Implications of financial liberalization for Vietnam's long-term growth prospects

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Abstract: Financial liberalization is a widely adopted policy for countries to enhance growth. Financial liberalization enables financial institutions to proceed with innovative activities by familiarizing themselves with fewer mortgage loans in the financial market. Financial liberalization is a widely adopted policy for countries to enhance growth; however, it is a complex and controversial issue, with different studies providing contrasting perspectives. Financial liberalization is considered an efficient way to measure and change the financial market and structure in order to reach a position to get financial liberalized markets under an efficient and effective guideline. In the case of Vietnam, very few scholars have investigated the issue of financial liberalization-led growth. This endeavor examines the effects of financial liberalization on economic growth in the presence of control variables for Vietnam over the period of 1990 to 2021. This study uses the Autoregressive Distributive Lag Model approach due to its several advantages. The results show that financial liberalization enhances economic growth, which implies that more liberalization results in enhanced growth in Vietnam. Improved access to credit is another positive outcome of financial liberalization, as it can result in greater access to credit for individuals and businesses, enabling them to make investments and expand their operations. Hence, the results support the neo-liberal view of liberalization.

Keywords: ARDL, Economic growth, Financial liberalization, Vietnam.

1. Introduction

Financial liberalization is the removal of restrictions on the financial sector, resulting in greater competition, efficiency, and internationalization [1]. Hence, financial liberalization enables financial institutions to precede innovative activities by familiarizing themselves with fewer mortgage loans in the financial market. Financial liberalization is a widely adopted policy for countries to enhance growth; however, it is a complex and controversial issue, with different studies providing contrasting perspectives [2]. Financial liberalization is considered an efficient way to measure and change the financial market and structure in order to reach a position to get financial liberalized markets under an efficient and effective guideline. When a nation’s economy applies this reaction to their state’s economy, a phenomenon called financial liberalization, financial openness, or fiscal liberalization [3]. Financial openness brought into existence by introducing the money description and also by applying financial despotism strategies in addition to limitation on external possession. Financial liberalization or financial evolution is very helpful for different criteria of the nation’s economy. An advanced financial organization of an economy plays a bright role and key character in the enlargement of the economic evolution of a state [4, 5].

In the initial stages of the 1970s, unindustrialized nations, here by unindustrialized nations we mean under developing countries’ first focus on infrastructural expansion. In this time, the developing countries assumed that such investments would serve as a key indicator and provide the way toward industrialization and economic growth of the developing state. So, these countries move toward
focusing on the construction of roads, bridge connections, communication linkages and channels, etc. At this time, these states believed that a well-performing organization would be able to encourage the private sectors to invest in new plans that would encourage economic growth. Though the development of agronomy, industrial sectors, and service area sectors of the country may reach targeted profitable levels; on the other hand, an isolated segment investment may have no ability to rise as expected because the assets were not managed professionally due to supremacy snags and exceedingly well-ordered monetary arrangements through the supervisory specialist. When a situation was founded that economic growth over infrastructural change miscarried, due to this flaw, developing countries became discouraged from this way of economic development. Then these developing countries made shifts from infrastructural development toward financial sector development, which means that developing countries became too involved in the process of financial liberalization or financial openness. In the initial period of the 1970s, the financial zone of most advanced economies was already in a liberalized position, while in most underdeveloped economies it was particularly blocked. The liberalization progress was continuous and under practice in most regions, excluding Latin America, due to a vital reverse observed in the 1980s. At the start of the 1970s, liberalization was in speedy motion in Latin American states.

This was essentially determined by the southern cone countries, which were involved in the laissez-faire concept of financial strategies that mainly involved a continuous, clear private contribution role in financial markets instead of straight government intervention in economic decisions of the state. The financial systems were gaining popularity in underdeveloped countries, which were categorized by their small official variety and the minor convenience of substitute financial tools, procedures, techniques, and resources. On the other hand, there was also a solid connection between managements and banks, with often supporting the government expenses. Moreover, the market positions of many of these nations were noticeable, with a small variety of savings rates and a poor appearance of productions to credit, which contributed significantly to the economic development of the state. Thus, these nations got a position and started to follow some plans of financial liberalization with the objective and goals of reaching better macroeconomic as well as microeconomic acts and higher fiscal development over and done with the linkage of monetarist organization expanding and financial organization growth and development [6].

