FINANCIAL REFORM AND ECONOMIC DEVELOPMENT IN VIETNAM

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“Our present slogan must be capital, capital and more capital.”
—Do Muoi, Vietnam Communist Party Secretary General

To presume that one could begin to discuss the progress of financial reforms in Vietnam along with other Asian countries conjures a descriptive quotation by Montaigne: “The sullen arrogance of a gloomy face.” For in comparison with the newly industrialized countries of Asia, Vietnam, despite her reform efforts and economic gains, presents a gloomy face indeed. Vietnam’s recent growth rate (near nine percent) is quite impressive, but, given the absolute values, she must witness many more years of economic prosperity before catching up to the region’s economic leaders. More important, the quick gains of recent years may reflect elimination of inefficiencies in past economic mismanagement. It remains to be seen whether Vietnam is committed to policy reforms aimed at achieving real, sustainable economic growth.

The facade is even gloomier if one focuses on Vietnam’s financial sector. Despite some recent liberalization of domestic banking regulations and the admission of foreign banks, efficient banking services remain illusory. The World Bank soberly characterizes Vietnam as an “underbanked” country. And notwithstanding repeated calls from party leaders, Vietnam has yet to develop a securities market. All of which prompted U.S. officials to declare that Vietnam’s financial sector, despite its “slow progress,” is underdeveloped, overregulated, and noncompetitive.

Even Vietnam acknowledges these shortcomings in its plan for economic development. As Prime Minister Vo Van Kiet

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acknowledged to the National Assembly, "The financial system is not keeping pace with the development of the economy. Our capital markets are still too primitive. We have been too slow in the equitisation of state companies as well as in the establishment of a stock market." 5

Thus, to avoid the risk of "sullen arrogance" in comparing Vietnam's financial sector with those of her Asian neighbors, this Article evaluates banking regulation and capital markets development in Vietnam from a more parochial perspective. The analysis focuses on Vietnam's needs at this stage of her economic development and explores how financial sector reforms could best be tailored to meet those needs. Part I explores the role of financial intermediation in facilitating economic growth for developing countries. Part II provides a brief introduction to the progress of Vietnam's recent reforms and explains Vietnam's need to develop its financial sector. Part III discusses Vietnam's banking services, focusing on current industry structure and performance and on the regulatory barriers to more efficient provision of basic banking services. Part IV discusses the progress in plans for a securities market and suggests how the Company Law and restrictions on the issuance of debt hinder the development of that market. Finally, the Article concludes in Part V with an assessment of the prospects for further policy reforms affecting the financial sector.

I. FINANCIAL INTERMEDIATION AND ECONOMIC DEVELOPMENT

In a very simple economy, one in which there is no transfer of capital, households can only allocate consumption across time. 6 The foregone consumption in one period (savings) may be consumed in a future period, or it may be invested in a more productive enterprise. In such an economy, an entrepreneur with an innovative idea can rely only on his own savings to finance the investment required to translate his idea into productive output. Conversely, others are limited by their own

5. Cooke, supra note 3, at II.
6. The analysis draws from the seminal works of Ronald McKinnon and Edward Shaw discussing the link between finance and development. See RONALD I. McKINNON, MONEY AND CAPITAL IN ECONOMIC DEVELOPMENT (1973); EDWARD SHAW, FINANCIAL DEEPENING IN ECONOMIC DEVELOPMENT (1973). The so-called McKinnon-Shaw model has generated much literature on financial liberalization. For a review, see Maxwell J. Fry, Models of Financially Repressed Developing Economies, 10 WORLD DEV. 731 (1982). On modifications to incorporate specific policy recommendations, such as removing excessive reserve requirements and artificially low interest ceilings, see Yoon Je Cho, McKinnon-Shaw Versus the Neostructuralists on Financial Liberalization: A Conceptual Note, 18 WORLD DEV. 477 (1990).
ideas in the use of their savings. Each economic unit is limited to the opportunities available to it. If a household has excess savings but no opportunities that would yield a higher return than its existing use of capital, then it would either consume the savings in the current period or roll the savings over to a future period. If an entrepreneur has an innovation yet insufficient savings, he must wait until he accumulates enough savings to turn the idea into productive output.

Introduce now into this simple economy the ability to transfer capital from one household to another. A saver without a superior investment opportunity available to him individually (e.g., an innovative idea) could transfer his savings to the entrepreneurial investor who offers such an opportunity. The investor would solicit from additional savers until he acquired the capital necessary to transform his idea into productive output. Societal resources are thereby allocated more efficiently, leading to an increase in real income. In a perfectly competitive economy with perfect information and zero transaction costs, savers and investors could match their respective needs perfectly, and all saved funds would flow to investments with the highest rates of return in productive output. In such an economy, capital is perfectly allocated, and increases in real income are limited only by the availability of innovative ideas and accumulated capital.

But such a frictionless economy does not exist, and financial intermediaries help to ameliorate imperfections in the process of capital transfer from ultimate savers to ultimate investors. Intermediaries serve two basic functions in the capital transfer process. First, they provide a common means of transfer for the economy by creating a common currency and by administering the payment mechanism through which monetary transfers are cleared. Second, they serve as matchmakers for the ultimate savers and ultimate investors, who lend to and borrow from the intermediaries, respectively.

One way in which intermediaries perform the role of financial matchmaker is by reducing search and information costs. In a typical finance contract, the lender has less relevant information available to him than does the borrower. Relevant information may include the

7. See MAXWELL J. FRY, MONEY, INTEREST, AND BANKING IN ECONOMIC DEVELOPMENT 62 (2d ed. 1995).
9. See Fry, supra note 7, at 294.
10. See id.
financial position of the borrower, his creditworthiness, the intended use of the borrowed funds, and expected returns on investments made with the borrowed funds. For most investment opportunities, the borrower knows more about each of these subjects than the lender. This asymmetry of knowledge imposes costs on individual lenders to discover the true state of information with respect to each borrower and opportunity before committing funds. Because of wealth constraints, lenders can perform only limited searches before they must make a decision based on imperfect information. And even after the lending decision, lenders incur additional costs of monitoring the project to ensure that the borrower honors the terms of the loan contract. An individual lender thus may forego more productive opportunities and make investments that do not yield the highest marginal returns. Financial intermediaries alleviate this problem by reducing search and monitoring costs. They do so through economies of scale, market specialization, or by investing in better information technology (which is not cost-effective for individual lenders). Therefore, "[f]inance and financial institutions become relevant in a world of positive information, transaction, and monitoring costs."13

Another way that financial intermediaries facilitate the transfer of capital from ultimate savers to ultimate investors is by minimizing liquidity risks. A typical investment entails a period of delay between the initial expenditure of capital and the realization of profits from the investment. This "slow cycle of production"14 imposes the risk that the investor will require the use of the invested capital before enough profits are realized to meet that need. In the hypothetical simple economy without capital transfers, where the investment is self-financed, the investor must self-insure against such liquidity risks by leaving some accumulated capital in liquid, yet unproductive, assets. If he does not so self-insure and an unforeseen liquidity need arises, he must liquidate the productive investment opportunity. In either event,
capital is diverted from productive investment. The liquidity risks inhere even if the investor does not self-finance but seeks funds from other savers, because savers may require the use of the loaned capital before enough profits from the investment can be realized. The saver thus may choose to accumulate capital in unproductive liquid assets (if withdrawal restrictions are imposed on capital invested), or the investor must borrow more than necessary in order to self-insure against unpredictable withdrawal demands. Again, in either event, capital is diverted from productive investment to unproductive liquid assets.

