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Transition To A Market-Oriented Economy Of Vietnam Over 1986-2011: The Equitization Process Of State-Owned Enterprises And Financial Market Development

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Abstract:

This study is to aim at providing a brief overview on the Vietnamese economy since the introduction of economic reform in 1986, in which we mainly focus on the equitization process of state-owned enterprises (SOEs) and the development of financial markets. Results from the paper shows that the extensive 1986 economic reform package had a significant and positive impact on the Vietnamese economy. Moreover, we find that the number of SOEs has significantly reduced over the past two decades given measures of the government in re-organizing SOEs. Of all the measures, the equitization programme plays an important role with the contribution of over 36 percent to the total number of reorganized SOEs. Finally, we can see that in the Vietnamese economy bank lending and recently, equity financing, have prevailed as important souces of fund for financing firm investment.

Keywords: Vietnam, equitization, economic reforms, SOEs, financial markets

JEL classification code: D13, D14, D31, G31, G50

1. Introduction

Since its reunification in April 1975, the Vietnamese economic history can be devided into two phases of development with 1986 as a “structural break”. Prior to 1986, the Vietnamese economy was centrally-planned. In December 1986, the Sixth National Party Congress decided to implement substantial economic reforms in order to transform the central planning mechanism

into a market-based economy, usually referred to as doi moi (i.e. economic renovation in Vietnamese). However, it was not earlier than 1989 when a radical and comprehensive reform package was practically started to stabilize and open the economy (Thanh and Quang, 2008). This comprehensive economic reform resulted in many positive changes to Vietnam's economy. It in effect ended an autarky era by recognizing the contribution and the vital role of private domestic and international capital flows as one of the major engines for the economic growth (Vuong, 2010). In order to achieve the necessary change, the Vietnamese authorities have conducted, among others, a comprehensive State-Owned Enterprise (SOEs) Reform Programme. In addition, many measures have been introduced to develop the financial sector in general, and financial markets in particular. These developments can be considered as important components of the transition to a market-oriented economy. This paper therefore aims at providing a brief overview on the Vietnamese economy since the introduction of economic reform in 1986, in which we mainly focus on the privatization process of SOEs and the development of financial markets.

The remainder of this paper is structured as follows. Section 2 provides some economic indicators of the Vietnamese economy. In section 3, we present the glimpse of the equitization process of SOEs. Next, we highlight milestones of the financial markets (section 4). Finally, we conclude in section 5.

2. Some economic indicators of Vietnam since 1986

Table 1 presents the annual economic growth rate and inflation rate of Vietnam over the period 1986-2011. As can be seen from the table, during 1989-2011, Vietnam has enjoyed an high and steady average economic growth of 7.3 percent per annum since the economic reforms were officially introduced in 1986,. The GDP growth rate reached a highest level at 9.5 percent per annum in 1995 but slowed down in late 1990s mainly due to the Asian financial crisis 1997-1998 (Ninh, 2003; Rina, 2013). Another cause of this economic slowdown was the increasingly unsustainable composition of growth in the past depending heavily on capital-intensive investment (mainly by state-owned enterprises in uncompetitive sectors) (Rina, 2013).

Table 1. Annual gross domestic growth rate (GDP) and consumer price inflation rate of Vietnam (1986-2011)

Year	GDP growth (%)	CPI inflation rate (%)
1986	2.8	487.0
1987	3.6	317.0
1988	5.1	311.0
1989	8.0	35.0
1990	4.5	67.0
1991	6.1	68.0
1992	8.6	18.0
1993	8.1	5.0

1994	8.8	14.4
1995	9.5	17.1
1996	9.3	5.7
1997	8.8	3.2
1998	5.8	7.3
1999	4.8	4.1
2000	6.8	-1.7
2001	6.9	-0.4
2002	7.1	3.8
2003	7.3	3.2
2004	7.8	7.8
2005	8.4	8.3
2006	8.2	7.4
2007	8.5	8.3
2008	6.3	23.1
2009	5.3	7.1
2010	6.8	8.9
2011	5.9	18.7

Source: Ninh (2003) for the period of 1986-2000 and World Bank (2012) for the period of 2001-2011

Since 2000 the economy has recovered largely due to a revival of domestic investment, which resulted in a steady increase in the GDP growth rate, peaking at 8.5 percent before its significant drop in 2008. During the following years, the GDP growth rate has slowed down, reaching 5.9 percent in 2011, which can be largely attributed to tighter monetary and fiscal policies and spillovers from the global economic crisis 2008/2009 (Rina, 2013).

On the other hand, the country experienced hyperinflation over 1986-1991, which is mainly attributed to the failure of the economic model run by the state and the poor harvest due to hard weather finally resulting in imbalance between supply and demand of goods and services. Another cause for this hyperninflation is pointed to the state's policy package of September 1985 (increasing official prices and wages and converting old legal currency to the new one) (see, e.g., Fforde and De Vylder (1996); Ninh (2003)). However, inflation was brought down from annual rates exceeding 300 per cent in 1986-88 to below 20 per cent in 1992 by the tight monetary and fiscal policy of the government (Camen, 2006).[1] In addition, the decline in the inflation trend is also thank to the positive contribution of private and foreign-invested sectors in the first half of 1990s. More specifically, financial distress was alleviated and inhabitants' income increased when capital investment and cash inflows (from both FDI and domestic entrepreneurs) increased. These

[1] E.g., the State Bank of Vietnam aggressively employed an aggressively tight monetary policy in which interest rates raised up to 12 per cent per month and exchange rate was rigidly pegged to USD (see, e.g., Nguyen and Nguyen (2010)).

developments together with better production output and purchasing power represented by a rise in GDP contributed to have stabilized the consumer prices (Vuong, 2004). Inflation was in a declining trend and reached 17 percent in 1995, while it further has dropped down to a one-digit level since 1996. During 2000-2001, Vietnam experienced a mild deflation period stemming from excess capacity and depressed commodity prices (Maliszewski, 2010). After two years of mild inflation in 2002-2003, inflation has picked up since 2004, reaching its highest annual rate of 23 percent in 2008. This can be attributed to sustained increases in international commodity prices and growing excess demand (Rina, 2013). The weakening domestic demand owning to inflation stability efforts by the government and the lowering food and energy prices caused by the global economic crisis brought inflation down in 2009. Since 2010 there has been a sharp increase in inflation from 8.9 percent to above 18 percent in 2011, which is mainly attributed to the loose monetary stance, the local currency devaluation and the rise in prices of domestic materials (oil and electricity) and food (see, e.g., Nguyen and Nguyen (2010); Rina (2013)).

