

VIETNAM POST WTO ACCESSION: MICROFINANCE AND ACCESS TO CREDIT FOR THE RURAL POOR

Report
27 June 2008



Centre for Development and Integration ***Research team:***

176 Thai Ha, Dong Da, Ha Noi, Vietnam -
Tel: 84 4 2163615 / 2163617 - Fax: 84
4 5377479
Email: info@cdivietnam.org
Website: www.cdivietnam.org

Ha Hoang Hop, Ph.D. (Team Leader)
Nguyen Minh Huong MA
Ngo Thi Minh Huong, MDM

TABLE OF CONTENTS

INTRODUCTION.....	3
CHAPTER 1 INTRODUCTION	4
1.1 BACKGROUND	4
1.2 OBJECTIVES	5
1.3 SCOPE OF THE STUDY.....	6
1.4 METHODOLOGY:	6
1.5 LIMITATIONS OF THE STUDY	8
CHAPTER 2 CONTEXT ANALYSIS: GLOBALISATION, WTO AND RURAL MICROFINANCE SERVICE – OPPORTUNITIES AND CHALLENGES	9
II- 1 GLOBALISATION AND THE WTO	9
II- 2 WTO CHALLENGES: VIETNAM IN THE FIRST TWO YEARS AS WTO MEMBER (2007-2008).....	10
II.3 POLICIES IN BANKING AND FINANCIAL SECTOR IN FACING WITH WTO CHALLENGES	12
CHAPTER 3 RURAL CREDIT AND MICRO FINANCE SERVICES - DEVELOPMENT TREND	17
III.1 HISTORICAL VIEWS AND DEVELOPMENT EXPERIENCE OF MICROFINANCE	17
III.3 COMPETITIVENESS OF MICRO FINANCE SECTOR IN VIETNAM.....	21
<i>III.3. 1 Supply</i>	21
<i>III.3.2 Demand side</i>	24
<i>III.3.3 Challenges and Opportunities to the microfinance sector</i>	28
CHAPTER IV RURAL CREDIT AND MICROFINANCE FOR VIETNAM – POLICY GAP	36
IV.1 WHAT HAS BEEN DONE REGARDING LEGAL AND REGULATORY FRAMEWORK FOR MICROFINANCE SERVICE IN WTO CONTEXT?	36
IV.2 THE CURRENT MICROFINANCE STRATEGY	41
IV.3 REMAINING POLICY GAPS	42
CHAPTER V RECOMMENDATIONS AND CONCLUSION.....	44
DEVELOPMENT STRATEGY	44
LEGAL FRAMEWORK	45
MFIS OPERATIONS	46
Table 1 – Needs and expectations by each category	26
Table 2 – Loan structure by banks	27
Table 3 Interest rate posted by selected banks (as of 17 June 2008)	29
Table 4 Banks and non-banking credit institutions in Viet Nam	31
Table 5 – Policies roadmap for financial services and Micro finance	36
Table 6; Recommended MF Sector Policy Roadmap	45
Table 7 Recommendations to the operations of MFIs/ Microfinance funds	47
Table 8 Comprehensive Recommendation Matrix	49
Box 1 Observation from the stakeholders consulted on globalisation from the field trips	16
Box 2 The reflection from the 3 visited study field with borrowers and lenders confirm that the recent risk for microfinance services came much from external factors like.....	25

ANNEXES:

Annex 1: Terms of Reference

Annex 2: Field work programme

Annex 3: List of interviewees

INTRODUCTION

The study on “ VIETNAM POST WTO ACCESSION: MICROFINANCE AND ACCESS TO RURAL CREDIT FOR THE POOR” is the result of an effective cooperation among the Center for Development and Integration and ActionAid Vietnam with collaboration with a ActionAid’ Microfinance (M7 network) .

The objective of the study is to present the analysis of policies and possible WTO impact on microfinance services in Vietnam.

The study introduces the analysis of globalization, WTO and policies challenges that may affect rural microfinance sector, in both policies and realities. The study also describes the development of microfinance services with some successful model and that relates to the development of microfinance institutions in Vietnam. With the comprehensive research approach, the strengths, weaknesses, opportunities, and policy gaps to microfinance, combining literature review, data analysis and participatory and stakeholder consultation, the research results indicate some key suggestions for policy makers and practitioners in Microfinance for Vietnam in the future.

Hopefully, this work would establish more basic backgrounds for the research and microfinance policy advocacy within the framework of assistance and cooperation to support and strengthen Microfinance institutions and operations to the poor in Vietnam.

The research has been conducted and written by a research team including Dr. Ha Hoang Hop, Ngo Thi Minh Huong and Nguyen Huong of Center for Development and Integration. Special thanks to Ms. Le Hanh Le, Ta Van Tuan of ActionAid Vietnam, and Dr. Adrianus Gerardus Rijk who provide valuable support and comments during the study. Grateful to M7 and their members and also ActionAid Vietnam’s leadership.

1.1 Background

Vietnam became the 150th member of the World Trade Organization (WTO) in November 2006. This event marks a milestone for trade liberalization, stiff competition, privatization process, and more involvement of foreign agencies in the country's market. WTO membership will require Vietnam to undertake amendments to its trade and financial policy regime to comply with WTO requirements. In the context of financial services, "liberalization" refers to both domestic financial deregulation and the opening of the economy to international trade and capital flows. It also refers to the withdrawal of government intervention through privatizing state-owned banks, freeing key prices such as interest rates to be determined in the market, and easing restrictions on cross-sectoral activities to allow banks, insurance, finance companies to enter each other's sub-sectors.

The negotiations over the financial services agreement (FSA) in the WTO will open the banking sector of Vietnam to foreign involvement, which in some instances will help deepen banking markets and strengthen banking institutions. Domestic financial reforms have the potential to play a role in poverty alleviation. But the link between financial reform and poverty alleviation is not a straightforward one. The poor usually do not transact in the kinds of markets involved. The commercial and foreign banks in most cases are reluctant to step into the informal lending sector as small traders and rural producers are considered to be risky borrowers. At the same time, privatization of public banks may influence their social target and exclude the disadvantaged clients. In this regard, innovative microfinance can be a form of financial development that contributes effectively to poverty alleviation.

Thus, with WTO commitments, there will be opportunities and potential adverse impacts on access to rural credit and financial service. The poor are probably only small participants in the boom, but will often suffer significantly in the bust. Several previous researches indicated that domestic financial liberalization, through giving up control of interest rates and removing credit subsidies, has not translated into high level of savings, but decreased access of the poor to rural credit (Mosley P. (1999a), 'Micro-macro Linkages in Financial Markets: The Impact of Financial Liberalization on Access to Rural Credit in Four African Countries', *Journal of International Development* 11, pp.367 -84.) If these probable effects are not explicitly considered and addressed, poor and excluded people in Vietnam may not benefit and may even be negatively affected .

ActionAid Vietnam started working in Vietnam in 1989 in response to the Hunger Eradication and Poverty Reduction Campaign initiated by the Government of Vietnam. Its programs aim at eradicating poverty of poor women, men, boys and girls by ensuring their rights and entitlements to a life of equity and justice. Since 1993, in partnership with local mass organizations, AAV has developed and facilitated microfinance schemes in rural and mountainous areas. In estimation, more than 30 thousands of households are currently benefiting from these programs. Seven schemes also have been formed to a network namely M7 to promote the partnership, capacity building, and participation in wider microfinance community in Vietnam. With AAV's support, five schemes have transformed their status into MFIs and social funds.

Under a funded project through ActionAid Italy for M7, AAV plans to carry out a study on possible impacts of trade liberalization on microfinance and on access of the poor to financial services (rural credit) in Vietnam. This study also expresses AAV's commitment in advocating for pro-poor policies and monitoring the possible impact of economic integration, post WTO accession.

The term of reference (annex 1) aims to establish initial objectives, scope of work, process, budget, and timing for the completion of the study.

1.2 Objectives

The overall objective of the study is *to assess the opportunities and probable effects of trade liberalization on financial services for the poor in Vietnam*. The specific objectives are as follows:

- To identify accessibility of the poor and excluded people to financial services in the context of WTO membership;
- To assess the coming opportunities, challenges, and potential risks for MFIs in Vietnam, including administration and operation, self-sufficiency, market-based source of fund, and sustainable development;
- To figure out a mechanism of supportive financial service that improves access of the poor to affordable marketing and production credit.

The findings of the study will be used to advocate for pro-poor policies in banking sector. It also provides recommendations for MFI, especially for M7's members on appropriate arrangement and subsequent programs. AAV will use relevant results for its post WTO monitoring systems in other thematic programs.

1.3 Scope of the Study

With respect to the objectives, the study includes three parts: (1) review relevant policies and regulatory framework of banking sectors and microfinance in Vietnam in relation to WTO accession; (2) re-examine the current situation of MFIs and M7's members to identify gaps, challenges, and opportunities for them; (3) draw lessons learned of success and failure from other countries in the region.

At the same time, a study on access to rural credit of the poor of other country under the context of trade liberalization will be conducted. It will review related literature and focus on the case of the Philippines where MFIs have been successfully commercialized and contributing to poverty reduction. It should address the government's role and identify how financial innovations in rural access and the development of MFIs could cater to the poor improved access to rural credit and lower poverty.

It is seen that the study team observed that awareness of people on globalisation is low due to no available dissemination, propaganda... reached people. especially grassroots people. No relevant information upgrades for leadership at local level - province, district, commune - after one year of membership of Vietnam to WTO

“By broadening our current imagining of microfinance, we can harness the process capital more fully and do far more to alleviate poverty”

Fazel Hasen Abed and Imran Matin of Building Resources Across Communities (BRAC-Bangladesh)

1.4 Methodology:

- The study has conducted with literature reviews, individual and institutional interviews in-depth interviews with several key banking agencies such as State Bank of Vietnam, Bank for Agricultural and Rural Development, Bank for Social Policies, some foreign and domestic commercial banks, and potential donors for financial service in Vietnam. The interviews with M7 network helped to analyze opportunities and challenges of MFIs in commercialization, their awareness and strategy for the new context of WTO.

- Literature review includes reviews of relevant legal and regulatory framework for banks and non-banking in relation to WTO accession.
- Field work limits to visit and consultation with M7 in three selected areas: Son La, Quang Ninh and Ninh Thuan province (see annex 2. Field trip programme)
- The field work include individual interviews and sharing workshop with stakeholders where the lead consultant presented the key issues and implication of Microfinance industry and services to get the most relevant comments and inputs from stakeholders. This process can be seen as interventions to raise awareness of WTO impact and advocacy. (annex 3 - list of interviewees). The field work included group work with poor microfinance borrowers and people to verify their access and their feedback on microfinance services.

Analytical framework

The studies follows the Diamond Model in analysing the Microfinance sector for its future strategy and option. The model will help to understand the situation around microfinance in Vietnam including Supply Side (Pull Factor) and Demand Side (Pull Factor) with full mixture of challenges and opportunities as External Environment for Microfinance. The related industries or services relating to Microfinance will also be analyzed in order to understand fully any competition or advantages of the microfinance services in Vietnam.

