

REFORMING THE STATE BANK OF VIETNAM TOWARDS AN INDEPENDENT CENTRAL BANK: THE APPLICATION OF NEW PUBLIC MANAGEMENT IN VIETNAM

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ABSTRACT

The dependence of the State Bank of Vietnam on the Government has shown a number of weaknesses that should be overcome in the next stage of the development process, especially when Vietnam becomes an official member of the World Trade Organization (WTO) in 2018. In this paper, three issues will be covered, including: (1) The independent central bank (ICB) and its positive impact on the development and stabilization of the economy as a theoretical framework for discussion on the need for and the way of the reform of the central bank in developing countries and Vietnam should not be an exception; (2) a factual analysis of the SBV's problems resulting from its high dependence upon the government, as well as opportunities and challenges of reforming the SBV towards an independent central bank; (3) recommendations to ensure the success of SBV reform in the future.

INDEPENDENT CENTRAL BANK – THE NPM MODEL APPLICATION IN GOVERNANCE OF THE CENTRAL BANK IN DEVELOPED COUNTRIES

The central bank (CB) plays an important role in the development of a sound and effective financial system as well as in the economic development and stabilization of developed countries. However, there is general agreement that in these countries the relationship between the CB and the government, the level of independence of the CB from the government, has been specified so that the central bank can carry on well its functions. It's very important and should be emphasized that in developed countries, the governance of the CB is based on the three main principles of New Public Management (NPM) model.

The New Public Management model (NPM), as applied to the CB of developed countries, is defined by three key concepts, also called three 'pillars' [4]: (1) CB independence; (2) CB accountability; (3) CB transparency. Of these, CB independence (CBI) must be the first and primary 'pillar'. While the last two pillars are self-explanatory due to their alignment with the main features of the NPM model, the CBI needs more justification. As discussed in Section 2, the CBI will shift the relationship between CB and commercial banks towards contractual and a market-based nature, allowing bank supervision to be more client-focused and result-based. In fact, all such changes are the evidence of application of the NPM model in the governance of the CB. This implies that the reform of the CB towards an independent model could thereby be seen as one of the most important elements of the public administration reform program in developing countries, particularly in the case of reforming the State Bank of Vietnam in this development stage and onward of the country's economy.

THE IMPORTANCE OF CBI IN STABILIZATION AND DEVELOPMENT OF THE ECONOMY

The most essential advantage of CBI is fighting inflation. Based upon a great deal of real evidence, many economists believe that with more independence the CB can carry out a more creditable and

efficient monetary policy in terms of inflation control and formulation of stabilization of the economy. It is argued that the CB is functioning both as a ‘money stock’ by issuing money and as a ‘money pump’ by controlling over-supply of money and by regulating money demand in the economy.

The ICB can create sustainable real economic growth. According to Lybek [5], both the stability of the financial system and interest rate setting are very important for sustainable real economic growth because both have crucial effects on financial process in the economy. Without the effect of an interest rate setting mechanism of the CBI, the price of using funds is often not reasonably directed by the government, being too low or too high, so that savings cannot be transferred well into investments. Debelle and Fisher [3] have mainly based their work on the CB function while Lybek [4], [5] has approached to the goal and target of independence and also distinguished between the goal and target of the autonomy. However, the general agreement on the types of independence could be defined in a number of aspects including: (1) Legal framework; (2) Policy goal design; (3) Operation determination; (4) Management tools. It is understood that the first aspect is a basic condition and meaningful for the remaining aspects of independence.

RECENT REFORM OF THE BANKING SYSTEM AND THE STATE BANK OF VIETNAM

Prior to the start of the reform in 1988, there was only one bank in Vietnam, namely the National Bank with the straightforward or hierarchical model of organization¹, carrying out the function of both a CB and a commercial bank simultaneously; it was therefore a mono banking system. This system was a former Soviet one and applicable to the previous model of the economy, but no longer suitable for the changes in the economy that have been made since the 1986 renovation programs. From late 1988, Vietnam’s banking system has been transferred into a dual model, in which the State Bank of Vietnam has granted the CB to act separately from commercial banking, which is the role of the four state owned commercial banks (SOCBs) that had been generated² at the time to exercise the function of profitable or business institutions.

Secondly, two Ordinances were enacted in 1990 to define the legal framework for the banking operation of the banking system’s mechanism and activities. Based on the two Ordinances (1990), the SBV had since 1992 no longer continued to have relationships with companies, including state owned enterprises (SOEs), and has since then specialized in the functional operations of the CB of the country. The CB’s clients now are only the commercial banks and the government.

Thirdly, as a result of the above changes, there were a number of remarkable achievements that helped open opportunities for banking supervision and the development of banking markets. It was the first time in Vietnam that the monetary policy and banking supervision had been introduced to conduct the growth of money supply and commercial banking based upon market oriented principles. One should emphasize that the above achievements have had a significant impact on the development and stabilization of the Vietnam economy during the period 1992 to 2002 as well as contributing to the development of the economy up to now. In fact, hyperinflation and many other problems were solved

¹ That is one head office at the central level and its branch networks from province levels to the basic lower levels.

² From specialized departments and branches of the former National Bank of Vietnam.

right after the banking reforms had begun, and the Vietnam economy has experienced a golden period of sustainable development with high rates of economic growth and controlled rates of inflation³.

It is clear that the organization of the SBV is still a typical one, characterized by a Bureaucratic or Hierarchical model: The head office at the central level has multiple functional divisions with a cumbersome network of branches located in each province. This situation has caused too many limitations on the SBV management activities; especially, there is overlap of control in some areas of the banking operations while there is no control or management at all in some others. In addition, there have been a lot of regulations and rules issued, and they are all too specific and complicated for either understanding or applying [6]. This means that the SBV management is not really 'final result-based' but still '*rules-based*', and the consequence is that many of these regulations and rules are 'null and void'⁴.

