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POLICY PAPER

Enhancing Vietnam’s Financial Sector

Insights from the New Institutional Economics Perspective with a Case Study of Vietnams Current Bond & Real Estate Market

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ANALYSIS

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1. Introduction

Vietnam stands out as a vibrant and rapidly expanding economy, earning its place among the fastest-growing nations in the world. The country's transformative journey began with the introduction of market-oriented reforms in 1986, known as Đổi mới, and its subsequent embrace of international trade. These progressive steps have propelled Vietnam to achieve remarkable growth rates over the past few decades. As the economy flourished, the financial market experienced also changes, bolstered by a series of reforms that strengthened its foundations. However, the Vietnamese financial market also shows its weaknesses: There is no international relevant financial marketplace in the country and the current situation on the private bond market leads to several defaults, which could lead the relatively young bond market to distress and spill-over to Vietnam's overall economy. The reasons for this are complex, but in the end, they lead back to one important factor: Institutions.

Institutions play a central role in economic growth and social development, as Douglass C. North already emphasized in his 1994 paper "Institutions Matter" (North, 1994). North argues that only societies with effective institutions, with clear and enforceable rules, can succeed in achieving prosperity, innovation, and growth. Doing this, he defines institutions as "the rules of the game in a society" which can be formal, such as laws and constitutions, or informal, such as social norms and customs (North, 1994).

This paper examines this influence of institutions on the financial sector in Vietnam. First it highlights the theory of New Institutional Economics (NIE) and its impact on the financial market. By exploring the foundations of this economic theory, this paper then bridges institutional factors and their influence on Vietnam's current financial market, especially the private bond market. Based on NIE Theory and Vietnam's status, recommendations are proposed that may help to improve Vietnam's financial market and bring the country closer to its vision of becoming a developed, high-income country in 2050 (Minh, 2023).

2. Theoretical Background

1.2 Overview New Institutional Economics

The influence of institutions on the economy can be traced back to the work of Adam Smith in the 18th century, who emphasized the importance of institutions such as the legal system and the separation of powers for the functioning of markets (Kaufman, 2007). In the late 19th and early 20th centuries, especially the economists John R. Commons, Thorstein Veblen, and Wesley Mitchell explored an institutionalist approach that emphasized the importance of rules and institutions in economic systems, which can be referred to as Old Institutional Economics (OIE). Commons, for example, emphasized the importance of informal institutions, such as norms and codes of conduct, and their influence on economic behavior (Richter and Furubotn, 2003).

In the early 1970s, the research field of NIE emerged, building on the foundational work of OIE, but also extending it by viewing and studying institutions as contractual relationships between individuals (Richter, 2005). NIE emphasizes the importance of formal institutions, including laws, property rights, and contract rights, for economic development (Richter, 2005).

The origins of NIE can generally be traced back to Ronald Coase's seminal 1937 essay, "The Nature of the Firm" (Coase, 1937). Ronald Coase's essay addressed the question of why firms emerge as they do. He argues that firms as individuals are better able to deal with transaction costs in economic transactions (production and exchange of goods), i.e., in using the market and economize transaction costs (Coase, 1937). Coase's work is generally considered to be the starting point for the idea of transaction costs and the design of contracts for the functioning of markets (Coase ,1998; Kaufman, 2007).

Afterwards, Olivier Williamson expanded Coase's framework in 1973 by elaborating on the concept of transaction costs and coining the name NIE as a new field of economic research (Ménard and Shirley 2005; Whitford, 2015). His most influential paper is "Markets and hierarchies: some elementary considerations", which sets the basic framework for the theory of transaction cost economics (Williamson, 1973). This concept was developed further by Williams in its paper "Transaction-cost economics: the governance of contractual relations" (1979) and it explains beyond his paper from 1973, how different kinds of transactions with differently high transaction costs are connected (Williamson, 1979).

Building on the initial ideas of Coase as well as Williamson and the general concept of transaction costs, North's 1990 paper "Institutions, Institutional Change and Economic Performance" laid an important foundation for the NIE by focusing on the importance of institutions for economic development (North, 1990). North argued that institutions are a central factor in the economic growth and development of societies. North's work also emphasized the importance of path dependence and independence, which play a key role in the development of institutions and, conversely, influence economic behavior within a society (North, 1990). His work is considered one of the most influential in the field and laid the foundation for further research in this field (Ménard and Shirley, 2005).

Based on the idea of transaction costs and the understanding of the influence of institutions on the economic development of a society, the research field of NIE has grown rapidly in recent years (Betz, 2021). Within this research framework, many researchers have analyzed various factors influencing institutions and the general functioning of institutions. Anyway, as the research field is very broad and includes different emphases and areas, it is difficult to make a clear distinction. To provide a simplified overview, this policy paper will break down the research field of NIE into three major areas. The subdivision here refers to considering the respective institutions and how they influence the economic development:

Economic Institutions

These refer to the forms of organization and structuring of markets, firms, and business associations that influence the efficiency and performance of the economy. This includes principal-agent theory and governance structures within firms (Acemoglu, Johnson, and Robinson, 2005).

Political Institutions

These refer to the political structures and regulations that can influence the economy. Examples include the role of government, political stability, the distribution of power in society, and the form of government. Subfields include constitutional economics, which studies the influence of different forms of government on economic development (Rothstein, 1996).

Legal Institutions

These refer to the legal framework that influences economic activity. Examples include property rights, contract law, and the enforcement of contractual obligations (Hadfield, 2015).

Overall, respective research papers cannot always be clearly assigned to one of the three fields, as the entire research area is structured in a very interdisciplinary way. For simplicity, this policy paper will generally refer to the three institutions mentioned above.

2.2 New Institutional Economics and Financial Industry

Based on the general field of NIE research, the influence of institutions on the economic or general development of a country has already been highlighted. However, there is also a sizable literature in the research field of NIE that examines the impact of institutions on the financial sector. Especially, many studies developed and emphasized with the so-called "Theory of Law and Finance" that focuses on the role of legal institutions in explaining international differences in financial development (Beck and Levine, 2005). According to this theory, in countries where legal systems enforce, for example, private property rights, support contractual agreements, and protect investors' rights, savers are more willing to finance firms and financial markets flourish. In contrast, legal institutions that do not support private property rights or facilitate the enforcement of private contracts discourage business financing and impede financial development (Beck and Levine, 2005).