Research questions:

- How are the poor and other beneficiaries from microfinance's expectations for better access of micro finance services?
- What are the challenges and opportunities for microfinance services in Vietnam in the context of WTO?
- What the government has done to meet the WTO requirements regarding financial services?
- What are the existing policy gaps that challenges the microfinance operations in the context of WTO and to serve the poor in Vietnam?
- The final research question is how microfinance sector can sustain and maintain inclusion of the poor at the same time in the context of WTO accession?

1.5 Limitations of the Study

The study is conducted in Vietnam, with little connection to South East Asia , South Asia and elsewhere in the world where developed microfinance services happened. The study used the secondary data from other literature banking reports and report data from banks also from various sources for its desk review. The study also captures the reflection from stakeholders in the field, with limits to 3 provinces where M7 of ActionAid Vietnam is operating. Hence, in reviewing the microfinance institution operation, the study also gave priority for M7 network, as the microfinance services of NGO sector, initiated under ActionAid Vietnam programme. The field work or in-depth study does not go to other services (like TYM of Vietnam Women Union or CEF in the South and other NGOs programme which are also covering large market share of rural credit). This may imply that the analysis and recommendations on institutional sustainability may not represent for all.

II- 1 Globalisation and the WTO

1. Globalisation consists of complex phenomena that affect every nation today. There are at least three different, albeit related, phenomena that have come to be associated with globalisation. First, global economic integration, which means in effect the standardisation by governments of broadly neo-liberal economic policy solutions and approaches to restructuring their interactions with markets both at home and abroad. Second, the transfer of certain powers from states to other actors, most notably institutions of global and regional governance. Third, there is a global spread of culture or cultures modelled on patterns of social organisations, life style, attitudes and beliefs.

2. Globalisation as economic integration, but in linkage with governance and socio-cultural phenomenon. Economic integration brings changes in the global norms of domestic economic management. The norms are embodied mainly in the latest type of the so-called "Washington consensus" with conditionalities. These conditionalities would restrict the room for manoeuvring of some developing economies. These economies integrate themselves to the world's economy with hope to take more opportunities for development. Opportunities mean challenges and go with challenges. For developing economies, including Vietnam, globalisation is interpreted primarily by international economic integration and accession to the World Trade Organisation. These economies need relevant knowledge, information, experience and cross-cultural understanding in order to be able to draw necessary resources to help develop own economies. Cultures link to socio-economic development. In agriculture and rural development in developing countries, cultures link to poverty reduction's instruments like rural and micro finance.

3. WTO makes decisions on policy and practice for all WTO members. WTO is one of the institutional realities of globalisation, and for developing countries, including Vietnam, WTO is a reality of globalisation and international integration. Two major implications for Rural and Microfinance service development in Vietnam are: (i) WTO conditions on agriculture in the short and medium terms, bring more challenges and difficulties to Vietnam, (ii) WTO conditions and requirements for financial services would be about to bring more opportunities after 2012, when these conditions and requirements fully available. But WTO first and foremost is about trade. Each WTO has the mandates not to WTO but to each nation -member

to link trade and fair trade, fair trade and development, fair trade and the poverty reduction. Rural and Microfinance consists of a relatively small set of technical tools for poverty reduction in rural areas. With respect to financial service in general, Rural and Microfinance is just a small part in the whole volume of financial service for a country like Vietnam.

4. Doi Moi in Vietnam that started in 1986 had enabled opportunities to open up the country to the world's economy. The Government of Vietnam determined to follow its policy of international economic integration. High growth rate for years helped take Vietnam from the list of poorest economies, stabilize the society and sustain development. Hunger was eradicated, reduction of poverty policy and practice helped to reduce significantly the rate of poverty. The first steps on governance reform took place in the end of 1990s with primary policies on public administration reform and anti-corruption. Earlier, in June 1994 Vietnam entered negotiations on membership of GATT, as GATT became WTO in 1995, Vietnam negotiated for WTO membership from 1st January 2005 and completed in the end of 2006 that resulted on the 150th membership of the WTO from 11th January 2007.

5. WTO defines rules for world's trade, in which opportunities are complex and difficult to seize, especially for the case of WTO members who are developing economies. Comparative advantage and the gains from trade have been *status quo* crucial for international trade in the context of WTO. All WTO members must consider the same dimensions of international trade like before accession they had to: exchange rates, effect of tariff, customs unions, protection. In the following, the report presents how Vietnam prepared for WTO accession, and after one year of taking WTO membership, what would be the impacts, especially the impacts to agriculture, agribusiness and poverty reduction.

II- 2 WTO challenges: Vietnam in the first two years as WTO member (2007-2008)

6. The challenges from WTO are clearer in terms of financial stability of the Vietnam economy. Budget deficit in 2007 was told to be more than 5.9 per cent that is one of reasons for high inflation in the first two quarters of 2008. The Government targeted a budget deficit ratio of maximum 3 per cent of GDP, compared to an average budget deficit of about 8 per cent to GDP in the 1980s. The budget deficit had amounted to 1.3 per cent of GDP in 1999, 2.7 per cent in 2000, 2.9 per cent in 2001, 2.3 per cent in 2002 and 2.1 per cent in 2003. The Government of Vietnam also aimed at maintaining a surplus of current revenue over current expenditure at 4.5 per cent of GDP. The respective ratios had been 5.1 per cent

in 1999, 5.2 per cent in 2000, 3.9 per cent in 2001, 5.8 per cent in 2002 and 5.1 per cent in 2003.

7. Political awareness for the accession to WTO had been built up in broad-based balances and consensus on what had been pros and cons. Sometimes, the balances had been in favour of knowledge-based economy more than a deep look to potential consequences of WTO accession to the agriculture and the other activities in the rural areas. The competence and capacity building for the commercial banks and all other financial institutions aims to the 'big' markets, not to the microfinance.

8. WTO has clear policy on transparency and conducts of businesses – the norms and practices of corporate social responsibility (CSR). Transparency and CSR may be the only social dimension of trade policy of WTO that would be supportive to poverty reduction, thus supportive to rural and microfinance. Awareness on CSR had been heightened gradually in businesses and country's leadership. But how to apply CSR practices in local levels, especially in districts and communes, had been still an issue. This is also the issue for microfinance presented later in this study report.

9. Vietnam's trade growth is significant in terms of export of goods. Overall comparative advantage, especially in agricultural goods for export is improved. While the exchange rates remain an issue of how to maximize the managed floating rate mechanism, finance to those production areas who produce export goods is improve significantly. This means the financing and rural crediting to large production of agricultural goods, including mining, oil and gas is better.

10. WTO membership is burdened to developing economy's food and agriculture system: the most important issue is to foster the market to operate. When the market does operate, the farmers and households are, as a rule, free to produce what they want, in the way they decide, and to sell for the best price they can get. The entrepreneurship of million individual farmers and households, together with the dynamism of agribusiness – the sectors that supply inputs to agriculture as well as those which process and distribute the food – have made possible the ample supplies from which consumers benefits.

11. The State intervention under the context of WTO membership will not in supporting prices, but to control production in cases of overproduction, or to promote structural change. There is intervention to agribusiness, too, which – like any other form of business – is subject

to various State controls aiming to curb restrictive practices and monopolistic tendencies. Poverty reduction consists of special policies and practices that afford some social costs together with the common costs to help the poor get out of the poverty. The principles of self-help, self-responsibility and self-administration reflect both economic and social costs in microfinance activities. But these activities will have to be economically sustained similar to what the microfinance in Western Europe has performed, counting the specialities of culture in where the poorest is living.

12. Globalized world brings to Vietnam the tendency of countering against microfinance with major reasons such as: lending regulation would be in favour of profit and not social lending, demand for microfinance is not that high, and profitability and social lending seen as opposites. At the same time, globalized world also brings to Vietnam other reasons for supporting microfinance activities: growing demand, subsidies available, graduation methodology works, no specialised finance institution for micro-enterprises yet for fostering small business. As microfinance shares a small proportion in the whole – some less than 5 per cent of rural credit – linking one –year performances of WTO membership to microfinance solely would be a unclear action. Almost all microfinance service had not been directly linked to the production of export goods, thus the attraction of financial service for microfinance was little.

II.3 Policies in banking and financial sector in facing with WTO challenges

13. The main objective of Vietnam's monetary policy is to stabilize the value of the Vietnamese dong (VND), control inflation and promote socio-economic development. Credits are channelled into activities making full use of the potentials of various economic sectors. The State Bank of Viet Nam (SBV) uses monetary policy instruments such as refinancing, reserve requirements, interest rates, exchange rates, open market operations and other supplementary instruments to regulate the money supply. SBV applied a uniform rediscount rate for all commercial banks since 1999. Credit policy continues to be improved to meet sufficiently the financing requirements for economic growth in line with monetary policy objectives from time to time. The credit mechanism has been amended to become more liberal in order to improve efficiency, improve the autonomy and accountability of credit institutions, and enhance credit quality.

14. Dollarisation of VND would be a big source of risk for Vietnam's monetary system and the economy. In 1989, Vietnam had first applied a managed float flexible exchange rate mechanism in 1989. Foreign exchange transaction centres had been opened at the end of 1991, and an inter-bank currency market for commercial banks had been established in October 1994. The SBV monitored the balance-of-payments and foreign exchange reserves position of Vietnam, and the SBV could intervene in the market as necessary. The SBV published the average transaction exchange rate of the Vietnamese dong against the U.S. dollar in the inter-bank foreign exchange market on a daily basis. Controls on current account transactions had been liberalized. In respect of capital transactions, Vietnam had relaxed capital transfers by foreign investors and foreign borrowing by resident organisations. Vietnam only maintained restrictions on (i) capital transfers abroad for investment by resident organisations, which were subject to approval by the competent agencies and within the amount of foreign currency owned by them; and (ii) payment and repayment of foreign loans by resident organisations, which had to be registered with the SBV.

15. The promulgation of the Ordinance on State Bank of Vietnam and the Ordinance on Banks, Credit Cooperatives and Finance Companies in May 1990 officially transformed Vietnamese banking sector into a two-tier system with the establishment of State Bank of Vietnam (being the Central bank and member of cabinet) and 4 state-owned commercial banks. State Bank of Vietnam (SBV) is responsible for supervision of the banking system in Vietnam and this function is specifically task of SBV Banking Supervision. The organization of SBV Banking Supervision consists of Banking Supervision Department (at H.O.) and Banking Supervision at SBV branches in 64 provinces and cities with more than 700 staffs in total, of which about 100 are working at Banking Supervision Department. To keep pace with the robust development and the opening process of the banking system, modernization and improvement of effectiveness of Banking Supervision's operation have been identified as crucial tasks and a breakthrough in the whole process of developing a modern central bank. To this end, Banking Supervision Department is currently developing a project "Reform and renovation of the organization and operations of Banking Supervision" with the following focuses:

- Renovation of the Banking Supervision's model in the direction of establishing a General Directorate of Banking Supervision within the State Bank of Vietnam with organization structure and functions designed consistent with international best practices;

- Development of a completed legal framework for the new organization and operation of the General Directorate of Banking Supervision, and issuance of prudential regulations in banking operation;
- Reform of operational methodology for banking supervision in the direction of gradual shifting from compliance-based supervision to risk-based supervision, and improving effectiveness and quality of the off-site supervision;
- Enhanced training to improve qualifications of supervisors;
- Strengthened international cooperation by enhancing exchange of information on banking supervision and financial system safety.

