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Developing Vietnam's financial market: Using examples from Japanese experience

by

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ABSTRACT

Since 1986, Vietnam has started making the transition from a centrally-planned to a market-based economy. In general, the progress of economic transition in Vietnam has been rapid and highly successful. Though there are many challenges appearing from war, poverty and backward lagging behind the world, Vietnam has gained significant achievements and improvement in economy. The development in Vietnam is not only the result of herself effort but also coming from the cooperation and support from many other countries in the world, in which the collaboration with Japan plays a very important role. In that economic condition, Vietnam's financial market has also faced with various difficulties in financial construction reform, monetary policy management, and global financial-economic crisis.

Japanese financial market, in comparison with America's and United Kingdom's ones, has not been a strong and perfect system. However, through the achievement gained by this 2nd biggest economy of the world, it is admitted that Japan's financial system has significantly contributed on the economic development as a key sector. In 1990s, Japan successfully passed economic-financial problems related to deflation that never happened before, and the risk of tremendous frozen capital during this period. The Japanese banks had approached many suitable and special monetary and financial policies to stabilize and develop national economic system. The experiences on financial policy making of Japan in last decades, especially after recent global financial crisis in 2008, has become a valuable lesson not only for Vietnam but also for many other countries in the world that facing similar financial problems in economic system.

The main objective of this paper is to asset financial policies implemented in Japan in last 20 years. Based on the current policy analysis and lessons getting from Japanese experiences this paper also intends to provide some policy suggestion to promote Vietnam's financial market stabilization.

CHAPTER 1

OVERVIEW ABOUT VIETNAM'S FINANCIAL MARKET

I. FINANCIAL MARKET

1. The formulation and development of the banking system

1.1. Period before 1990s: operated under one-level banking model

On 6th May 1951, the State Bank of Vietnam (SBV) was officially established. At that time, SBV was called as the National Bank of Vietnam, operated under one-level bank model. With a view to allocating the capital to the Economy, the specialized banks, turn by turn, were given birth. In which, the Bank for Investment and Development of Vietnam(BIDV) was established in 1957. The Vietnam Bank for Foreign Trade(VCB) was established in 1963, The Bank for Agriculture and Rural Development and the Vietnam Bank for Industry and Commerce were established in 19881.

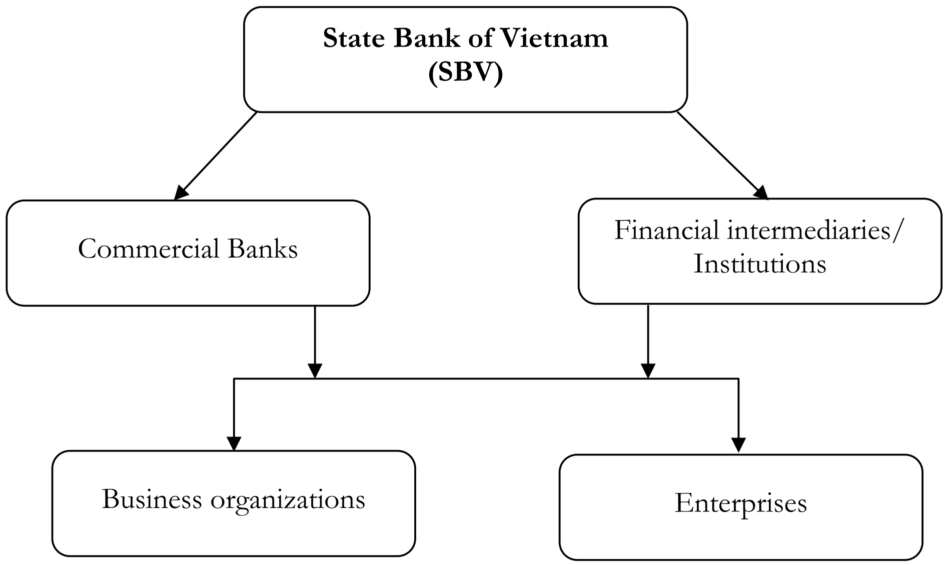
In 1986, Vietnam started the process of renovation. There have been three noteworthy points. Firstly, the period 1986-1988 was the most unstable duration of the macro-economy in which the Vietnamese economy experienced with the fact that the Government used the printing of money to offset the budgetary deficit, galloping inflation with three digits. Secondly, this effort for the financial liberalization had been proceeded whilst there had been almost no reforms in the sectors of industry, stated-owned enterprises (SOE) and foreign trade activities. Thirdly, the liberalization had been gone so far that all economic organizations could be permitted to do currency business. In the mean time, the financial supervisory system had not been existed. Organizations mobilized the capital from the people in the form of savings deposit for lending without having to comply with traditional banking regulations, such as obligatory reserves and capital ratio/debit balance.

1.2. Period from 1990 to present: operated under two-levels banking model

In 1990, SBV's Law was announced. Under that law, banking operation system started with two-level model, in which SBV was the 1st level and other commercial banks were at 2nd level. In the two – level banking system, the state bank played the role of the Central Bank of the Socialist Republic of Vietnam continued to renovate and kept the active role in the international integration (Figure 1.1).

From 1990, commercial joint-stock banks was started to establish, foreign banks were permitted to participate in the form of the establishment of branches or joint-venture with domestic banks. In 1995, the Bank for the Poor was established. Until 2002, it was changed its name into the Social Policy Bank. In 1997 , one other state commercial bank, namely, the Bank For the Housing Development in the Mekong Delta was established with its initial functions expressed in its called name, but later on, it was possible that due to the failure of the housing development program in the Mekong Delta, this bank becomes presently a purely-commercial bank.

Figure 1.1: Two-level banking system in Vietnam



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(Source: The State Bank of Vietnam's website : www.sbv.com.vn)

Recently, the structure of the State Bank of Vietnam contains: 5 State Commercial Banks; 39 Commercial Joint Stock Bank; 40 branches of State Bank; 5 joint venture banks; 17 finance companies; 13 leasing companies; and 53 representative offices of foreign bank located in Vietnam.

In the two – level banking system,the state bank played the role of the Central Bank of the Socialist Republic of Vietnam continued to renovate and kept the active role in the international integration in the orientation of:

1. Improvement of organizational model: State central bank, state bank branches in provinces, cities; units under the direct authority; Banking Institute and Banking University in Ho Chi Minh City.

2. Ceaseless upgrading of state management capabilities in the field of currency, especially the construction and improvement of legal environment on banking activities to guarantee in strict accordance with the spirit of resolutions of various Party Congresses as well as the strategy in the renovation period, integration of the Vietnamese Communist Party promulgated in 1998 and amended, added in 2003; the law on credit organizations was also promulgated in 1998 and amended, added in 2004. In 2007, the amendment of and addition to the two afore-stated banking laws was continued to put in the plan for the third time in order to be in conformity with international practices, especially commitments to open the door integrate in the finance and currency market in the framework of the World Trade Organization (WTO). By-law documents and other legal documents on currency, credit and banking operations had been promulgated quite fully, synchronized, conformed gradually with international practices, to entrust the autonomy and create the fairer competition in business activities of commercial banks, credit organizations and banking operations.

3. Forceful renovation and ceaseless enhancement of validity, efficiency of activities on inspection, control, auditing of activities on currency, banking. Guarantee of activities on currency, credit, banking and activities of credit organizations for increasingly safe, efficient, protecting the interests of clients, citizens, investors, money-depositors at the bank. Especially the Decree on the prevention and fighting against money laundry and specialized agencies for the prevention and fighting against money laundry had been established.
4. Upgrading of capabilities on construction and operation of monetary policies, effective use of banking operations of the central bank, in conformity with international practices and international integration tendency, active effects upon the development of the financial market, especially, the monetary market, to guarantee for the socialist-oriented role of state management and operations. Especially, the State bank transferred the use of direct tools into the use of indirect tools in managing the monetary policy. The very important achievement was the successful implementation of objectives of operating monetary policy, accelerating the economic growth , monetary stabilization, curbing inflation, boosting the creation of new jobs in the society and renovation of business activities of enterprises, family household, in which, it was worth of mentioning that the state bank transferred to the operation according to agreed interest rate mechanism. Commercial banks and credit organizations played the active role in fixing the interest rate for deposited money and lending interest rate, From 2000, the State Bank put into use the operation of the open market and up to present, this market has been operating increasingly with great scale, intervening effectively in the available assets of commercial banks, credit organizations and the interest rate on the monetary market, the state bank cancelled the foreign exchange sale ratio, expanded variations of exchange rate transaction in the purchase and sale of foreign exchange between credit organizations and their clients. Regulations on the receipt and payment of foreign exchange had also been renovated in the favorable direction and creation of the active choice in selling or receiving whatsoever kind of foreign exchange for the foreign exchange receiver. Other regulations on foreign exchange management were also amended, added in conformity with international practices.
5. Acceleration of the financial market with the participation of multi-economic components in the activities of banking and financial market, absorption of foreign-invested capital in banking activities, absorption of money deposited by the people, in the society, investments in different channels for the socio-economic development, in which, state commercial banks played the leading role. At the same time, the establishment of the Bank for the Poor, later on, being the Social Policy Bank to implement the policy to eradicate hunger and alleviate poverty and other social policies of the Party and the State.

2. Scale of operations of the Vietnamese banking system

The biggest contribution of the Vietnamese banking system in the renovation years and the active integration to the international economy in the field of finance – currency were the successful implementation of the national monetary policy, acceleration of the development of the financial market and the high economic growth of 7.0% - 7.6% and the stability in recent years, the inflation under control, stable currency. The Bank for the Poor, presently, the Social Policy Bank contributed significantly to the national program for hunger eradication and poverty alleviation, creation of jobs, student's borrowing for studies. The development of the monetary market allowed the maximum mobilization of idle monetary source, capital sources in the economy to the banking-investment system for socio economic development. The Stock market began to be formed and developed.

With regard to specific targets in banking activities. In recent year the total payment facilities increased from 20% - 34% of the total mobilized capital source increased 25%- 34%; the total lending credit balance and investment for the economy increased averagely 22% -30%

The banking system attained the highest level of capital mobilization and lending debit balance never seen before. Until the end of 2008, the system of commercial banks and credit organizations all over the country had the lending debit balance and capital investment for the economy increased to 37.8% as compared to the end of 2006 and increased about two-fold in comparison with the anticipated level from the beginning of the year : 17-21%. The total of mobilized capital source, until 31 December 2007 was estimated to increase to 36.5%, more than 3.5 times the economic growth rate. In Ho Chi Minh City, calculated until the end of December 2007. The total mobilized source of commercial banks and credit organizations in the area attained VND487,028 Billion, increasing 70.6 as compared to the end of 2006; The total lending debit balance attained VND406,353 Billion, increasing 76.9% as compared to the end of 2006.

Table 1.1: A number of main targets of monetary – banking operations in 1991-2008

Year	Growth rate of payment methods %	Increase rate of mobilized capital %	Increase rate of lending credit balance for economy %	Money volume supply to the economy %	Increase rate of gold price %	Price increase rate USD %	Bid-won treasury bond volume (VND Billion)	Economic growth rate %	Inflation %	Foreign exchange absorption %
1991					88.7			5.8	67.4	35.00
1992					31.3			8.7	17.5	136.64
1993					7.4			8.1	5.3	140.98
1994	27.8				8.0			8.8	14.4	249.47
1995	22.6				-3.0			9.5	12.7	284.96
1996	22.7			22.7	2.5			9.3	4.5	468.99
1997	26.1	25.7	22.6	26.1	-6.6	14.2	2,917.5	8.8	3,6	400.00
1998	23.9	34.0	16.4	25.6	0.7	9.6	4,011	5.8	9.0	950.00
1999	39.25	34.0	19.2	39.3	-.02	1.1	3,011	4.8	6.8	1,200.10
2000	26.5	43.3	38.14	25	-1.7	3.4	4,766	6.8	-0.6	1,157.00
2001	25.53	25.1	21.44	-	5.0	3.8	3,955	6.8	-0.2	1,820.00
2002	17.7	19.4	22.2	-	19.4	2.1	8,140	7.0	4.0	2,154.00
2003	24.94	25.8	28.41	-	26.6	12.2	15,901	7.2	3.0	2,580.00
2004	30.39	33.2	41.65	-	11.7	0.4	19,465	7.5	9.5	3,000.00
2005	24.4	23.11	20.6	32.24	11.3	0.9	22,120	7.7	8.4	3,500.00
2006	29.7	33	24.8	32.59	27.1	0.9	22,075	8.16	6.6	4,200.00
2007	36.9	36,5	37.6	37	33	0.10	10.220	8.46	12.6	5,500,000

(Source: The State Bank of Vietnam)

Banking operations developed rapidly, strongly, firmly, efficiently with the quality and scale, thus speeding up the renovation of production and business activities, services and upgrading the level of knowledge of the people on monetary-banking activities

The group of commercial joint stock banks transferred from the rural area to become urban commercial joint stock banks attained the highest growth rate

The group of commercial joint stock banks belonging to middle category had also the impressive growth rate

The group of commercial joint stock banks belonging to leading category still kept the tradition

The state commercial joint stock bank block in possession of firm growth rate

Table 1.2: Operation Scale of Commercial Banks in 2007

Unit: Billion VND

	VCB	Vietinbank	BIDV	Agribank
Total assets	196,117	172,000	204,000	
Capital mobilized directly from economy	143,635	153,434	149,468	295,048
Total lending debit balance and investment	95,579	101,282	125,660	281,869
Pre-tax profit	3,100		2,000	2,000

(Source: The State Bank of Vietnam)

The Block of foreign banks and joint-venture banks attained the high growth rate in several years symbolizing the improvement of investment environment of Vietnam:

The block of foreign bank branches had also very impressive business results. Until 2007, in Vietnam there were 35 foreign bank branches, 5 banks joint-venturing with foreign countries, 4 finance leasing joint venture companies and 2 finance leasing company with 100% foreign invested capital. The total assets of foreign bank branches and credit organizations having foreign-invested capital and credit organizations with foreign-invested capital amounting to over VND 215,000 Billion, the of the pre-tax total income of the block of banks and credit organizations having foreign-invested capital attained over VND 2,400 Billion.

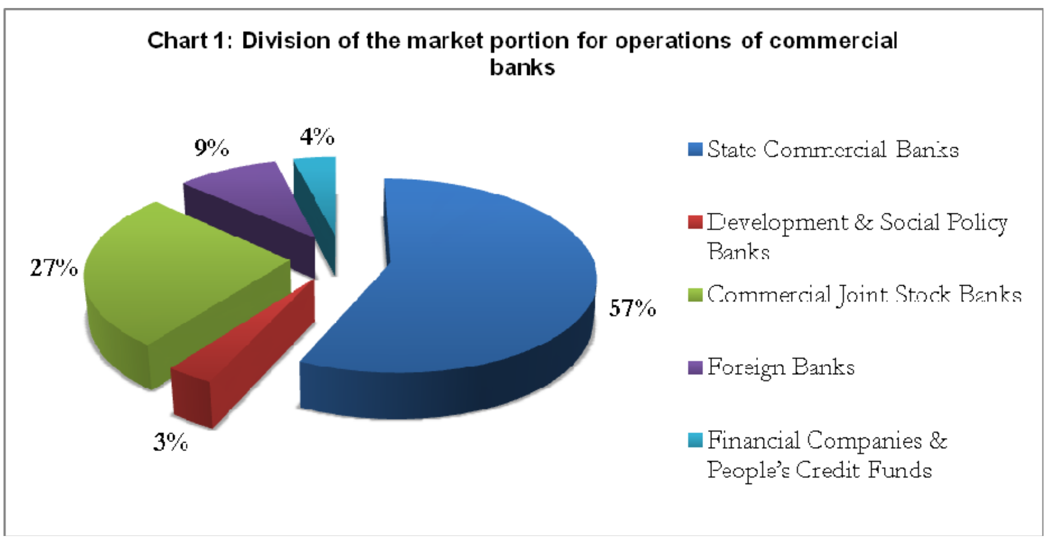
The Block of joint venture banks, credit funds, finance companies and finance leasing company had the more modest growth rate.

The social policy bank was more diversified for the capital-borrowing programs and objectives. Especially, the effective development with great scale of programs for students and pupils to borrow capital for their studies.

3. Division of the market portion for operations of commercial banks

The financial market portion, specifically speaking, was the market for mobilizing the capital and lending of the banking system that developed rigorously in the increasingly competitive environment. The competition had brought forth the result that the market portion of the state commercial banks were having the tendency to narrow, although, there had been still the big density, the market portion of the commercial joint stock companies were having the tendency to expand. Until the end of 2007, state commercial banks occupied about 56.9% of the market portion, thus decreasing drastically as compared to the level of 72% - 73%, 3 years ago; 1 development bank and 1 social policy bank occupied 3.3% of the market portion; commercial joint stock banks occupied about 26.5% of the market portion, sharp increase as compared to the level of 16-17% 3years ago; the block of foreign banks with 39 branches in Vietnam and 5 joint-venture banks occupied 9.4% of the market portion; 9 finance companies, 12 finance leasing companies and 996 People's credit funds occupied about 39% of the market portion. In addition, there had been 51 representative offices of foreign banks and foreign credit organizations in Vietnam acting as the bridge linking to investment activities, financial-monetary services of the foreign banks in Vietnam.

Figure 1.2: Division of the market portion for operations of commercial banks



(Source : The State bank of Vietnam)

First, all Commercial Bank and Credit Organizations has developed quickly and totally, yielded sustainable profits , and participated actively in the financial market.

Second, the Commercial Banks of Vietnam proved active changes in handling stagnant debts, reducing bad debts, increasing credit quality.

Until now, the Commercial Banks and Credit Organizations has bad debt proportion under 5.0% according to international standard. The debt classification and risk spare budget is implementing and will do as international common practice.

Third, the Commercial Banks of Vietnam have many measures of diversifying the services, opening new, modern and useful services and enhancing the service quality of traditional banks.

Forth, the organization structure of the Commercial Banks of Vietnam become more and more properly and efficiently, the system becomes more diversified, expanded and developed, which spreads substantially towards urban and potential areas.

That system ensures closeness to the people, and facilitates the transactions of them and of the enterprises. The joint stock Commercial Banks system has a rapid expanding speed in cities, important economic zones, new urban areas, industrial and dense populated areas.

Fifth, Commercial Banks and credit organizations of Vietnam have deep insights about mentality, customs, clients incomes, and local markets. Modern banking technology is applied effectively in clients transactions, managements and administrations. These are the strong competitive points in international integration in the area of finance – monetary.

Sixth, Commercial Banks of Vietnam have abundant human resource, with a big number of cadres basically trained, experienced and having administrative, managerial and organizational capacities in banking; the human resource quality is also elevated.

Seventh, there is effective cooperation between big economic corporations and Commercial Banks, which increases the competition strength and the active integration to international economy.

Table 1.3: Effectiveness of the State Commercial Banks during the period of 2000-2007

Unit: %

Target/year	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Overdue debt/total debt balance	11.19	8.74	7.58	5.01	4.98	5.25	4.8	2.3
Net profit/ROE	12.81	15.85	9.43	6.54	6.53	6.50	6.5	6.6
Net profit/ROA	0.36	0.38	0.3	0.38	0.41	0.42	0.43	4.5

(Source: State Banks of Vietnam, Data in 2007 is the author's estimation)

As international practice, a good bank is one which has average ROA at 1% and ROE at 15%. During 1999-2007, the ROA index of the State Commercial Banks got only 0.42 - 0.60%, while ROE tended to decrease continuously during 2001-2007, from 15.85% in 2001 to 6.54% in 2003 and 6.5% in 2005 in which the reason of low profit-yielding capacity was due to the very high proportion of passive debt. Therefore, the current productive capacity of the State Commercial Banks (CB) is very low compared to other good banks in the world.

Table 1.4: Mobilized capital source and loan debt balance of the CB in 2001-2007

Unit: billion dongs

No.	Target	2001	2002	2003	2004	2005	2006	2007
1	Mobilized capital source	231.000	290.000	337.000	475.000	584.000	776.720	1.080.000
2	Loan debt balance	215.000	281.000	328.000	454.000	545.000	661.630	1.012.860
3	GDP	481.295	535.762	613.443	713.071	837.858	906.060	982.647
4	Mobilized capital/GDP	48%	54%	55%	67%	70%	85.7%	109.8%
5	Loan debt balance/GDP	45%	52%	53%	64%	65%	60%	103.1%

(*Source: State Banks of Vietnam, Data in 2007 is the author's estimation)*

4. Evaluation of the monetary market development process

4.1. The formation and development process of monetary market

The monetary market which is mainly the open market and the market of state exchequer bills tender managed by the Vietnam State Bank has developed as this process:

In continuing the operation renovation following the integration trend, from July 2000, Vietnam State Bank officially introduced the Open Market Operation (OMO). This is one of many sorts of the monetary market. The open market operation is an activity of dealing short-term valid papers or short-term dealing of valid papers between the Central Bank and the Commercial Banks, Credit Organizations and other organizations, through which the available and reserve capital of such organizations is involved and the interest rate of the monetary market is impacted.

While the transaction turnover in 2 years of 2000-2001 on the open market was still small, it rose annually at the rate of 200% in the years from 2002-2004, in which the transaction turnover in 2004 was 2.92 times of the 2003 and 16 times of one of 2001. The transaction turnover increased quickly because the OMO sessions were held more regularly, and the turnover of each session also increased. In 2005, the transaction turnover was 165.5% compared to 2004. In 2006, the transaction turnover on the open market reached fairly high level, which was 100,000 billion dongs.

