

Credit in Rural Vietnam

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Abstract: In addition to official credit institutions, forms of semi- and non-official credit in the models such as borrowings-cum-saving, lending-cum-investment, and rotating saving groups... play an important role in the provision of capital in the rural Vietnam. Besides the enhanced access to official credit by means of improvement of lending procedures to be more simplified and appropriate to the people's level of knowledge, flexible in terms of the repayment time and borrowed amounts, the officialisation of the other credit channels make positive impacts on the creation of sources of capital for rural households, given its efficiency. The efficiency is reflected in the low expenses for the apparatus, the flexibility in terms of the due dates and scales of the loans, the clearly defined purpose of borrowing, and the high feasibility and repayment possibility.

Keywords: Credit, rural, Vietnam.

1. Introduction

At present, in Vietnam, more than 60% of the population and 90% of poor people live in rural areas. Their incomes depend mainly on agriculture. However, agricultural productivity is very low and under great influence of natural disasters and diseases. As a result, people are unable to obtain accumulations. Many studies have pointed out that accessing credit is one of the farmers' solutions to deal with risks and vulnerability [6]. It is also an important factor in boosting agricultural production and the change into other sectors such as growing crops and breeding livestock. In rural areas, loans are often used for

investments to enhance the productivity on individual and household levels in order to escape poverty, become richer and create possibilities for economic growth for the society as a whole. However, the access to such loans is often limited, especially in the domain of official credit. Farming households always have difficulties accessing commercial and financial transactions. On the one hand, they do not have collateral assets and have low incomes. On the other hand, financial institutions are not keen on lending funds to low-income earners. Therefore, the Government plays a role in ensuring the access to credit by farming households, especially poor ones. The article analyses forms of credit in rural

Vietnam and provides solutions for farmers to have access to credit funds in rural areas.

2. Access to official credit

Since the beginning of the renovation, the Government has promulgated many policies and created various programmes to enhance the access to credit by farming households, providing them with assistance to improve their lives and minimise vulnerability. Policies on the development of a rural credit system are designed to encourage credit institutions to boost lending to farming households at market interest rates, facilitate them with conveniences so that they are no longer dependent on unofficial credit - via simplifying procedures, making information transparent, minimising transaction fees and providing borrowers with insurance against risks, especially force majeure that is usually encountered in agricultural production. Many current rural credit programmes have a component of preferential credit which is heavily subsidised with interest rates that are nearly half of those of commercial banks. The programmes are focused on enhancing agricultural production, boosting the growth of the business activities by rural enterprises, eradicating hunger and reducing poverty, improving education, creating employment and protecting the environment. As in other developing countries, in Vietnam, although the State's intervention into the rural credit markets through different programmes remains a controversial issue, it is still widely accepted since it can make adjustments to the failures of those markets [7].

The amount of state budgets spent on programmes and projects approved by the Government is transferred through state

financial institutions, among which the Vietnam Bank for Social Policies (VBSP) and the Vietnam Bank for Agriculture and Rural Development (VBARD) are the two main focal points. While the VBARD, also known as the Agribank, operates on a commercial basis, the VBSP acts as a microfinance institution and is considered the main tool of social policies in approaching poor people in rural areas. The latter provides preferential lending programmes with low interest rates, sometimes at 0%, for poor households, those with difficult conditions and people with disabilities. Established in 2003, it is currently the only bank to provide credit on the basis of social policies in replacement of the bank for the poor.

Farming households access official credit via two ways: direct and indirect. In the first way, they can borrow funds directly from credit institutions when they have sufficiently met the requirements and demands of the institution. In the cases, the borrowers are mainly households with large-scale businesses, belonging to the group of better-off households. In the second way, people borrow funds indirectly via social mass organisations such as "*Hội Nông dân*" (Farmers' Association), "*Hội Phụ nữ*" (Women's Union), "*Hội Cựu chiến binh*" (War Veterans' Association) and "*Đoàn Thanh niên*" (Youth Union). The borrowers in these cases are normally households entitled to benefit from policies (policy beneficiaries), individuals given priority, or poor households without collateral assets. As for the VBARD, they can carry out transactions directly as well as via the guarantees of mass organisations. Therefore, it can be asserted that social mass organisations play a very important role in the process of accessing official credit by farming households. Specifically, the communes'

People Committees help the VBSP verify poor households with difficult conditions, and other social mass organisations help the bank create and monitor loans. Without the need for collateral assets as pledges for the loans, these organisations provide a guarantee fund. To ensure the possibility of loan payback/collection, social mass organisations organise the customers (i.e. borrowers) into “credit groups”. The whole group shall be collectively responsible for the payment of principals and interests. Then, this method is replaced by a more flexible one where an individual is only responsible for his/her own loan and not for the loans of other members in the group [1].