Hence the need for financial intermediaries. Banks and other financial institutions accept deposits from a number of individual savers. As the number of depositors increases, their individual random liquidity needs become more predictable; the larger the number of depositors, the more predictable their withdrawal demands will be to the bank. Capitalizing on this operation of the rule of large numbers, banks can make long-term loans on short-term deposits. They hold assets (loans) that are less liquid than their liabilities (deposits). The predictability of withdrawal demands enables banks to hold less in unproductive liquid capital in anticipation of these demands, compared to the aggregate amount that individual investors must hold to self-insure against liquidity risks. Finally, by aggregating otherwise self-financed investments, banks prevent the abandonment or liquidation of projects by investors who face unexpected liquidity needs. "In short, an intermediation industry permits an economy to reduce the fraction of its savings held in the form of unproductive liquid assets, and to prevent misallocations of invested capital due to liquidity needs."16

The story told thus far assumes that financial intermediaries play a passive role in the economy—that they simply funnel savings to investment and do not contribute to the permanent growth path of the economy. Indeed, much of the early literature on economic development ascribed little, if any, role to finance in promoting or affecting real economic growth. "A magisterial history of the idea of economic development is bare of any references to the role of finance in development, a reflection of the state of the art rather than of any bias on the part of a studiously eclectic economist."17 Thus, even though

15. This steady-state analysis ignores, of course, the case of an unexpected run on deposits at the bank.
empirical data indicated a positive correlation between financial development and economic growth, observers were careful not to assume the answer to the chicken-or-egg question of whether financial development facilitated or followed economic growth. As a theorist of financial development candidly acknowledged, "Although a higher rate of financial growth is positively correlated with successful real growth, Patrick's (1966) problem remains unresolved: What is the cause and what is the effect? Is finance a leading sector in economic development, or does it simply follow growth in real output which is generated elsewhere?"

However, recent theory and evidence suggest that financial intermediaries, beyond passively channelling capital between savers and investors, play a more dynamic role in the process of capital formation and technological progress—the key determinants of economic development. At a basic level, by reducing the information, transaction, and monitoring costs associated with financial transactions, intermediaries increase the net rate of return to savers. To the extent that the amount individual households save corresponds with the rate of interest (that is, where the price elasticity of saving is greater than zero), improved intermediation increases savings and thus capital formation and economic growth.

More fundamentally, intermediaries select among new ideas and attempt to channel resources to those innovations which most enhance societal productivity, thus shifting the technological path upward and increasing real growth. Ideas and the entrepreneurs who undertake to translate ideas into productive output vary in quality. Because ideas make poor collateral and the ability of entrepreneurs is difficult to assess, evaluation of these investment opportunities is difficult, at times prohibitively so. Financial intermediaries screen these opportunities

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19. See GOLDSMITH, supra note 18, at 408-09.
21. This "new view" is actually an application of modern research methodology to theories championed by Joseph Schumpeter and others. See Robert G. King & Ross Levine, Financial Intermediation and Economic Development, in CAPITAL MARKETS AND FINANCIAL INTERMEDIATION 156, 156-59 (Colin Mayer & Xavier Vives eds., 1993).
22. See Boyd & Kwast, supra note 8, at 234; FRY, supra note 7, at 296.
and finance those investments that are most efficient, that is, those that have the highest expected improvements in productivity. The positive externalities attendant to such investments (in the form of, for example, firm-specific human capital) increase technological progress and thus have a long-term effect on real economic growth. Moreover, intermediaries may directly influence the behavior of firms by serving as providers of entrepreneurial and managerial skills, as the German investment banks did:

From their central vantage points of control, the banks participated actively in shaping the major—and sometimes even not so major—decisions of the individual enterprises. It was they who very often mapped out a firm's paths of growth, conceived farsighted plans, decided on major technological and locational innovations, and arranged for mergers and capital increases.

The theoretical analysis and historical observations have been buttressed by some empirical evidence. In cross-country studies, differences in economic growth can be explained in part by differences in financial development.

[T]here is a major positive effect on economic growth of increasing the size of the financial intermediation system: roughly one-third of the gap between very fast and very slow growing countries is eliminated by increasing the scale of the financial intermediation sector (from the mean in very slow growing countries to the mean in very fast growing countries).

Beyond being positively correlated with economic growth, financial development may actually play a causal role in promoting such growth. In a study of data from over eighty countries for thirty years (1960 to 1989), King and Levine confirmed the previously observed correlation between financial and economic development: "We find that higher levels of financial development are positively associated with faster rates of economic growth, physical capital accumulation, and economic

23. See King & Levine, supra note 21, at 159–60, 187.
efficiency improvements both before and after controlling for numerous country and policy characteristics." 26 More important, King and Levine reported that financial development correlates positively with growth and efficiency improvements in the future. "We find that the predetermined component of financial development is a good predictor of long-run growth over the next 10 to 30 years. Furthermore, higher levels of financial development are strongly associated with future rates of capital accumulation and future improvements in the efficiency with which economies employ capital." 27

Capital, of course, could flow from ultimate savers to ultimate investors more directly, through the operation of a securities market. In such a market, firms issue equity or long-term debt to disaggregated ultimate savers, usually on a formal exchange or over-the-counter clearing facilities. In order to participate in such a direct market, however, ultimate savers will need to evaluate the quality of the securities issued by the ultimate investor firms. The asymmetry of information between savers and investors in less developed economies thus prevents the efficient operation of a securities market, and financial intermediaries remain more effective in evaluating investments and allocating capital. 28

As companies become less "opaque" and the asymmetry of information between savers and investors decreases, the development of a securities market provides more flexibility in financing decisions. Companies with track records of creditworthiness can attract capital directly from savers, and the securities market provides the matching and clearing mechanism necessary for such direct transfers. The securities market also ameliorates the differential in liquidity needs between the savers and investing firms; savers who irrevocably contributed capital to the investor by purchasing a security could still meet unexpected liquidity needs by selling the security in the secondary market. By reducing the costs of intermediation, the development of a securities market facilitates capital formation. 29 Finally, because banks ration credit to borrowers below the market clearing equilibrium, 30 an equity market serves to ensure optimal allocation of capital. 31 Along with a

27. Id.
28. See White, supra note 11, at 103.
29. See Fry, supra note 7, at 341.
30. See supra note 12.
competitive intermediation system, a well-functioning securities market thus promotes allocative efficiency and contributes to economic growth.

That financial development promotes economic growth should not be surprising. Indeed, even before such a link had been developed in the extant academic literature, the World Bank and other international institutions advocated improvements in the financial sectors of developing countries as a means to promote growth.\(^{32}\) What is gained with the new learning, beyond intellectual appreciation of the role finance plays in development, is the ability to evaluate financial sector policies with reference to a policy objective at least commonly professed by developing countries—promoting economic growth. This theoretical framework provides the means to move beyond asking whether development of the financial sector is worthwhile to an assessment of what reforms should be undertaken in order to maximize the potential for economic development. I now turn to that task for Vietnam.

II. THE GOVERNMENT AND ECONOMY OF VIETNAM

A. The Progress of Doi Moi

Vietnam, with a current population of approximately seventy-six million,\(^{33}\) is formally structured as a Socialist Republic, or a "state of proletarian dictatorship."\(^{34}\) Prior to 1992, the unicameral National Assembly elected a collective executive body, the Council of State. A new constitution in 1992 abolished the Council of State and provided that a president be elected by and from the Assembly. The president, in turn, nominates a vice president, prime minister, chief justice of the Supreme Court, and head of the Supreme People's Inspectorate, all subject to approval of the Assembly.

The Communist Party, with over 2.1 million members,\(^{35}\) defines overall state policy. The Party Congress elects the Central Committee,

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32. See generally THE WORLD BANK, WORLD INVESTMENT REPORT 1989.

