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Financial Liberalization Process of Vietnam

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Abstract: Liberalizing the financial system is not only the mandatory requirement for international integration but also a trend that is able to bring enormous potential to each country. During the integration process, Vietnam has made remarkable strikes in order to accelerate the process of liberalization of financial system. The paper uses Principal Component Analysis method for calculating the financial liberalization index for the purpose of assessing the progress of Vietnam financial liberalization over a period from 1990 to 2016. After reviewing and analyzing the efforts that the Vietnamese Government has made in recent years, the paper offers several policy implications to promote the process of financial liberalization of Vietnam over a coming period.

Keywords: financial liberalization index (FLI), principal component analysis (PCA), financial liberalization process.

1. INTRODUCTION

Financial liberalization is a key element in preparation for the international integration process. It would assist each country with facilitating transparent financial environment, supporting individuals and organizations access to various types of diversified financial services thus increasing the competitiveness and stimulating economic development.

For Vietnam, the process of financial liberalization began in the 1990s with innovations in the macroeconomic policies in the direction of opening the economy to integration with the world economy. Over the past two decades, Vietnam has made remarkable strides, such as the gradual liberalization of interest rates, reduction in restrictions on the activities of credit institutions, attraction of foreign investment flows to promote the liberalization of the economy in general and of the financial system in particular. Especially when Vietnam became a member of international trade organizations such as the WTO, APEC, ASEM, AEC and signed the Trans-Pacific partnership agreement, financial liberalization is having more important role. Therefore it is necessary to have an accurate analysis of the process of financial liberalization in Vietnam in order to promote the benefits and limit the negative impacts on the economy while providing appropriate direction for the Vietnamese economy for the coming period.

The objective of the paper is to calculate financial liberalization index (FLI), using Principal Component Analysis method (PCA) to analyze the policies that the Vietnamese Government has implemented over a period of 1990-2016. Based on the empirical results, the paper suggests some policy implications for the Vietnamese Government for consideration.

The paper is consisted of 4 parts in which the introduction is in Part 1. Part 2 presents literature review. Methodology and empirical results are shown in Part 3. Conclusion and policy suggestions are given in Part 4.

2. LITERATURE REVIEW

Given the inevitability of financial liberalization for the economic integration process and the impact that it brings to countries and regions, the subject of financial liberalization is an attractive topic for many economic researchers. There has been a lot of papers addressed various aspects of financial liberalization process.

The process of financial liberalization in Vietnam are shown in the papers presented at the symposium namely "Financial Liberalization – tendency and policy solutions" organized by the State Bank of Vietnam (2007) and analyzed by Hoai N. (2007), Thien (2011), Nhan T. M. Truong (2011) and Tinh T. T. Bui (2013). Various aspects of the financial liberalization in Vietnam are examined by many authors. Long V. (2002) introduces the process of interest rate liberalization. Andreas Hauskrecht and Nhan Le (2005) concentrate on the opening capital market process, which has been implemented since 1990, and analyze its effects on capital flows and process of dollarization in Vietnam. Ngoc M. Phan (2007) comments on prospects of capital account liberalization in Vietnam based on experience of China. Hung (2009) suggests policy implementations for capital transactions liberalization in Vietnam. Hang et al. (2010) evaluate elements affecting exchange rate policy in the process of recovering the economy of Vietnam.

Measuring financial liberalization is done by many researchers around the world. Quinn (1997) constructs an international FLI for 21 OECD countries over a period of 1950-1997 and for the years 1959, 1973, 1982, 1988, 1997 for 43 developing countries. Bandiera (2000) calculates FLI using 8 dummy variables representing various dimensions of liberalization process. Laeven (2003) uses the similar method to construct FLI, however, he excludes the components relating to stock market and external sector in his index. Quispe -Agnoli and McQuerry (2001) aim to construct an index measuring the level of liberalization in banking sector from 1980 to 2000 in five countries in Latin America. The authors indicate the important factors contributing to the process of financial liberalization in those countries. Kaminsky and Schmukler (2003) show the impact of short-term and long-term financial liberalization to capital markets using FLI and market ratios of 28 countries from1973 to 1999. The empirical results are used to compare liberalization levels of developed countries with those of emerging countries. The paper concludes that the liberalization process could be followed by "booms and bursts" in the short run, but could help stabilize markets in the long run. Atsede and Kolawoleadeniji (2008) assign scores to liberalization events to measure the degree of financial liberalization in Nigeria. Abiad *et al.* (2008)

