller, and so they can be more easily funded through banking fund rather than direct financing. Therefore, it is recommended that the Vietnamese government should make utmost efforts to develop and establish the indirect financial system first and then attempt the development of the direct financial system(Sumihide Jinnouchi 1993, 101).

Mobilization of long terms fund is very important for industrialization and promote competitiveness of the industries. Thus it is natural that the Vietnamese government is considering to develop capital market for mobilization and allocation of long-term fund. In the market economy, the mobilization and allocation of long-term fund are made through capital markets, mostly security market.

Thus it is understandable that the Vietnamese government tries to set up institutional framework for the long term fund. However, the government should not overly enthusiastic for the idea, not certainly before the full-fledged development of the financial intermediaries based on banking networks. At this time, even the indirect financial intermediation through the banking system has not developed sufficiently. Only few percentage of total population is exposed to banking. Moreover, the direct financing mechanism through the security market requires many preconditions before it works and performs properly such as sound management of many stock companies and their transparency, perfect information collection and dissemination system, etc. Currently the number of companies which could be eligible for listing seems to be quite limited in Vietnam and the number would not seem to grow rapidly in the near future.

Perhaps Vietnam could learn from the Korean experiences in this respect. We had started our drive for economic development from the early 1960s, and yet the fund mobilization through security market began to make impact from the late 1970s or early 1980s. They were lots of irregularities in the market. It is recommended that the Vietnamese government should make more efforts for development of the banking system such as developing more attractive long-term savings products, and allow extension of term loans from one year to two or three years as the time goes on. While even the bank and bank deposits do not have complete public confidence, it would be difficult to make people to invest in stocks and bonds which are issued by mostly private corporate. The Vietnamese people had lived under socialism for a long period of time during which time the government had been a sole provider and protector for the people, having assumed responsibility for the decision makings. Thus the Vietnamese people, who have been exposed to capitalism rather short period of time, may not understand and accept the harsh reality that one's life time wealth can be crushed in matter of days when they have made wrong investments or when the stock market crashes due to external causes. They may not and will not bear the full responsibility of their own decisions when the stocks of their own choice become worthless.

(4) Lack of Market Integration and Settlement System: Individual banks in Vietnam seem to operate independently in the different financial markets which are not integrated. Even different branches of the same bank do not seem to have been integrated completely. It means surplus in one region can not be transferred to a region in shortage. And branches with surplus coexist with branches suffering from shortage in the same bank. This indicate that the banking system has not integrated adequately and the

financial fund is not allocated efficiently through the banking system. It is recommended that the legal framework should be made for settlement, liquidation, accounting. And the financial information network should be built in order to collect and disseminate financial information speedily and cheaply among the branches of the same bank and throughout different regions.

Since the current settlement system has not developed adequately, the development of banking system is greatly hampered. Currently cash is the main payment instrument. The fact that the share of gold in transaction is relatively higher than other Southeast Asian countries indicates underdevelopment of check clearing system. The ratio of currency in the broad money is almost 50%. It is very high ratio, comparing with the Southeast neighboring countries with 10%, and the East-European transitional economies with 25%. Cash is issued with relatively small denomination. The largest denomination was 10,000 dong(about 1 dollar) before 1993. Even though currencies with 20,000 dong and 50,000 dong denominations began to circulate from early 1993, still it hampers liquidity and make foreign currencies such as dollars circulate as a payment instrument. It deprives the Vietnamese government of seigniorage. In a word, development of payment and settlement system should be an urgent task for Vietnam. It requires development of banking system with complete public trust and confidence. Therefore, banks should play the main role in the settlement system.

(5) Taxation on Banking Industry: Even though there are many constraints in financial intermediation in Vietnam, perhaps one of the most bizarre characteristics to the eyes of the market system should be the taxation policy on banking industry called 'turnover tax' and 'profit tax'. The operation of banks are subject to turnover tax, ranging from 2% to 30% depending on type of operation and type of banks. Profit tax of banks also differ depending on type of bank. For example, the state-owned commercial banks are subject to pay 50% of profit tax, foreign bank branches and joint banks pay 25%. This difference is hard to justify on

economic ground, because it discriminates the domestic state-owned commercial banks over foreign banks. In a word, the banking system in Vietnam is burdened with too much tax with respect to international standards(World Bank 1993, 54).

Turnover tax has detrimental effects to both the depositors and borrowers as well, because the tax would reduce deposit rates and raise the loan rates. Moreover, turnover tax on banking industry banks distorts the operation of banks, because different rates are levied on according to the types of banks, and that retards development of universal banking system. Since the turnover tax is levied on the spread between deposit and loan rates, banks are apt to borrow fund, for example, issuing bank debentures rather than increasing deposits for loans. It discriminates new banks which should rely more on deposits rather than borrowings. It is recommended that the turnover tax should be discarded.

Profit tax is levied to the banks in the market economy; however, what makes the profit tax in Vietnam troublesome is that the rate seems to be too high. Profit tax is levied on the profit before deducting allowances on non-performing loans. In order to make the Vietnamese banks compete with the foreign banks, profit tax should be levied on the profit after having made all kinds of deductions such as allowances for default loans, etc. Then the bank would pay more attention to non-performing loans because they affect the profit level directly and make the bank managers shy away from accumulating non-performing loans. Without this kind of legal framework, banks are tempted to accumulate non-performing loans, even after the current non-performing loans were once restructured(World Bank 1994, 23).

V. Conclusion

Even though market mechanism and rapid economic development are good for the country; however, the high national leaders of Vietnam have rooted into revolution and sacrificed a great deal during the long drive for national unification. Thus they might have some reservation about the rapid accumulation of wealth to certain people through the market mechanism.

Also Vietnamese people have been living under the socialist system for a long period of time and are accustomed to equality and therefore, could be less patient to income disparities among people and among regions. Thus there would be intense desire for income redistribution when the economy gains surplus. It will be detrimental for capital accumulation utilizing the surplus through the financial intermediation by banks.

Despite of these adverse circumstances, Vietnam has established the environment which are conductive for successful development of the banking industry. Banks pay positive real interest rates which would contribute for more efficient allocation of fund. Also the government has tried to reduce subsidies and preferential treatment of specific sectors. The central bank began to supervise over the bank operations and introduced indirect macroeconomic policy. However, it is deemed that the banking reforms still have long distance to go in Vietnam.

Further tasks of banking reforms are diverse. First of all, legal frameworks should be sufficiently established by enacting systematic and consistent laws and regulations, especially economic laws such as commerce law and bankruptcy law in order to support banking activities. In order to mobilize domestic fund, various measures to enhance the public confidence on banks and banking system should be made. It is believed that the establishment of the indirect financial intermediation system should be made prior to that of direct financial system, specially stock market. The banking industry should be consisted of large banks with universal banking principle and relatively small specialized banks. Taxation on the banking industry should be remedied.

Even though it is no doubt that Vietnam is a country with great potential market in the long run, the foreign banks would face lots of difficulties and could not expect quick profit in the short run due to the lack of adequate infrastructure such as legal and institutional frameworks. Therefore, Korean banks should make loans, not mainly based on collateral but on the future prospects of profitability of the projects financed by bank loans. It implies that the banks should promote to have professional man-power who can accurately appreciate the profitability and viability of the investment projects. Even when Korean banks enter the Vietnamese banking market, it would be better to launch with a joint-bank format rather than going there alone as an independent branch, because local participation would make it relatively easier in recovering default loans, since the local partner would be of great help.

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