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Financial Markets in Developing Countries he Role of Financial Integration and Globalization and pratices in Vietnam

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FINANCIAL MARKETS IN DEVELOPING COUNTRIES, THE ROLE OF FINANCIAL INTEGRATION AND GLOBALIZATION, AND PRATICES IN VIETNAM

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I. Introduction:

Over the last thirty years, financial integration and globalization become more and more important. They are considered as an inevitable and irreversible trend.

There are various studies on financial globalization which show that financial globalization brings many benefits for developing countries. The main benefits of financial globalization are promoting the development of financial systems in developing countries and fostering economic growth. The integration of developing countries in the international financial market makes their financial markets become more diversified, complete and better regulated. Consequently, the development of financial markets will boost the economy growth.

However, financial globalization and integration also carry potential risks. Because the financial system in developing countries is premature and incapable of coping with risks, when integrating in the international financial market, the financial market of these countries become more vulnerable. They are exposed to shocks and crises from developed countries. The crises in financial market can substantially disrupt the economy. In addition, massive influx of foreign capital can lead to excessive credit growth and asset bubbles in the developing countries which can make them collapsed. However, the literature shows that the net effect of financial integration and globalization on developing countries is likely positive.

Vietnam implemented a comprehensive and radical reform in 1986. It started to open the economy and integrate its financial market with the international financial market from the early of 1990s. Since then, the country has experienced a quick development. It moved from one of the poorest countries in the world to a lower middle income country in 2011 and hit Millennium Development Goals in 2015. The average of GDP growth rate from 1990 to 2015 is around 7%, among the fastest in the world.

Nevertheless, integration and globalization also brought to Vietnam many challenges; especially the negative effects from Asian financial crisis which was triggered in Thailand in 1997 and from the international financial crisis which stemmed from the USA in 2007. Vietnamese economy became more volatile. Inflation fluctuated widely and soared to two digits during the periods of global financial crisis. Vietnamese financial market faced with high risks from the significantly increasing non-performing loans (NPLs). Therefore, I am motivated to study the role of financial integration and globalization in developing countries in order to acquire a thorough knowledge and understand possible measures to maximize the benefits of globalization and minimize its risks.

II. Methodology:

I will mainly base on literature review of papers which cover all aspects relating to financial globalization and effects of financial globalization on developing countries. The papers are collected from different sources including academic research from World Bank, IMF, economic journals, online articles, etc… The purpose is to deepen my understanding on financial globalization by synthesizing knowledge from different sources and produce a general idea of the role of financial globalization and integration in developing countries.

Basing on the synthesized knowledge, I will make a link and comparison to the practices in Vietnam. How have the financial market and the economy of Vietnam evolved since it integrated in the international financial market? What is the structure of financial market in Vietnam at this moment? I will analyze data including GDP, FDI, import and export, etc… to see the achievements of Vietnamese economy through the integration process. Besides, I will also analyze data such as inflation, interest rate, NPLs ratio, stock market price volatility, and etc… to evaluate negative effects of financial globalization on Vietnamese economy.

III. Literature review:

1. Definition:

Sergio L. Schumukler (2004) and Eswar Prasad et al (2003) define financial integration as a process through which a country opens its financial market to foreign parties, or integrate it with the international financial market. It leads to a situation in which capital or funds can move easily from this country to other countries, or vice versa. It implies the elimination of barriers for international financial intermediaries to operate in the country or to offer cross-border financial services to the country. Regarding financial globalization, it is another terminology which is defined as global linkages through cross-border financial flows. In general, these two concepts, financial integration and financial globalization, are relatively similar to each other so that in this paper, they are used interchangeably.

2. Benefits of financial globalization on developing countries:

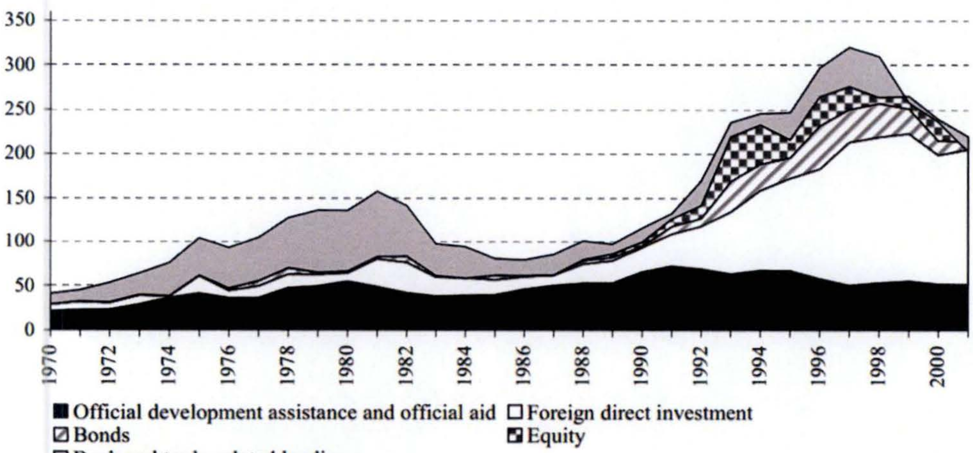
Literature shows that developing countries can benefit largely from financial globalization, especially the development in their financial system, followed by the stimulation for economic growth.

Financial globalization can help to develop the domestic financial system through several channels. Firstly, the presence of foreign financial institutions in the domestic market creates greater competition with domestic financial institutions. Greater competition forces the domestic financial institutions to innovate, enhance their operations and management and construct a better legal and accounting infrastructure in order to be able to compete with the foreign institutions. Even more, Mishkin (2003) argued that with the presence of foreign banks in the domestic financial markets, governments are less likely to bail out domestic banks when the domestic banks have solvency problems so that the domestic banks are encouraged to a more prudent behavior and better management. Therefore, financial integration improves the quality and efficiency of domestic financial institutions. Secondly, financial globalization promotes better economic policies and more advanced financial system. When entering the market of developing countries, foreign financial institutions bring along their expertise, best practices in credit assessment and risk management, and diversified financial instruments, so that it leads to reforms of the financial system in developing countries to improve its functioning. The stringent market disciplines imposed by financial globalization forces the government of developing countries to reform economic policies and regulation in order to adapt with international standards. The adoption of international standards and better economic policies, in turn, increase the transparency and efficiency of the financial system, minimize risks, and promote economic growth.

Financial globalization also provides benefits for developing countries by creating a better access to capital. It helps funds move easily from countries with excess funds to countries with a shortage. When a country integrates into the international financial market, it signals a more friendly investment environment, which results in more capital inflows. In addition, labor is cheaper in developing countries so that the return of capital can be higher in these countries. One could expect capital flows from developed countries where the return of capital is relatively low to developing countries where the return of capital is relatively high. Sergio L. Schmukler (2004) showed that net capital flows to developing countries had increased dramatically by all types (bonds, Foreign Direct Investment FDI, Official Development Assistance ODA, equity, bank and trade-related lending) since the 1970s via the following figure.

Figure 1: Net Capital Flows to Developing Countries 1970-2001: By Type of Flow

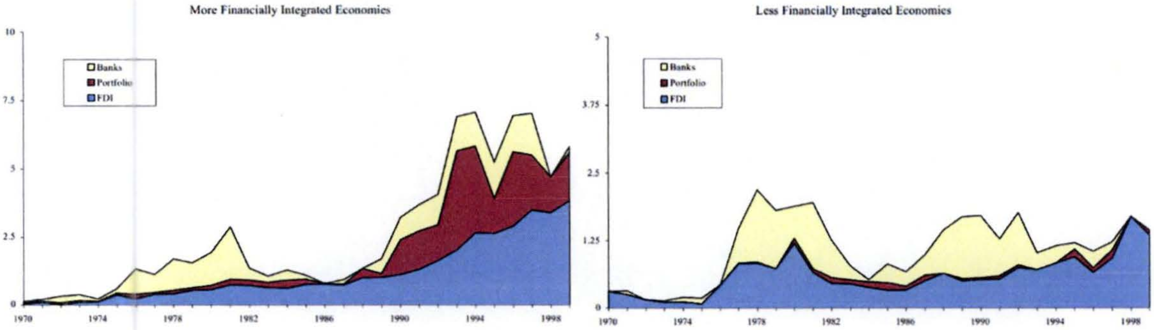
(In billions of constant US Dollars)



Source: Benefits and Risks of Financial Globalization: Challenges for Developing Countries, 2004, by Sergio L.Schmukler.