16. Measures were taken since 2001 to reorganize State-owned commercial banks in order to improve their efficiency. Assets quality, disciplines, and risk management were improved; policy lending had been separated from commercial credit activities and entrusted to social policy banks; State-owned commercial banks had been required to establish their own credit handbook, which had been applicable since late 2004 - early 2005; and the credit risk management system had been brought into line with international standards. Credit organizations and State-owned commercial banks were required to put in place an internal audit system and a supervisory board responsible for supervising the organization's financial and accounting activities, ensuring the safety of credit operations, and conducting periodic internal audits. Debts and non-performing loans of the State-owned enterprises to commercial banks are high.

152. Under the World Bank's Second Rural Finance Project, the Vietnam Bank for Industrial Development (BIDV) has been appointed to accredit MFIs that satisfy eligibility criteria (in this context MFIs can mean commercial banks, joint stock banks, cooperatives, PCFs, and NGOs) and wholesale credit to them for onlending provided that they satisfy the accreditation criteria. In the course of the project BIDV will undergo substantive institutional reform. If successful, a future consideration may be the use of BIDV as a supervisory intermediary, but for the time being, SBV is effectively the only institution qualified to supervise.

17. In terms of interest rate policies, since 2004, commercial banks can determine their own interest rates. But today, VBARD is in some cases still following interest rates policy suggested by SBV, although VBARD and CCF/PCF have mobilized significant deposits. The NGO and mass organization schemes have set interest rates for their own. VBARD's branches follow strictly the instructions from the VBARD headquarters, no branch can initiate a local policy that limits the flexibility of the bank to meet the local demand for microfinance services by regions or target groups.

18. Other laws developed in accordance to WTO requirements that may relates to investment, business development have somehow put effects on increase of credit activities but may not have impact on development of micro finance in Vietnam.

	Tax reform	
Years	Law and macro policies	Impact GDP ratio from 13.1 per cent in 1991 to 22.6 per cent in 1995 streamlining the tax rate structure, non-discrimination, a broadening of the tax base, improved tax administration
1995	Law on Value-Added Tax	value-added tax (VAT) to replace a turnover tax
2003	Law on Corporate Income in 2003	The amended Law provided for a general tax rate of 28 per cent and preferential rates of 10, 15 and 20 per cent, and for a uniform set of criteria for entitlement to tax incentives for both domestic and foreign-invested enterprises
2005	Investment Law	Meet international treaties: investors' equal access to sources of capital, foreign exchange, land and natural resources, legal instruments and data on the national economy and investment opportunities, and ensured the investors' right to lodge claims, make denunciations or initiate legal proceedings
2003	Land Law	enterprises to mortgage assets associated with land and the value of land use rights to secure loans from all credit institutions permitted to operate in Vietnam
2003	Law on Taxes on the	2 per cent on land used in agricultural, forestry and aquatic production, and 4 per cent on land used for

	Transfer of Land Use Rights	residential, construction and other purposes
2009	A Law on Personal Income Tax, will be effective in 2009	a single tax system compatible with the Law on Value-Added Tax and the Law on Corporate Income Tax

19. Other limitation is that though Vietnam joined WTO for over 1 year but only few people in remote area especially grassroots people and no relevant information upgrades for leadership at local level - province, district, commune - after one year of membership of Vietnam to WTO knows about WTO and its impact due due to no available dissemination, propaganda that might reach people.

Box 1 Observation from the stakeholders consulted on globalisation from the field trips

1. No relevant information upgrades for leadership at local level - province, district, commune after one year of membership of Vietnam to WTO. Leaders had received non-comprehensive information on globalisation and WTO.
 2. Awareness of people especially grassroots people on globalisation is low due to no available dissemination, propaganda... that has reached people.
 3. Mid-levels and officials of VBARD, VBSP are not fully aware on the impacts of globalisation and WTO to their activities especially on how the open-up in financial services would bring opportunities to the MFIs.
- Source: Research Team documentation, 2008*

III.1 Historical views and development experience of microfinance

20. Literature on international experience provides evidence of positive impact of commercial banking development in rural areas mainly in terms of employment creation and poverty reduction.

21. The first microfinance service in Europe was founded in Germany in 1860s by F.W. Raiffeisen in response to the problems of credit in agriculture, crafts and small industries in rural areas at a time of rapid industrialisation together with severe pressures on farm product arising from low-priced imports, while the commercial interest rates were high. Very small co-operative loan societies that based on the principles of self-help, self-responsibility and self-administration: deposits by members formed the basis for loans to members, and profit were re-invested or distributed. As individual societies would be too weak on their own, Raiffeisen formed in 1872 a Union at national level, combining a vertical with a horizontal structure.

22. Today, there are some 60 microfinance services in Western Europe, nearly half of them founded in 2000 or later, with most operate on a small scale. Only several services are in national level, e.g. France Adie and Finland Finerva. There are 10 services having plans to grow their loan portfolio by about 240 percent by 2006. For example, Adie (Association pour le Droit à l'Initiative Economique), founded in 1989, today has 300 employees, 700 volunteers. Target group of Adie consists of unemployed and welfare recipients – this target group shares 50 percent of all borrowers. Adie gives loans up to EUR 5,000 at market rates, government financed start-up grants and non-interest bearing subordinated loans. It gives additionally individual business advice to micro entrepreneurs. The income covers costs only that is around 30 percent. Since 1989, Adie had given loans to 23,000 clients. In 2004, I had 10,000 active borrowers. Another example is Fundació Un Sol Món. Based in Spain, established by the savings bank Caixa Catalunya in 2000, Fundació Un Sol Món operates on regional level. Its target group includes under-privileged people and communities, solo entrepreneurs in the service sector. Its products are traditional bank loans between EUR 5,000 to 8,000. Since end of 2004, the interest rate (6%) covers the risk (4,6%) and starts to cover transaction costs (by now 75%). Since 2000, more than 600 issued microloans with a total volume of EUR 5,6 million.

28 Eastern and Central Asia's microfinance has quickly evolved from a start-up sector to a profitable and sustainable industry. The speed at which the region achieved financial self-sufficiency is of particular importance. As many microfinance organisations strive to reach financial self-sufficiency to cover costs and attract investment, many lessons can be learned from the characteristics of Eastern and Central Asia microfinance. Even with their smaller scale and higher than average operating costs, microfinance organisations in the region rapidly developed a model that leads to positive returns. The sector's profitability stems from the region's strong credit culture, skilled staff, and tightly controlled loan portfolios. Furthermore, microfinance organisations in this regions dedicate more resources to their loan portfolio, their most lucrative asset, than their global peers. Despite its impressive financial performance, the dynamic sector still faces a handful of challenges. It is less efficient and productive than most other regions and has the poorest outreach in th e industry. Although the microfinance sector in many of the region's countries is becoming more sophisticated in terms of product diversification, the region as a whole, still lacks innovation and offers limited savings. Growing competition within the microfinance sector as well as from commercial banks will lead to further innovation, but more importantly, deepen outreach as microfinance organisations are forced to seek new clients. As it continues to develop, the young sector has the benefit of being able to learn from the best practices in other regions. Only in Easter Europe, microfinance continued to grow after 1990s. More than 4,000 organisations, a Gross Loan Portfolio of over US\$ 800 million and over 1,5 million active borrowers in 2003. Eastern Europe has four models (none Western model applied in Eastern Europe): credit unions (more than 4000) , NGO MFIs (31) microfinance banks (3) and downscaling commercial banks. Market penetration estimated 11 percent of the potential demand. Growth rates are stagnating lately (2002 to 2003 only 5 percent) Most credit unions are very small community-based organisations with average loan-portfolios of less than US \$ 100,000 . Well established NGO MFI-sector with a lot of small programmes and some profitable big pla yers like Fundusz Mikro. Since 2002, the largest East European MFI in terms of loan portfolio, active borrowers and outreach is a microfinance bank: the ProCredit Bank Bulgaria (active borrowers 2003: 16,000, loan portfolio: US\$ 790 million) . Based in Poland, Fundusz Mikro established in 1994

- nationwide active (32 branches), 93 employees. Target group: micro -entrepreneurs
- Products: loans for operating micro-enterprises with positive cash flow; use of co-signing as replacement for collateral; graduation pr inciple; operational break-even in 1997/98.
- Since 1994, 33,800 micro enterprises were financed. 11 058 active borrowers in April 2005.

29 In Western Europe microfinance serves different aims: social inclusion, micro enterprise development, development of regions, job creation. Microfinance services give access to finance for start-ups and existing micro businesses and preparing them for access to banks. It provides a tool for local and regional development through investment in deprived communities and fostering indigenous growth, helps build a bridge for the excluded and long term unemployed welfare dependents back into the economy through self -employment. Small enterprises are the job motor of Europe, so micro-investments enable the enterprises to grow and create new jobs.

30 Common activities that the microfinance institutions carried out (that Vietnam's microfinance institutions would learn from) :

- Definition of a product for the mass market
- Socio-economic analysis of the entrepreneurial assets
- Standardised cash-flow analysis
- Collateral and guarantees serve mainly as an incentive/signal, less for collection results.
- Graduation principle: repayment in time opens up additional financing opportunities (larger, longer, cheaper loans)
- Imitation of main features of informal financing („money lenders“): Loan officers are responsible for the whole loan-cycle, achievement-oriented payment (dependent on number, volumes and quality of loans)
- Decentralisation, efficient controlling and IT -support
- Maximization of clients benefits (usability, short process time)

31. The basic Raiffeisen principles have continued to guide the formation of credit co-operatives throughout the world, subject to national differences depending on the existing credit structure, legal provisions and social conditions. In Western Europe, many banks operated in rural areas have more or less related to Raiffeisen system. Today, these banks no longer give micro-loans because they chose to shift out of the microfinance sector, the knowledge and experience have been learned elsewhere in the rest of Europe, Asia – Philippines, China, Bangladesh, and... Vietnam.

23. The experience of India, for example, indicates that the expansion of rural banking can transform production and employment, lead to poverty reduction, and increases in output.

