SUMMARY PROGRAM IMPACT ASSESSMENT
Microfinance Development Program – Subprogram 1

I. Introduction

1. The ADB's Staff Operating Manual (OM) requires proposed Programs to properly justify the loan amount suggested.[1] The impact assessment should attempt to *ex ante* estimate the costs and benefits of the proposed Program as well as discuss the importance of the sector and adjustment costs as required. This Program Impact Assessment (PIA) presents a methodology for assessing the impact of the proposed first subprogram of the Microfinance Development Program on stakeholders.

2. This impact assessment estimates the reform program adds approximately $1.8 billion to GDP, equivalent to 1.8% using 2010 levels. The benefits arise from improved state allocative and operational efficiencies. The costs of the reform program in terms of government administrative costs and fiscal costs of implementing reforms amount to around $110 million, thus the Program providing a net benefit to the economy of some $1.7 billion.

3. The following section presents a brief Program Impact Assessment (PIA) for the Microfinance Development Program. In line with best international practices and prior PIAs, this section applies, to the evaluation of costs and benefits of the proposed program, a four-step methodology including: a) the definition of the problem (Section II); b) the definition of the impact and outcomes of the proposed program (Section III); c) a range of options considered for achieving the defined impacts and outcomes (Section IV); d) the assessment of costs and benefits (Section V). Section VI summarizes the adequacy of the program financing proposed.

II. Definition of the problem

4. **Lack of access to finance** is consistently regarded as one of the major constraints to new enterprise development and employment creation across Viet Nam. However, nowhere is the lack of adequate financial services more acute than in rural areas. Despite accounting for around 72% of the total population, rural areas of Viet Nam are host to 94% of the poor. Still, rural areas are estimated to receive just some 17% of total bank credit and less that 20% of the rural population has access to financial services.

5. A rich network of **state-owned micro-financial institutions** has steadily been developed since the advent of *Doi Moi* to cater to the rural population's need for credit and other financial services. Currently, state-owned credit institutions such as the market oriented Viet Nam's Bank for Agriculture and Rural Development (VBARD) and the non-profit Viet Nam Bank for Social Policies (VBSP) coexist with about 1,040 member-based People Credit Funds (PCFs) and some 50 semi-formal Micro Finance Institutions (MFIs) two of which have transformed into licensed credit institutions.

6. **The establishment of a level playing field for private MFIs** is however at its early stages. The current regulatory framework for the creation of private MFIs or the registration of existing semi-formal entities has been criticized for being overly complex, inefficient and restrictive, effectively imposing barriers to the development of the sector. While the last few years have witnessed a massive expansion of micro-credit services (some 50% of rural households were reported to have access to micro-credit at the end of 2009), most of the

[1] OM Section D4/BP issued on 14 October 2011.

expansion is due to government-owned entities (specially the heavily subsidized VBSP), while semi-formal MFIs accounted for just about 5% of clients and less than 1% of loans.

7. In addition, regulatory **constraints to new MFI creation** limit private sector-led innovations and overall sector efficiency, which may partly explain why micro-financial services other than micro-credit are largely absent in rural areas. The dominance of state-owned financial entities in micro-credit also means an **increasingly heavy and unsustainable fiscal burden to Government in terms of equity and loan infusion, direct subsidies, and ODA funding to VBSP collectively estimated to grow at an annual average rate of 27% from 2003–2009 and has accumulated to about D23,360 billion (USD 1.2 billion) as of end 2009, or 1.4% of GDP.** In the absence of market-led competitive pressures, state-owned financial entities have little incentive for efficiency improvement or innovation in their business processes and products. More importantly, the uneven playing field will stunt the growth and diversity of microfinance providers, that will in turn limit the choices of clients for such services.

8. The **small market share of both clients and lending** accounted by semi-formal MFIs is also due to their own limited capacities. The latter extend from inexperienced human resources to weak financial reporting skills, even at the current, relatively simple stage of development of the micro-finance industry in rural areas of Viet Nam.

9. In spite of advances to the regulatory framework exemplified in the approval of the recent Credit Institutions Law in January 2011, institutions such as the State Bank of Viet Nam will be unlikely to have the **necessary capacity to supervise registered entities** unless the number and capacities of examiners are substantially increased.

10. Lastly, Viet Nam faces a largely **inefficient financial infrastructure**, exemplified in the: (i) lack of credit information exchange among credit institutions that will help ensure portfolio quality; (ii) absence of efforts in promoting financial literacy and customer protections, and (iii) under-developed training institutions and modules for stakeholders and practioners.