Eswar Prasad et al (2003) also examined capital flows to developing countries over the last four decades. They divided the developing countries into two groups, one is MFI – More Financially Integrated countries and the other is LFI – Less Financially Integrated countries and they found that most of capital flows went to MFI; only a small fraction of capital flows went to LFI. This pattern was also true for FDI, portfolio flows as well as bank lending.

Figure 2: Gross Capital Flow (Percent of GDP)



Note that the left scales on the two panels are different.

Source: Effects of Financial Globalization on Developing Countries: Some Empirical Evidence, 2003, by Eswar Prasad, Kenneth Rogoff, Shang-Jin Wei and M. Ayhan Kose.

Thus, the more integrated in the international financial market a country is, the more capital it can attract from foreign countries. The availability of investment capital is an important factor to facilitate economic growth. Firms can easily access capital at a lower cost, invest more, and expanse their business. They can not only borrow from the domestic market but also from international markets and so, reduce equity risk. The increased capital inflows make the domestic financial market become more liquid and the participation of both domestic and foreign investors creates a greater risk sharing mechanism.

In addition, the increased capital inflows, especially FDI, are often accompanied by high technology and advanced management. Therefore, financial globalization can generate a transfer of technological and managerial know-how from developed countries to developing countries which can raise the productivity in developing countries and stimulate economic growth.

Eswar Prasad et al (2003) examined the positive effect of financial globalization on growth. Table 1 shows that the countries which experienced a high economic growth are more financially integrated while the countries which experienced a slow growth or negative growth are less financially integrated.

Table 1: Fastest and Slowest Growing Economies during 1980–2000 and Their Status of Financial Openness

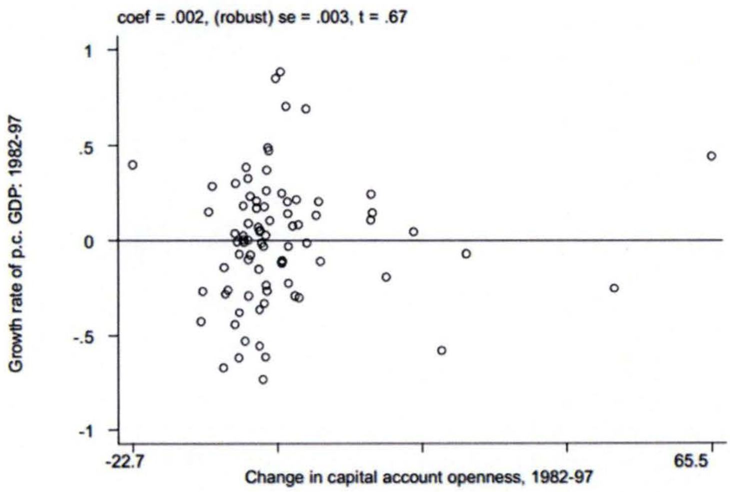
	Fastest Growing Economies, 1980–2000	Total Percentage Change in p.c. GDP	More Financially Integrated?	Slowest Growing Economies, 1980–2000	Total Percentage Change in p.c. GDP	More Financially Integrated?
1	China	391.6	Yes/No	Haiti	-39.5	No
2	Korea	234.0	Yes	Niger	-37.8	No
3	Singapore	155.5	Yes	Nicaragua	-30.6	No
4	Thailand	151.1	Yes	Togo	-30.0	No
5	Mauritius	145.8	No	Cote d'Ivoire	-29.0	No
6	Botswana	135.4	No	Burundi	-20.2	No
7	Hong Kong SAR	114.5	Yes	Venezuela	-17.3	Yes/No
8	Malaysia	108.8	Yes	South Africa	-13.7	Yes
9	India	103.2	Yes/No	Jordan	-10.9	Yes
10	Chile	100.9	Yes	Paraguay	-9.5	No
11	Indonesia	97.6	Yes	Ecuador	-7.9	No
12	Sri Lanka	90.8	No	Peru	-7.8	Yes

Note: Growth rate of real per capita GDP, in constant local currency units.

Source: Effects of Financial Globalization on Developing Countries: Some Empirical Evidence, 2003, by Eswar Prasad, Kenneth Rogoff, Shang-Jin Wei and M. Ayhan Kose.

However, the authors also mentioned that the causal relationship between financial globalization and economic growth is not strong or robust. Indeed, China and India experienced a fast economic growth during the period but in fact, they did not fully liberalize their financial markets. Mauritius and Botswana also experienced a high growth while they had a closed financial markets. On the contrary, Jordan, Peru and South Africa, although they had financial integration, their economy still declined. The paper examined even deeper the relationship between economic growth and the increase in financial integration. The result which is presented in figure 3 does not show a positive relation between economic growth and the increase of financial openness.

Figure 3: Increase in Financial Openness and Growth of Real Per Capita GDP, Simple Correlation, 1982–1997



Note: Capital account openness is measured as (gross private capital inflows + gross private capital outflows) / GDP.

Source: Effects of Financial Globalization on Developing Countries: Some Empirical Evidence, 2003, by Eswar Prasad, Kenneth Rogoff, Shang-Jin Wei and M. Ayhan Kose.

Generally, empirical evidences show that financial integration may create opportunities that the developing countries can make use of to stimulate their economic growth. However, in order to achieve a positive growth, it depends on many other conditions within the countries, and in fact, the developing countries also have to face with many challenges when integrating in the international financial market, which will be described in the next part.

3. Challenges of financial globalization on developing countries:

One main risk of financial globalization is that it makes developing countries become more exposed to international risks and shocks. When an economy is closed, only domestic investors monitor the economy and react to unsound fundamentals. In an open economy, the joint force of domestic and foreign investors can generate a crisis when fundamentals deteriorate.