Indian Microfinance increased in recently partly because of self-help group (SHG) and on account of the substantial growth of microfinance institutions (MFIs) offering small value financial services to low income families. The assessment from India on models of microfinance delivery said it ranged from experiment of SHGs of NGOs traditionally to Grameen joint liability groups and individual banking arrangements of the savings and credit cooperative societies. However, in terms of efficiency, the levels of efficiency is not much to choose between microfinance models. The SHG-based MFIs have slightly better staff efficiency than the others. Urban MFIs are able to have far more efficient operations. SHGs and some MIFs are estimated to reach 17 million families by mid-2006 (Finance for the Poor-September 2007. Sanjay Sinha).The key reason for outreach in India include:

- a. Initiatives by NGOs and the greater participation of banks (such as Syndicate and Canara Banks) into the programmes
- b. Better governance by NGOs, SHGs/or MFIs
- c. More vibrant local economies
- d. Higher literacy and participation rate of women in local economic making them more suitable to MFIs

32. Grameen Bank in Bangladesh had followed similar way of doing microfinance business to traditional Raiffeisen system. Grameen Bank extended its activities to cell phone telecommunications (GSM) with Grameen Telecom firm as part of technology application in microfinance business. One of the most crucial dimensions of a succeeded microfinance service is the cultural dimension. However, legal and social conditions in Bangladesh differ from others.

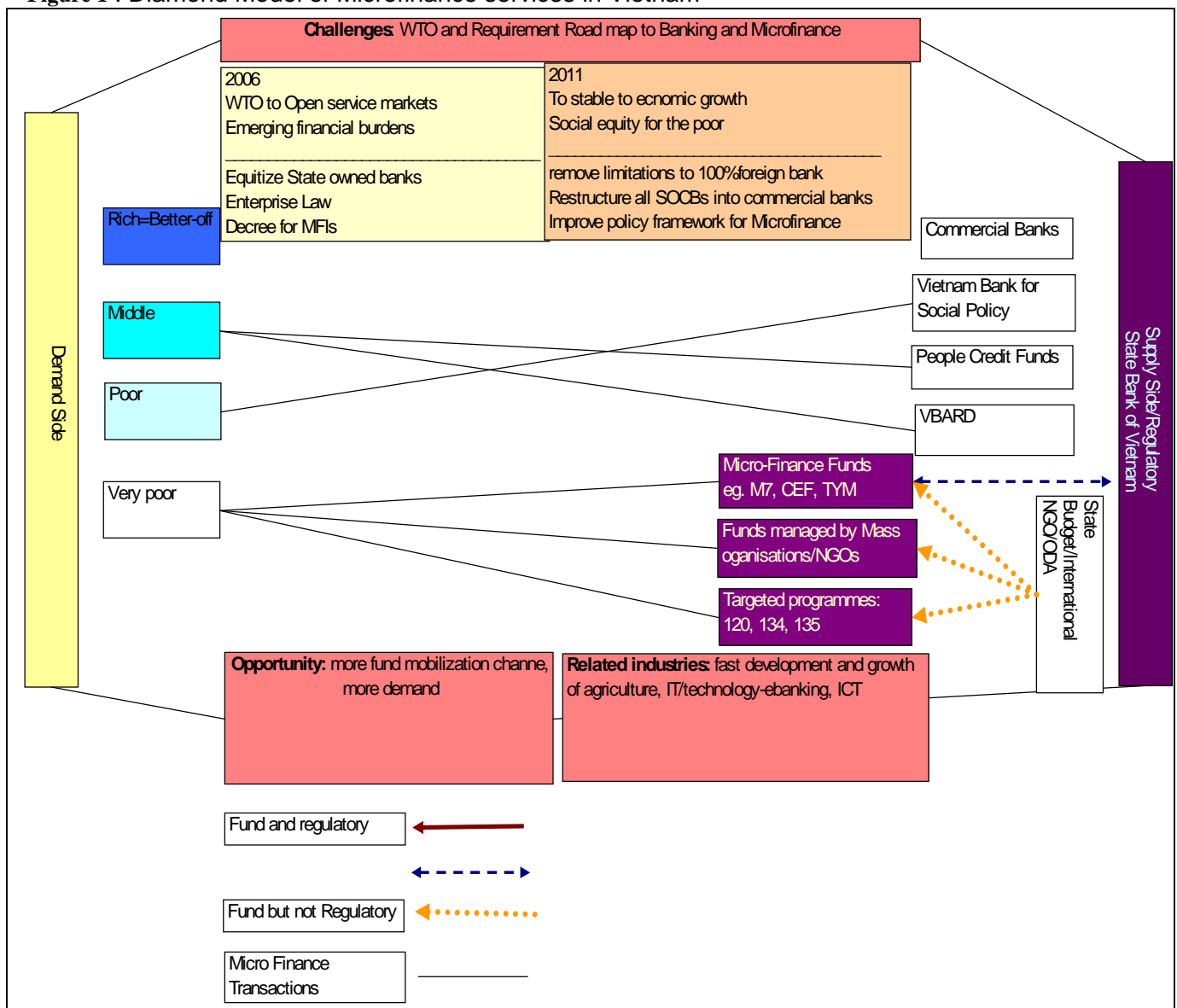
33. In Viet Nam, rural banking has been developed as part of donor funded program, the World Bank funded Rural Finance Project is an example. As part of this project, mobile banking to rural un-served areas is provided by VBA and BIDV; mobile banking cars were first introduced on a large scale in Viet Nam in 2000 and 2001 with 159 mobile banking cars. On average, each mobile banking car visits 62 remote locations per month, adding around 2,000 new savings accounts, worth VND19 billion, and nearly 2,000 new loans, worth VND15 billion; and collecting more than VND10 billion in loan payments a month. These mobile banking operations helped rural households, including ethnic minority households, to maintain and improve their livelihoods through increasing their access to banking services . It would be very beneficial if this model was expanded to banks of other ownership forms not just state -owned banks.

III.3 Competitiveness of Micro Finance sector in Vietnam

Analytical framework: Diamond model

- ⌚ *The microfinance environment, strategy and competitors*: strategic decisions of banks/MFIs or the whole sector generally have impacts on their future competitiveness. Synergized competitiveness will enable MFIs to compete with external rivals in the integration process;
- ⌚ *Supply conditions*: the effectiveness, quality and specialization of inputs, which financial institutions use in their operation to acquire human resources, capital, facilities, technology and science;
- ⌚ *Demand conditions*: in the context of Viet Nam, the sophistication of demand for micro finance services will orientate competitiveness, diversity of services and the sector's technology level; and
- ⌚ *Relevant and supporting industries*: also influence the banking sector's competitiveness through the supply of inputs for the banks. The availability and development of supporting industries including telecommunication, information technology and auditing will increase the productivity and competitiveness of banking services.

Figure 1 . Diamond Model of Microfinance services in Vietnam



III.3. 1 Supply side

34. The provision of microfinance services in Vietnam has been divided into formal, semiformal sectors, now working under some valid laws and regulations like Law on Credit Institutions, Law on Cooperatives and Prime Minister's Decree on Microfinance institution (Decree 28 March 2005) for formal sector and in many case under Decree 179 for non-profit organisations (like case of M7) and some funds under institutional function like TYM of Women Union or CEF of the Trade Union as semi-formal sector

35. **Formal sector** provision of rural financial services is dominated by VBARD, the CCF/PCF network, and VBSP. Combined, they represent over 90% of outreach. VBARD and the VBSP are owned by the state. CCF is partly owned by SBV and partly by its member PCFs. PCFs are in turn owned by their members. Since 2003, VBARD had policies to support the delivery of the services of VBSP. As from 2003, all poor household loans have been transferred to VBSP to manage, that laid high pressures to VBSP in non-performing loan. Due to VBSP's subsidized interest rates and receive fund from other SOCBs, VBSP does not mobilize significant deposits from clients. Though VBARD has a nationwide network covering all provinces and districts, giving it the largest branch network in Vietnam. With its switching strategy to move away from the poor clients to production and better off households since 2003, VBARD does not explicitly target the poor, but approximately 47 percent of its clients are poor compared to VBSP's 49 percent (as of 2007) putting its aggregate outreach to the poor significantly higher than that of the ostensibly poverty-focused VBSP. VBARD reports that its non-performing loan (NPL) ratio is 5%. However, this rate is after rescheduling and write-offs; VBARD's actual NPL rate is considered significantly higher, although its accounting does not allow a precise determination. VBARD has been successful at mobilizing deposits — retail and enterprise deposits, combined with bonds, constitute more than 80 percent of its resources. However, VBARD does not mobilize significant deposits from the poor. Deposits of less than 500,000 VND (about US\$33) account for only 2 percent of its deposits.

36. Vietnam's Bank for Social Policy (VBSP) is quite controversial. Before VBSP was created, policy lending was provided by the four SOCBs distorting their commercial business. The Viet Nam Bank for Social Policies (VBSP) was established to take over small-scale policy and directed lending programmes previously administered by SOCBs and other government entities. This was carried out in recognition of the need to separate policy lending programs from the State Owned Commercial Banks (SOCBs) and to consolidate numerous policy lending programs into one institution. The VBSP became operational on March 11, 2003, and its institutional arrangement envisions a non-profit bank that offers a full range of financial

products and services at subsidized rates. The bank is exempt from many of the regulatory provisions that govern the operation of SOCBs and will not be covered by the proposed regulatory framework for microfinance institutions (MFIs). A positive aspect of VBSP's establishment is that it shows the government wishes to separate policy and directed lending from commercial banking. However, the existence of such a subsidized credit arm in parallel with commercial banks is considered by bankers as another distortion of sound financial market practice. According to its mission statement, VBSP should provide directed lending, lending at preferential rates using the government budget, and also mobilize deposits with subsidized interest rates for non-commercial purposes. Activities include lending to the poor, job creation activities, student loans, and lending to flood-resistant housing. This raises "doubts concerning the sustainability of its system", the issue of "social policies versus financial principle", and "targeting issues". VBSP's services are currently necessary for social policy purposes, but it should be considered as a transition measure towards more market oriented lending. VBSP helps the poor to accumulate productive assets so that they can escape poverty. It also aims at becoming commercially viable for part of its operations at some point in the future, with profits made being used for policy lending, to reduce funding from the government.

37. People's Credit Funds (PCFs) are commune-level, autonomous, small-scale financial institutions, is a form of co-operative credit organization operating according to the principle of voluntary membership. By 1997, the system had and a Central People's Credit Fund (CCF) with 24 branches and operates in 53 of Viet Nam's 64 provinces and cities and nearly 1,000 grass root PCFs reaching up to 4.8 million people. 84% of PCFs' assets are funded internally, through savings and capital, contributing to their autonomy. The 1998 economic crisis impacted on the PCFs and, mindful of the former collapse of credit cooperatives in Viet Nam, SBV intervened and restructured and strengthened the existing network, including closure of many grass root PCFs. As of November 2004, PCF had assisted 955,657 households, mainly farmers and small entrepreneurial households. By 2006, there are now 889 PCFs¹². SBV has done an admirable job of building up the network and requiring adherence to prudential regulations. PCF capacity in numerous areas (e.g., risk management, human resources development, IT systems, marketing) remains weak however, and it has received little TA from donors. About two thirds of the total financial resources of PCFs are mobilized from savings. PCFs are shareholding banks and do not target the poor directly. They are providing a viable rural finance system to farmers and small entrepreneurial households stimulating

¹

²² Annual report, People Credit Fund 2006

economic development, which indirectly contributing to poverty eradication. Just over 50% of its borrowers are Low-income households (LIHs).