In 2007, the open market service achieved great success in intervening in the available capital of the Commercial Banks and drew money back from circulation, repressed inflation. The total quantity of short-term valid papers that the State Bank bought in short-term went up to 61,133 billion dongs, timely responding to the needs of available capital for the Commercial Banks. But in the same year of 2007, the total turnover of State Bank bills and valid papers sold was 356,850 billion dongs, reached the highest level until then. This number also showed the very high capacity of absorbing money back of the State Bank.

Especially, the State Bank has organized a big number of 355 transaction sessions, on some days 2-3 sessions was hold to respond to the market's need. In many sessions, the State Bank offered at the price of 10,000 billion dongs. This is the remarkable number till present. In total, there were 584 participations of bidding members, in which 399 participants were the State Commercial Banks, 142 were joint stock Commercial Banks and 43 were the branches of oversea banks in Vietnam; there were 481 participants won the contracts, in which 360 were the State Commercial Banks, 86 were joint stock Commercial Banks and 35 were the branches of oversea banks in Vietnam. This was a different happenings compared to the previous years and showed the wide scope of participation, the role of the open market to Commercial Banks as well as to the management of the monetary policies. The terms of valid papers transacted were also different, but in multiform, about 10 terms, but mainly 7 days, 14 days… The interest rate tended to increase and stayed at high level compared to the recent years.

The market of bidding for exchequer bills through the State Bank was introduced since 1994. This was a very important channel of capital mobilization to timely respond to the State needs in capital in particular, and to the economy in general. It was a premise for the development of stock market, the secondary market and the implementation of services of the Central State Bank (the market of dealing bills, open market, discount on short-term valid papers and loan backed by advancing short-term valid papers).

Currently, after 14 years of operation, the market of bidding for exchequer bills (TPKB) included 47 members, in which: 5 State Commercial Banks (NHTMNN); 18 joint stock Commercial Banks (NHTMCP); 4 joint venture banks (NHLD); 13 branches of oversea banks in Vietnam; 6 insurance organizations and the Central Credit Fund. However, in the past years, it seems that only the state commercial banks participated in and won the bids. In 2006, there were 82 successful tenders from the state commercial banks out of 86 winning members. Or in other words, the banking circles supposed that this market is only reserved for the state commercial banks. The bloc of joint stock, joint venture and Oversea affiliated banks… still act as outsiders. The main reason was that this bloc of banks have only small source of capital, limited available capital to be afford to enter the bids. But another reason was the method of bidding organization that deprived small-scale banks of winning the bid. The total successful bid turnover in the exchequer bills bidding market reached more than 22,000 billion dongs.

In the year of 2007, the exchequer bills bidding market was not as eventful as the previous years, but it continued to take an important role in the intervention of the State Banks to the available capital of the Commercial Banks and in the creation of transaction goods for the open market, that impacted on the interest rate of the monetary market and on the rate of mobilized capital of the Commercial Banks. The transaction scale of the exchequer bills bidding market in 2007 did not reach the estimated high level from the beginning of the year and was lower than in 2006, the total successful bid turnover was 10,220 billion dongs, the lowest in recent years. But the operation of the exchequer bills bidding market supported substantially to the management of monetary policies of the State Banks, especially in creating transaction goods for the open market.

4.2. Evaluating the real situation of the monetary market development

This was the earliest developing market and the most recognizable in the economy development process following the market mechanism of our country. The members operating in this market were mainly the finance intermediary organizations, with the focus on Commercial Banks, investment funds… Therefore, beside of the emergence of the dual banking system: the State Bank taking the duty of governmental management of banking operation; the commercial banks and the other Credit Organizations doing the monetary business and banking services; the system of Commercial Banks and Credit Organizations also developed extremely various with many types of diverse ownerships. Next to them are the Insurance organizations and Investment Funds, the Financial lease companies, the Finance companies in the model of state parent companies, the Postal savings service companies.

Until present, the participant members of the various kind of monetary market include 5 State Commercial Banks and Social policy banks, 37 Joint stock Commercial Banks, 4 Joint venture banks, 39 Oversea affiliated banks, 5 Joint venture banks, the Central credit fund, nearly 1,000 civil-based credit funds, some insurance and re-insurance companies, Credit funds…

The mechanism of impact and intervention on monetary market was showed intensively in the tools for managing monetary policies and the Central Bank service. Based on that, and for the suitable step by step changes to common practice, from June 2002, the State Bank switched to carrying out the mechanism of managing the interest rate per agreement instead of the previous mechanism of managing the interest rate per basic rate. Combined to that is the monthly announcement of the State Bank of the basic interest rate, but still regulating the refinance and rediscount interest rate; together with the interest rate of Swap foreign exchange service, of the open market, to the exchequer bills bidding market that impact on the market interest rate, the mobilized capital interest rate and the Credit funds loan interest rate.

The compulsory reserve tool also impacts on the interest rate. When the State Bank adjusts up the proportion of required reserve, it makes the input expenditure of the credit funds to increase. As a result, the credit funds must either keep the interest rate of mobilized capital intact and rise up the loan interest rate; or they must both increase the loan interest rate and rise up the mobilized capital interest rate.

The tool for controlling the exchange rate also impacts on the interest rates of the credit funds in the monetary market, but not very clear.

With the growth of the finance intermediary organizations, especially the credit funds, and with the management mechanism of the monetary policies and the Central Bank service coming close to the common practice, the Commercial Banks and Credit funds are allowed to take initiatives in mobilizing capital and loan activities, to participate actively, dynamically and to compete one another strongly in the monetary market, and thanks to that, they have good conditions in pushing forward the monetary market.

Besides participant members of the interbank market, the exchequer bills bidding market, the open market…do not include all the aforementioned organizations, only the State Commercial Banks, the Urban Joint stock Commercial Banks, the Joint venture banks, the Oversea affiliated banks, some insurance companies.

4.3. Evaluation of the real situation in developing the market of deposit and mobilized capital

This is the market where the competition is most fierce and eventful between the finance intermediary organizations in the absorption of idle money of the public. In recent times, the Credit funds launch these forms of activities:

- Compete to encourage clients to open personal account, card account…All blocs of Commercial Banks strongly develop the service for personal bank to absorb deposits and idle capital in society into the bank system. It is estimated that until the end of June 2008, there were about 9.2 million personal accounts opened in Commercial Banks all over the country, more than 8 million cards were issued, in which 7.7 million local cards, more than 302.000 international cards, over 4,300 ATM machines and 23,000 POS equipments were installed.

- Compete to absorb non-term deposits of the economic social organizations. Competition between the credit funds in absorbing deposits of the State Exchequer, the Vietnam social insurance, Bao Viet, the human insurance, post and telecommunication, electric…

- Compete to attract the savings deposits: this is a traditional form of capital mobilization between the credit funds and the Post office savings service Company, especially the civil-based credit funds. In recent times, some banks launched a new service in order to encourage the clients: deposit at one place and draw at many places; accumulate savings or in other words collective savings; savings associated with human insurance; progressive savings with interest rate according to deposits – the higher the deposit and the higher the interest rate; flexible savings which means the clients may draw the money at their needs and the interest rate is calculated per real days deposited correlative to the nearest term; savings with reward…

- Issue deposit certificate, term note, bond…mostly mobilize the capital with terms of 6 months and more, and attractive interest rate.

In the near 6 years of 2003-2008, there was a hectic competition in the market of absorbing deposit and capital mobilization, especially the finance intermediary organizations implemented various and diverse products and services in absorbing deposit and capital mobilization.

However, in the development of this market, a big shortcoming still exists – the no-term deposits, the idle money of people were not absorbed in maximum into the banks, and so not choose the payment service via banks or cash checks for needs at anytime. This is a very big and important capital source which can make a momentum for the monetary market development, since it helps increasing the source of no-term deposits and available capital to the Credit funds.

5. Evaluation of the development process of the capital market

5.1. The formation and development process of stock exchange market

5.1.1. The operation of the Stock Transaction Center in HCMC

In 1997, the State Stock Committee was founded to carry out the initial functions that prepared for the birth of the Stock Market in Vietnam, which were to set up the legal basis, train the officers, build up the infrastructure and technology… Three years after the appearance of the State Stock Committee, in carrying out the decision of the State Prime minister dated July 20, 2000, the Stock Transaction Center was opened and operated and held the first stock transaction on July 28, 2000. This was an important milestone which marked the presence of the first and intensive stock transaction market in Vietnam after a prompt and active preparation process of the necessary conditions about the related legal frame, the human resource, the technology infrastructure and material facilities.

The initial name, the location to open the market was pondered very carefully in the Model of Vietnam Stock Market and the document of the State Stock Committee submitted to the Party and State leaders for permission of establishment of the Stock Transaction Market. The name of "Stock transaction center" and not yet the "Stock Transaction Service" indirectly expressed the orientation of the step, scope, capacity, method of the initial stock transaction arrangements of the market. A different feature of Vietnam compared to other countries in the world was in the initial formation and development period of the Stock Market was that Vietnam did not have a real market economy, and goods on the market were mostly stock shares equitized from the state enterprises and the government bonds were issued by the Ministry of Finance; enterprises and the public had chance to access for the first time to the concepts and forms of capital mobilization, investment on Stock Market. The state invested all the material facilities, trained human resource, issued regulations on establishing and initiating the first Stock Transaction Center into operation; in hierarchy, the Center is a unit directly belonged to the State Stock Committee.

To have a real concept about the operation of the intensive stock exchange market, to obtain the operation regulations of the Stock Transaction Service for reference and selection suitable to Vietnam situation, many cadres of the State Stock Committee had participated in survey team, studied at the Stock Transaction Service and stock companies, the Center of Stock Link of friendly countries during 1997-1999 as the technical support projects agreed at Government level between the two countries. In supporting the initiation and operation of HCM city Stock Transaction Center, the State Stock Committee temporarily assigned key cadres, young trained with good capacity cadres to the positions of Director of Stock Transaction Center, to lead important service departments of the Center in the first years of operation.

Until June 2008, with 8 years of operation, the Stock Transaction Center of HCM city has held approximately 1,850 stock transaction sessions; the information announcement, transaction supervision became more and more effective, respond basically to the needs of market growth; the operation and management of the Center grew to be more and more professional.

From October 2007, the Stock Transaction Service of HCM city (changed from the Stock Transaction Center of HCM city since August 2007) began to implement the continuous order matches beside of the implementation of the term match method exerted in nearly 8 previous years. From two companies that posted stocks on the first exchange session, there were 150 shares and 2 stock investment fund certificates posted and transacted at the end of June 2008. The scope of the posted shares market on the Stock Transaction Service of HCM city grew significantly from only more than 1% GDP at the end of 2005 to nearly 50% GDP in June 2008. the Stock Transaction Service of HCM city has admitted the 75th transaction member as stock company, compared to only 5 members in the start. Such numbers proved a really big effort and endurance of the Stock Transaction Service of HCM city in such a limited conditions in technology infrastructure and human resource. From the mid of March 2008, the Stock Transaction Service of HCM city turned to use the no-floor transaction method based on modern technology.

5.1.2. Operation of the Stock Transaction Center in Hanoi

The active and total change of Vietnam Stock Market together with the experience gathered after 5 years of organizing and operating the Stock Market is a basic and important premise for the Government to permit the operation of Hanoi Stock Transaction Center on March 8, 2005. Pursuant to the Development strategy of Vietnam Stock Market approved by the Prime minister, the operation trend of Hanoi Stock Transaction Center is to hold a market for special transaction stocks; shares of small and medium enterprises, unposted enterprises in HCM city market… following a flexible transaction method, suitable to the needs of the market and based on modern technology. The birth and operation of Hanoi Stock Transaction Center following this trend has contributed to complete the structure of the Stock Market, organize markets in more diversified post standard, gradually narrow the operation of free market without control, and diversify the channels of capital and investment mobilization for the enterprises as well as for stock investors. More than 2 years before, there were only 6 companies posted shares with a total value of 1,500 billion dongs per nominal value, then in June 2008, there were more than 130 companies with a total posted value reached to 31,000 billion dongs. The number of securities companies as members of Hanoi Stock Transaction Center rose from 11 starting members to 70 companies.

5.2. Lessions on the development of 2 stock exchange centers

After 8 years, it can be seen that Hanoi and Ho Chi Minh city stock exchange centers have overcomed many difficulties, including the policy changes, lack of management experience, the requirement of investors and stock companies. Those stock exchange centers help to make market more clear and public and reduce the complex of administrative procedure

The leading principle of market development is from small to large scale, from low to high level and from simple to a modern and international standard. Vietnam gets experiences during the practice, then issue suiltable policy to the government, market manageremnt institutions, especially when the market becomes "too hot" or "too cold", affected by global financial market.

In addions, those center have contributed into the renovation of state enterprises through privatization progress; capital mobilization for the governement with low cost via bond tender. The privatization of enterprises has been made more clear and public.

The development of Vietnamese stock market has received attention of many other foreign stock markets. Vietnam has expanded signing MOU with foreign stock exchange centers, especialy the big center like New York, Tokyo, London.

5.2.1. Achievement in the liberalization progress of Vietnam following WTO

1. First, Vietnam has selected a correct way on commitment. Vietnam commited to implement financial liberalization based on the policy of more FDI attraction, more foreign trade activities in Vietnam to enhance capacity of domestic financial mechanism such as using foreign capital, learning management skills, then gradually develop financial market. However, Vietnam applied cautious actions on liberalization to avoid competition in domestic market and protect national enterprises.
2. Second, Vietnam has made basic reform on legal system in accordance with international and WTO regulation. The policy of single window in administrative reform brings good condition for investment environment and banking business.
3. Third, Vietnam has applied cautious commitment in financial liberalization such as remaining the limittation of foreign branches, limited capital mobilization in VND, limitted branches openess of foreign banks, and litmiited real estate mortgage for foreign banks.

5.2.2. Issues

1. Vietnam have to improve legal frame to make good condition for commitment implementation. Vietnamese law systme has not been comprehensive and fit with international law.
2. Vietnam has not have a effective supervision mechanism. In banking system, SBV has already issued regulations on banking safety such as safe capital rate, debt classification, fund for risky management. However, the supervission system is backward compared with international stardard that could not encourage financial organizations in risky management. Thus, it is necessary to build up a supervision system following international standard (Basel capital agreement).
3. Vietnam should be careful when applying liberalization on capital account. Currently, Vietnam has many similar points as countries that facing financial crisis with high inflation,

high nominar interest rate, low foreign currency reserve, chronic account deficit, bad-debt, high risky rate, weak management skills, inflexible exchange rate.

4. The macroeconomic management ability of Vietnam is still weak, especially in the field of policy predictation. That leads to the negative impact when any unusual factor appear to economic system.

II. VIETNAM'S MONETARY POLICY IN CURRENT YEARS

In last two decades, one of the most important sectors that significantly contributed to Vietnamese economic archievement, especially the participant to WTO as an official member, is the role of monetary policy. Based on the economic development periods, it is observed that Vietnam's government and the State Bank of Vietnam (SBV) has successfully selected suiltable monetary policy which effectively impacts on all economic faces.

1. Vietnam's monetary policy before global financial crisis 2008

The main objective of monetary policy in any country at any time is to stabilize money's value, control inflation rate, and make contribution to the stablization of macro-economics. According to macro-economic theories, monetary policy creates impact on the economic growth in short term, but long term on inflation. Thus, the State's implement of both "easy monetary policy" and "tight monetary poilciy" at a same period aims to reach one of two above objectives. "Easey monetary policy" supports to economic growth in short term. It doesn't make any impacts on economic growth in long term, but increases inflation rate. In order to curb inflation when it raising too fast, the State 'makes money tight" through a "tight monetary policy".

In fact, in last 10 years in Vietnam, based on the level it could device inflation into 2 period:

1.1. Low rate inflation period (1999- 2003)

In this period, the economic growth was lower than potential output (lower than the output in which economic uses maximum its source). Thus, it leads to the low rate inflation (0,5 – 4%),

1.2. Higher rate inflation period (2004- 2008)

In this period, economic growth is higher than potential output about 1%- 6%, leading to a higher rate of inflation. In 2007, the inflation rate was 12,6 % that made Vietnamese State implemented "tight monetary policy" together with following supporting policy instruments:

1.2.1. Setup required reserve ratio for commercial banks.

According to Decision No 187/2008/QĐ-NHNN dated 16 January, 2008 all commercial banks have to raise bank deposits with reserve requirement and increase 1% for reguired reserve ratio in compared with current stipulation

This decision has not been applied to financial institutions in rural areas

1.2.2. Open market operation and Treasury Bill Placement

On 13 February, 2008 the State Bank promulgated Decision No 346/QĐ- NHNN in which State Bank's treasury bill was placed in VND compelled to commercial institutions with total 20.300 billion dong due on 364 days per year, interest rate 7,8%. The treasury bill have been distributed to 41 commercial banks that hold a capital source,including 4 state-commercial banks, 28 join stock commercial banks, 7 branches of foreign banks, 2 joint venture banks and 1 petro finance corporation

As the adjustment of required reserve ratio, the open market operation aims to reduce capital flow, control the growth rate of payment method and debit balance increase, and curb inflation for a sustainable macroeconomics.

1.2.3. The adjustment of rediscount interest rate and basic interest rate.

The interest rate liberalization process in Vietnam has been implemented through the following steps:

- From June, 1992 to 1995, the interest rate was adjusted in consistence with interest rate frame mechanism. Accordingly, the State Bank set deposit rate floor and lending rate ceiling for sectors of the economy. Financial institutions, commercial banks would base on interest rate frame of the State Bank to set suitable interest rate for themselves. It was this interest rate mechanism that marked an opening for the interest rate liberalization in Vietnam.

- From 1996 to July, 2000, the interest rate ceiling mechanism was applied. Accordingly, liberalization of mobilized interest rates as well as flexibility of lending interest rate ceiling were allowed by the State Bank. This mechanism facilitated the economic growth, controlled inflation, and stabilized purchasing power of Vietnam dongs in comparison with other currencies in the area after the Southeast Asian monetary crisis in 1997 – 1998.

- From August, 2000 to May, 2002, the State Bank applied the management mechanism of prime interest rate accompanied by rate band. Accordingly, the basic interest rate and rate margin would be published monthly and the State Bank only made adjustment when necessary. This mechanism showed determination of the State Bank in changing interest rate policy in direction of liberalization and step by step shortening the gap between domestic and regional and international interest rate.

- From June, 2002 to 2006, negotiated interest rate mechanism was applied. In fact, from May, 2001, this mechanism had been carried on by the State Bank for lending in foreign currencies; but it was until May, 2002 that it came into practice for domestic financial activities. In 2007 and early 2008, the interest rate continuously jumped.

- On 30 January 2008, the State Bank of Vietnam promulgated Decision No 305/ QĐ-NHNN on basic interest rate adjustment in VND from 8,25% to 8, 75%, 7.5% for refund interest rate and 6% for rediscount interest rate.

However, some commercial banks faced difficulty on liquidity after the implementation of interest rate adjustment because they have invested in stock and property loan. Thus, it started a strong competition among commercial banks. Though the State Bank required financial institutions not to mobilize saving interest rate over 12% per year, the saving interest rate was about 13-14% in reality. In order to cope with those problems, the State Bank has issued Decision No 16/QĐ-NHNN on "mechanism of basic interest rate adjustment". In this Decision, the ceiling interest rate at 12% had been officially removed to the rate of market merchanism. On 10 June 2008, basic interest rate was adjust to increase from 12% to 14% and the basic interest rate of Lombard credit was required at the ceiling rate of 15%

Thus, basic interest rate is not only a mail instrument of monetary policy but also plays a role in market interest rate, as a necessity of market-oriented economy. This led to two urgent issues in this period was solved by the increase of basic interest rate, including:

First, ceiling interest rate of Vietnam's financial banks reached at 21%

Second, it made good conditions for financial banks to increase saving interest rate, attract more unused capital, reduce financial burden of State bank's refund, and contribute to the bank liquidity, tighten mony supply and curb inflation.

However, before long-lasting effects of the global financial and economic crisis, the domestic economy kept strong decline. During this time, the State Bank implemented cautious currency relaxation policy by continuously reducing basic interest rate in six remaining months of 2008. In details, in the last three months of 2008 (from October, 2008 to December, 2008), after four continuous deductions, the basic interest rate fell from 14% to 8.5% per annum, refinancing interest rate from 15% to 9.5% per annum and discount rate from 13% to 7.5% per annum.

The flexibility of interest rate management of the State Bank supported financial institutions to decrease lending interest rate, encouraging production and export, stabilizing micro-economic and ensuring safety of banking system.

Some main landmarks of monetary policy implemented by the State Bank

- Since 01 June 2007, the State Bank has doubled required reserve ratio from 5% to 10% for VND deposit under 12 months and from 2% to 4% for deposit from 12 to 24 months.
- In the first 6 months of 2007, the State Bank withdrawed from capital flow 90,000 billion, in compared with about 150,000 billion dong spending on buying USD.
- On 29 May, 2007 the State Bank issued direction No 03/2007/CT-NHNN about debit balance ratio and stock mortgage control that not exceeding 3% of total debit balance.
- On 30 January 2008, The State Bank announced interest rate adjustment in which basic interest rate increased from 8, 25 to 8, 75% per year, lending interest rate increased from 6, 5 to 7, 5% per year, rediscount interest rate increased from 4, 5 to 6,0%/ per year.