Financial liberalization can have positive implications for economic growth in Vietnam. One of the main benefits is increased foreign investment, which can provide a boost to the economy and spur growth. However, the legal system in Vietnam remains weak, impeding the development of financial sector. Improvements, lawful infrastructure, and implementation are therefore essential. Big public sector borrowing to finance financial deficits as well as sufferers of state-owned enterprises has added to the weaknesses of the banking system. The self-satisfaction of the banks, who were going to charge greater than market prices for actions such as product financing, has been removed to low-risk biased assets in their collection by loaning to the government, and thus the demonstration higher capital competency ratios and larger profits could have thoughtful consequences on economic growth, employment, financial exclusion, and price constancy in the future. This is the basic point that has put the financial steadiness of Vietnam most in danger on the economic side. The financial sector improvements started in the latest period, which was given the name of first generation reorganizations in Vietnam, which completed the numbers of development, but similarly, at the mean tie, some of the trials gained were fairly difficult. The program for the process of achievement is allocation for further multifaceted in second-generation reorganizations and the need for outstanding responsiveness and attentiveness is even more persistent. The next generation of transformations should be fabricated on the strong suit of the financial structure, work on eliminating the flaws and breaks in the current financial structure, and have to be studied endlessly to adapt them according to the varying situations both nationally and globally [77]. In the case of Vietnam, financial liberalization has been important for the country’s economy in several ways. First, with financial liberalization, more private banks and other financial institutions have entered the market, providing consumers and businesses with a wider range...
of financial products and services. This increased competition has made credit more widely available and affordable, supporting economic growth and development. Second, by opening up its financial sector to foreign investors, Vietnam has been able to attract more foreign capital, which has helped to spur economic growth and development. Third, by reducing government interference and regulations, financial liberalization has encouraged innovation and competition in the financial sector, leading to more efficient and effective use of resources and ultimately supporting economic growth. Financial liberalization has been a significant contributor to Vietnam’s economic progress, facilitating enhanced credit accessibility, foreign investment attraction, and efficiency enhancement.

This study explores the influence of financial liberalization on the economic growth of Vietnam over the period from 1990 to 2021. This endeavor finds out the possible solutions and important strategies for the economic growth of Vietnam on the basis of financial liberalization or financial openness. It will help us improve economic growth as well as the well-being of the country. This research paper is of interest to policymakers, economists, and financial experts who are concerned with understanding the effects of liberalization. By synthesizing the existing literature and providing new insights, this paper contributes to the ongoing debate on the role of liberalization in helping growth.

2. Literature Review

The issue of financial liberalization (FL)-led growth is extensively studied by different researchers in the context of different economies [2, 8-17]. FL refers to the process of removing government limits on the financial sector, leading to greater competition, efficiency, and internationalization. The impact of FL on growth is a complex and controversial issue, with different authors providing contrasting perspectives. Some studies have found a positive correlation between FL and economic growth Abiad, et al. [18]; Fowowe [19]; Fowowe [20]; Levine [21]; Mattoo, et al. [22]; Reinhart and Tokatlidis [23]; Rioja and Valev [24]; Schmidt-Hebbel and Servén [25]; Shrestha and Khoshed [26]; Tang and Liu [27] and Williamson and Molly [28]. Hye and Wizarat [28] argue that FL leads to an increase in access to finance, improved allocation of resources, and increased efficiency, which in turn fuels economic growth. Others have argued that FL can lead to increased financial instability and, hence, low economic growth [6, 28-36]. A recent paper by Nguyen, et al. [37] provides updated evidence on the influence of FL on growth. They find that the literature provides conflicting evidence on the effects of FL. Banam [8] employed time-series techniques to gauge the influence of financial liberalization on growth in Iran. The conclusion showed that capital, financial mediation, and Research &Development (R&D) are significant and positively correlated with growth. While, the reserve requirement is insignificant and negatively associated with growth, exports showed an insignificant but positive association with growth, while labor showed a negative and insignificant association with growth.