Table 2 and Figure 1 provide an overview picture of the annual net capital inflows into Vietnam over 1986-2011 from various sources, i.e., foreign direct investment (FDI), official development assistance (ODA), remittances and equity portfolios.

Figure 1 shows that there has been a steady increase in the value of FDI, ODA and remittances over time, while the trend has not been stable and clear for the portfolio of equity. The small value and very unstable trend of the inflows of investments could be easily understandable given the young and less developed financial market of Vietnam. The significant increase in equity inflows throughout 2007, reaching at about 6.2 USD billion from just 1.3 USD billion in 2006, could be explained by foreign sentiments buoyed by the optimism associated with Vietnam's entry into the WTO (Leung, 2009). In contrast, the negative value in 2008 could be due to the negative influence of the global financial crisis. As for FDI, the inflow has started to increase since 1987 when the original Law on Foreign Investment was officially passed, and has become a major economic force for the economic reform of Vietnam since 1988 (World Bank, 1997). Particularly, the inflows surged from negligible values in the first half of the 1980s to an average of approximately 1.3 USD billion in 1990-1999, peaking at about 2.4 USD billion in 1996, before a steep drop as a result of the 1997 Asian financial crisis. Other reasons for the decline in FDI inflow may be due to the lack of transparency in property and land rights, dispute resolution mechanisms, preferential treatment of local firms and suppliers, corruption, and infrastructure constraints in Vietnam (Schaumburg-Müller, 2003). Following the Asian financial crisis, the downward trend of FDI inflows bottomed out at just 1.3 USD million during 2000-2001. Since then there has been a remarkable and gradual recovery of FDI inflows every year. The period of 2007-2011 was an incredible flourishing time for FDIs in Vietnam. FDI inflows were almost four times as much in 2008 compared to 2006, reaching about 9.6 USD billion. Despite the negative influence of the global financial crisis 2008-2009, FDI inflows have still stayed at relatively high levels during the subsequent years. Regarding ODA, the inflow seems to show an unpward and stable, but not always growing trend. Until the early 1990s, the small amount of ODA inflows into Vietnam was mainly contribtuted by countries

in the communist block (e.g., the Former Soviet Union, Eastern European countries and China), and a few "outside" donors such as Sweden and some international organisations. In about 1993 when relations between the United States and Vietnam improved, a full cooperation between Vietnam and the international financial community was established. Since then ODA inflows has risen gradually and stably owning to a persistent confidence in Vietnam by the donor community (see, e.g., Le, et al. (2009)).

Turning now to remittances, the sharp increase of the inflows since the early 2000s could be explained by a new policy of the Vietnamese government to welcome back overseas Vietnamese people who left the country for political reason after the Vietnam War in 1975.

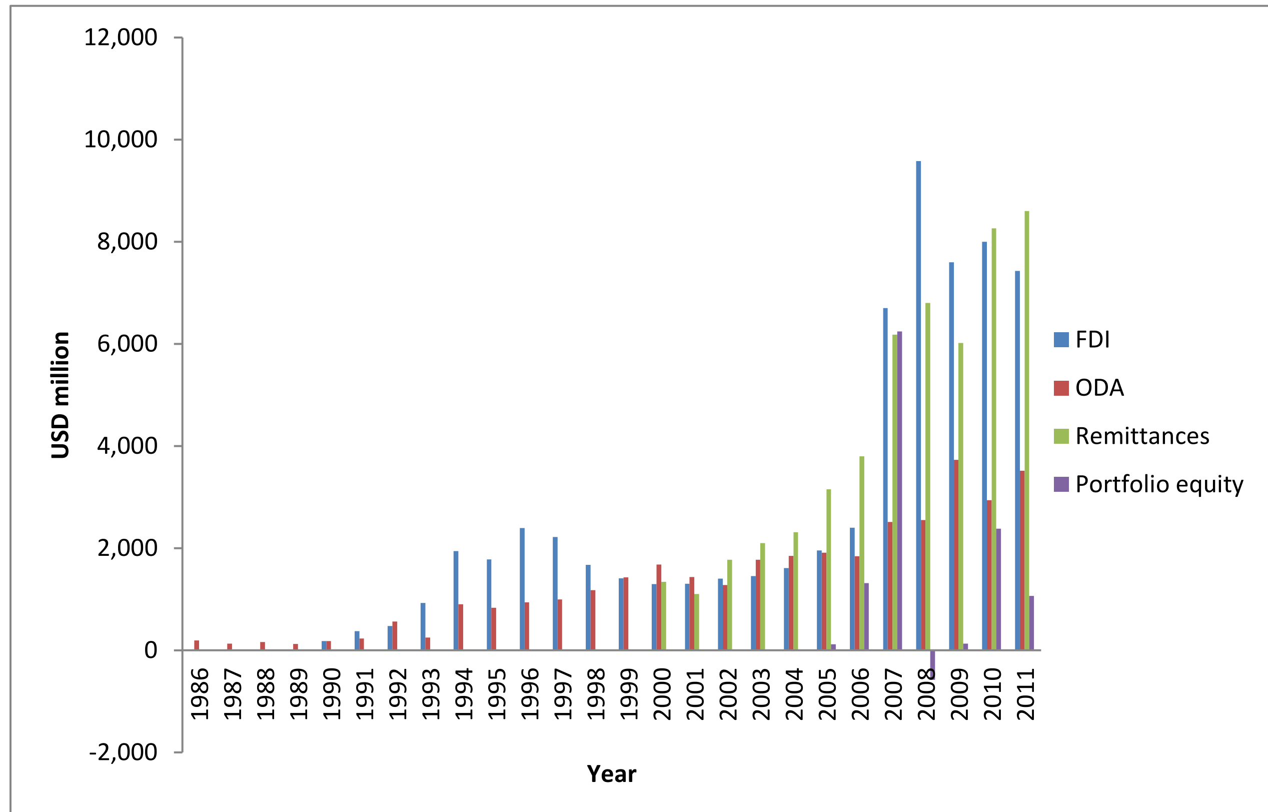
Table 2. Net capital inflows (1986-2011) (measured in USD billion)

