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# The development of financial systems of ASEAN-5 and Vietnam: A comparative analysis

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**Abstract.** This paper looks at the development of the financial systems of ASEAN-5 countries and Vietnam. By making a comparison between factors that foster the financial development of ASEAN-5 and Vietnam, it suggests that both the two sides share common characteristics including: financial repression, bank based development, accelerating liberalization of the financial sector, capital movement, inefficiency, due to lack of competition, effective governance, and managerial freedom. The health of financial system of the ASEAN-5 has improved substantially during the period post 1997-98, with increase in foreign ownership, movement into business line, suitable adjustment for financial deepening and broadening. On the Vietnamese side, it shows rapid changes in the financial sectors with existence of capital market and financial resources as well as risks, resulting from the reforms and international integration. Contrasting the financial development of the two sides, this paper finds that ASEAN-5 is implementing a more stable strategies and moving towards a more balanced financial structure, while Vietnam is taking step by step restructuring and developing its out of date banking sector; as well as supporting for the stock and bond markets. For both Vietnam and ASEAN-5, the banking system and capital market have a large room for further development.

## 1. Introduction

During the last few decades, the economies of East Asia have been growing quickly that shaped the modern ways of life. No other region in the world was able to achieve such an extensive economic growth in such a short period of time. ASEAN-5[(1)], a major group belonging to East Asia, is integral part of the success story that followed import-substitution industrialization "ISI"-policy before switching to an export-oriented industrialization "EOI"-policy. Belonging to ASEAN group, Vietnam (that became a full member of ASEAN in 1995) is a small economy with a modest economic scale in comparison to those of ASEAN-5. Vietnamese government officially launched its ***Doimoi (Renovation)*** process in 1986, but only started a radical and comprehensive reform package aimed at the economic development since 1989. Though Vietnam built up the market economy rather slowly than ASEAN-5, its recent fundamental achievements have proved that Vietnam has step by step narrowed the stance with ASEAN-5. After eleven years of negotiation for accession, Vietnam eventually got the nod from the World Trade Organization "WTO" in November 2006.

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(1) ASEAN-5 is the abbreviation term, which stands for the five economies in ASEAN including Indonesia, Malaysia, the Philippines, Singapore, and Thailand.

In spite of recent achievements, the development of the financial system in ASEAN-5 countries in general and in Vietnam in particular, to some extent, could not keep up with economic growth, their fragile and weak financial systems have been affected by the globalization of capital markets and this turmoil has highlighted the inherent problems of ASEAN-5. Aware of this problem, both ASEAN-5 and Vietnam have striven to develop their financial systems while trying to maintain financial stability and sustained economic development. This is also the reason for the paper trying to make a comparison of ASEAN-5's and Vietnamese financial systems, thereby identifies some similar experiences and different challenges. The financial reforms have progressed much further in ASEAN-5 than in Vietnam. On the way to integrate the financial system into the region and the world, Vietnam should consider ASEAN-5 countries as the navigators and learn the lessons from the ASEAN-5. The paper also explores that on the way to integrate the domestic financial market into the international one, Vietnam can evaluate herself the current level of the financial deepening and liberalization, and how is efficient the Vietnamese financial system in comparison with ASEAN-5 level, thereby having policy recommendations for sustained development.

The paper is divided into four major sections. Section II briefly takes the bird's eye view of the common characteristics of the general consensus about the development patterns and characteristics of the financial systems in ASEAN-5 in the period before the 1997/98 financial crisis. Section III analyzes in a greater detail on the economic fundamentals and the financial sector development of ASEAN-5 and Vietnam following the restructured reform process. Then, section IV reviews and summarizes the major findings about the similarities and differences in the process of reforming the financial system of ASEAN-5 and Vietnam, thereby makes some evaluation on the stage of financial development of Vietnam in comparison to those of ASEAN-5 and draws about some recommendations for Vietnam to sustaining high economic growth and sound financial development.

## 2. ASEAN-5 and Vietnam: An overview of unique patterns of financial development

Although it is difficult to come to the definite answers, background information and previous studies (especially on periods before the 1997/98 financial crisis) have found that the development patterns of the banking system of ASEAN-5 and Vietnam share several key characteristics including: financial repression, bank-based development, accelerating liberalization of the financial sector and capital movement, inefficiency and lack of international competitiveness.

First, financial repression often refers to the limits on interest rates and entry and obligatory lending to policy - preferred sectors and projects. As White 1995 suggests that financial repression was an adjunct to the nationalistic import-substitution policy with which they began their post-war independence in ASEAN-5. In the economy of Vietnam, the financial sector was totally repressed or subsumed in fiscal policy and preferred state owned sectors for industrialization. Financial repression may have made some constructive contribution such as overcoming market failures in the early period of development when information infrastructure was weak. However, the adverse effects of financial repression, such as misallocating resources and suppressing domestic savings are usually extremely strong even in the early period of industrialization, especially if bureaucracy is neither efficient nor clean. Under the financial repression, the informal financial sector of either ASEAN-5 or Vietnam has gradually emerged to complement the inflexible formal sector while small and medium-sized firms belonging to private sector do not have enough access to bank finance, and tending to rely on informal finance (Masuyama, 1999).

