



Received: 02-12-2024
Accepted: 12-02-2024

International Journal of Advanced Multidisciplinary Research and Studies

ISSN: 2583-049X

Dollarization in Vietnam: Current Situation and Solutions

Nguyen Thi Thu Le

University of Labour and Social Affairs, Hanoi, Vietnam

Corresponding Author: **Nguyen Thi Thu Le**

Abstract

The process of globalization of the world economy has linked the economies of countries together. This connection leads to currency penetration between countries, the currency of one country is circulated in another country and vice versa. Furthermore, globalization promotes the unification of the world economy. This unification inevitably requires the formation of a world currency to strengthen the connection between individual economies. When a world currency does not have enough conditions to be established, during the transition period, a national currency accounting for a large economic proportion in the world economy and with high convertibility can play the

role world currency replacement game. The USD is the number one currency in performing this role. In recent years, although inflation has been controlled and tends to stabilize at a low level, dollarization is still a common phenomenon in Vietnam. In an economic environment where dollarization persists, the management of macroeconomic policy in general and monetary policy in particular faces many difficulties. This article analyzes the current situation of dollarization in Vietnam, its impact on policy administration, and then proposes some appropriate solutions.

Keywords: Dollarization, Exchange Rate, State Bank

1. Introduction

Dollarization, or more broadly foreign currencyization, is not a new phenomenon in the world economy, but it has only developed strongly in the last two decades, especially in developing countries. The impact of dollarization on economies is still a fiercely debated issue. But it can be seen that dollarization has had a great influence on the development of the financial market as well as the management of financial and monetary policies of each country. Currently, Vietnam is considered a country with a dollarized economy. Vietnam's view on this economic phenomenon is very consistent, that is, Vietnam must gradually reduce and gradually eliminate the phenomenon of dollarization from the economy. However, Vietnam's specific policies and solutions are often inconsistent and their effectiveness does not meet economic development requirements. Although there have been a number of domestic and foreign studies on dollarization in Vietnam, it can be said that these studies only focus on studying this issue within a narrow scope. Therefore, comprehensively studying the phenomenon of dollarization in Vietnam, especially placing this issue in the context of Vietnam's active participation in the world economy, is a necessary theoretical requirement and practicality.

2. Research overview

The concept of dollarization

In a narrow sense, dollarization is the phenomenon in which the US dollar is commonly used to replace the domestic currency in an economy.

Dollarization, from the perspective of currency circulation, is the phenomenon in which one or several foreign currencies replace the monetary functions of the domestic currency to varying degrees.

This substitution of the monetary function may be officially accepted by a country (formal dollarization) or not accepted (informal dollarization). Official dollarization is the formation of a fixed exchange rate regime and a monetary union between the dollarized country and the country issuing the dollarized currency.

Evaluation criteria: IMF evaluates the level of dollarization on the basis of foreign currency deposits (FCD)/base currency (M2). Besides, we can evaluate dollarization according to: Asset dollarization criteria (foreign currency deposits/total deposits), currency dollarization (foreign currency cash in circulation/total cash in circulation), index Non-core dollarization

(cash and foreign currency deposits/expanded monetary base).

Classification of dollarization

Criteria for legality

With this criterion, the dollarization phenomenon is classified into the following 3 basic types:

Unofficial dollarization: A situation in which foreign currency is used by residents of a country as a medium of exchange, a unit of value calculation, or a means of accumulating value widely in the economy without permission or recognition. Recognized by the law of that country.

Semi-official dollarization: This type of dollarization is also known as partial dollarization. This is a situation where a foreign currency is used as a unit of accounting, a medium of exchange, a store of value, and a means of payment while that country's domestic currency still exists and circulates. With this type of dollarization, foreign currency is used as a second legal currency of the economy.

Official dollarization: Also known as full dollarization. Foreign currency is used by residents to perform the functions of currency and is permitted or recognized by the law of that country. That is, foreign currency is legally used in contracts between private parties and legally used in Government payments. The official dollarization phenomenon will be associated with the official foreign exchange market, which is where foreign currency trading transactions are allowed to serve the purposes of payment and foreign currency trading according to the provisions of law. Like at commercial banks.