- On 30 January 2008, the State Bank filled up pumping more than 12,000 billion dong to satisfy banks' liquidity
- On 31 January 2008, the State Bank announced to add 15,000 billion dong to the market.
- On 31 February 2008, the State Bank announced to issued compulsory treasury bills on 17 March for 41 commercial bank with the total value of 20,300 billion dong, due date 364 days and interest rate: 7,80% per year.
- On 19 and 20 February 2008, the State Bank provided 23,000 billion to open market
- On 21 February 2008, the State Bank added more 10,000 billion to open market
- On 27 February 2008, the State Bank applied ceiling interest rate at 12% per year for capital mobilization of commercial banks
- ON 16 May 2008, the State Bank issued Decision No16/QĐ-NHNN on mechanism of basic interest rate operation in VND, in which ceiling interest at the rate of 12% was removed
- On 10 June 2008, the State Bank issued Decision No1317/QĐ-NHNN increasing basic interest rate 2%, from 12% to 14%

1.2.4. Flexible exchange rate policy

In last decades, the exchange rate of VND cemented with a strong foreign currency that was USD. This strong attachment with one foreign currency led to contrary impact on national economic development at different periods. When US's economy developed, the exchange rate increased making none impact on the export price of Vietnam's products. However, when there was a crisis in US' economy, the exchange rate between VND with a losing value foreign currency created bad influence to export activities. It is remarkable that more than 70% export value of Vietnam's products were paid by USD.

However, in recent years, Vietnamese Government has applied a more flexible exchange rate, upon that there is an adjustment of exchange rate between VND and USD (and other foreign currencies) based on market's demand-supply relation. Simultaneously, the government has enlarged deal of foreign currency in financial institutions from 0.75% to ±2% in compared with average transaction's exchange rate of interbanks.

Together with monetary policy instruments, the Governement simultaneously implemented tight fiscal policy (controlling public investment and overspending) and other domestic market management instruments.

The weakness points of monetary policy

*/ The Decisions of government were not consistent. For example, based on some above landmarks of monetary policy, it can be seen that:

- In February the State Bank withdrawed 20,300 billion dong from capital flow through compulsory treasury bills, but then the State Bank provided about 40,000 billion dong to commercial banks for payment liquidity and stock and real estate invesmnt.

- In May 2007, because of the increase on stoct market and stock debit balance, the State Bank issued Direction No03/2007/CT-NHNN to curb debit balance and keep stock debit balance at the rate of 3%. However, commercial banks raised credit leading to the increase of capital flow. This made unstable in monetary market and puzzled by commercial banks and enterprises.

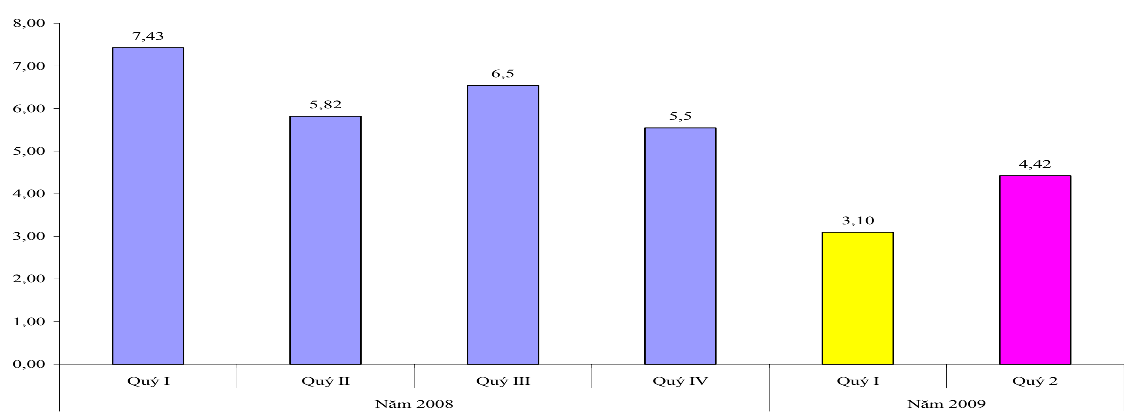
*/ There was a lack of initiative from policy makers and market participants. Most of policies have been based on market approach without scientific forecast basis, leading to unactive measures. Monetary policy has been changed frequently making disorder in financial market and macroeconomic environment.

2. New points of monetary policy in global financial crisis 2008

Though there was an ominous sign of financial crisis in summer 2007 with a sudden increase of oil, food and basis materials price (the price of crude oil was 147 USD per gallon, steel: 830USD per ton, 1,000USD per ton, the price of real property in US reduced, ect), until 15 September 2008 the financial crisis official known in US with the bankrupt of Lehman Brothers Bank of Investment and AIG Insurance Company, Washington Mutual Inc Bank and quickly spreaded out EU's financial market and other areas. In order to prevent financial market from collapse and economic recession, the State banks of developed countries such as US, Germany, France, England, Japan and other developing countries have already applied many method to increase financial liquidity and extend credit for a effective support to financial banks and institutitons. The easy monetary policy have been applied by reducing interest rate, providing more money to capital flow at many countries, in which Vietnam is not a exeption.

Firstly, it have been clearly seen that the global financial crisis has made a negative impact on the economic growth of Vietnam (below figure).

Figure 1.3: Quarter economic growth in 2008-2009



(*Sourse: General Statistics Office)*

In the graph, Vietnam's economic growth slowed down in 02 consecutive quarters of 2009. The growth rate increased to 5.5% for the 4th quarter of 2008, 3.1% for the first quarter 2009, and 4.42% for the second quarter 2009. The economic growth rate in 2nd quarter 2009 was higher than the first's, but it was still lower than the rate of 4th quarter 2008.

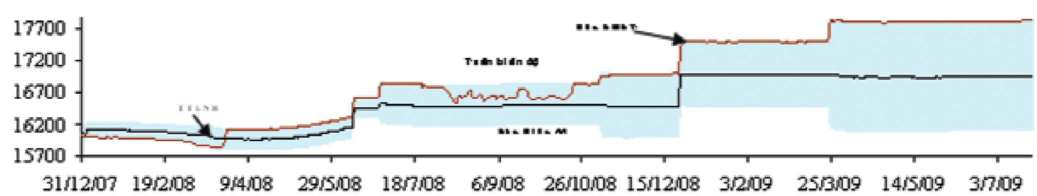
In macroeconomic environment, inflation was in a low rate but there was a trend of high inflation because of impact from economic stimulus policies; budget deficit increased caused by oil prices and reduced export price. The export turn-over decreased 13.4% in the first 7 months of 2009 and there was a decrease in FDI, ODA disbursement, and low overseas national currency exchange in compared with 2008.

- The deposit in foreign banks had been to withdrawed before due date leading to the reduction of benefits; there was a decrease in capital mobilization from oversea; the cost of borrow services and bad debt also increased in compared with 2008.

Facing with those difficulties of economy, monetary policy has followed economic stimulus strategy of the Government.

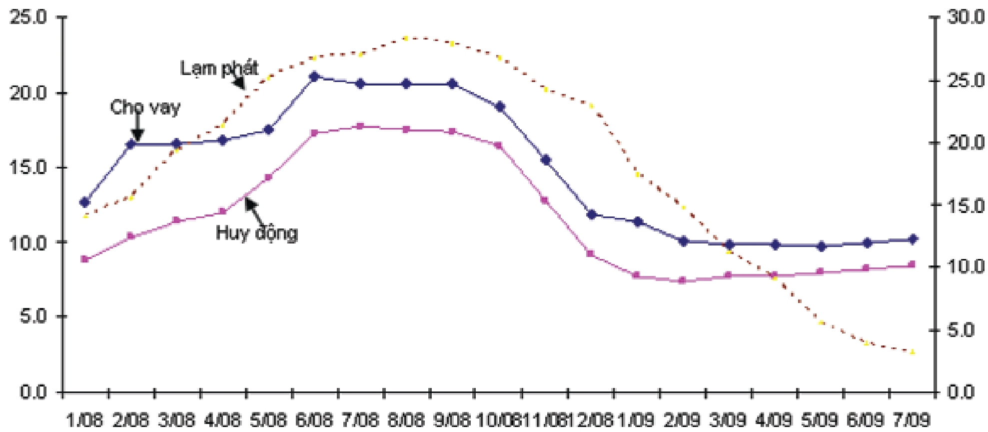
1/ Since October 2008 the State Bank has prudently changed from "tight monetary policy" to a "easy monetary policy" in which: (1) There was an adjustment on decisive interest rate (basic interest rate reduced from 13% per year down to 7% per year, refund interest rate reduced from 14% per year down to 7% per year, rediscount interest rate reduced from 12% per year down to 5% per year; the required reserve ratio in VND reduced from 11% down to 3%; flexible open market operation and foreign currency exchange to support to commercial bank's liquidity; adjust interest rate for required reserve from 10% per year down to 1,2% per year; (2) Flexible operation on USD/VND exchange rate by increasing exchange rate between VND and USD from +3% to +5% for all transaction of commercial banks. The result showed that there was a suiltable increase in total payment methods and credit (in 2008, total payment methods increased 20%, credit increased 23,58%; in the first 7 months of 2009, those number were 20,22% and 22,61%); the market interest rate became stable, VND/USD exchange rate increased 2,12%, the financial system run savely and smoothly (below graph)

Figure 1.4: Exchange rate VND/USD in period 2007-2009



(Source : The State Bank of Vietnam)

Figure 1.5: Capital mobilization's interest rate, loan interest and inflation period 2008-2009



(Source: the State Bank of Vietnam)

2/. The implementation of interest rate support mechanism at 4% per year

In the first months of 2009, the State Bank, Ministry of Industry and Trade, the Government's Office and other relevant Ministries has cooperated to conduct interest rate support mechanism following the Prime Minister's requirement. The support method is: when financial banks, financial institutions, social policy banks, Vietnam Development Bank, and local Investment and Development Funds collect interests from customers, they deduct their interest from customers and receive the compensation from the State Bank through their report. At the end of July 2009, total debit balance of interest rate support for customers reached the number of 403,448 billion dong.

Through the analysis of economic stimulus package of other countries, Vietnam's economic policy in last decades, and the result of interest rate support mechanism, it is observed that the use of 17,000 billion dong for this support mechanism is a suiltable policy for Vietnam's economic condition.

(*) Source: Harvard Report-State of the Nation,s Housing 2008 Repor

(**) Source: "Japan,s lessons for a world of balance-sheet deflation" ; Financial Times

CHAPTER 2

FINANCIAL SYSTEM AND MONETARY POLICY OF JAPAN

I. JAPANESE FINANCIAL SYSTEM

1. General evaluation

Up to now, there is no sufficient basic to ensure that the Japanese financial system is the strongest, most perfect among countries which have developed economies in the world. However, despite of many economic and financial hazards in 1990s, Japan has strived to reach the 2nd position, only after the United States, in term of GDP. Before the Second World War, Japan was known as a poor country in natural resources but often suffered calamity such as earthquakes. After the War, however, its look was entirely changed. All the world had to look up to Japan – a country that lost the battle took revenge by economic miracles. Japan owns brands of high quality products such as Toshiba, Sony, Toyota that became symbol of Japan as well as pride of dedicated employees who devote themselves for nowadays Japan. Besides, it can't be ignored the significant role of Japanese financial and banking system and monetary policy that contributed much on the miraculous economic development of Japan.

In 1980s, the Japanese financial system was widely accepted as an example by both developed countries and emerging economies. It was the financial system support that Japanese companies were partly strengthened in the international market. Japan owned the highest savings rate in the world, which were invested effectively by Japanese companies. Bank system was always confident that capitals supplied by banks would be usually invested effectively in the long term by the strict inspection of at least one main bank. In case of an enterprise faced any contingency, the main bank would seriously inspect and support enough capital for the enterprise to recover from the difficult time until liquidation was thought to be necessary.

In addition, with the support, management and strict control of Bank of Japan as well as the appropriate monetary policies in each development stage of the country's economy, the Japanese financial system has generated more sustainable growth, facilitating both the economy to maintain the position as one of the three leading economies (the United States, EU, Japan) in the world and the general development of the international financial system. Monetary measurements and policies that Japan implemented in the most harsh period, especially when the country had to face the long-lasting deflation, high non-performing loan rate and financial crisis in 1990s, and most recently, the challenges and impacts of the global financial crisis in 2008, have become valuable experiences that should be learnt by other countries.

2. Characteristics of Japanese financial system

2.1. Households' Invested Assets promoted the Japanese financial system

After the United States experienced burst of "bubble economy" in the late 1980s, private businesses promoted structural reforms including advancement of new business lines. After that, in 1990s, the United States generated the outstanding growth rate based on the active performance of capital market as a key support. Similar to Japan in 1995, in early 1990s, U.S. authorities maintained a very low interest rate policy, thus, real savings interest rate decreased to about zero to boost economic growth and profits for financial institutions.

Table 2.1: Changes in Households' Asset Allocation in the U.S and Japan

(1) The U.S.		**($billion)**
	1985-90	1991-96
Investment Trusts	390	940
MMF	176	162
Pensions and Insurance	1358	1688
Credit Market	811	458
Time and Saving Deposits	646	80
Corporate Equities	-554	-677
Others	281	473
Total	3108	3124
(2) Japan		**(¥trillion)**
	1990 – 94	1995 - 99
Public Sector		
Postal Savings	67	60
Postal Life Insurance	39	32
Public Pensions, etc.	45	34
Subtotal	151	126
Private Sector		
Cash and Deposits	88	85
Insurance	40	14
Pensions	31	35
Securities	-26	7
Subtotal	135	140
Total	286	266

(Source: Okumura, 2001)

Data in table 2.1 shows the main movement of financial assets from household sector to mutual funds (similar to "investment trust") in the United States. However, there was not such movement of financial assets in Japan. Instead, data in Japan shows more than 50% of 552 billion of additional household financial assets accumulated in 10 years was moved to public finance sector (postal savings, postal life insurance…). Although the postal savings or other assets of public finance sector were in effect risk-free, their interest rates were relatively equal with private banks' rates. However, in Japan, despite the low interest rate, individual investment funds were definitely kept in postal savings deposits because high-yield, risk-free financial products were guaranteed by the postal savings system in years. It was also the reason why in many years afterwards, this system has become the significant savings instrument for many families. It can be said that it was the households' invested assets that promoted the Japanese financial system growth and formed reliable mainstay for Japanese enterprises. This conclusion is based on the following points:

- Firstly, in consideration of the composition of the financial assets held by the household sectors in Japan, the US and Germany, it can be seen that the Japanese households owned high rate of savings and deposits, half of which were deposited at banks. In Germany, this rate was similarly high but significantly decreased in 1990s. In Japan, however, this rate continued to grow.

- Secondly, in Japan, capital-safe financial instruments were dominant. Beside savings earnings, especially since fixed-earnings products were considered as the core of insurance policy and pension plan, more than 80% of household assets were defined as capital-safe financial instruments. It means that Japanese household sector met nearly no financial risk. Meanwhile, in the United States, not only the low interest rate savings and deposits, but also insurance policy and pension plan were defined as nonprofit-making or capital-unsafe financial instruments. In the United States, households bears high financial risk while in Japan, it was financial institutions, instead of households, who took that risk.

2.2. The close relationship between banks and enterprises and the enterprise capital supporting responsibilities formed Main Bank System

Japan bank system experienced 3 panics in 1920s, in specific, in 1920, 1923 and most seriously in 1927. To solve the situation, the government issued new bank code, which officially came into effect in January, 1928. The Department of Finance took the responsibility to enforce the new law and since the early enforcement, it had great impacts on every system activity. In order to cut a large bank quantity, one principle was born, which was "one bank in one prefecture". Accordingly, banks were granted self-governance in a certain area. The bank quantity cut process gained results thanks to the support of consolidated public fund. In the situation, the government had to directly participate in the financial system before starting the war against China and the United States.

In 1930s, the financial market, especially the share issue, played an important role in the funding of industry. In the period 1931-40, shares provided 31.7% of funds, bonds 4.3%, loans from private financial institutions 27.3% and retained earnings 37%. After the war, market share of shares reduced about 5 to 10% while market share of financial institutions and their retained profits increased remarkably. And the "Main Bank" system was established in the beginning of wartime control from 1937 to 1941. During this period, the Temporary Law of Fund

Adjustment of 1937 allowed further government intervention, including their ability to require all enterprises above a certain size to increase their equity base or merge.

However, some large banks of the Zaibasu group responded against the government control because they didn't want to centralize capitals to munitions companies. The government moved to counter this resistance and gradually applied system of central control of financial resources, in which, Bank of Japan played a central role. This process came to top when the munitions companies designated financial institutions system in January 1994. As the system's regulations, each defense company was allowed to nominate one main bank who then took responsibility for the financial demand of the company. Since then, the relationship that was born in the war time has developed into postwar "main bank" system.

From the above analysis, the basic characteristic of main bank system is the long-lasting relationship between banks and enterprises and the main bank relationship ensures the bank acts a delegated monitor and helps to overcome the agency problem between managers and the firm. Beside capital allocation through the Reconstruction Financing Bank (RFB) and The Japan Development Bank (JDB), the Government intervened in the financial system by holding interest rate at low levels between 1950s and 1960s. This brought back a serious of great impacts, one of which was the provision of rents to banks. These rents helped facilitate the solvency of banks and stabilize the financial system.

3. Japanese financial market

One easy-to-see point is in the Japanese financial system, banks gained the better advantage. It means that the stock market was at the weaker position in the comparison. Fact shows that, however, the strong economic growth of the United States in 1990s was generated by the efficient support of NASDAQ and other securities markets supported by IT companies. Therefore, it is necessary to boost stock market's capacity in the financial system, especially in such a changeable period as now.

After deregulation corresponding to the financial Big Bang, Japan actively supported the stock market to perform better, which resulted in the competitiveness at the same level as the U.S and EU markets.

Table 2.2: Major Financial Markets in Japan and Their Size

		Balance (Market Capitalization)	(JPY in hundred millions)
Long-Term Financial Markets	Bond Market	Straight Corporate Bonds	624,434
		Straight Government Bonds	5,488,230
	Stock Market	TSE (all companies listed)	3,630,393
		JASDAQ	113,922
Short-Term Financial Markets	Interbank Market	Call	186,529
		Bill	297,900
	Open Market	Public and Corporate Bonds Repurchase Market	178,806
		Public and Corporate Bonds Loan Market	575,097
		CD	302,333
		CP	155,753
		TB/FB	1,267,672
		Tokyo Offshore	398,461

(Source: Yamori, 2005)

Similar to any financial market, the Japanese stock market was also divided into component markets: short-term monetary market and middle and long-term capital market.

- Short-term monetary market is the market in which trading capital's term is usually one year or shorter. This market, in general, is classified into inter-bank market, which are limited to banks and other financial institutions and the open market where non- financial companies can participate. The inter-bank market is the market, in which financial institutions manage their temporary financial losses or profits. This market holds the most important role in credit checking for Bank of Japan.

- Long-term financial market is the market in which, trading capital's term is one year and more and usually classified into the bond or stock market and other markets, such as the bond futures markets. Among traditional stock markets, the Tokyo Exchange Section I maintains the dominant share.

4. Japanese bank and financial institution system

4.1. Organizational structure

The Japanese bank and financial institution system was divided into 2 classes as in figure 2.1. This figure shows that, the central bank – Bank of Japan – was the bank of banks, took responsibility for planning the monetary policies and managing the whole system. Next was the system of financial intermediaries and other financial institutions. In the commercial bank system, city banks were the largest making up 20% of the total savings of all financial institutions in the whole country (S.Eijffinger, A.van Rixtel 1991). These banks provided a large amount of short-term capital for domestic enterprises and were ranked into top 25 biggest banks in the world.

Figure 2.1: A classification of Japanese financial institution

.**FIGURE 2.1: A classification of Japanese financial institution**

Classification	Institution	Number of Institutions	Amounts of deposits (Vbillion)
Central Bank	The Bank of Japane	1	-
Private Financial Institutions – Private Financial Intermadiaries – Depository Institutions – Commercial banks	City banks	13	172,817
	Regional banks	64	120,522
	Foreignl banks	82	1,463
Long-term financial institutions	Long-term credit banks	3	44,085”
	Trust banks	7	10,485
Financial institutions for small business	Sogo banks	68	47,732”
	Zenshinren bank	1	9,533
	Shinkin banks	455	65,574”
	National Federation of Credit Co-operatives	1	2,635
	Credit co-operatives	419	16,287”
Financial institutions for agriculture. Forestry and fishery	Norinchukin Bank	1	25,948”
	Agricultural co-operatives	3,979	47,275
Non-depository Institutions – Insurance companies	Life insurance companies	24	-
	Non-life insurance companies	23	-
Other Financial Institutions	Securities companies	210	-
Public Financial Institutions	Postal Savings System	1	123,938

Deposits + bank debentures issued
Deposits + installments
Deposits + savings

After the burst of the Japanese bubble economy, a series of banks and financial institutions failed. From August 1995 with the collapse of Hyogo bank to March 2002, other 16 banks went to bankrupt. To reorganize the collapsed banks, a large amount of money, up to 17,9 billion yen, were called, in which, about 10 billion yen came from the Government fund because the savings insurance funds' amount remained too low and not enough to cover.

For banks not going bankrupt, the reorganization still continued to be implemented. However, this process took place crucially in city bank sector because they played central role in the Japanese bank system. Typical examples were city banks in big cities such as Tokyo, Osaka and their branches in all over the country, all of which had close business relationships with large enterprises. If in March 1990, the number of city banks were 13, then by March 2003, they combined into 5 large groups. Four of that (Mitsubishi Tokyo Financial Group, Mizuho Financial Group, Sumitomo Mitsui Financial Group and UFJ Holdings) were called 4 megabanks because they held a system of companies and many bank branches.