introduce a set of financial reforms covering 91 economies over a period from 1973 to 2005. The authors give scores to historical events in order to create an index of financial reform. Ning Yu (2014) analyses 19 countries of G20 to measure the level of financial and capital account openness. In this paper, capital account liberalization events are given score and estimated weights to find out the degree of openness. Along with the openness level, the paper indicates that in developed countries there is a trend of limitations to FDI for national safety, however, developing countries are welcomed flows of foreign capital.

Constructing FLI using Principle Component Analysis is done by several authors. Shrestha and Chowdhury (2006) measure financial liberalization in Nepal during the period 1970-2003. The components of FLI are Interest Rate Deregulation, Removal of Entry Barriers, Reduction in Reserve Requirements, Easing in Credit Controls, Implementation of Prudential Rules, Stock Market Reform, Privatization of State-owned Banks and External Account Liberalization. The authors give each of these components with such values as 0, 0.33, 0.5, 0.66, 1 depending on the degree of liberalization status. 0 means component is totally restricted by the government and 1 is given for the ones fully liberalized by the government.

Similar method is used by Adikari (2014), who chooses values such as 0, 0.25, 0.5, 0.75, and 1 to assess the financial liberalization process of Sri Lanka from 1977 to 2011. The 0 and 1 are given to components totally controlled and completely opened by the government, respectively. The researched components are Interest Rate, Exchange Rate, Reserve Requirements, Credit Supply, Capital Account Liberalization, Current Account Liberalization, Share and Bond Market Reform, Money Market Reform, Banking Policy Reforms.

Bouzid and Padhia (2014) estimate FLI of Tunisia for a period from 1980 to 2012. Natural numbers from 0 to 6 are chosen to assign for the liberalization events. The variables of this model are Deregulation of Interest Rates, Removing Barriers to Entry, Reduction in compulsory reserve requirements, Relaxation in credit checks, Regulation and Banking Supervision, Privatization of State-owned Banks.

3. METHODOLOGY AND EMPIRICAL RESULTS

Financial Liberalization is considered as a process of reducing the government's restrictions on operation of national financial system so that this system would perform more independently and effectively in accordance with the market rules.

In order to assess the level of financial liberalization, the paper analyzes the process of both domestic and international liberalization. Domestic financial liberalization is defined as the reduction or elimination of interest rate controls as well as the application of policies which enable financial institutions to carry out transactions based on market rules. International liberalization means that the government's restrictions on capital transactions between Vietnam and other countries are reduced or removed.

In this paper, the level of financial liberalization in Vietnam from 1990 to 2016 is measured using the FLI. The paper model is constructed based on the methods done by Shrestha and Chowdhury (2006), Adikari (2014), Bouzid and Padhia (2014).

All of these papers use Principal Components Analysis (PCA) method to derive a FLI for a particular period. Firstly, each components of the model is analyzed using PCA method. The results given by PCA are scores of the components. In the end, a FLI is calculated by summarizing the scores of each year. The purpose of using PCA is to reduce a large set of highly correlated variables to a small set which still contains most of the information in the original one.

3.1. Components of Financial Liberalization Index

The period of this research began from 1990 when Vietnam converted into the dual level banking system, in which there were commercial banks operating under the Bank Ordinance No 37-LCT/HĐN issued by the State Bank of Vietnam (SBV).

The main components of FLI in this paper are following (1) Interest rate liberalization (IR); (2) Exchange rate liberalization (ER); (3) Financial and Capital account liberalization (FCA); (4) Privatization of State-owned Banks and liberalization of financial institutions' operation (PSBFO); (5) Liberalization in the stock market (SM); (6) Reduction in Reserve requirements (RRR); (7) Easing in Credit Controls (CC).

Validated policies promulgated by the government and the SBV as well as economic - financial events are collected and assessed to assign values to the above components.

3.1.1. Interest rate liberalization (IR)

Interest rate is considered to be liberalized when the equilibrium rate is completely adjusted with market signals. The central bank not only uses an indirect mechanism to regulate interest rates but also allows commercial banks and other financial institutions to decide by themselves the interest rates.

