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STAFF APPRAISAL REPORT

SOCIALIST REPUBLIC OF VIET NAM

RURAL FINANCE PROJECT

APRIL 2, 1996

Agriculture and Environment Operations Division
Country Department I
East Asia and Pacific Regional Office

CURRENCY EQUIVALENTS
(As of March 23, 1996)

Currency Unit = Vietnamese Dong
US$1.00 = Dong 11,018

WEIGHTS AND MEASURES
Metric System

ACRONYMS

ADB	Asian Development Bank
BIDV	Bank for Investment and Development of Viet Nam
BP	Bank for the Poor
CGAP	Consultative Group to Assist the Poorest
DOSTE	Department of Science, Technology and Environment
FRP	Fund for the Rural Poor
GOV	Government of Viet Nam
ICBV	Industrial and Commercial Bank of Viet Nam
IFAD	International Fund for Agricultural Development
MAFI	Ministry of Agriculture and Food Industry
MARD	Ministry of Agriculture and Rural Development
MOF	Ministry of Finance
MOSTE	Ministry of Science, Technology and Environment
MPI	Ministry of Planning and Investment
NGO	Non Government Organization
PCF	Peoples' Credit Funds
PFI	Participating Financial Institution
RDF	Rural Development Fund
SBV	State Bank of Viet Nam
SOE	State Owned Enterprise
SOCB	State Owned Commercial Banks
UNICEF	United Nations Children's Fund
VBA	Viet Nam Bank for Agriculture
VFU	Viet Nam Farmer's Union
VIETCOMBANK	Bank for Foreign Trade of Viet Nam
VLSS	Viet Nam Living Standards Survey
WU	Viet Nam Women's Union

FISCAL YEAR (FY)

Government: January 1 - December 31
IDA: July 1 - June 30

SOCIALIST REPUBLIC OF VIET NAM

RURAL FINANCE PROJECT

CREDIT AND PROJECT SUMMARY

Borrower:	Socialist Republic of Viet Nam
Implementing Agency:	State Bank of Viet Nam (SBV)
Beneficiaries:	Participating Financial Institutions and Bank for the Poor
Poverty Category:	Program of Targeted Intervention. The Project includes specific measures to increase access to financial services for the poorer half of the rural population.
Amount:	SDR82.7 million (US$122 million equivalent)
Terms:	Standard IDA terms with 40 years maturity
Commitment Fee:	0.50% on undisbursed credit balances, beginning 60 days after signing, less any waiver.
Relending Terms:	The Government of Viet Nam (GOV) represented by SBV would onlend the proceeds of the IDA credit to Participating Financial Institutions (PFIs), either in US dollars or in Dong and to the Bank for the Poor (BP), in Dong, to finance eligible sub projects. SBV would bear the credit risk at the level of the PFIs. Maturities of loans from SBV to PFIs and BP would conform to the composite maturities of sub-loans made by the PFIs and BP to sub-borrowers. Dollar loans to PFIs would bear a LIBOR-based variable rate of interest plus margin. Local currency loans to PFIs would bear a variable rate of interest equal to the weighted actual cost of loanable funds adjustable quarterly, or a fixed rate with a return similar to that of the variable rate. Onlending to sub-borrowers would be at commercial (market) rates and terms of the PFIs for similar lending operations in accordance with a lending policy manual agreed to with IDA. GOV would bear the foreign exchange risk associated with the Credit in SDRs and either the PFI or the end-user would bear the foreign exchange risk associated with dollar loans. For the Fund for the Rural Poor (FRP), IDA proceeds would be onlent to the BP in Dong to finance eligible sub-projects, at a fixed or variable rate of interest adjustable quarterly. For both the RDF and FRP, proceeds accrued from the repayment of the principal of the loans to PFIs and BP would be used to establish and maintain revolving funds for onlending for the same purposes and under the same terms and

conditions as those for onlending under the IDA Credit (RDF and FRP).