38. The “semi-formal sector” consists of (i) Government ministries providing microfinance services; (ii) mass organisations including the Viet Nam Women’s Union (VWU), the Viet Nam Farmer’s Union (VFU) and the Viet Nam Youth Union (VYU), which provide small loans on their own account, implement programs for international NGOs, and facilitate the formation of credit groups for VBARD; and (iii) some 58 international NGOs that support microfinance programs, for the most part channelled through the mass organisations. Virtually all deliver services at below-market interest rates, following the lead of VBSP and VBARD. These organisations are recognized by the Government, but have not been legally regulated or supervised in their financial sector operations by SBV. The semi-formal sector is small and accounts for only about 5 percent of the rural credit market. Most of the semi-formal MFIs has the following constraints:

- Projects of International NGOs targeted to short term social objectives in carrying out microfinance services. When completion of the project fund for microfinance, they changes to new projects hence MF lack of sustainability
- INGOs do not have long term strategy for Microfinance sector
- It is not clear about the fund ownership
- MF scheme lack of professional skills, staff working by part-time manner
- Lack of clear structure
- Lack of internal control system
- Lack of legal framework that allows for institutional development and fund mobilisation.

III.3.2 Demand side

39. With respect to the poor, more than 75 per cent of Viet Nam’s poor live in rural areas, and more than 30 per cent of rural households in the country’s poorest locations are poor. Vietnam’s poor depend largely on farming and are characterised by relatively low agricultural productivity resulting from low access to capital, land and knowledge. The poor are also vulnerable to shocks from illness and death in the household, commodity price fluctuations, and natural disasters. Development of sustainable rural finance can therefore have a significant impact on economic growth and poverty reduction.

Box 2 . The reflection from the 3 visited study field with borrowers and lenders confirm that the recent risk for microfinance services came much from external factors like

- Disaster, Flood
- Increase and price booming
- Competition from banks: the bank change the interest so frequently that MFIs can not adjust and may lose their clients. Competition is also clear because the banks are subsidized for operational expenses and staff remuneration
- There is no microfinance insurance scheme that work for MFIs

Source: Field study, Mai Son, Dong Trieu, Ninh Thuan, CDI – AAV 2008

40. It is important to understanding right about Microfinance as "microfinance" often refers to microcredit. As we are finding out, a great number of poor, and especially extremely poor, clients exclude themselves from microcredit as it is previously or formally designed. Microfinance and rural poor people who do not have any stable income—would be hardly to be microfinance clients, as they will only be pushed further into debt and poverty by loans that they cannot repay. As currently designed, microcredit requires to be sustained with regular payments from poor families. At some level, the very cause of poverty is the lack of a sustained, regular, and significant income. Even though a family may have a significant income for extended periods, it may also face months of no income. Thereby the existing scheme of most of MFIs of formal sector in Vietnam to require big payment at certain time of the loan term would reduce the ability of the poor to enter into the type of repayment commitment. These extremely poor people and special groups like homeless or invalid at the bottom percentiles of those living below the poverty line need safety net programs that can help them with basic needs; some of these are working to incorporate plans to help "graduate" recipients to microfinance programs.

41. The borrowers, however, think of Microfinance options very variable. They wanted the scheme to be flexible and best offer so that they can borrow at different time as to meet the different purpose. Banks in formal financial sectors and MFIs in semi-formal sectors are now offering variety of options which to some extent meet the needs to the borrowers. However, as above paragraph has mentioned, the poor are still difficult to use more

It is quite clear that the poorest of the poor still needs special schemes and programs. MFIs tend to offer the services which serve more to the better-off with strict procedures and irrelevant to the poor in order to ensure its sustainability and low risk prudential level.

often the rural financial services due to irrelevant or operational scheme offered or complicated procedures. The following table describes the needs of the poor in rural areas by credit purpose category, which would help to understand the local people perspectives on rural financial services. (see table below)

Table 1 – Needs and expectations by each category

	VERY POOR	MIDDLE POOR	BETTER OFF	RICH
Demand side				
	To survive for shocks (health, disaster) To buy seeds and agricultural inputs To raise small husbandry Needs from 500.000VND to 2 mil VND	To buy seeds, fertilizer To grow garden or husbandry Needs for 7 mil to 8 Mil VND	To open business (services, small and medium sized husbandry raising) Needs for above 10 mil VND	To expand the farms (large scale fishing ponds etc.) Needs for above 35 mil to 200 mil VND)
Supply side				
Services/Institutions	Some funds (Women Union, TYM, CEF, M7 as MFIs and NGO) Programme 135 for poverty reduction VBSP and VBARD normally do not approve the high credits for poor due to high risks	VBSP, Funds or Target programme can not meet the demand due to the limit in credit line to 1-5 mil VND/borrower Programme 135 for poverty reduction	VBARD; PCF/CCF Others: Programme 120 for vocational and jobs	VBARD Commercial banks available
Procedures	Avoid complicate certification at commune authority	Need the poor list and approval from the commune authority and bank documentation	Complicated Costly with fees	
Scheme	Group guarantee scheme Savings together with borrowing Membership	Individual lending Based on need Fixed scheme	Individual lending Based on need Fixed scheme	Flexible scheme

Offers	Interest and principle divided equally – easy for the poor to repay	Term up to 3 years, interest paid every quarter, principle paid two times during the loan periods	With collaterals Documentation processing fee	With collaterals Documentation processing fee
	Still big difference in credit and saving interest (free to set based on the market)	No mortgage/collaterals - Difficult for the poor to accumulate big amount for repay	Higher (market interest rate) Savings is separate	Higher (market interest rate) Savings is separate
	Group activities: trainings included			

Source: Group Discussions from field – Quang Ninh, Mai Son, Ninh Thuan, CDI-AAV, 2008

42. In summary, the needs from the poor, especially the rural and remote areas for rural microfinance services varies. The following table shows type of loans and target groups by each credit and microfinance institutions. It shows that MFIs and credit institutions like bank (VBARD and VBSP) though carrying the social purpose to support the poor and rural development, but tends to go to large scale and big credit. This might imply the exclusion of the poorest who only want the seasonal and small scale to survive over unexpected shocks.

Table 2 – Loan structure by banks

	VBSP	VBARD	PCF	MFI/Funds/NGO
Target groups	Better off and Middle	Poor, not very poor	Middle	Poor and very poor
Loan amount	1.3 mil VND	1.8 Mil VND	Above 300.000 VND	From 200.000VND
Terms	3 years	3-5 years	1-3 years	Up to 2 years
Purpose of borrowing	HH business	Business	Multi purpose	Seasonal Living expenses and micro HH economic activities
Other options	No savings	Saving separate from borrowing	With savings	With small savings mobilization

III.3.3 Challenges and Opportunities to the microfinance sector

43. All MFIs (including M7) are in lack of understandings on finance and microfinance. Cooperation between MFIs and extension services are not efficient. After some ten years of activities, almost all of MFIs have yet to reaching necessary professional level of microfinancing. A more serious concern about MFIs is its lack of a commercial lending culture: it channels subsidized loans from the Central Government to poor households via mass organizations (Farmer Associations and Women Unions), with the Government covering all lending risks and losses

44. Challenges are also from competition from other formal lending institutions. Subsidies for some state-owned banks like Policy Bank, VBARD has continued. They also have surplus and favourable funding sources from State. Mrs. Soat of Dong Trieu Fund said : “ it is not fair competition to our small microfinance fund,. It is also not completely certain that money can be lent to the poor”. Such funds like us also work with the poor, but we do not have such favourable conditions”

45. The challenge remains in certain limitations of linkage of the poor to the formal financial institutions: The formal financial institutions in its current approach are still traditional: borrowers need to have collateral or creditworthy given by mass -organisations. In many case, local elite or family connection will form strong basis for trust lending. It may influence the target to the poor to access easier to microfinance services. The challenge also is seen in bringing financial institutions like banks to reach out by setting up more operational network with mass organizations to deliver the services. However, still it is not official for semi-formal MFIs now to franchise to credit institutions or big banks like VBSP or VBARD and VIDB

46. The challenges from WTO are clearer in terms of financial stability of the Vietnam economy. Budget deficit in 2007 was told to be more than 5.9 per cent that is one of reasons for high inflation in the first two quarters of 2008. Consumer Price Index (CPI) of 2007 hits 10.95 percent compared the high GDP growth rate of 8.5% . The CPI of first 5 months of 2008 also hits 19.09 percent. This has been a big worry to maintain a sustainable economy. World Bank Viet Nam Director Ajay Chhibber suggested the government reduce its intervention measures to enable the economy to adjust itself when inflation occurs. “WTO accession will help Viet Nam reduce inflation pressure by importing goods at low price,” The increase in CPI led to increase in price of agricultural inputs (seeds, fertilizer, petrol etc.) . The government has highly aware of the situation and puts more strict policies on tightening the prices and consumption of basic goods amongst the other 8 policy solution groups ¹ as to follow market

¹ National Assembly, 3rd session of XII terms, Report of the Prime Minister, “Control the inflation, stabilize macro economic situation and ensure the social security and sustainable development”

mechanism with no subsidies to goods and agriculture, it has challenged the borrowers and farmers to balance the input costs and turnover in agricultural products.

47. The increase in interest rate in the recent economic turmoil also created big burden. The interest rate racing of commercial banks beyond the control of the SBV starting in second quarter of 2008 has shown the effects of WTO and flexible interest rate policy. Prime Minister on 17 May has removed the ceiling lending rate applied by credit and lending institutions, but set the new ranges of saving rates. However, after the removal of ranges of saving rates, again banks including the SOCBs and Commercial Banks are running the interest race (see table xxx). The banks said they have to increase the interest rate to compete and keep their customers. The current situation really puts MFIs in rural areas in very difficult competition and coping solution with this rapid changes in interest rate.

Table 3 Interest rate posted by selected banks (as of 17 June 2008)

Banks	Saving rate (max/year)
SOCBs	
BIDV	17%
Eximbank	17.5%
Vietcombank	17%
Joint Stock Commercial Banks	
Nam A Bank	18,36%/year
Ngân hàng Thương mại cổ phần Sài Gòn (SCB)	19%/year
Techcombank	18%/year
SeABank	19,2%/year
Sacombank	17.52%/year
ABBank	18%/year
VBank	17.5%
VIBank	17.5%
Foreign Banks	
ANZ	13.5%
Standard and Chartered	12%
Vinasiam	13.5%

SBV, and vneconomy 17June 2008

48. Though there seems to be less opportunities from WTO/Globalisation to Microfinance sector, an enabling legal, regulatory, and supervisory framework set by the Government could provide incentives to invest in the sector while remaining focus on the poor would be a key to the rural and microfinance sector development.

49. Moreover, the opportunities for the rural and microfinance sector comes from a variety of high demand for micro-loans in rural areas. Though agricultural based rural economy has decreasing trend over the years to leave space for rural services and trade, rural micro-enterprises would be still typical target group for microfinance institutions. While rural banking activities are not so strong pro-poor, microfinance still emerges as a major opportunity for the poorest to access to loans. Social lending is supportive to the poorest as they start from the simplest enterprises through that they step-by-step exit poverty.