For example, in their paper "Law and Finance" (1998) Porta, Lopez-de-Silanes, Shleifer, and Vishny examined how the quality of the legal system and the related enforcement of contract and property rights affect the financial system and how this affects economic growth. The authors argue that countries with good legal systems and good enforcement of contract and property rights tend to have better developed financial systems and higher economic growth. They also examine the role of information asymmetries and collateral in the financial system and how these are affected by the quality of the legal system (Porta et. al., 1998). A further example is the work of Levine (1998, 1999), who examined how different factors, such as the legal system and the regulation of financial institutions, can influence financial development and economic growth. He argued, for instance, that a good legal system and effective regulation of banks can help to increase the trust of investors and lenders and thus promote economic growth (Levine, 1998), and that a good legal system can help investors and lenders to invest in a country and thus promote financial development and economic growth (Levine, 1999). An additional illustration is the work of Johnson, Boone, Breach, and Friedman (2000), who find that weak legal institutions help explain cross-country differences in stock market declines and currency devaluations during the Asian crisis. They suggested that economic shocks lead to greater expropriation, greater stock market declines, and greater capital outflows in countries with weak legal institutions (Johnson et al., 2000).

While it is widely accepted that effective investor protection enables efficient corporate finance and growth-enhancing financial development, not all researchers argue that strong legal institutions are ultimate determinant of financial development in a country, but that there are other institutions or factors that have a decisive impact on the financial sector. (Roe, 1994; Pagano and Volpin, 2001; Rajan and Zingales, 2003).

Nevertheless, based on the previous work, conclusions can be drawn about a positive effect of (strong) institutions on the development of the financial sector.

3. Vietnam's Financial Market

Having discussed the positive relationship between institutions and the financial sector, we will now examine Vietnam's financial market in more detail. For this, two main resources are used – The FDI & GFCI indices.

1.3 IMF Financial Development Index (FDI)

The International Monetary Fund's Financial Development Index (FDI) is a holistic assessment of the development and stability of financial systems in countries around the world. It measures several factors that contribute to a well-functioning financial system, including size of financial institutions and markets, the ease of access to credit, the degree of financial stability and soundness, the efficiency of payment systems, the strength of investor protection, and the extent of financial inclusion (International Monetary Fund, 2022a).

The Financial Development Index aims to capture both the qualitative and quantitative aspects of a country's financial system and to assess its ability to promote economic growth, attract investment, and provide financial services to the population (International Monetary Fund, 2022b).

FD Index and GDP per capita (2020)

In examining the Financial Development Index (International Monetary Fund, 2022c) and GDP per capita (World Bank, n.d. a) for a variety of countries around the world, important findings stand out:

- FDI values range from 0.04 to 0.95, indicating significant differences in the development of financial systems across countries (0= financial system is not developed, 1 = financial system is perfectly developed).
- Countries with the highest FDI values include Switzerland, the United States, Japan, and Australia, suggesting a well-developed financial system.
- On the other hand, countries with low FDI values, such as the Central African Republic and the Comoros, have less developed financial systems (and low GDP per capita)

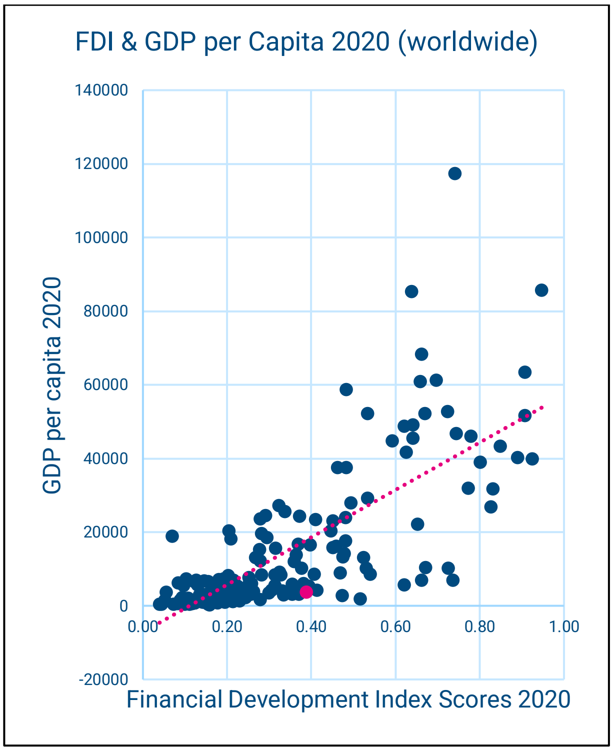

Figure 1 Scatterplot FDI & GDP per capita for the year 2020 – Including 180 countries. Own Illustration (International Monetary Fund, 2022c).

Overall, the chart shows a clear relationship between financial system development and a country's economic strength (Purple circle reflects Vietnam; FDI: 0.39, GDP: 3586.35). The better developed the financial system, the higher the economic strength of a country (vice versa). Nonetheless, it is also important to emphasize that in addition to financial development, other factors also shape a country's economic prosperity. However, this chart provides us with a clear indication of why the financial sector should be at the core of a country's economic development.

Overview FDI Vietnam

Analyzing the FDI data in the ASEAN region with a focus on Vietnam, the conclusions are as follows (International Monetary Fund, 2022c):

- Vietnam's FDI values range from 0.27 to 0.45 from 1993 to 2020, and there is a general upward trend, indicating the continuous development and improvement of Vietnam's financial system. Nevertheless, compared to GDP growth rates, the growth is not as significant.
- The average FDI value for Vietnam is around 0.3775 over the entire period, indicating a moderate level of financial development compared to the other countries in the dataset.

