In search of a soft landing

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While the government has committed itself to the idea of introducing risk assessment guidelines for aiding state commercial banks, concrete measures appear as allusive as ever. And as time ticks on, loose lending practices, particularly to chronically indebted SOEs, is pushing the sector towards an inevitable crunch as bad debts balloon out of control. Vuong Quan Hoang looks at how the sector reached such a precarious state and what can now be done to extricate the industry.

REFORM of the domestic financial sector began with the establishment of four primary state-owned commercial banks in 1989, a move prompted by a slide in the State Bank's commercial lending operation at the time.

The Law on Banking Organisations and Credit Cooperatives (1990) subsequently bolstered the introduction of these financial entities and helped expand credit activities in a commercial fashion.

Reform of the domestic financial sector, however, did not stop there. More than 50 joint stock commercial banks were established throughout the country to operate alongside their state-owned cousins (but only 48 have survived).

Over time, the country's nascent financial market also attracted a considerable amount of interest from foreign investors to set up banks, investment corporations, leasing companies and a host of supplementary financial institutions. These early steps towards market reform were effectively grounded by the introduction of two significant banking laws in 1998: the Law on the State Bank and the Law on Credit Institutions.

However, despite undertaking such arduous reforms, the question that continues to be bandied around the corridors of the State Bank is simply: 'Are these reforms enough?'

This writer suggests that the answer is 'no' or, at the very least, 'not yet'.

Risky business

Over the last decade of the 20th century, various factors have hindered the establishment of true banking sector reform.

A growing number of private operations have been financially squeezed by the existing gulf between legislative rationale and its ultimate implementation. In addition, state-owned banking powerhouses have exceeded their thin equity base by continuing to support risky loan portfolios and recording overdue debt ratios.

Capital definition

The cost of capital definition stands as a key issue in the operation any state commercial bank. Until recently, state regulations have dictated the cost to the ultimate benefit or detriment of domestic banks in Vietnam.

However, such restrictive regulations ultimately challenge the efficiency of a bank because market forces are often left out of the capital equation. Certain government bonds, for example, earn bondholders greater interest returns than they earn from riskier bond bonds over the same maturity.

This dilemma, economists suggest, is by no means justifiable under modern finance theories and makes no economic sense for a government attempting to spark public interest in commercial bank bonds.

In light of this, they add, the establishment of fundamental concepts about the functioning of Vietnam's financial markets deserves a lot more attention. Thus far, it has been sufficiently proven that the financial performance of banks' lending portfolios can not be simply managed by regulations and legal instruments.

A few fundamentals

In view of the existing dearth of regulations relating to risk assessment of credit, domestic banks should apply the following principles:

(i) Follow international lending practices. Domestic banks should follow established industry norms when making an assessment of a client's creditworthiness. A bank should never grant discretionary loans.

This principle should be strictly followed to ensure that all loans are commercially viable and granted as a result of undue pressure or the relationship between the two parties.

(ii) Promote transparency and accountability. Transparency and accountability need to be promoted with an emphasis on public disclosure and reporting standards in a bid to get rid of misinterpretations and/or misunderstandings in the financial analysis of public information.

(iii) Install professional code of conduct. Numerous banking experts claim this is badly needed in Vietnam. While this practice is somewhat standardised in many countries around the world, it appears underemphasised in Vietnam's banking industry. The existence or not of such a code is particularly important in cases where professionals have been given more discretion in the decision-making process.

Indeed, an ethical code of conduct, which clarifies the professional responsibilities of a loan manager, should not sound so intimidating, rather familiar and understandable.

(iv) Implement more liberal policies. From a forward-looking point of view, this is key to a functional financial market. The recent removal of mortgageable assets as a compulsory requirement for private enterprises to borrow is one such step along these lines. It is a step which has been debated for years.

Conclusion

At present, the financial reform programme adopted by the government remains inconsistent. Additional reforms should, therefore, be introduced together with institutionalised financial market fundamentals in a 'Vietnamese' context.

Only by introducing financial market fundamentals in this way can the nation hope to have a sound modus operandi for its long-term financial and economic development.

Ultimately, this is crucial as the smooth operation of a financial system in a market-oriented economy will prove instrumental to the country's entire economic evolution.