Besides financial repression, the bank-based financial system has become the debating point of development pattern. Observation from the fact indicates that the banking system often developed first, and then the money market and capital market were introduced gradually as a supplement to the banking system both in ASEAN-5 and Vietnam. Indeed, in the ASEAN as a whole, most financial systems are considered as bank-based system, which is dominated by banks, and the money and capital market have just become more important since the 1990s ( for the case of ASEAN-5) and since 2000s (for the case of Vietnam). Bank- based financial systems suffer several weaknesses as a result of the dominance of banking. When businesses are mainly obligated to creditors rather than equity holders, they are less able to withstand fluctuation in asset prices and economic conditions. Despite the rapid expansion of equity markets in ASEAN-5 in the 1990s, bonds markets are still underdeveloped. As (Masuyama, 1999) pointed out, ASEAN-5 suffered a dearth of long-term finance capabilities as a result of the long-standing bias of financial systems toward banking. Typically, banks are reluctant to take on the additional risk of long-term lending where information is insufficient and enforcement infrastructure is inadequate. The relative lack of long-term finance alternatives has resulted in term mismatches in the balance sheets of corporations and financial institutions throughout ASEAN-5. Moreover, financial systems in which banks predominate are less inclined to finance venture enterprises that have no credit history, resulting to small and medium sized enterprises usually do not have access to capital market financing.

Table 1: Economic Size, GDP growth, Inflation, Investment, and Current Account

| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | average |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| GDP(bilUS$) | | | | | | | | | | | | | | | | |
| Vietnam(1) | 20.8 | 24.7 | 26.9 | 27.2 | 28.7 | 31.2 | 32.5 | 35.1 | 39.6 | 45.5 | 52.9 | 60.9 | 71.1 | 89.8 | 89.2 | 45.1 |
| ASEAN-5(2) | 128.27 | 142.399 | 134.12 | 87.918 | 103.29 | 110.13 | 105.2 | 117.7 | 132.1 | 147.94 | 164 | 196.99 | 235.17 | 271.55 | 256.49 | 155.5 |
| (1)/(2)yearly | 0.16 | 0.17 | 0.20 | 0.31 | 0.28 | 0.28 | 0.31 | 0.30 | 0.30 | 0.31 | 0.32 | 0.31 | 0.30 | 0.33 | 0.35 | 0.3 |
| GDPper capital (US$) | | | | | | | | | | | | | | | | |
| Vietnam (3) | 288.9 | 337.5 | 361.9 | 360.9 | 374.7 | 401.6 | 413.3 | 440.2 | 489.0 | 554.1 | 636.1 | 721.9 | 835.3 | 1040.4 | 1019.0 | 551.7 |
| AEAN-5 | 6669.6 | 7111.57 | 6959.6 | 5508 | 5631.1 | 6155.7 | 5617 | 5831 | 6274.2 | 7185.1 | 7769 | 8745.6 | 10126 | 11068 | 10511 | 7410.9 |
| (3)/(4)yearly | 0.04 | 0.05 | 0.05 | 0.07 | 0.07 | 0.07 | 0.07 | 0.08 | 0.08 | 0.08 | 0.08 | 0.08 | 0.08 | 0.09 | 0.10 | 0.1 |
| GDP growth (%) | | | | | | | | | | | | | | | | |
| Vietnam | 9.5 | 9.3 | 8.2 | 5.8 | 4.8 | 6.8 | 6.9 | 7.1 | 7.3 | 7.8 | 8.4 | 8.2 | 8.5 | 6.2 | 3.3 | 7.2 |
| AEAN-5 | 8.0 | 7.5 | 4.8 | -6.6 | 4.4 | 7.0 | 1.1 | 4.8 | 5.3 | 6.8 | 5.6 | 6.1 | 6.5 | 3.8 | -3.5 | 4.1 |
| Inflation (%) | | | | | | | | | | | | | | | | |
| Vietnam | 16.9 | 5.6 | 3.1 | 8.1 | 4.1 | -1.8 | -0.3 | 4.1 | 3.3 | 9.4 | 8.4 | 7.5 | 8.3 | 23.1 | 6.0 | 7.1 |
| AEAN-5 | 5.7 | 5.4 | 4.5 | 16.2 | 6.0 | 2.4 | 4.5 | 3.4 | 2.7 | 3.6 | 5.2 | 5.7 | 3.0 | 7.3 | 2.2 | 5.2 |
| Share of GDP (current price) | | | | | | | | | | | | | | | | |
| Agriculture, cur | | | | | | | | | | | | | | | | |
| Vietnam | 27.18 | 27.76 | 25.77 | 25.78 | 25.43 | 24.53 | 23.24 | 23.03 | 22.54 | 21.81 | 21.02 | 20.40 | 20.89 | 21.30 | | 23.6 |
| ASEAN-5 | 12.28 | 11.73 | 11.14 | 11.85 | 11.43 | 9.86 | 9.58 | 9.85 | 9.99 | 9.91 | 9.34 | 9.29 | 9.14 | 9.19 | | 10.5 |
| Manufacturing, cur. | | | | | | | | | | | | | | | | |
| Vietnam | 14.99 | 15.18 | 16.48 | 17.15 | 17.69 | 18.56 | 19.78 | 20.58 | 20.45 | 20.34 | 20.67 | 21.29 | 22.30 | 22.60 | | 19.1 |
| ASEAN-5 | 25.62 | 25.91 | 26.02 | 25.88 | 26.80 | 28.39 | 27.74 | 28.03 | 28.28 | 28.66 | 28.71 | 29.01 | 29.11 | 29.30 | | 27.4 |
| Finance, cur. | | | | | | | | | | | | | | | | |
| Vietnam | 2.01 | 1.89 | 1.74 | 1.74 | 1.87 | 1.84 | 1.82 | 1.82 | 1.77 | 1.78 | 1.80 | 1.81 | 1.83 | 1.86 | | 1.8 |
| AEAN-5 | 11.09 | 11.52 | 11.96 | 11.50 | 10.75 | 10.39 | 10.90 | 10.87 | 10.59 | 10.15 | 10.22 | 10.29 | 10.33 | 10.08 | | 10.9 |
| Total investment | | | | | | | | | | | | | | | | |
| Vietnam | 25.42 | 26.32 | 26.70 | 27.02 | 25.70 | 27.65 | 29.15 | 31.14 | 33.35 | 33.25 | 33.13 | - | | | | 29.0 |
| ASEAN-5 | 33.81 | 34.98 | 33.72 | 26.73 | 23.30 | 23.83 | 23.10 | 21.69 | 21.31 | 21.58 | 21.53 | 21.44 | | | | 25.6 |