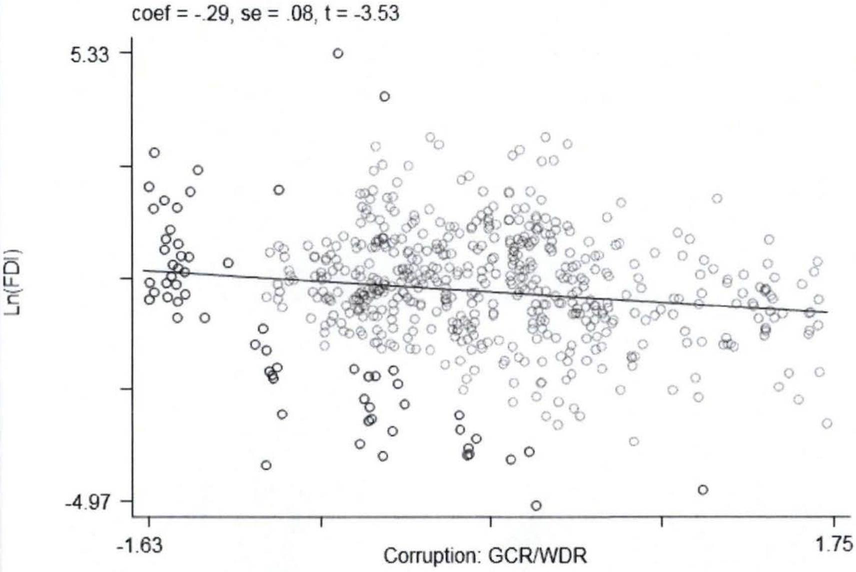
Financial globalization helps to increase capital flows to developing countries, and so, it can make these countries become more dependent on foreign capitals. If there is a sudden stop in foreign capital flows, the countries have to cope with financial difficulties. This sudden stop does not only derive from domestic problems or internal shocks but also derives from macroeconomic conditions from developed countries as mentioned by Eswar Prasad et al (2003). When developed countries face with economic downturns, they normally minimize their investments on developing countries. This is one of the channels that the shocks and crises from developed countries can be transmitted to developing countries. Various papers mention the transmission of shocks or financial crises across countries as a contagion effect. A closed economy can be isolated from foreign shocks, but when a country integrates in the international financial market, it can be affected by external shocks and crises. Sergio L. Schumukler (2004) explains three channels of contagion effect, including: real links, financial links, and herding behavior. Real links are also referred as trade links. When two countries have trade relationship or share the same exporting market, devaluation in currency of one country will make the other country become less competitive. As a consequence, this country also has to devaluate its currency to ensure competitive advantage. Regarding financial links, Sergio L. Schumukler (2004) gives an example in which two countries are connected through the financial market. When financial institutions in one country face negative shocks, they need to increase their reserves in order to ensure solvency and liquidity, so that they will sell their valuable assets on the other country where is still not affected by the shocks. Consequently, the shocks are transmitted to the other country. Finally, Sergio L. Schumukler (2004) mentions herding behavior and imperfections in financial markets. Because information is costly. Investors often base on actions of investors in other markets to infer future market information. Asymmetric information generates herding behavior, speculative activities, or bubbles, etc… These channels of contagion effect are quite match with the idea of Eswar Prasad et al (2003). Even more, in this paper, financial linkage is considered to transmit shocks and crises much more quickly than real channels.

Sergio L. Schumukler (2004) also mentioned another risk of financial globalization is that without adequate financial supervision institution in place, the developing countries have to cope with credit risks when they can borrow excessively from the international capital market and expand lending to overly risky economic activities. The idea is consistent with Philip R. Lane (2012) that financial globalization contributes to rapid domestic credit growth on both supply and demand sides. Because domestic banks can raise funds from the international market and foreign investors can also access the domestic market both through portfolio equity and FDI, the credit supply will increase. Relating to demand side, the increased capital inflows can lower domestic interest rate and improve the net worth of domestic borrowers by pushing up domestic asset prices so that the credit demand will increase. Therefore, although financial globalization can result in welfare-increasing factors through the availability of funds, the increase in investment, smoother consumption, etc... but it also leads to welfare-decreasing factors due to excessive growth in credit markets, over-borrowing distortions, or asset bubbles which are considered as a contributor of financial crises. Philip R. Lane (2012) argues that the excessive credit growth and asset bubbles increase asymmetries in the financial market which keep an important role in propagation of financial crises.

Beside the above risks, literature shows that financial globalization also brings challenges to developing countries, one of which is the challenge in governance. In an internationally integrated financial market, a government has fewer policy instruments to conduct economic policy. The participation of foreign financial institutions in the domestic market, and the increase in size and complexity of domestic financial market create more difficulties for the governments to conduct policies and manage risks. Anne O. Krueger (2006) shows a lesson from South Korean in the 1990s whereas the financial system was not well regulated and transparent so that the damage and crisis were triggered on the economy. The chaebol, which are conglomerates in Korea, had close links to each other, including investing on each other, guaranteeing bank debts for each other, borrowing from banks owned by the same chaebol, so that it brought risks to the economy.

Another challenge for developing countries relates to capital absorptive capacity. Prasad, Rajan and Subramanian (2006) show that there is a lack of development of the financial system in poor countries and there is no mechanism by which domestic and foreign capital can be absorbed efficiently, hence the capital tends to move, in an opposite way, out to rich countries instead of inflows. Eswar Prasad et al (2003) mention several aspects related to governance that can affect the attractiveness ability of foreign capitals, including transparency, corruption, regulation and financial supervision. The authors combined several ways to evaluate corruption, the result in figure 4 shows that corruption has a negative effect on inward FDI.

Figure 4: Corruption and Foreign Direct Investment

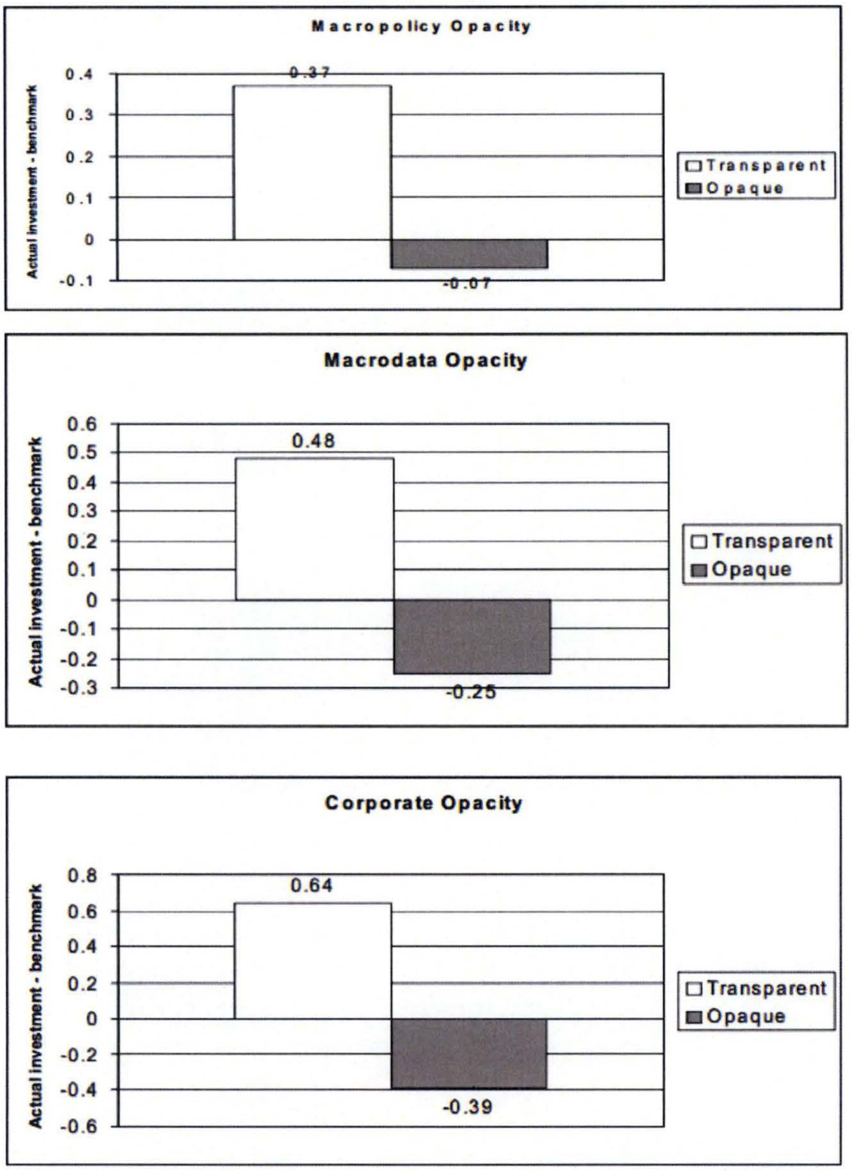


Note: Bilateral foreign direct investment from 14 major source countries to 41 host countries, averaged over 1996-1998. Index of host country corruption is derived by combining the measures from the Global Competitiveness Report (World Economic Forum and Harvard University, 1997) and World Development Report (World Bank 1997). More details can be found in Wei (2001).

Source: Effects of Financial Globalization on Developing Countries: Some Empirical Evidence, 2003, by Eswar Prasad, Kenneth Rogoff, Shang-Jin Wei and M. Ayhan Kose.

