POLICY BRIEF:

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- Borrowing relatively small amounts might enable rural households to invest in productive activities, providing them with new sources of income or increasing their income from traditional sources, for example by investing in new agricultural equipment.
- However, many commercial banks are not active in rural areas, and the Government has stepped in to this gap in the market by setting up the Vietnamese Bank for Social Policy (VBSP) and the Vietnamese Bank for Agriculture and Rural Development (VBARD).
- This policy brief summarises the findings of a detailed household survey on the level of access to credit, the kinds of households that take on loans, and the effect of those loans on income.
- The data are taken from the Vietnam Access to Resources Household Survey (VARHS) implemented in 2006, 2008 and 2010 in 12 provinces in Vietnam. The households for which a full panel is available are spread over 437 communes, 130 districts and total 2,200 households.
- These data show that households are generally able to borrow, and that households that have loans are not very different than households that do not, suggesting that households are not generally being excluded from accessing loans.
- Loans from VBARD appear to cause higher incomes, more saving and higher productivity of household labour, while this is not true of loans from VBSP, which are frequently used for consumption, not investment.
- The overall results show a high level of access to credit, and that VBARD loans are effective in increasing income and

The full in-depth study and our other research papers and policy briefs are available at : www.ciem.org.vn/ Financial support from Danida is acknowledged with thanks.

The availability and effectiveness of credit in rural Vietnam: Evidence from the Vietnamese Access to Resources Household Survey 2006 -2008-2010

Finn Tarp
Development Economics Research Group (DERG), University of Copenhagen, and UNU-WIDER, Helsinki

Carol Newman
Department of Economics, Trinity College, Dublin

Nguyen Le Hoa,
Centre for Agricultural Policy (CAP), Institute of Policy and Strategy for Agriculture and Rural Development (IPSARD), Ministry of Agriculture and Rural Development (MARD) of Vietnam

Background

Credit (loans) allows businesses to expand or enable investment in new businesses. This may be particularly important for households in low income countries that may be able to increase their incomes through entrepreneurship but do not have access to a pool of savings or other capital to do so.

Commercial banks generally do not operate in the rural sector because of lower operating costs in urban areas, higher risks of lending to rural customers whose income is derived mainly from agriculture, and difficulty getting information about rural borrowers.

In response to this gap in the market, microfinance have been found to be effective in increasing the supply of loans to households in many situations, but have also been criticized in some countries because they fail to reach the poorest households and are not cost-effective since they require continued subsidies.

Similarly, not all loans are useful: if borrowers use loans for consumption (for example, borrowing money when sick or due to unexpected flooding), then increasing access to credit might just increase their burden of debt, rather than allowing them to invest in new sources of income.

Finally, not all loans are the same: there are many informal sources of borrowing (local moneylenders or family), and there is significant evidence that this plays an important role in rural credit in Vietnam.

Introduction:

In Vietnam, rural households can access credit through two main sources: the Vietnamese Bank for Social Policy (VBSP) and the Vietnamese Bank for Agriculture and Rural Development (VBARD).

The VBARD operates on a commercial basis, while the VBSP is similar to a microfinance institution that offers lower interest rate loans to rural households, with a focus on people who are disadvantaged or disabled.

Since VBARD offers commercial loans and VBSP offers non-commercial loans at unprofitable interest rates, it is important to understand how these loans affect the households that receive them. This is not easy to answer because households that obtain loans from either the VBSP or VBARD may not be the same as households that do not obtain those loans.

We can generally measure these institution's effectiveness based on three factors: outreach, sustainability, and impact. Outreach is the whether most borrowers can access VBARD and VBSP's services; sustainability is whether these banks can operate without government subsidies, and impact is the actual effect of borrowing on households.

This policy brief summarizes evidence about the level of access to credit in rural Vietnam (outreach) and the effectiveness of these loans (impact). Using data from the VARHS shows that overall access to credit in Vietnam is very high relative to rural areas in other countries, with around 49% of households holding some kind of loan in 2010.

Examining trends over time, we see that informal credit continues to play a very important role in rural communities, while the share of VBARD loans in total credit has declined and the share for VBSP has increased. This reflects the fact that VBARD operates increasingly as a commercial bank, while VBSP focuses on low-interest loans to rural communities. But while getting a picture of access to credit is useful, what matters for household welfare is how that credit is being used.