In Vietnam, after 2 years during which the SVB set the interest rates directly, the regulation mechanism had been eased since 1992 with the "frame of interest rates". In 2002, the Decision No.546/2002/QĐ-NHNN was published by the SBV, according to which the interest rates had been fully liberalized and decided by the commercial banks.

Due to the "interest rate race" among the commercial banks in the years of 2008 – 2011, the SBV had to change the regulation. In order to stabilize the market, interest rate ceiling was applied again. The ceiling level has been declined when the market temperature subsided. In 2015, the financial liberalization process has deviated slightly since the SBV assigned USD deposits the interest rate of 0% to prevent the process of dollarization and to attract VND deposits as well as to reduce the pressure on exchange rates.

3.1.2. Exchange rate liberalization (ER)

In the process of financial liberalization, the exchange rates are gradually determined by currency supply – demand relationship in the market. The Decree No.70/2014/NĐ-CP states that the Vietnamese dong exchange rate system is a managed floating system regulated by the SBV in accordance with macroeconomic objectives for each period of time. Until the year of 2014, the exchange rates had been published by the SBV using interbank market rates.

3.1.3. Financial and Capital account liberalization (FCA)

Financial and Capital account liberalization means that capital flows can transfer freely from low to high return countries without any restrictions imposed by the government.

Since 1990, FCA had been implemented in the first step when Vietnam allowed firms with foreign capital to operate. However, the proportion of invested capital was assigned by the Committee of Ministers. One year later, the Decree No.28-HĐBT permitted to establish enterprises with 100% foreign capital to operate as limited liability companies. For direct investments abroad, the Decree No. 78/2006/NĐ-CP restricted the minimum of capital for projects sponsored by the state budget.

In 2000, after the Law on Foreign Investment in Vietnam (1996) had been amended, the tax rates applied to investors transferring return to foreign countries and investing in Vietnam both decreased to create good conditions for capital inflows.

Several significant events expanding international economic relations of Vietnam during the period of 1990-2016 such as establishing relations with the International Monetary Fund IMF and the World Bank (1993), participating in various trade agreement such as ASEAN Free Trade Area (1995), the Asia-Europe Meeting ASEM (1996), Asia-Pacific Economic Cooperation APEC (1998), World Trade Organization WTO (2007) have also contributed to speed up the process of financial liberalization in Vietnam.

3.1.4. Privatization of State-owned Banks and liberalization of financial institutions' operation (PSBFO)

The PSBFO is defined as the elimination of the government direct controls on activities of financial institutions. The PSBFO means that the Government recognizes private ownership of commercial banks and financial institutions, the right of those institutions to run their business independently. It also includes an expansion of international cooperation along with foreign financial institutions as well as a reduction in reserved requirements.

According to the Bank Ordinance No 37-LCT/HĐN issued by the SBV in 1990, there were only four State owned- commercial banks such as Vietnam Bank for Industry and Trade (Vietinbank), Bank for Foreign Trade of Vietnam (Vietcombank), Bank for Investment and Development of Vietnam (BIDV), Bank for Agriculture and Rural Development (Agribank), which are permitted to provide bank services. The Amended Law on Credit Institutions Vietnam in 2004, however, had allowed foreign credit institutions, foreign banks' branches and their representative offices to operate in Vietnam.

The year of 2008 marked an important event in Vietnamese financial liberalization process when Vietcombank, the first of the 4 State owned-commercial banks successfully held an IPO on June, 2nd. Following Vietcombank IPO were Vietinbank's in December, 2008 and BIDV's in April 2012. Nowadays Agribank is remained the only bank totally owned by the Government of Vietnam.

3.1.5. Liberalization in the stock market (SM)

Liberalization in the stock market is one of important factors of the whole liberalization process. A liberalized stock market allows the Vietnamese and foreign investors to hold securities legally and attract more capital flow into Vietnam.

The Vietnam stock market has officially opened since 2000 when the first transaction was carried out in the Ho Chi Minh Stock Exchange on July 28th. The UPCoM market was opened in the middle of 2009 allowing transacting securities of unlisted public companies.

