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Microfinance in Vietnam

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Vietnam is a communist-controlled country of 86 million people in Southeast Asia. In 1986, the country underwent a series of massive economic reforms, called Doi Moi, in order to shift their market economy from centrally-planned to socially-oriented. This market revolution has "boosted economic performance, improved rural infrastructure, curbed inflation, raised the living standard, reduced national poverty, and [helped to] establish trade relations with other countries" (McNamara 377).

Despite this incredible progress, including an average gross domestic product growth rate of 6.7% between 1986 and 2013 ("GDP Growth" 1,5), as well as a 977% increase in gross domestic income per capita between 1990 and 2013, poverty is still a major problem for the Vietnamese ("GNI per Capita" 1,4). In 1993, an astonishing 58.1% of Vietnamese had a per capita expenditure under the poverty line. 66.4% of the rural population and 24.9% of the urban population make up this total 58.1%. By 2004, these rates had dropped to a more promising 19.5%, split 25% and 3.6 for rural and urban populations, respectively (Cuong 157).

Aware of this poverty problem, Vietnam has invested extensively in the growing microfinance movement inspired by Bangladesh's Grameen Bank. Microfinance is an umbrella term that generally refers to the providing of financial products and services to the poor. These include credit, savings, and insurance, among other financially related entities. An important facet of microfinance is microcredit, which are the small loans

given, usually to groups of entrepreneurial women, with the goal of alleviating poverty through microenterprise development.

As a result, the Vietnamese government has created the Vietnam Bank for Social Policies, or VBSP. The VBSP uses a Grameen Bank inspired model to lend credit to the poor at low interest rates without the need for collateral. It is a group-based lending scheme in that in order to receive a loan, a household must join a credit group in their area. Each credit group is made up of between five and fifty households; each household is usually represented by a woman.

There are four main factors that determine whether a household has eligibility for the program. First, the household must have a long-term residence permit. This is likely to deter the theft of loans. Second, each household must have at least one member who is able and willing to work. The ability to generate an income is important because of the required weekly payments. Third, each household must have a demonstrated demand for credit. That is, they must show why they need the money, how they will use it, and how it will generate future cash flows. And finally, each household must be classified as poor by Vietnam's Ministry of Labor, Invalid, and Social Affairs (Cuong 156).

Once a group is established, they may apply for a loan as one unit. After the loan is disbursed, the group decides which member will have access to the funds first, as only one member may use the loan at any given time. This creates a policy of self-policing, which is furthered by mandatory

weekly group meetings. In these meetings, entrepreneurial progress and problems are discussed. Additionally, this is where the required weekly principal and interest payments are collected, as well as mandatory deposits into a savings account (Nghiem 622). As of 2006, the Grameen Bank model for microcredit has helped 113 million clients, 95 million of which are women, and has averaged a 95% loan repayment rate (Shakya 1215).

Despite the outreach and astonishing repayment rates, both considered strong metrics of success, the microfinance programs have failed to achieve their desired results with regards to development and the alleviation of poverty in Vietnam. That is, creating a sustainable system of development targeted exclusively at the poor population. Higher than expected leakage rates show that the programs have increasingly helped the non-poor. In addition, there is evidence that some microcredit providers, including the VBSP, avoid distributing loans to the poorest of the poor altogether. And because of the misuse of capital and debt manipulation, as in loan swapping, the microfinance picture has become an increasingly unstable cycle of debt, foreshadowing a likely collapse of the programs due to unsustainability.

This is not to say that the programs have been a complete failure. A major objective of microcredit is the creation of microenterprises, and there is conflicting evidence that suggests that it has been successful on this front. There is also some evidence that microfinance has increased income and consumption among the poor. However, these increases are far from

consistent enough to be considered a widespread success. Further, none of the apparent successes of microfinance in Vietnam have shown any potential to alter the inherent unsustainability of the programs.

In one study, clients of a program based in Hanoi admitted that the loans would be “suitable and convenient for start-up and very small businesses”, or microenterprises (Nguyen 86). In addition, it was shown that the loans helped shape saving habits, build social capital, and overall, had a positive impact on the lives of their borrowers, all of which are objectives of microfinance (Nguyen 91-92).

In another study, it was shown that duration of participation in microfinance programs significantly increased income by up to 5% per month. In addition, those participating in the program for over five years saw increases in income and consumption. However, when controlled for two variables, average education level and age of the household head, the results became insignificant. The increases in income and consumption when controlled were just 0.35% and 0.19%, respectively. Consequently, it was ruled that microfinance loans have no statistically significance effects on household welfare in Vietnam (Nghiem 628-630).

One problem with microfinance in Vietnam is the increasing leakage rates. The term leakage rate refers to the amount of benefits that are distributed but not received by the target group. In this case, the leakage rate is the percentage of non-poor households, defined by the Ministry of Labor, Invalid, and Social Affairs, that have received microcredit aid in lieu

of poor households. In 2004, the microcredit leakage rate in Vietnam was 73.2%. In addition, non-poor households receive loans that are, on average, 14.6% larger than those of poor households. To reiterate, 75.8% of aid supposedly earmarked specifically for poor households went to those households defined by the Vietnamese government as not poor. Further, only 17% of poor rural households borrowed money in 2004 (Cuong 159-160).   This is especially alarming considering that 95% of Vietnam's poor population comes from rural areas (Cuong 157).