Financing Plan:	See Para.3.8
Economic Rate of Return:	For sub-projects requiring loans greater than the equivalent of US$50,000, a cash flow analysis would be required for RDF sub-loans. No overall rate of return is applicable. FRP sub-loans will not exceed $1,000 and therefore no cash flow analysis will be required.
Staff Appraisal Report:	No. 15088VN
Project Identification No:	4847

Socialist Republic of Viet Nam
Rural Finance Project

Staff Appraisal Report

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This report is based on the findings of a pre-appraisal mission of July 1995 and an appraisal in December of the same year. Mission members were Messrs. William Cuddihy (Task Manager), Arie Chupak (Sr. Financial Analyst, EA1AE), Cuong Hung Pham (Operations Officer, RMV), Khalid Siraj (ASTTP), Carlos Cuevas (ASTHR) and Klaus Vogl (PMDAI). Peer reviewers were Ms. Lynn Bennett (ASTHR), Mr. Jacob Yaron (AGRAP), and Mr. Khalid Siraj (ASTPP). The responsible Division Chief was Mr. Jeffrey Gutman (EA1AE) and the Director was Mr. Callisto Madavo (EA1). The Task Assistant responsible for document processing was Ms. Amanda Days.

TABLES IN TEXT

ANNEXES

CHARTS

1. THE RURAL SECTOR

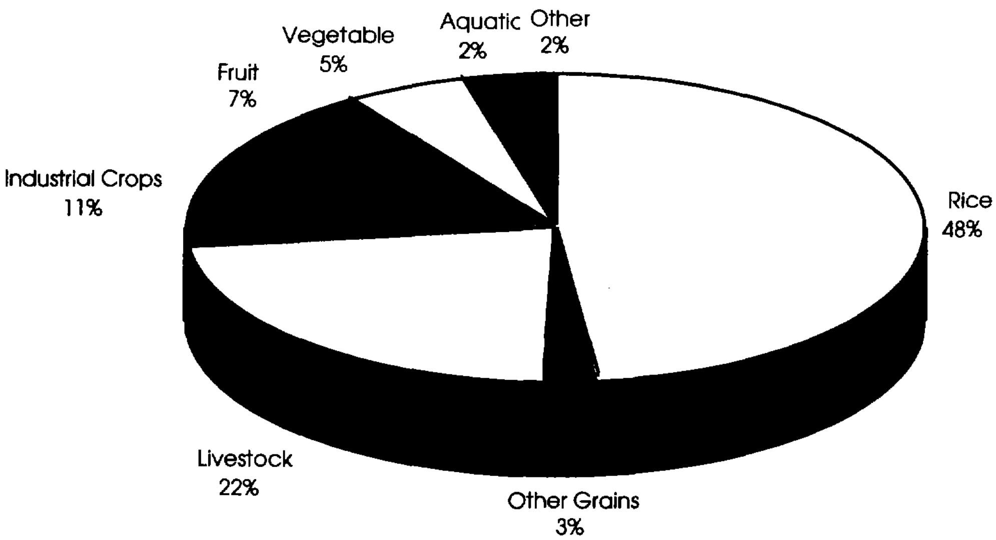
Agricultural Structure and Performance

1.1 Background. Viet Nam's society is predominately agrarian and its traditions are based on production and distribution of rice. Some 80 percent of the population of 73 million people live in rural areas and 70 percent of these rely exclusively on farming. Another 20 percent are dependent on a mix of farming and non-farm employment. The total workforce in rural areas is about 27 million of which some 22 million are engaged in agriculture. Despite increasing urbanization, the rural workforce is growing rapidly due to the young age structure of the population. Recent growth in sectoral GDP of some 4 percent has been high relative to that of other countries but low relative to that of the economy as a whole currently approaching 9 percent. The main source of sectoral growth has been intensification of rice production following de-collectivization and the return to family farming after the 1986 - 89 reforms. The different rates of sectoral growth have transformed the structure of the economy and agriculture now contributes 36 percent to GDP, behind services at 37.5 percent of GDP and growing at 10 percent per year, and soon to fall behind industry at 25.3 percent of GDP and growing at 14 percent per year. The uneven growth has also resulted in widening income differentiation and concerns about poverty concentration in rural communities (para. 1.9).