In the current reformist era, the label has become increasingly irrelevant:

When I asked a member of the Politburo what kind of government Vietnam had, he replied: "It's true that we are officially the Socialist Republic of Vietnam. But that is a matter of tradition. Labels don't matter anymore. It doesn't matter what we are called, it's what we do that will determine our future.

from which virtually all ministers and senior government officials are
drawn. The Central Committee elects its Politburo, which serves as the
primary policy-making organ of the Party. Between 1945 and 1995,
fewer than fifty persons have been full members of the Politburo. 36

At the Sixth Communist Party Congress in December 1986, Vietnam
began a program of reform and renovation, doi moi, to revitalize the
stagnant economy. The next two years were chaotic. The government
had abandoned its system of economic command and control, but did
not clearly adopt a replacement. Severe macroeconomic imbalances
ensued. The budget deficit swelled to ten percent of gross domestic
product. Savings were negative, and the value of exports was less than
half the import bill for 1988. 37 Inflation was well into three digits,
reaching 800% in 1988. 38

It was not until 1989 that Vietnam began a “[r]adical departure from
the old Stalinist-Maoist model of economic development.” 39 In March
1989, the government implemented a series of accelerated reform
measures. Official price controls were abolished for almost all goods
and services in the economy, and consumer goods sold through state
outlets were priced at the free market level. The dong was devalued
dramatically to bring the official rate in line with the prevailing market
rate. State enterprises were granted more autonomy, and official state
allocations and planning targets were abandoned. 40 The path toward
reform was sanctioned by the “watershed” Seventh Communist Party
Congress in 1991, 41 and the government drafted legislation designed
to facilitate the transition to a market economy. Among the newly
enacted legal reforms are the Civil Code, the Law on Private
Enterprises, the Company Law, the Law on Land, the Law on Foreign
Investment, and the Bankruptcy Law 42—all of which were promulgated
pursuant to the mandate of doi moi.

36. See id.
37. See Adam Fforde & Stefan de Vylder, Vietnam, in FROM CENTRALLY PLANNED TO MARKET
38. See id. at 359; John Kohut, DoiMoi Now for the Hard Part, ASIA, INC., May 1996, at 28.
39. NGUYEN M. HUNG, DOI MOI: THE INTERPLAY BETWEEN ECONOMICS AND POLITICS (forthcom-
ing 1997).
40. See Fforde & Vylder, supra note 37, at 357.
41. NGUYEN, supra note 39.
42. See Civil Code, Oct. 28, 1995 (Vietnam); Law on Private Enterprises, Dec. 21, 1990, as
amended July 7, 1994 (Vietnam); Law on Companies, Dec. 21, 1990, as amended July 1, 1994
(Vietnam); Law on Land, July 14, 1993 (Vietnam); Law on Foreign Investment in Vietnam, Dec.
29, 1987, as amended June 30, 1990 and Dec. 23, 1992 (Vietnam); Law on Business Bankruptcy,
Vietnam has also reorganized its bureaucracy to improve efficiency and curb corruption. Styled as an effort to "smooth the country's transition to a market economy," 43 Prime Minister Vo Van Kiet merged eight government bodies into three "super-ministries" in October 1995. The agriculture, water, and forestry ministries were combined into the Ministry of Agriculture and Rural Development. The heavy industry, light industry, and energy ministries were combined into the Ministry of Industry. Finally, the State Planning Committee and State Committee for Cooperation and Investment (SCCI), which was responsible for promoting and facilitating investments, were combined into the Ministry of Planning and Investment. The official explanation for this last change was "to improve the environment for foreign investors." 44 The new ministry is headed by the former head of the State Planning Committee, and the former chairman of the SCCI now heads the State Project Evaluation Council, which plays an advisory role with respect to major investment projects. 45

Vietnam's economy has responded favorably to this package of reforms. According to official statistics, the real GDP growth rate has steadily increased, and inflation, after peaking in 1988, has been under control. 46

The success of Vietnam's effort at economic reforms thus far has been met with enthusiasm by the world community. The International Monetary Fund (IMF) agreed to resume lending to Vietnam in October 1993, an announcement which led the World Bank and the Asian Development Bank to recommence their lending shortly thereafter. In 1995, the United States lifted its embargo on trade with Vietnam, in place since May 1975, and in doing so provided a major boost to Vietnam's effort to rejoin the international economy. Continuing its progress toward economic integration, Vietnam joined the Association of Southeast Asian Nations (ASEAN) in 1995, and is seeking admission to the Asia Pacific Economic Cooperation (APEC) forum.

Despite the economic progress, questions remain as to whether Vietnam can continue on its path of successful reform and development. Among the macroeconomic problems facing the country are


44. Jeremy Grant, Foreign Investment: Dissent in the Ranks, FIN. TIMES, Nov. 13, 1995, Survey, at II.


capital shortfalls, growing overseas debt, and a burgeoning current account deficit.\textsuperscript{47} Over fifty percent of the population still lives below the World Bank poverty level,\textsuperscript{48} and a growing income gap threatens to sidetrack reforms. Residents of Ho Chi Minh City, with an estimated per capita GDP between US$1000 and US$1600, enjoy a much higher standard of living than their rural counterparts, who produce less than US$200 per person;\textsuperscript{49} the growing differential has prompted official concern that “the present society is being divided into two opposite classes: an exploiting class and an exploited class.”\textsuperscript{50}

Additionally, legislative reforms to date have yet to establish an adequate legal infrastructure for development, one that is “predictable, transparent, and fair.”\textsuperscript{51} In theory, the new laws, which were drafted in broad terms, were intended to create a consistent, stable legal environment with the flexibility to accommodate the needs of

\begin{table}
\centering
\caption{Real GDP Growth and Inflation in Vietnam 1986–1995}
\begin{tabular}{|c|c|c|c|c|c|c|c|c|c|}
\hline
Year & 86 & 87 & 88 & 89 & 90 & 91 & 92 & 93 & 94 & 95 \\
\hline
Real GDP Growth (%) & 2 & 3 & 4 & 5 & 6 & 7 & 8 & 9 & 10 & 11 \\
\hline
Retail Price Index & 50 & 100 & 150 & 200 & 250 & 300 & 350 & 400 & 450 & 500 \\
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\end{tabular}
\end{table}

\textsuperscript{48} See Frank Gibney, Jr., \textit{A Tale of Two Worlds}, TIME, Feb. 5, 1996, at 12.
\textsuperscript{49} See Goodman, \textit{supra} note 34.
\textsuperscript{50} Id. (quoting Le Huu Tang, vice director of the National Center for Social and Human Services, Hanoi).
VIETNAM

particular localities. The decentralized structure of the Vietnamese government, which gives local governing bodies considerable discretion in the implementation of subordinate legislation, subscribes to this theory; within the broad framework of national laws, local governments can issue decrees to fill in the details. What actually results, however, is a legal regime comprising numerous decrees, many of which undermine the national law. Although the national government is attempting to implement coordinated administrative reform, it is still hindered by the decentralized government structure and “its reluctance to deprive party cadres of power and privileges.” The decentralized system also means inadequate oversight of administrative action. Local authorities abuse their positions in order to advance their own interests, raising corruption to systemic levels. To complicate matters, different levels of government pass different and at times conflicting decrees on the same issues.

The sheer volume of legislation also defeats the transparency and predictability that is necessary for an effective legal system, and resolving a legal issue often requires diligent tracking and reconciliation of various decrees. Even this effort can ultimately be frustrated by subsequent, contrary legislation at the highest levels of government. For example, in an attempt to discourage land speculation, a 1995 decree required non-governmental land users to pay “rent” on previously unregulated land without offering affected users any means of recourse. This type of remedial legislation, while effective at tending to immediate concerns, contributes to the uncertainty surrounding the system of legal rights. The collective inadequacies of the legal system have led to concerns that much of the economy will shift to informal sectors.