*Note:* All data of 2009 in this paper are estimates.
*Source:* IMF(World Economic Outlook Database 2009), BIS, and the author's calculations.

As for the financial liberalization, it was introduced gradually and accelerated with the general shift of economic policies towards deregulation and liberalization with the development of capital markets, particularly stock markets over time. Throughout ASEAN-5, governments have move to phase out credit allocation, to liberalize interest rates, loan portfolio, business lines, and market entry including entry by foreign institutions, and to develop and reform securities markets. Among ASEAN-5, the Philippines were the navigator by removing its interest ceilings in 1949. The same process was carried out in Malaysia in 1973. Following is Indonesia and Thailand, these countries began to liberalize its interest while the government of Vietnam adopted to liberalize the deposit rate first and then the loan rates.

Other similarities, such as institution building relating to strengthening prudential regulation and financial supervision, become the necessary counterpart to financial liberalization in order to avoid market failure. However, the progress of institution building in ASEAN-5 has generally lagged behind financial liberalization, a situation that has contributed to a number of financial crises in the region, including recent global crisis. Lack of transparency is partly the legacy of financial regression when governments exercised a high degree of discretion over management of the financial sector and it is also partly attributable to the region's relationship-oriented business practices. Commercial banks that had strong government connections were often perceived to have implicit guarantees that they would not be allowed to fail. The lending practices of state-owned commercial banks in Vietnam are example of these consequences (Herve, 2008).

On the other hand, literature also found that the accounting system of ASEAN-5 and Vietnam is not up to internationally accepted standards. Most ASEAN-5 members and Vietnam used to undergo their colonial histories; Malaysia and Singapore inherited accounting systems bases on a British model, while the Philippines based on Anglo-American model. The structural weaknesses in Indonesia's legal and accounting systems have resulted in poor implementation and enforcement of prudential rules and regulations. The legal and accounting systems designed to function in Vietnam's planed economy are in need of total overhaul as that country attempts to transform its economy based on market principles. There is also weak governance behind an underdeveloped institution structure. In some ASEAN-5 economies, official corruption in organizations such as central banks resulted in inadequate supervision. Undisciplined financial institutions can lead to adverse selection, of misallocation of resources, and bad corporate governance which in turn leads to inefficient corporations. In Vietnam, non-arm's length lending by state-owned commercial banks to state-owned enterprises has undermined corporate governance.

In sum, with the exception of Singapore, the financial development of ASEAN-5 in general and Vietnam in particular are generally inefficient because they lack competition, effective governance, and managerial freedom, mainly due to excessive restrictions and inadequate regulation and supervision. Inefficient financial systems misallocate the increased inflow of capital attracted by financial and capital liberalization and uncompetitive domestic institutions succumb in the face of increased entry of foreign financial institutions, threatening financial stability. This poses a difficult policy question because, while financial liberalization is necessary in order to improve the efficiency of a financial system, rapid liberalization may undermine the stability of that system.

## 3. ASEAN-5 and Vietnam: Recent economics fundamentals and financial sector development(1).

(1) Financial development can be defined in several ways. In fact, financial systems can develop in terms of size but also in terms of the efficiency in which they intermediate funds. Financial development in terms of size (financial

Turning to the factors that foster financial development, the literature concentrated first on macroeconomic ones, i.e. GDP growth rate, inflation, GDP per capital, and some legal and regulatory system of financial institutions, as well as the structure and functioning of the financial system itself. Some researchers also found that for the economies in transition, the external financial liberalization and particularly that of the capital account strongly contributes to the development of the financial sector in the long run (IMF,2000; Bailliu, 2000).

### *3.1. Movement of the Major Macroeconomic Variables*

While ASEAN-5 has recorded quite high economic growth over nearly 15 years from 1995 to 2009, averaging 4.1% per annum, (excluding the negative 6.6% in the year 1998 and negative 3.5% in the year 2009 as expected due to the regional and global financial crisis, respectively), Vietnam has even achieved much higher economic growth with the average rate of 7.2% during the period 1995-2009 (Table 1). Accompanying with such a high growth rate, GDP per capital of Vietnam gradually rose yearly from $288USD in 1995 to about $1019USD in 2009. There was a signal factor that allowed Vietnam to overcome the status of a poor country in the coming years. Despite the GDP per capital of Vietnam has improved substantially during the period, it has been very small (around 10.26%) as compared to that of ASEAN-5. Besides, the structure of the economy of both ASEAN-5 and Vietnam has changed towards industrialization. It could be seen that the share of manufacturing of ASEAN-5 on average is still higher than that of Vietnam. While the share of manufacturing in the GDP of Vietnam increased from 14.99% in 1995 to 22.60% in 2008, accounting for 19.1% in the GDP, that of ASEAN-5 has increased at a lower speech but accounting for 27.1%. As for the contribution of the financial sector in relation to the GDP, there has been an upward trend in ASEAN-5 along with the high economic growth rate and the improvement of economic structures during 1995-2009. In Vietnam, the contribution by the financial sector to the GDP was very modest with the average of 1.8% from 1995 to 2007 (Table 1). Table 1 also suggests that either ASEAN-5 or Vietnam have been successful in combating inflation; there were, however, inflation has emerged as a major concern in Vietnam since 2005. After a spike in 2005-2007, inflation began moderating progressively and consequently reached the highest level of 23.1 % in 2008. The rather high economic growth corresponded with a significant increase in total investment (Table 1) though its ratio to GDP has tended to decline since 2000. However, it has been playing an essential role and has consistently contributed to the economic development in the region.