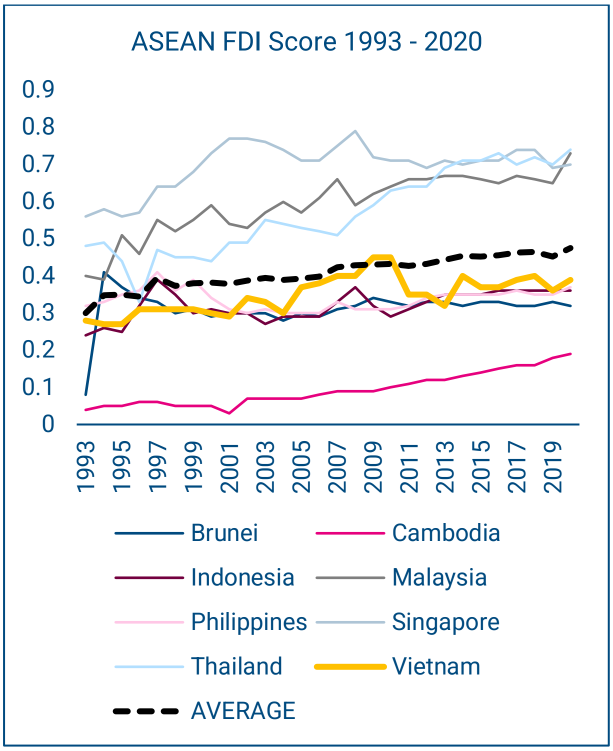

Figure 2 ASEAN FDI Scores 1993 - 2020. Own Illustration (International Monetary Fund, 2022c).

- Compared to the other ASEAN countries, Vietnam's value is lower than that of Malaysia, Singapore, and Thailand, indicating that the financial systems of these countries are more developed. In addition, Vietnam is below average throughout the period (except for 2009 and 2010).
- Vietnam's FDI values show a relatively stable pattern

with slight fluctuations over the years. There is no significant volatility, which indicates a relatively stable financial environment, but has also resulted in lower levels of development.

Overall, the data suggest that Vietnam has made progress in developing its financial system over the years, although it remains behind some of its neighboring countries. Nevertheless, the steady development is also an indicator that the development of the financial sector has not increased significantly in recent years compared to other countries.

2.3 Global Financial Centres Index (GFCI)

The presence of financial centers reflects a country's level of financial development, and an important measure of this is the Global Financial Centers Index (GFCI). Published biannually by the Z/Yen Group and the China Development Institute, two private think tanks, the GFCI has provided ratings, rankings and profiles for 111 financial centers worldwide since its inception in 2007 (Z/Yen Group & China Development Institute, 2016). The index is based on two data sources: instrumental factors from external indices and responses to an online survey. By considering a total of 138 factors from these sources, the GFCI produces a comprehensive ranking of the evaluated financial centers (Z/Yen Group & China Development Institute, 2016).

In the context of Vietnam, Ho-Chi-Minh City represents the country in the GFCI and appears as the only financial center associated with Vietnam in the index (Z/Yen Group & China Development Institute, n.d.). However, the assessment of Ho Chi Minh City as the only representative financial center for Vietnam does not fare well. Ho Chi Minh City ranks last in the Asia-Pacific region and ranks far behind ASEAN cities such as Jakarta, Bangkok, Kuala Lumpur, and Singapore (which ranks first in the region). On a global scale, Ho Chi Minh City ranks 112 out of 120, indicating a relatively low standing (Complete overview in Appendix I). It is also important to note that Ho Chi Minh City has dropped 8 places compared to the previous period, with its rating falling 11 points to 567 (Z/Yen Group & China Development Institute, n.d.).

Overall, the city's ranking has deteriorated since it was first included in the index, from positions 102, then 104, to 112. This reflects that Ho Chi Minh City as a financial location has deteriorated over time (Z/Yen Group & China Development Institute, n.d.).

3.3 Summary FDI & GFCI

- There is an indication of a positive correlation between financial sector development and GDP per capita.
- Vietnam has increased its FDI value from 0.27 to 0.45 from 1993 to 2020, but this is less compared to its economic growth.
- Vietnam's FDI value is lower than the ASEAN average (especially lower than Thailand, Singapore, and Malaysia).
- Vietnam has only one relevant financial center, Ho Chi Minh City, which is included in the GFCI scores.
- But Ho-Chi-Minh City is the lowest ranked financial center within the Asia-Pacific region and 112th out of 120 worldwide.
- Based on GFCI, Ho-Chi-Minh City has declined as a financial center in recent years.

4. Status Quo – Vietnam's Legal Institution

As explored in chapter 2.2, there is a clear academic reference in the NIE, and the financial sector based on the "Theory of Law and Finance" (Beck and Levine, 2005). Therefore, the focus of this chapter is on legal institutions and their assessment in relation to Vietnam. To this end, data from two relevant indices are used to quantify the legal institutions of Vietnam: Worldwide Governance Indicators (WGI) and Index of Economic Freedom (IEF) from the Heritage Foundation.

1.4 Worldwide Governance Indicator (WGI)

The WGI are a collection of indicators that measure the quality of governance in different countries around the world (World Bank, 2021). The indicators have been compiled by the World Bank from 1996 to 2021 and are based on a survey of experts and citizens (World Bank, 2021). The created measures for each indicator correspond to a standard normal distribution with a mean of zero and a standard deviation of one, ranging from -2.5 to 2.5, with higher values corresponding to better value.

Utilizing the WGI Index, of the total six indicators, the following three legal institutions are particularly relevant to the "Law and Finance Theory": *Rule of Law, Control of Corruption*, and *Regulatory Quality*.

Rule of Law

This indicator measures the quality of the judiciary and adherence to the rule of law (World Bank, n.d.b).

- Vietnam's scores fluctuated over the years but showed a general improvement from 1996 to 2021.
- In the early years (1996-2000), Vietnam's scores were below the average, indicating weaker adherence to the Rule of Law compared to ASEAN average.
- From 2000 to 2010, Vietnam's scores started to approach ASEAN's average, indicating some progress in strengthening the Rule of Law.
- There was an improvement in Vietnam's scores from 2013 to 2016, reaching positive territory in 2015.
- But the scores declined again from 2016 to 2021, indicating a regression of the Rule of Law.
- In general, Vietnam is below the ASEAN average.