52. Directive No. 833/TTg on Elaborating the Implementation of the Civil Code (Directive No. 833) instructs the Ministry of Justice to prepare a list of laws, ordinances, and other legal documents and ensure that all legislation is consistent with the Civil Code of 1985. Similar directives were given to other ministries, central and local authorities. See Frank Meier, Preparing to Implement Vietnam’s New Civil Code, E. ASIAN EXEC. REP., May 15, 1996, at 21.

53. NGUYEN, supra note 39.


56. See Decree on Rights and Obligations of Domestic Organizations with Land Allocated or Leased from the State, No. 18-CP, Feb. 13, 1995 (Vietnam).

57. See Gillespie, supra note 55, at 334.
It remains unclear how much further these reforms will go. Since the introduction of *doi moi*, Vietnam has been struggling with the tension between a market-oriented economy and command and control policies. Many of the legal reforms are predicated upon ideas, such as the recognition of property and commercial rights, which challenge traditional Communist ideology. Hardliners continue to insist on a dominant state role in determining future economic development. "[W]hile the government has been working to downsize SOEs [state-owned enterprises] from some 12,000 in 1990 to about 7,000 today, the results so far have been to eliminate many small ones rather than the 300 or 400 that form the backbone of Vietnam's light and medium industries, manage its transportation infrastructure and power grid, and control all of its oil and gas resources." Indeed, despite the public attention to the rise in private enterprise in Vietnam, the state sector has actually increased its share of GDP. The contribution to GDP from state-owned enterprises has grown from 7,646 to 16,980 billion *dong* (at a 1989 constant price) between 1985 and 1995, compared to private sector increases from 16,704 to 26,817 billion *dong* in the same period.

The signals of retrenchment from economic reforms are at times explicit. When President Clinton lifted the U.S. embargo on trade with Vietnam in 1995, he called for political reforms: "I strongly believe that engaging the Vietnamese on the broad ... front of economic reform, and the broad front of democratic reform, will help to honor the sacrifice of those who fought for freedom's sake in Vietnam." And when then-Secretary of State Warren Christopher visited Hanoi to open the American embassy, he called on Vietnam to "move beyond just opening doors" and guarantee economic rights and civil liberties. Responding to these open calls for democratic reform and the internal push for further economic liberalization, the government instituted a campaign denouncing "cultural pollution" and the "social

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58. See generally NGUYEN, supra note 39.
59. See id.
60. See The Power Monopoly of Vietnam's Communists, SWISS REV. WORLD AFF., July 1, 1996.
61. Goodman, supra note 34.
63. *Quote to Note on Extending Ties with Hanoi*, J. COMM., July 14, 1994, at 3A.
VIETNAM

TABLE 2
CONTRIBUTIONS TO VIETNAM'S GDP
BY STATE-OWNED AND PRIVATE ENTERPRISES
1985–1995
(in billion 1989 dong)

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"evils" caused by foreign interests.65 Leading up to the Eighth Party Congress, an official report vowed that the country will not "stray onto the capitalist path" and recommended that the state sector increase its share of GDP to sixty percent in the next twenty-five years.66

The Eighth Party Congress, held in late June 1996, failed to resolve the tension between reform and retrenchment. The top three officials, mixed in attitudes toward reform, retained their posts at the top of Vietnam's political hierarchy. The size of the Politburo was expanded, and the number of members with military backgrounds increased from four to six.67 By opting for the status quo of cautious reforms, Vietnam continued to duck the fundamental question facing its future: can capitalist economics coexist with communist rule?68

68. See The Power Monopoly of Vietnam's Communists, supra note 60.
B. Capital Formation in Vietnam

A central component of the move toward a market economy, at least in certain sectors, is the formation of capital necessary for productive investment. As Vietnam's Minister of Finance recognized:

First and foremost, we have to formulate policies and work out measures for mobilizing capital for development investment . . . . To this end, we should adopt policies and take measures to attract investment, practice economy, clear obstacles on all channels for capital mobilization, establish and develop a capital market and diversify instruments for capital mobilization.\textsuperscript{69}

Until recently, Vietnam's capital formation focus has been directed almost exclusively at foreign direct investment.\textsuperscript{70} With the introduction of doi moi, Vietnam established the SCCI, a ministry-level department charged with promoting, approving, and regulating foreign investment. Indeed, the first major legislative initiative of doi moi, even before laws providing basic commercial rights, was the Law on Foreign Investment in Vietnam, which opened with the following invitation:

The State of the Socialist Republic of Vietnam welcomes and encourages foreign organizations and individuals to invest capital and technology in Vietnam on the basis of respect for the independence and sovereignty of Vietnam, observance of Vietnamese laws, equality and mutual benefit.\textsuperscript{71}

Up through 1995 foreign investors responded favorably to the government's overtures, as the number of projects approved and their total dollar values steadily increased.\textsuperscript{72}

This picture, however, does not tell the whole story. A considerable gap exists between the approval of projects and actual commitment of capital: of the approximately US$22 billion in foreign investments approved, only twenty percent have been disbursed.\textsuperscript{73} Further, the government has recently adopted negative rhetoric toward foreign


\textsuperscript{70} See Nick Freeman, Choosy Before Final Lift-off, BANKER, Feb. 1994, at 53.

\textsuperscript{71} Law on Foreign Investment in Vietnam, supra note 42, art. 1.


\textsuperscript{73} See Balfour & Barnathan, supra note 66, at 45.
influence, thereby discouraging investor interest in Vietnam, already considered to be the riskiest and most stressful place to do business in Asia.\textsuperscript{74} Approvals for foreign projects at the end of May 1996 had fallen forty-eight percent from a year earlier,\textsuperscript{75} and the Ministry of Planning and Investment forecasts that pledges of new foreign investment will drop ten percent in 1996, from US$6.6 billion to US$6 billion.\textsuperscript{76}

Vietnam's heavy reliance on foreign direct investment as the solution to capital formation problems hinders the economic development process. Such reliance exposes the country to risks of macroeconomic shocks resulting from external economic conditions or a decline in foreign investor confidence.\textsuperscript{77} At a fundamental level, economic growth depends on the effective mobilization of domestic savings for investment. "The importance of mobilizing savings in the context of overall developments in the world economy is self-evident."\textsuperscript{78} The empirical evidence is clear that "everywhere national saving provides the bulk of

\textsuperscript{74} See Vietnam: Realism Reigns, supra note 47.
\textsuperscript{75} See Balfour & Barnathan, supra note 66, at 45.
\textsuperscript{76} See Vietnam: Realism Reigns, supra note 47.
resources for investment,"79 and thus national saving in developing countries must finance the majority of the increase in domestic investment.80

Vietnam appears to have appreciated the need to move beyond reliance on foreign direct investment in the capital formation process. On June 22, 1994, the National Assembly enacted the Law on the Promotion of Domestic Investment

[i]n order to mobilize and utilize effectively sources of capital, natural resources, labour, and other potential of the country for the purposes of economic and social development and making Vietnam a wealthy and strong country and its society fair and civilized.81

The law provided that the State will protect and encourage private investment by Vietnamese residents and organizations, overseas Vietnamese, and foreigners who are permanent residents of Vietnam.82

The rate of domestic capital formation has steadily increased in the past decade.83 In pursuit of its new focus on domestic capital, Vietnam has announced that it plans to raise US$20 billion in the next five years in domestic investment—a figure roughly equal to the country's annual GDP.84 Although Vietnam is unlikely to achieve this aggressive goal, it is certain that any substantial progress for Vietnam's capital formation efforts depends in large part on Vietnam's ability to develop its financial sector.85

III. REGULATION OF BANKING SERVICES
A. The Banking Industry

Financial reforms under doi moi, codified in several 1990 ordinances, established a two-tiered banking system. Vietnam's central bank, the State Bank, is comparable to the central banks of other countries and is

79. Maxwell J. Fry, National Saving, Financial Saving and Interest Rate Policy in Asian Developing Economies, in SAVINGS FOR DEVELOPMENT, supra note 78, at 29, 29.
80. See id.
82. See id. art. 1.
83. See Balfour & Barnathan, supra note 66, at 45.
84. See id.
85. With respect to Vietnam, "a country where cashing a check is practically impossible, most experts think that goal [$20 billion in domestic investment over five years] is pie-in-the-sky." Id.
charged with "managing money, credit, and banking operations throughout the country in order to stabilize the value of money." It is prohibited from lending directly to any enterprise, agency, economic organization, or private person. Instead, the State Bank oversees the second tier of banking services—the commercial banks that engage in direct lending. In this regulatory capacity, the State Bank grants and revokes operating licenses, issues regulations, and acts as a clearinghouse for credit institutions. Along with the Ministry of Finance, the State Bank is also responsible for the organization of Vietnam's ambitious plans for a stock exchange.