There are several reasons why Vietnam's microfinance initiatives have not effectively targeted the poor, sometimes avoiding the poorest of the poor completely. The first factor is by design of the group system. Being that all group members are responsible for the loans dispersed within their own groups, there is a built-in selection bias. One borrower said, "We don't allow some people with weak economic status to join our borrower group for fear they won't be able to repay their loans and we would become liable" (Shakya 1222). Non-poor households are seen as more responsible and more likely to cover their weekly principal and interest payments. Also, it is assumed that the non-poor are not poor for a reason, and thus they will use the funds more effectively than their poor counterparts. As a result, credit groups are much more likely to accept applicants that fit this non-poor criteria. By associating with the non-poor, the credibility of the group as a whole is, naturally, increased (Cuong 161).

Similarly, in rural areas with larger populations there tend to be more households in need of loans. As a result, there are more credit groups and more applicants for said credit groups. This allows each group to become increasingly selective when evaluating new applicants. The same selection bias from above is again apparent (Cuong 165).

The third explanation as to why the microfinance initiatives have not efficiently targeted the poor is because poor households tend to apply for smaller loan amounts than those of non-poor households. It is assumed that the poor are poor for a reason, whether it is because of less education, lack of skills, or other deficiencies. Factors stemming from these deficiencies, such as reliability and consistency issues with regards to the required weekly principal and interest payments, may help to explain why poor households are reluctant to apply for loan amounts that are similar in stature to their non-poor peers. (Cuong 160).

The biggest issue with regards to microfinance in Vietnam is its increasing instabilities due to the misuse of loans and loan swapping. Instead of microenterprises being created, sustained, and grown, these actions are causing the microcredit cycle to be used as a form of wealth creation and consumption funding. As a result, microcredit is not alleviating the problem, it is becoming part of it as it becomes embedded into society.

The misuse of capital stems from microfinance's financial motivations. Lenders, including the VBSP, frown upon lending for projects with long

profit cycles. Also frowned upon are loans for projects deemed “socially stigmatized”, such as alcohol brewing, and loans for consumption, because of their obvious lack of profit. As a result, borrowers commonly indicate favorable projects on their loan applications with the intention of using the money for whatever they had initially planned. In fact, 78% of those surveyed in Vietnam reported misusing loans. The predominant reason was for consumption purposes; this includes paying down other debts (Shakya 1220).

This unsanctioned use of debt to pay down other debts is known as loan swapping, allowing borrowers to prolong their debt cycle. 92% of those surveyed in Vietnam admitted to loan swapping. As one client put it (Shakya 1220-1221):

> I keep several loans going at once…I borrow from the Women’s Union [auxiliary] fund to repay my loan from the bank. Then, later I will repay the Women’s Union fund by selling corn or borrowing money [from my neighbors] for a very short time… Sometimes I repay the loan from Women’s Union fund with the [RDSC microfinance] project loan…(Shakya 1221)

Some groups have put in place deterrents to prevent defaulting, such as seizing land, which has made loan swapping an increasingly popular method to avoid missing payments and defaulting. Additionally, loan swapping allows borrowers the ability to take advantage of the lowest available interest rates at any given time, while also leveraging their debt.

This is especially true in Vietnam where microfinance institutions offer significantly higher interest rates than some of the state run banks (Shakya 1222-1223).

Another result of the programs clear financial motivation is the incentives it offers staff for achieving increasing loan volumes and pristine repayment rates. Because borrowers who have been part of the microcredit programs longer are eligible for larger loan amounts, staff continually push existing members to borrow more and more money. This is in lieu of the programs real goal, social outreach. Those that are in most need of loans, remote rural villagers, are overlooked purely because they are not guaranteed to positively influence a staff member's metrics as much as a well-established borrower. Yogendra Shakya and Katharine Rankin sum up the cycle perfectly (Shakya 1225):

> The entire system of rural finance appears to be growing increasingly unstable, as the oversupply of credit enables consumers to endlessly finance consumption with debt. Microfinance has a distinctive role to play in this process. It was undoubtedly helped to bring interest rates down but, has also helped to perpetuate cycles of indebtedness, undermine social forms of investment and encourage borrowers to shift resources out of the subsistence agriculture base into potentially risky income generating activities. Microfinance programmes have been extremely clever in mobilising

> 'traditional' categories, such as honour, to foster entrepreneurial subjectivities in a neoliberal vein. However, governing neoliberalism has proven more complicated – less financially sustainable and politically progressive – than proponents of microfinance had anticipated. (Shakya 1227).

As was previously stated, it is clear that Vietnam has been successful in alleviating poverty, with rates declining 38.6% in the eleven years between 1993 and 2004. One possible explanation for this astonishing decline in poverty rates (3.51% per year) may be because of Vietnam's commitment to a socially-oriented market economy stemming from the Doi Moi reform initiated in 1986. However, the poverty rate is still too large, at 19.5%, and there is not enough statistically significant evidence to suggest that microfinance programs will alter this rate further.

More importantly, Vietnam's microfinance initiatives are wholly unsustainable. Microfinance is a program that was constructed to help the poor develop microenterprises; it is a program designed as a stepping stool to reach the bottom rung of Jeffrey Sachs' "development ladder". Due to high leakage rates and the misuse of loans, it is clear that households classified as non-poor are using microcredit as a form of short-term consumption funding. This phenomenon is not only taking away the poor's possibility of climbing out of poverty, but it is creating an unstable debt cycle that is surely to end in a financial collapse.

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