Year	FDI	ODA	Remittances	Portfolio equity
1986	0.04	191.42	N/A	N/A
1987	10.36	127.21	N/A	N/A
1988	7.68	163.97	N/A	N/A
1989	4.07	124.55	N/A	N/A
1990	180.00	180.55	N/A	N/A
1991	375.19	227.30	N/A	N/A
1992	473.95	565.22	N/A	N/A
1993	926.3	251.61	N/A	N/A
1994	1,944.52	903.30	N/A	N/A
1995	1,780.40	834.80	N/A	N/A
1996	2,395.00	936.00	N/A	N/A
1997	2,220.00	998.25	N/A	N/A
1998	1,671.00	1,177.33	N/A	N/A
1999	1,412.00	1,428.58	N/A	N/A
2000	1,298.00	1,681.36	1,340.00	N/A
2001	1,300.00	1,431.95	1,100.00	N/A
2002	1,400.00	1,280.22	1,770.00	N/A
2003	1,450.00	1,771.91	2,100.00	N/A
2004	1,610.00	1,846.31	2,310.00	N/A
2005	1,954.00	1,913.46	3,150.00	115.00
2006	2,400.00	1,844.54	3,800.00	1,313.00
2007	6,700.00	2,510.94	6,180.00	6,243.00
2008	9,579.00	2,551.93	6,805.00	-578.00
2009	7,600.00	3,731.69	6,020.00	128.00
2010	8,000.00	2,940.08	8,260.00	2,383.00
2011	7,430.00	3,513.77	8,600.00	1,064.00

Source: Asian Development Bank (2011)

This policy allows them to reconnect with their relatives in Vietnam, which initiated the inflows of remittances to the country. From 2000 through 2008, the annual amount of overseas remittance inflow to Vietnam has been more than tripled, to 6.8 USD billion. The amount of remittances slightly dropped to about 6.0 USD billion in 2009 amid the global economic downturn and have strongly rebounded since 2010 at more than 8.0 USD billion. To put this in perspective, the annual amount of remittances has been close to the respecitive figure of FDI, while slightly higher than that of ODA in Vietnam since it was recorded in 2000.

Figure 1. Net capital inflows (1986-2011)



Source: Asian Development Bank (2011)

3. Glimpse of the equitization process in Vietnam

The privatization programme emerged from the State-Owned Enterprise (SOEs) Reform Programme, of which legal framework was provided by the Decree 388/HDBT on 20 November 1991 by the state. This Decree defined specific conditions for establishing new SOEs and closing existing SOEs. Particularly, if an SOE is classified into one of the following groups: (i) poor performance (continuous loss-making); (ii) lack of capital or technology; and (iii) insufficient market demand for its products, it could be forced to be dissolved or to merge with another one.

Following a resolution of the tenth session of the Eighth National Assembly, the Prime Minister issued Decision 202-CT to launch a privatisation programme in mid-1992, officially called

"Equitization Programme" by the public. The equitization programme refers to the transformation of SOEs into joint-stock companies and selling part of the shares in the company to private investors. Differing from privatization in the usual western sense, equitization in Vietnam does not necessarily imply the loss of ultimate control over the firm by the government. Practically, the Vietnamese government still holds decisive voting rights in many cases. In addition, it also varies from the usual Western privatization practices in that a substantial portion of the shares in the equitized firms is held by employees and managers of the equitized firms.

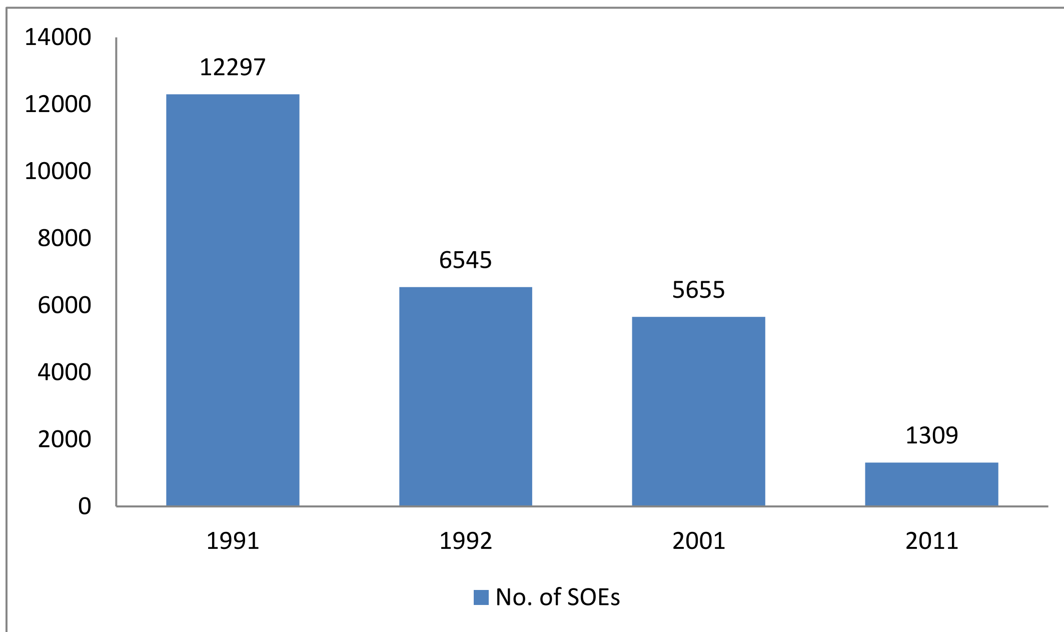
Main features of the equitization programme in Vietnam can be briefly summarized as follows. The general objectives of the equitization programme defined by the government include: (i) diversifying firm's ownership structure in order to improve its performance and competitiveness; (ii) raising financial resources from employees and outside investors (domestic and foreign investors) for renewing technologies and developing enterprises' business and (iii) balancing interests of the stakeholders (the state, employees and shareholders) in the equitized firm. There are several forms of equitization from which SOEs can choose, depending on their characteristics. First, SOEs can maintain the existing capital of the state and issue additional shares to raise more capital for developing their business. Second, they can either sell a part or sell off the entire existing state capital in the firm. Finally, they can combine the aforementioned forms, i.e., they can partially or entirely sell the existing capital of the state and concurrently to issue additional shares to raise more capital (see, e.g., Truong (2006)).