The Ordinance on Banking, Credit Cooperatives, and Financial Companies governs the operation of banks in the commercial tier: state-run commercial banks, equity commercial banks (or share banks), joint venture banks, and foreign banks. The Ordinance also authorizes and regulates credit cooperatives, other financial companies, and the Investment and Development Bank, a state bank which facilitates investment in priority sectors. The commercial banking system remains dominated by the state-run banks, largely because the State Bank gives preferential treatment to the state-owned commercial banks, and foreign or joint venture banks are limited by regulatory constraints. According to official figures, the four state-owned commercial banks accounted for seventy-seven percent of deposits and eighty-nine percent of loans in 1989, and the World Bank estimates that they "accounted for nearly ninety percent of total assets held by deposit money banks."  

Besides the four state-owned banks, approximately fifty joint stock banks and three foreign joint venture banks currently operate in Vietnam. Additionally, there are a substantial number of foreign banks with a permanent presence in Vietnam. A recent survey reported seventy foreign bank representative offices and twenty-two approved (licensed) branches. Since 1995, when the United States lifted its trade embargo, foreign bank activities have increased, and, by one estimate, foreign banks now hold a fifteen percent share of the national
The competition arising from the joint stock and foreign banks has transformed the commercial banking industry, partly by improving the technology of services. Nevertheless, foreign banks are rather limited in their permitted operations. Foreign and joint venture banks are subject to minimum capital requirements of US$15 million and US$10 million, respectively. In order to break even with the required $15 million capitalization, the industry standard for total bank assets is approximately US$200 million, compared with US$100 million in Singapore. However, foreign and joint venture banks can only accept Vietnamese dong deposits to the extent necessary to offset dong loans, and then not to exceed twenty percent of the bank's capital. As a result, most foreign and joint venture banks operate in the realm of trade finance.

Foreign bankers twiddle their thumbs while trying to make a profit as commission agents on foreign exchange, remittances, letters of credit, and occasionally financing commodity trades in rice, seafood, coffee, and oil. But the banks' real business of lending money has been blocked by Hanoi's reluctance to see state-owned assets falling into foreign hands.

To the extent that foreign banks are involved in domestic investment projects, they end up competing for the same promising state industries with good foreign exchange earning prospects, such as petrochemicals and telecommunications.

Finally, banking services are also provided by a network of small institutions, formally established as credit cooperatives. There are reportedly more than 7500 credit cooperatives operating in rural areas, with total assets of about 90 billion dong. More recently, urban credit cooperatives, or "people's credit funds," have also begun operation. At the beginning of 1990, there were about 300 urban credit cooperatives, accounting for approximately 400 billion dong in deposits.

93. See id.
94. See Nick Freeman, Going for a Dong, BANKER, Jan. 1996, at 33.
96. See id.
98. See Fforde & Vylder, supra note 37, at 367.
99. See id. at 368.
B. Obstacles to Efficient Banking Services

Not surprisingly, the commercial banking sector, dominated by the state-owned banks, is "attuned to serving large public conglomerates rather than the needs of the private sector." In 1989, state enterprises received ninety percent of all commercial loans. While private sector lending has tripled in the past three years, state companies still account for more than sixty percent of total bank credit. And although the commercial banks are chartered to operate for profit, the state-owned banks are often required to extend credit to state-owned enterprises at a low interest rate. In an attempt to offset the losses incurred by the extension of these credit subsidies, they charge higher interest rates to other, potentially more profitable enterprises. Moreover, such cross-subsidization raises doubts about the true value of the banks' assets—the actual worth of outstanding loans. As state enterprises fail, loan defaults and non-repayments have become a significant problem. As of August 1996, Vietnam's commercial banks were facing debts from overdue credit loan payments totaling 2,112 billion dong (approximately US$20 billion), a twenty-nine percent increase over the previous year. According to World Bank estimates, the value of the state-owned commercial banks' portfolio of bad debts exceeds their capital assets and reserves; writing off these loans would render the banks bankrupt.

Required to carry the bad loans of state-owned enterprises, the banks are able to provide less intermediation to the capital formation process. Moreover, the banks' cross-subsidization of state-owned enterprises through lending practices defeats a primary contribution financial intermediation makes to economic development—the efficient allocation of capital to enterprises with the highest productivity enhancing potential:

[T]he inherited stock of bad loans is directly distorting the allocation of credit and indirectly impeding improvements in

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100. VN Is 'Underbanked'? supra note 90.
101. See Fforde & Vylder, supra note 37, at 371.
102. See Cooke, supra note 3.
103. See id.
104. See Fforde & Vylder, supra note 37, at 367.
allocative efficiency. Banks are issuing credit to troubled firms to help them pay wages and service old debts and are not establishing business relations with emerging private firms as aggressively as might occur in the absence of a large stock of bad loans. Furthermore, the unresolved state of old debts, their potential seniority to new debts, and the difficulty old debts introduce in attaching secure collateral claims for new loans hinder efficient capital allocation. Finally, the large stock of bad loans retards improvements in capital allocation by slowing the pace of bank privatization, thereby delaying enhancements in incentives and the importation of foreign expertise through joint ventures. Indeed the inability of banks to make sound credit decisions could impede transition and contribute to a decline in economic activity. 107

A number of options are available to resolve the bad debt problem facing the state-owned banks—none of them, unfortunately, attractive. 108 But, as in Eastern Europe and other transitional socialist countries, "the existing bad debt problem must be confronted, and resolving the bad debt problem in a cost effective way should assist the formulation of forward-looking financial sector reforms focused on creating a healthy and secure domestic financial system over the next years." 109

Another major problem facing bankers is the unpredictability of government regulations. The State Bank announced in July 1996 that it would seek to tighten control over the commercial banking industry in an effort to "synchronize" macroeconomic policies in banking. 110 It remains unclear what regulatory changes the government would pursue in its effort to tighten the reins on the industry and what policies it would seek to synchronize and control. More fundamentally, however, current policies and regulations remain an obstacle to an effective banking system.

At a very basic level, the property rights regime remains anathema to the extension of credit to domestic enterprises. The 1993 Law on Land provides that all land belongs to the people but is administered by the

108. See id. at 20–21.
109. Id. at 20.
State. Land-use rights are inadequate as property interests given the unpredictability of government policies affecting such rights; a 1995 government decree, for example, declared that the authority to allocate land for use other than in agriculture or forestry would be limited to the authority to lease such land from the state. As a consequence, local businesses would no longer be granted the valuable certificates of land-use rights. Many businesses are thus deprived of a major asset, and banks are less willing to extend loans without adequate collateral. Moreover, there is inadequate protection for creditors when debtors default. Despite the adoption of a well-drafted bankruptcy code, there remains a lack of regulations to implement and enforce the legislation. Finally, the lack of an effective, uniform auditing system retards the ability of potential lenders and investors to assess the value and creditworthiness of domestic enterprises.