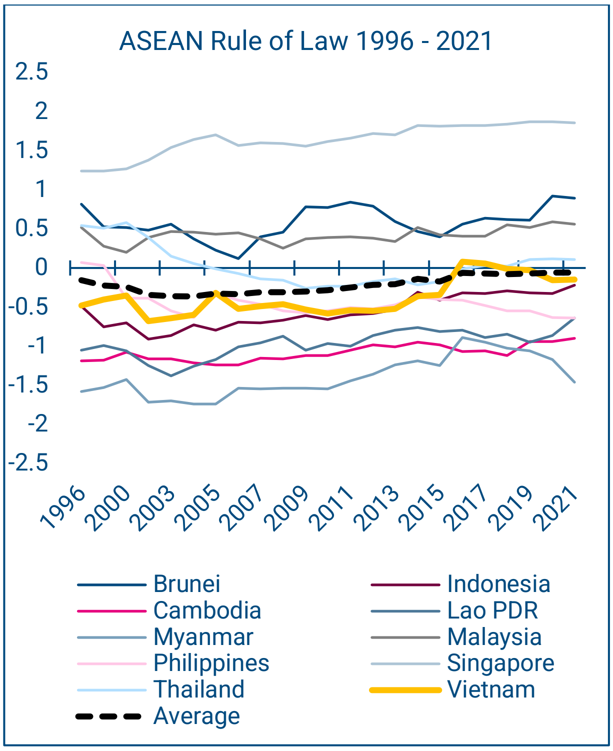

Figure 3 ASEAN Rule of Law Scores 1996 - 2021. Own Illustration (World Bank, n.d.b).

Control of Corruption

This indicator measures the fight against corruption and the effectiveness of anti-corruption measures (World Bank, n.d.b).

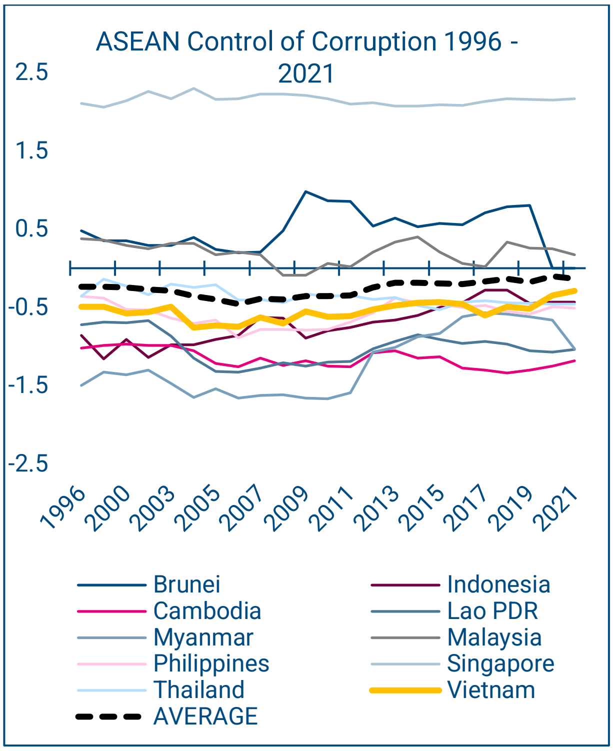

Figure 4 ASEAN Control of Corruption Scores 1996 - 2021. Own Illustration (World Bank, n.d.b).

- Vietnam's scores on the Control of Corruption indicator were generally below the ASEAN average, indicating challenges in controlling corruption within the country.
- In the first years there was a decline of corruption control in Vietnam, with a little improvement in 2005 onwards.
- In recent years (2018-2021), Vietnam's scores have shown some more recovery, but they remain below the global average.
- Overall, Vietnam has not been able to significantly reduce corruption over the past 25 years and has remained below the ASEAN average.

Regulatory Quality

This indicator measures the quality of regulation in various areas, such as the economy and the environment (World Bank, n.d.b).

- Vietnam's scores on the Regulatory Quality indicator have generally been below the ASEAN average, indicating challenges in regulatory quality within the country.

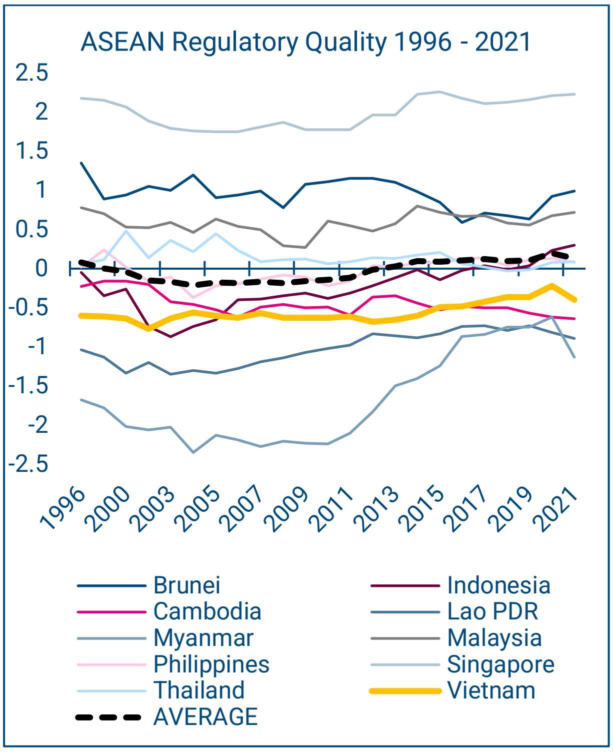

Figure 5 ASEAN Regulatory Quality Scores 1996 - 2021. Own Illustration (World Bank, n.d.b).

- In general, the Vietnam's Regulatory Quality improved over the time, indicating some progress in regulatory quality but the improvement was not significantly.
- In recent years (2015-2021), Vietnam's scores have shown higher progress, but from 2020 to 2021 the regulatory quality declined again.
- Overall, Vietnam's Regulatory Quality is below 0 that means it is also under the worldwide average (based on standard normal distribution).