III.3.4 Related industries to microfinance services

50. Grow with the up and down of the economy, with the development of domestic financial market as well as the international integration trend, Vietnamese banking system currently consists of 5 state-owned commercial banks, 36 commercial joint stock banks, 5 joint venture banks, 34 branches of foreign banks, 7 finance companies, 11 financial leasing companies and 939 people credit funds. The state owned commercial banks are still playing the leading role in the market, accounting for 65.1% of total fund raised, 67.1% of total outstanding loans, and 62.3% of total assets of the whole system. The corresponding proportions of commercial joint stock banks are 21.3%, 19.6% and 22.3% while those of joint venture banks and branches of foreign banks, in combination, are 10.7%, 9.6% and 10.9%

51. Foreign banks entering the Vietnamese market would not yet create pressure for MFIs in rural sector but advanced new established commercial banks are aggressive in expanding their network, launching new services, tailoring their products to fit differentiated groups of customers, etc. indicates a booming banking market with a greater choice for customers. It implies the market size will become bigger and be shared by more players, but it will also become more segmented, with more diverse customer's needs, allowing different players to find their own niche areas. It may challenge MFIs will need to compete to serve more to SMEs in rural areas in additions to its traditional clients as the poorest.

Table 4 Banks and non-banking credit institutions in Viet Nam

	Financial/credit institutions in Vietnam	Number	Market Share rural credit/MF
1.	Joint Stock Commercial Bank	36	5%
2.	Joint Venture Bank	5	
3.	Foreign bank Branches	35	
4.	Financial Company	9	
	Of which foreign investment	2	
5.	Finance leasing Co.	11	90%
	Of which foreign investment	4	
6.	State Owned Commercial bank	5	90%
	Of which VBARD, VBSP, BIDV as MFIs	3	
7.	People Credit Fund (PCF)	939	
8.	Ohter MFIs/NGOs	58 NGOs, 9 MFIs	5%

Source: State Bank of Vietnam., 2007

52. Rural finance is key to the development of food and agriculture system, both to the agricultural inputs sectors (farms and household) and agribusiness (marketing, processing, distribution). The main benefit of food and agriculture system is taken for granted: the availability, at prices most people can afford, of a wide range of foodstuffs. Subsidies, after becoming WTO member, no longer allowed in food and agriculture system. Policy issues are always to make food and agriculture system in Vietnam moving towards a market system, by removing price controls and consumers subsidies, building private farms and households, and reforming the food processing and distribution channels. The market system in rural areas has facilitated the growth of services and businesses. It therefore promotes the increasing demands for microfinance services by the households or farms to enter more into the goods market.

53. Rural agriculture sector is the most affected sector by WTO. The concerns are made over the low competitiveness of the sector due to production scale and capacity, processing, trade mark etc. Though 2007 still continued to be a successful year for agro products and

exports with increase of 20% over 2006¹, Investment in rural areas will facilitate higher demand for financial services but still very limited for foreign investment due to high risk of disaster, low turnover rate of agro products. The rural economy will develop based on strong rural development including infrastructure, technology in production, business attraction and development. The changes by applying technology will drive more investment. With the price fluctuation in agricultural products and inputs, more demand for rural financial services will focus on processing of agricultural products together with marketing and distribution system.

54. MFIs and microfinance has more favourable to apply technology and ICT for banking in its modernisation process. Investment in IT to strengthen the customer information protection system and technical solutions for future. Mobile or internet banking or mobile phones or ATM can be future banking options for rural clients. However, in Vietnam, with their limited financial and operational capacity, the modernization challenge has turned into a large pressure. If new banking technology is not planned for and adopted, banks will continue to take unnecessary risks and an inefficient use of resources

¹ Ministry of Planning and Investment, report 2007

III.3.5 Competitiveness of MFIs

55. Despite the success of some schemes operated by NGOs, they only reach 5% of the microcredit market in Vietnam. INGOs implement microfinance projects through mass organisations, in particular the VWU. They channel funds received from external sources through projects and provide technical support to local partners. They bring experience and knowledge of international microfinance best practices, and in result a number of programs have shown excellent results in terms of credit, with 99% repayment rates on average and use of sustainable commercial interest rates.

56. Some strong semi-formal MFIs in Vietnam like TYM of Women Union, CEP of Labour Union of Ho Chi Minh City, M7 of ActionAid Vietnam and MF model of Save Children US has moved to institutional sustainability and have set the longer term strategy for Microfinance services including clear and transparent structure and financial mechanism. They also aim to serve the poor. Specialised microfinance funds: Only two major microfinance-focused funds exist in Vietnam, CEP working in Ho Chi Minh City, enjoying relative autonomy from the local Labour Confederation, and TYM Fund managed by the VWU, operating in mostly rural areas. CEP operates in urban areas and is considered the most successful microfinance organisation in Vietnam, reaching more than 50,000 clients and having reached operational self-sufficiency. It has made substantial investment in institutional development (MIS, training, standardisation). Action Aid Vietnam has recently transformed its program in two districts into autonomous funds.

57. ActionAid Vietnam is among some 58 international NGOs who support microfinance projects and programmes, mostly channelled through local mass organisations. As the former micro finance projects of ActionAid Vietnam tended to be small scale and not -so-sustainable without ongoing subsidies because the mass organisations generally have insisted on charging lower interest rates. For years now, these projects have account for less than 5 percent of the rural credit market. Under the World Bank's Second Rural Finance Project, the Vietnam Bank for Industrial Development (BIDV) has been appointed to accredit MFIs that satisfy eligibility criteria - in this context MFIs can mean commercial banks, joint stock banks, cooperatives, PCFs, and NGOs - and wholesale credit to them for on-lending provided that they satisfy the accreditation criteria. In the course of the project BIDV will undergo institutional reform.

58. ActionAid Vietnam transformed its microfinance programs in two districts into social funds managed by local communities. It transferred its programs in different provinces to district local officials, local VWU groups, or to a newly established local NGO. Action Aid program is also considered a good example in terms of savings mobilisation. After over 10

year of work, Saving and Credit model of ActionAid is going on right track of institutional development and financial mechanism to reach to formal MF Is establishment, especially thanks to the current legal framework (Decree 28). Upto now, ActionAid has set up 7 two -tier microfinance services institutions in Son La, Lai Chau, Ha Tinh, Quang Ninh (Uong Bi and Dong Trieu) and Ninh Thuan.

Table 5 Operations performance of M7 (by June 2007)

Indicators	Mai Son fund	Uong Bi Fund	Dong Trieu Fund	Dien Bien Phu Fund	DBP District	Center for the poor of Can Loc	Ninh Phuoc fund	Total
Years of services	1993	1995	1997	1997	1998	1999	2001	
Membership	4,436	7,978	5,826	4,119	2,455	3,890	2,452	31,156
Total credit (mil ng)	5,883	9,241	8,684	4,084	2,514	7,649	2,799	40,854
Overdue debt	1%	1,45%	0.1%	1%	0.19%	0.58%	3.2%	
Total assets (mil dong)	6,590	9,491	9,259	4,184	2,798	9,258	4,181	45,761
Savings balance (mil dongs)	2,743	4,872	4,553	2,323	898	5,524	1,095	22,008

Source : M7 và CFRC, 2007 www.m7group.org

59. In summary, constraints of Microfinance as sector are critical that imply a great challenge for MFIs to grow for commercial and sustainable manner . The constraints for rural microfinance operations include:

- a. Regulatory and supervisory framework remains unclear and unnecessarily restrictive in certain respects
- b. Interest rates continue to be unduly influenced by SBV, crowding out investment and distorting financial sector; SPB continues subsidized lending
- c. Mass organization schemes in the semi formal sector delivering microfinance services sponsored by NGOs are not subject to any governance regime designed for financial institutions or businesses and are not professionally and transparently managed
- d. Several NGOs have lobbied for a forum for information exchange and discussion

- e. The Vietnamese framework has provided a relatively sound basis for the regulation of commercial and the CCF/PCFs system, but the absence of provisions for MFIs has discouraged their development and fostered the development of many small NGO-supported schemes implemented through mass organizations. This has helped to discourage the mobilization of domestic resources, and where resources have been mobilized (such as the savings activities of the WU), depositors have gone unprotected
- f. Low investment in sustainable MFIs
- g. Weak capacity of MFIs

IV.1 What has been done regarding Legal and Regulatory Framework for Microfinance service in WTO context?

60. Efforts to increase access to rural financial services in Vietnam enabled at the same time with agricultural reforms in the early 1990s, particularly the formation of private farms. These reforms created a demand for capital by the 12 million rural households, of which about 10 million were decollectivized farms. National strategies to expand rural finance have been pursued mainly through the state sector using specialized banks and credit unions. For example, Vietnam Bank for Agriculture and Rural Development (VBARD) has about 4 million clients; the Social Policy Bank has about 5.7 million clients (2007); and the credit union network of the Central Credit Fund (CCF) and its affiliated People’s Credit Funds (PCFs) have almost 1 million clients. The expansion of the banking network made financial services accessible to about 7 million rural households, including about 3 million poor households. While expansion of outreach has been impressive, nearly half of rural poor households still do not have access to financial services from institutional sources.

61. Policy roadmap: Viet Nam is gradually implementing its own approach to financial liberalization and the major policies spearheading this approach are described in the following table

Table 5 – Policies roadmap for financial services and Micro finance

Year	Policies
1991	Reduce State Budget deficit to less than 5%, bank required reserves to 10%
1996	Law on Cooperative
1997	Apply flexible exchange rate mechanism
1998	Law on State Bank Law on Credit Institution issued covers operations of licensed banks and non - bank financial institutions (PCFs and credit cooperatives) but no comprehensive legal framework for microfinance services as they effectively fall outside the law on Credit Institutions. SBV lends to state owned banks such as VBARD and VBSP, which conduct microfinance activities. It also directly supervises the People' s Credit Funds system and issue individual licenses to new PCFs.
2000	SBV officially allowed the VWU to operate credit and savings schemes in pursuing its goal of poverty eradication. However, other social organisations are also mobilising saving without explicit legal support
2002	Established social and policy bank Apply a negotiable interest rate mechanism: Credit institutions are encouraged to expand their networks to further source capital and provide loans at market

	interest rates. More autonomy to banks SBV has liberalised interest rates, except for the VBSP, however in practice only a few organisations apply market-based rates to cover their costs, due to informal and political pressures
2003	Amended Law on Credit Institution raising operational quality, management capacity, while encouraging the autonomy of credit institutions
2003	Law on Cooperative Cooperatives operate like a type of enterprise, having legal person status, being autonomous and self-determining regarding financial obligations for their chartered capital, accumulated capital and other capital sources
2004	Allow establishment of 100% foreign owned finance company
	After WTO 2006-2011
2007	Allow establishment of 100% foreign owned bank and branches
2008	Continue Flexible exchange rate and interest rate policy 18 May 2008, removal of negotiable interest rate (by Prime Minister) . Banks have to apply a range of 1.5 times of lending rate over the borrowing rate
2011	Remove limitation of 100% foreign owned banks

Source: State Bank of Vietnam, and Asia Pacific Rural Finance, APRACA 4/2003 by Dr. Do Tat Ngoc, Deputy General Director, VBARD; Government 5 year socio -economic development plan 2006-2010

62. In line with WTO requirement¹, To further improve the operational efficiency of State-owned commercial banks SBV intended to equitize most State -owned commercial banks by 2010, while it would remain responsible for State management, inspection and supervision over State-owned commercial banks and credit organisations. According to the Government's plan, two State-owned commercial banks were to be equitized in 2006 . Pursuant to Government Decree No. 187/2004/ND-CP. Viet Nam's Prime Minister had decided to equitize two State-owned commercial banks, the Bank for Foreign Trade of Viet Nam (Vietcombank) and the Mekong Delta Housing Development Bank².