In order to attract more capital, the Government of Vietnam had also eased regulations for foreign investors. The Decree No.58/2012/NĐ-CP issued by the Government in 2012 permits foreign investors to purchase shares or to invest capital own up to 49% of the charter capital of securities investment company. According to the Decree No.60/2015/NĐ-CP in 2015, the foreign investors shall be entitled to make unrestricted investments in certificates of securities investment funds, stocks of securities investment companies, non-voting stocks of public companies and derivative securities.

3.1.6. Reduction in Reserve requirements (RRR)

One of the SBV's methods to control activities of credit institutions is the Reserve requirements, with which the State Bank is able to impact on banks' amount of loans and interest rates. During the period of 1990 – 2016, required reserve ratios have been adjusted by the SBV based on market conditions. The SBV has been continuously maintaining the ratios lower than 10% and reducing every year. In spite of the declining required reserve ratios, the ones for short term deposits (less than 12 months) in 2008 were 11%. In 2015, apart from some banks under special control, other banks under reconstruction shall be also considered to have reducing required reserve ratios in order to finance further recoveries and investments post-M&A.

3.1.7. Easing in Credit Controls (CC)

Credit Controls are the restrictions on the amount of loan provided by banks and other credit institutions for the economy. This tool is only used by the SBV during high inflation stage in order to control money supply.

During the period from 1991 to 1995, the SBV had been strictly applying credit restriction on each bank and implemented a tight money policy so that there were direct effects on limiting the increasing of money supply M2. The period of 1998 – 2010 was the "liberal" stage with credit operation when the credit controls had not been used as a common tool for conducting money policy. However, due to the "too hot" credit growth and high inflation with the CPI of 18.13% in 2011, the SBV had to bring back the restrictions. Within the two years of 2015 and 2016, the controls have been operated but adjusted in accordance with the banks' conditions.

3.2. Measurement of Financial Liberalization Index

On the basis of analyzing the events and policies happened during a 27 year period of financial liberalization, the paper assigns value to each components of the FLI. Each of the 7 factors mentioned in 3.1 can take a value between 0 and 1 depending on the increasing level of liberalization. Particularly, the components totally restricted take the 0 value while 1 is used for the ones completely liberalized. The values of 0.17, 0.33, 0.5, 0.66, 0.83 are given to components, which are in various levels of liberalization process.

In the model, the 7 components of the FLI are expressed in the following equation:

$$\mathrm{FLI} = w_1\ \mathrm{IR} + w_2\ \mathrm{ER} + w_3\ \mathrm{FCA} + w_4\ \mathrm{PSBFO} + w_5\ \mathrm{SM} + w_6\ \mathrm{RRR} + w_7\ \mathrm{CC}$$

In this equation, FLI means the financial liberalization index and w_i is a weight of component given by PCA method.

Table 3.1
Data of Financial Liberalization components in Vietnam

Year	*IR*	*ER*	*FCA*	*PSBFO*	*SM*	*RRR*	*CC*
1990	0	0	0,17	0,17	0	0	0
1991	0	0	0,17	0,17	0	0	0
1992	0,17	0	0,33	0,17	0	0	0
1993	0,17	0	0,33	0,17	0	0	0
1994	0,33	0,17	0,33	0,17	0	0	0
1995	0,33	0,17	0,5	0,17	0	0,33	0
1996	0,33	0,17	0,66	0,17	0,17	0,33	0
1997	0,33	0,17	0,66	0,17	0,17	0,33	0
1998	0,33	0,17	0,66	0,17	0,33	0,33	1
1999	0,33	0,5	0,5	0,17	0,33	0,66	1
2000	0,5	0,5	0,66	0,17	0,5	0,66	1
2001	0,66	0,5	0,66	0,17	0,5	0,66	1
2002	1	0,5	0,66	0,17	0,5	0,66	1
2003	1	0,5	0,66	0,17	0,5	0,66	1
2004	1	0,5	0,66	0,33	0,5	0,66	1
2005	1	0,5	0,66	0,33	0,5	0,66	1
2006	1	0,5	0,5	0,33	0,5	0,66	1
2007	1	0,5	0,83	0,33	0,5	0,33	1
2008	0,66	0,5	0,83	0,5	0,5	0,33	1
2009	0,66	0,5	0,83	0,5	0,5	0,66	1
2010	0,66	0,5	0,83	0,5	0,5	0,66	1
2011	0,66	0,5	0,83	0,5	0,5	0,66	0
2012	0,5	0,5	0,83	0,5	0,66	0,66	0
2013	0,5	0,5	0,83	0,5	0,66	0,66	0,17
2014	0,5	0,5	0,83	0,5	0,66	0,66	0,17
2015	0,5	0,5	0,83	0,5	0,83	0,66	0,33
2016	0,5	0,5	0,83	0,5	0,83	0,66	0,33