Another paper by La Porta, et al. [13] reaches similar conclusions, finding that FL leads to improved resource allocation and a more stable financial sector, thereby promoting growth. On the other hand, some authors have argued that FL can have a negative impact on growth. For example, a paper by Okoye, et al. [30] argues that FL can lead to greater financial instability, as increased competition can result in riskier lending practices. Hye and Wizarat [28] examined the association between FL and growth in Pakistan for the time span of four decades. The results of the ARDL approach showed a positive association between growth and FLI in short run. Nevertheless, FL is not associated with growth in the long run. Hence, the paper rejected neo-liberal world in the long run. Capital and labor are positively correlated with growth. Nwadiubu, et al. [38] carried out the study to find out the role of liberalization in the growth of Nigeria. The authors found that liberalization is positively correlated with growth in Nigeria. Similarly, a paper by Bumann and Lensink [12] argues that FL can lead to increased income inequality as access to finance remains limited for certain segments of the population, leading to an unequal distribution of the benefits of growth. Orji, et al. [39] also studied the impacts of FL on growth in Nigeria for the period 1981 to 2012. The authors found robustly positive effects of private investment and liberalization on growth in Nigeria. Despite its negative
consequences for income inequality and poverty, several studies argue that FL is beneficial for economic growth \cite{6, 21, 39-52}.

In the case of Vietnam, very few scholars have investigated the issue of FL-led growth Le, et al. \cite{5}; Tran-Nam \cite{53}; Qiuhe and Anni \cite{54} and Jincheng and Liyong \cite{55}. Le, et al. \cite{5} argue that FL has had a positive impact on growth in Vietnam. They find that the expansion of the financial sector, facilitated by FL, has led to increased access to finance for businesses, which in turn has spurred investment and growth. Tran-Nam \cite{53} presents a different perspective, arguing that while FL has increased access to finance, it has also led to increased financial instability in Vietnam. According to the author’s argument, the presence of instability has had a detrimental effect on economic growth, resulting in less investment and diminished levels of economic activity. In conclusion, the literature suggests that the impact of FL on economic growth in Vietnam is complex and multi-faceted. On the one hand, it has facilitated the development of the financial sector, resulting in increased access to finance. On the other hand, FL has also led to increased competition and financial instability, which have dampened growth.

In conclusion, the impact of FL on economic growth is complex and depends on a number of factors, including the specific context in which it occurs and the degree of government intervention. The literature does not agree on the effects of FL and growth. Some studies have found a positive relationship between FL and growth \cite{2, 8, 11, 30, 50}, while others have argued that FL can lead to increased financial instability and hence low economic growth \cite{13-17}.

3. Methodology

This study explores the influence of FL on economic growth of Vietnam over the period of 1990 to 2021. This section is categorized the analytical structure and is further split into following parts:

3.1. Model Specification and Data

The econometric model used for this study is given below

\[ Y_t = \beta_0 + \beta_1 \Delta Y_{t-1} + \beta_2 \sum_{i=0}^{p} \Delta F L_{t-i} + \beta_3 \sum_{i=0}^{p} \Delta Z_{t-i} + \lambda_1 Y_{t-1} + \lambda_2 FL_{t-1} + \lambda_3 Z_{t-1} + \mu \]  

(1)

Where \( Y \) represents the economic growth rate, \( FL \) represents financial liberalization, \( REER \) represents the real effective exchange rate, which is the measure of the value of a currency against a weighted average of several foreign currencies, and \( PINV \) represents private investment, which is measured by gross fixed capital formation. The data for economic growth, financial liberalization, \( REER \), and \( PINV \) for Vietnam were collected from the IMF \cite{56}. Data on financial liberalization were collected from the General Statistics Office of Vietnam (GSO).