Table 2.3: Banking Groups and Consolidated Assets

(Billions of yen)

New Groups	Major Subsidiary Banks	Former Banks	Consolidated Assets March 2003
1. Mizuho Financial Group (MHFG) (Established in January 2003)	Mizuho Bank, Mizuho Corporate Bank, Mizuho Trust & Banking	Industrial Bank of Japan, Daiichi Kangyo, Fuji, Yasuda Trust Banks	134,033
2. Sumitomo Mitsui Financial Group (SMFG) (Established in December 2002)	Sumitomo Mitsui Banking Corporation (SMBC)	Sumitomo Bank, Sakura Bank	102,395
3.Mitsubishi Tokyo Financial Group (MTFG) (Established in April 2001)	Banking of Tokyo-Mitsubishi (BTM), Mitsubishi Trust & Banking Corporation	Bank of Tokyo-Mitsubishi (BTM), Mitsubishi Trust Bank, Nippon Trust Bank	96,532
4. UFJ Holdings (Established in April 2001)	UFJ Bank, UFJ Trust Bank	Sanwa Bank, Tokai Bank, Toyo Trust & Banking	80,207
5. Resona Holdings (Established in December 2001)	Resona, Saitama Resona, Kinki Osaka, Nara Banks, Resona Trust & Banking	Asahi Bank, Daiwa Bank	42,892

(Source: PRI- Japan' banking system: from the Bubble and Crisis to Reconstruction)

For weaker local financial institutions in the bank reorganization process, they began cooperate with each other.

Table 2.4: Number Changes of Private-Sector Financial Institutions by Business Type

	3/1980	3/1990	3/2000	1/2005
City Banks	13	13	9	7
Regional Banks	63	64	64	64
Second Regional Banks	71	68	54	48
Credit Associations	462	454	386	301
Credit Cooperatives	483	414	291	179

Source: Inoue (2003) and materials on Nikkins' website

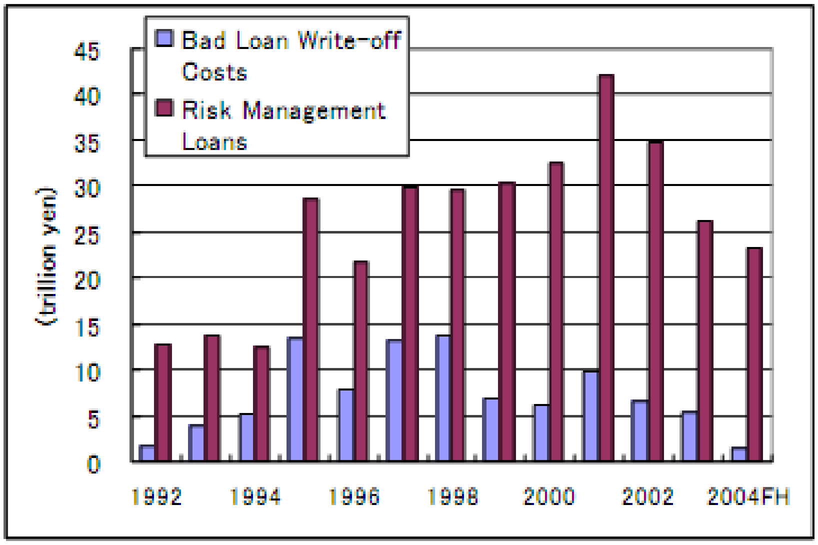
This table shows the change in the financial institution quantity, including major banks, in the Japanese private sector at this time. Data from table 4 indicate that in 10 years, from 1980 to 1990, the number of credit co-operatives fell remarkably, in which, the number of other financial institutions remained unchanged. In 10 years afterwards, from 1990 to 2000, however, the major decline in quantity lied on city banks (from 13 to 9), making up 31%; credit co-operatives reduced from 12 to 3 or 30% and Shinkin banks 15% although the deduction rate was not high. In contrast, the number of local banks remained unchanged. In 5 years, from March 2000 to January 2005, financial institutions continued to fall in quantity; city banks was only a half of the initial quantity (from 13 to 7). The outstanding point here is that in 5 years, from 2000 to 2005, the number of Shinkin banks and credit co-operatives fell significantly, 85 and 112 in respectively.

4.2. Non- performing Loans

Non-performing loans are the loans by cash and valuable securities that their interest and principal are not paid as commitment. Similar to many other countries, it was the problem that the Japanese bank system had to face in period of 1992-2004.

In fact, Japanese banks usually took land as collateral or mortgage when dealing with loans, but because land price fell strongly, banks couldn’t recover lending amount by selling land.

Figure 2.2: Non-performing Loans and Write-off Costs by Japanese Banks



(Source: Yamori, 2005)

Data from the figure state the total amount of non-performing loans and their settlement costs. The total loss value jumped up to 15 billion yen in the highest. Fortunately, since 2002, because of the government's financial system recovery programs which promoted main banks to actively deal with non-performing loans, and the positive progress in the economic environment and stock price, bad debit balance decreased significantly.

Table 2.5: Outstanding Stock and Disposals of Non-Performing Loans

(End of Fiscal Year)

(Unit: Billion yen)

	FY1992	FY1993	FY1994	FY1995	FY1996	FY1997	FY1998	FY1999	FY2000	FY2001	FY2002
Non-performing Loans: Outstanding Stock	-- (12,774)	-- (13,576)	-- (12,546)	28,504 (21,868)	21,789 (16,491)	29,758 (21,978)	29,627 (20,250)	30,366 (19,772	32,515 (19,281)	42,028 (27,626)	34,849 (20,433)
Loan Loss Provision: Outstanding Stock	-- (3,698)	-- (4,547)	-- (5,536)	13,293 (10,345)	12,334 (9,388)	17,815 (13,601)	14,797 (9,258)	12,230 (7,678)	11,555 (6,939)	13,353 (8,657)	12,585 (7,897)
NPL Disposals	-- (1,640)	-- (3,872)	-- (5,232)	13,369 (11,067)	7,763 (6,210)	13,258 (10,819)	13,631 (10,440)	6,944 (5,398)	6,108 (4,290)	9,722 (7,721)	6,658 (5,104)
New Net LLP	-- (945)	-- (1,146)	-- (1,402)	7,087 (5,576)	3,447 (2,534)	8,403 (6,552)	8,118 (15,490)	2,531 (1,339)	2,732 (1,371)	5,196 (3,806)	3,101 (2,042)
Direct Write-offs	-- (424)	-- (2,090)	-- (2,809)	5,980 (5,490)	4,316 (3,676)	3,993 (3,501)	4,709 (4,268)	3,864 (3,609)	3,072 (2,650)	3,974 (3,414)	3,520 (3,038)
Other	-- (271)	-- (636)	-- (1,022)	302 (1)	0 (0)	863 (766)	804 (683)	548 (449)	304 (269)	552 (501)	37 (25)
Operating Profits	4,685	4,439	4,484	6,753	6,418	5,503	3,129	4,675	4,768	4,693	4,674
Total Loans: Outstanding Stock	474,783	477,150	477,801	482,701	482,312	477,979	472,610	463,484	456,965	440,610	423,286
NPL/Total Loan (%)	--	--	--	5.91	4.52	6.23	6.27	6.55	7.12	9.54	8.23
Capital Adequacy Ratio (%)	--	--	--	--	--	--	10.06	10.88	10.75	10.12	9.52

Note: (1) Data in the table are figures for the Banking Accounts of All Domestically Licensed Banks (i.e., city banks, long-term credit banks, trust banks, and regional banks) while data in parentheses are those for city banks, long-term credit banks and trust banks. Data for operating profits and capital adequacy ratios also include foreign trust banks.

(2) Non-performing loans in this table refer to "risk management loans" (losses + loans more than 3 months overdue + loans with term restructured), except that the definitions prior to FY1997 are slightly different: they are losses + overdue loans for FY1992-94 and losses + loans more than 6 months overdue + loans with interest reduced for FY1995-96.

(3) The capital adequacy ratio is the ratio of capital to risk assets.

(Source : Financial Services Agency; Bank of Japan.)

However, compared with 1990, the non-performing loans still remained high and how to settle non-performing loans rested on the economic growth or decline rate. If the economy returned to decline again, non-performing loans would continue to increase. Therefore, it was too soon to say that the non-performing loan problem had been settled at this time.

4.3. Business profits of Japanese banks

In discussion of operational efficiency of commercial bank system, many people agree that low profit in the business of Japanese banks was the concerned problem. This issue can be explained on the following basics:

- The change in relationship between main banks and enterprises

As analyzed above, the main bank system's preeminence lies in the stable long-term relationship between banks and companies. Through this relationship, the main banks usually provided customers with consultancy and basic, essential and reliable information. In many cases, these provided information can save or help customer reorganize its activity. Moreover, when any crisis signal occurs, the main banks would actively implement methods to prevent bankruptcy as representative of creditors. For companies, it was regarded as insurance.

However, later on, the dependence of companies (mainly of capital demand) on banks increasingly reduced and the soundness of banks becomes faded. All of these reasons resulted in changes in relationship between main banks and companies. An example of this change was the fast and brief dissolution of cross stockholdings which previously were considered as symbol of main bank relationship. The lower dependence of enterprises on banks, as analyzed above, meant the bank's lower business profits.

- The government's protection through low interest rate policy

In bank business, the major profit that every bank pays special attention to comes from the efficiency of credit business, especially the difference between lending and deposit rate. However, this difference was so small in Bank of Japan (less than 2%), while it is 4% in the United States. Besides, in comparison of bank profits in term of both ROE and ROA between the United States and Japan, the profit of Japan's banks is much lower than that of the United States.

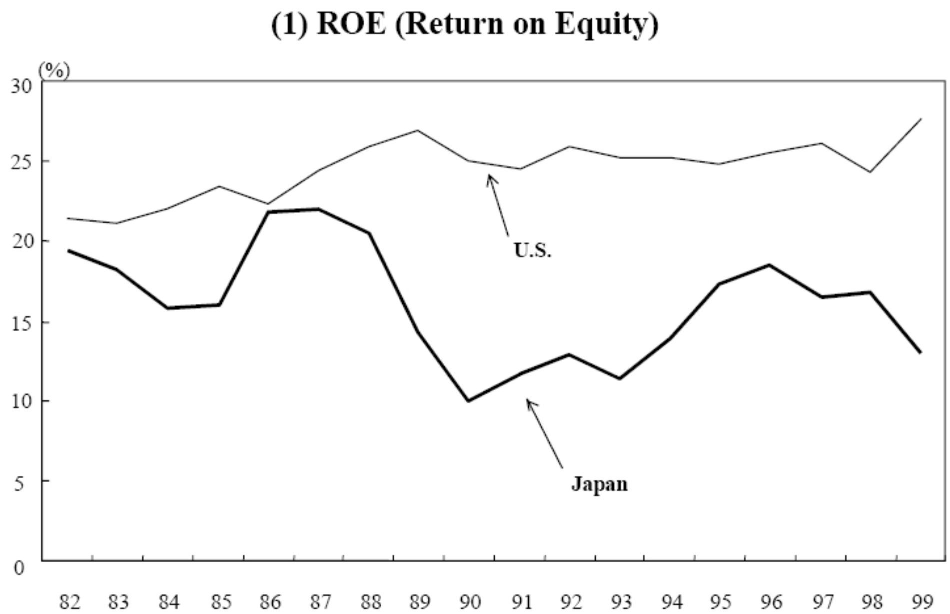
Table 2.6: Profitability of Japanese Banking Sector

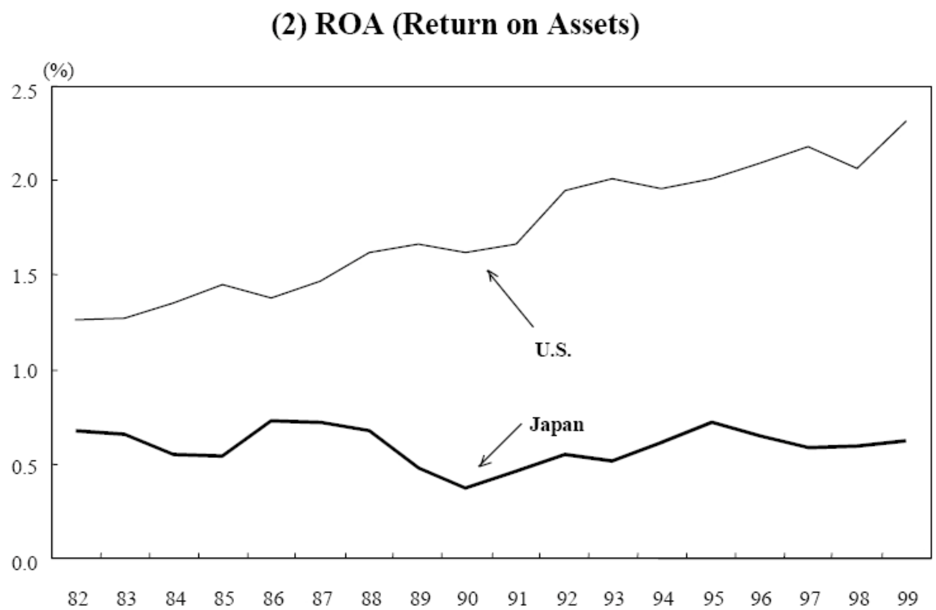
Trillion yen

Financial Year	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Lending Margin (A)	7.1	8.9	9.8	9.2	9.7	10.8	10.7	10.0	9.6	9.7	9.4	9.8	9.4
Other Revenue (B)	2.6	2.2	2.5	2.8	2.1	3.3	3.7	3.6	3.1	2.5	3.0	3.1	3.6
Operating Costs (C)	7.1	7.5	7.7	7.7	7.8	7.8	8.0	8.0	7.5	7.3	7.1	7.0	7.0
Salaries and Wages	3.7	3.9	4.0	4.0	4.0	4.0	4.0	4.0	3.6	3.5	3.4	3.2	2.8
Gross Profit (D)=(A)+(B)-(C)	2.6	3.5	4.5	4.3	4.0	6.3	6.4	5.6	5.2	4.9	5.3	5.9	6.0
Loan Loss (E)	0.8	1.0	2.0	4.6	6.2	13.3	7.3	13.5	13.5	6.3	6.6	9.4	7.0
Net Operating Profit (F)=(D)-(E)	1.8	2.5	2.5	-0.4	-2.2	-7.0	-1.0	-7.9	-8.3	-1.4	-1.3	-3.5	-1.0
Realized Capital Gains (G)	2.0	0.7	0.0	2.0	3.2	4.4	1.2	3.6	1.4	3.8	1.4	-2.4	-4.1
Net Profit (F)+(G)	3.8	3.3	2.5	1.7	1.0	-2.6	0.2	-4.2	-6.9	2.3	0.1	-5.9	-5.1
Asset	927.6	914.4	859.5	849.8	845.0	848.2	856.0	848.0	759.7	737.2	804.3	772.0	722.0
Outstanding loans	522.0	537.0	542.0	539.0	539.0	554.0	563.0	536.0	492.0	476.0	474.0	465.0	452.0

Note: Financial Statement of All Commercial Banks
Other revenue (B) includes all the other profit such as dealing profits and fees but excludes realized capital gains of stocks and real estates.
Realized capital gains include gains of stocks and real estates.
(Source: Japan Center for Economic Research)

Figure 2.3: Banks' ROE and ROA: US and Japan





(Source: IMES Discussion paper series)

In general, Japanese banks accepted a low-margin, high-volume strategy. In post-war period, the Japanese financial system developed upon the basic of indirect finance. This system was improved and strengthened by low interest rate policy applying for not only lending but also deposit rate. Moreover, this system got protective bank supervision under the auspices of Convoy System. The government would guarantee the stability so that banks could gain fixed marginal profit although it was at low rate. In the period of 1980s, the competition among banks in attracting deposits was considered based on a so reasonable reserve rate that banks could meet capital requirements and ensure the marginal profit by interest rate regulation.

However, the stability of bank's profits as stated above and the bank management reduced gradually under the impact of interest rate liberalization, the strong competition in the capital market and the fall of promising loan applications due to the fact that the economy became increasingly cautious. So, from this moment, Japanese banks couldn't ensure enough profits to cope with borrower's credit risks and profit standards regulated for international banks.

Therefore, one fact was that banks can't raise profits unless they raise capital, and of course, the credit loans. On the other hand, the banks must strongly cut costs, increase lending margins and then non-interest income by extending bank investment transactions. Banks mustn't passively wait for the companies because the companies have to make repayment beside borrowing, causing lower profits.

So, banks and financial institutions should think about a new business method. They should actively boost ability to create capital for local customers, flexibly utilize information generated in many years to consult and strengthen the relationships with customers. There is no other choice if they want to survive and grow sustainably.

5. Reforms of the Japanese financial system

5.1. Actual situation

During 1980s, thanks to long-lasting residual current balance of payment, benefits gained from yen appreciation boosted Japanese banking system to position that was on equal term with banks of international standards of the United States and England. In term of total bank assets of the world, Japanese banks made up 35%, more than double compared with American banks (in second position with 15.8%), and four times with French banks (in third position with 8.3%) . It was the appearance of Japan before 1990s, when the financial and banking system was considered to be in the most prosperous period.

However, from 1991, Japan began falling into economic depressions. Along with the collapse of "bubble" economy, share and land price falling resulted in bankruptcy of series of companies and marked an opening for the longest depression period in Japanese history from the Second World War. In the unavoidable "misfortune", it was the Japanese financial system that borne most severe consequences.

5.2. Depression causes of the Japanese financial market

The first was ***the inefficient performance of stock market*** that manifested clearly in rapid decline of share, stock and foreign currency trading. In the most prosperous period of the economy, the trading quantity of Tokyo Stock Exchange was 3 billion of shares per day but in 1994 and 1995, it fell to 200 – 300 million shares or 10% of the estimated quantity1. Moreover,

[1] http//www.mof.go.jp/big-bang/bb32.h

trading fee of Tokyo Stock Exchange was very expensive, conditions for stock market entrance was strict. Therefore, many domestic investors and monetary organizations didn't find Japanese market interested anymore and then turned into other Asian country's markets. If the number of foreign companies, in this period, entering into New York market was 290, London 533, Paris 187, it was only 67 in Tokyo market2.

The second was ***the mass collapses of financial institutions***. The fact that the "bubble" economy came to burst pushed Japanese economy into serious recession. Series of banks and financial institutions fell down; the most outstanding example were Kobe Bank with loan payable of 8 billion US dollars and the largest bank in the world – Sumitomo bank – with declaration of 3 billion US dollar loss in early 19953. This fact made both domestic and foreign investors lose confidence in the Japanese financial market.

Besides, in mention of main reason why the Japanese banking system was so weak, it can't be ignored ***the Japanese financial institution's habit of dependence on the State***. In comparison with other European and American colleges, Japanese financial institutions were weaker in term of business competence and experiences, so when Japan was forced to liberalize financial sector under pressure of Western countries, the Japanese financial system encountered many great risks and mistakes.

Non-performing loans and overdue debts were also problems that caused crisis of Japanese financial and banking system. In early 1980s, being affected by the United State's dollar devaluation for the purpose of improving trade deficit, yen was strongly appreciated; and especially after the disturbance of the United State's stock market in October, 1987, yen immediately jumped. Small manufacturers of Japan, who met many difficulties in production investment, turned to acquire short-term loan from banks to invest into shares and real estate, while the larger ones borrowed from banks to invest abroad. In this context, price of real estate and shares jumped significantly, real estate was used as collateral for new loans while Japanese banks and financial funds lost ability of risk evaluation and management for new lending.

The weakness of management skills and accounting profession of Japanese banking system, as stated above, was also rooted from so long protection of the State for this sector. In a long time, the Japanese financial system used a different accounting mode without external control. Meanwhile, banks tried to hide its poor performance by announcing debt at relative low rate compared with the real rate published by Financial Services Act after its investigation.

5.3. The need for reform

It can be seen that for Japanese bank and financial system, there have been so many strict regulations issued, implemented and seriously controlled. An example is the basic price type rating within the financial system, including bank deposit interest rate, commission for stock

[2] Nihon no kiuyukaikaku ni tsuite
[3] Study on Japan – No. 6/1999, page 3

trading transactions, insurance fee, or requirements for establishment of bank, insurance company, new stock company.

In fact, these regulations curbed the competition among financial institutions, although their impacts on preventing financial institutions from failure or bankruptcy had been confirmed. In 1980s and early 1990s, the overregulation' influences became so clear and under both domestic and abroad pressures, the regulations on finance began to be abrogated but slowly. Besides, there still existed some outstanding problems in the Japanese financial system that need settled. Their details were as follow:

- Financial and capital markets were hollowing out. Financial activities were shifted from home country to overseas due to some loose regulations or others; Japan's derivative business developed very well at the abroad market while a large number of foreign companies who wanted to list on the Tokyo stock exchange were not allowed to do so…

- In the domestic financial market, the strain of bank's non-performing loans became increasingly clear and many financial institutions went to bankrupt.

- For many years, Japanese banks had been placed under the Convoy System, which began to show many shortcomings under the reform pressure. The regulatory and supervisory authorities were forced to be aware of the need of change from bank direct regulation and supervision based on internal information to management and supervision mechanism based on market principles corresponding to the current international trends.

- The country got older very fast, so financial guarantee for citizens when they retired was required.