III. Impact and Outcome of the Sector Development Program

11. The expected impact of the MDP is greater financial inclusion and deepened financial sector. The program outcome will be increased access of the poor women and men to sustainable and affordable microfinance services.

12. The outputs expected from the program of reforms include: (i) the creation of a policy and regulatory environment conducive to the development of a sustainable market-based microfinance; (ii) the strengthening of supervisory and regulatory capacities for a sound development of the microfinance sector; (iii) the strengthening of microfinance operating financial institutions to provide diversified, responsive, innovative and sustainable services to the poor; (iv) the strengthening of the financial infrastructure for the microfinance sector.

IV. Options to address the sector’s challenges

13. The outputs of the MDP through the program activities will include:

- (i) the creation of a policy and regulatory environment conducive to the development of an inclusive and sustainable market-oriented microfinance sector;
- (ii) the strengthening of the supervisory and regulatory capacities of the microfinance sector regulators;

(iii) the strengthening of the financial institutions involved in microfinance to provide affordable and sustainable services to the poor; and
(iv) the development of the infrastructure for the microfinance sector.

14. To help the MDP deliver its outputs, Government will provide fiscal support to:

(i) assist VBSP in its efforts to achieve operational self sustainability and financial self sustainability in line with its Development Strategy towards 2020,
(ii) initiate the transformation of CCF to become a cooperative bank and the restructuring of the CCF/PCF network along widely-accepted financial cooperative principles, and
(iii) help the Banking Academy establish a microfinance center to provide capacity building services to the microfinance sector.

V. Impact Analysis

15. This section presents estimates of the economy-wide benefits and costs of the Microfinance Development Program, subprogram 1. The assessment of net benefits associated to the package of reforms contained in this program would ideally require the consideration of both the static and dynamic dimensions of the reform. That is the first and subsequent rounds effects of the activities implemented. The latter are somewhat hard to estimate due to absence of data. Accordingly, this summary analysis is necessarily limited to the partial assessment of static costs and benefits. In a static analysis, we concentrate in the impact of the variation of a single variable on our variable of interest, assuming all other relevant factors remain immutable. A common example is the analysis of the impact on income tax revenue collections from a reduction on the marginal tax rate.

16. A dynamic assessment would in turn require forecasting the levels of a wide range of variables over the medium to long term, and then estimating the expected costs and benefits of the set of reforms proposed, based on the evolution of the whole set of variables over time. In our earlier example, the reduction of marginal rates in the income tax may affect the size of the tax base due to increased compliance by tax payers. Thus the impact of collections will be a function of not only the tax rate, but also of the way the tax base evolves with such changes on the rate (or other variables). For dynamic cost benefit analysis, computer general equilibrium models have been widely used as a preferred methodology.

17. Despite its obvious limitations, it is possible to draw substantial insights from the short term static analysis of the net benefits expected from the reforms. And in fact, our preliminary assessment below suggests that very sizeable gains can be obtained from the proposed program.

Benefits Estimation – Economy wide gains from improved Microfinance

18. Weaknesses in the policy and regulatory framework the micro finance sector and distortions in the incentives facing state-owned and private financial institutions can impose severe costs on the economy that impede economic growth. The first cost arises from the misallocation of budgetary resources to inefficient institutions not subject to market demands, the so-called allocative efficiency.

19. Improving the sector's efficiency and quality and diversification of microfinance products could render important benefits in the form of reduced transaction costs and reduced financial expenditures for households. Improved efficiency of microfinance operations could reduce the

transaction costs associated to the lending process (time spent in identifying suitable lenders and products, cost of processing loans, etc.). In addition, better targeting and product development would assist improved financial management by households, who would not need frequent access to financing from formal or informal lenders. This would likely result in overall lower interest payments by households.

20. The mobilization of savings deposits will contribute to the increase on M2/GDP ratio by 10% in 2014, which is generally correlated with the level and rate of change in GDP growth, and to the overall level of financial development in a country. In the case of Viet Nam, for such relation to take effect, it will be critical to upgrade the infrastructure of the microfinance sector, which will be addressed with fiscal support by Government to relevant entities. Under the very modest assumption of a 1 percentage point of GDP increase per a 10% increase in the M2/GDP ratio, the Program's overall impact would contribute 1 billion dollars to the national GDP.