Criteria for the scale of foreign currency use in the economy

This criterion classifies dollarization into two types:

Full dollarization: Is the case where foreign currency is used throughout the economy as the only legal currency (or the local currency accounts for only an insignificant proportion) and is allowed by law. Full dollarization is always official dollars.

Partial dollarization: Is the use of foreign currency in a certain area of the economy. Partial dollarization can be formal or informal dollarization. The phenomenon of partial dollarization often reflects people's desire to diversify their assets to ensure their assets do not lose value due to the depreciation of the local currency in the context of economic instability. And high inflation.

Criteria based on monetary function

Asset replacement dollarization: Is the use of foreign currency by residents instead of domestic currency as a reserve of value. This is reflected in businesses and people holding foreign currency in cash and maintaining foreign currency accounts in the banking system.

Payment substitution dollarization: Is the use of foreign currency by residents instead of domestic currency in means of payment and unit of calculation.

Causes of dollarization

The phenomenon of dollarization is quite common in developing countries and countries with transition economies. However, for each different country, the causes of dollarization will also be different. Below are some of the most basic causes leading to dollarization in the economy:

Because the domestic currency is not freely convertible: In a country, the domestic currency is not freely convertible, especially the current balance, the domestic currency will become less attractive compared to other countries. currency. From there, foreign currency reserves will occur and as a result, the foreign currency will overwhelm the domestic currency in the storage function and the phenomenon of dollarization will exist as an objective economic phenomenon.

Due to high and prolonged inflation: If in an economy the value of the domestic currency tends to depreciate compared to other foreign currencies, then among the three functions of currency, the function of reserve value of currency is to is always considered first when deciding on asset and financial investment portfolios. If an economy's domestic currency is devalued and purchasing power is reduced, people will not reserve in domestic currency but will often invest in foreign currency to ensure asset value.

Loose foreign exchange management policies: Foreign exchange management policies in countries that allow people to freely store, receive, pay, and withdraw foreign currency will contribute to increasing the level of foreign exchange. Dollarization. Accordingly, if countries have foreign exchange policies that allow businesses to receive foreign currency too widely, banks that widely open foreign currency exchange, or remittance policies that allow people to receive, send, and withdraw easily in foreign currency, that country is creating favorable conditions for increased dollarization.

Underdeveloped banking payment system: If a country where payments in the local currency are sometimes difficult due to an underdeveloped banking system, payments are mainly made in cash and for countries with small denominations, cash payment activities in foreign currencies will develop. This increases the phenomenon of dollarization as payment replacement.

The need for international payments: Increases and the influence of international capital flows. From there, businesses need to hold an amount of foreign currency to expand international trade and investment.

Enforcement of laws and Foreign Exchange Ordinances: Is not strict and there is no close coordination between agencies, so payment transactions in foreign currency still exist on the free market.

Number of foreign tourists: Increasing, the number of foreigners coming to live, work, and study increases, leading to an increase in the amount of foreign currency spent.

Due to people's habit of storing assets in foreign currency

Impact of dollarization on the economies of dollarized countries

Positive effects

Dollarization provides a pressure relief valve for the economy during periods of high inflation. Dollarization helps reduce costs and risks in transactions. Holding and using foreign currency will also help businesses and people limit risks and transaction costs in transactions related to foreign currency. Dollarization creates conditions to attract foreign investment. In addition, dollarization can be a factor in attracting tourists due to the ease of buying, selling and exchanging foreign currency.

Negative effects

Dollarization will make it difficult to predict the evolution of the total means of payment because besides the domestic

currency, there is also a parallel dollarized currency that the country cannot control. From there, dollarization reduces the operating effectiveness of monetary policy. Dollarization will reduce or eliminate monetary privileges. Printing money is an important source of income to underwrite public expenditures in addition to taxes and state loans in the event of a crisis. Dollarization will limit this privilege because some foreign currency is used instead of the domestic currency. The dollarized banking system is the cause of financial crises. A dollarized banking system will increase solvency risks arising from differences in mobilization and lending currencies. The economy is strongly affected by fluctuations in the value of the dollarized currency with other strong currencies, and the political prestige of dollarized countries is reduced.