In the bleak situation of the economy in general and the financial system in specific as analyzed above, the Japanese government saw that the step-by-step financial deregulation couldn't solve problems briefly and absolutely. Instead, it required the strong changes which have wide and deep influences on the face of the whole country. And by November, 1996, the Japanese financial Big Bang initiated by Prime minister Ryutaro Hashimoto was issued.

5.4. The main reform programs

5.4.1. The Japanese financial Big Bang

Before the unsatisfactory situation of the economy in general and the financial system in specific, the Japanese government saw that step by step financial regulation removal couldn't solve problem promptly, thoroughly; instead, absolute changes with wide and deep impacts on total appearance of the country were required. By November, 1996, the Japanese financial Big Bang initiated by Prime Minister Ryutaro Hashimoto was issued. In financial sector, the Japanese financial Big Bang was, in nature, based on reforms implemented in the United Kingdom's Stock Exchange. The Japanese Prime Minister wanted to set out the "Japanese version" of these reforms. Its main goal was to build a new, dynamic and global financial system of freedom, equality, flexibility, and transparency that facilitated foreign financial organizations available in

Japanese market to accept competition in "economic freedom" principle, and more importantly, to help Japanese financial market compete with other markets of New York, London. To archive this goal within 3 years, the Japanese financial Big Bang focused on implementing the 8 following basic issues:

1. Floating entirely price and financial services
2. Opening foreign exchange market
3. Removing boundary among three industries including banking, insurance and stock trading, as well as allowing banks, stock and insurance companies to penetrate into each other's field
4. Allowing capital flows to circulate freely in both domestic and overseas markets
5. Enforcing financial institutions to publish exact statistics of their business
6. Step by step decreasing and then eliminating all kinds of tax that restrict real estate sales and transfer
7. Boosting independence of the central bank
8. Abolishing discrimination against foreign players in the financial and monetary market.

5.4.2. The Postal Saving System Reform (2007)

As analyzed in previous chapter, one of the most important traits of Japanese financial system is to be laid foundation on Postal Savings System.

Japanese Postal Saving System (PSS) is the largest financial organization in the world. In 2001, there was about 2,4 thousands billion US dollar in cash and 250 thousand billion Yen as deposit in this system. Japan has 24,000 post office, and each has a bank inside. PSS was established in 1875 based on the model of England created in 1861. In 19th century, it was hard for people from rural areas to go to banks and banks also did not have modern system to protect money. To solve this problem, the Government stared setting up bank equivalents in post offices. Since then, PSS provided a series of services for people such as pension payment, insurance selling, and state bond selling. PSS has become an important saving system for many households. 85% households have postal saving account. PSS plays a role as a financial organization that provides saving services to people and contributes into personal accumulation through hard working to deal with any risk might be happen in their normal life.

Besides, the Government can invest in public project and provide capital to enterprises with purpose of economic development by using money from PSS. It is asserted that the Households' Invested Assets significantly contributed to the strength of Japanese financial system and economic development.

Although the benefit from PSS is significant, economic experts analyse that if PSS is privatized, it will attract more capital than household's saving. In addition, the Japanese population is getting older, and then it is necessary to improve social welfare by setting up a completed saving system based on personal responsibility.

Thus, the privatization plan for PSS raised by President Koizumi was approved by Senate in October 2005 that will be remaining in 10 years, from 2007. Based on this plan, Japanese Posting Corporation has been divided into 3 companies and 1 bank named Yucho with large amount of capital. Those 3 companies include 1 post Mail Company, 1 postal service company, and 1 insurance company. Together with Yucho, insurance company prepares for stock quotes in 2011. Recently, Japanese Postal Corporation is the biggest employee in Japan with 400,000 staffs working at 24,700 post offices.

However, it is early to make conclusion about result, effect, and benefit of this reform. The reform has clearly showed Government's policy viewpoint, leading by President Koizumi, on a renovation for postal sector in which PSS can bring significant effect to society.

Result of financial market reform really marked an opening for the unprecedented competition among domestic and foreign companies in a field that had been for a long time strictly controlled by the government; series of challenges for Japanese banking and financial system; and the mutual elimination between Japanese and Western, especially American banks.

Successes of the reform

Firstly, the Japanese banking system was in process of restoring its position after many years shrinking. Many large banks began declaring profits after a long time of loss. The pioneer of this process was the largest trust bank in Japan - Mitsubishi Trust and Banking Group – which announced profits for the end of the fiscal year in March, 2000 of 126.5 billion yen (or USD. 1.2 billion) compared with the loss of 193.8 billion yen of the previous year.

Table 2.7: 10 largest banks in the world in 2000

Banks	Country	Assets
Mizuho Financial Group	Japan	1.316.000
Sumitomo Mitsui Banking	Japan	955.738
Deutsche Bank AG	Germany	843.879
Mitsubishi Tokyo Financial Group	Japan	836.271
Sanwa Tokai Tokyo Trust Group	Japan	808.852
Citigroup	The United State	716.937
BNP Paripas	France	701.964
Bank of American Corp.	The United State	632.574
UBS AG	Switzerland	614.558
HSBC Holdings PLC	England	569.139

(Source: Vietnam Financial Times 10/2000)

Among ten largest banks in the world nowadays, Japan owns four ones (see in table). One of them is the giant banking group called Mizuho, the merging consequence of three commercial banks including Daichi Kanggo Bank, Industrial Bank and Fuji Bank. It is the first group in the world holding assets of more than 1 thousand billion US dollars.

Secondly, the relaxing monetary policy or the zero interest rate policy in pinnacle had great impacts on the Japanese economic growth. In accordance with the reform, Bank of Japan carried out many effective methods, including the adjustment of monetary policy. The monetary policy was relaxed "in maximum", which manifested clearly in interest rate policy. BOJ cut over-day lending interest rate to the minimum of 0.25% per annum in September, 1998; 0.15% per annum in February, 1999 and 0.03% per annum on April, 1999 (this rate equalled management cost so lending real rate was 0%.) In the context of interest rate deduction, disposable funds in the monetary market jumped strongly, leading to the significant improvement of capital turn-over in trading of enterprises. The difference of interest rate between Japanese and international monetary market was also shortened, confirming that the Japanese financial system reforms were in right direction.

Thirdly, the Tokyo Stock Exchange became hot again. Trading quantity in the stock market slightly rose from 555.70 million to 565.16 million shares[4]. The National Association of Securities Dealer Automatic Quotation (NASDAQ-JAPAN) attracted more than 30 brokerage firms including many famous ones such as Cyber Communication Inc – a online advertising firm, Noda Soreen – a IC producer, in spites of its new birth in June, 2000.

By 2001, almost all of reforms were completed but unfortunately, they didn't continue to be implemented sufficiently to achieve the initial goal of building a financial institution which has ability to compete in the international market.

II. JAPANESE MONETARY POLICY

1. The monetary policy by periods

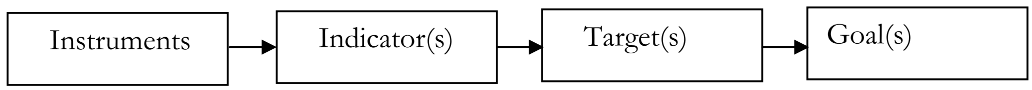
For other countries in the world, their awareness and respect of Japan don't limit to the economy of spectacular development in more than half of a century after the war but more importantly, the reasons behind this success. As an indispensable part of the financial system, Japanese monetary policy, before, in and after the war, had many great contributions to the economic development of the country.

After all, the monetary policy of any country, although its contents changed by the time, aimed at price and financial market stabilization, domestic currency value guarantee and macro-economic development of the country.

Based on Eijffinger (1986), the development and transmission mechanism of the monetary policy was executed by the following channels:

[4] Vietnam Economic Times 9/2000

Figure 2.4: The transmission mechanism of monetary policy



(Source: S.Eijffinger and A van Rixtel , Serie Research Memoranda, 1991)

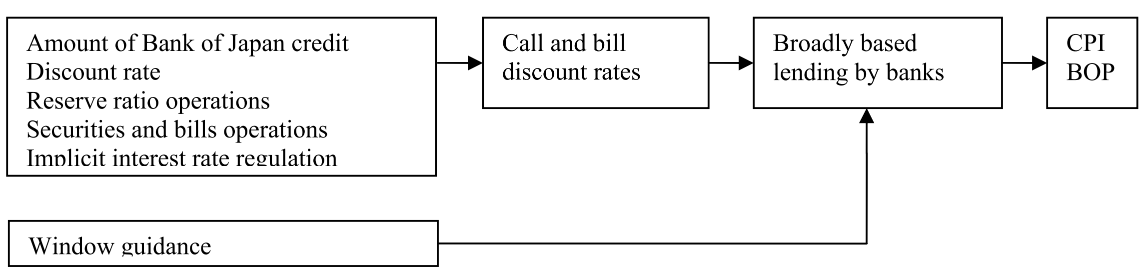
In case of Japan, the transmission mechanism of the monetary policy from early 1950s to now has been divided into 3 main periods as following:

1.1. The period of 1953-1975: The traditional monetary policy

Since 1953, the Japanese economy experienced an excessive development and was called High Growth Period. In this period, the main financial supply source for enterprises was bank credit. In other word, enterprises virtually depended on credit loans of financial institutions. The reality of the over-loan and the dominance of non-governmental organization's credit supply was created by the underdevelopment of the capital market and the exist of the main bank system or so-called Keiretsu. Keiretsu was, in nature, the unofficial combination between financial and non-financial institutions. Its members could borrow from Keiretsu in favorable terms. As analyzed above, most enterprises had close relationships with at least one main bank and would be supported by the main bank in any case. The structure of the main bank and Keiretsu remains until today and still contributes to credit lending in Japan.

The Japanese traditional monetary policy in this period focused on the inter-bank market. Bank of Japan used inter-bank interest rate, short-term savings rate, and then bill discount rate since 1971 as indicators. Through its lending policy, BOJ had a great impact on the inter-bank market. Because of the significant importance of the bank reserve system in the policy, its impact reserves up to now. In its turn, the commercial banks must keep a certain percentage of savings as the non-interest bearing at BOJ. Therefore, in early 1980, BOJ owned a large amount of reserve and most of them had become the bank's credit source. So as a rule, BOJ's lending policy had great influence on financial institution's reserve. By changing the credit amount in its bank, BOJ could affect the financial institution's total deposit reserve and inter-bank interest rate.

Figure 2.5: The traditional money policy



It can be said that BOJ's lending policy was very efficient at the time implementing the traditional monetary policy, which was mainly as a result of the macro situation of over-loan.

This above fact shows that funding positions of the banks largely depended on the central bank – BOJ and similarly, the inter-bank interest rate. Beside lending policy, BOJ also used many other policy instruments to control the inter-bank interest rate such as valuable securities and bill transactions to balance the surpluses and deficits of the monetary market.

1.2. The period of 1975-1981: New monetary policy

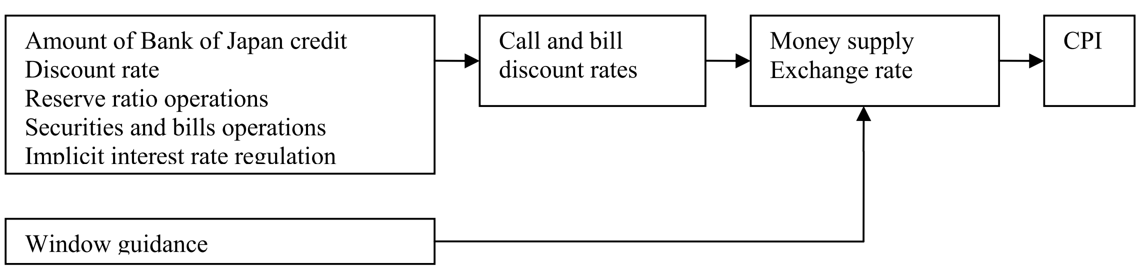
In 1971, the international monetary system Bretton Woods collapsed. This event as well as the oil crisis negatively affected the world economy, including the Japanese economy. The decrease of the economic growth rate forced the Japanese government to orient the economic development policy as Keynesian oriented monetary and economic policy.

The economic decline led to the sudden fall of enterprise's credit demands in the situation of over-borrowing. At the same time, to support the currently issued economic-monetary policy, a large amount of public bonds were issued. The large-scale bond issue meant the encouragement of stock market development and lower dominance of non-governmental financing, or in other word, official financing increase. All of the above factors reduced the importance of credit in the monetary policy process.

At the same time, the financial liberalization was being deployed at Japan and this process, on one hand, improved the flexibility of the interest rate but on the other hand, reduced the efficiency of channel between inter-bank interest rates and broadly based lending by banks of the traditional monetary policy. The financial liberalization process was also the factor leading to the establishment of more open non-regulated financial markets with more flexible interest rates.

To prevent inflation, the main goal of the new monetary policy was to obtain price stability. The yen-USD exchange rate was the second goal proposed to prevent import inflation.

Figure 2.6: The new monetary policy



1.3. The modern monetary policy 1981

In May, 1981, BOJ sold financial bills to free market in order to improve the market liquidity surpluses. This event was considered as a turning point, marked the development toward a new form of the monetary policy, the modern monetary policy. It was also the first time since the Second World War that the central bank implemented valuable security selling and buying transactions in the free market in order to directly intervene into the larger or smaller scale of the monetary market. These transactions were executed between BOJ and money creating financial institutions, so they didn't have direct impact on money supply. However, the indirect effect couldn't be avoided. It can be explained as follow:

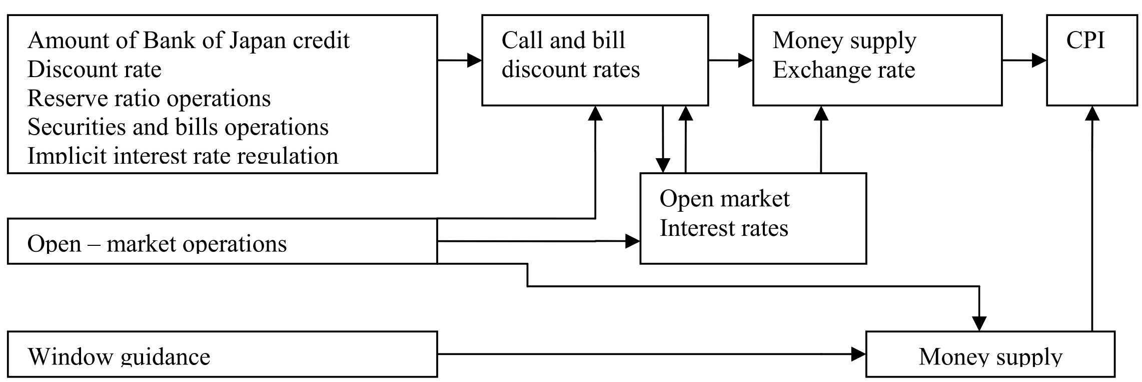
- Firstly, in the implementation of transactions, the total reserves of the financial institutions would increase or decrease. On this situation, money creating institutions would readjust their reserve in the inter-bank market, which resulted in the inter-bank interest rate change, forcing the financial institutions change their lending and then change the money supply scale.

- Secondly, the inter-bank interest rate change would affect the interest rate in the free market and finally the individual investment and money supply and demand.

The main reason why BOJ participated in the free market transactions was to develop a series of open, less regulated financial markets in Japan, such as the deposit certificate market, and then the market for banker's acceptance and the Tokyo offshore market and so on. The interest rate in this market was mostly flexible, leading to strongly increasing market shares of free markets in the total money market.

Beside the transactions of valuable securities and financial bills, BOJ also used various financial instruments to implement their initiated open market policy such as treasury bills (1981), certificates of deposit and commercial paper (1989). And to support BOJ to succeed in this policy, the Japanese Department of Finance issued treasury bills in August, 1989 and then continued in 1990.

Figure 2.7: The modern monetary policy



(Source: Series Research Memoranda, 1991)

So, it can be seen that by implementing transactions in the open market in the period of the modern monetary policy execution, BOJ obtained some results: (i) money supply increase for financial institutions, (ii) development of open, less regulated financial markets.

The chart shows the money supply and yen-USD exchange rate policy were still considered to be goals of BOJ's monetary policy. The Japanese central bank, on one hand, wanted to stabilize prices through the money supply growth rate control, but on the other hand, wanted to keep yen exchange rate at a reasonably higher than USD to prevent imported inflation.

2. Zero interest rate policy

In late 1990s, the monetary policy committee (took office in April, 1998) had to face the financial market's changes: the average growth rate strongly decreased (about 1% from 1992); financial institution system became weaker, in which, the main bank failed in November, 1997; the financial market's confidence was on the ebb; some weak financial institutions moved to lower ranks by ranking institutions were forced to pay premium higher than the inter-bank rate.

There were 3 factors contributing to the Japanese economy weakening in 1997-1998, including the increased VAT, Japanese bank crisis in November, 1997 and the fact that Japanese financial institutions had to pay premiums when borrowing U.S dollars in the London offshore markets.

In theory, to cope with the worsened economic situation, both financial and monetary policies must be relaxed. In fact, however, the monetary policy wasn't truly relaxed because the official discount rate reduced to the lowest in the history at 0.05% and interest rate (short-term capital interest rate) was only slightly higher than the official discount rate.

Table 2.8: Change in the Official Discount Rate by Date

2/23/1987	2.50%	7/27/1992	3.25
5/31/1989	3.25	2/4/1993	2.5
10/11/1989	3.75	9/21/1993	1.75
12/25/1989	4.25	4/14/1995	1
3/20/1990	5.25	9/8/1995	0.5
8/30/1990	6	1/4/2001	0.5
7/1/1991	5.5	2/13/2001	0.35
11/14/1991	5	3/1/2001	0.25
12/30/1991	4.5	9/19/2001	0.1
4/1/1992	3.75		

Note: Prior to January 2001, the rate for discount of commercial bills and the lending rate of the loans secured by government bonds or similar instrument; After January 2001, the basic discount rate and the basic lending rate

(Source: Yamori , 2005)

Table 2.7 indicates the official discount rate change from 1987-1987 marked the lowest rate: 2,5%. Then, in order to response with the excessive increase in the asset value, the official discount rate raised from 2,5% to 6% during one year (from May, 1989 to August, 1990). From

1991, the official discount rate reduced again due to the slower economic development, which decreased to 0.5% in 1995).

In September, 1998, BOJ's monetary policy committee decided to promote unsecured short-term lending interest rate about 0.25% in average. So basically, the monetary policy remained unchanged except the short-term capital interest rate deduction from 0.5% to 0.25% and the decision allowing commercial paper monetary policy operation instruments.

In addion, when economic recovery goal wasn't achieved, in February, 1999, unsecured short-term lending interest rate of around 0,15%" strategy was initiated and after that, along with market situations, the interest rate was reduced continuously, which resulted in zero interest rate policy because total supplied capital and short-term lending interest rate decreased to near 0%. At this time, the Policy Board accounced plan of keeping the lending zero interest rate until the situation showed no worry of deflation.

The turning point was made in August, 2000. While almost all members of Policy Board thought that it was time deflation came to an end and decided to raise unsecured short-term lending interest rate to 0.25%, member of Ministry of Finance and economic and planning agency supposed that it was too soon to adjust the zero interest rate policy at this time and asked to delay the vote of the Policy Board. However, the Policy Board, in agreement with the government's request, implemented the vote and in accordance with the majority of affirmative votes, the lifting of the zero interest rate policy was approved.

However, after the interest rate was raised, the economy turned back to decline. Therefore, after only 6 months from the time of interest rate rising (February, 2001), "unsecured short-term lending interest rate of around 0.15%" strategy was deployed again and then zero intererst rate came into practice.

In February, 2001, Lombard-type lending was set out and implemented in March, 2001. As specified in the plan, any financial institution which could provide valuable securities (such as government bonds or corporation bonds) could borrow from BOJ at this rate.

Since the implementation of this plan, BOJ's traditional lending (where lending term and value were identified by BOJ) disappeared. By September, 2001, the official discount rate decreased 0.1%.

Similar to other developed countries, the main Japanese monetary policy instrument in this period was open market activities. To obtain the policy's purpose, BOJ regularly executed monetary supervision and closely inspected the short-term capital rate in the short-term financial market (especially the over-night savings rate of the unsecured short-term capital market).

On the other hand, since the economic recovery goal couldn't be reached, the idea of "unsecured short-term lending rate of around 0.15%" strategy was initiated in February, 1999 and then, combined with market situations, the rate was decreased regularly. It was called the zero interest rate policy because the total value of money supplied and short-term capital interest rate decreased up to about 0%. Also at this time, the policy committee declared that the zero interest rate policy would continue until the deflation possibility was eliminated.

The basic turning point was in August, 2000. Most of the policy committee's members thought that the deflation occurred and decided to increase the unsecured short-term lending interest rate to 0.25%. However, members of the Department of Finance and economic planning agency claimed that it was too soon to adjust the zero interest rate policy at this time and request vote delay at the policy committee. However, the committee still follow the government's requirement to implement the vote and because the affirmative votes made up the majority, the lifting of the zero interest-rate policy was approved.

However, after the zero interest-rate policy was lifted, the economy became weakened again. Therefore, only after six months from the time of interest rate increase (February, 2001), the "unsecured short-term lending interest rate increase of about 15%" plan was replaced again by the zero interest rate policy.

Although the zero interest rate policy was raised one more than but it was easy to see that there was not enough strength to recover the worsened economic conditions. Therefore, BOJ continued to propose economic recovery methods at the conference of the monetary policy committee on March, 2001. This strategy mainly controlled the monetary market by current balance of payments managed by BOJ instead of the normal unsecured short-term lending interest rate, and decided to increase current account about 5 billion yen in this period (this increase was 1 billion yen higher than the estimated of about 4 billion yen). It was called quantity relaxation for the target amount replacing interest rate.