2.4 Index of Economic Freedom (IEF)

The next benchmark considered is the Index of Economic Freedom (IEF) from the Heritage Foundation. The annually published analyze measures the degree of economic freedom in countries around the world. This is done by measuring the extent to which governments allow individuals and businesses to operate freely in the economy without excessive interference or regulation. The IEF uses a scale of 0 to 100, where a higher score indicates greater economic freedom (The Heritage Foundation, n.d. a).

The most important indicators based on the "Theory of Law and Finance" for our analysis are as follows: *Property Rights*, *Judicial Effectiveness*, and *Government Integrity*.

Property Rights

The property rights dimension assesses the ability of individuals to own private property securely under enforced laws. It considers protection against expropriation, judicial independence, levels of corruption, and contract enforcement for a conducive business environment (The Heritage Foundation, n.d. b).

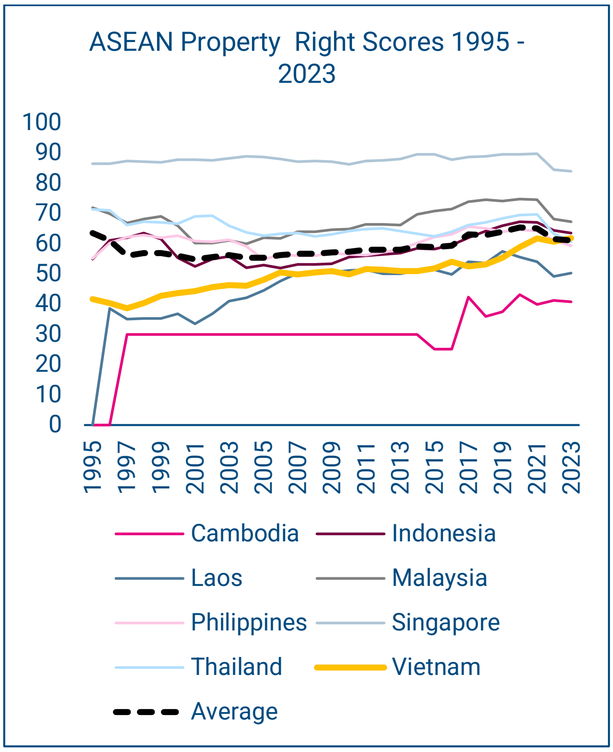

Figure 6 ASEAN Property Right Scores 1995 - 2023. Own Illustration (The Heritage Foundation, n.d. c).

- From 1995 to 2023 the property rights score for Vietnam has shown improvement over the years. It started at 41.7 in 1995 and reached 61.8 in 2023. This indicates an upward trend in the protection of property rights over the long term.
- Compared to the ASEAN countries, Vietnam's property rights score is relatively moderate. It is lower than countries like Singapore, Malaysia, and Indonesia but higher than Cambodia, Laos, and the Philippines.
- In the most recent years, Vietnam's property rights score has remained relatively stable. It was 61.7 in 2021 and slightly decreased to 60.6 in 2022, followed by a minor increase to 61.8 in 2023.

Judicial Effectiveness

The Judicial Effectiveness requires a strong legal framework and is measured by the extent to which citizens' rights are protected, the independence of the judiciary is guaranteed, and fair trials and impartiality in government decisions are enforced (The Heritage Foundation, n.d. b).

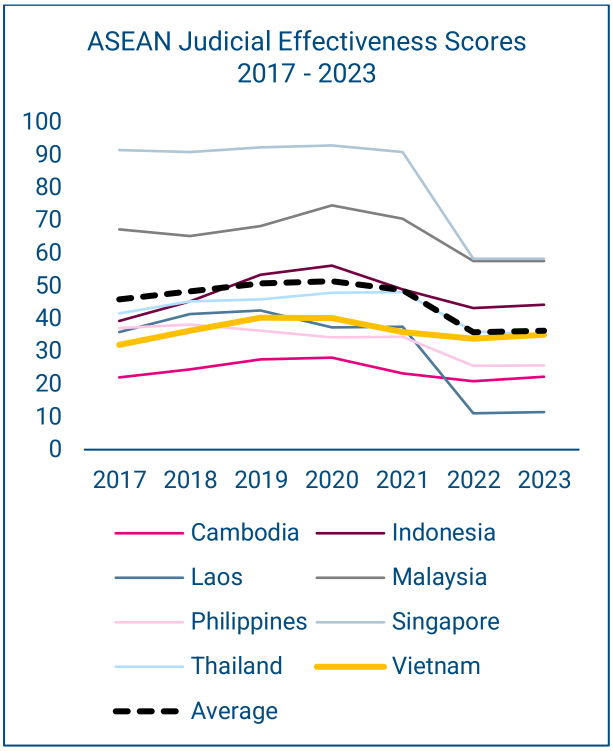

Figure 7 ASEAN Judicial Effectiveness Scores 1995 - 2023. Own Illustration (The Heritage Foundation, n.d. c).

- The judicial effectiveness score for Vietnam has remained relatively low. It started at 32 in 2017 and reached 35.1 in 2023. This suggests that Vietnam faces challenges in terms of the effectiveness of its judicial system.
- Compared to other ASEAN countries, Vietnam's judicial effectiveness score is generally lower. It is below the regional average and lower than countries like Malaysia, Singapore, and Indonesia.
- There are fluctuations in Vietnam's judicial effectiveness score over the years. While there was a slight improvement from 2017 to 2021, the score decreased in 2022 before experiencing a minor increase in 2023.

Government Integrity

The Government Integrity Score is determined by evaluating several key factors. These include the level of public trust in politicians, the prevalence of illicit payments and bribes, the transparency of government policies, the extent of corruption, the perception of corruption, and the transparency of the government and civil service (The Heritage Foundation, n.d. b).