Similarly, the paper proves that transparency has a similar effect on inward capitals. Transparency includes both government transparency and corporate transparency, in which corporate transparency measures the level of financial disclosure and the availability of information about business opportunities in a country, and government transparency covers two aspects: transparency of macro data release, and transparency of macroeconomic policies. The findings presented in figure 5 show that the capital inflows tend to go to the countries which have a higher level of transparency.

Figure 5: Difference between Actual International Mutual Fund Investment and the MSCI Benchmark: Transparent versus Opaque Countries



Note: On the horizontal axis on each figure is the difference between the share of global investment funds' actual investment in a country in its total portfolio, averaged across the funds, and the share of that country's stock market capitalization, adjusted for availability to foreign investors, in a global market portfolio based on the Morgan Stanley Capital International (MSCI) index (in percentage points).

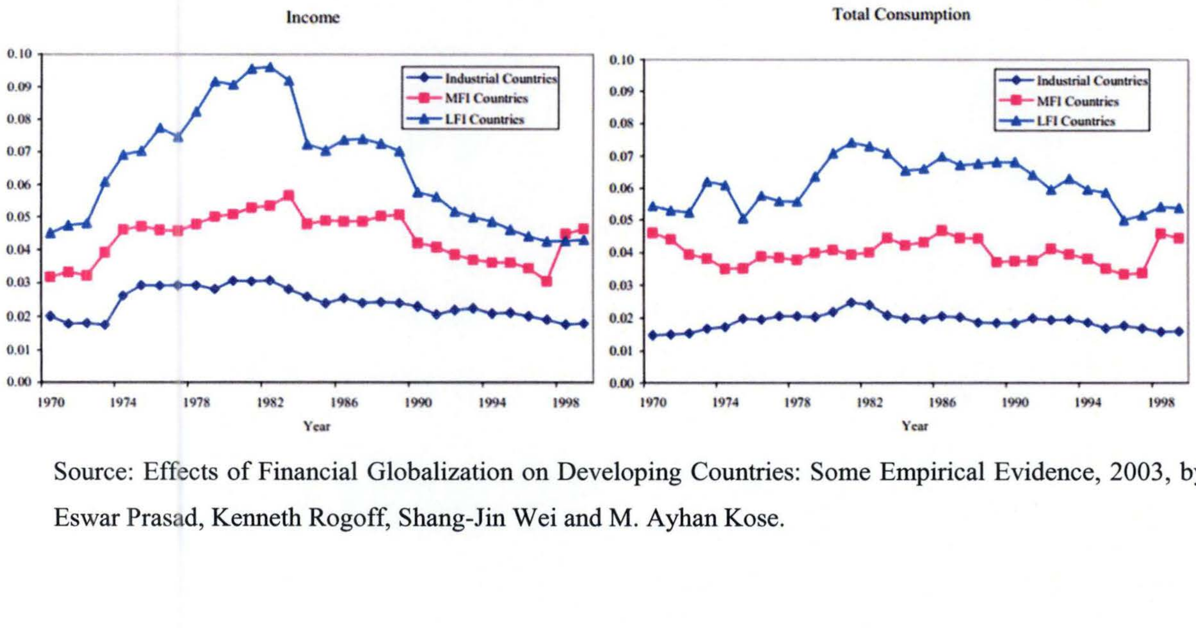
Source: Effects of Financial Globalization on Developing Countries: Some Empirical Evidence, 2003, by Eswar Prasad, Kenneth Rogoff, Shang-Jin Wei and M. Ayhan Kose.

Moreover, the effect of foreign investment on growth depends on many aspects, such as the level of human capital, the development level of financial market, the quality of governance and macroeconomic policies. For countries with relatively low human capital, there is no clear positive effect of foreign investment on economic growth. Generally, benefits of financial globalization can be achieved only when the developing countries reach a certain level of absorptive capacity.

Additionally, some empirical studies also examined the impact of financial integration on volatility and showed that financial integration at initial stage is often associated with greater volatility, the volatility is only reduced when the country attains a certain level of financial development. On one hand, financial integration helps to increase the access to capital, to reduce equity risk, to smooth consumption, and to create a risk sharing mechanism between domestic and foreign parties, so that financial globalization should theoretically reduce volatility. On the other hand, financial globalization can derive to increasing specialization of production due to comparative advantages that can make the economy become more vulnerable to the shocks specific to industries (Razin and Rose, 1994). Financial globalization makes the domestic economy become more exposed to international crises, dependent on foreign capital, and can lead to excessive credit growth. Therefore, it can make the developing countries greater volatile after financial liberalization, especially when these countries have under-developed financial systems in order to be able to regulate well their markets. O'Donnell (2001), Bekaert, Harvey, and Lundblad (2002), Kose, Prasad, and Terrones (2003a), Eswar Prasad et al (2003)…, all show that in industrial countries with developed financial systems, volatility is reduced through financial integration, but in developing countries, financial integration is often associated with higher volatility.

Figure 6: Volatility of Income and Consumption Growth

(10-year rolling standard deviations; medians for each group of countries)



Source: Effects of Financial Globalization on Developing Countries: Some Empirical Evidence, 2003, by Eswar Prasad, Kenneth Rogoff, Shang-Jin Wei and M. Ayhan Kose.

In conclusion, the literature shows that some developing countries benefited from financial integration and achieved high economic growth rate whereas some countries experienced financial crises and collapsed after integrating in the international financial market. However, the net effect of financial globalization is likely positive (Sergio L. Schumukler, 2004) because increased risks seem to appear in the short run, right after they liberalize financial markets, while in the long run, the financial system in these countries becomes more developed and better regulated, volatilities and crises seem to decrease, so that the benefits of globalization can outweigh the risks and economic growth is stimulated. Both Philip R. Lane (2012) and Eswar Prasad et al (2003) suggest that improving governance, building a sound macroeconomic framework and enhancing domestic financial market can help the developing countries fully benefit from financial globalization and develop their economies.

IV. The role of financial integration and globalization in Vietnam:

1. Brief introduction of financial market in Vietnam:

In 1986, Vietnam conducted a comprehensive and radical reform in all areas, economy, politics, and society. From this year, the country moved from centrally planned economy to market oriented economy, and Vietnamese economy started to grow. However, at that time, the financial market in Vietnam was still immature, with a mono-bank system; the state-owned banks functioned as both commercial banks and central bank. Financial operations were extremely simple; banks mobilized deposits from residents and domestic companies, then provided credit only to state-owned companies.

In May 1990, the government issued a new banking law which consisted of two decrees: one regulated State Bank of Vietnam (SBV), which is the central bank of Vietnam, and the other regulated commercial banks. Beside four state-owned commercial banks, joint stock commercial banks were established in Vietnam from 1992. Also during the 1990s, Vietnam became integrated into the global economy. The country liberalized its financial market to the international financial market. Since then, Vietnamese financial market started to develop properly. The banking system extended credit to all economic sectors. The average of credit growth was around 36% per year. In addition, new legislation for non-bank financial institutions such as insurance companies, financial companies, leasing companies, etc… was issued in the second half of the 1990s.