If the amount supplied through quantity relaxation raised to high rate, the interest rate – money price – would strongly fall. In fact, due to the quantity relaxation, the unsecured short-term lending interest rate began to decrease to about zero. When the rate reached zero, it was not necessary for the zero interest rate policy to execute another relaxation. And then, the possibility was that no longer would a policy that targeted interest rate (more exactly, nominal interest rate) be accepted.

However, relaxation could continue to be implemented even when interest rate reached zero.

3. Exchange rate policy

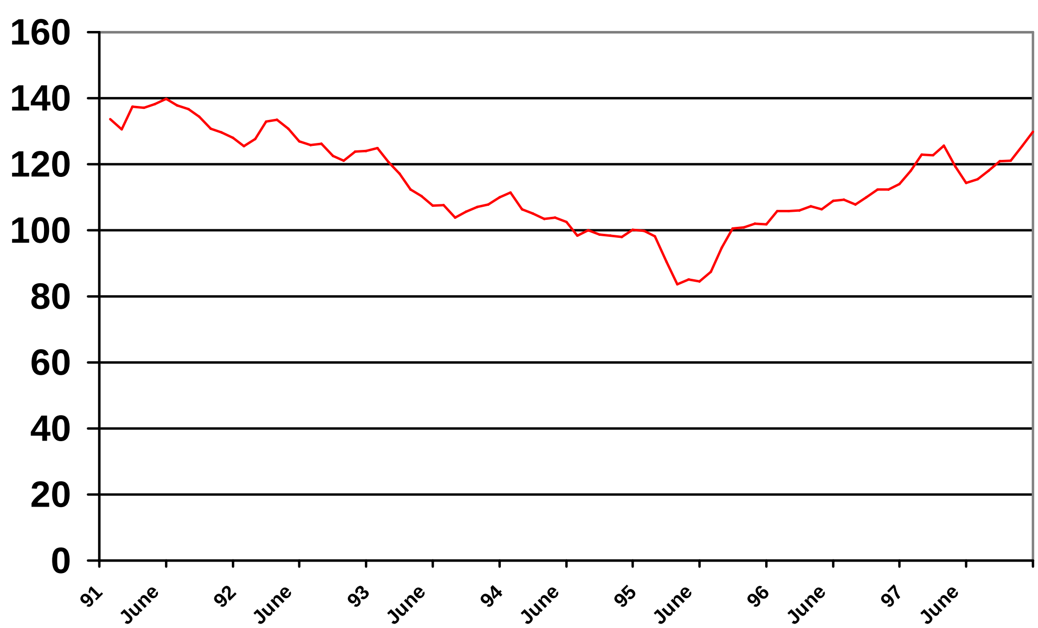
In the monetary policy, the exchange rate policy always plays a special important part. It is the macro-economic variable that gives government a critical basic in planning and balancing the monetary policy's goals. The exchange rate is regarded as a link between the domestic economy and the overseas. Therefore, before the implementation of any foreign trade goal, it is necessary for countries to consider cautiously and thoroughly a reasonable exchange rate policy: any devaluation of domestic currency will promote export, decrease import volume and vice versa. Many Asian countries have known how to apply flexible exchange rate policy to escape from crisis and obtain spectacular economic development as South Korea, China…

Fact shows that the currency devaluation policy is usually chosen among many developing countries in the world because these countries orient to base on export to develop the economy. In contrast, the currency appreciation can harm export of not only developing countries but also the developed ones which own so hot growth rate such as Japan. From 1971 to now, the worry about the yen appreciation compared with the US dollar became a big problem in the eye of the Japanese government. In the early 1970s, yen was fixed at 360 yen to 1 dollar. In 1995, the rate jumped to 80 yen to 1 dollar.

Yen appreciation from 1971 to 1995 was mainly caused by pressure from the United States's enterprises. Market shares of American manufacturers decreased because their goods couldn't compete with Japanese ones. At this time, the Japanese trade surplus was at the same rate as the United States's trade deficit, resulting in numerous discussions in trade and JPY-USD echange rate between the two countries.

- In 1989 - 1990, due to oil price increase in 1989 and then gulf crisis, BOJ had to turn into currency tightening policy and in late 1991, BOJ began relaxing monetary base supplement (through buying 5.9 billion US dollars from trade surplus) to expand investment, which caused yen to be devaluated (140 yen for one US dollar).

Figure 2.8: The exchange rate JPY / USD in the period 1991 – 1997



(Source: Nippon Facts and Figure, 1992, 1994, 1997)

However, the purpose of BOJ was not to allow a fast depreciation of Yen, thus BOJ then continued to increase money supply in 1992, 1993, 1994, 1995

Table 2.9: Money supply to Japanese economics

Rate \ Year	1991	92	93	94	95	1/95	3/95	6/95	9/95	12/95
Monetary base at the end of period (bil Yen)	39,882	39,026	41,626	42,880	46,244	37,563	38,127	39,393	38,532	46,224
% changes compared with previous year	1,9	2,2	3,6	4,9	5,3	5,2	4,4	5,1	4,5	6,5
% changes of money supply – M1	5,2	4,5	3,0	5,4	8,2	5,5	4,5	7,0	9,9	13,1
% changes of money supply M2+CD	3,6	0,6	1,1	2,1	3,2	3,2	3,6	3,3	2,8	3,3

(Source: BOJ : Main economic indicators of Japan, April 1996)

- After a strong fall in late 1991, yen kept being appreciated in these days. The main cause was that (i) the increase rate in currency value was still lower than the amount of USD flowing into trade surplus, (ii) yen appreciation was supported by BOJ's low discount interest rate policy, which increased investment and encouraged consumption, (iii) countries which continuously had trade deficit with Japan, especially the United States, kept placing pressure on the country.

Table 2.10: Foreign trade balance and general payment account

Unit: Billion $US

Rate \ Year	**1989**	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**
Import	2,012.2	2,431.8	2,424.0	2,546.7	2,407.8	2,621.2	2,862.0
Export	2,079.3	2,391.8	2,429.9	2,591.1	2,503.1	2,725.5	2,964.7
Foreign trade balance	-40.9	-40.0	5.9	43.3	95.4	104.4	102.6
Payment account	57.2	35.8	72.9	117.6	131.4	135.7	128.8

(Source: IMF : World economic Outlook, October 1995)

In the context, the Japanese was so wise when intensifying on capital export, mainly to the United States' market at the time of yen appreciation. With capital flowing abroad, the Japanese desired to plug the Japanese flag into the United States market; by this exported capital, Japanese factories would grow up in the United States and made finished goods for sales right in this market.

Table 2.11: FDI of Japan to overseas.

Fiscal year / Rate	1992	1993	1994	1995	1996	1997
FDI value	28.459	30.025	40.408	50.694	48.019	53.972
% changes		5,5	36,7	23,5	-5,3	12,4

(Source: Japanese Ministry of Finance – in Nippon Facts and Figures JETRO White Paper on Investments 1999)

After the Southeast Asian financial and monetary crisis in 1997, the Japanese economy fell into serious decline, marked by strong fall of stock market, delayed production, record high unemployment rate during 45 years. Moreover, GDP was so low at – 0.7% in 1997 and – 1.8% in 1998 while Yen fluctuation was great: the record high JPY-USD exchange rate was 144.68 yen per dollar in June, 1998, creating a currency devaluation effect among many Asian countries to maintain their competitiveness in the market. By July, 1998, the Japanese Central Bank and the Federal Reserve Board of the United States had to intervene to set out an exchange rate floor for yen. The cooperation between the two countries made USD-JPY exchange rate more flexible and also prevented a so great yen appreciation or devaluation in the future. Besides, to avoid the situation that JPY and USD decreased too much, Japanese nominal interest rate must be raised to at least the same rate as that of the United States.

When the rate jumped to 144 yen to 1 dollar in January, 1999, the average yen appreciation from 1971 to that time was about 4% per year. In fact, at this point, the market still expected yen continued to increase at the same rate as the previous time. Evidence is that the interest rate of dollar bonds was always 3 to 4% higher than yen bonds of the same term. It is because the market continued to expect yen appreciation so they were willing to keep the Japanese government bonds at the interest rate of only 1,7% while the US treasury bill's interest rate was 4,7%.

However, along with the yen appreciation was the deflation in Japan, which restricted both individual and organizational demands. At the time of yen appreciation, both citizens and enterprises would cut new consumption and investment plans because they were worried that when yen devaluation happened, value of assets and investment would be reduced. The yen devaluation also restricted the country's competitiveness in the world market.

The Japanese central bank couldn't relax the monetary policy to promote consumption demand in the context of negative exchange fluctuation and low interest rate. The nominal interest rate couldn't decrease to less than 0% (because at that rate, the citizens would keep cash instead of bond) and the real interest rate remained high because of deflation.

So, how to put an end to the deflation? Currency devaluation was a smart choice for an economy in the situation of inflation. However, the yen devaluation with high amplitude could lead to the devaluation of a series of Asian currencies as domino effect, which was a concerning problem for the United States who was sharing the relatively large trade deficit with Japan. Besides, the US and Japanese government desired to deal with the root of the problem. The government of both countries reached an agreement providing that they would maintain the exchange rate of the two currencies at 120 to 130 yen per dollar. However, specific figures were essentially not as important as a fixed exchange rate proposal in the long-term. So why did the United States involve in a seem-to-be personal problem of Japan? From 1971 to 1995, it was the pressure of American enterprises that appreciated yen. Market share of the U.S producers and manufacturers increasingly fell because they couldn't compete with Japanese goods and the fact that the Japanese trade surpluses were equal to the U.S trade deficits caused a lot of controversy between the two countries.

In order to avoid the trade sanction of the United States as well as restrict the competitiveness of Japan in the world market, the pressure for yen appreciation increased more and more. The yen appreciation had been implemented in a long time and led to the deflation as mentioned above. By 1999, because trade surpluses of Japan rose again, it was predicted that the yen appreciation pressure would return. To avoid this possibility, the United States was forced to support Japan so that Japan could continue the fixed yen exchange rate policy. Therefore, both countries kept on maintaining a reasonable exchange rate and in this case, Japan would have to keep yen at 120 yen per dollar. Before that time, in June, 1998, yen fell from 130 to 147 yen per dollar, which caused such an effect that many Asia countries wanted to devaluate their own currencies to ensure the competitiveness in the market. By July, 1998, the Japanese central bank and the U.S Federal Reserve Board had to intervene to establish a floor yen exchange rate. This cooperativeness between the two countries made the USD-JPY exchange rate more flexible and also prevented the significant yen devaluation or appreciation in the future. Besides, to prevent the great fall of real USD-JPY exchange rate, the Japanese nominal interest rate needed rising to at least equal with that of the U.S. The USD-JPY exchange rate agreement promoted consumption in Japan because the citizens were confident in the stable asset value. Investors felt safe to invest without worrying about profit loss and citizens could had a peace of mind to buy house without being afraid that their house would lose value in the future.

However, after more than one bleak decade due to the collapse of the stock market and the bubble real estate market combined with eight years trying to recover from the deflation and the slow-down economy, in finally, Japan reached a positive growth rate, equal with that of the pre-crisis period. GDP growth rate in 2005 was 4.5%, an impressive figure for such an economy as the Japanese. The financial performance of the whole bank system was restored, enterprises started to have recruitment and investment demands. Price still continued to fall but the scenario that the deflation was settled could be seen clearly. Such economic stability helped Japan contribute more to the world economic growth rate and adjust the imbalance of balance of payment. The Japanese current balance surplus decreased from USD 85.9 billion in the second haft of 2004 to USD 82.8 billion in the first half of 2005, up about 12% compared with the same period of the previous year. The yen real exchange rate increased 3.3% in the first half of 2005. The yen devaluation at 7% in comparison with the U.S dollar in two years, 2004-2005, reflected expectation of the U.S's interest rate increase. The Japanese government didn't intervene in the foreign exchange market in 2005 and in fact, stopped its participation from March, 2004. The Japanese exchange reverses still remained unchanged, only rose about USD 1 billion or 0.1%, at USD 825 billion in 2005.

4. The Japanese current financial system – problems and solutions

4.1. General evaluation of the Japanese current financial system

In general, the Japanese financial system is stable despite some effects of the global financial crisis in 2008. The financial situation in term of lending to enterprises still signals positively after some bad news in the period from late 2008 to early 2009. However, long-lasting risks in financial institutions related to bond holding and financial risk continue to rise. Especially, in 2008, under the impact of the financial crisis, the yen jumped 67% compared with GBP and 75% compared with South Korea's won. Therefore, export goods, especially the electronic devices (initially occupying 50% of the Japanese electronics turn-over) became more expensive for foreign consumers, leading to the lower export. Car sales in Japan came to the lowest point since 1974. In an economic forum in January, 2009, the Japanese Minister of Finance, Mr Shoichi Nakagawa, commented that "the Japanese economy is facing the fall of export and production. Consumption is lower and lower and the economy is becoming worse."

4.2. Challenges

Challenges for the Japanese financial system don't occur for the first time but have accumulated over the years.

- The Japanese financial institutions need to ensure the stability of basic profit, promote business by active risk management and control.

- The financial institutions need to have countermeasures to cope with market risks which come along with bond holding. One easy-to-see point is that unsecured bond holding can affect profit and bank losses mostly come from bond holding which exceed the profits gained from main business activities in the previous two years.

- The Japanese financial institutions should raise capital through recapitalization and profit accumulation.

- In finally, the financial institutions should prepare sound basics for the management of financial intermediary function. For the long-term economic development of Japan, the financial institutions must re-identify their potential growth rate and provide financial services efficiently.

4.3. Countermeasure policy

In the context of worsened economic and financial situation, the government and BOJ has tried their best to implement financial and monetary policies and stabilize the financial system until the end of the financial year 2009.

- Firstly, focusing on unemployment problem, financial measures and front loading for public works project in the “Policy Package to Address Economic Crisis” in April, 2009. One important part of this project is to promote using special methods to strengthen financial intermediary function.

- In order to support finance for small enterprises, Credit Guarantee Association provided 20 thousand billion yen as emergency guarantee instrument. The total value of these instruments are 30 thousand billion yen. The Japanese Financial Association also supplied 3 thousand billion yen to ensure the security and efficiency of lending network. For this purpose, Shoko Chukin bank added 2.4 thousand billion yen.

- In financial field, to support the economy, right after the 3^{rd} quarter of 2008, BOJ proposed some methods such as interest rate policy reduction, measures to stabilize the financial market, finance supply to enterprises. BOJ also decided to resume its purchases of securities by other financial institution’s help in March, 2009; by the end of 2009, the total purchase amount was 38.1 billion yen.

- Also in April, 2009, BOJ built principles and conditions for subordinated loans by allowing financial institutions to maintain enough capital, which facilitates the financial institutions to do well their financial intermediary function and stabilize the financial system. The bank also consults and guides each main financial institution to pay special attention to risk management.

- For policies that are applied after April, 2009, the bank will extend types of eligible mortgages for loans on deeds to the government and those with government guarantees.

These above solutions force the bank more active in financing and create more favorable conditions for activities in the monetary market.

- Not only for the domestic financial market, BOJ also acts for the international financial market development. For this purpose, BOJ proposed “Collateral Guidelines on Eligible Foreign Bonds” on May, 2009, allowing government bonds of the United States, England, Germany, and France that are issued in the domestic currency to be used as quality collaterals.

- Beside the specific policies and measurements above, BOJ has carried out many studies and analysis on the long-term stability of the whole system which don’t limit to the domestic business environment but extend to the overseas to objectively evaluate the business conditions of financial institutions. Moreover, with the long-standing cautiousness, the bank wants to assess the current situation of the financial system and challenges that it has to face. In the opinion of the bank, the evaluation will bring back a comprehensive look for strategy and policy planning, thus, contributing to the stability and sustainability of the Japanese financial system.

CHAPTER 3

PRACTICAL LESSONS FOR VIETNAMESE FINANCIAL MARKET

Vietnam is still a developing country. Compared with many other countries in the world, the Vietnamese economy has a low starting point, poor infrastructure, technology backward while usually dealing with foreign aggressors. Therefore, although near 3 decades and a half have passed since the war came to an end, up to now, economic achievements gained by Vietnam, regardless of their changing effects on the country's appearance, are still limited against orientations and goals that the government has set out for the international economic integration process. Vietnam still ranks 105th among poor countries in the world. One of the reasons why Vietnamese economy is so deficient is the inefficient performance of the financial market. Despite its life-line role in the economy, the Vietnamese financial system is still young and vulnerable to external environment and inexperienced of self-defense. Having suffered from the Southeast Asian financial crisis in 1997 and most recently, the global financial crisis in 2008, Vietnam has drawn many valuable lessons from collapses of many financial institutions in term of State's management mechanism and implemented some methods to stabilize the financial market and rescued the economy. However, all of them are still band-aid solutions and only considered as the initial step for the market-oriented sustainable economic development strategy. Therefore, learning from lessons of developed and experienced countries is very necessary.

The Vietnamese economic context and its movement nowadays own some commons with Japan's in the previous four decades. The similarity of them is that both are war victims who bear many serious losses after the war came to an end. The difference is, however, that besides a highly damaged infrastructure and ragging poverty that the Second World War left Japan, "western-style" economic development model penetrated the Japanese market which, combined with Japanese brain power, the government's economic reconstruction and development strategy, formed a foundation for many Japanese economic miracles. Meanwhile, the picture is so different in Vietnam. With a close economy depending crucially on agriculture, poor and backward infrastructure sunk in aggressive wars for a long time, the reconstruction and development process after the war has been started in conditions of much difficulty and deficiency. It is partly reason why the Vietnamese economy has been so delayed after almost 35 years of reconstruction and development.

After studying the Japanese financial system development experiences in reflection with specific conditions of Vietnam, it can be drawn the five main following lessons:

1. The first lesson

It is important to define the independent role of the State Bank in market management and regulation and the Government shouldn't intervene excessively.

Before analyzing the role of BOJ in financial system management, viewpoints of central bank's relative independence on government must be clarified. Not limited to Japan but nowadays, Vietnam and some other countries in the world still maintain two schools with two different viewpoints of central bank's organizational model. One school supposes that the central bank must be an independent institution on government while the other considers central banks as a body under the government. Each country can find between them the most suitable central bank model for themselves or can combine reasonably the above two schools, however, in the context of continuous social and economic development, reality and economic efficiency are the most reliable measure and appropriate answer.

Bank of Japan was founded in 1982 in consistence with the model of National Bank of Belgium – a joint stock company, in which, since new birth, the State's capital only made up 55 million yen. However, from the beginning, BOJ has identified its guiding principle to be a bank supporting for the State and in reality, private shareholders were not allowed to raise opinions about BOJ's policies. By 1904, BOJ was reorganized in the manner of combination between Reich bank's structure and unique organizational form of Japan. To 1991, BOJ's total assets were up to 43.1 thousand billion yen (or USD 320.5 billion).

In many previous decades, especially in 1980s and 1990s, despite many great progresses in monetary policy planning so that it would be suitable with each economic development stage and facilitate growth targets, the Japanese economy, after all, fell into depression and crisis. There are many reasons for the said consequence, one of which was BOJ's undeniable dependence on the government. Many decisions of BOJ on monetary policy were influenced by the government, especial the Ministry of Finance. BOJ couldn't independently inspect commercial banks, which partly led to non-transparency of banking system. The Ministry of Finance had spies all over the country but was lack of firmness. Therefore, the government's interventions were considered as "support". For commercial banks, "mutual help" tradition was still maintained, in which, large banks would assist the smaller ones when problems occurred. In last resort, the government would show off to rescue by hundred billion yen drawn from tax funds. These relations created ambiguity between the government's management function and enterprise's business control function, restricting the efficiency, competitiveness and flexibility of market mechanism.

It can't be denied one positive fact that, although Japanese financial institutions didn't really have powerful internal force, they developed very fast under the government's support. The government's protection methods made Japanese financial institutions more advantageous than experienced and potential western competitors. However, also under the government's assistance and due to deviation in pursuing economic profits, financial institutions spent much money in risky investments such as real estate and raging lending. Meanwhile, the government carried out so many market control regulations, many of which were against market principles. The concentration of management on the Ministry of Finance gave this body so much power, resulting in corruption and bribery that some economics considered to be one of the reasons of the Japanese financial and monetary crisis. Besides, the financial liberalization was in strong progress and regarded as indispensable trend. Therefore, the Japanese financial market had to implement reform to enter into a new development phase.

To separate BOJ from the government, revised Banking law was passed by by Japanese parliament in July, 1997 and came into effect from 01st Aril, 1998. Accordingly, BOJ was transformed into an entirely independent body which was entitled to directly inspect and investigate commercial banks. Ministry of Finance's power and the government's intervention in BOJ was limited. In term of model, BOJ was reformed in the same manner as Bender bank of Germany and in term of transparency, as Federal Reserve Board of the United States.

When discussing about the solution for enhancing the self-control of private banks, there is a question on which level the self-control should be?

There are 4 levels of the self-control of State Bank

- Self-control in setting up targets
- Self-control in building action plan
- Lower level: self-control in selecting monetary instrument
- Lowest level: limited self-control, or none self-control

Currently in Vietnam, the self-control of the State Bank is in the lowest level. The Government makes policy, target, even the action plan and intervene into implementation process. It affects the ability of the State Bank that plays the role as a Central Bank in the international integration and globalization.