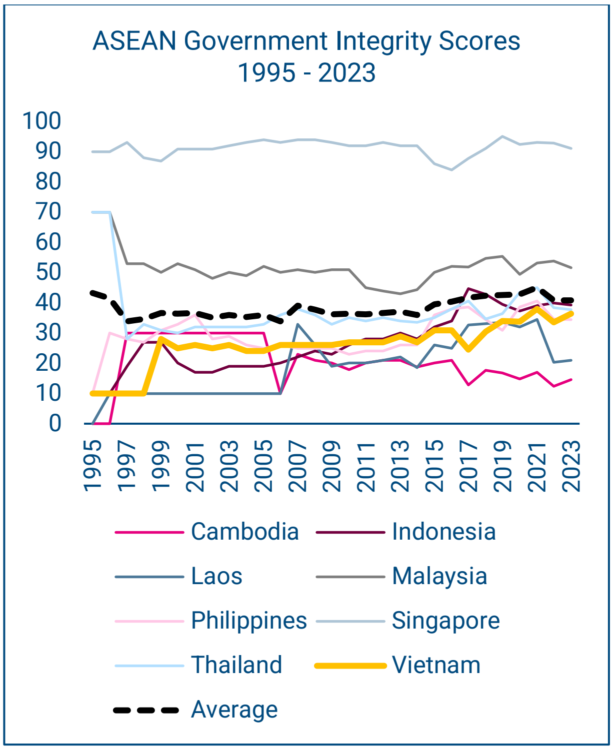

Figure 8 ASEAN Government Integrity Scores 1995 - 2023. Own Illustration (The Heritage Foundation, n.d. c).

- The government integrity score for Vietnam shows fluctuating values throughout the analyzed period. It ranged from 10 to 38, indicating variations in the perception of government integrity in Vietnam over time.
- In the most recent years, Vietnam's government integrity score has remained relatively stable, ranging from 36.4 to 40.7625. This indicates a consistent perception and no significant improvements.
- Compared to other countries in the region, Vietnam's government integrity score is relatively moderate. It is higher than countries like Cambodia, Laos, and Indonesia but lower than countries like Singapore, Malaysia, and Thailand.
- Overall, Vietnam has always scored lower than the ASEAN average throughout the period considered.

3.4 Summary WGI & IEF

- Vietnam's Rule of Law scores showed overall improvement from 1996 to 2021, but currently remain below the ASEAN average.
- Over the past 25 years, Vietnam has failed to significantly reduce corruption and is ranked below the ASEAN average in controlling corruption.
- Regulatory quality remains challenging in Vietnam, which ranks below the ASEAN average.
- Compared to ASEAN, Vietnam has improved in protecting property rights over the long term, scoring moderate compared to ASEAN.
- The effectiveness of Vietnam's judicial system remains challenged, and it ranks lower than other ASEAN countries.
- Vietnam's government integrity scores fluctuate over time, but consistently remain below the ASEAN average.

In summary, Vietnam has made progress in certain institutional areas, such as property rights, but significant challenges remain to strengthen the rule of law, control corruption, improve the quality of regulations, enhance the effectiveness of the judiciary, and promote government integrity. While Vietnam's scores have improved in some areas over time, there have also been fluctuations and regressions. Overall, Vietnam's performance in these areas remains below the ASEAN average, indicating the need for continued efforts to improve governance and uphold the principles of transparency, accountability, and protection of rights and freedoms.

5. Failure of Legal Institutions: Case Study Vietnam’s bond market

The current situation in Vietnam's domestic corporate bond market is a recent example of the negative impact of poorly functioning legal institutions within the financial sector. Prior to an analysis of the impact of legal institutions, it is important to have an overview of Vietnam’s current corporate bond market as well as the real estate market and their issues.

1.5 Current situation Vietnam’s bond market

In the last years there was in increase in the overall corporate bond issuance. In 2022 and starting 2023, however, there was not only a decline in overall bond issuance (Figure 9 and 12), but also general market turmoil that had a broader impact on market participants and regulators (Anh, 2023). The reason for this is the high number of corporate bond defaults. According to FiinRatings[1] (2023a), as of March 2023, there were already 69 issuers with at least one outstanding bond that were

[1] Note: FiinRatings is one of the two local credit rating agencies in Vietnam licensed by the Ministry of Finance under Decree 88/2014/ND-CP (FiinGroup, n.d.)

unable to meet their debt obligations on the due date. The total value of defaults amounted to VND 94.43 trillion, these defaults accounted for approximately 8.15% of the total value of outstanding bonds in the market.

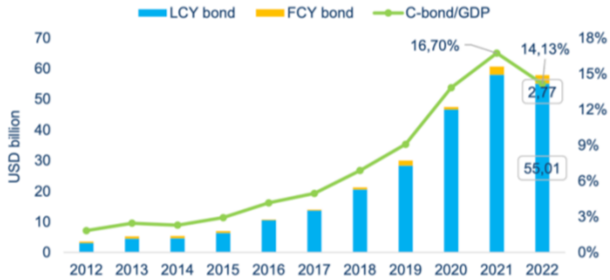

Figure 9 Vietnam's LCY and FCY Corporate Bond Over Years[2] (FiinRatings, 2023b).

In recent months, default rates have increased significantly, rising to 9.77% in April 2023 and a further increase to 11.74% in May 2023, as shown in Figure 10. (FiinRatings, 2023b). Based on FiinRatings evaluation, this trend can be mainly attributed to a weakening credit environment triggered by interest rate hikes, speculative real estate cycles, tightening bank credit, and unprepared retail investor involvement in the corporate bond market (FiinRatings, 2023a).

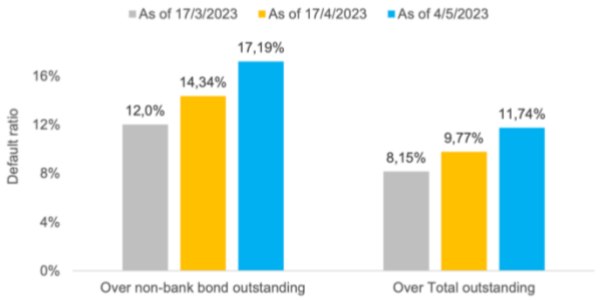

Figure 10 Corporate Bonds Default over the last months (FiinRatings, 2023b).