1.2 Land Use and Production Structure. Of the total land area of 33 million ha. in Viet Nam, 7 million ha. are cultivated. Some 5.5 million ha. of this are cropped annually and 1.5 million ha. are planted to perennials and pasture. The area served by irrigation is 2.4 million ha. and is mainly for rice growing. Food crops, mostly rice, account for about 50 percent of the gross value of sectoral output of some US$7,503 million at current prices for 1994, while livestock and industrial crops account for some 22 percent and 11 percent, respectively (Chart 1). Fruits and vegetables contribute another 7 percent and 5 percent. Inland aquatic products contribute 2 percent and other minor crops make up the balance of 2 percent.

1.3 Production and Growth. Until the recent reforms, the major constraints on aggregate growth were low levels of on-farm investment, weak production incentives, and poor performance of state farms and collectives. Response to the policy changes has been remarkable with a 37 percent increase in paddy output between 1988 and 1994, from 17 million tons to 23.4 million tons. Most of the growth comes from a 37 percent aggregate yield increase with marginal expansion of irrigation area and cropping intensities. Yields are moderately high at 5.0 tons/ha. for the spring crop and low at 2.8 tons/ha. for the summer crop mainly as a result of cloud cover during much of the growing season. The major rice production regions are the Mekong Delta producing 50 percent of the paddy crop and the Red River Delta producing a further 20 percent.

Chart 1 - Viet Nam: Structure of Agricultural Production



1.4 Among other crops, the production response has been slower but is beginning to emerge. For example, production of industrial crops of coffee, tea, rubber, groundnuts, jute, sugarcane, soybeans, coconut, cotton and mulberry has been concentrated among state owned enterprises (SOEs) and was disrupted by the curtailing of subsidies and financing. Enterprise restructuring and the entry of the private sector has begun to show an output response. Production of other food crops such as fruits, vegetables, maize, sweet potatoes, and cassava is increasing slowly but the poor development of export markets generally discourages investment except in special cases. For example, fruit tree establishment is beginning to displace large areas of paddy in the Plain of Reeds. The livestock subsector, dominated by pork production is growing rapidly at about 4 percent annually fueled by urban demand and exports. Similarly, output of inland aquatic products is expanding rapidly, from 876 tons per year in the late 1980s to about 1,200 tons per year by 1995.

1.5 Supply Potential. Although most of the recent sectoral growth comes from adjustment response in rice production, there is still considerable scope for paddy yield improvements. Progressive growers in those areas well served with reliable irrigation, extension, credit and other services are routinely achieving 8 tons/ha. of spring paddy. With the spread of improved services, it can be expected that this yield level would at least flow through the major deltas. In particular, the further spread of hybrid rice would increase average yields. In addition, major gains would come from closing the 30 percent gap between irrigation design service areas and areas actually irrigated. Of the industrial crops, the lagged production response is beginning to be evident particularly in rubber, cotton, coffee and tea. However, yields are still low. Renovation of the generally outdated primary processing facilities would greatly improve prices received from higher overall product quality and better grade differentiation - particularly for rubber and tea. Output of other foodcrops, fruits, vegetables, and livestock products is expected to grow rapidly to meet rising domestic demand in urban areas. Based on these considerations, a continued annual growth rate in agricultural value added of about 4 percent is to be expected. The main constraints on reaching a higher growth rate are the limited scope for expansion of any one crop without reduction of the area of another or moving into marginal lands (para.1.11) and the shortage of investment funding for on-farm development and for improvement in supply of public services, particularly irrigation.