This high level of access to formal credit from VBSP or VBARD is probably not due to the fact that households holding loans are very different from those that are not: hardly any households report asking for a loan and not receiving one, and these households generally received the amount they requested.

However, it may still be the case that the households without a formal loan would like to have one but are excluded. Looking purely at household data suggests that households that have a formal loan are on average richer, better educated, larger, and more likely be headed by a man, own a Red Book for land, and be members of Women's and / or Farmer's Unions.

Who gets a loan ?

Despite the difference in *average* characteristics of households with a loan from VBARD or VBSP and those without one, statistical analysis of the household data shows that there are, overall, no major differences between households with and without formal borrowing. This is preliminary (and encouraging) evidence that households without credit are not being excluded from the market for formal loans.

Another very strong finding is that households that experience sudden, unexpected falls in income (for example, the head of the household becomes ill and cannot work) are more likely to have a loan through VBARD or VBSP. Borrowing money appears to be one way households cope with bad events.

Mass organizations also play an important role when considering access to credit. Households that are members of Farmer's Unions are more likely to access loans for agricultural purposes while households that are members of Women's Unions are more likely to access loans for non-farm and investment purposes.

Finally, in many cases the loans are used for a different purpose than the one originally stated, suggesting that both VBARD and VBSP have difficulty following up on loans they have made and tracking their use.

How do loans affect rural households?

Despite the significant level of access to credit, there is very little available information on the effect of loans on income or other outcomes. Since the VARHS data allows us to track households over time, we can observe the effect of borrowing in 2006 on outcomes in 2010.

There is an overall positive relationship between credit accessed in 2006 and income in later years. This important result is only available because VARHS tracks the same households over time. This effect is particularly true for agricultural income, and suggests that access to credit is a useful tool for fighting poverty at the household level.

There is some evidence that the loans increase income by raising labour productivity, so that households that take loans earn more income for the same amount of work, compared to households that do not borrow. This effect would be consistent with households borrowing to invest in technologies that make labour more productive, particularly agricultural technologies.

We are very interested in how different types of loans affect household income, and we find some surprising results: the effect of loans from VBSP is much smaller than loans from VBARD, which have a strong positive effect on labour productivity. This effect on labour productivity is not observed for VBSP loans.

VBARD loans are also the most effective source of loans when households are borrowing for agricultural investments, but any type of borrowing (including from informal sources other than banks) increases agricultural productivity.

The in-depth study also finds some evidence that consumption loans from the VBSP reduce the number of different sources of income households have, which might be interpreted as consumption borrowing substituting for other income-generating activities. Finally, the study finds a strong effect of VBARD loans on savings, regardless of the use of the loans, while VBSP loans have no effect on savings.

The overall story is that VBARD and VBSP loans serve fundamentally different purposes. The productivity-enhancing effects of loans are only evident for loans from the VBARD, particularly for loans accessed for the purpose of investing in agriculture. In contrast, VBSP loans have a positive effect on income diversity and a negative effect on rice productivity suggesting that households accessing loans from the VBSP use them to diversify income sources rather than specializing to yield productivity improvements.

Moreover, when VBSP loans are further disaggregated it appears that consumption loans from the VBSP reduce income diversity but have no effect on other income generating activities. This suggests that they act as a substitute for productive activities.

Conclusions

- Increasing the supply of commercial credit may be a very effective tool to increase welfare in rural areas.
- Vietnam is doing well compared to many other developing countries: very few people request loans and do not receive them, and those that request loans are relatively similar to those that do not have loans, suggesting that households are not being systematically excluded from credit.
- However, not all loans are the same. When VBARD makes a loan based on commercial considerations, it appears to increase households' income, the productivity of household labour, and level of savings.
- On the other hand, loans from the VBSP are less effective, because households that experience a negative shock use these loans for consumption and to invest in less risky production activities.
- VBSP loans are important for rural households but the long-term consequences should be considered: borrowing for consumption increases households' debt but does not increase their income.
- These households will benefit from access to insurance, which provides the same service but will be cheaper for households or for the Government if it is subsidised.