Since its inception in 1992, the equitization program can be basically classified into two stages, i.e., the pilot stage (1992-1996) and the expansion period (1996-onwards) (Truong, 2006). The legal framework for the first stage is based on the Decision 202-CT by the Prime Minister in 1992, which stipulated that selected SOEs for the pilot programme should be small or medium-sized and profitable or at least potentially profitable firms, but should not be "strategic enterprises". Moreover, according to the Decision, employees of equitized firms have a first right to buy the shares at preferential terms (e.g., discounted prices). Due to the cautious implementation by the government, only five SOEs were equitized over this pilot period. The Decree 28-CP by the Prime Minister in 1996 marked the end of the pilot stage and the start of a new stage of the equitization process. According to this decree, the general principles of the pilot programme have still been maintained, but the scope of equitization has been extended to all non-strategic small and medium-sized SOEs. This decree moreover requires the controlling agencies of SOEs, e.g., ministries, People's Committees of provinces and state corporations, to select firms for equitization. Since 1996, a number of other measures have been further implemented by the state to foster the equitization process, significantly contributing to the reducing of SOEs over time.

Figure 3 and Figure 2 illustrate the progress of corporate renovation and equitization of SOEs since 1992, respectively. As can be seen from Figure 3, over two decades the number of wholly SOEs has been significantly reduced given measures of corporate re-organization by the government, from about 12 000 before the year of 1992 to 5 655 in 2001, and 1 309 in 2011. Over 36 per cent of these re-organized SOEs, approximately 3 875 firms, have been equitized. However, from

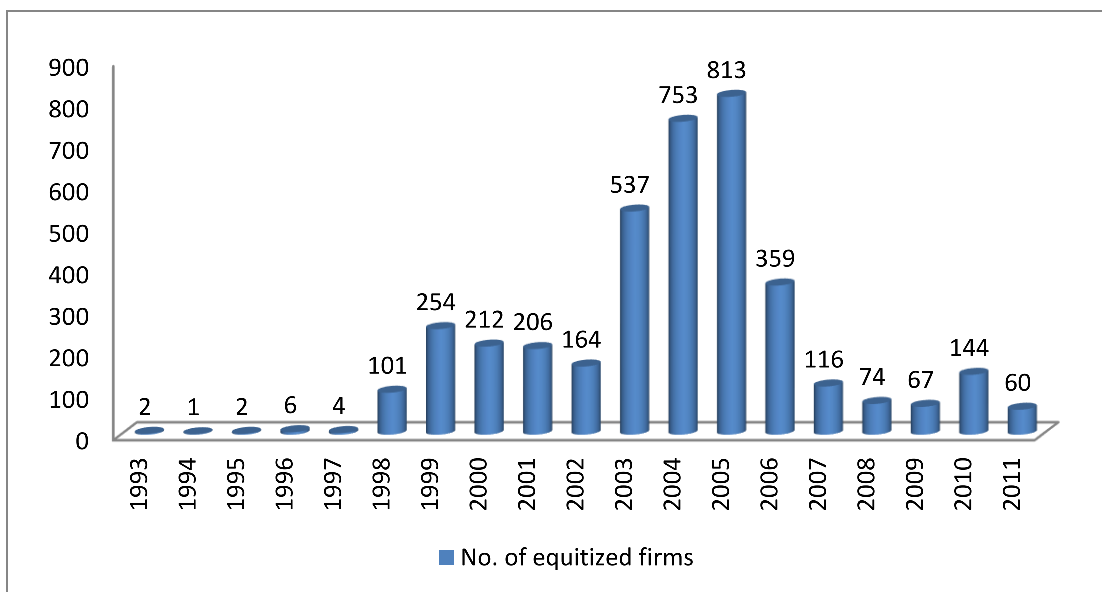
Figure 2 we can see that the progress of equitization has not been conducted regularly. While the progress was very sluggish over the first decade, it was speeded up during the beginning of 2000s reaching the highest points during 2003-2006 owning to fostering efforts by the authorities, but has been slow down recently. Between 2008 and 2011, only 117 SOEs were equitized, equivalent to the number of equitized SOEs in 2007.

Figure 2. A snapshot on the number of SOEs over 1992-2011.



Source: Ministry of finance (2011), General Statistics Office (2004), and the Steering Committee on Corporate Renovation and Development (2011).

Figure 3. Equitization progress of SOEs over 1993-2011



Source: Truong (2006), ministry of finance (2011), the Steering Committee on Corporate Renovation and Development, and various issues of public media.

4. Overview of the Vietnamese financial markets

4.1 Prior to 1986

Financial markets almost did not exist for the period before the start of economic reforms (Vuong, 2004). Only three wholly state-owned financial institutions had been operating before 1986 comprising of the National Bank of Vietnam (NBV), the Bank for Investment and Development of Vietnam (BIDV), and the Bank for Foreign Trade of Vietnam (VCB). The NBV de facto functioned both as a central bank (with a limited scope of activities such as money production) and as a commercial bank (but only funding the needs of a centrally planned and highly subsidized economy in war times by executing the commands and decisions of the government). This dual role of the NBV had lasted until the legal changes from late 1980s through 1990. The BIDV and VCB functioned to serve specific needs of reconstructing the economy. These two banks were established to accomplish the economic plan set out by the government in each period. By and large, they were not commercial banks and were normally referred to as the "policy banks". Under the mono-banking model, the banking system via its role in providing fiscal resources to the State and funding for SOEs served as a vehicle for the implementation of government policies, in which directed credit at highly subsidized interest rates was the only development financing instrument (Rosengard and Du, 2009).