1.6 Demand Potential. Both domestic and foreign demand prospects are strong. Rising population and real income is increasing demand for more, and more diversified, farm products. Just to maintain the present situation a 3 percent real growth in sector output would be required. The scope for import substitution is large with, for example, present dairy production meeting only 10 percent of current consumption and present cotton production only meeting 7 percent of cotton demand. On the export side, there is strong demand particularly for Vietnamese rice and for rubber in which Viet Nam has a strong comparative advantage due to low labor costs and considerable sunk costs in plantation infrastructure. However, Vietnamese agricultural products are generally sold at a discount on world markets because of low and variable quality resulting from poor processing facilities. Exports from rural areas account for more than 70 percent of Viet Nam's total exports. Agricultural exports make up about 65 percent of total exports. Rice exports are the largest (US$423 million in 1994), and together with rubber and coffee exports (US$462 million), are of greater value than petroleum exports (US$866 million). Recent growth in the value of agricultural exports has been quite high with rice exports growing at about 15 percent per annum and rubber and coffee exports growing at 80 percent and 190 percent per annum, respectively, over the last three years.

Rural Industries

1.7 Some 10 percent to 30 percent of the gross value of production in rural areas comes from non-farm activities - rural industries and services. Rural industries in Viet Nam are small, mostly employing 5 people or less, are not well developed, have low productivity with equipment typically 15 - 25 years old, and are usually associated with primary processing of farm products. Nevertheless, the presence of industry in a rural location is strongly correlated with income levels and growth. In 1993, the value added per worker in agriculture was Dong 1,673 compared with Dong 4,174 for the economy as a whole reflecting the higher value added of industry and services. The 1994 Viet Nam Living Standards Survey (VLSS) confirmed that farm families with some off-farm income typically had higher incomes than those without. Of the total rural labor in that year, some 83 percent were occupied in agriculture, forestry and fisheries while 6.5

percent were occupied in industry and construction, and a further 10.5 percent were occupied in services and administration. A 1992 Ministry of Agriculture and Food Industries (MAFI) survey of 60,019 rural enterprises found that 98 percent belonged to the private sector and that most lacked adequate capital, market knowledge, technology and management skills.

Rural Services

1.8 Supply of services to rural areas, such as water supply and sanitation, electricity, health, education, savings and credit are inadequate and relatively less than those provided to urban areas. The VLSS indicated that formal credit covered about 30 percent of households receiving loans with the balance coming from private money lenders at an interest rate of up to 9 percent per month. The MAFI survey indicated that only 25 percent of the demand for credit for industrial enterprises in rural areas was being met and that terms were too short for industrial enterprise development. Despite installation of over 80,000 rural water supply facilities, UNICEF estimates that less than 25 percent of the rural population has access to safe drinking water. Similarly, rural areas typically have poor access to electricity, transport, health and educational services. In 1994, 50 percent of rural households were without electricity and 60 percent without telecommunications service. The road density of Viet Nam is only 0.03 km/ square km compared to ratios of 0.15 for Thailand and 0.52 for the Philippines, and with 90 percent of local roads being unpaved.

Rural Poverty

1.9 Viet Nam is poorer than the Philippines, Indonesia, or China with 51 percent of its people living in absolute poverty compared with 37 percent, 15 percent, and 9 percent respectively for the other countries. The Bank/SPC poverty report " Viet Nam : Poverty Assessment and Strategy", of January 1995, uses the broad definition of poverty that includes consumption of food and non food and found that more than 90 percent of Viet Nam's poor live in the countryside and the incidence of poverty in rural areas is 57 percent, more than twice that of 27 percent for urban areas. Poverty incidence is highest among minorities and in the mountains of the Northern Uplands and the Central Highlands. The 1993 data show that the poorest provinces of Son La and Lao Cai in the Northern Uplands had per capita annual average incomes of only US$60 and US$80 equivalent. Malnutrition continues to be a serious problem. Nearly 50 percent of children under the age of 5 suffer from malnutrition and more than one half the population eats less than 2,100 calories per day. The main cause is that the average farm is simply too small to support the average family. For example, a typical farm family of seven would require about 2.5 tons of paddy per year to meet its minimum income requirements. An average farm size of 0.3 ha. in the North giving two crops per year would give about 2.0 tons of paddy per year. Families with less than the average area or unable to double crop would not meet acceptable subsistence needs.