3. Current status of dollarization in Vietnam

The phenomenon of the Vietnamese economy widely using the US dollar in business transactions began to be noticed in 1988 when banks were allowed to accept deposits in dollars. Dollarization is divided into stages:

Period 1988 – 1997:

This was the period when Vietnam began to open its economy before the regional financial and monetary crisis. During this period, our country moved to build a socialist-oriented market economy, eliminating the centrally subsidized management mechanism and the foreign trade monopoly regime. Regarding foreign exchange policy, on October 18, 1988, the Council of Ministers issued Decree No. 161-HDBT with the main content that our State implements unified state management of foreign exchange and foreign exchange business. Prohibiting the circulation of foreign currency domestically, outside the system of Foreign Trade Banks and foreign currency sales stores. The State manages foreign currency according to plan.

From the perspective of deposit dollarization, the level of dollarization in Vietnam tends to decrease, from over 30% in the late 90s to below 20% today. However, analyzing by period, the level of dollarization fluctuates: The sharp decrease in the period 1991-1993 is due to the interest rate of VND being much higher than the interest rate of USD, the need for foreign currency for transactions. Foreign economic relations were not high when the economy opened, the amount of foreign currency deposited in banks by the population was insignificant; in the period 1994 - 1996 was quite stable.

Period 1998 – 2002

Dollarization of the Vietnamese economy was initially successful when it sharply reduced the level of USD deposits in banks to 20% in 1996. But the subsequent Asian financial crisis caused the decline of the Vietnamese Dong. Decreased in value and Vietnam continued to be under pressure from dollarization. By the end of 2001, the ratio of USD deposited in banks increased to 30.26%, which was the highest ratio in recent years and thanks to the efforts of the State Bank, this ratio tended to decrease in recent years. Later. However, the absolute amount of deposits in USD is constantly increasing, in 1995 it was 1.5 billion USD.

Period 2002- 2008

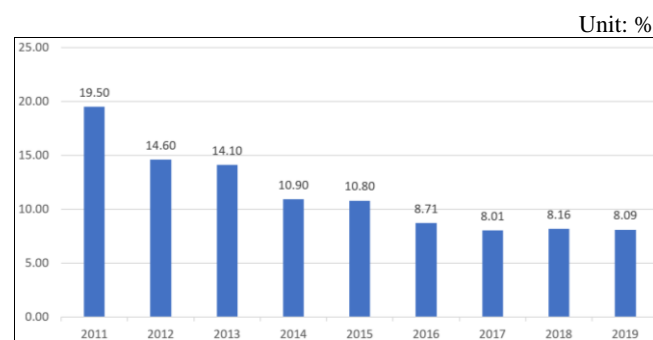
Dollarization during this period tends to decrease again thanks to the interest rate of VND being more attractive than foreign currencies, the fluctuation of exchange rates is not large (exchange rates only increased by about 6% in the 5 years from 2002 - 2007 thanks to Abundant foreign currency

supply, especially foreign currency supply from attracting foreign capital), since 2008, the level of dollarization has been quite stable (about 20%). Assessing the reason why the level of dollarization does not continue to decrease as in the previous period is because during this period inflation has increased again, exchange rates have increased pressure, foreign currency interest rates have increased.

Period 2009 - present

Vietnam's dollarization level is quite high, always above 20%. Since November 2009, the dong has depreciated four times, causing people to lose confidence and accelerate the process of dollarization. In recent years, the absolute amount of deposits in USD at banks has continuously increased, especially the banking systems in two large cities, Hanoi and Ho Chi Minh.