Table 3.2
Result of Principal Component Analysis

Principal Components Analysis
Sample: 1 27
Included observations: 27
Computed using: Ordinary correlations
Extracting 3 of 7 possible components
Maximum number of components: 3

Eigenvalues: (Sum = 7, Average = 1)

Number	*Value*	*Difference*	*Proportion*	*Cumulative Value*
1	4,911359	3,703758	0,7016	4,911359
2	1,2076	0,906354	0,1725	6,118959
3	0,301246	0,051553	0,043	6,420206

Eigenvectors (loadings):

Variable	*PC 1*	*PC 2*	*PC 3*
IR	0,358688	0,391618	0,45123
ER	0,43874	0,05945	-0,13472
FCA	0,396257	-0,25863	0,036072
PSBFO	0,309847	-0,57232	0,539204
SM	0,422174	-0,18515	-0,18628
RRR	0,413737	0,033149	-0,63783
CC	0,276434	0,642873	0,21136

The results from Table 3.2 show that seven components of financial liberalization process in Vietnam are converted into 3 "principal components" such as PC1, PC2, PC3. The Eigenvectors of each PC are the w_i values of the original variables. The Eigenvalues display how much "information" conveyed in each PC.

Table 3.3
Eigenvectors and Eigenvalues

Variables	*Eigenvectors (λk)*			
	λ1	*λ2*	*λ3*	
IR	0,358688	0,391618	0,45123	
ER	0,43874	0,05945	-0,13472	
FCA	0,396257	-0,25863	0,036072	
PSBFO	0,309847	-0,57232	0,539204	Sum of Eigenvalues
SM	0,422174	-0,18515	-0,18628	
RRR	0,413737	0,033149	-0,63783	
CC	0,276434	0,642873	0,21136	
Eigenvalues (λk)	4,911359	1,2076	0,301246	**6,4202**

According to Table 3.3, PC1 is accounted for 77% of the total Eigenvalues (conveying the most "informatively"). This means that the research model is able to take w_i values calculated with λ1. The FLI Equation is following:

$$FLI = 0{,}358688*IR + 0{,}43874*ER + 0{,}396257*FCA + 0{,}309847*PSBFO + 0{,}422174*SM + 0{,}413737*RRR + 0{,}276434*CC$$

The FLI of each year is estimated by summing up the scores that 7 components have taken with their corresponding w_i. The following table presents summarized FLI from 1990 to 2016.