Sectoral Issues and Policy

1.10 Food Security. The main sector issues are food security, land use, poverty, and regional imbalance, and low resource mobilization. Viet Nam's population is likely to continue to grow at some 2 percent annually for the rest of the decade then to decline to about 1.4 percent annually thereafter. This would add another 10 million people by the year 2000 and would end rice exports and give rise to localized shortages even in producing areas, unless production growth can be maintained. While famine no longer occurs, malnutrition is still common with severe food shortages in the northern uplands and elsewhere in the winter months. The alternative of importing shortfalls is not entirely satisfactory because of the lack of purchasing power of significant groups and the logistical difficulties involved in distributing food over the poor transport network in an emergency. Government policy requires floor prices for paddy in formal markets, maintains strategic rice reserves, and regulates use of paddy lands as well as investing in irrigation, drainage and support services.

1.11 Land Use. The competition for land between farm and non-farm use is particularly intense around urban areas as buildings spread and land prices increase. Within agriculture, the competition is between diversified crops to increase incomes and spread risk, and basic food production. In upland areas, land use competition between shifting cultivation and watershed protection is particularly severe. Of Viet Nam's 19 million ha. of forest land, only 48 percent is actually covered by trees. The Bank's 1995 study "Viet Nam: Environmental Program and Policy Priorities for a Socialist Economy in Transition", estimates that forest cover on the Northern Mountains, the largest forested area, has declined from 95 percent to 17 percent over the recent decades and that the remainder is degraded. Watershed degradation by shifting cultivation of steep slopes is the cause of land slides, destroyed roads and bridges, erosion, dam siltation, river bank scouring, and increased flood damage. This issue is particularly difficult to resolve because some 3 million people are dependent on this economic activity. Government has initiated an extensive reforestation program and is assisting with resettlement into lowlands. Unfortunately, the absorptive capacity of the already crowded lowlands is small and resettlement is being directed to marginal lowlands that have other severe land use limitations such as susceptibility to frequent and severe flooding, and acid sulphate soils.

1.12 Labor Productivity. Viet Nam's labor force is well educated with a 90 percent literacy rate, highly motivated and disciplined yet labor productivity is low because of a high degree of underemployment - there are too many workers on the land. SPC estimates that some 6 million could leave farming without materially affecting agricultural output. Between 1987 and 1993, employment was terminated for almost 2 million workers in the state sector including the military. During this period the number nominally employed in agriculture rose by 3.5 million as school leavers joined the retrenched workers. With the supply of land relatively inelastic and technology changes requiring even fewer workers it is unlikely that growth in land productivity will have a large impact on rural underemployment.

1.13 Resource Mobilization. The limited availability of formal credit in rural areas is a major constraint on investment in modernization and expansion of rural industries as well as on long term on-farm investments. The main cause is the very low level of savings mobilization and the poor coverage of financial services. In 1993, less than 8 percent of household savings were deposited with banks, 10 percent were held as local currency, 4 percent held as US$, and 44 percent as gold.

1.14 Rural Policy. The Government's rural development policy explicitly recognizes that both improved land productivity and income diversification are required to make a significant impact on rural incomes. For land productivity gains it supports utilization of modern inputs, better husbandry, and provision of support services and recognizes the difficulty of reconciling food security considerations with farm income maximization by growing higher value crops. It is encouraging investment in land by issuing land titles and improving credit availability. To improve income diversification opportunities the Government is rebuilding the former strengths of the education and health systems and investing in infrastructure to attract private investment to rural areas.