¹ WTO report ref. **WT/ACC/VNM/48**, 27 October 2006

² The Vietcombank would be equitized in accordance with the Prime Minister's Decision No. 230/2005/QD-TTg of 21 September 2005 and the Mekong Delta Housing Development Bank pursuant to Decision No. 266/2005/QD-TTg of 27 October 2005.

63. The issue of the autonomy of credit institutions has been resolved and they are now able to make independent decisions concerning loans, mortgage requirements, and interest rates for both deposits and loans. Discrimination between state-owned and private companies in financial operation has been minimized and different credit institutions are ostensibly treated equally when doing business, pursuant to applicable laws, particularly the Law on Credit Institutions. Commercial business and social-policy functions are being separated into state-owned commercial banks. A Social Policy Bank has been established with its functions tied to social policy

64. The Government thus far has primarily supported the development of rural finance through the establishment and operations of state-owned institutions, such as VBARD, VBP, and VBSP, as well as quasi-government institutions such as the CCF/PCFs and mass organizations like VWU. As discussed above, VBARD and VBSP reported reach over 60% of rural households. Recently, policy makers have recognized that, in addition to the state-owned institutions, the approaches and methods of microfinance institutions can make an important contribution in Viet Nam, particularly in extending outreach into the remoter areas where poverty is most concentrated and where the presence of these state-managed institutions is limited. Therefore, the Government decided in 2001 to prepare a framework for microfinance development, including an appropriate regulatory and supervisory regime. The unclear regulatory framework for microfinance has been a major impediment for the development of the microfinance sector in Vietnam, with investors and donors reluctant to enter the sector. Before the Decree No. 28 on MF was issued in March 2005, no comprehensive legal framework for microfinance services because they effectively fell outside the Law on Credit Institutions. The legal status and the legality of activities carried out under MF projects supported by ministries, mass organizations, and international donors was ambiguous.

65. Decree No. 28 places MFIs under the supervision of SBV but this supervision regime is yet to be well established. The SBV Banking Inspectorate Department (BID) is responsible for the inspection of all credit institutions, which must be inspected on-site at least once each year. Rural credit institutions are inspected the same way as other financial in BID. Per its establishment decree, SPB is not subject to prudential supervision even though it is authorized to mobilize deposits. Supervision based on Decree No. 28 includes: (i) supervisory and regulatory procedures, (ii) accounting and financial restitutions. Off-site inspection is done monthly based on financial institution reporting requirements, (iii) manuals for onsite and off-site supervision and reporting formats, and (iv) reporting and disclosure requirements for MFIs whose scale of operations is too small for formal regulation. These are yet to implement in reality. A policy challenge is to amending to the Decree No. 28, in short term,

and in longer term, making a new legal basis for microfinance, that will totally differ from micro-credit.

66. While the resulting Prime Minister's Decree no. 28, issued in March 2005, marked an improvement inasmuch as there is now greater clarity and the scope of permissible activities and institutional forms, the Decree also suggests a Government desire to maintain tight controls on microfinance provided by private and foreign investors and development partners. The decree is likely to make a substantial change in the microfinance landscape in Vietnam by promoting sound and transparent microfinance practices, by encouraging donors, banks and investors to support microfinance providers, and by developing savings mobilisation

- The general provisions of the decree, outlining the scope of regulation and the objects of application;
- Conditions under which licenses to MFIs can be issued, cancelled and revoked and the kind of procedures any MFI has to follow for the same;
- The kind of organizational structure and management an MFI should have for carrying out its administrative functions and maintaining its control over opening and stopping of operations of different defaulting units;
- The types of capital mobilization and credit activities any MFI can engage itself in;
- The accounting and reporting mechanism;
- The special control and powers that the State Bank of Vietnam has in cases of bankruptcy, dissolution and liquidation of any MFI;
- Penalties and sanctions that are likely to be invoked in case of violation of this regulation

Box 3 ... Feedback from a MFI executive on legislation for microfinance operations

Decree 177 does not allow us to mobilise fund, as we are not a real MFI since we can provide full financial services. The management costs are not exceeding 5% of the total income. It does not allow for micro insurance services though such insurance is very useful for the poor and farmers

Decree 28 requires minimum balance of 5 billion dong to be the capital to set up an MFI to be able to mobilise fund from savings. However, very few semi-formal MF funds (from mass organisation) has initial capital amount.

The coverage and demand for MF to MFIs are very big, but it has constraint in small fund. Many project with big fund like UNFPA, UNICEF, after project completed, remaining fund were transferred to new projects. Actually, people are keeping very big and cheaper resources to be able to mobilized, but we are not allowed.

Decree 28 also does not allow to Microfinance Fund like us, if not established like MFIs, to borrow from members. The current regulation of such insurance services requires 10 billion dong capital, which is very big for us. However, from 4 years now, Our Fund is still operating the similar insurance scheme, for which the poor are served well, with only 2000 dong per member a month but member is ensured with 1 million dong in case of death, getting 50% health expenses but not exceeding 200,000 dong and get support of 200,000 dong in case of death of dependents. . MFIs can only be the Agent for Insurance company, not as the Insurer. In fact, Ministry of Labor and Invalid and Social Affairs have pilot scheme of Risk Mitigation Fund in Thanh Hoa and Hoa Binh, which may be a good example.

Other difficulty for the local MFIs like us is according to Decree 165, Funds like M7 funds will hardly get the official operating license by the State Bank. The root cause is lack of initial capital to establish MFI.

The option may be that funds may join together, each fund will be managed different geographical areas. It somehow is difficult for management but the network could be a strong institution.

Noted from Mrs. Nguyen Thi Soat, Director, Dong Trieu Credit and Saving Fund of M7.

IV.2 The Current Microfinance Strategy

67. The Government has primarily supported the development of rural and micro - finance through the establishment and operations of state-owned institutions, such as VBARD, VBSP, as well as quasi-government institutions such as the PCFs and mass organisations like VWU. VBARD and VBSP reported reach over 60 percent of rural households. Policy makers recognized that, in addition to the state-owned institutions, the approaches and methods of microfinance institutions can contribute substantially in extending outreach into the remote areas where poor is most common

68. Government initiatives: Subsidised credit programs managed by government departments and public banks distort the financial market and prevent the development of sustainable microfinance in Vietnam. As part of government initiatives, the two state-owned banks, VBARD and VBSP, provide subsidized credit to targeted poor households. VBSP was specifically established to provide subsidized credit to the poor, and other vulnerable groups. VBSP is exempted from profit and capital tax, and uses preferential government policies to subsidise interest rates to the poor. It is very difficult for other microfinance providers, such as specialised funds, NGOs, or even PCFs to compete with state-owned banks. The dominant role of state owned banks in the microfinance sector prevents the emergence of new microfinance institutions. Mixing purpose to increase access to finance with charity by MFIs would lead to problems of credit rationing, corruption, and unsustainability of any institution.

69. Regarding the interest rate policy, the Government supports more for the formal sector as characterized by a mix of market and subsidized interest rates. Subsidized interest rates, foreign borrowing (especially from donors), and budgetary allocations have meant that the focus has been mainly on credit. Consequently, savings mobilization has suffered, although VBARD and CCF/PCF have mobilized significant deposits. In June 2002, SBV revised interest rate policy. Currently, credit institutions (except SPB) are, in principle, able to determine their own interest rates. However, past policies and continued Government influence mean that subsidized interest rates remain embedded in the system, and VBARD's or VBSP current interest rates are still below cost-recovery levels. The NGO and mass organization schemes have generally followed VBARD in setting interest rates. As a result, savings mobilization in these schemes, although only total about 10% of total outstanding loans in these schemes. has not been given particular emphasis and is absent altogether in some schemes.

70. Roadmap for opening Vietnam's financial services market to the international financial institutions has been implemented effectively. Vietnam's financial institutions, especially

commercial banks, have learned basic lessons on how to build up the capacity for competing and cooperating with each other and with international financial institutions. All Vietnam's commercial banks are willing to link their business to microfinance. Non -agricultural banks do not compete VBARD. VBARD itself does not see benefit in doing business in microfinance. The poorest may hope to access to micro-credits provided by microfinance projects and programmes that link to mass organisations with the support by international NGOs and donors. Micro-enterprises did exist, but their growth in terms of knowledge has been low, especially the knowledge on how to access to microfinance resources. An opportunity for microfinance in Vietnam's rural areas is mobilizing international financial sources based on pure business conditions. This opportunity is indispensable because deposits in the poorest regions are small, local banks do not want to lend with current interest rates and no social lending has in the mind of the local bankers. But to date, there are difficulties for international finance to enter Vietnam, going to the poorest locations.

IV.3 Remaining policy gaps

71. The Government sets its target and policy development regarding Develop Credit Organisations

¹. The strategy identifies several key policy measures as:

- (i) reform and develop Vietnam commercial bank system in diverse forms of ownership and organisation, international practices, healthy competition;
- (ii) develop and improve quality of PCFs to become credit institutions in line with law
- (iii) open the international banking services in line with international commitments and roadmaps. By 2010, establish a comprehensive legal framework to safety in monetary-banking business in line with Law on State Bank and Law on Credit organisations.

72. However, given the current fact and economic turmoil in 2008, policy areas to be addressed could include:

- a. put in practice an effective interest rate liberalization;
- b. refinements to the microfinance regulatory and tax regime as identified during the early stages of implementing the new regulations;

The absence of an effective legal form for MFIs has meant that the transition from mass organization or NGO activities to formalized MFI to licensed bank was not possible; for schemes that want to attain legal status, the PCF model was the only one available. However, as adoption of the PCF model results in membership of the CCF apex, it has not been possible for an MFI to emerge on a national scale.

¹ 5 year Socio-Economic Development Plan 2006 -2010, MPI,2006

- c. continued commercial banks and SOCBs restructuring, including cessation of directed lending, increased autonomy including continued implementation of its Action Plan, publication of IAS accounts, performance-based recapitalization, and possible equitization as a first step to privatization and social support.
- d. Reforms VBSP to reduce its distortion effects; and
- e. delegation of MFI supervision to an appropriate institution such as VBARD, VBSP, or MFI Association.