3.2. Econometric Technique

To estimate model 1, this study uses Autoregressive Distributive Lag (ARDL) Model. The basic reason for applying the ARDL is that it has several advantages. ARDL provides precise and consistent estimates, particularly in small sample spaces. Moreover, ARDL estimates are efficient while tackling the problem of endogeneity. The ARDL equation is given as:

\[ \Delta Y_t = \alpha + \beta_1 \sum_{i=0}^{p} \Delta Y_{t-i} + \beta_2 \sum_{i=0}^{p} \Delta F L_{t-i} + \beta_3 \sum_{i=0}^{p} \Delta Z_{t-i} + \lambda_1 Y_{t-1} + \lambda_2 FL_{t-1} + \lambda_3 Z_{t-1} + \mu \]  

(2)

Where \( Y \) represents real Gross Domestic Product (GDP) growth rate, \( FL \) represent financial liberalization variables. \( Z \) represents control variables. Wald test is applied to check the restrictions on model 1 (Ho: \( \lambda_1 = \lambda_2 = \lambda_3 = 0 \)). The equation for estimating long run coefficients of ARDL is given below:
4. Results and Discussion

In the first section, the Augmented-Dickey-Fuller (ADF) and Phillips-Perron (PP) unit root tests are used to determine whether or not the data are stationary. The findings are shown in Table 1, which indicate that the variables have a mixed order of integration. This paves the way for the application of the ARDL econometric technique.

$$Y_t = \alpha + \lambda_1 \sum_{i=1}^{p} Y_{t-i} + \lambda_2 \sum_{i=0}^{p} FL_{t-i} + \lambda_3 \sum_{i=0}^{p} Z_{t-i} + \mu_t$$

Table 1. Unit root results

<table>
<thead>
<tr>
<th>Variables</th>
<th>ADF (Drift&amp; trend)</th>
<th>P- P (Drift&amp; trend)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Level</td>
<td>1st diff</td>
</tr>
<tr>
<td>Y</td>
<td>-5.47*</td>
<td>----</td>
</tr>
<tr>
<td>FL</td>
<td>-5.62*</td>
<td>----</td>
</tr>
<tr>
<td>REER</td>
<td>-0.52</td>
<td>-3.53**</td>
</tr>
<tr>
<td>PINV</td>
<td>-2.81</td>
<td>-7.62*</td>
</tr>
</tbody>
</table>

Note: *, ** and *** shows significance at 1%, 5% and 10% level.

In the next section, the optimum lag length of 1 is obtained through Akaike Information Criteria. Moreover, the F-statistic value is significant at lag length of one, which indicates the long run relationship among the variable of model 1. The results are provided in the following Table 2:

Table 2. Testing for co-integration.

<table>
<thead>
<tr>
<th>Order of the lags</th>
<th>AIC</th>
<th>HQ</th>
<th>SBC</th>
<th>F-test statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>K = 1</td>
<td>71.58*</td>
<td>71.73*</td>
<td>72.48*</td>
<td>3.58**</td>
</tr>
<tr>
<td>K = 2</td>
<td>73.61</td>
<td>73.13</td>
<td>74.28</td>
<td>2.29</td>
</tr>
</tbody>
</table>

Breusch-Pagan-Godfrey heteroscedasticity test: 3.52(0.41)
Jarque-Bera tests = 0.95 (0.52)
LM tests = 0.88 (0.52)

Table 3 presents the results of the ARDL method. The ARDL’s estimates show that FL is positively associated with economic growth. The sign of FL is negative, which might be due to the fact that more liberalization often results in hampering growth in developing countries. Improved access to credit is another positive outcome of FL, as it can result in greater access to credit for individuals and businesses, enabling them to make investments and expand their operations. Increased competition in the financial sector is another benefit of financial liberalization, leading to a more efficient allocation of resources and improved economic performance. Moreover, FL can also promote macroeconomic stability, providing a more favorable environment for economic growth. Nevertheless, it is important to note that FL can also have potential downsides, such as increased economic volatility and the unequal distribution of benefits, which must be carefully considered and monitored. Overall, the positive impact of FL on economic growth in Vietnam will depend on the specific circumstances of the country and the effectiveness of accompanying policies and regulations. The estimates show that PINV is positively associated with economic growth. The impact of private investment on economic growth in Vietnam is a complex issue with multiple implications. Private investment can bring in new capital, technology, and expertise, leading to the creation of new businesses, jobs, and increased economic activity. This can drive economic growth and improve the standard of living for the population. The results also show that the real effective exchange rate is negatively associated with economic growth. The negative impact of REER on economic growth in Vietnam has implications for Vietnam’s economy and its citizens. One of the main
implications is a reduction in competitiveness for domestic firms, leading to a decline in exports and a decrease in economic growth.