2. THE RURAL FINANCIAL SECTOR

Structure

2.1 Vietnam has already taken basic macro level actions to give its economy a market orientation. As part of this reform, the formal financial sector has been restructured. The mono bank system was replaced by a two-tier banking structure to serve the needs of a market oriented economy, and facilitate implementation of monetary and credit policy for more effective macro-economic management. Accordingly, the government reorganized the State Bank of Vietnam (SBV) to function exclusively as the central bank of the country and established the Vietnam Bank for Agriculture (VBA) and the Industrial and Commercial Bank (INCOMBANK/ICB) to take over its commercial banking activities together with the two specialized banks, the Bank for Investment and Development (BID) and the Bank of Foreign Trade (VIETCOMBANK/BFT). These four State Owned Commercial Banks (SOCBs) were also restructured as independent economic entities to undertake general commercial banking activities in addition to their traditional functions. In addition the government has paved the way for the establishment of private banks, branches of foreign banks, joint venture banks, and rural credit unions. Work is also under way for the promotion of the payment system as well as bonds and equity markets. The interest rate structure has been significantly rationalized and brought closer to market conditions. All this is happening in the financial sector along with substantial liberalization of the economy including prices. The response of the financial sector has been impressive.

2.2 Financial services in Vietnam are provided by a network of banks, non-banks financial institutions, and to a large extent by the informal financial sector, particularly in the rural areas[1]. As part of the reform in the formal financial sector, the entry into the sector has been increased substantially in the last four years. The formal financial sector in Vietnam consists essentially of the banking sector. The banking system, comprises the State Bank of Vietnam (SBV), 4 SOCBs, 46 private shareholding banks, 3 joint venture banks, 9 foreign banks (and about 35 foreign bank representative offices), 69 credit cooperatives, about 200 People's Credit Funds (PCFs), 2 finance companies, and one government owned insurance company. Total deposits in SOCBs and 16 reporting private commercial banks amounted to about US$4 billion[2] (September 1994), of which SOCBs accounted for about 90 percent (US$3.6 billion).

2.3 The commercial banking sector is currently dominated by the SOCBs, which accounted for about 85 percent of commercial bank operations in Vietnam in 1994. Despite transitional problems (mainly, the inadequacy of the legal framework and banking regulations, inadequate equity and SOEs non-repayment of frozen debts, little public confidence in the banking system, and inadequate experience and expertise in commercial banking operations) commercial banks have made significant progress. Total

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[1] According to the Vietnam Living Standard Survey (known as VLSS) loans from informal sources such as moneylenders, relatives, and private individuals account for about 72% of total private rural borrowings.

[2] Based on the Financial Sector Review dated March 15, 1995.

assets of all commercial banks almost tripled between 1990 and 1994. The share of SOCBs in total bank assets, which was about 95 percent in 1990/1991, declined to about 85 percent in 1994, reflecting the significant entry of shareholding and foreign banks into the sector. There has been substantial growth in fund mobilization from, and credit to, the private sector since 1990. While in previous years most credit funds were borrowed from SBV, in 1994 about one third emanated from resources mobilized by the banking system on its own, about one third was borrowed from foreign banks, and net borrowing from SBV was reduced to about one third.

2.4 An assessment of bank financial performance is problematic as accounting practices deviate in many ways from international standard. Such information as exists on bank operations is scanty, scattered, and incomplete. Except the Vietnam Bank for Agriculture (VBA), none of these financial institutions has been audited by an external independent auditor (there are, however, plans to carry out an external auditing for all SOCBs and joint stock banks under the Banking Modernization Project during 1996). Bank profits are difficult to measure, as the information regarding their non-performing loans is incomplete and provisioning practices are inadequate. The main data available regarding bank performance and the quality of their loan portfolio relate to overdue on loan repayment, which were as high as 20 percent of their loan portfolio in 1991, but declined to 12 percent in 1994. More than 60 percent of these overdue loans are loans related to State Owned Enterprises (SOEs) of which most were inherited from SBV.

2.5 There are positive developments in the provision of rural credit through VBA, which reflect the VBA's shift away from financing SOEs toward financing private households and businesses. In 1994, VBA's lending to private rural households continued to grow, both in relative and absolute terms. From US$0.25 billion or 35 percent of its total lending in 1992, to US$0.7 billion or 57 percent in 1993, and to US$1.1 billion or 62 percent in 1994. However, VBA, and other rural financial institutions such as the emerging rural shareholding banks, the PCFs, and other credit pilot programs remain undercapitalized and require significant institutional strengthening.