Table 3.4
Financial Liberalization Index from 1990 to 2016

Year	*IR*	*ER*	*FCA*	*PSBFO*	*SM*	*RRR*	*CC*	*FLI*
1990	0,0000	0,0000	0,0674	0,0527	0,0000	0,0000	0,0000	0,1201
1991	0,0000	0,0000	0,0667	0,0514	0,0000	0,0000	0,0000	0,1181
1992	0,0610	0,0000	0,1294	0,0514	0,0000	0,0000	0,0000	0,2418
1993	0,0610	0,0000	0,1294	0,0514	0,0000	0,0000	0,0000	0,2418
1994	0,1184	0,0742	0,1294	0,0514	0,0000	0,0000	0,0000	0,3734
1995	0,1184	0,0742	0,1961	0,0514	0,0000	0,1355	0,0000	0,5756
1996	0,1184	0,0742	0,2588	0,0514	0,0722	0,1355	0,0000	0,7105
1997	0,1184	0,0742	0,2588	0,0514	0,0722	0,1355	0,0000	0,7105
1998	0,1184	0,0742	0,2588	0,0514	0,1401	0,1355	0,2869	1,0653
1999	0,1184	0,2182	0,1961	0,0514	0,1401	0,2710	0,2869	1,2821
2000	0,1793	0,2182	0,2588	0,0514	0,2123	0,2710	0,2869	1,4779
2001	0,2367	0,2182	0,2588	0,0514	0,2123	0,2710	0,2869	1,5353
2002	0,3587	0,2182	0,2588	0,0514	0,2123	0,2710	0,2869	1,6573
2003	0,3587	0,2182	0,2588	0,0514	0,2123	0,2710	0,2869	1,6573
2004	0,3587	0,2182	0,2588	0,0998	0,2123	0,2710	0,2869	1,7057
2005	0,3587	0,2182	0,2588	0,0998	0,2123	0,2710	0,2869	1,7057
2006	0,3587	0,2182	0,1961	0,0998	0,2123	0,2710	0,2869	1,643
2007	0,3587	0,2182	0,3255	0,0998	0,2123	0,1355	0,2869	1,6369
2008	0,2367	0,2182	0,3255	0,1513	0,2123	0,1355	0,2869	1,5664
2009	0,2367	0,2182	0,3255	0,1513	0,2123	0,2710	0,2869	1,7019
2010	0,2367	0,2182	0,3255	0,1513	0,2123	0,2710	0,2869	1,7019
2011	0,2367	0,2182	0,3255	0,1513	0,2123	0,2710	0,0000	1,415
2012	0,1793	0,2182	0,3255	0,1513	0,2803	0,2710	0,0000	1,4256
2013	0,1793	0,2182	0,3255	0,1513	0,2803	0,2710	0,0488	1,4744
2014	0,1793	0,2182	0,3255	0,1513	0,2803	0,2710	0,0488	1,4744
2015	0,1793	0,2182	0,3255	0,1513	0,3525	0,2710	0,0947	1,5925
2016	0,1793	0,2182	0,3255	0,1513	0,3525	0,2710	0,0947	1,5925

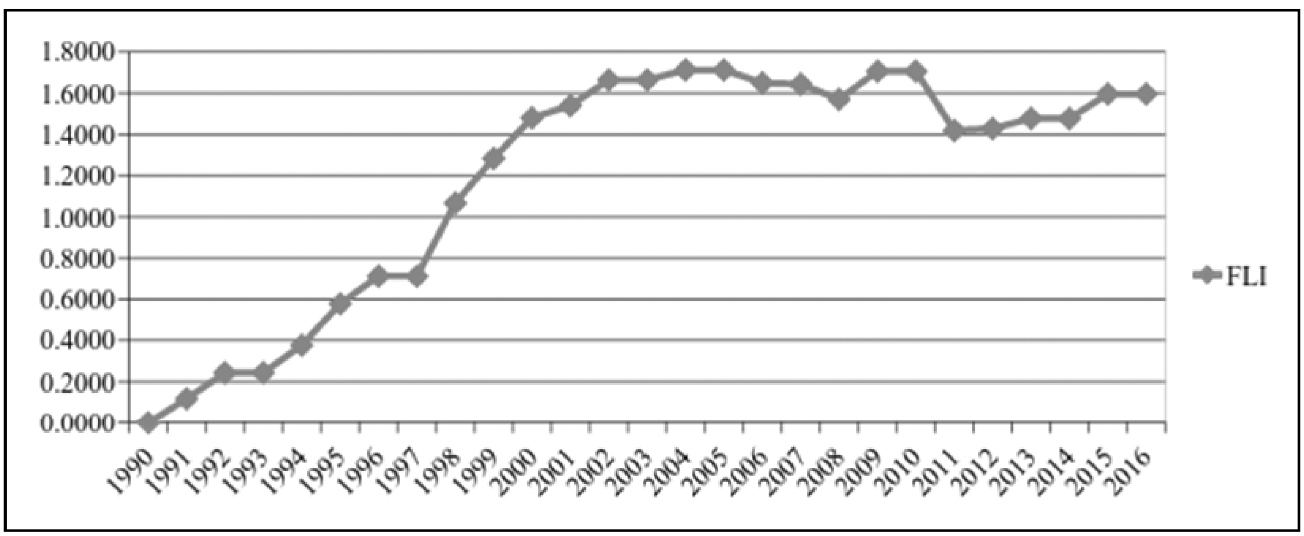

Figure 3.1: Financial Liberalization Index from 1990 to 2016

The model's line graph shows that financial liberalization process in Vietnam began from 1990s and has observed many sharp fluctuations such as fast growth in the end of the 20th century, long-term stability in the period of 2002 – 2007 and remarkable instability in the period of 2008 – 2016.