However, most of the increase in bond default rates is attributable to corporate bonds issued by real estate developers (Figure 11 – approx. 25% default in real estate sector). In recent months, this sector has driven the corporate bond market and attracted a significant number of investors (FiinRatings, 2023b). Therefore, to understand fully the implications of the bond defaults in Vietnam, it is essential to examine the real estate market, as the two markets (bonds and real estate) are closely linked.

Figure 11 Bond Default Ratio by Sector, Updated as of May 4, 2023 (FiinRatings, 2023b).

2.5 Real Estate market as starting point for bond defaults

During the Covid-19 pandemic, Vietnam's real estate sector faced numerous challenges, including rising interest rates, inflation, sluggish construction progress, and reduced bank lending. To overcome liquidity problems, real estate developers turned to the bond market as an alternative source of funding (Kokalari, 2023). The bulk of these bonds were purchased by retail investors as other investment opportunities for Vietnamese citizens are rare (Kokalari, 2023).

At the same time, the Vietnamese government was concerned about the influx of inexperienced retail investors into the market. As a result, they implemented already in 2020, a restriction[3] that only professional investors could invest in complex bond products. This complexity was often due to the limited data transparency required to issue these kinds of bonds. This means that real estate developers had two options how to issue their bonds: 1) bonds for the public, which required higher transparency, or 2) bonds for professional investors, which required limited information and were not subject to regulation (LuatVietnam, n.d.).

Despite the government's efforts to protect retail investors, individuals found ways to circumvent the VND 2 billion asset requirement to qualify as professional investors (it was only necessary to have the VND 2 billion assets on account for one day). This means that retail investors could qualify as professional investors and buy the bonds that were subject to limited regulation. For real estate developers, this means that they could easily issue bonds for "professional" investors where no regulation was required as the number of investors was more or less the same as the public (Anh, Nhung, & Thao, 2022).

This circumvention of the regulations drew attention to the need for tighter supervision and stricter adherence to the intended criteria. Especially as the situation in the bond market deteriorates: More and more real estate developers defaulted on their bonds and private investors lost their investments. Furthermore, most private investors were

[2] LCY = Local-currency bonds / FCY = Foreign-currency bonds

[3] Decree No. 153/2020/ND-CP

also unaware of the risks, thinking that buying bonds was like making bank deposits – which was how it was sold by some bank tellers. (Kokalari, 2023; Mai & Hoa, 2023). The situation has been further inflamed by investor protests, such as in Ho Chi Minh City, where private investors complained to the Saigon Commercial Joint Stock Bank that their supposedly safe bond investments had become worthless (Mai & Hoa, 2023).

In response, the government intervened by introducing new regulations[4] to curb these practices (Huyen, 2022). Nevertheless, as shown in the figure 12, this new regulation led to a significant decline in total bond issuance (This is also an indicator that the market was dominated by private investors who did not have the VND2 billion assets for 180 days to be a professional investor). The decline in investor confidence to invest more in bonds created significant liquidity problems for real estate developers, jeopardizing the progress of several construction projects.

Figure 12 Domestic Corporate Bonds issue activities over the last months (FiinRatings, 2023b).

Following pressure from the real estate industry and the concern that numerous construction projects will no longer be completed, the government later revised these new implemented rules with a few months and eased the restrictions.[5] This decision was driven by the need to provide support to real estate developers to enable them to secure the necessary financing and maintain ongoing projects (LuatVietnam, 2023). This easing of bond market regulations offered a lifeline to the real estate sector, addressing liquidity challenges and providing opportunities to continue with their projects (Ha, 2023). Nonetheless, from a regulatory perspective, the current bond market has the same problems and dangers as at the beginning of the bond float of real estate developers. Especially under the circumstances that the default rates were still quite high and most of the investors were not professional but retail investors.

3.5 Failure of Vietnam's (legal) Institutions

Apart from the potential economic impact and risks that the high default rates of real estate developers pose to the Vietnamese overall economy, there is also the risk of losing confidence in the Vietnamese financial market in general - especially for retail investors.

However, the challenges of regulating bond issuance and combating regulatory evasion demonstrate in particular the importance of strengthening Vietnam's legal institutions to ensure long-term transparency, fairness, and strong investor protection.

Overall, the situation in the bond market reveals weaknesses in regulatory quality, as the easy circumvention of qualification criteria to be considered a professional investor indicates regulatory shortcomings. From the beginning, the legislator has failed to find a regulation that truly declares the professional investor as such. In addition, with the latest decree, the situation of the origin continues to be the same and the shortcomings are still consciously considered.

In addition, the governmental effectiveness in the bond market seems to be ineffective, as it is not possible to prevent uninformed investors from buying risky products based on clear and straightforward laws. In addition, the effective use of the laws did not ensure that the regulator was able to assess the situation in the best possible way and to better calibrate the consequences of the regulatory measures. This was particularly illustrated by the fact that Decree No. 65/2022/ND-CP was repealed after only a few months.

In addition, the "back and forth" nature of regulatory changes, at first the overall weak regulation, then excessive regulation, and then a return to the initial situation, undermines government integrity. This not only undermines the integrity of government, but also reduces the credibility of legal institutions by appearing to change too quickly. This also carries the risk that market participants cannot rely on the long-term nature of laws. This makes planning for all market participants much more challenging, increases transaction costs and reduces trust.

Another concern is the control of corruption in the market. The fact that real estate developers can issue bonds that are not subject to significant public disclosure requirements creates a high risk of corruption. Also, the behavior of banks offering bonds to customers with hardly any regulation and selling them as "bank deposits" casts a questionable light on the market.

In summary, weaknesses in legal institutions, i.e., regulatory quality, judicial effectiveness, government integrity, and anti-corruption, have been a critical factor in the emergence of this current market turmoil. In addition to the current problems in the bond and real estate markets, this may lead to far-reaching problems for Vietnam's overall economy. Therefore, it is particularly important to draw important conclusions from the current situation and to enhance the (legal) institution over the years.