Data from the surveys on farming households’ access to resources carried out in 2006, 2008, 2010 and 2012 in 12 provinces and cities of Vietnam showed that the level of access to credit by Vietnamese rural households was relatively high as compared with other developing countries, with almost half of the number of rural households able to access official credit. Among the borrowing households, less than 2% stated that they had completed the procedures for loans but were not accepted and a very small percentage received loan amounts that were less than their expectations. Households in the poorest group had a higher proportion of loans than

the others. This showed an expansion in the rural microcredit market, targeting the poorest households [2].

Our survey [1] showed similar results: among the rural households that were borrowing or had borrowed before, 43.6% borrowed loans from the VBSP, 25.2% borrowed from the VBARD, 23.1% borrowed from unofficial loans (18.2% from relatives and friends, 8.2% from lenders, 0.3% from “*phường hội*” (Vietnamese tontine – a savings scheme whereby each member within a group of people agree to contribute an amount of money at a pre-specified time. Each time, after the total amount has been collected, it will be given to one member who can use the fund for his/her own private matters. The members shall take turns in getting the summed amount each time the money is contributed), and 12.2% from other sources (Figure 1). Several other studies also showed that while the percentage of households who had access to official credit was high, and so was the proportion of households accessing unofficial lending and other sources, i.e. around 20% [2]. Thus, why did farming households approach forms of semi- and non-official credit while the percentage of those who had a demand for official credit but were rejected was rather small (only 2%)?

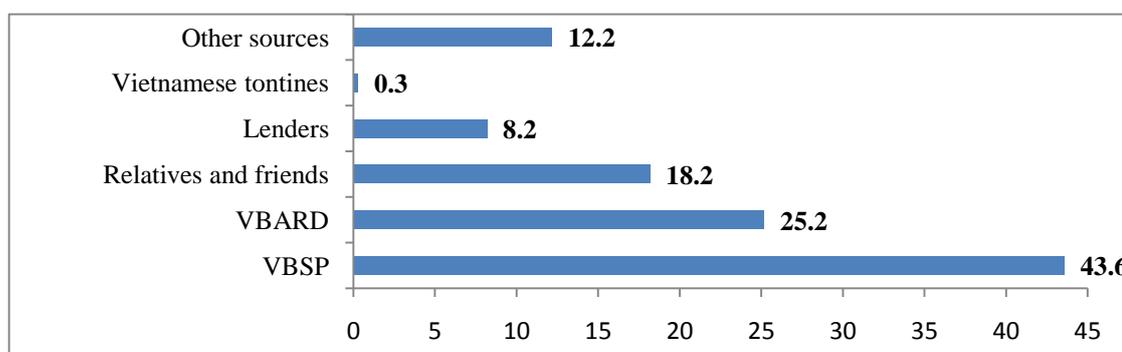


Figure 1: Sources of Funds that People Usually Borrow from [1]