<table>
<thead>
<tr>
<th>Variables</th>
<th>Coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td>Y (-1)</td>
<td>0.048**</td>
</tr>
<tr>
<td>FL</td>
<td>0.053***</td>
</tr>
<tr>
<td>REER</td>
<td>-0.048*</td>
</tr>
<tr>
<td>PINV</td>
<td>0.092*</td>
</tr>
<tr>
<td>C</td>
<td>1.491*</td>
</tr>
</tbody>
</table>

Adjusted R² = 0.96
F-statistics = 13.31 (0.000)
Dh Stat = 1.91

Table 3. Results of ARDL approach.

5. Conclusion

Financial liberalization is a widely adopted policy for countries to enhance growth; however, it is a complex and controversial issue, with different studies providing contrasting perspectives. Financial liberalization is considered an efficient way to measure and change the financial market and structure in order to reach a position to get financial liberalized markets under an efficient and effective guideline. In the case of Vietnam, very few scholars have investigated the issue of FL-led growth. This study investigates the financial liberalization-led growth in Vietnam over the period from 1990 to 2021. Furthermore, this study critically reviews the financial liberalization and related economic growth processes in Vietnam. This endeavor finds out the possible solutions and important strategies for the economic growth of Vietnam on the basis of financial liberalization or financial openness. It will help us reduce income inequality and improve economic growth as well as the well-being of the country. This research paper is of interest to policymakers, economists, and financial experts who are concerned with understanding the effects of FL. By synthesizing the existing literature and providing new insights, this paper adds to the literature on FL. Using the ARDL approach, we find that FL enhances economic growth in Vietnam. The long-run regression results suggest that financial liberalization negatively affects economic growth. The results did not support the neo-liberal view of liberalization. This study imparts better policy recommendations for the financial liberalization policy as more liberalization may further hamper the growth process in the long run. Financial liberalization has been important for Vietnam’s economy in several ways. With financial liberalization, more private banks and other financial institutions have entered the market, providing consumers and businesses with a wider range of financial products and services. This increased competition has made credit more widely available and affordable, supporting economic growth and development. Second, by opening up its financial sector to foreign investors, Vietnam has been able to attract more foreign capital, which has helped to spur economic growth and development. Third, by reducing government interference and regulations, financial liberalization has encouraged innovation and competition in the financial sector, leading to more efficient and effective use of resources and ultimately supporting economic growth. Overall, financial liberalization has played an important role in Vietnam’s economic development, helping to improve access to credit, attract foreign investment, and boost efficiency.

The positive impact of FL on economic growth in Vietnam has several important policy implications. Firstly, policymakers should continue to encourage and support the FL by removing restrictions and regulations that limit competition and innovation. Secondly, the government should focus on strengthening the regulatory framework to guarantee that the monetary sector operates in a safe and stable manner. Additionally, policymakers should work to improve financial education and literacy among the general population, as this will encourage greater participation in the financial sector.
system and promote economic growth. Additionally, it is imperative to foster initiatives aimed at promoting foreign investment within the financial sector, as this will facilitate the infusion of capital, technological advancements, and specialized knowledge necessary for the expansion and development of said sector. Overall, continued FL in Vietnam has the potential to drive economic growth and development, and policymakers should take an active role in promoting these positive impacts.

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**Competing Interests:**
The author declares that there are no conflicts of interests regarding the publication of this paper.

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