4.2 Financial market development since the start of economic reform in 1986

Following the overall reform program of Vietnam's economy is the emergence of its financial market. Economic reforms have in effect revolutionized the financial sector in general, and the financial market in particular (Vuong, 2004). In this section, we highlight chronologically some relevant milestones of the developments of the Vietnamese financial market. For the sake of this thesis, we will discuss only the bank credit market (i.e. the loan market), the equity and corporate bond market, and we will mainly focus on developments over the last decade on which we conduct our empirical research.

a) The bank credit market:

The first milestone is the issuance of the Decree No. 53/HDBT by the Price Minister in 1988, gave the state-owned banking system a more commercial functionality. In this piloted scheme, the banking system then consisted of the National Bank of Vietnam (NBV) and four state-owned sector-specialized commercial banks (SOCBs) comprising of the Vietnam Bank for Agriculture Development, the Vietnam Industrial Commercial Bank, Bank for Investment and Development of Vietnam and Bank for Foreign Trade of Vietnam.[2] While the NBV is responsible for directing

[2] Nowadays, these four banks are known as the Vietnam Bank for Agriculture and Rural Development (AGRIBANK), the Vietnam Joint Stock Commercial Bank for Industry and Trade (VIETINBANK), Joint Stock Commercial Bank for

and supervising the operation of the whole system, SOCBs targeting a different sector of the economy provided credit and financial services to the economy. Two years later, the introduction of the new legislation[3] transformed the monobank system into a two-tier banking system in 1990. The State Bank of Vietnam (SBV) was established on the foundation of the National Bank of Vietnam and was regulated to function as a more modern central bank as well as to stay away from commercial banking activities, a significant departure from the previous dual role of the NBV (Vuong, 2004). Following the move, the four SOCBs were modified and restructured to take on the commercial role of the NBV. These four SOCBs have since then dominated the banking system and been the major players in the Vietnamese financial market (Ho and Baxter, 2011). Triggered by the new legislation in 1990, from 1991-1992, a wave of establishing the joint-stock commercial bank (JSCBs) with its equity held legitimately by various entities (SOEs, SOCBs, individuals and private enterprises) surged.[4] This legislation together with the Law on Foreign Investment also opened up the banking system for the entry of representative offices and branches of foreign banks, as well as joint ventures between foreign banks and state-owned commercial banks.[5] It in addition allowed for the birth of non-bank financial institutions, namely finance companies, people credit funds, financial leasing companies, etc. (see, e.g., Ninh (2003); Vuong (2004)).[6]

In 1994, the promulgation of the temporary Decree 64-CP by the Prime Minister allowed the foreign-invested finance companies doing business in Vietnam in the form of joint venture (see, e.g., Vuong (2004)), an additional step to attract foreign investment in the domestic financial markets. The year of 1997 was marked by the introduction of the two first laws governing the banking system of Vietnam: the Law on the State Bank of Vietnam and the Law on Credit Institutions. These laws have enabled the legal and regulatory framework for the banking and financial institutions to operate to the generally accepted industry standards until today. In order to comply with requirements under the US-Vietnam BTA (Bilateral Trade Agreement) in 2001, in 2004 the government amended the 1997 Law on Credit Institutions, setting the stage for the establishment of wholly foreign-owned banks in Vietnam. As a further move, the Decree 22-2006-ND-CP by the Prime Minister was issued in 2006, specifying the requirements for establishing wholly foreign-owned banks.[7] The Decree also eased restrictions on foreign bank branches and joint venture banks such as their license periods and the number of foreign branch service transaction points to include ATMs. However, the participation of foreign investments in the

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Investment and Development (BIDV), Joint Stock Commercial Bank for Foreign Trade of Vietnam (VIETCOMBANK), respectively.

[3] The Ordinance on the State Bank of Vietnam, and the Ordinance on commercial bank, credit cooperative and finance company in 1990.

[4] E.g., over 1992-1997, 56 JSCBs were founded.

[5] The number of foreign banks started doing business Vietnam after this new legislation increased quickly, e.g., it was 28 in August 1993 and 39 in June 1994 (cited by Ninh (2003)).

[6] E.g., until 2000, about 70 credit funds and a total of 16 financial leasing and finance companies were established and operational throughout Vietnam.

[7] The applicant must have at least USD 20 billion in assets in the year prior to application and must be owned at least 50% of the new bank’s capital by its single parent bank.

Vietnam banking system only started in 2008, when the first four wholly foreign-owned banks had been licensed to operate. Recently, in January 2011, Vietnam has further levelled the playing ground for foreign banks in accordance with its WTO (World Trade Organization) accession commitments in 2007. Vietnam has granted foreign bank branches an equal treatment as domestic banks with respect to the deposit and lending rules, and the banking service providing.

After having reviewed milestones of the credit market since the introduction of economic reforms in 1986, we will now have a look at its main characteristics over the past decade.

Table 3 shows a snapshot of the number of formal credit institutions at various points in time. As can be seen from the table, since the mid of 2001 players in the formal credit market of Vietnam have become relatively diversified, comprising of both banks and non-banking credit institutions. Until the mid of 2010, the banking system picture has been filled with the participation of five wholly foreign-owned banks. Within the group of banks, the number of SOCBs, JVBs and JSCBs seems to show a stable trend over time since the mid of 2001, while that of foreign bank branch and representative offices has steadily increased. As for non-banking credit institutions, there has been a gradual increase in the number of all types but PCFs over time. To sum up, over the last decade the system of formal credit institutions has been gradually developed and become fairly crowded in structure.