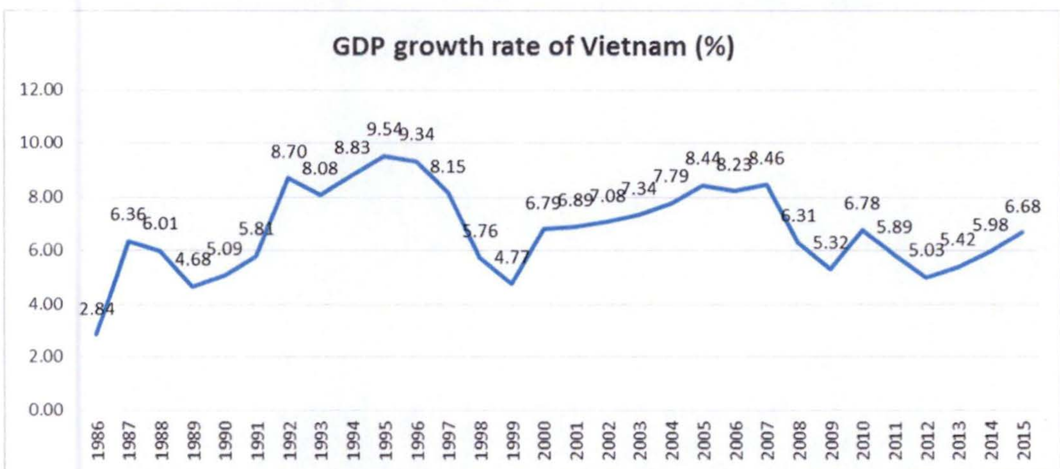
In July 2000, the stock market was established in Vietnam. This was a milestone in the development of financial market in Vietnam. Capital flows moved more easily both within the country and across borders. Financial integration became deeper and wider, and the financial market as well as the whole economy achieved impressive accomplishments.

2. *Impacts of financial integration and globalization on Vietnamese economy:*

Vietnam opened its economy and liberalized its financial market in the early of 1990s. Also from this period, the country experienced a strong economic growth. However, it is unclear that the strong economic growth is derived from financial integration, or from the general economic integration, or it is due to various reforms that the country conducted during the same period or due to the combination of all reasons. Therefore, this paper can not measure exactly how much the financial integration and globalization contributed to the development of Vietnamese economy. The idea of the paper is to see how the economy evolved since the country integrated in the international financial market.

Figure 7 depicts GDP growth rate of Vietnam during the last 30 years. Before 1986, GDP growth rate was only around 2%. However, due to the comprehensive reform launched in 1986, GDP growth rate increased sharply more than 6% in the late of 1980s. The economic growth became booming since the country integrated in the global economy from the early of 1990s with the peak of GDP growth rate which was in 1995, at 9.54%. From 1990 to 2015, the average GDP growth rate of Vietnam was round 7%, among the fastest in the world.

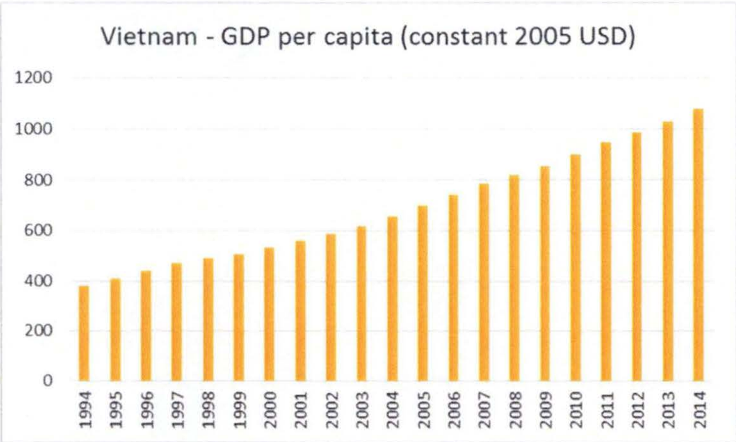
Figure 7: GDP growth rate of Vietnam



Source: World Bank and Vietnam government portal www.chinhphu.vn.

Figure 8 shows the remarkably increase of GDP per capita in Vietnam from 1994 to 2014. While it was nearly 400USD in 1994, it became almost triple in 2014, at around 1,100USD. According to the assessment of World Bank about Vietnam, poverty was reduced dramatically; the poverty rate fell sharply from 60% in 1993 to 13.5% in 2014.

Figure 8: Vietnam – GDP per capita (Constant 2005 USD)

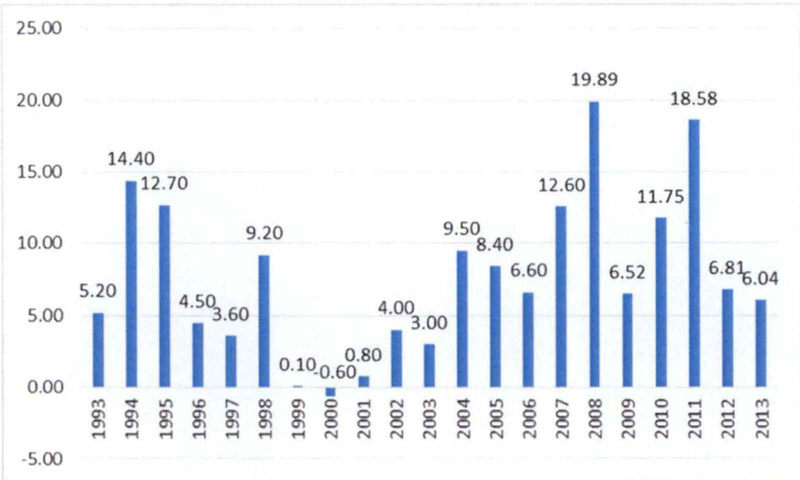


Source: World Bank.

However, negative impacts of integration and globalization on Vietnam can also be seen in figure 7. This truly matches with the literature mentioned in the previous part. When a country integrates in the international financial market, it becomes exposed to international shocks and crises. It is through the contagion effect that the shocks can be transmitted from foreign countries to the domestic economy. In 1997, a financial crisis was triggered in Thailand due to a series of asset bubbles. It spread rapidly to other Asian countries. Vietnamese economy was also affected significantly. GDP growth rate declined quickly from 9.34% in 1996 to 5.76% in 1998, and hit the bottom at 4.77% in 1999. Similarly, the financial crisis started from the USA in 2007 caused by subprime mortgage: it was transmitted rapidly throughout the world and once again, Vietnamese economy was affected. GDP growth rate decreased from more than 8% during 2005-2007 to 6.31% in 2008 and 5.32% in 2009. Indeed, Vietnamese economy became more volatile due to the external shocks.

Figure 9 shows that inflation fluctuated widely in Vietnam from 1995 to 2013. In 1998, due to the impacts of Asian financial crisis, inflation rate increased by three fold, from 3.6% in 1997 to 9.2% in 1998. Similarly, during the global financial crisis in 2007, inflation rate in Vietnam also increased significantly from 6.6% in 2006 to 12.6% in 2007, further to 19.89% in 2008. One of the main reasons of high inflation in 2008 is due to the sharp increase of capital inflows during 2006-2008. As a result, the country received a quickly increasing amount of foreign currency. In order to maintain the exchange rate, SBV had to supply a large amount of Vietnam Dong (Vietnamese currency) into circulation. At the same time, the capital absorptive capacity of the economy was low so that the big increase of money supply turned inflation rate in 2007 and 2008 into 2 digits.

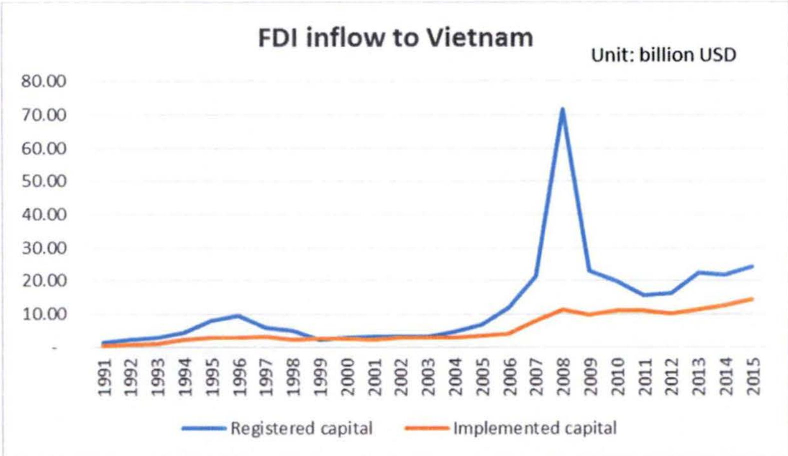
Figure 9: Inflation rate in Vietnam from 1993 to 2013



Source: ADB and General Statistic Office of Vietnam.