### *3. 2. Development of the financial system*

*Key policy reforms*

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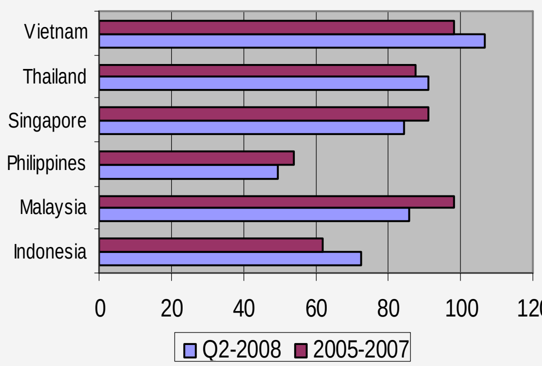
depth) is typically measured by the size of total financial assets (the sum of commercial bank liquid assets, stock market capitalization, and bond market capitalization) in relation to gross domestic product (GDP). Differently from financial depth, financial efficiency is hard to measure for the financial system as a whole. For the banking sector, the common used measures are the profitability indicators such as economic efficiency relative to bank assets (ROA), and the capital efficiency relative to bank equity (ROE). Besides, asset quality (as measured through non-performing loan ratios); and Capital Cushions (as measured by the Basel I ratios of regulatory capital to risk-weighted assets and the ratio of market capital to risk-adjusted assets) could reflect the financial position of banks. As regards the capital markets, the most readably available measure of efficiency is turnover, which gives the values of stock transactions relative to the size of the financial market (Gallego, Herrero, and Saurina 2002). Besides, financial development is somewhat reflected by financial broadening, which refers to the tendency for diversify or broaden structure of the total financial assets (Ghosh, 2006). Financial broadening is usually assessed through changes in the relative size of bank and capital market assets as financial systems evolve from predominantly bank-based financial intermediation to capital market finance, capital market assets tend to increase in relative importance.

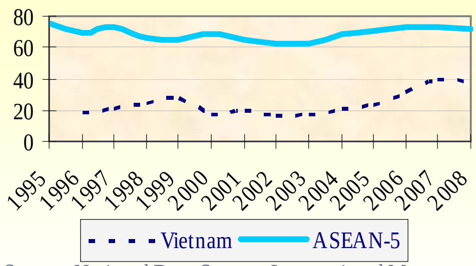
In the ten years since the 1997-98 financial crisis, the financial systems in ASEAN-5 have restructured significantly, and the relative importance of structural reforms has varied across economies and over time. In the most-affected crisis economies like Indonesia, Thailand, and Malaysia, a number of financial institutions (banks and non-banks) were closed or merged with healthier institutions; official and private asset management companies were established or strengthened to assist in the resolution of impaired assets; and official and private capital was injected into the banking sector. Even though it did not experience a banking crisis, Vietnam has also undertaken substantial restructuring during the years after the regional crisis. During 1999-2001, a round of restructuring and mergers, particularly over-competition among joint stock commercial banks (JSCBs), took place that makes the banking market to be more open. The largest state owned commercial banks (SOCBs), which had been highly protected, have been under restructuring and privatization. As a result, the number of the JSCBs fell from 51 to 34 by 2008. Since 2005, some JSCBs and SOCBs have been listed on the stock market. It can be seen that both ASEAN-5 and Vietnam have undergone the closures, especially of smaller institutions, as well as mergers and acquisition after the regional crisis; the economies of ASEAN-5 and Vietnam, however, pursued different strategies behind their reform process for development. In the case of ASEAN-5, this has been a response to long-standing weaknesses in its banking system and management. But in the case of Vietnam, it has followed the international integration and commitments to financial services liberalization associated with WTO entry, that Vietnam must renovate its non-market economy, allowing the market to competition from either foreign players or JSCBs. It was subjected to the relevant laws and regulations as promulgated by the competent authorities of Vietnam to ensure consistency with Article VI of the GATS and Para 2(a) of the Annex on Financial Services. Within the ASEAN-5, most economies have adopted Master Action Plan (MAPs) directed at financial sector strengthening and reform (mainly the official sector) during the last ten years (Charles,2008).

Figure 1: Private sector loans to total deposits (%)




Source: IMF and WB

Figure 2: Financial Deepening (% of GDP)




Source: National Data Source, International Monetary Fund.