Table 3. A snapshot on the number of formal credit institutions

Group	Type	June/2001	2006	June/2010	2012
Banks	State-owned commercial banks (SOCBs)[8]	5	5	5	5
	Joint-stock commercial banks (JSCB)	43	34	37	34
	Wholly foreign-owned bank	0	0	5	5
	Joint-venture banks (JVB)	4	5	5	4
	Foreign bank branch and representative offices	31	31	48	99
Non-banking credit institutions	Finance company	N/A	6	17	18
	Finance leasing company	N/A	11	13	12
	People credit funds (PCFs)	959	950	1038	698

Sources: Ninh (2003); Thanh and Quang (2008); Vo, et al. (2011); SBV (2012).

Turning now to the market share of credit institutions over 2000-2009 in Table 4, several points worth mentioning. First, it is obvious that the five SOCBs have absolutely dominated the credit market with over a half of the total market share in both mobilizing and lending. Particularly, they

[8] Excluding two state-owned policy banks: Vietnam Bank for Social Policies and Vietnam Development Bank (VDB). Of the five SOCBs, there is also a policy-oriented bank, Mekong Housing Bank (MHB), which may not significantly contribute to the credit market for firm investment.

account for about 56-80 per cent of the mobilizing market share and approximately 54-80 per cent of the lending market share. JSCBs held the second largest market share, followed by the group of JVBs and foreign banks. PCFs seized a stable market share of around one and a half per cent. On the other hand, the table also shows that there has been a steady decline in SOCBs' market share since 2001, while the opposite trend can be clearly seen for JSCBs. Yet, it seems that until 2009 SOCBs were still the main players in the credit market of Vietnam. In addition, the market share of the JVBs and foreign bank group has also slightly increased, but the trend is less clear than that of JSCBs. These facts (the decrease in market share of SOCBs and increase in that of the other market players over time, and especially the entry of foreign-owned credit institutions) in general reflect the process of reforming and liberalizing the banking sector of the country over decades.

Table 4. Market share by types of formal credit institutions

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Panel A: Market share in deposits (%)										
State-owned commercial banks (SOCBs)	77.00	80.10	79.30	78.10	75.20	74.70	68.80	59.30	56.88	57.63
Joint-stock commercial banks (JSCB)	11.30	9.10	10.10	11.20	13.30	15.70	21.80	30.40	31.21	28.97
Joint-venture banks (JVB) and foreign banks	10.30	10.00	9.40	9.30	9.70	8.00	8.10	8.80	8.26	9.10
People credit funds (PCFs)	1.00	0.80	1.10	1.10	1.00	1.00	1.00	1.00	1.10	1.21
Others	0.40	0.00	0.10	0.30	0.80	0.60	0.30	0.50	2.54	3.10
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Panel B: Market share in lending (%)										
State-owned commercial banks (SOCBs)	76.70	79.00	79.90	78.60	76.90	73.00	64.50	55.10	58.15	54.10
Joint-stock commercial banks (JSCB)	9.20	9.30	9.50	10.80	11.60	15.00	21.20	28.60	26.52	31.94
Joint-venture banks (JVB) and foreign banks	12.40	10.40	8.80	8.90	9.50	9.60	9.30	9.00	10.95	9.19
People credit funds (PCFs)	1.40	1.20	1.70	1.50	1.40	1.50	1.40	1.30	1.33	1.28
Others	0.30	0.10	0.10	0.20	0.60	0.90	3.60	6.00	3.05	3.49
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Sources: Thanh and Quang (2008) for 2000-2007 and own estimation based on data provided by To (2010) for 2008-2009.

Table 5. Some financial indicators (1986-2011)

Year	Domestic credit/GDP (%)	M2/GDP (%)
1986	25.5	18.7
1987	18.5	16.4
1988	17.0	16.7
1989	23.9	26.4
1990	23.7	27.1
1991	18.4	26.4
1992	15.5	24.6
1993	19.3	23.0
1994	21.3	24.1
1995	20.6	23.0
1996	20.3	23.8
1997	21.3	26.0
1998	22.4	28.4
1999	22.4	35.7
2000	35.1	50.5
2001	39.7	58.1
2002	44.8	61.4
2003	51.7	67.0
2004	60.8	74.4
2005	69.8	82.3
2006	75.0	94.7
2007	95.9	117.9
2008	94.3	109.2
2009	123.0	126.2
2010	135.8	140.8
2011	120.8	123.3

Source: Computed from data provided by Asian Development Bank (2011)

Table 5 shows the ratio of domestic bank credit to GDP and of money supply (M2) to GDP over 1986-2011. From the table we can see that the size of the Vietnamese banking sector, measured by M2-to-GDP ratio, has increased steadily since 1987. Similarly, it can also be seen from the table that bank credit has increasingly become an important source of finance over time. This is especially true since 2003 when the annual domestic-bank-credit-to-GDP ratio has stayed at above 50 per cent and exceeded 100 per cent in 2009. These developments have obviously reflected the progress of financial liberalization since the economic reform as discussed above.

b) The stock market:

Together with reforms and liberalization in the credit market, the intention for establishing a stock market as a second channel of raising and allocating fund for the economy was also a part of the financial reform package by the government (see, e.g., Vuong (2004)). Another motive for the plan also partially came from the state-owned enterprise (SOEs) reform program, i.e., facilitating the equitization process of SOEs. Nevertheless, the first serious move of this plan was the launch of a dedicated organizing panel, the State Securities Commission (SSC), as per the Decree No. 75-CP by Prime Minister in 1996. Following advances were the issuance of Decision No. 127/1998/QD-TTg by the Prime Minister governing the Stock Trading Centers and the Decree No. 48/1998/ND-CP by the Prime Minister overseeing Securities and Securities Markets in 1998. While the latter development provided the first legal framework for the stock market operation, the former one paved the way for establishing the first Vietnamese stock exchange, the Hochiminh Stock Exchange (HOSE) (formerly known as Hochiminh Securities Trading Center) in 2000. In order to foster the SOEs equitization process as well as support the private sector development, in 2005 another stock exchange for small caps was launched in Ha Noi city, Hanoi Stock Exchange (HNX). Despite these developments, the Law on Securities had just been passed by the legislators in 2006, providing a standard legal framework for the general operation of securities market. In an effort to develop the stock market, in 2010 the authorities amended the 2006 Law on Securities closer to international standards.