[4] Decree No. 65/2022/ND-CP

[5] Decree No. 08/2023/ND-CP

6. Implications

An examination of Vietnam's (legal) institutions reveals that there have been very limited improvements over the past 25 years. The control of corruption, the quality of regulation, rule of law, and especially the effectiveness of the judiciary has remained at the same level for many years. However, there have been some positive trends, particularly in the areas of property rights and government integrity. Nevertheless, all these indicators remain below average compared to other ASEAN countries.

Despite Vietnam's significant economic growth in recent years, this progress has not translated into institutional improvements. This is particularly the case in the financial sector. Vietnam does not have a significant financial center and ranks in the bottom quartile in global and ASEAN comparisons. Although there has been some improvement in financial development, Vietnam still lags behind the ASEAN average.

As Vietnam strives to become a developed country with a high level of income by 2050, a strong financial sector is of critical importance to the country. A first beneficial step towards improvement is to establish the necessary framework through well-functioning (legal) institutions.

Accordingly, the following measures may be considered:

Strengthening Rule of Law: An independent and efficient judiciary is essential for ensuring legal stability, judicial effectiveness, and the rule of law. Reforming the judicial system and ensuring the independence of the judiciary are crucial. Improving judicial institutions involves various measures to increase their efficiency and fairness. These include:

Ensuring that all people have equal access to justice, regardless of their financial status, their background, their nationality, or any other individual factor. In addition, the use of technology to streamline processes, reduce paperwork and increase overall efficiency can enhance the effectiveness of the judicial system. Ensuring transparency and accountability is also critical, with accessible legal processes and mechanisms to address misconduct. Along this process, continuing legal education is an important factor in improving the quality of legal representation and decision-making. Another factor that can improve legal institutions is the active engagement of people and the community, as it can promote trust and understanding of the legal system. It can also be beneficial to promote cultural sensitivity to ensure fair treatment and communication for diverse populations. Finally, international cooperation with international institutions or other countries that are leaders in the rule of law can provide an opportunity to learn from best practices and collaborate on global legal issues.

Anti-corruption fight: Corruption remains one of Vietnam's biggest challenges. Implementing strict anti-corruption measures and promoting transparent governance can boost investor and business confidence. In addition, strong anti-corruption units can actively fight corruption.

Encourage Freedom: Freedom is a cornerstone not only in the realm of legal institutions, but in all institutions. The freedom of individuals in a society or organization to express their opinions, beliefs, and ideas without fear of repression or retaliation is a human right. This freedom extends to the right to participate in decision-making processes and to have a voice. Moreover, freedom and economic well-being are closely intertwined. Economic freedom can contribute to prosperity, poverty reduction, human development, and social participation.

Financial sector development: While institutions are fundamental building blocks for financial sector development, building modern financial infrastructure, promoting fintech initiatives and strengthening the banking sector can be supported to enhance confidence in the financial market and attract investment. In addition to the above, improving financial literacy and consumer protection are another important priority. By educating the public about financial products and risks, and putting in place robust consumer protection measures, citizens may be more informed in their choices, contributing to a sounder and more resilient financial ecosystem.

In addition, fostering cooperation between the public and private sectors is essential to promote innovation and inclusiveness in the financial sector. Partnerships can facilitate the development of innovative solutions, expand access to financial services for underserved populations, and promote overall economic growth.

Finally, implementing a sound regulatory framework and ensuring effective supervision are critical to maintaining financial stability and mitigating systemic risks. A well-regulated financial system may foster investor and stakeholder confidence and promotes a resilient and dynamic financial sector that can support Vietnam's economic development goals.

Financial Education: By educating and ensuring the public about the basic functioning of the economy and the financial sector, Vietnamese (private) investors can be provided with important tools. This could empower them to evaluate investment decisions and to better assess financial transactions (or in the current case, real estate transactions) and their risks. In the long run, this may improve transaction costs in the Vietnamese financial system and promise a better allocation of financial resources.

Overall, improving (legal) institutions can contribute to the development of Vietnam as a financial center in the future. Moreover, the positive impact of institutions is not limited to the financial sector, rather it can foster the development of all sectors of the economy and society, promising growth, and prosperity in the long run. At the same time, improving institutions requires a willingness to change, the participation of all citizens, and an ongoing process.

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Appendix I – GFCI 33

Overview Financial Center in the Asia / Pacific region

Center / City	GFCI 33 Rank	GFCI 33 Rating	Rank (+/-)	Rating (+/-)	Region
Singapore	3	723	0	-3	Asia/Pacific
Hong Kong	4	722	0	-3	Asia/Pacific
Shanghai	7	717	-1	-6	Asia/Pacific
Seoul	10	714	1	-4	Asia/Pacific
Shenzhen	12	712	-3	-8	Asia/Pacific
Beijing	13	711	-5	-10	Asia/Pacific
Sydney	15	709	-2	-7	Asia/Pacific
Tokyo	21	703	-5	-10	Asia/Pacific
Melbourne	28	696	3	-2	Asia/Pacific
Guangzhou	34	690	-9	-14	Asia/Pacific
Qingdao	36	688	0	-5	Asia/Pacific
Busan	37	687	-8	-13	Asia/Pacific
Osaka	38	686	-1	-6	Asia/Pacific
Chengdu	44	680	-10	-15	Asia/Pacific
Wellington	52	672	-6	-10	Asia/Pacific
Kuala Lumpur	58	641	-2	-31	Asia/Pacific
Mumbai	61	631	9	14	Asia/Pacific
Taipei	63	629	-8	-44	Asia/Pacific
New Delhi	65	627	3	8	Asia/Pacific
GIFT City-Gujarat	67	625	8	13	Asia/Pacific
Bangkok	71	621	8	13	Asia/Pacific
Dalian	72	620	8	13	Asia/Pacific
Nanjing	75	617	8	13	Asia/Pacific
Tianjin	79	612	8	12	Asia/Pacific
Hangzhou	80	611	5	9	Asia/Pacific
Jakarta	83	608	12	16	Asia/Pacific
Xi'an	105	586	13	55	Asia/Pacific
Manila	108	583	-5	-1	Asia/Pacific
Wuhan	111	571	8	70	Asia/Pacific
Ho Chi Minh City	***112***	***567***	***-8***	***-11***	***Asia/Pacific***

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