The problem of financial repression, which was regarded as rather serious both in ASEAN-5 and Vietnam, has been step by step alleviated. It was reflected in Figure 1 by the ratio of private sector loan to deposit, inwhich Vietnam ranks the first as compared to ASEAN-5. Private sector loans to total deposit not only explains credit strength in recent years but also proves a risky signal when the economic performance of other sectors goes down (as the consequences of crises), affecting the economic performance of the banking sectors. Structural changes in the banking system can also be proved by the movement of banking institutions into investment banking-type activities. Traditionally, banks in both ASEAN-5 and Vietnam have concentrated on the core business of providing relatively illiquid loans to businesses and households, financed by liquid deposit liabilities. Even though this role remains dominant in regional banking systems, a decade of long restructured reforms have seen an increasing number of bank moving into investment-banking and related activities. Table 2 depicts the ratio of the securities investment to total bank assets. In particular, Indonesia and Philippines banking system hold relatively high ratios of securities investments in relation to total assets. The increasing trend has been continuing until 2008 in ASEAN-5. The data also shows that the similar tendency happens to Vietnam when the securities investment to total bank asset went up from 4.2% in 2006 up to 16.3% in 2007 before reduced to 12.4% in 2008.

Table 2: Securities Investment to Total Bank Assets of Commercial Banks (%)

| | 2000-2004 average | 2004 | 2005 | 2006 | 2007 | 2008[2] |
|---|---|---|---|---|---|---|
| Indonesia | 18.3 | 20.2 | 18.0 | 24.8 | 27.8 | 17.4 |
| Malaysia | 12.7 | 10.6 | 9.6 | 9.3 | 11.9 | 13.1 |
| Philippines | 26.6 | 31.6 | 32 | 30.0 | 28.3 | 29.1 |
| Singapore | 16.9 | 17.1 | 16.5 | 15.9 | 15.8 | 14.3 |
| Thailand | 15.2 | 16.0 | 16.0 | 15.8 | 15.9 | 14.7 |
| ASEAN-5 | 17.94 | 19.1 | 18.42 | 19.16 | 19.94 | 17.72 |
| Vietnam | | --- | --- | 4.2 | 16.3 | 12.4 |

**Source:** CEIC; National sources; and *Global financial stability report*, International monetary fund.

*Financial deepening and broadening*

While similarities have been found, a brief comparison of the degree of financial development in ASEAN-5 and Vietnam will now be conducted. Figure 2 indicates that financial deepening[(2)] in ASEAN-5 and Vietnam has changed significantly over time. In Vietnam, financial depth was very low before 1998, averaging about 22% of GDP and exclusively concentrated in the banking system. Financial deepening was just shortly improved after 1998 before going to be stalled during 2000-2005. As shown in the second section, both ASEAN-5 and Vietnamese financial systems have traditionally been predominantly bank-based, and not market-based one. In ASEAN-5 countries, it has been characterized by the so-called “normal process” as the differentiation began to blur, first with the expansion of domestic bond markets in the second half of 1990s (Figure 3), and the second with the stock market boom of the early 1990s (Figure 4), while the commercial bank liquid assets to GDP has been rather stable at a high rate of around 80% of GDP (Figure 5).

(2) As far as the development of financial scale is concerned, the ASEAN-5 financial systems were about ten times as large, with the total financial assets of 80% of GDP on average. In Vietnam, financial depth has been a rather shallow with the underdeveloped financial market in comparison to those of ASEAN-5; and the bond and stock market capitalizations have just made up only about one tenth those of ASEAN-5. (Figure 2,3&4). However, since the new millennium, especially since 2004, the fast growing domestic credit with an annualized average of 33.4% and the commercial financial assets to GDP of nearly 99% in 2008 (increasing from 20% in 1996) have promoted financial deepening in Vietnam. During this period, there were also sharp increases in the growth of money supply (M1 and M2 that are reflected in Figure 6&7). Moreover, this movement has been fueled by the short booming of both the stock and the bond markets in 2006 and 2007. As the result, the financial depth in Vietnam has been improved significantly and gone in line with that of ASEAN-5.

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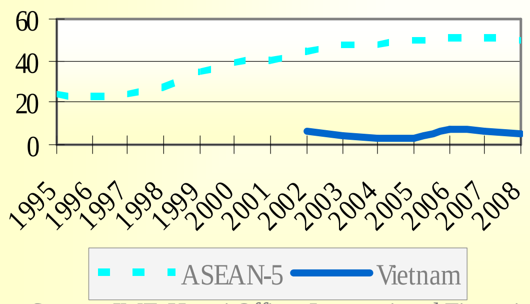
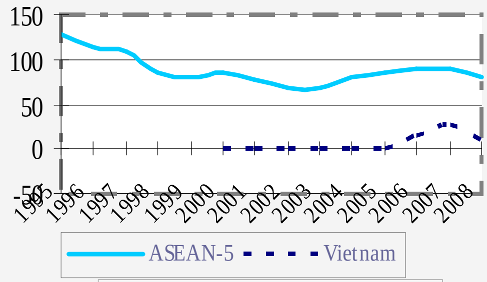
**Figure 3: Bond market capitalization (% of GDP)**



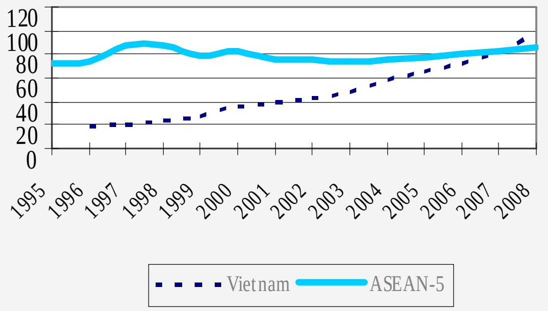

Source: IMF, Hanoi Office; International Financial Statistics (IMF) and The World Bank