But with the continuous efforts of the State Bank by issuing circulars regulating the maximum interest rate of capital mobilized in US dollars by organizations and individuals, in the direction of reducing the interest rate of USD mobilization of organizations and personal down. The State Bank requires state-owned enterprises, corporations and corporations to sell foreign currency to credit institutions and increase the compulsory foreign currency reserve ratio. The State Bank's move clearly demonstrates the tightening of the foreign exchange market, limiting the holding and borrowing of capital in USD, and gradually combating the dollarization of the economy.



Source: State Bank 2012-2020

Fig 1: FCD/M2 ratio in the period 2011-2019

Fig 1 shows that the proportion of dollars deposited in banks tends to decrease significantly from 19.5% in 2011 to 8.09% in 2019. This is a positive trend, showing that The dollarization of debt assets in the commercial banking system is being effectively curbed. People have more confidence in the domestic currency. Although the dollarization rate is tending to decrease, however, according to experts, in the coming time, Vietnam needs to continue to have policies to regulate the market, because the current market is still present. There are factors that affect the goal of limiting dollarization in the economy.

Accordingly, the dollarization situation is due to increased demand for international payments and the influence of international capital flows. Since the opening of the economy, export and import turnover and foreign investment capital flows into Vietnam have been increasing, so businesses need to hold a large amount of foreign currency to serving the needs of expanding international trade and investment. In addition, remittances increased with regulations allowing individuals to hold foreign currency in the form of savings and foreign currency accounts in the banking system, stored in the form of foreign currency cash.

In addition, the dollarization situation is due to the unbalanced interests held between VND and USD, mainly due to fluctuations in exchange rates, actual and expected interest rates, especially when VND is not yet a convertible currency., Vietnam's inflation is relatively high compared to other countries in the world and region.

Not only is it steadfast in gradually tightening foreign currency lending, the State Bank continues to maintain the USD mobilization interest rate at 0% for many years, while the VND mobilization interest rate remains at 5% - 7.5%/year. Along with that, the exchange rate is also controlled by the State Bank within a stable range over the years. Faced with this reality, many people have reduced their foreign currency holdings and switched to holding VND to enjoy high savings interest.

Vietnam aims to gradually reduce the ratio of foreign currency credit to total outstanding credit, moving towards stopping foreign currency lending, to basically overcome the dollarization situation in the economy by 2030 at the latest. The move to tighten foreign currency credit will help stabilize the USD exchange rate, businesses and markets will no longer hold or speculate foreign currencies, thereby reducing risks related to exchange rates.

4. Solutions to limit dollarization in Vietnam

Firstly, implement policies to stabilize the macroeconomy and stabilize the value of VND

Continue to stabilize VND par value structure. Strengthen and improve the quality of banking services and facilities, especially the non-cash payment system. Promote propaganda on card use, including international credit cards. Besides, using monetary policy tools to influence market conditions to make VND more attractive than the Dollar, interest rate policy must aim to create and maintain an interest differential. Positive interest rates between VND and USD deposits, thereby limiting the tendency to convert from VND to Dollars. For people to have confidence in VND, at the macro level, it is necessary to stabilize and develop the economy sustainably, maintaining a low inflation rate. In addition, narrowing the number of subjects allowed to borrow foreign currency compared to now, except for loans to import machinery, technology, raw materials, semi-finished products... for export. Currently, lending foreign currency to projects that essentially only require VND not only increases the level of dollarization, but also poses risks to credit institutions and banks. In addition, strictly control the listing of sales advertisements in foreign currency and gradually move towards banning the sale of domestic goods and services with prices listed and collected in foreign currency for all entities in the economy. To achieve this requires the coordination of all ministries, departments and branches.

In the long term, it is necessary to increase the reserve ratio for dollar deposit accounts, as well as reduce the phenomenon of dollarization of outstanding loans of credit institutions. In Vietnam, there has not been complete financial liberalization, so Vietnam needs to take advantage of this time to reduce social dollarization, develop the economy and establish strong enough foreign exchange reserves. With mobilized foreign currency capital, banking and financial institutions provide effective investment loans for key and important national projects, as well as for enterprises with export business strategies. Effective slogan, this will create conditions to promote economic growth and

create many jobs for workers.