21. The Program estimates regulatory reforms geared towards increasing access to microfinance services would allow a 10% increase in savings accounts, or an estimated one million new accounts. Over the duration of the program, it is expected that savings mobilized from MFIs will increase by some $25 million of otherwise unproductive capital.

Benefits Estimation – Strengthening of financial institutions

22. The leading provider of microfinance services, the VBSP offers interest rates between 0 - 10% to its over 7 million clients, effectively offering a negative real interest rate at times where year-on-year inflation is running at some 20%. The alignment of the largely subsidized interest rates applied by the VBSP with market leader's rates and inflation rates would allow the collection of over $230 million per year in interest payments based in VBSP's 2008 loan portfolio[2]. Over the full duration of the program (3 years), the benefits could amount to over $600 million. Such alignment would be conducted at minimal marginal cost for clients that currently benefit, on average by less than 2 dollars per month per household from the subsidized rates, and would ease fiscal pressure on Vietnamese tax payers now footing the bill.

23. The reform of VBSP into a market-oriented institution could render savings of over $200 million from reductions in direct subsidies in the next few years. That would require a reduction of over 20% on the amount of direct subsidies as the fiscal self-reliance of the institution increases as it applied market principles to its operations. Savings would be obtained from the reductions of direct subsidies, lower opportunity costs on capital infusions and borrowing from SBV (enhanced efficiency), higher income tax receipts and lower foreign currency losses.

24. The reforms proposed under the program, in particular improvements to the operations of the VBSP that enhance the latter's operational and financial sustainability would also allow reducing the current financing gap by some $230 million (bringing it down from 58% of total loans disbursed to 30%). The associated enhanced savings mobilization would help reduce financial lending costs, and would assist the modernization of operational practices as MIS reduce administrative costs.

25. The formalization and strengthening of semi-formal MFIs could render savings on interest payments of up to $9 million if rates were to be aligned with those of the market leader. The differential on interest rates between semi-formal MFIs and the VBARD is around 1

[2] Estimates assume a monthly interest rate of 1.67% (or 20% per annum) for market leaders and VBSP monthly rates at 0.65, over a total loan portfolio of close to $2 billion dollars for VBSP in 2008.

percentage point, which represents $750,000 of additional interest payments per month on their overall loan portfolio (or $9 million per year) than if VBARD rates were to be applied. These estimates could be doubled if other fees and compulsory savings required from MFIs were to be reduced in half as their efficiency as lending institutions is improved.

26. The package of reforms aims to allow PCFs to operate like true financial cooperatives which have universally been proven as a good financial service providers, especially in rural, remote areas and among lower income HHs who otherwise cannot be serviced by banks; financial cooperatives promote self-reliance, mutual assistance and thus are good financial intermediators among members. In essence, this could allow replacing the GoV's social protection scheme operated by VBSP relying on the state budget with the private sector operations of PCFs supported by their members.

27. Proposed amendments to the regulatory framework of PCFs will allow them to increase their outreach and thus compete efficiently with other institutions (and even offer option for the exit of Government from VBSP) turning over direct financial savings in financial costs and fiscal savings for the GoV. VBSP alone claims 3.8 million out of a total 7.8 million clients as poor. Given the latest poverty rate of 13% (MOLISSA) and assuming a national population of 85 million (with 20 million households), the total of poor households would be around 2.6 million, below VBSP's 3.8 million of poor clients.

Table 1. Potential Economic Gains from MDP Subprogram 1

		Gains (million USD)	Share of GDP (%)
1.	Economic growth from allocative efficiency	1,000	1%
2.	Lower fiscal burden from alignment of VBSP interest rates with market	600	0.6%
3.	Lower fiscal burden from reduction on direct subsidies	200	0.2%
4.	Strengthening of semi-formal MFIs	9	0.01%
5.	Savings mobilization from MFIs	25	
	Total	1,834	1.82%

Costs Estimation

28. Adequate, albeit static, estimation of the costs associated to the proposed program requires the consideration of costs borne not only by Government agencies, but by the financial institutions and relevant stakeholders as well. For the former, we classified costs among: 1) administrative costs (or directly derived from the implementation of the program by Government agencies); 2) enforcement costs (incurred during the enforcement or regulations and monitoring of compliance); and 3) fiscal costs (associated to required budgetary expenditures, foregone tax revenue, financial costs, etc).