73. Often governments and aid agencies wish to use microfinance as a tool to compensate for some other social problem such as flooding, relocation of refugees from civil strife, recent graduates from vocational training, and redundant workers who have been laid off. Since microfinance has been sold as a poverty reduction tool as mainstreamed into the targeted programmes like P135, 120 ect. it is often expected to respond to these situations where whole classes of individuals have been “made poor”. This is simply unrealistic. Running a program with substantial default rates undermines the very notion of credit and destroys credit discipline among those who could repay promptly but who look foolish given that many do not.

74. In summary, the 2005 Decree No. 28 on the Organisation and Operation of Microfinance Institutions marks an improvement in the enabling environment by clarifying what is and is not allowed. However, the decree leaves many details for SBV and others to determine by issuing a variety of guidelines, regulations, circulars... to implement the decree. For example, SBV must issue (i) guidelines on MFI branch establishment; (ii) regulations regarding sound operations of MFIs wishing to mobilize deposits; (iii) guidelines for consolidation, merger, splitting, dissolution, bankruptcy, and liquidation of MFIs; (iv) guidelines on the qualifications, election, appointment, and dismissal of an MFI’s board of management, control committee, and general director; (v) regulations on entitled microfinance operations; (vi) guidelines on the maximum size of loans made, and deposits accepted, by MFIs; (vii) guidelines on MFI accounts and ledgers; (viii) guidelines on reporting and statistical obligations in conjunction with the Ministry of Finance (MOF); and (ix) provisions on the rights and duties of inspected MFIs. Moreover, MOF is to issue (i) instructions on licensing fees of MFIs; and (ii) a circular covering guidelines on finance in (receipt) and out (payment) of MFIs; regulations on the development, maintenance, and use of funds in MFIs; and guidelines on reporting and statistical obligations in conjunction with SBV. One year after getting membership to the WTO, no new legal documents (regulations, directives, guidances etc.) has been issued on the basis of Decree No. 28.

The chapter is based from the above chapters which comes at conclusion for the microfinance options that how it would sustain to serve the poor in WTO accessi on context. In particularly the development strategy of rural and microfinance envisions the sector's actions and policies to cope with the challenges placed by WTO requirements . The recommendations would also address to MFIs that how they maintain the serve the poor who have been affected by WTO with their particularly institutional policies. The operational recommendations address technical issues to MFIs so that they could strengthen and serve the poor better.

V.1 Development Strategy

75. Taking “financial system” development approach to rural and microfinance development in Viet Nam, the vision for the rural and microfinance sector should be that of a growing market-oriented formal sector, consisting of both public and private banks and MFIs, which operate professionally and sustainably, and which are linked to the formal banking sector through commercial relationships. Micro finance services should focus on institutional sustainability from the outset, and in time the sector should be served primarily by fully licensed, regulated, and supervised MFIs that are profit-oriented.

76. Bring permanent access to institutional financial services for a majority of poor and low-income households and their micro-enterprises is the core of the development strategy for microfinance. The strategy would focus on: (i) creating a policy environment for microfinance; (ii) developing financial infrastructure; (iii) building viable institutions; (iv) supporting pro-poor innovations, (v) supporting social intermediation, and (vi) building human resources capacity.

77. Areas for support to microfinance sector could include: (i) further capacity building in MFIs and SBV, as it can be expected that capacity will be weak in the nascent stage of the sector's development; (ii) capacity building in CCF/PCFs; (iii) assisting VBARD and other commercial banks to create a wholesale lending function to link MFIs with the commercial bank sector; (iv) facilitate the formation of an MFI credit information service, a microfinance equity fund, and/or a microfinance training institute (v) establishment of MFI Association, (vi) develop a microfinance code of conduct to promote best practices, and (v) providing general purpose funding for MFIs. The Government plans to develop Microfinance sector with the following roadmap:

Table 6; Recommended MF Sector Policy Roadmap

Policy achievements by 2005	Policies recommended by 2010
Improved policy environment for microfinance PM decree on microfinance Decree 28	SBV regulations; amended PM decree as appropriate Amended Decree and regulations enable diversity of MFIs by allowing unimpeded market entry for organizations that satisfy eligibility criteria
Increased investment in sustainable MFIs	Donors and practitioners accelerate efforts to ensure that best practices and capacity-institution building are introduced into all sponsored projects VWU and other existing semiformal fund either upgrades skills to manage microfinance professionally, or transfers management to professional managers Foreign and private commercial investment permitted to MFIs to access funding
Improved corporate governance in VBARD and VBSPs Further, effective interest rate liberalization VBARD interest rates still influenced by SBV	Directed lending in SOCBs would need end VBARD management fully autonomous, under objectives set by government BARD sets interest rates without SBV influence
Microfinance Working Group meets periodically to discuss sector issues/ Micro Finance association or official business group	A common Code of Practice with regard to microfinance including risk management is developed and incorporated into a model microfinance charter Microfinance forum formally established to ensure dialogue between government and practitioners

Source: SBV, 2006 based figures of on ADB's TA 3741 -VIE

V.2 Legal Framework

78. An enabling legal, regulatory, and supervisory framework that provides incentives to invest in the sector while remaining focused on the poor will be a key to the sector's development. Decree 28 issued in March 2005 falls short of stakeholders expectations and the enabling principles agreed to, but still represent an improvement in the regulatory

framework. Decree is itself a by-law document that would need to be amended so that at the same time the number of regulations, directives, guidance would be minimized and the implementation of the decree would be seamless and effective, i.e. it would create a more appropriate regulation for microfinance with larger lending window. SBV and MOF would, on each part, and in cooperation, review the decree in the context of WTO conditions for financial services in order to improve this legal basis. Legal and policy framework for microfinance should respond not only to the issues of poverty reduction, but to the profitability of microfinance.

V.3 MFIs Operations

79. Concentration on all survived starters in microfinance would be a priority in operations. In cases public authorities support, it is relevant to maintain the social inclusion clients. Each MFI should have a clear set of objectives, as regards of clientele. It is crucial to follow market-driven approaches in microfinance. However, in cases of need, let compromise in subsidising higher running costs in satisfying the demands of client groups. To sustain the operations, a mixture of public and private funding will help create sustainable institutions. Also MFI services needs to operate with quick and flexible lending scheme with no collateral procedures that avoid possible hot lending from money lenders especially to the poor.

80. Small loan size discouraged some borrowers who considered such loans too small to be useful. Group lending was in many case work well for borrowers from remote areas. In other cases, monthly or quarterly payment of interest charges were required instead of giving borrowers the option of repaying all charges at the end of the loan period when they had a large sum of money from animal sale. Finally, a maximum of 3 years of lending period was commonly observed due to lack of sufficient long-term funds. In many case, borrowers cope with repayment constraint by borrowing from a moneylender to repay the first loan, and borrow a second loan from MFIs to repay the moneylender. This practice effectively enabled the clients to extend their loans, but at a high cost that was unnecessary. A better alternative may be a new policy that allows good clients to repeatedly extend their short - or medium-term loans as an alternative of obtaining long-term loans, that the borrowers had good repayment capacity, and the loans had low risk.

81. Some poor households in isolated areas need not only access to loans, but also advice on how to use loans effectively, and loan officers were in the best position to provide such advice like the case of all MFIs of M7 and some other NGOs group, which carried great social mandate. This is another rationale justifying subsidies to MFIs especially in remote areas to cover the higher cost of commercial lending to poor households. As compared to the

provision of subsidized loans to borrowers with leakages, it may be better to provide subsidies directly to MFIs to encourage the expansion of commercial lending to poor households in remoter areas. Such subsidies should be linked directly to the number of individual loans made to poor households in the remote areas.

82. The following table describes the likely impact of WTO and implications for MFIs

Table 7 Recommendations to the operations of MFIs/ Microfinance funds

Table xxxx.	
Social impact of WTO	Implications
Challenges:	
<ul style="list-style-type: none"> ○ More difficult than before: increase in poverty gap, poverty lag behind and slower in reduction ○ Financial services are more commercialised: but unstable in financial market (interest) ○ More financial services channels ○ Banks tends to lend to better-off rather the poor ○ Increasing trend in hot lending from money lender sor small traders 	<ul style="list-style-type: none"> ○ The Fund should continue the Social work to help and reach out the poor as very important task ○ The Localities will need to mobilize more fund from: NGOs, Targeted Programmes, ○ Mass-Organisation takes part more professionally ○ Establishment of Women’s Bank ○ Development of MF model at local levels
Opportunity:	
<ul style="list-style-type: none"> ○ More information to access the fund or changes in policies ○ Decree 28, encourage the fund to perform more professional and transparent ○ Globalisation and integration: open for more fund from foreign sources 	<ul style="list-style-type: none"> ○ Many poor people can overcome poverty due to hardship and more economic opportunities and borrowing ○ Increase the fund access for the Saving and Credit Fund, transform to MFIs as per 177 ○ Reduce dependence of MFIs on external sources ○ Need for Networking amongst MFIs ○ Need to Prioritize fund management ○ Need specific terms for remote and mountainous areas for implementation of Decree 28

Weakness/Constraints

- Lack of fund to relending
- Profit is low, not sufficient for operations with high social mandate of MF.
- More demand from poor people and the social work in microfinance services
- Low professional level of the Fund Manager or staff

- The Funds will need to change business strategy in Fund Mobilisation based on revised legitimate legal framework that allow diversify fund mobilisation for MFIs
- Expand of market to commercial lending groups
- Increase effectiveness and efficiency
- Transform to work as a bank/credit institutions in terms of (i) Risk management (ii) Decentralisation (iii) Capacity building for staff (iv) creating relevant performance based incentives for Fund Staff

Table 8 Comprehensive Recommendation Matrix

#	Issues	Responsibility	Actions Implications
Legal and Regulatory Framework			
	Regulations review for MFIs operations – Amendment of Decree 28	SBV	More feasible for small MFIs to register Allo MFIs to link with VBSP, VBARD in franchising or credit
	Regulations and instruments for financial transparency for MFIs	SBV	Reduce information problems and facilitate MFIs to continue with high risk groups
Policy			
	Clarification of quasi-bank institutions regarding WTO rules and preferred credit arrangements	SBV, SOCBs commercial banks	Avoid potential countervailing actions from trading partners against domestic support (eg. agriculture)
	Stabilize and harmonize interest policy, clear interest margin for quasi-credit institutions	SBV, VBSP, VBARD, MFIs, PCF	Guarantee access of financial services of the poor
	More open capital market instruments for MFIs	SBV, possible BIDV	The financial sector developed with economic growth and banking liberalization: more channel of fund mobilization to MFIs
	Rural banking and social objective	VBSP, VBARD, SOCBs	Set up a network and funds served for disadvantaged groups and areas, allow rural MFIs to join the network, besides the PCF network
Operations of MFIs			
	Performance Based remunerations and rewards	MFIs	Rights incentives to employees
	Modernisation and competence building	MFIs	Increased performance, governance, IT and able to compete
	Franchising	Commercial Banks, SOCBs	Allow wider access to rural areas Promote and educate rural customers and create new demand for services