Regarding capital inflow to Vietnam, figure 10 plots FDI in Vietnam from 1991 to 2015. It includes both registered and implemented capital, in which registered capital is the amount that foreign investors initially register with Ministry of Planning and Investment when they want to invest in Vietnam and implemented capital is the amount that they actually invest. The figure shows that FDI increased dramatically in Vietnam as the literature review that financial integration helps developing countries get better access to capital. The two periods from 1994 to 1996 and from 2005 to 2008 were considered as the two booming periods of FDI to Vietnam. The registered capital in 1996 was 9.64 billion USD while it was only 1.28 billion USD in 1991; an increase of more than seven times. In 2006, Vietnam officially became a member of WTO, then it experienced a sharp increase of foreign investment capital. FDI to Vietnam got a peak in 2008 when the registered capital went up to 71.73 billion USD, more than triple the amount in 2007 and 55 times bigger than the amount in 1991. The low expense for investment and operations, cheap labor, together with preferences or incentives from government were the main reasons of this significant increase. In fact, the FDI flows contributed largely to the economic growth in Vietnam. Under an assessment of Sovicoholdings about impacts of FDI on Vietnam, FDI accounted up to 25% of the total investment capital in Vietnam, contributed approximately 20% of GDP, more than 40% of export volume (not including crude oil and petroleum), and 3.5% of labor.

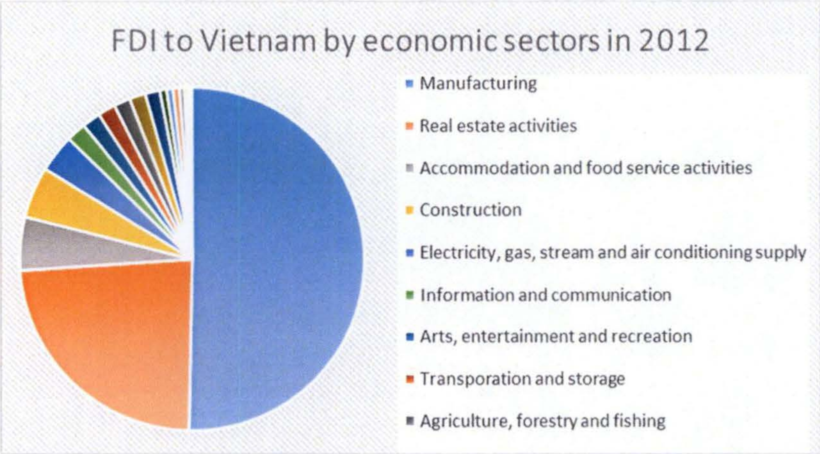
Figure 10: FDI inflow to Vietnam



Source: General Statistics Office of Vietnam.

However, the significant increase of FDI also brought disadvantages for the country. As mentioned earlier, the sharp increase of foreign capital combined with the weak management of the government led to high inflation in 2008. Additionally, the country became dependent on foreign investment capital so that it had to face with difficulties when the foreign investment capital declined sharply during financial crisis periods. Like GDP growth, FDI in Vietnam was also volatile due to external shocks which is not good for the economy. The financial crisis in Asia starting from 1997 led to a significant decrease of registered FDI in Vietnam, from 9.64 billion USD in 1996 to 2.28 billion USD in 1999, and the international financial crisis in 2007 made the registered FDI decline dramatically from 71.73 billion USD in 2008 to the lowest level at 15.6 billion USD in 2011. Moreover, the registered capital was only the amount which was committed by foreign investors, whereas the amount which was implemented in reality was much lower than the registered one. Especially during financial crises, the gap between registered and implemented capital became much bigger, creating potential risks for the country. Otherwise, there were imbalances in sectors attracting FDI. Figure 11 illustrates the share of FDI among different economic sectors in 2012. Most of FDI flowed to manufacturing sector, which mainly focused on exploiting natural resources, and to real estate activities. The quick increase of foreign capital in real estate area generated asset bubbles in Vietnam which led to financial crisis in the late of 2000s and risks for the whole economy.

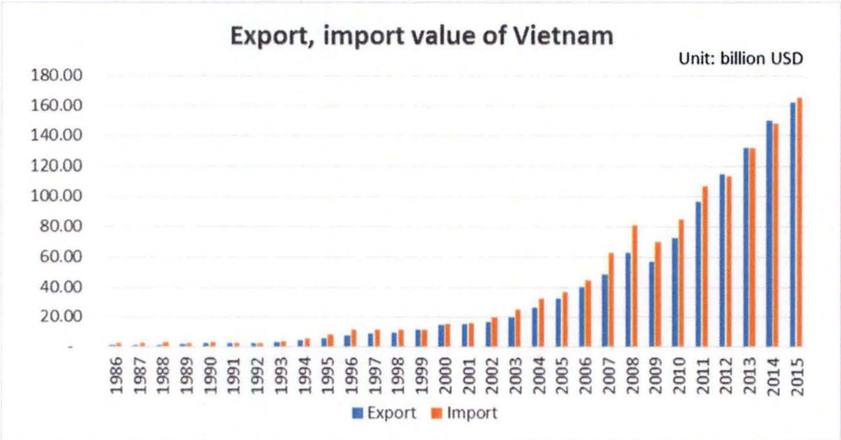
Figure 11: FDI inflow to Vietnam by economic sectors in 2012



Source: 'Imbalances of FDI in Vietnam: facts and recommendations', Economy and Forecast Review, Le Mai Trang.

Figure 12 depicts the evolution of import and export in Vietnam over the last 30 years. It can be seen clearly that import and export have been improved significantly since the 1990s. Total value of import and export increased by 10 times between 1986 and 2000; in 1986, the total value was only 3 billion USD but in 2000, the value reached up to 30 billion USD. After the following 15 years, in 2015, the value continued increasing by more than 10 times, and achieved an impressive number at 327 billion USD.

Figure 12: Import, export value of Vietnam



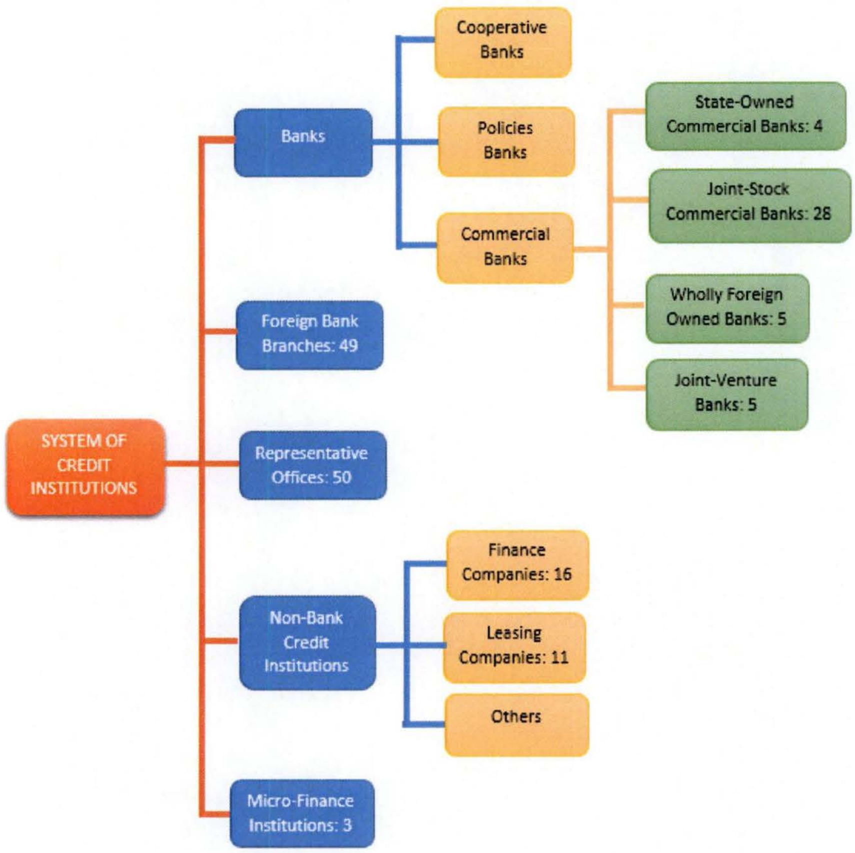
Source: Vietnam Customs Office.