The second problem is shown by the first Article of the State Bank Law (2010), that the SBV is 'a ministerial agency of the Government, which performs the State management of monetary and banking activities and acts as the CB of the Socialist Republic of Vietnam; and performs the State management of public services under the jurisdiction of the State Bank'. That implies that the SBV is much more completely dependent on the government. The government deficit is financed by additional money issued by the SBV while it belongs to the government; all of which causes a trend toward inflation. Moreover, setting interest rates and exchange rates and regulating them are thereby easily influenced by the government goals at times. This problem is not only reducing the banks' promotion in improving efficiency but is also creating a dubious atmosphere around the banks' operation⁵.

The third problem is concerned with the SBV's financial ability to adjust or regulate the financial markets in order to achieve given goals. It is very clear that the higher the financial controlling position, the stronger the adjustments the CB can make. However, according to the State Bank Law (1998, 2007 and 2010), 'the financial activities of the SBV are completely funded by the government budget based on the State Budget Law'. The question is how an adjustment could be made if there is no general agreement between the State Budget and the SBV on the financial costs or related matters. The SBV is not only heavily dependent on the government but on the State Budget as well.

The fourth and the fifth problems come from the same sources, partly from the three problems discussed above, and partly from using under-qualified human resources rather than 'merit-based' staff. More important is that these two problems will have a negative impact on the SBV accountability and transparency.

REFORMING THE SBV TOWARDS AN ICB MODEL: OPPORTUNITIES AND CHALLENGES

Based on the problems found in the Vietnamese banking system and SBV operations, further SBV reform programs are needed in many ways. The NPM model must be applied to the SBV's functional operations to give it higher independence or autonomy since the SBV is a government agency. Another

³ During 1992-2002, the average growth rate was about 8,3%, while average inflation rate was less than 5,4%.

⁴ An example is that the regulation of foreign exchange management is the most difficult, but the Dollarization and black markets for foreign exchange in Vietnam are still very popular.

⁵ Banks try to hide their profit and financial information will be distorted.

argument is that ‘financial development leads to economic development’ whereby the SBV and the banking system reform could be seen as the correct way to target the goals of industrialization, modernization and global integration of the Vietnam economy.

Currently, there are abundant opportunities, opening for the SBV to be independent, that come from groups who are benefitting from the sustainable development of the Vietnam’s economy. In order to have ‘*good governance*’ of the CB, they are strategic stages to be worked through should be aimed at more independence, accountability and transparency of the SBV. Hence, first, most Vietnamese people will support the reform of the SBV toward an ICB model because it can help satisfy their essential demands. Second, foreign investors doing business in Vietnam also need a sound and transparent environment for their investments and will support the independence of the SBV. Third, international development organizations such as the World Bank (WB), the International Monetary Fund (IMF), the Asian Development Bank (ADB) and the likes would help Vietnam in many ways to implement this reform since they would also gain in turn from the reform of the SBV.

However, on the opposite side, there are also a number of challenges that would obstruct the progress of the reform. Some challenges would come from groups of people who will lose the power of keeping the SBV that helps finance their needs⁶. Other challenges would also stem from the leaders who want to maintain the Bureaucratic model in public sector management [9]. They are either under-qualified or unfamiliar with the NPM model and worry therefore about a possible financial crisis, which may leave them no other choices, if the SBV is allowed to become independent. Finally, people who choose to satisfy their self-interests by corruption will be against the independent model of the SBV because they will no longer be able to continue their corruption due to the soundness and transparency of the SBV operations resulting from the independence.

RECOMMENDATIONS

Regardless of the realized challenges, the reform of the SBV must be continued, and the success is doubtless. Beside many other undertaken solutions and recommendations, the five following solutions could be additionally applicable.

- a) The reform of the SBV should be accompanied by an improvement in the thinking of the leaders and with a change in their points of view. This solution is critically important because it will yield more powerful leaders to support the new model of the SBV. It is necessary for them to attend related intensive training courses conducted by experienced professors and practitioners. In addition, advisory boards in each field of governance should be organized to assist the leaders in making decisions on the orders for the reform process.
- b) It is necessary to improve the legal framework for the SBV’s functional operations to support the independence of the SBV from the government. This solution is also very important since the above-mentioned legal framework is the primary condition and necessity for the SBV to be independent. The State Bank Law (2010) should be improved so that the SBV will be no longer a ministerial government agency. At the same time, the articles, which regulate the SBV’s operation mechanisms, should be revised for ease of general understanding and comprehension rather than being complicated with too much detail, as in its current version.

⁶ They need to reach faster economic growth as well as other social goals before election time

c) Restructuring the SBV organization according to the model of the CB in financially developed countries, resulting in a good CBI and good governance of the CB. Many large and developed countries with strong economies have the organization of their CB's simple and far different from the bureaucratic organization of SBV. Changes in organization will support the changes in the operation mechanisms, particularly by applying the model of 'NPM' emphasizing the combination of more result-based and law-based management tools.

d) Increasing the financial position of the SBV. This solution should be also considered as the 'second runner-up' because the SBV would not be independent, if the SBV is granted independence or autonomy, with such weakness of financial capability, even at its current strength. It is imperative to separate the SBV activities from the State Budget facilities by determining the amount of capital that the SBV should have to conduct its own functions.

e) Last but not least, improving the money markets in Vietnam, in which the SBV will be the biggest bank, or having partnerships with any other banks without supreme control, is a very significant solution. It is argued that money markets development is the best way for interest rate and exchange rate setting [7] because these 'prices' are also determined by market forces, as any other type of markets. Furthermore, the SBV can minimize the costs of intervention and adjustment programs from the developed money market operation.

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