**Figure 4: Stock market capitalization (% of GDP)**



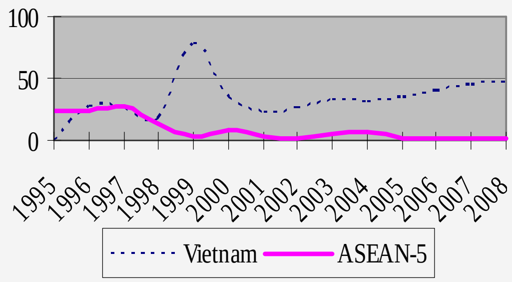

Source: IMF and The World Bank

**Figure 5: Commercial Bank Liquid Assets (% of GDP)**

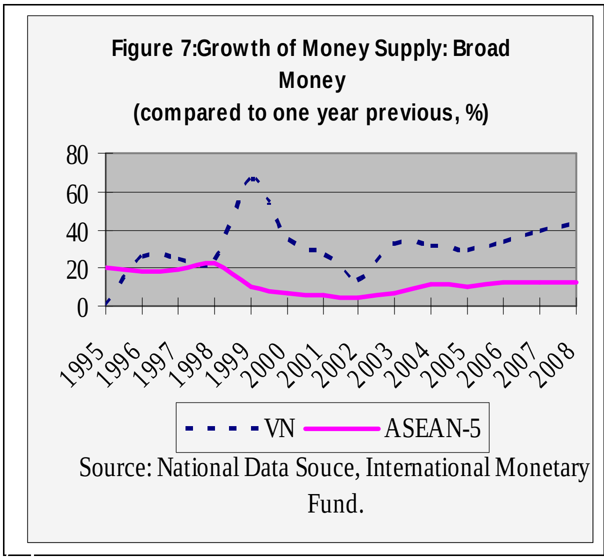


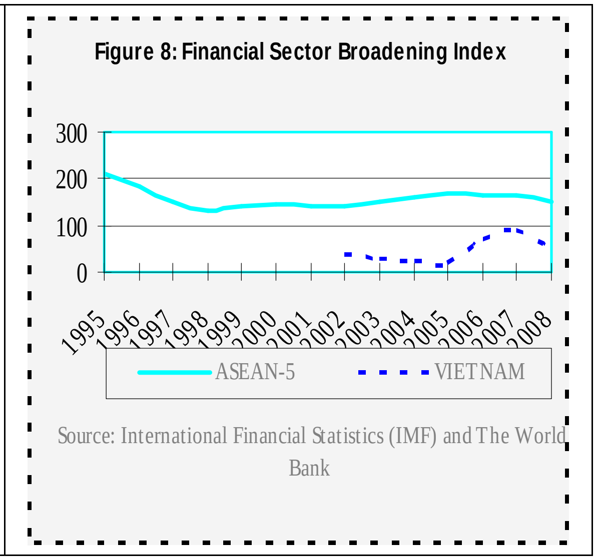

Source: International Financial Statistics (IMF) and The World Bank.

**Figure 6: Growth of Domestic Credits to the economy (compared to one year previous, %)**




Souce: National Data Souce, International Monetary Fund (IMF).




In addition, we can see from figure 6 and 7 that the growing of money supply in ASEAN-5 has been maintained at a rather stable ratio (about 12%) after 2000 while the evolution of money supply growth in Vietnam has been very complicated since 1995 (that reached 52% for M1 growth and about 68% for M2 in 1999 and was very high during 2003-2004 due to that fuelled inflation during these periods).

Financial broadening has occurred in both ASEAN-5 and Vietnam as reflected in Figure 8. It suggests that the ratio of capital market assets (including stock and bond market asset) to banking sector assets has increased over time in Vietnam while it has been adjusted at a rather stable level in ASEAN-5. For the most part, financial sector deepening and broadening have move together in ASEAN-5. However, a slight negative relationship could be identified between financial depth of Vietnam and of ASEAN-5, particularly since 2002. It has been subject to occasional fluctuations relative to trend, related to the business cycle and financial booms and busts.

*Financial efficiency, profitability and soundness*

As regard financial efficiency, the credit market and the capital market will be analyzed separately due to the lack of global indicators. Regarding economic efficiency of commercial banks, we can see from Table 3a that the rate of return (ROA) has shown improvements in ASEAN-5, averaging 0.98% in the period 2000-2004, reaching 1.68% in 2004 and 1.44% in 2007. In Vietnam, ROA was just slightly below the average level of ASEAN-5 at rate of 1.31% in the period 2006-2008.

Table 3a: Rate of Return on Commercial Bank Assets (% per annum)

| | 2000-2004 average | 2004 | 2005 | 2006 | 2007[1] | 2008[2] |
|---|---|---|---|---|---|---|
| Indonesia | 1.7 | 3.5 | 2.6 | 2.6 | 2.8 | 2.7 |
| Malaysia | 1.3 | 1.4 | 1.3 | 1.3 | 1.5 | --- |
| Philippines | 0.8 | 1.0 | 1.1 | 1.3 | 1.4 | 1.2 |
| Singapore | 1.0 | 1.2 | 1.2 | 1.4 | 1.4 | --- |
| Thailand | 0.1 | 1.3 | 1.4 | 0.8 | 0.1 | 0.3 |
| ASEAN-5 | 0.98 | 1.68 | 1.52 | 1.48 | 1.44 | --- |
| Vietnam | --- | --- | --- | 1.3 | 1.33 | 1.31 |

Source: CEIC; National sources; and *Global financial stability report*, International monetary fund.