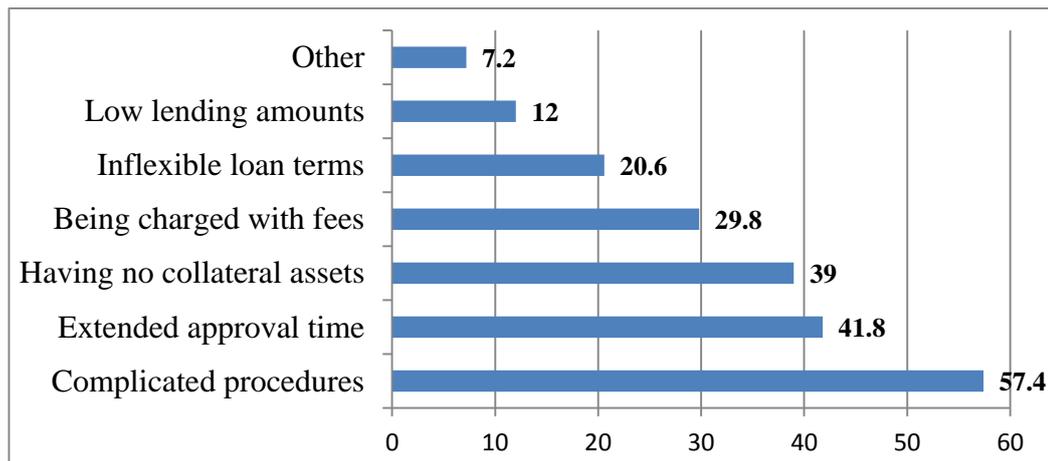


Figure 2: Difficulties that Deter People from Accessing Official Credit [1]

Difficulties that deter farming households from accessing official credit include complicated procedures, extended approval time, having no collateral assets, being charged with fees, low lending amounts, and inflexible loan terms (Figure 2). Results of our studies also reveal specific difficulties for the households in accessing official credit. They are categorised by socio-economic groups as follows:

- The poorest and low-educated households tend to shy away and not take initiative since they lack information on how to access the funds, are unable to complete loan procedures and to create business/production plans on their own; lack an understanding of production techniques and market information; are incapable of using the borrowed funds effectively; are unable to pay the loans when they are due. In addition, the poorest group has to face a stricter credit screening compared to other groups due to pressure from the credit institutions in exchange for commitments to provide assistance to collecting debts. Only households that are

able to repay the loans quickly are approved to join borrowing groups, i.e. the credit groups. This has caused difficulties to poor households in accessing official credit even though the very aim of microcredit programmes is to provide credit for poor and low-income households.

- Most households with low-scale business want to borrow funds at the VBSP since the interest rates are suitable with their production conditions and collateral is not required. However, many still choose unofficial credit instead of accessing official credit. The reasons are that the procedures and lending method at the VBSP are much more complicated; those allowed to borrow must meet all the requirements and have documents that certify them as poor households or as those having difficulties; the time needed for loans approval is quite long and not suitable with the production/crops; the average loan amount is much lower than the household's demand for investment in production, i.e. around VND 10-15 million; the loan duration is short, not

appropriate for investments in production activities that have long payback time, such as growing perennial plants and developing farm economy.

- Households with larger scale of business encounter difficulties in terms of the flexibility of the loans and the evaluation of collateral assets upon accessing official credit of commercial banks. They said that banking staffs in many places still consider the value of collateral assets, which are normally land measured in prices set by the State's price frame and hence lower than their real value, to be a prerequisite upon assessment of loans, without paying attention to the efficiency of the projects and the borrowers' ability to repay. As a result, it is hard for people to access official credit on demand.

3. Accessing unofficial credit

Unofficial credit plays a certain role in enhancing the farming households' access to funds to be used for production. This is also the most diversified segment of the rural credit market in terms of the provider, type and scale of the loan, interest rate, loan duration as well as payment method. The limitations in the possibilities of accessing official credit [11] and the flexibility and the ease in accessing unofficial credit have made households more dependent on the latter source of credit. In a number of localities with their specific professions, the use of unofficial credit outstrips that of official credit. For example, shrimp-breeding households in Bac Lieu province borrow

funds to carry out activities that involve latent risks and unpredictability [1], [4].

Our studies in 6 provinces and cities show that loans under unofficial credit include short-term credit for emergencies, normally related to health and essentials of rural households; short-term investment, such as buying feeds for livestock before harvesting; long-term credit, often used for education, building and repairing houses, building warehouses, buying machines and production tools and building ships. The main groups of agents that provide unofficial credit for households include private lenders; friends, relatives and neighbours; rotating saving (tontine); lending as a form of investment with commitments made. These loans tend to be small-scale and short-term (by season or by days). The interest rates are higher than those under official credit, or even equal to 0% (in case the lenders are parents, relatives and friends, and there is no need for collateral assets or loan certifying papers). These loans account for one third of the borrowers asked in our survey. Savings groups and revolving lending are relatively popular in rural Vietnam. People in rural areas feel that joining tontine schemes is more convenient than depositing money into banks despite the fact that no interest is paid. Members of the scheme must contribute an amount of money on a monthly, quarterly and seasonal basis². To avoid currency depreciation, some schemes calculate the amounts to be paid according to the prices of rice, building materials, gold... at the time of contribution. Individuals can make a bid, draw lots or make agreements to determine the order of priority in receiving the money. This form of savings is chosen