In additions, as analyzed in chapter 1, the existing Vietnamese banking system is a two-level one. In this system, the State Bank (the central bank) is a body directly under the government; bank governor is a member of the government. Therefore, similar to Japan previously, the government is both the rule maker and the player. It is the government – the central bank who planned monetary strategies and policies and it is also it who implemented policies such financial and credit institution refinancing or open market operation… It is the main reason why in so many years, the Vietnamese financial market, especially the commercial bank system, has been so passive, instable, unable to promote their competitiveness as financial institutions or operate in consistence with market signals. Under the overprotection of the State, especially when economic and financial crises happened in the world, commercial banks still maintains the habit of "dependence" on the State, resulting in low competitiveness and inefficiency.

In order to solve above problem, Vietnam have to speed up building a more seft-control Central Bank. The 112 Decision approving the project on banking development to 2020 of the Government, the Prime Minister specified "the State Bank is independent on making policy and implementing monetary policy, exchange rate policy, and interest rate policy". State Bank should initiatively control monetary policy to protect the strength of domestic currency and curb inflation without depending on executive bodies. It is expected that the policy makers will consider about this.

It can be said that up to now, lessons drawn from the Japanese financial system reforms which made the central bank more independent in late 1990s remain valuable for Vietnam.

2. The second lesson

The monetary policy management mechanism should be flexible and efficient.

Suffering near five decades since the Second World War, the Japanese financial market in general and the monetary policy in specific has made many positive contributions to the Japanese economic recovery and development. Main cause of the monetary policy success is that BOJ carried out flexible responses in monetary policy initiation and comprehensive implementation in conformity with each economic development period.

1/ Interest rate policy

To adjust interest rate and interest rate structure suitably with supply-demand in the monetary market, BOJ combined various policies such as the official discount rate policy, regulation policy by open market operation instruments and monetary base supply instrument, in which, the discount rate policy played a central role, because similar to the United State, discount rate was the guiding rate of bank rate and rate of monetary market.

Because the basic goal of the Japanese regulation policy was to promote growth in priority, BOJ often maintained a low discount rate, which encouraged both domestic and overseas investment, changed the economic structure and helped Japan recover from depression and slow-down period at ease.

Table 2.7 shows that the BOJ's discount rate continuously fell from 6% (August, 1990) to 0.1% (September, 2001). With determination to reduce interest rate to promote economic growth and rapidly adjust structure, the interest rate was fixed at the lowest rate in the history (near zero).

Up to now, it can be seen that Japan is the unique country that is consistent to pursue zero interest rate policy in a long time (from February, 1999 to 2006) to cope with deflation and economic slow-down from early 1990. Although many members of BOJ's Monetary Policy Board argued about time and plan to raise unsecured short-term lending interest rate to near 15% (February, 2001), the zero interest rate policy was still maintained, because the economy didn't see any recovery signal. It was the capital sources with zero interest rate that helped Japanese enterprises have enough capital to expand business, increase productivity, lower goods price and then boost competitiveness of Japanese goods in the international market.

Corresponding with the discount interest rate deduction of BOJ, other interest rates in the entire market decreased across the board. For example, when the discount rate fell to near 1%, short-term interest rate also reduced to 2%, red-hot lending interest rate was only 0.38%, long-term interest rate also set record with the low rate of 4%, 21.5% down compared with 1992.

Table 3.3: Impact of discount interest rate reduction on other interest rate

Year / Interest rate	1990	1991	1992	1993	1994	1995
Short- term	7,6	7,2	4,3	2,8	2,2	2,0
% changes compared with previous year	----	-5,2	-40,2	-34,8	-21,4	-10,0
Long-term	7,0	6,3	5,1	4,0	4,6	5,1
% changes compared with previous year	----	-10,0	-19,0	-21,5	15,0	10,0

(Source : IMF : World economic outlook from May 1990 to May 1996)

Table 3.4: Market interest rate (IR) after adjustment policy on discount interest rate

Year / Rate	1/95	2/95	3/95	4/95	5/95	6/95	7/95	8/95	9/95	10/95	11/95	12/95	1/96
Short-term IR	4,046	4,032	3,997	3,092	3,740	3,575	3,454	3,353	3,171	3,050	2,963	2,788	2,79
Interest rate in hot market	2,156	2,125	1,687	1,218	1,200	1,190	0,730	0,790	0,350	0,370	0,370	0,350	0,38

(Source: Le Vinh Danh – Monetary policy and macro adjustment of Central Bank at developed countries)

Besides low interest rate policy, BOJ creatively used other instruments of monetary policy such as open market operation (strictly monitoring and managing short-term interest rate in unsecured short-term capital market); carrying out Lombard-type lending in February, 2001; shifting the monetary market control strategy from unsecured short-term lending interest rate to current balance of payment managed by BOJ and increasing the current balance of payment to 5 billion yens in this periods.

Continuously decreasing discount rate created favorable condition for Japanese investment: overseas investment of Japan in 1993 was up to 10 billion yen, investment in accuracy, high-tech industries and high quality consumer goods began to dominate in domestic production.

So it can be seen that positive sides of the Japanese interest rate policy in this period includes:

- The fact that the interest rate was maintained low and continuously reduced at decisive points helped Japanese economy stand firm before negative effects of the world economic and political environment.

- The low interest rate facilitated investment, consumption, domestic production, resulting in the sharp rise of export. Residual balance of foreign trade, in return, would support strongly for yen.

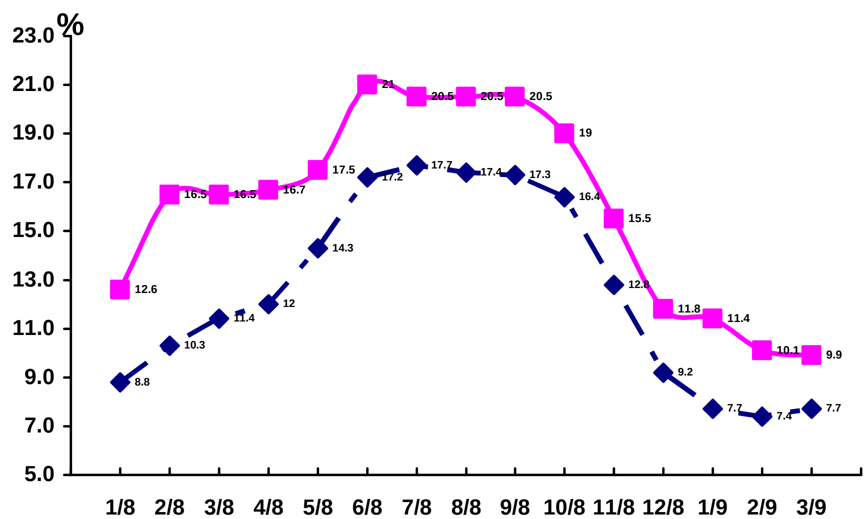
- Japanese policy makers were clearly aware of the close relationship between interest rate and investment, interest rate and growth. Therefore, when setting growth goal in priority, BOJ used low discount rate to form interest rate policy for the general capital market, and considered it to be main instrument to orientate investment and affect production structure to provide potential output.

- Through discount rate adjustments, BOJ's fairness in policy management was manifested clearly. BOJ was so consistent to pursue a policy that it considered to be beneficial to the economy but at the same time, also quick-witted to change its opinion when new change occurs in the market. It was the firm and flexible management method that helped BOJ guide the Japanese economy out of the most difficult time.

For Vietnam, in many years, especially in two recent decades, the economy has still been in conditions of undercapitalization, low growth rate, unstable inflation. Besides, similar to many other countries in the region, Vietnam has to bear negative effects of the global economic and financial crisis.

Coping with both internal and external challenges, Vietnam has continuously implemented flexible and market-oriented interest rate mechanism. After five changes, from positive real interest rate in 1992 to interest rate frame in 1992 – 1995, interest rate ceiling mechanism in 1996 – 2000, basis interest rate accompanied with its band in 2000 – 2002, to negotiated interest rate in 2002 – 2006, it can be said that the interest rate in Vietnamese market nowadays is stable. Borrowing demand of enterprises is afforded better; savings continues to be deposited due to the halt and downward signals of the stock and real estate market.

Figure 3.2: Progress of mobilized interest rate and VND lending interest rate in 2008 – 2009.



(Source: International workshop –The impact of the global economic crisis and policy implications for Vietnamese banking and finance sector, Hanoi , June, 2009)

However, despite many efforts to drive interest rate to a low one, Vietnam, compared with many countries in the region, still maintains a relative high rate. From success lessons of Japan (the zero interest rate policy), the State Bank of Vietnam should step by step change its thoughts and implement suitable interest rate solutions.

Basic interest rate management mechanism was kept applying because it was a suitable solution for macro-economic targets and capital supply and demand in the market. It could be said that basic interest rate was an indispensable instrument in implementation of monetary policy that focused on macro-economic targets. As a macro-economic monetary instrument, basic interest rate of the State Bank was considered to be a clear signal of monetary relaxation policy (for depression prevention) or tightening (for inflation control) by commercial banks.

- Basic interest rate was kept cutting to facilitate commercial banks to reduce lending interest rate in the market, ensuring enterprises to approach capital at low cost so that they could decrease production expanse, boosting economic growth.

- Money was injected into circulation in two channels: (i) lending commercial banks at low interest rate so that they could reduce interest rate applied for enterprise to boost liquidity of banking system, and (ii) tax refunding to population to stimulate consumption demand in the economy.

2/ Exchange rate policy

Successful exchange rate management art of BOJ in many decades is a valuable lesson for not only Vietnam but also many other countries in the world. It have to admit that yen position as the third largest reserve currency (after US dollar and Deutsche Mark), continuously residual balance of trade in many years since 1991 as well as increasing national reserve rest much on the contribution of exchange rate policy. For such a hot developed economy as Japan, it is not easy to build and manage an exchange rate policy to both increase export for foreign currencies and stabilize domestic market while gaining positive effects on international market before the external pressures. However, in last four decades, with remarkable efforts and firm will, the Japanese government and BOJ has step by step pursued right steps in financial market reform planning including monetary policy.

Successes of Japanese exchange rate policy partly helped the economy recover and restore growth rate that had been seriously ruined by the collapse of “bubble” economy in early 1980s, 8 years of deflations and especially the Southeast Asian monetary crisis in 1997 and the global financial crisis in 2008. These successes can be summarized into the following points:

- *Single exchange rate implementation*: Japan belongs to group of countries which own strong currency such as the United States, England, and Canada and don’t set official exchange rate and its band limit. The exchange rate is identified entirely in basis of supply and demand law, and a single exchange rate will be applied for all related economic and financial activities. BOJ only intervene through open market operation in case of necessary when the exchange rate has great fluctuation compared with BOJ’s target. Being rooted from many historical reasons, Japan sets yen (JPY) in relation with USD; therefore, if BOJ wants to intervene in exchange rate, it has to purchase or sell USD to support the rate.

- *The collaboration among monetary policy instruments for a economic growth*. Similar to the interest rate policy, the most important successes of the exchange rate policy are (i) the creative co-ordination of monetary policy instruments (monetary base management rate, interest rate and open market operation, (ii) that the tightening or relaxing monetary policy is issued and implemented in appropriate times, facilitating goal of stabilizing domestic currency and promoting economic development

+ Monetary relaxation policy for economic recovery:

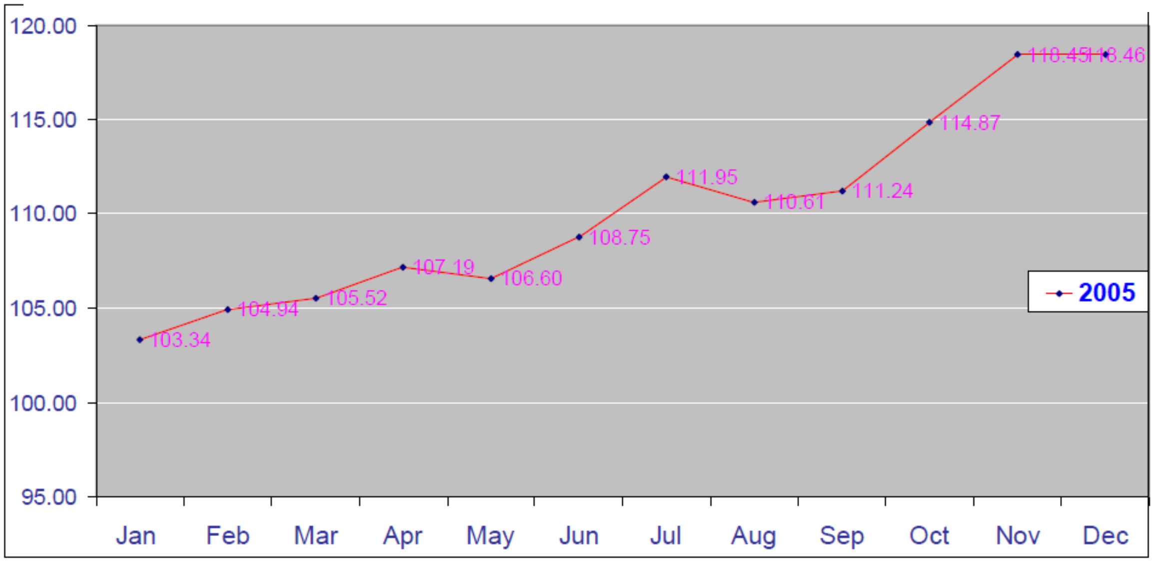
After the collapse of "bubble economy" in late 1980s and especially the Southeast Asian financial and monetary crisis in 1997 which burned out in the South first and then spread into the North, the center of the Asian economy – Japan – a pride, successful symbol of the Asia - was directly threatened. The crisis seriously ruined the financial and economic stronghold and by December, 1997, the Japanese government had to accept that the national economy was in depression and standstill. To help the economy step by step recover from the crisis, a financial system reform of large scale and unprecedented stature – the Japanese Big Bang – was deployed. In this reform, monetary liberalization and relaxation policy was one of the basic contents. After 3 years implementing this program, although it hadn't achieved expected results, the market showed some positive signals. The financial and banking system came to stability, JPY-USD exchange rate fluctuated in narrow margin at 119 – 120 yen per dollar.

+ Monetary tightening policy after economic recovery and inflation curb.

In March, 2006, BOJ made a turning-point decision to tighten monetary policy which, considered to be so easy, was maintained in five years, to restrict deflation. The Monetary Policy Board passed by this decision after strategies showing signals of price rise and putting an end to deflation was announced. On 11th July, 2006, next to economic recovery signals, BOJ increased basic interest rate to 0.25% for the first time after five years. Then, on 21st February, 2007, BOJ decided to raise interest rate more to 0.5% when seeing signals of growth stability.

Although the interest rate hasn't change significantly and its changes haven't been great in these years, fact shows that any act of BOJ on interest rate have direct impact on yen. In details, after decision of maintaining basic interest rate at 0.25%, which had been raised by BOJ on 18th January, 2007, was announced, on 22nd January, 2007, yen was devalued 2.66% compared with the early 2007 period (from 118,7 JPY per USD to 121,95 JPY per USD). Moreover, JPY/USD exchange rate has borne great influence of FED's interest rate policy. In specific, in 2005, when BOJ still maintained fixed rate of 0%, FED raised rate continuously eight times, from 2.25% in the beginning of the year to 4.25% in the end of the year (each time of 0.25%). It was the large difference between the United State's basis interest rate (5.25%) and that of Japan (0.25%) that made yen devaluated (from 103,34 JPY per USD in the beginning of the year to 118 JPY per USD in the end of the year)

Figure 3.3: Exchange Rate of JPY / USD (2005)



(Source : IMF (www.imf.com))

Despite this fact, BOJ was still cautious in basis interest rate increase decision. Governor of the Japanese central bank, Mr. Toshihiko Fukui, said that BOJ's monetary policy would come closely with the economic recovery rate.

- Different from many other countries, this second largest economy bears pressure of yen appreciation in a long time from countries that usually has trade deficit with Japan. Under pressure of countries such as England, Germany and especially the United States, yen used to appreciate to the record rate of 86 JPY per USD. In this context, the Japanese government responded by capital export to these countries to "cool" its so hot economy and to solve decade's long lasting "cold war" with the United States. This policy shows the firmness and flexibility of Japan in its monetary policy: it is really a tool to kill two births with one stone and the Japanese gains success.

- In late 2008 and during 2009, in spiral of the global economic and financial crisis, the economic growth rate of Japan came to halt, unemployment jumped, yen was appreciated strongly and deflation signal came back. In this context, BOJ decided to more relax its monetary policy though cheap loans. On 1st December, it made secret vote in consideration of the proposal of financing commercial banks short-term loan of 10 thousand billion yen (equal with USD 115.8 billion) to boost liquidity and at the same time came back again to the basic interest rate of 0.1%. Besides, BOJ was also placed under pressure to implement some methods to intervene into deflation situation after many months of continuous price falling.

In case of Vietnam, the State Bank's interest rate policy, in general, has come in right direction and brought back favorable impacts on the economy. However, some economic experts suppose that the State Bank's exchange rate management and policy has still been conservative and rigid and information transparency has not been well guaranteed. Therefore, to form and apply a more flexible and effective exchange rate policy, the State Bank of Vietnam should focus on solving the following main issues:

+ First and foremost, shortening gap between official exchange rate of the State Bank and the exchange rate in free market to lay foundation for a single exchange rate.

As mentioned above, a unique exchange rate was applied for all related activities in Japan, and it was determined by supply and demand in the monetary market. In Vietnam, so many years ago and up to now, two kinds of exchange rates has still been in force: the official exchange rate of the State Bank and the exchange rate in free market. Although the State Bank has applied many methods to shorten the gap between the two rates, the rate in free market is still higher, up to 19,000 Vietnam dongs per US dollars sometimes in late 2009, while at the same time, the official exchange rate was approximately 18,500 Vietnam dongs per dollar (less than 2.7%). This fact forces the State Bank to reconsider about exchange rate supply and demand and the general trade balance of the country to set out more authentic methods.

+ Applying fexible exchange rate policy under control of the State now and in near future.

In current Vietnamese social and economic context, the application of one flexible exchange rate under control of the State is appropriate. This mechanism can even last in a longer time. Because up to now, the Vietnamese economy hasn't been accepted to be a sufficient market economy. Therefore, orientation for selection of suitable exchange rate policy must be based on the economy's capacity, in which, the foreign currency reserve is required to be great enough to intervene into the market when neccessary to stablize purchasing power of the currency. So, the State Bank's intervention is essential in the near future. In specific, the government needs to intervene to expand fluctuation band and then come to remove this band when all conditions for a supply-demand exchange rate mechanism are converging.

+ Implementing multi-foreign currency mechanism:

Experiences of Japan and Thailand in so many years, especially Thailand - a victim of a policy that strictly tied its domestic currency to USD – shows shortcomings of it. Because nature of the fixed exchange rate policy was to creat stability, but when the standard that the rate is tied to is no longer stable, then the stability can't be obtained anymore, especially in the context that the US dollar has been devaluated continuously and in a long time like now.

Vietnam is not an exceptional case. Up to now, Vietnam dong has been only tied to US dollar without any other foreign currencies. Illustration is that trading quantity (including both current and captial trading) in US dollars makes up a great proportion of the total trading quantity of trade balance. In term of exchange rate identification and annoucenment method, Vietnam dongs exchange rate is identified in basis of US dollar but separately from other foreign currencies such as EUR, JPY, GBP and so on. It means that when there is any fluctuation of

USD in the world, it will immediately affect USD/VND exchange rate and normarlly, in negative way.

From the above analyses, Vietnam should obtain an exchange rate policy Band- Basket – Craw (BBC) that ties the domestic currency to a group of strong foreign currencies of some countries that Vietnam has the most close payment, commercial and foreign affair relations with such as ERU, GBP, CAD, JPJ... to make payment and reserve and lay foundation for exchange rate adjustment. If so, stability of norminal exchange rate will be boosted and risk of exchange rate fluctuation will be limited.

+ Step by step boosting Vietnam dong prestige, faciliating VND to be a convertible currency.

Now, Vietnam dong hasn't been highly evaluated in the international financial and monetary market. Therefore, almost all international payment activities between Vietnam and other countries are made in USD (making up more than 70%) and a few other foreign currencies. Accordingly, responsibility of the State Bank and the entire economy in improving Vietnam dong prestige is so important. In term of current balance, free convertibility of domestic currency will help national export and import more eventful, boost competitiveness of domestic enterprises and approach of export goods to the international market. In term of captial transactions, currency convertibility can have great impact on attracting foreign investment, restricting dollarization which is so popular in Vietnam now.

Besides, free convertible currency can reduce direct intervention of the government in exchange rate management policy and in term of exchange rate management, facilitate it to be more effective.

3. The third lesson

Healthy financial institution system is the decisive factor for a stable and sustainable financial and monetary market.

The collapse of "bubble" economy in late 1980s was the crucial and direct cause of the Japanese long-lasting economic slowdown and put an end to the miraculous development period of the sun-set country. It was the harsh time for the Japanese economy; although the Japanese government and BOJ had made many efforts, in early 1990s, the economic growth rate was still low while the financial-monetary system was nearly frozen. Under the government's strong overprotection policy toward financial institutions, strict and rigid regulations on exchange management as well as reserve effects of low interest rate and yen appreciation policy (easy credit financing and capital market gaps) made the Japanese financial and monetary market turn into wrong direction, lose stability of a healthy financial and monetary market. All of the above problems placed Japanese economy under request of a thought revolution and a structural change after many years of miraculous development

With goal of reforming the financial and monetary system in direction that made organizations healthy and rehabilitated intermediate financial institutions, the reform focused on the following issues:

1/ Non-performing loan settlement

The low interest rate in early 1990s resulted in raging lending and risky investments such as real estate. The day by day increasing backlog overdue debt with devaluated collaterals upset Japan, pushed financial institutions on verge of mass bankruptcy. To save the situation:

*/ Japanese parliament passed by law on asset turn-over nominated by companies to set legal foundation for financial institutions to comfortably liquidate over-due loans through debt securitization.