Meanwhile, Table 3b shows the rate of return on equity (ROE) of commercial banks. It is clear that the capital efficiency has been increasing in ASEAN-5 from 10.7% on average in the period 2000-2004 to above 13% during 2004-2008. The capital efficiency seems slightly higher than that of Vietnam at around 11.4% in 2006 and 12.6% in 2007 (Table 3b). After the 1997/98 financial crisis, the banking industry of ASEAN-5 has significantly developed its financial strength by cleaning up banks' balance sheets and increasing capital through issuing new stocks as well as increasing financial reserves. As a result, the financial position of banks has improved significantly in terms of non-performing loans (NPLs) and capital adequacy (see Table 4 and 5). For example, the NPLs of ASEAN-5 were reduced from 10.62% in the period 2000-2004 to about 4.88% in 2006 and about 3.58% in 2007. In Vietnam, the NPLs of banks have been controlled efficiently from the high level of 13% in the period 2000-2004 to about 3% in 2007. Moreover, the period since the crisis has seen substantial rehabilitation of ASEAN-5 banking system with the capital adequacy ratio (CAR) has been very high and far-reaching the minimum level of 8% required by the Basel 1 Accord. It strongly indicates a cautious management within the banking system. Nonetheless, the CAR ratio has not fully applied in Vietnam with the average capital ratio of about 6% in the period 2006-2008. However, commercial banks of Vietnam are going to face challenges as they must ensure the minimum CAR by 2010 under Vietnam's commitments to the WTO.

Table 3b: Rate of return on commercial bank equity (% per annum)

| | 2000-2004 average | 2004 | 2005 | 2006 | 2007[1] | 2008[2] |
|---|---|---|---|---|---|---|
| Indonesia | 18.5 | 22.9 | 16.5 | 16.4 | 17.7 | 19.2 |
| Malaysia | 16.2 | 16.0 | 16.8 | 16.2 | 19.7 | --- |
| Philippines | 5.8 | 7.6 | 9.5 | 11.5 | 11.8 | 10.6 |
| Singapore | 9.6 | 11.6 | 11.2 | 13.7 | 13.4 | --- |
| Thailand | 3.4 | 15.7 | 14.2 | 8.5 | 2.4 | 14.4 |
| ASEAN-5 | 10.7 | 14.76 | 13.64 | 13.26 | 13 | --- |
| Vietnam | --- | --- | --- | 11.4 | 12.6 | --- |

Source: CEIC; national sources; and *Global Financial Stability Report*, International Monetary Fund.

Other comparisons between the soundness of financial sector in ASEAN-5 and Vietnam are shown in the stock market capitalization. Figure 5 suggests that at the time when the stock market had not established in Vietnam yet, the financial broadening process has strongly fluctuated in ASEAN-5 and this period also witnessed stock market capitalization (turnover) decline as a result of the crisis, then gradually recovered as the result of expanding liberalization in financial sector and improvement in management after the crisis. In Vietnam, despite the stock exchange market was officially established in Ho Chi Minh City in 2000, the existence of the stock market had not been recognized until 2005 when it suddenly skyrocketed in 2006 and 2007 in terms of market capitalization (from 0.02% of GDP on average during 2000-2005 to about 27% of GDP in 2007). Besides, number of listed companies and investor's accounts, participation of securities companies, and investment management funds were also booming at that time. The corresponding trends are shown in Figure 6. Notably, the total value of stock exchange market had been as one-fourth as that of ASEAN-5 only within three years from 2005 to about 2008.

In sum, financial systems have contributed to develop and grow in size as well as efficiency both in ASEAN-5 and Vietnam. Financial deepening has been at a range between 60-80% of GDP in ASEAN-5 and a range between 18-36% in Vietnam. Financial efficiency of Vietnam can reached at the nearly average level of ASEAN-5. Financial broadening has increased in Vietnam after 2005. However, it is proved that the development of financial market in ASEAN-5 is more sustainable than that of Vietnam as a long-term adjustment and reform. Both the banking system and capital market have a large room for further development both in ASEAN-5 and in Vietnam.

Table 4: Nonperforming Loans (% of commercial bank loans)

| | 2000-2004 average | 2004 | 2005 | 2006 | 2007[1] | 2008[2] |
|---|---|---|---|---|---|---|
| Indonesia | 10.6 | 5.7 | 8.3 | 7.0 | 4.6 | 3.9 |
| Malaysia[3] | 8.9 | 6.8 | 5.6 | 4.8 | 3.2 | 2.4 |
| Philippines | 14.8 | 12.7 | 8.2 | 5.7 | 4.4 | 4.0 |
| Singapore | 5.3 | 5.0 | 3.8 | 2.8 | 1.8 | --- |
| Thailand | 13.5 | 10.9 | 2.2 | 4.1 | 3.9 | 3.3 |
| ASEAN-5 | 10.62 | 8.22 | 5.62 | 4.88 | 3.58 | 3.4 |
| Vietnam | 13.0 | --- | --- | 3.0 | 3.2 | 3.6 |

Source: CEIC; national sources; and *Global Financial Stability Report*, International Monetary Fund.