In general, Vietnamese economy has achieved impressive accomplishments since the 1990s. GDP grows at a high rate, foreign investment capital, import and export increases significantly, and poverty is reduced remarkably. However, the economy also has to face with risks from the integration and globalization process which are becoming exposed to external shocks and crises, high volatility, high inflation, etc...

3. *Impacts of financial integration and globalization on Vietnamese financial market:*

The financial market in Vietnam also experienced a strong development over the last 30 years. In 1990, there were only 4 state-owned banks in Vietnam. Banking operations were extremely simple. Banks mobilized deposits from residents and domestic companies, then provided limited loans to state-owned companies. However, in 2015, Vietnam developed quite a diversified credit institution system.

Figure 13: Credit institution system of Vietnam in 2015



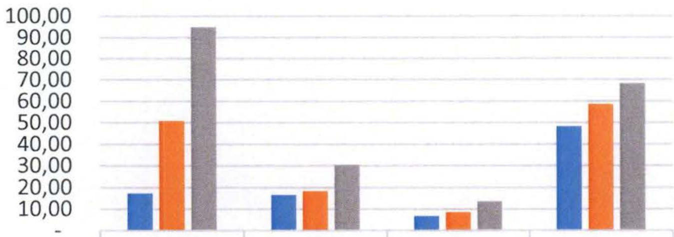
Source: State Bank of Vietnam

Beside 4 state-owned commercial banks, the country had 28 joint stock commercial banks, 5 wholly foreign owned banks, 5 joint venture banks, 49 foreign bank branches, and 50 representative offices of foreign banks. Non-bank credit institutions also developed strongly with the presence of 16 finance companies, 11 leasing companies, and several micro-finance institutions. Applying advances from developed countries, banks in Vietnam develop more and more diversified products and services. Swap, derivatives, repo transactions, etc… are used popularly to manage risks.

In addition, the financial market is not only improved in quantity but also in quality. The market becomes better regulated. For instance, Ministry of Finance of Vietnam established Vietnamese Accounting Standards (VAS) in 2003 referring to International Accounting Standards (IAS). The country is also expected to adopt International Financial Reporting Standards (IFRS) to the current VAS by 2020 to enhance comparability and improve transparency; and in fact, some Vietnamese companies already apply IFRS in order to meet the requirements of integration and globalization, to attract more foreign investment, or to expand investment opportunities to other countries. In banking sector, Vietnam is also moving towards international standards of risk management. SBV adapts its regulation relating to risk management in light with Basel requirements. Furthermore, from 2005 to 2010, SBV regulated the minimum capital requirement (or Capital Adequacy Ratio – CAR) for banks by 8% under Basel recommendation, then due to the international financial crisis in 2008 and the increasing risks in the domestic financial market, SBV even increased the minimum CAR to 9% by Circular 13/2010/TT-NHNN in 2010. Moreover, although SBV replaced Circular 13/2010/TT-NHNN by the new one, Circular 41/2016/TT-NHNN in 2016 to apply Basel II for the whole banking system, some domestic banks started to study and apply Basel III, the newest standards issued in 2011 with the transition period up to 2019, within their banks.

In order to assess the depth of the financial institutions, private credit to GDP is one of the most important indicators. It presents the size of credit provided by the financial system to the private sector of a country in a share (%) of GDP. It shows the capacity of the financial system to provide financial resources to meet the need of firms, households and individuals. Figure 14 shows that private credit to GDP in Vietnam evolved significantly over the period. In 1996, it only accounted for a small share of GDP, 17.24%, but in 2004, it almost tripled, accounted for 50.74% of GDP, and in 2014, it took 94.71%. In 1996, the indicator of Vietnam was quite similar with the average of Lower Middle Income (LMI) countries, doubled the average of Low Income (LI) countries, and was much lower than the average of High Income (HI) countries. However, from 2004 to 2014, private credit sector of Vietnam increased dramatically, tripled the average of LMI countries. In 2004, the indicator of Vietnam is relatively similar with the average of HI countries, but in 2014, it became much bigger than the average of HI countries. This reflects the rapid evolution of financial market in Vietnam over the period which stemmed from the liberalization of the financial market from 1990s.

Figure 14: Private credit to GDP (%)

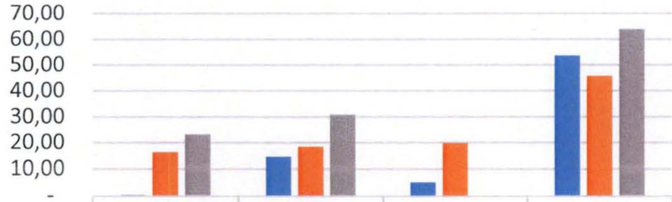


	Vietnam	Lower middle income	Low income	High income
1996	17,24	16,45	6,67	48,23
2004	50,74	18,29	8,55	58,47
2014	94,71	30,38	13,46	68,05

Source: World Bank.

Regarding the depth of the financial market, the indicator Stock market capitalization to GDP is commonly used. This indicator presents the total value of all listed shares in a stock market as a percentage of GDP. Figure 15 shows that the ratio of Vietnam was extremely low in 2004, only 0.41%, whereas it was 14.62%, 5.02% and 53.61% respectively for the average of LMI, LI and HI countries. The reason is that Vietnam just established a stock market in 2000. However, the evolution was quite rapid. The ratio soared to 16.25% in 2012 and 23.14% in 2014, just a little bit smaller than the average of LMI countries. Although the ratio was far lower than the average of HI countries, it did prove a significant progress in the evolution of the financial market in Vietnam. According to State Securities Commission, in 2015, the country had 2 stock exchanges, 89 securities companies, 41 fund management companies, and 21 securities investment funds, with 686 listed companies.

Figure 15: Stock market capitalization to GDP (%)

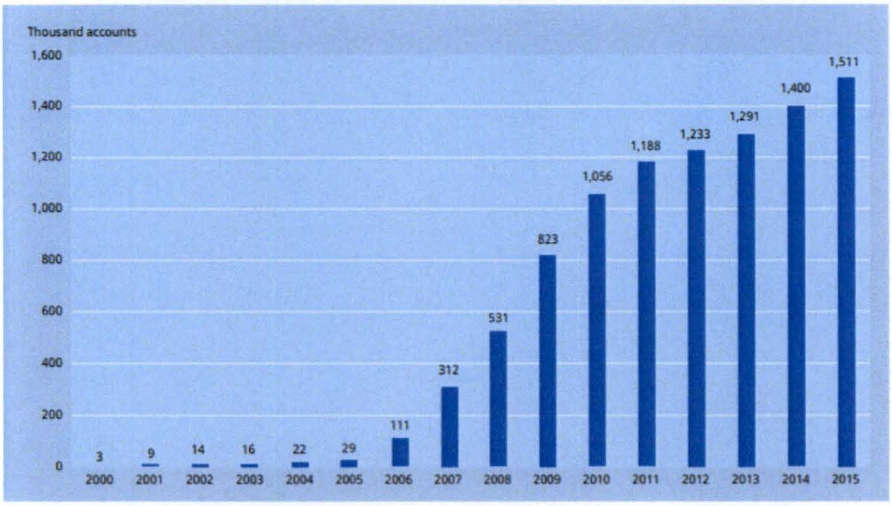


	Vietnam	Lower middle income	Low income	High income
2004	0,41	14,62	5,02	53,61
2012	16,25	18,38	19,73	45,71
2014	23,14	30,68		63,81

Source: World Bank.