Development of the banking industry is further hindered by the industry’s inability to attract deposits. To start, banks face a relatively low domestic savings rate. Soaring inflation in the early 1980s, at times in the three digit range, often yielded negative real rates of interest and retarded saving incentives. Those who did save substituted away from the official dong toward more stable currencies and hard media of exchange, such as the dollar and gold, which trade outside of the formal banking system. Past inefficiencies also contributed to the severe distrust in banking institutions. For a period in the 1980s, state banks refused to honor deposits. In 1989, the system of

111. See Law on Land, supra note 42, art. 1.
112. See Decree on Rights and Obligations of Domestic Organizations with Land Allocated or Leased from the State, No. 18-CP, Feb. 13, 1995 (Vietnam).
114. As observers note, “collecting and foreclosing on collateral is a nightmare. For example, a banker must petition the state for permission to seize an asset after a default occurs.” Balfour, supra note 106, at 50.
115. See Law on Business Bankruptcy, supra note 42.
118. See VN Is ‘Underbanked’?, supra note 90.
119. See Fforde & Vylder, supra note 37, at 349, 352.
120. “The high level of inflation, its wide magnitude of fluctuation, the persistent budget deficits, the lack of financial and capital markets, and a distrust of the formal banking system may be the main reasons behind the use of US dollars and gold for transaction purposes as well as savings purposes.” Ngo Huu Duc, Currency Substitution in a Developing Economy with Special Reference to Vietnam (1995) (unpublished manuscript, on file with Law and Policy in International Business).
credit cooperatives collapsed, as many of these cooperatives were mismanaged and some were outright pyramid-scheme frauds. Scandals involving the cooperatives triggered runs on deposits which left many cooperatives, along with some 2000 small private enterprises, bankrupt. Following the crash, the State Bank imposed minimum reserve requirements and other regulatory reforms. Although the distrust of banks has slowly begun to dissolve as reforms take hold, only four to five percent of Vietnamese make use of consumer banking services, and one-third of them are bank employees.

The paucity of deposits and the crowding out of loan capital by favored state-owned enterprises leave few bank funds available for investment in small and medium-sized enterprises. A study of the non-food packaging industry, for example, concluded that “a lack of capital to buy new machinery” was behind the small size and slow growth of the industry. Likewise, much of the work in the construction industry is undertaken by manual labor because there is a lack of capital to purchase equipment. The problem affects even state-owned enterprises. According to the director of Viha, a bicycle manufacturer, “We could produce more than our current output of about 20,000 bicycles a year, but we haven’t had the capital to expand.”

A survey of small and medium-sized businesses in Vietnam demonstrated that bank credit was not readily available. “Bureaucratic red-tape, mortgages and distrust between Vietnamese banks and businesses pose obstacles in use of bank credit to expand small and medium enterprises in Vietnam.” Thirty-five percent of companies said they were not given the credit they sought, and fifty percent responded that the bank credit they received was not enough. In short, “[b]ank credits do not account for major shares in the operating capital of the

121. See Fforde & Vylder, supra note 37, at 368.
122. See id.
128. Id.
VIETNAM

One alternative source is the informal credit market. Although the size of the non-bank financial sector is presumed to be large, little information is available about it. As of April 1996, it was estimated that thirty-five percent of the total payment volume of the economy existed outside of the formal banking system. One estimate holds that Vietnamese are still hoarding up to US$10 billion in gold (about US$140 per person). And unofficial estimates suggest that between two and five billion U.S. dollars are in circulation in Vietnam, as compared to foreign deposits in banks ranging from US$500 million to US$700 million between 1989 and 1993.

At first blush, the existence of a large informal financial sector may not be a cause of concern; indeed, it may even give reason to be optimistic. If the formal financial sector is, as in Vietnam's case, "underdeveloped, overregulated, and noncompetitive," then the operation of a more competitive and agile informal sector serves to meet the financial intermediation requirements of economic growth. Indeed, to the extent that repressive banking regulations and financial policies drive more money to the informal sector, liberalization of restrictions on the formal sector may actually hinder a country's short-term economic progress. That is so because liberalizing policies, such as eliminating interest rate ceilings and promoting competition among banks for depositors, may have the effect of drawing capital away from the dynamic informal sector into the more sluggish banks.

Upon closer examination, however, the existence of a large informal credit market should give pause. First, the informal sector does not

129. Id. According to a World Bank official in Hanoi, there is a "huge demand" for medium and long-term financing among private enterprises, "but the domestic financial system just isn't generating enough." Balfour, supra note 106, at 50.
130. See Fforde & Vylder, supra note 37, at 373.
131. Vietnam Upgrades Payment System, ASIAN BANKER, Apr. 1996. The payment volume, however, is increasing rapidly, by an estimated 50% per year. Id.
133. See Duc, supra note 120, at 2.
136. See Cho, supra note 6, at 478.
137. See Sweder van Wijnbergen, Interest Rate Management in LDCs, 12 J. DEV. ECON. 433 (1983).
138. There may exist a core informal finance sector that is "autonomous" rather than "reactive," that is, whose existence is independent of conditions in the formal sector. See
provide greater intermediation than banks. The argument that the informal sector is more dynamic than banks rests on the assumption that informal lenders hold no reserve funds, or less than the reserve levels required of commercial banks. In fact, as the model set forth in Part I explained, all financiers—self-financiers and informal financiers included—face a differential in liquidity needs between savers and investors. To assume that informal lenders do not hold reserves to meet normal liquidity demands is to assume that they do not provide a core service of financial intermediaries—pooling small deposits into larger loans necessary for productive investment. To the extent that formal intermediaries are better bearers of liquidity risks through the operation of the law of large numbers, they provide more intermediation than informal lenders. Moreover, the informal sector does not operate within the umbrella of protection provided by applicable laws. The additional exposure to loss in the event of bankruptcy or default will require informal lenders to hold even higher reserves and thus provide less intermediation. In any event, to the extent that formal reserve requirements are excessive—that is, they are higher than the minimum necessary to insure for normal liquidity risks and thus repress the level of intermediation—the answer lies in adjusting the reserve requirements, not in driving money out of the system.

Moreover, the informal sector is less efficient at allocating capital to the most productive investment uses. That is so because the informal lenders have a smaller information base than commercial banks. Informal lenders may operate within only limited geographical areas and thus have access to fewer investment opportunities. For those opportunities that are available, there is potentially less information because the data is gained through private networks and not through formal application and disclosure requirements. Finally, because of their limited size and scope, informal lenders are less likely to invest in gathering information or in developing expertise to evaluate applications and monitor loans.

The existence of a large informal credit and currency market in Vietnam should therefore serve as a wake-up call. Although such an

Chandavarkar, supra note 17, at 135. Because such autonomous informal finance, by definition, serves a market unexploited by formal intermediaries, it is beneficial to the capital formation process.

139. See generally supra Part I.
140. See Cho, supra note 6, at 478.
141. See id.
informal sector develops naturally in order to meet the excess demand for intermediation services created by the inadequate system of commercial institutions, it is a poor substitute for a well-developed and properly regulated formal financial sector. Informal lenders alleviate the credit crunch caused by inadequate banking services, but they do not provide the essential elements of the link between financial and economic development—effective intermediation services and efficient allocation of accumulated capital.

IV. DEVELOPMENT OF A SECURITIES MARKET

The development of a market for securities is not generally seen as critical for a country in the early stages of economic development. Under the framework set forth in Part I, in a market with highly imperfect information, financial intermediaries are better equipped to specialize in evaluating investment opportunities and allocating capital than individual investors are. Thus, the banking sector is "the only organized capital market in most developing countries."  