Table 5: Risk-Weighted Capital Adequacy Ratios (% of risk weighted assets)

| | 2000-2004 average | 2004 | 2005 | 2006 | 2007[1] | 2008[2] |
|---|---|---|---|---|---|---|
| Indonesia | 12.0 | 19.4 | 19.5 | 20.5 | 19.3 | 17.1 |
| Malaysia[3] | 13.4 | 14.3 | 13.6 | 13.1 | 12.8 | 12.5 |
| Philippines | 17.0 | 18.7 | 17.7 | 18.5 | 15.9 | 15.7 |
| Singapore | 17.7 | 16.2 | 15.8 | 15.4 | 14.0 | --- |
| Thailand | 13.2 | 13.0 | 14.2 | 14.5 | 15.4 | 15.7 |
| ASEAN-5 | 14.66 | 16.32 | 16.16 | 16.4 | 15.48 | 15.25 |
| ASEAN-5 average | | | 15.71 | | | |
| Vietnam | --- | --- | 5.3 | --- | 7.4 | 7.2 |

Source: CEIC; national sources; and *Global Financial Stability Report*, International Monetary Fund.

**4. Conclusion and recommendations**

During the last two decades, much has changed in ASEAN-5's and Vietnamese financial systems. A brief overview of the literature on the unique patterns of financial development of the ASEAN-5 and Vietnam has drawn out several key characteristics, which include: financial repression, bank based development, accelerating liberalization of the financial sector and capital movement, and inefficiency and lack of competition, effective governance, and managerial freedom, mainly due to excessive restrictions and inadequate regulation and supervision. A comparison between ASEAN-5's and Vietnam's fundamental macroeconomic factors and financial system has proved that both ASEAN-5 and Vietnam are in the similar process of economic development, in which Vietnam has achieved a higher economic growth rate while its GDP per capital and economic output has been still left behind the average level of ASEAN-5. In the quest for sustainable development, Vietnam is similar to ASEAN-5 in nature but in timing and context. Both ASEAN-5 and Vietnam have implemented key structural reform processes in the banking sectors, however, they undertake them in different contexts. For the case of ASEAN-5, it has been the result of long-term adjustment after the financial 1997/98 crisis. And for the case of Vietnam, it has been due to the required steps for a transitional economy. ASEAN-5 moves towards a more balanced financial structure, which basically started in the early 1990s, while Vietnam takes steps to restructure and develop its out of date banking sector while establishing and gradually support for the stock and bond markets almost a decade later than ASEAN-5 (in the year 2000s). In fact, financial systems have contributed to develop and grow in size as well as efficiency both in ASEAN-5 and Vietnam. For the case of Vietnam, financial liberalization started later than in ASEAN-5 and took longer to complete partially because of an outdated economic infrastructure, and transitional process from centrally planned economy to market oriented one. Financial efficiency can reach at a nearly average level of ASEAN-5, and financial broadening have increased after 2005. However, it is proved that the development of financial market in ASEAN-5 is more sustainable than that in Vietnam as a long-term adjustment and reform. For both Vietnam and ASEAN-5, the banking system and capital market have a large room for further development.

** Possible lessons from ASEAN-5 experience for Vietnam's financial syste*m

The prospect for Vietnam's development is bright according to a number of achievements in recent years and forecasts in the near future: the economy will likely continue to grow at an annual rate of 8-9% in coming years. Presently, room for financial development remains very large. Like ASEAN-5, Vietnam is still largely bank-based, and the capital markets are only at an early stage of development. The ASEAN-5 experience also highlights the sequencing of financial sector reforms when the regulatory environment is weak since moral hazard tends to increase, at least in the short run, in a more liberalized system. The ASEAN-5 financial system shows how important it is to be improved from a view of the fierce.

For Vietnam, measures to sustain economic growth and sound financial development while mitigating the possible financial risks are critically dependent upon both longer term reform processes and the implementation of necessary macroeconomic policies. This paper therefore recommends a broad reform package that aims to: (1) modernize the banking systems by modernizing the State Bank of Vietnam, strengthening risk management in the banking sector under the Basel I capital adequacy framework and financial supervisions systems. The focus is also on capital market development based on the improvement of its fundamentals and speeding up the privatization of large SOEs; and (2) open up the gateway to the region and the world by further financial liberalization and testing the market for necessary adjustments, strengthening the prudential screening and monitoring the marco-policy to prevent speculative financial activities.

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# Sự phát triển hệ thống tài chính của ASEAN-5 và Việt Nam: Phân tích so sánh

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**Tóm tắt**: Bài báo phân tích sự phát triển hệ thống tài chính của ASEAN-5 và Việt Nam. Bằng phương pháp phân tích so sánh, nghiên cứu đã chỉ ra năm điểm tương đồng; đó là áp chế tài chính, hệ thống tài chính lấy ngân hàng làm trọng tâm, tự do hóa tài chính, hệ thống kế toán, và những qui chế tài chính. Hạ tầng cơ sở tài chính của ASEAN-5 và Việt Nam bị lạc hậu so với sự phát triển kinh tế. Cuộc khủng hoảng tài chính tiền tệ Đông Nam Á 1997-1998 đã để lại cho các nước ASEAN-5 nhiều bài học quý liên quan trực tiếp đến việc xây dựng và kiểm soát hệ thống tài chính, để từ đó các nước này triển khai hiệu quả những tiêu chuẩn về toàn vốn tối thiểu, trong khi vấn đề này ở Việt nam chỉ từng bước được đẩy mạnh sau khi gia nhập WTO. Bên cạnh đó, các nước ASEAN-5 đã tiến hành những điều chỉnh phù hợp để tăng cường và mở rộng hệ thống tài chính với nỗ lực xây dựng một hệ thống tài chính bền vững và hiệu quả, trong khi đó Việt Nam còn trong giai đoạn tái cấu trúc để hội nhập với quốc tế và đang từng bước xây dựng thể chế luật pháp đồng bộ cho sự phát triển thị trường tài chính.