*/ The government forced private banks and Cooperative Credit Purchasing Company (CCPC) to sell their loans at reasonable prices.

*/ The government issued new auditing mode to improve banks' financial transparency, especially for over-due debts.

*/ The government sold bad debts to foreign financial organizations. In two financial years, 1997 and 1998, the foreign financial organizations bought about 1,572.5 billion yen of over-due debts from Japanese banks. Besides redemption and merge, in February, 1998, GE Capital of the United States bought Toho Life Insurance Company and in January, 1999, Daihyaku Life Insurance Company was purchased by Canada Manulife Financial.

Table 3.1: Loan Sales of Japanese banks in fiscal years 1997 and 1998

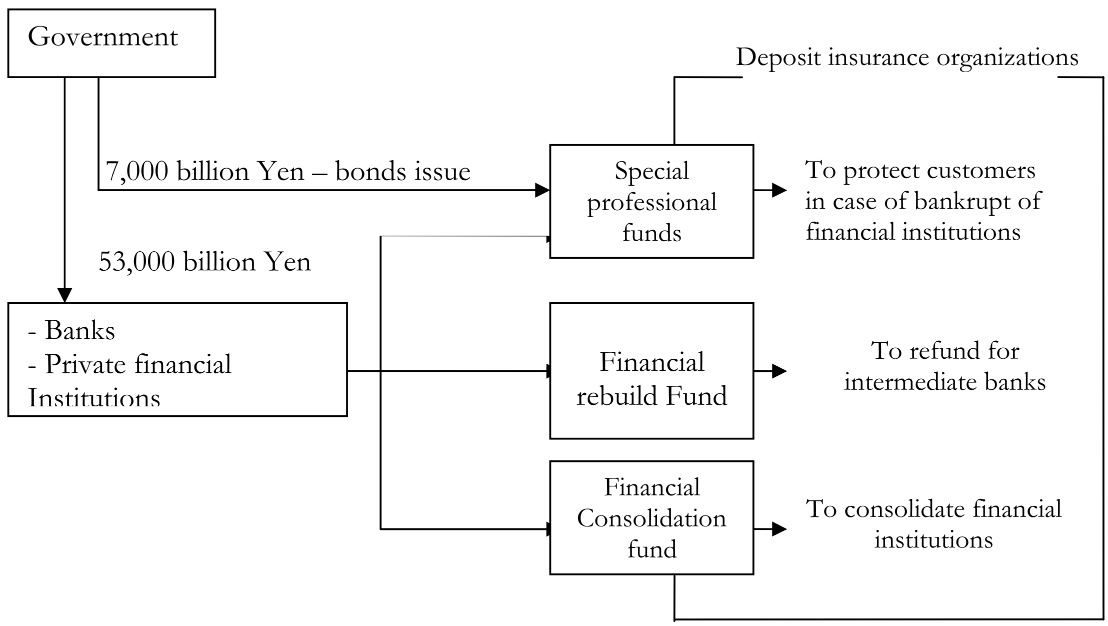
Unit: billion Yen

Fiscal year	Buyers	Sellers	Value
1997	Goldman Sachs & Co	Sumitomo Bank	40,0
	Bankers Trust Co và Deustche Bank	Crown Leasing Co	280,0
	Goldman Sachs & Co	Bank of Tokyo – Mitsubishi	12,5
	Lone Star Opportunity Fund LP	Bank of Tokyo – Mitsubishi	20,0
	Unknown	Sanwa Bank	150,0
	Merrill Lynch & Co, Lone Star Opporrtunity Fund LP	Sakura Bank	400,0
	Secured Captital Corp., Credit	Mitsui Trust & Banking Co	130,0
	Suisse First Boston	Sumitomo Bank	100,0
1998	Daiwa Securities America Inc., J.P.Morgan & Co	Bank of Tokyo Mitsubishi	100,0
	Merrill Lynch & Co, Lone Star Opporrtunity Fund LP	Sanwa Bank	30,0
	Merrill Lynch & Co, Lone Star Opporrtunity Fund LP	Fuji Bank	50,0
	Unknown	Daiichi Kangyo Bank	200,0
	Unknown	Sumitomo Bank	60,0

(Source : The Nikkei Weekly, March ,1999)

*/ The government decided to build a public fund of 60 thousand billion yen to assist financial institutions to solve problems in bad debt settlement.

Figure 3.1: The distribution plan of 60 trillion Yen public fund.



(Source : Niho Keizai Shinbun, October,1998)

In Vietnam, the debt of financial banks, especial state banks, has been a big problem. The bad debt settlement is given priority to the banking reform and improving banking system.

According to calculation, the result of banking reform in previous years has solved 60% over-due debt, reduced the bad debt from 14% in 2000 to 5% in 2005. However, according to IMF "over-due debt of Vietnamese banks is about 40% of total debit account, 8 times higher than accepted level, in which 58% over-due debt is unrecoverable". Thus, Vietnamese banks have to make more risky reserve fund that affect to national budget and salary.

In order to solve bad-debt, it is necessary to establish a debt dealing company that independent with commercial banks. This kind of company was setup before but it was depend on commercial banks, thus it could not make bad debt settlement effectively. In addition, it should separate policy lending and commercial lending. Finally, in credit policy, the mechanism of "asking-giving" has already existed for many decades, especially in the state enterprises. Those enterprises are often given priority in both amount of debt and interest rate. It is not a fair game for SMEs and private enterprises.

2/ Transparency improvement, financial disclosure and inspection and risk prevention reinforcement

*/ To restore confidence of both domestic and foreign investors, since March, 1998, financial institutions must disclose their bad debts in consistence with standards of U.S. Securities and

Exchange Commission (SEC). If they violated financial disclosure rules, they would be punished in accordance with Japanese financial system reform law issued on March, 1999.

*/ In June, 1998, Financial Services Authority (FSA) was founded to supervise financial and monetary market veraciously based on clear principles. In addition, FSA was also allowed by banking law to request financial institutions to report self-inspection result; based on this, FSA would consider and set out suitable solutions.

Solutions implemented by Japan as stated above transformed the Japanese financial system from risky, nontransparent market into a discipline, safe and reliable one.

In case of Vietnam, it lacks of clear regulations and specific actions in risk prediction and market management and control to prevent negative external effects, in all circumstances, to the market. Learning from Japan, Vietnam should foremost promote role of the National Financial Supervisory Commission (NFSC) (founded in…); intensify periodic check of financial reports and real business performance of financial institutions; apply suitable international standards when monitoring bank's performance (Basel principle II). Banks can be free to operate but must meet three conditions: (1) sufficient capital, (2) reliable risk guarantee system and (3) market principle conformity and information transparency. Besides, Vietnamese commercial bank should actively build information system for management and risk prevention, don't let grass grow under feet like now.

3/ Purge, strengthening and settlement of financial institution's bankruptcy

Economic depression led to collapse of series of financial institutions: many banks couldn't meet capital ratio as required, lose liquidity, while many others were on verge of bankruptcy. Therefore, a series of prevention and settlement methods were carried on by the government:

*/ The urgent adjustment program, backbones of prevention methods applied from September, 1998 for banks who didn't apply capital ratio, included three steps: firstly, requiring banks to improve business conditions; secondly, forcing banks to follow methods as regulated by the government; and thirdly, in case the situation got no improvement, requesting banks to stop business.

*/ Finance additional conditional capitals to financial institutions who were capable to survive. Applications for financing through share or stock purchasing or for additional loans must be submitted to and examined by relevant authority. By early 1999, 13 among 15 Japanese large banks were officially financed with the total capital of 7459 thousand billion yen (Index 5-3). In returns, these banks must accept some conditions of the financial reconstruction committee such as: cut twenty thousand jobs, closed 13% of their branches. Regardless of these conditions, after these organizations were financed, their capital safety ratio went up to 11% (the ratio of equal or above 8% was considered to be healthy). This result shows efficiency of implemented methods and they are valuable lessons for Vietnam

*/ For financial institutions which were on verge of bankruptcy, FSA would nominate its staff to bear management in these organizations as well as find private banks who accepted to purchase or took over them. In case of not finding purchaser, FSA would transfer them to a deposit insurance agency to settle. There were two settlement forms for financial institutions which came bankrupt. First was to nationalize them into special public management banks and then sell them to a private financial institution (Japan long-term credit bank and Nippon Saiken bank were nationalized temporally in late 1998). Second was to transfer them into bridge banks and then, after two years, sell them to a private organization and in case no private organization wanted to buy, the bridge banks would be dissolved in consistence with normal bankruptcy procedures.

In case of Vietnam, purge, strengthening and cleaning up financial institutions should begin by:

*/ Reorganizing banking system in the direction that decreases quantity by rearranging joint stock commercial banks; disposing, disclosing poor performance banks, merging inefficient banks (in term of legal capital and administrative ability) into large banks to form financial banking group which have high competitiveness in regional and international scale; not allowing widely economic groups to establish commercial banks direct under them (Petrolimex bank, FPT bank) because once being manipulated by holding groups, these banks can be easily pushed to unsafe and highly risky situation.

*/ Improving financial ability for Vietnamese commercial banks. Compared with other commercial banks in the world, the largest difficulty of Vietnamese commercial banks lays in its internal force. With humble infrastructure, small capital scale, underdeveloped technology, limited human resource and others, Vietnamese financial institutions are so vulnerable to strong foreign banks now available in the market. By 2007, average own fund of a state-owned commercial bank is 4,200 billion Vietnam dongs and the total amount of five state commercial bank only equal to that of a medium regional bank. Legal capital of Agricultural and Rural Development Bank is at highest level with 5,000 billion VND, the Trade and Industrial Bank with 2,500 billion VND. Average capital safety ratio of Vietnamese commercial bank is still low (below 5%), while as required by the State Bank and international practices, it must be 8%. (Source: Doctor Le Quoc Ly 'Vietnamese commercial bank development in integration context', August, 2007). It should be noted that market shares of state owned commercial banks make up 75% of market-mobilized capital and 73% of credit market.

Thus, in order to ensure the minimum safety rate based on international standard (8% owned capital/ total asset), the supplement capital must be 10,000 billion VND to ensure the average debit balance at 18% per year.

4/ The Japanese financial Big Bang is an important reform which set firm legal foundation for the recovery and development of a free, equal, active and integrated financial market.

One of the reasons of disturbance of the Japanese financial market in financial crisis period is that there were so many regulations for financial institutions. These regulations bound and restricted efficiency of activities in monetary market and became a barrier for transactions between domestic and foreign investors. Big Bang program with 8 contents was promoted strongly and really brought back an absolute change, marking an opening for the harsh competition and mutual elimination between Japanese banks and other western financial institutions, especially ones of the United States, England, Germany and so on.

Vietnamese financial market now is repeating what Japan experienced. There are so many overlapping legal documents and regulations, in which new ones continue to be issued with contents denying that of the still valid old ones. In addition, many documents are not suitable with integration requirements such as law on credit institutions, insurance business law… Besides, to prevent the negative sides of financial liberalization, the Vietnamese government needs to build a legal frame for foreign intermediate financial institutions which consists of technical barriers suitable with international practices and ensure the implementation of international commitments on financial liberalization.

4. The fourth lesson

Close relationship between "main bank" and enterprises in capital allocation is an important factor directly affecting Japanese economic growth rate.

Main bank system was originated before the war but became well-known only when new banking law was born in 1928 and set out "one bank in one prefecture" principle. When each bank was assigned self-control in one certain area, they created a close relationship with enterprises, regularly checking and capital financing to business of enterprises especially in the most difficult period. Not limited to capital financing, Japanese commercial banks were also good consultants for enterprises about market information, risk anticipation methods and business planning. This relationship was more strengthened when the Japanese government made strong intervention by applying system of central control of financial resources, in which BOJ played a central role. The government also carried out low interest rate policy in 1950s and 1960s to help recover the economy in post-war period and create good conditions for the stable development of financial market.

All is reversed in Vietnam. In many years, Vietnamese commercial banks haven't defined its role as efficient supporter for enterprises. The situation can be explained that banks are special business form and operate foremost for their own profits. Although it can be interpreted through names of four large state-owned commercial banks (Joint stock commercial bank for foreign trade of Vietnam, Vietnam joint stock commercial bank for industry and trade, Vietnam agriculture and rural development bank, and Bank for investment and development of Vietnam – now, two among these four banks have been capitalization) that each bank has own specific duty in its economic sector. However, in context of increasingly harsh competition nowadays, the said interpretation about economic zoning becomes so uncertain. The government (the State Bank) hasn't applied "job assignment" principle for banks or regularly assisted banks through capital refinancing or low-interest rate like in Japan. Therefore, relationship between banks and enterprises in Vietnam isn't so close; banks don't perform for benefit of enterprises and their relationship, if any, is still customer relationship and for profits and safety of financial institution only. Banks haven't really cared about efficiency of their loans and enterprise's business performance who are their customers. Moreover, capital allocation for economic sectors is not really fair. Nowadays, state-owned commercial bank system makes up the majority in term of both scale and market share: 6 state-owned commercial banks now contribute up to 70% of mobilized capital and credit (See in table 2), and normally, they crucially lend state-owned enterprises; so it is hard for small and medium enterprises to approach their official capital sources.

This fact creates many difficulties in shifting bank system's operation to basis of real commerce to establish a fair play ground in banking field. The boom credit of Vietnamese commercial banks has been increased in recent years, in which credit balance in 2007 accounted for 95% of the GDP and nearly 100% in 2009, mainly focusing on state-owned enterprise loans. It is difficult for successful businesses to borrow working capital. By contrast, the venture investment activities with high level of speculation have been given more priority. Besides, large state enterprises who contribute its capital to the majority of joint-stock banks, can exploit state assets such as land and natural resources by getting advance in debt. More worryingly, the economic corporations expanded their abuse and make lucrative on young finance companies

Table 3.2: Bank's market shares in Vietnam (in late 2000)

	Number of institutions	Mobilized capital (% of the total system)	Credit (% of the total system)
Military commercial banks	6	73.0	71.2
Joint stock commercial banks	48	10.6	10.5
Branches of foreign banks and joint venture banks	30	15.0	16.5
People's credit fund	948	1.4	1.8

(Source: Bank magazine – No. 8-2002)

This situation made many difficulties in the changing progress of banking system which based on the basic of trade and fair competitiveness in banking sector.

5. The firth lesson

Be patient on Public Financial System Reform

The characteristic of Japanese financial system shows that Public Financial System (PFS) has played important role in economic development for many years. However, it is also criticized for ineffectiveness and being prerogative as government institutions. At this time (2005), the Koizumi Cabinet was trying to persuade Cabinet council to conduct PFS reform plan. Finally, this plan was approved by Senate in October 2005, remaining in 10 years from 2007.

Japanese PFS has been known as Fiscal Investment and Loan Program system (the FILP system). Before the fundamental reforms in 2001, FILP system took the form of a huge indirect-financial system. In this system, there were 2 financial models with different function. The first model has function of accepting funds, named Entrance Organization, including Postal Savings, Postal Life Insurance, Employees' Pension Insurance and the National Pension Fund. At the end of fiscal year (FY 2000), this model was accounted for 90% of PILP funds. The second model plays the role in fund investment, named Exit Organization. The formal name of this model is "FILP agencies" which have been owned by the Government.

In the old system, the Trust Fund Bureau (TFB) in Ministry of Finance functioned as a fund manager. The Postal Savings, Employees' Pension Insurance and National Pension Fund has responsibility to send all reserve fund to this Bureau, while the reserve fund of Postal Life Insurance was managed by Minster of Ministry of Post and Communication in the collaboration with FILP. A large part of TFB was invested with FILP agencies; the rest was with Japanese government bonds (JGBs).

FILP system was established in 1955 and as reportedly, made good effect in the fast economic growth period (1950s- mid 1970s). However, it was also criticized because out of control the amount of absorb funds that Entrance Organization received. In addition, although there was clear difference between function and objective of General Budget and the FILP Fund, they have a close relation. People criticized that the complex twists between those funds have promoted economic growth in public areas. This also contributed into the reform of public financial system.

Main causes of public financial reform

1/ The Ballooning Public Financial Sector.

Starting by the finish of high economic growth, the fund supply with large scale happened with almost Japanese industrial sectors. Early 1979, there was a abrogation of financial regulations implemented before 1970s. Many corporation and big companies that had acquired enough capital from bank or local started to diversify their financial instruments. However, there were many private banks facing with difficulties. In order to avoid negative impact in future's management, some large urban and regional banks turned to stock market and real estate. It is pity that the private banks could not made their benefit dream come true with the collapse of financial "bubble" at early 1990s.

Ignoring the difficulties faced by private banks, public financial organization was criticized depending on the Government's support to limit opportunities of private financial organizations. If the transition of the scale of FILP in 1955 only gained 0.3 trillion Yen, this number in 1965 was 1.6; 9.3 in 1975; 20.9 in 1985, 40.2 in 1995, 39.3 in 1999, and 37.5 in 2000.

2/ Lack of mechanism

As analysed, the capital of FILP was shaped based on annual plan of the Government. However, the deposit of Postal Savings or contract of Postal Life Insurance was not counted in this system.

Besides, the disadvantage of mechanism was related to the risk in interest rate in which money borrowed at low interest rate was paid at the time of high interest rate. This problem made system's branches invested in repaid funds at low interest rate and obviously suffered a unfavourable interest rate differences.

3/ Negative impact on productivity and capital market

The public financial system has the function to support industrial sector in expanding production and provide necessary capital for industrial development. However, the support for FILP such as interest rate subsidization, tax preference did not encourage target production sector but reduce their productivity.

In addition, it is realized that public financial system was not effective because it did not follow the regulation of market mechanism.

Though the public financial system reform has not yet brought a great result but it made the objective of this system more clear and a new method for Japanese enterprises approach capital sources for development and production.

This lesson has significant practical value for Vietnam because:

*/ The Government directly manage the public financial sector

- The investment of State is high but the contribution to the growth is still low

- There is a unbalance in FDI in areas and sectors. The investment in tourist significantly reduced in compared with previous years.

- The government expenses still rambling and subsidized. The investment is not effective and wasteful. The public financial sours has been misused.

*/ For the deposit market

- Although the deposit and capital mobilization market develop relatively fast in the recent period in many forms with diversified and various products, the economy in general can't afford enough capital. Idle money of population floating in free market is still high.

- It lacks of a persuasive mechanism and policy that makes population change their attitude and play role as an economic engine in bank deposits. Moreover, in writer's opinion, similar to Japan of previous years, even when source of the postal savings system of households is deposited in a commercial bank, it is necessary that the State controlled allocation and made decisions on investment. To do this, the government or financial institutions should define fixed profits for household deposit products as well as insure financial risks.

- Almost all of savings from populations consigned in banks are for interests; they are deposited even in periods of high inflation or domestic currency devaluation, because people don't have any other choice. Besides, sectors which can be invested such as real estate or especially stock exchange usually change in negative directions, causing risks and unfavourable conditions for investors.

- Along with capital mobilization acceleration, banks should pay special attention to credit quality. One recent fact is that banks tend to lend more easily, leading to higher risks. To restrict lending boom, a part from financial institution's customer cautious inspection and classification and loan safety evaluation, the State Bank should consider about regulations on compulsory reserve ratio or increase regulations on acceptable risks. Coordination methods between the State Bank and financial institutions will abate pressure of capital flows and improve vulnerability of banking system.

The solution for those issues is ensuring savings and the effectiveness of public financial expenses. It is necessary to enhance revenue source through development of production, domestic income increase, and tax reform. The state enterprises and commercial banks should be privatized based on market mechanism, especially unprofitable enterprises.

CONCLUSION

Having analyzed the situation of the Vietnam's financial market before and after“ doi moi“ we have come to understand that, Vietnamese financial system is stil young and vulnerable to external environment and inexperienced of self- defense. However, struggling with many difficulties from the Southeast Asian financial crisis in 1997 and the global financial crisis 2008, Vietnam has drawn a lot of valuable lesson from developed and experienced countries in the wold and has implemented some tools to stabilize the financial market and rescued the economy.

The Japanese financial system has successfully passed economic problems related to deflation and the risk of tremendous frozen capital during the period. The Bank of Japan had approached many suitable and special monetary and financial policies such as reducing target interest rates to zero, expecialy the reform program, such as reform of Public Financial System to stabilize and develop the economy.

Based on the current policy analysis and experiences getting from Japan this paper has drawn 5 lessons for Vietnam, such as:

-It is important to define the independent role of the State Bank in market management and regulation and the Government shouldn't intervene excessively

- The monetary policy management mechanism should be flexible and efficient.

- Healthy financial institution system is the decisive factor for a stable and sustainable financial and monetary market. Healthy financial institution system is the decisive factor for a stable and sustainable financial and monetary market.

- Close relationship between "main bank system" and enterprises in capital allocation is an important factor directly affecting Japanese economic growth rate.

- Be patient on Public Financial System Reform.

This paper also intends to provide some policy suggestion to stabilize and develop Vietnam's financial market. The author hope that the financial market will be successful in near future in Viet nam.

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