by many rural people because, in their opinions, the amounts contributed at each term are not too large compared with their incomes. At the same time, they can easily borrow from the scheme if necessary. The scheme's advantage is that it immediately uses one person's savings to sponsor another without the need for the latter to wait until he/she can accumulate the needed amount on his/her own. By doing so, it increases the benefits for the participants and decreases the wastefulness incurred when the savings are not used quickly [9]. However, this form of savings carries many latent risks due to asymmetrical information³ and limitations in the ability to exercise law enforcement against one another as members are merely individuals without legal enforcement capacities [5]. Therefore, the phenomenon of "*giặt bụi*", when the person heading the scheme disappears, happens quite regularly in our country recently, causing panic among many people and limiting the benefits of this form of credit in mobilising idle money among the public to serve profit-generating activities in the economy.

Another form of lending is investment lending with commitment, whereby credit is granted by local entrepreneurs or providers of input materials for agricultural production, livestock and poultry breeding and raising and catching aquatic products. This form of unofficial credit is for the long term and normally used for investments in warehouses, machineries and production tools and materials. Borrowers usually cannot meet the requirements for collateral when accessing official credit, or the collateral assets are not sufficient to borrow loans large enough for the investments. In some

cases, long-term loans under unofficial credit act as a form of initial investment by the creditors. As a result, they are given the priority to buy goods manufactured from the invested capital at competitive prices. The proceeds from the selling of such goods will be paid partly to the borrower for re-investment and the rest will be gradually deducted from the principal and interest. This type of commercial credit, offering loans in material/in-kind form, has lower risks as compared with normal types of providing credit in cash [8]. With respect to credit risk management, the person who sells on credit - and thus acts as an investor - is in a much more advantageous position than credit institutions in terms of the customer information and purpose of using the loans via transactions of goods. For example, the sellers of materials on credit will feel assured that after the transactions are finished, the buyers will immediately have the materials needed for production and hence one can be certain that the loans are, almost certainly, used for the right purpose. Moreover, when the buyers show signs of deviation or inability to repay the loans, the sellers can immediately take the sold materials to sell to other people. It is hard for financial credits/funds to do that since they do not have the functions and skills of trading in the goods, such as agricultural materials and warehouses, to convert the goods into cash in the quickest manner to recover the funds.

The assessment of several types of unofficial credit reveals that if the loan amount is small, collateral is basically not necessary. For greater amounts, the borrowers normally use valuable assets

such as houses, farming land, vehicles, machineries, etc, as collaterals. The people or organisations providing the credit or the guarantees often live in the same localities with the borrowers. As a result, they are well aware of the conditions of the borrowers and the purpose of the loans. They often use such information as a basis to determine the loan amount, term and binding conditions. In other words, the flexibility in the duration and methods of payment/settlement (in cash or products) of loans under unofficial credit can partly make up for the higher interest rates as compared to those of official credit. Unofficial credit is deeply rooted in the communities because it can perfectly solve issues encountered when accessing official credit, such as asymmetrical information, transaction fees, controlling the use of the loans and the progress of the projects... Unofficial credit can attract farming households who have difficulties accessing official credit or unable to get loans that are large enough to finance their projects.

4. Semi-official credit

Semi-official credit was formed and developed via microcredit programmes that were funded by programmes of international funds or non-governmental organisations (NGOs). This type of credit normally provides microfinance services for households that are unable to access official credit. However, this sector only plays a minor role in the provision of microcredit in Vietnam since the financial

system lacks the legal framework for these financial activities, most of which are only developed along with projects carried out on the locality level. The semi-credit sector provides small loans with easy lending conditions and low interest rates. The loans are targeted at poor farming households who do not have enough land for cultivation, and at ethnic minority groups and women living in rural or remote areas. Organisations providing semi-official credit have good understanding of the borrowers and hence can select the right candidates and apply the debt-repayment enforcement mechanism in a flexible and effective manner to minimise risks. The values of loans under semi-official credit are smaller than those under official credit. However, they are able to be adjusted to meet the demand of the poorest. This type of credit is based on microfinance schemes and carried out by social organisations such as the Women's Union and the Farmers' Association. The organisations, having their own capital, manage the savings of their members and funds from donors' sources. They provide loans in a direct manner.