The ratio of stock market capitalization to GDP over a decade is shown in Table 6 as well as in Figure 4. As can be seen from the table, the total-stock-market-capitalization-to-GDP ratio increased from around a half of per cent during the first four-year period (2000-2004) to approximate one per cent in 2005. Since 2006 but 2008, the ratio has stayed at above 20 percent. It reached its highest at value of just 43 percent before significantly falling to 18 percent in 2008. In addition, we can see from the figures that the Hochiminh stock exchange (HOSE) plays the role of main stock market as its size, measured by the market capitalization, always doubles that of Hanoi stock exchange (HNX).

In short, the Vietnamese stock market has been still in its early stage of development. The authorities first prioritized the safety for prospective investors, while the growth, efficiency, liquidity, and other attributes of a well-functioning stock market were left to be dealt with later (Vuong, 2010). However, the role of Vietnamese stock market as an additional channel for funding firm investment has been recognized, given its recent development as can be seen in the next paper.

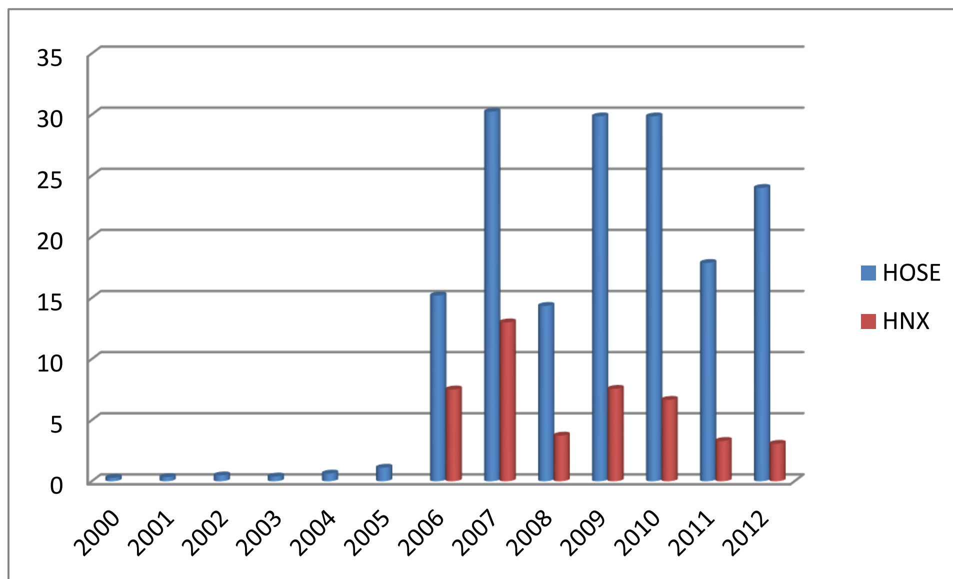
Table 6. Market capitalization as percentage of GDP (%)

Year	HOSE (%)	HNX (%)	Total (%)
2000	0.28		0.28
2001	0.34		0.34
2002	0.48		0.48
2003	0.39		0.39
2004	0.63		0.63

2005	1.11		1.11
2006	15.19	7.51	22.70
2007	30.23	13.00	43.23
2008	14.35	3.73	18.08
2009	29.85	7.56	37.41
2010	29.85	6.66	36.51
2011	17.86	3.30	21.16
2012	24.00	3.06	27.06

Source: Vietnam Ministry of Finance (2011); Computed from data provided by annual reports of HOSE, HNX and Vietnam General Statistics Office.

Figure 4. Market capitalization as percentage of GDP (%)



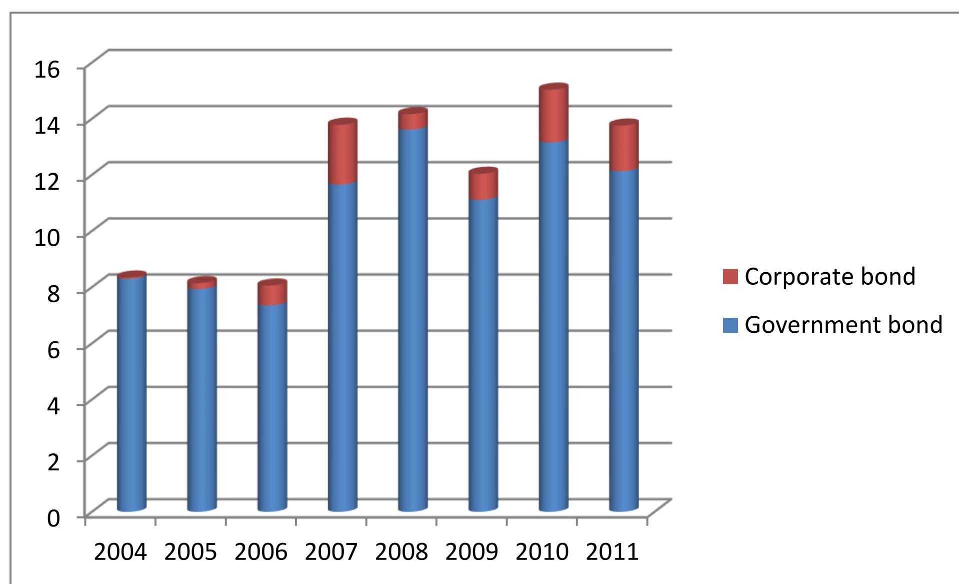
c) The corporate bond market:

Before 1986, cong trai (i.e. government bonds) were issued occasionally by the central government to finance both public expenditures and (in part) SOEs' capital needs. Civil servants and bureaucrats are the main purchasers of these bonds as formal contribution of their salary. Bondholders usually kept the bond until maturity and were received a total amount equal to the face value of their holdings and a predetermined interest amount. A secondary market was not available.