29. On that basis, an initial estimate of costs would include:

Table 2. Potential Costs to Government from the MFDPL – SP 1

Viet Nam Microfinance Microfinance Development Program: Summary of Cost Estimates		
Types of Adjustment Costs	**Government and Statutory Agencies**	**Financial Institutions**[3]
Administrative Costs	1. Legislative initiatives: $6 million[4] a) Issuance of circulars and IRR on regulation for MFIs;[5] b) amendments to Insurance Law allowing micro-insurance schemes c) new Credit Institutions Law[6] (CIL) d) issuance of IRRs for new CIL e) draft amendments to VBSP decree 2. Policy, strategy formulation - $4 million [7] a) crafting VBSP strategy b) crafting CCF/PCF strategy, CCF conversion to cooperative bank c) drafting & adoption of microfinance strategy and roadmap, including set up of MF Steering Committee, MF Strategy Working Group; d) formulation of National Strategy on Gender Equality e) study options on social policy lending f) study regulatory & fiscal incentives for microfinance operating CIs 3. Capacity-building - $2 million for: - SBV regulators for supervision of MFIs, PCFs; & monitoring VBSP - MOF, MPI, MOLISA oversight units for supervision of VBSP 4. Banking Academy (BA) –	1. VBSP strengthening - $6.4 Million a) reforms and training to self-sustainability b) transformation of CGSs (200,000) c) clients' financial literacy program 2. CCF/PCF strengthening $4.6 Million a) CCF conversion to cooperative bank b) PCFs enhanced ownership & governance (1,100) c) Members' financial literacy program 3. MFI strengthening - $2.0 million (about 40 - including transitional non-regulated MFIs)

3 With fiscal support from Government for items 1 and 2 (strengthening of VBSP and CCF/PCF)
4 Involving various ministries, offices: MOF, SBV, MPI, MOLISA, Office of PM, and Parliament (for Laws)
5 Amendments to Decrees 28 and 165 which were considered restrictive
6 A far-reaching overhaul of the Banking Laws which include among others the integration of microfinance into the formal banking system, liberalization of interest rates, prescribing: ownership and governance structure of MFIs, People's Credit Funds (PCFs), Cooperative Banks, and oversight of policy banks
7 Same ministries and offices involved in legislative efforts as above-mentioned

	Microfinance Center increased operating costs $2.10 million 5. Credit Information Center - $200,000 setting up microfinance credit info exchange system	
Enforcement Costs	1. Increased supervision costs: $8 million - The augmented supervisory responsibilities of SBV over the reformed and more robust microfinance sector, and of MOF, MPI over VBSP will increase costs of monitoring, supervision and enforcement of regulations (estimated at $2 million/year, 4 years)	
Fiscal Costs	1. Tax holidays, exemptions and regulatory incentives offered to MFIs – unquantifiable as of now (estimated at $5 million per year). 2. Personnel and operating costs associated to the extension of the number of regulators for the SBV, and the capacities of the VAPCF and MFWG as knowledge exchange hubs for MFIs – unquantifiable as of now (estimated at $1 million per year).	
Business Compliance Costs		(i) Compliance requirements**:** $10 million 6 MFIs; 1,100 PCFs; Coop bank; VBSP; converted CSGs (ave. $ 2.5million/year, 4 years) - meeting regulatory requirements and international standards (registration, tax compliance, provision for general and specific loan loss reserves, deposit insurance, etc.) - adequate reporting and provision of financial information
Total Estimates	**$28.30 Million**	$23.1 million **Total discounted Present Value: $110 million**

VI. Program Financing

30. The government has requested a loan of $40 million to finance the first subprogram of the Microfinance Development Program from Asian Development Bank Special Resources. The size of the loan is based on a number of factors. The key considerations include:

(i) The relative importance of the sector to the economy. The set of policy reforms and project initiatives proposed may conservatively add $1.8 billion to GDP, or approximately 1.8 percentage points over the duration of the program.

(ii) The adjustment costs. The policy adjustment costs to the Government are conservatively estimated as a discounted present value lump sum of $110 million (Table 2). These include the administrative, investment and fiscal costs to the Government in implementing the reforms. As a result, the expected net benefit from the program is estimated at some $1.7 billion.

(iii) The reform program includes several politically sensitive and complex policy and institutional reforms that have are likely to be resisted. To support the reforms, the program amount loan provides leverage to the executing and implementing agencies to support implementation.

(iv) The program loan also reflects the government's development financing needs as well as the need to conform to the overall financing requirement from the country partnership strategy period.