In the first stage from 1990 to 1997, financial liberalization process started to extend virtually twice times for every 2 years (1990 - 1993) and kept extension from the late of 1993 to 1996 and remained stable until 1997.

The trend for FLI growth from 1998 to 2007 in Vietnam looked like arc directed to the left. Particularly, this index increased sharply annually during the period of 1998 – 2002 and remained around 1.7 in the following 4 years. In the last 2 years, the index started to decrease slightly to the number of 2002-2003.

The last years of a period from 2007 to 2016 have observed unpredictable instabilities of FLI in Vietnam. 2008 ended downward trend of FLI, however, the FLI just rose to 1.7 by 2010 and started to drop to 1.4 in 2011. The positive signs of the index appeared from 2012 to 2015. However 2016 did not recognize any significant changes in the financial liberalization policies in comparison with the previous years.

4. CONCLUSIONS AND SUGGESTIONS

The empirical results show that the FLI in Vietnam tended to increase gradually during the researched period. This indicates that the Vietnam market has become liberalized. However, some decreases in the line graph also show that the reasons of the low speed of financial liberalization in several years are negative economic events or restrictive policies imposed by the Government of Vietnam. Analyzing financial events and validated policies, which have resulted in those fluctuations, give us following conclusions about financial liberalization process in Vietnam.

The financial liberalization has speed up the process of opening the Vietnamese economy. As the Government of Vietnam was aware of the importance of financial liberalization so that all necessary conditions for foreign capital inflow considered as the earliest form of financial liberalization were permitted as early as the very beginning of reconstructing economy period. Although financial liberalization in Vietnam started later than in some neighbors' countries such as Thailand or China, however, its speed was faster as the restrictions on policies of exchange rate, interest rate and banking system operations were removed at the beginning stage. Due to those efforts Vietnam has gradually qualified integration criterions of international organizations such as ASEAN, WTO and AEC. The securities market boom in the period of 2006- 2007 in Vietnam surely contributed to the national economic development and attracted a lot of foreign investors. In spite of low growth recently the Vietnamese securities market still has potential investment opportunities because foreign investors now have been allowed to invest unlimitedly into Vietnam securities market.

It is also necessary to mention that huge capital inflows in the peak period of financial liberalization and insufficient management experience also resulted in unstable domestic market in Vietnam for some period of time. For example Vietnam faced high inflation rate right after WTO integration because of huge capitals inflows raising money supply. Besides, financial liberalization alongside not sufficiently transparent legal framework made the economy facing the process of dollarization and bubbles in credit growth. As a result, the government needed to intervene in the market by imposing more strictly policies. Due to financial liberalization the domestic banks and financial institutions are now facing more competitions from foreign financial institutions. Therefore, many local banks having low capital and weak risk management practices are now under the process of reconstruction.

In the scope of global integration trend, despite various advantages financial liberalization still implicitly has risks, especially for the developing countries. Therefore, policy-makers should take financial liberalization into consideration with proper strategies. Following suggestions may be considered in order to accelerate financial liberalization process in Vietnam for the near future.

Firstly, the inflation rates are needed to be controlled effectively. The situation in Vietnam shows that the stable macroeconomic conditions are essential for the success of implementing financial liberalization. Conducting financial liberalization under high inflation may result in uncontrolled growth of both interest rate and inflation rate, expansion of the gaps between real interest rate and nominal interest rate, fluctuations of exchange rates and capital flows as well as decrease of the effects of monetary policy.

Secondly, it is necessary to reconstruct financial system in order to ensure transparency and accountability. The government should adjust some regulations in the tendency of reducing its control over the financial system, limiting cross-ownership or privileges in financial institutions. These efforts would encourage transparent operations and enhance competitiveness of financial system in Vietnam.

Thirdly, it is important to be proactive in preventing financial liberalization risks. Particularly, reserving enough foreign currencies would assist the economy with controlling local currency depreciations. Besides, adjusting domestic legal regulations in compliance with international standards, controlling flexibly capital, interest rate and exchange rate as well as conducting monetary policy using the market principles would also help to reduce financial liberalization risks.

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