The transition into the market-oriented financial systems in 1990 facilitated the process of separating corporate bonds from government bonds. Particularly, in 1994 the government promulgated the Decree No. 120/1994/ND-CP to regulate on the bond issuing of SOEs. Although the corporate bond at that time was simply a financial vehicle to transfer funds from the population to SOEs, this Decree laid the foundation for the corporate bond market of Vietnam. Yet, at that

stage, there was still unclear distinction between government and corporate bonds since most bond issues of SOEs were guaranteed by the state up to some extent, e.g., a payment committed by Vietnam Ministry of Finance or the involvement of local state treasury-authorized offices in enhancing a smooth sale of the bonds proactively. Project bond, a primitive form of corporate bond, was issued by corporate entities (SOEs) in the mid-1990s to raise external debt funding other than conventional bank loans (see, e.g., Vuong (2010)). The use of these funds was to finance for specific projects. The establishment of the first stock market, Hochiminh stock exchange, can be considered as another milestone of the corporate bond market, since this has induced better activeness of the bond (e.g., improving in the number of successful issues and the market liquidity). In 2005, with the promulgation of the Enterprise Law, a shareholding firm has been conditionally allowed to issue bonds (corporate bonds, convertible bonds and other types of bonds). According to the law, issuing firms must have a sound financial position, meaning that they do not have signals of either low debt servicing capability or below-average profitability (see, e.g., Vuong (2010)). The year of 2006 was marked by the issuance of the Law on Securities, highest regulatory document governing issues and trading of both listed and public corporate bond.

Figure 5. Total outstanding amount of local currency bonds as percentage of GDP over 2004-2011



Source: Calculated from data provided by Asian Development Bank (various issues of Asia Bond Monitor and Economic and Financial Indicators).

Legally speaking, the corporate bond market was born in 1994. However its surge as a financing channel for firms has been noticeable only since 2005 (Vuong, 2011). Some essential characteristics of the Vietnamese corporate bond market over two decades of development can be briefly described as follows.

It can be seen from Figure 5 that the Vietnamese bond market size measured by the total-outstanding-amount-to-GDP ratio has been very small, ranging between about 8% and 15%. The figure also shows that government has been a main player on the market as its market share was at least five times as large as that of corporate issuers. Noticeably, the ratio of outstanding amount of corporate bond to GDP has been very small over the period, lying in the range of 0.02 percent to just 2.0 percent. This ratio was very small before 2006, while it rose up to the highest one at about 2.0 percent in 2007 possibly due to the buoyant optimism associated with Vietnam's entry into the WTO. The decline of the ratio in 2008 is probably owning to the global financial crisis, before recovering to the rising trend since 2009.

In addition to its small size in terms of market value, corporate bonds do not seem to be a popular financial vehicle for Vietnamese firms. Over two decades preceding 2009, only 63 large and well-known firms have attempted to issue 152 bonds. Listed firms account for 35 percent of the total number of issuers and the top five issuers mobilize 48 percent of the total raised fund. This number of issuers is quivalent to 31.5 percent of the 200 largest corporations of Vietnam, and is just a very small portion of the increasing corporate population of approximate 350 000 enterprises. In terms of issuer's industry, the financial industry accounts for about 34 percent of the total bond value (see, e.g., Vuong (2011)).

The Vietnamese corporate bond market can be characterized as a weak primary market with a virtually non-existent secondary market. Individual bond investors are unable to participate in the market due large capital investment and narrow return spreads, while only a small portion of eligible financial institutions is involved in bond transactions (e.g., only 86 primary market members and 27 secondary market members in December 2009). In terms market trading, while the secondary market is very illiquid, the primariry market is relatively inactive (Vuong, 2011). It was common in the corporate bond market that dealers and market makers had to take on the holdings of the underwritten amount until maturity. In addition, since the primary market is dominated by only a number of large commercial banks and their securities subsidiaries, an issuer must build close relationships with financial powerhouses to secure the funding from bond issues. Therefore corporate bond issuers have difficulties to identify primary market buyers and it is almost impossible to reduce transaction costs as theoretically expected when employing bond financing (Vuong, 2011).

Overall, although there have been improvements but the Vietnamese corporate bond market still has to deal with unsolved illiquidity problems. Even today, corporate bonds have still not become an important means of raising funds for Vietnamese firms.

5. Conclusion

In this paper, we highlight a number of relevant issues of the Vietnamese economy since its initiation of economic reform in 1986.

We first took a look at its economic picture over the past two decades using several main economic indicators of Vietnam including GDP, inflation rates and net capital inflows. It is shown that the extensive 1986 economic reform package had a significant and positive impact on the Vietnamese economy. The main achievements were: (i) an improved economic environment (increase in GDP growth rate, and decrease and stability in inflation rate; and (ii) an encouragment and ligitimation of the net capital inflows, forming part of the financial markets and planting the 'seeds' for economic growth.

In addition, we also provided a glimpse of the equitization process in Vietnam, an important component of the State-Owned Enterprise (SOEs) Reform Programme. We found that the number of SOEs has significantly reduced over the past two decades given measures of the government in re-organizing SOEs. Of all the measures, the equitization programme plays an important role with the contribution of over 36 percent to the total number of reorganized SOEs. Interestingly, the equitization programme mainly started since 2000s and peaked during 2003-2006, although the programme was introduced in 1992.

Finally, we reviewed several milestones of the Vietnamese financial market, focusing on the banking credit market, the stock and corporate bond market. A few noteworthy points can be summarized from this section including: (i) Financial markets were not likely to exist prior to 1986. The economic reform has opened up the financial market for the entry of private-sector as well as foreign-invested players, resulting in an increasingly crowded structure of the Vietnamese financial system; (ii) In the credit market, commercial banks have been dominated by SOCBs and other state-owned financials. This resulted in a more favourable access to loan finance for state-owned firms but not for private ones; (iii) Established in 2000, the Vietnamese stock market still is in its infancy, but its role as an additional and important channel for financing firm investment has been increasingly recognized; (iii) Over two decades of development, the corporate bond market still is in its early of development with problematic issues, preventing corporate bonds from becoming a familiar financing option for the corporate communities. Taken all together, we can see that in the Vietnamese economy bank lending and recently, equity financing, have prevailed as important souces of fund for financing firm investment. The banking sector continues to play a major role in the financial system of the country (Vuong, 2011).

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