Such attention to intermediated finance to the exclusion of securities markets, however, may not be the optimal policy to ensure efficient allocation of capital and promote economic growth. Because banks ration credit, mere liberalization of banking restrictions may not be enough: "In a credit market with imperfect information, liberalization of the banking system from interest rate ceilings and other government interventions would not, by itself, be sufficient to achieve full efficiency, though it may partially improve it." Moreover, a securities market would play an important role in the effort to privatize (or equitize, as officials put it) Vietnam's state-owned enterprises. Finally, development of a securities market may also directly encourage capital formation by attracting more foreign capital seeking portfolio investments in the country. As of February 1995, the five internationally-listed Vietnam investment funds, capitalized at over US$279 million, had invested only US$43 million, or 15.4% of their portfolios, directly in Vietnam.  

At least in public statements, Vietnam's leaders have emphasized the need to develop a well-functioning securities market. The former

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143. See supra text accompanying notes 15-31.
145. Id. at 198; see supra note 12.
146. See ING BARINGS, INDOCHINA COUNTRY FUNDS REVIEW (1996).
Minister of Finance recognized that Vietnam should "issue government bonds and enterprise bonds and shares; and form a stock exchange market so as to address in a timely manner the relations between supply and demand in capital and pull in as much capital as possible."\textsuperscript{147} As a State Bank official explained, "[s]uccessful businesses are in need of capital to further increase their efficiency."\textsuperscript{148} Although capital has been mobilized through such devices as savings funds, government bonds, and time bonds, these methods are "too primitive, too simple and too low for a capital market," and a stock market is necessary to meet long-term capital needs.\textsuperscript{149} This recognition was repeated as recently as November 1995 by the Prime Minister in a speech to the National Assembly: "Our capital markets are still too primitive. We have been too slow in the equitisation of state companies as well as in the establishment of a stock market."\textsuperscript{150}

A. The Market for Equities

Plans for an equities market have been underway since November 1990, when the deputy chief of Ho Chi Minh City announced the first steps toward developing a stock exchange,\textsuperscript{151} anticipated to open in the following two to five years.\textsuperscript{152} This estimation turned out to have been overly optimistic, however, and officials now acknowledge the reality that Vietnam will not have a stock market until the year 2000 at the earliest, and possibly not until 2005.\textsuperscript{153}

Although a National Securities Commission to oversee the future stock exchange has been established,\textsuperscript{154} regulations concerning the issuance of public shares, share insurance, the establishment of brokerage firms, and the activities of share brokers have yet to be created.\textsuperscript{155}

\textsuperscript{149} \textit{Id.}
\textsuperscript{150} Cooke, \textit{supra note 3}, at II.
\textsuperscript{152} See \textit{id}.
\textsuperscript{153} See \textit{Stock Market Struggles to Take Off}, \textit{BUS. VIETNAM}, Sept. 1996.
In addition, the expert personnel necessary for the operation and regulation of the exchange must be trained.\textsuperscript{156}

Beyond administration, development of a stock market faces a more fundamental problem: there are too few stocks. There is an "ideological unwillingness on the part of some in authority to sell off state enterprises."\textsuperscript{157} Many of these enterprises provide social services such as housing, education, and "an ability to employ more workers than required."\textsuperscript{158} Questions about land-use rights and asset evaluation have also hindered the privatization process.\textsuperscript{159} As of October 1996, the government had privatized (or equitized, in the official description designed to appease socialist conservatives) only six of some 6,000 state-owned enterprises.\textsuperscript{160} Vietnam recently offered tax incentives for firms to privatize, and as many as one hundred enterprises have responded and are now in line for equitization.\textsuperscript{161} In addition, while privatization has been purely voluntary for state managers, the government has directed various localities and ministries to equitize "at least 10 state-run businesses each" by the end of 1997.\textsuperscript{162} Until such privatization occurs, there is simply a dearth of companies to be listed on an equity market, since the state still owns the bulk of large enterprises in Vietnam.

A future exchange could, of course, list private companies. Private enterprise, however, still faces strict regulation.\textsuperscript{163} The Law on Private Enterprises, enacted in 1990, allows citizens to engage in private


\textsuperscript{157} \textit{VN Is 'Underbanked'?}, supra note 90. Rather than turn toward privatization, the government of Vietnam has instead backtracked and stated that the contribution of the cooperative and state sectors should be raised to 60% from the current level of about 45%. In addition, the government has even urged the creation of Communist Party cells within private enterprises and foreign joint venture operations to ensure overall control over the economy. \textit{See Stock Market Struggles to Take Off}, supra note 153.

\textsuperscript{158} \textit{Hanoi Refuses to Let Go}, BUS. VIETNAM, June 1996.


\textsuperscript{160} \textit{See ING BARINGS, VIETNAM REVIEW} 38 (OCT. 1996).

\textsuperscript{161} \textit{See Stock Market Struggles to Take Off}, supra note 153.

\textsuperscript{162} Id.

commercial activities, subject to a number of restrictions.\textsuperscript{164} For example, sole proprietorships seeking to engage in a number of activities must first seek the approval of the Prime Minister.\textsuperscript{165} Vietnam's Law on Companies,\textsuperscript{166} (202) enacted in December 1990, also restricts "an otherwise promising private sector."\textsuperscript{167} Following the French model, the law provides for two types of companies, the "shareholding company" (SA) and the "limited liability company" (SARL).\textsuperscript{168} Neither of these types (nor the Private Business Enterprise) is open to foreign investors.\textsuperscript{169}

The SA is the more important corporate form for the contemplated equity market because its shares are freely transferable.\textsuperscript{170} Currently there are about one hundred large Vietnamese enterprises formed as SAs, mostly in the South.\textsuperscript{171} The SAs face a number of restrictions that impede movement toward the establishment of an equities market, "reflecting a policy focused more on control of private enterprise than on the promotion of growth and development."\textsuperscript{172} The minimum capital requirement requires SAs to maintain specific levels of legal or paid-in capital.\textsuperscript{173} Founders of SAs must own a minimum of twenty

\begin{itemize}
\item \textsuperscript{164} See Law on Private Enterprises, \textit{supra} note 42, art. 1.
\item \textsuperscript{165} See id. art. 5. The article provides:

The approval of the Prime Minister of the Government is required for the establishment of private enterprises which propose to conduct business in the following areas and occupations:

1. Manufacturing and distribution of explosives, poison, and toxic chemicals.
2. Mining of certain precious minerals.
3. Production and supply of electricity and water on a large scale.
4. Manufacture of information transmitting facilities, postal and telecommunication services, broadcasting, television, and publication.
5. Ocean shipping and air transportation.
6. Specialist export and import business.

\textit{Id.}
\item \textsuperscript{166} See Law on Companies, \textit{supra} note 42.
\item \textsuperscript{167} Thuyet, \textit{supra} note 163, at 563.
\item \textsuperscript{168} See Law on Companies, \textit{supra} note 42, art. 2.
\item \textsuperscript{169} See Thuyet, \textit{supra} note 163, at 563–64.
\item \textsuperscript{170} See Law on Companies, \textit{supra} note 42, art. 30(4).
\item \textsuperscript{171} See Thuyet, \textit{supra} note 163, at 564.
\item \textsuperscript{172} \textit{Id.}
\item \textsuperscript{173} See \textit{id.} at 564–65. The Law on Companies provides that "charter capital shall be no less than the legal capital stipulated by the government." Law on Companies, \textit{supra} note 42, art. 15(2). The law thus leaves the establishment of required "legal capital" to the discretion of the government bureaucracy.
\end{itemize}

886
percent of their SA's total share value. And the law requires SAs to wait two years before issuing bonds or debentures, thus effectively preventing initial leveraged financing except by project financing with financial intermediaries.

Still other regulatory impediments discourage investment and incorporation. "A recent survey of domestic investors' perception of impediments to investment reveals that bureaucratic regulations, the legal system, and corruption are three of the five most serious obstacles to investment." While administrative regulations affect both foreign and domestic investors, "Vietnamese investment policy is inherently biased against domestic private investors." Administrative regulations in the corporate approval process, with their detailed nature and multiple steps, can stretch what is supposed to be a two-month process into as much as a year. The cumulative effect has been to drive businesses to operate outside the law, in the informal sector composed of approximately 300,000 "household business units."