Second, implement market-based anti-dollarization measures

The government needs to continue pursuing a flexible exchange rate policy; Developing domestic financial markets to diversify investment portfolios and attract investors. Strengthen regulations and prudent supervision measures, such as: Mandatory reserves in foreign currencies must be significantly higher than the domestic currency so that commercial banks have consideration in mobilization and lending activities. Currency; Only lending foreign currency in certain categories, moving towards ending lending and mobilizing foreign currency - this is a long-term measure with an appropriate and consistent roadmap. At the same time, it is necessary to reduce the loan-to-asset ratio for foreign currency loans; reduce regulations on foreign currency positions at commercial banks to reduce foreign currency hoarding.

Third, create a domestic investment environment capable of absorbing the existing foreign currency capital in the people

It is necessary to promote the development of the macroeconomic environment, creating a truly competitive environment among economic sectors in both production, trade, services and even the financial and banking sectors. Encourage investment participation of all economic sectors in the fields of oil and gas, bridges and roads, electricity, hydropower, post and telecommunications, public infrastructure.

Develop derivative financial tools, create conditions for organizations and individuals to participate in the foreign currency market openly and easily to highly service foreign exchange operations, normalize the role influence of foreign currency. Currently, the business of hedging exchange rate risks is still only done for businesses, but for people, foreign currency trading requires a large amount of business money (100,000 USD), so it is not really practical. Create an attractive investment channel for investors. The development of derivative financial tools helps create more investment channels for people and businesses. They can both make a profit and hedge against exchange rate risks.

Fourth, administrative measures

The promulgation of administrative measures needs to go hand in hand with market measures to avoid "shocks" to the market. Administrative measures that can be effective include:

Strengthen the effectiveness of inspection and control of all violations of the use of foreign currencies in payment and exchange of goods and services in the territory of Vietnam; Minimize the circulation and use of dollars, list prices in dollars on the Vietnamese market. Consistent policy of managing foreign currency circulation according to the motto: "In Vietnam, only pay in VND".

Prevent and gradually reduce underground economic activities, strictly control smuggling and selling goods to earn foreign currency in the country.

5. Conclusion

Vietnam's consistent view is that dollarization is not beneficial to Vietnam's economic development, therefore, this phenomenon must be limited and eliminated from the economy. However, Vietnam needs to solve this problem according to an appropriate roadmap, on the basis of rapid and stable economic development, controlled inflation and

enhanced convertibility of VND. In the long term, Vietnam needs to strengthen monetary cooperation with ASEAN countries and ASEAN partner countries (China, Japan, Korea) to enhance its financial resources, which does not exclude the formation of a common regional currency.

6. References

1. Prime Minister. Decision No. 98/2007/QĐ-TTg, dated July 4, 2007 approving the Project to improve the convertibility of Vietnamese currency, overcoming the problem of dollarization in the economy, 2007.
2. Foreign Investment Agency - Ministry of Planning and Investment. Situation of foreign investment attraction in 2020, 2020.
3. State Bank of Vietnam (2012-2020). Annual reports for the years from 2011 to 2019.
4. General Statistics Office (2012-2020). Statistical yearbook for the years from 2011 to 2019, Statistics Publishing House.
5. Nguyen Duc Do. Goldization, Dollarization and the effectiveness of macroeconomic stabilization solutions. *Journal of Finance*, No. 2, 2011.
6. Nguyen Thi Hong. Dollarization and monetary policy management in Vietnam. *Banking Magazine*, No. 5, 2011.
7. ADB. Dealing with multiple currencies in transitional economies, the scope for regional cooperation in Cambodia, The Lao People's Democratic Republic, and Vietnam, 2010.
8. World Bank. Personal remittances, received (current US\$) – Vietnam, 2020. Retrieved from: <https://data.worldbank.org/indicator/BX.TRF.PWKR.CD.DT?locations=VN>.