Our research carried out in Dong Thap province on semi-official credit shows that the loans are often small, being around VND 2-10 million, and the borrowers are mainly women. The purpose of lending is for small business activities. The principals and interests are gradually paid on a monthly basis. The funds are normally provided by international donors, with the Women's Union taking charge of the lending and debt collection. As the loans are small in

value, the subjects of lending are targeted groups and the purpose of lending is monitored, these loans hardly require any collateral and are disbursed quickly. Both the loans and repayments are highly flexible, being paid weekly or monthly.

5. Solutions for accessing credit in rural areas

Firstly, the legal framework needs to be completed to create a motivation for credit institutions to invest in rural credit while focus is still maintained on assisting poor households.

Organisations providing microcredit should diversify the purposes of lending to include not only agricultural production but also vocational training to enhance the skills of farming households, thus helping them raise their incomes by participating in non-agricultural activities or other labour markets.

In order to enhance the access to official credit, the institutions of that type of credit need to make improvements so that the procedures become more simplified, compact and suitable with the people. The situations where farming households must travel to and fro many times and wait for long hours should be avoided. Apart from providing a mechanism of interest rates that is reasonable and flexible, to suit every group of borrowers, official credit institutions need to raise the amounts of medium- and long-term loans for highly efficient households.

Official credit institutions are also to make agreements on the terms and values

of the loans based on credit revolving time, the projects' capability to recover funds and the customers' business plans.

Secondly, the access to microcredit by the poorest households as well as their use of the funds must be enhanced.

Programmes designed for capacity building in economic activities should be integrated with credit schemes so that potential households can set up financial plans for such activities.

Attention is to be given to asserting the role of social organisations and strengthening the linkage between them and official credit institutions to enhance the ability to access official credit in rural areas, especially for the average-income and poor households, who normally borrow based on creditworthiness. The close collaboration between credit institutions and social organisations will bring about efficiency to both borrowers and lenders. The information flow between the parties will help shortening the time needed for candidate selection, assessing the feasibility of the plans and monitoring the implementation, leading to a higher possibility in recollecting the funds.

Thirdly, policies should be directed towards regulating the rural credit market in order to overcome its weaknesses by relying on the strengths of other markets. The officialisation of unofficial credit channels will have positive impacts on the creation of funds for rural households thanks to its efficiency, which is reflected in the low expenses for the apparatus, the flexibility in terms of the due dates and scales of the loans, the clearly defined purpose of borrowing, and the high feasibility and repayment possibility.

In addition to lending, official credit institutions need to set up networks to attract investment capital in localities in order to mobilise savings among the public for the use in investments.

6. Conclusions

The system of official credit in rural Vietnam has operated with relatively high efficiency and equality with the number of households being granted loans gradually increased year by year while the number of those who are declined of this type of credit is very small. Mass organisations play a very important role as the “extended arms” of banks in providing guarantees in the form of groups. This mechanism is effective in overcoming the issue of asymmetrical information in screening for loans and monitoring debt collection in microcredit schemes. It will also contribute to improving the ability to properly access official, semi-, and non-official credit, and will continue to play an important role in capital provision in rural Vietnam via models such as borrowings-cum-saving, lending-cum-investment, and rotating saving groups.

Notes

² In several places, payments are made to the nhà cái (the host - the tontine leader), who is entitled to part of the contributed money and is responsible for paying the participants when their turn is due; in other places, money is paid directly to the person in his/her turn.

³ Asymmetrical information is a term used to denote a phenomenon where different parties do not have equal information on subjects with which they all are concerned. In credit activities, lenders are not as well-aware of the borrowers and the prospects of projects that will be carried out by the latter as the borrowers themselves.

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