Thus, the professed desire of Party leaders for a stock market will go unmet unless Vietnam is committed to significant changes in its laws and administrative practices. The administrative obstacles to the development of a stock market, while formidable, are surmountable. Fundamental reforms pertaining to corporate structure, governance, and activities must progress in order to facilitate private enterprise and corporate growth. There can be no market without stocks, and there are no stocks without successful business enterprises. With the passage of the Company Law, Vietnam has taken the initial, hesitant steps toward developing a corporate sector, and further reforms will con-

174. See Law on Companies, supra note 42, art. 36. Rather confusingly, the law refers to these instruments as "shares." Id.

175. See Thuyet, supra note 163, at 565. The Vietnamese government is currently drafting amendments to the existing Company Law in order to address some of these concerns. Current proposals, for example, would streamline the formation and incorporation process, permit some foreign ownership of shares, and eliminate the temporal restriction on the issuance of debt. The proposed revisions would also provide a comprehensive framework of corporate governance rules which would increase investor confidence and promote the use of the shareholding company form as a means of attracting investment capital. See Proposed Company Law, 5th draft (on file with the author).

176. Id. at 567. The other impediments noted in the survey were lack of financing and export difficulties. See id. at 567 n.117.

177. Id.

178. See id. at 568 (describing the process of applying for corporate approval).

179. See id.

180. Id. at 543.
continue to facilitate the development of an effective and well-functioning equity market. 181

B. Debt Securities

A securities exchange would also facilitate the emerging market in Vietnamese bonds. The performance of initial bond offerings has been sporadic thus far, and although the bonds are technically transferable, there is currently no mechanism to facilitate market transfers of these debt securities in secondary trading. 182

Three types of bonds are currently permitted by law: state-owned enterprise bonds, government bonds (T-bills), and state-owned commercial bank bonds. 183 Although technically both formerly state-run "equitized" companies and SAs may issue bonds, the process for approval is arduous. 184 Although Vietnam permits the issuance of bonds in foreign markets, so far only one enterprise, the formerly state-owned Refrigeration Electrical Engineering Company, has issued bonds to international investors. 185 The State Bank has postponed its inaugural Eurobond issue on the advice of the World Bank. 186 Thus, as a practical matter, only a few types of bonds are available to investors: state T-bills, bonds issued by state-owned or privatized companies, municipal bonds (although there has been only one such issue thus far by Ho Chi Minh City), and various bonds and certificates of deposit issued by state-run commercial banks. 187 Even these issues, however, are highly restrictive and have encountered a number of problems.

The organization of bidding for treasury bonds was addressed by the

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181. See supra note 175.


185. See Adam Schwarz, Another First: For Vietnam, a Milestone Bond Issue, FAR E. ECON. REV., Aug. 29, 1996.


187. See ING BARINGS, supra note 160, at 42.
governor of the State Bank in a 1995 decision. Bidding on treasury
bills is limited to financial institutions (including insurance companies,
insurance funds, and investment funds) with a minimum legal capital
of twenty billion dong. Bidders must also be approved by and registered
with the State Bank. For the most part, state-run banks and joint stock
banks have purchased the lion’s share of treasury bills, with foreign
banks and joint venture banks bidding only sporadically and success-
fully bidding even more rarely.

Vietnam also permits the issuance of international bonds. However, Vietnam’s large international debt (including unsettled debts with Russia for Soviet-era loans), inadequate foreign exchange reserves, and the lack of a sovereign debt rating have inhibited the issuance of international bonds. In August 1996, Refrigeration Electrical Engineering Company, a state company successfully equitized in 1993, issued convertible bonds to institutional investors in North America and Europe. The issue was labeled “experimental” by Ho Chi Minh City officials, and bureaucratic hurdles facing such bond issues “remain formidable.” The company had to secure permission from the local government of Ho Chi Minh City, the Ministry of Finance, and the Prime Minister.

Although it permitted the bond issue, the government “continues to harbor doubts about relinquishing control over state enterprises as well as having foreigners buy into them.” Government approval of the bonds was subject to several restrictions concerning their eventual conversion into equity. First, foreign shareholders will not be repre-
sented on the board and cannot vote on board members. Second, the total foreign shareholding in the company may not exceed twenty-five percent; should revenues decline and the bonds convert into more

189. See ING BARINGS, supra note 160, at 42.
192. See id.
193. The company’s revenues jumped US$19.9 million last year, a five-fold leap from 1993, and profits more than tripled to US$1.5 million over the same period. See Schwarz, supra note 185.
194. See id.
195. Id.
196. See id.
197. Id.
than twenty-five percent of outstanding shares, a portion of the bonds
will be repaid in cash to keep foreign shareholding below twenty-five
percent.\textsuperscript{198}

V. PROSPECTS FOR FINANCIAL SECTOR REFORM

Vietnam has considerable distance to cover on the road toward
developing a viable financial sector—an important, if not essential,
factor in sustained economic growth for the country. The commercial
banking industry is dominated by a small number of state banks, and
stringent regulations prevent other institutions, foreign and domestic,
from advancing into a naturally competitive position. The state commer­
cial banks themselves are burdened with a weighty portfolio of bad
debts from unproductive state-owned enterprises and face pressure to
cross-subsidize inefficient state companies with loans effectively fi­
nanced by interest from profitable loans. The state companies thus
crowd out credit to other worthwhile enterprises, and capital is ineffi­
ciently allocated. The combined effect of a state-dominated banking
oligopoly and the subsidies it provides to state enterprises generates
insufficient intermediation for both depositors and borrowers. Finan­
cial deepening is an unlikely prospect.

A securities market, although badly needed and genuinely desired, is
also unlikely to appear in the near future. Even if administrative and
organizational hurdles could be overcome, Vietnam faces a more
fundamental problem. The current laws governing private enterprises
still place stringent restrictions on the development of a viable corpo­
rate sector, which is necessary for a market in equities. State companies
continue to dominate the economy, and privatization is slow. Private
companies face prohibitively strict regulation of matters regarding
organization, finance, governance, and even basic transactions. The
bond market, although developing slowly, performs inefficiently, and
there is no mechanism to facilitate secondary trading.

An informal financial sector has emerged in order to meet the
capital needs of the growing economy. Although there are scant data
available on this sector, conceptual analysis suggests that informal
finance is less efficient than a well organized and properly regulated
capital market. The development of such a viable capital market, both
intermediated and direct, should remain a high priority goal in Viet­
nam’s push for sustained economic growth. In reference to the frame­
work set forth in Part I, Vietnam has yet to develop the financial sector

\textsuperscript{198. See id.}
necessary to meet the passive intermediation needs of the economy, let alone one that is poised to be a dynamic factor in promoting economic growth. The gains in economic growth from the development of a viable financial sector thus would be significant.

Further progress, however, requires Vietnam to answer more fundamental questions. The Vietnamese government understandably believes that its strength derives from its control over the state sector.\textsuperscript{199} For all the recent liberalizing initiatives, some Vietnamese leaders still appear to believe in a centrally planned economy, and "policies are aimed at improving it rather than scrapping it."\textsuperscript{200} Reforms toward a market-oriented economy, however, necessarily entail relinquishing a measure of governmental control. This truism is particularly applicable in the capital markets, where government control and state sector domination have resulted in inadequate intermediation and inefficient allocation of capital. Vietnam has professed a desire for a "multi-sector economy," one in which the state shares power with the market over different industries and markets. In order to continue on a path of sustained economic growth, the state should relax its grip on Vietnam's financial sector and allow it to develop into a properly regulated market.

\footnotesize

\textsuperscript{199.} See Hanoi Refuses to Let Go, supra note 158.
\textsuperscript{200.} Id.