Due to the financial integration and globalization, the number of foreign investors increased dramatically from 2000 to 2015. In 2000, there were only 3 thousand accounts of foreign investors in the stock market, but in 2015, the number increased by more than 500 times. The development of stock market is an increasingly important channel for mobilizing capital or funding in Vietnam, and for stimulating economic growth.

Figure 16: Number of foreign investor trading accounts in stock market



Source: Vietnam's Securities Market – 16 years of establishment and development, Huong Thi Thanh Nguyen and Thuy Thi Thanh Nguyen.

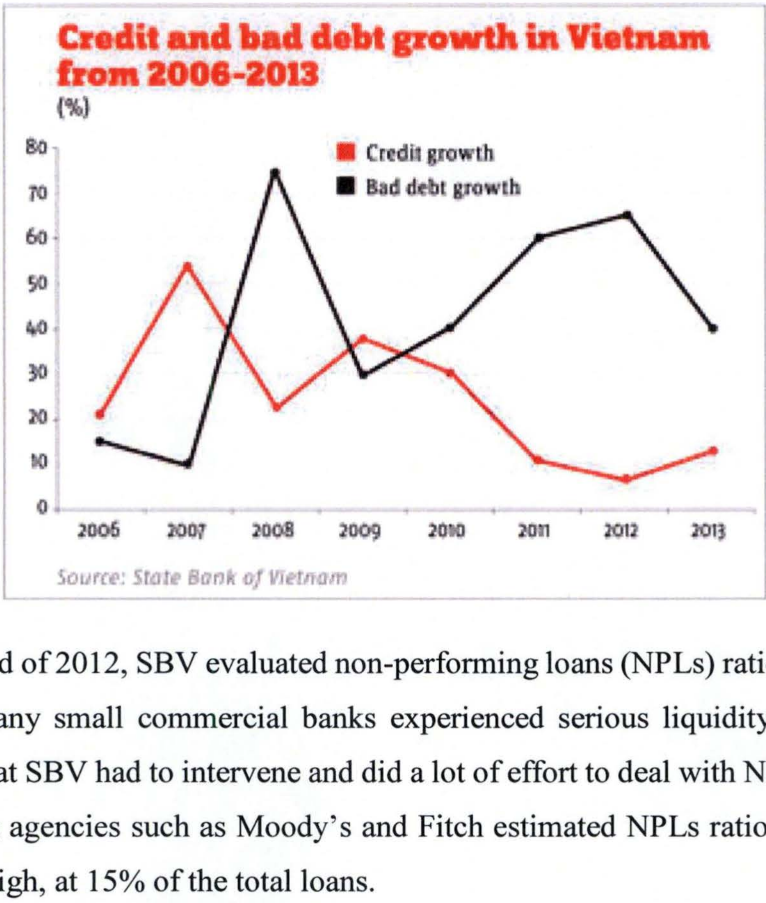
However, opportunities always come together with challenges. The involvement of giant foreign investors created market distortions, speculation, and bubbles in the stock market of Vietnam. The quick evolution was accompanied with high volatility. Figure 17 shows that stock price volatility in Vietnam is higher than the average of LMI and HI countries most of the time. It also got a peak in 2009 due to the impact of the global financial crisis which resulted from the USA in 2007.

Figure 17: Stock price volatility

Source: World Bank.

Direct investment, indirect investment, and credit increased sharply during a short period of time led to an excessive fund problem and asset bubbles in the economy. Funds were used ineffectively. In addition, most of investment capital and credit went to highly risky areas like securities and real estate resulted in potential risks. Figure 18 illustrates the growth of bad debt and credit in Vietnam from 2006 to 2013. The bad debt growth was much quicker than the credit growth. The figure also indicates that Vietnam was affected significantly by the international financial crisis in 2007. Credit growth declined dramatically in 2008 while bad debt growth soared up to more than 70%.

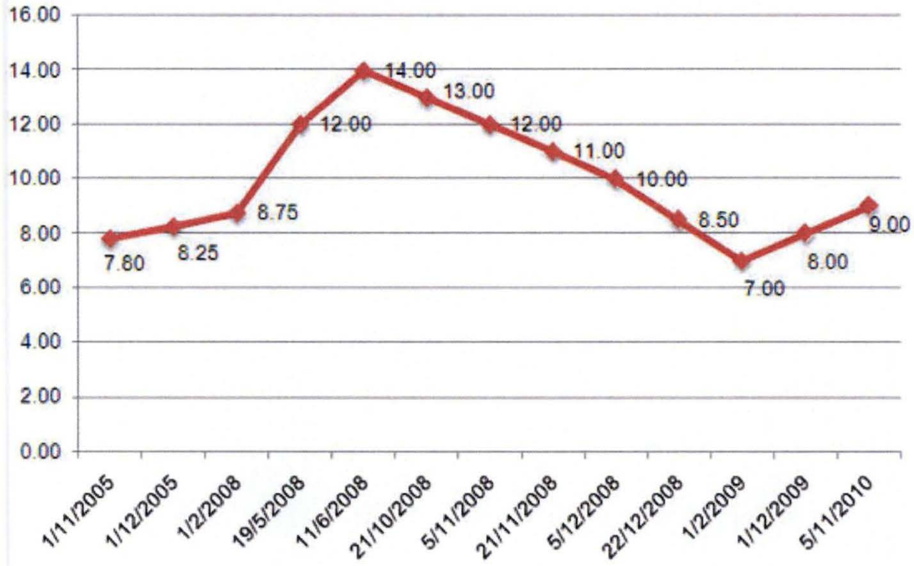
Figure 18: Credit and bad debt growth in Vietnam from 2006-2013



At the end of 2012, SBV evaluated non-performing loans (NPLs) ratio at 12% of the total loans. Many small commercial banks experienced serious liquidity and solvency problems so that SBV had to intervene and did a lot of effort to deal with NPLs. In the end of 2014, rating agencies such as Moody's and Fitch estimated NPLs ratio in Vietnam to be extremely high, at 15% of the total loans.

In addition, interest rate is also an obstacle of the financial market in Vietnam. Figure 19 illustrates the evolution of base interest rate from 2005 to 2010. Base interest rate is the rate regulated by SBV. Commercial banks were allowed to mobilize deposits or provide loans with the interest rate not exceeding 150% of the base interest rate. During 2005-2010, SBV had to increase interest rate continuously in order to control the high inflation. The base interest rate became extremely high in Vietnam and it reached the highest level at 14% in Jun 2008. In fact, small commercial banks also pushed deposit interest rate up to 20% in some periods to attract more funds in order to increase liquidity and to ensure solvency. The high interest rate made enterprises face with many difficulties in accessing capital, maintaining their business, or earning profit.

Figure 19: Base interest rate from 2005 – 2010 (%)



Source: State Bank of Vietnam

V. Conclusion:

In conclusion, literature shows that although risks increase during the process of financial integration, developing countries can still enjoy benefits, take advantage of financial globalization to develop their financial market and boost economic growth. Indeed, this is the case of Vietnam. The openness of Vietnamese economy and financial market in the early of 1990s made the country become exposed to external shocks and crises, induced excessive credit growth, asset bubbles, and high NPLs ratio. GDP growth rate, foreign investment capital, as well as stock market became volatile. However, the country still made use of the benefits of financial integration and globalization. Vietnamese financial market was improved impressively in both quantity and quality. The influx of foreign investment capital contributed largely to the economic growth. Vietnam achieved a high GDP growth rate at around 7% during the last 30 years. Generally, the net impact of financial integration and globalization on Vietnam is likely positive.

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