Policy Reforms and Outstanding Issues

2.6 Credit Needs. Agriculture and the rural economy account for a significant share of Vietnam's employment, production, and export. The sector has played a leading role in the transition to a market-based economic system through the formation of private farms and small scale rural enterprises. This transition has been accompanied by a major increase in private demand for both investment and working capital, which has exceeded the capacity of VBA and other financial lenders to meet. It appears that the institutional credit system (mainly VBA) is currently financing only about 30 percent of private rural households, providing mainly short term credit. Based on 1994 VBA's lending volume to rural households of about US$1.1 billion, it is estimated that total credit needs for the sector is at least US$3.5 billion, a shortage of some US$2.4 billion. The credit gap in the rural sector (including credit to finance agriculture and other rural economic activities), particularly for financing medium and long term investments, is even larger, and will likely remain that way until fundamental constraints are removed, competition is enhanced and more financial institutions would actively participate in providing financial services to the rural areas, and public confidence in the banking system is restored.

2.7 Interest Rates. The range of interest rates for deposits and lending, although positive in real terms, are still controlled by the SBV[3]. In 1993 the SBV moved away from imposing sector-specific lending rates and instead, introduced different rates for financing fixed assets and working capital. Its current interest rate policy sets maximum rates on lending with no ceilings on deposits. In January 1996, the ceiling on interest rates for short term loans was set at 1.75 percent per month (21 percent per year) while that for medium and long term loans was set at 1.7 percent per month (20.4 percent per year). Term deposit rates ranged from 1.1 percent per month to 1.25 percent per month. The main issue regarding SBV's interest rate policy is its inverted lending rate structure and the ceiling on the maximum spread allowed of 0.35 percent per month (4.2 percent per year). Interest rates on medium and long term loans are slightly lower than those for short term. This inverted rate structure does not reflect maturity or credit risk premia, and discourages term lending. This situation not only generates excessive demand for long-term loans, but also adversely affects the allocation of scarce financial resources. Also, as a result of the inverted term structure, the banks cannot offer competitive corresponding deposit interest rates that could facilitate increased long-term savings. Government policy is to liberalise interest rates over the long term and interest rate reform is being pursued under the three year ESAF 1994-96. The reform agenda and status have been updated by a Bank/Fund Policy Framework Paper mission which took place in parallel with the IMF second year ESAF mission from November 9-20, 1995. Agreement on an interest rate liberalization plan satisfactory to IDA and starting in 1996 was reached. The changes in January 1996 were in line with that agreement.

2.8 Non-Performance State Enterprise Debt. One of the major causes of poor performance of the banking system has been the large amount of non-performing state owned enterprise debt. The 1995 Law on State Enterprises and the State Enterprise Reform Action Program provides the comprehensive framework and plan for reforming this sector. Already much progress has been made in reducing the number of SOEs and reregistering those remaining. A General Department has been established within the MOF to represent the State as the owner of these enterprises and, inter alia, to settle the outstanding debt problems. As a first step, SOE non-performing debt has been taken off the balance sheets of the banks while asset liquidation and other measures are taken to reduce the amount owed. In the meantime this debt is guaranteed by Government.

2.9 Supervision and Prudential Regulations. SBV maintains an off-site surveillance system, developed with technical assistance from the IMF, which is based on monthly prudential returns submitted by banks. While improvements are required, the systematic collection and analysis of data are good first steps in ensuring supervisory oversight of the

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3 The Financial Sector Review (Report No. 13135-VN) dated March 15, 1995, does not recommend, at this stage, to fully liberalize interest rates and allow the market to determine the level and structure of interest rates. This is because Vietnam's macroeconomic stability is not yet strong enough to bear the impact of complete interest rate liberalization. Also, the performance of the banking system and its financial position is not yet sound and complete liberalization might encourage banks to move into more risky lending areas and further upset their profitability and soundness.

deposit money banks. On-site supervision is largely bottom-up at the branch or sub-branch level, and is conducted by the SBV's provincial branch network. A change in the focus of supervision to a more top-down approach is required to ensure the health and stability of the banking system as a whole. This implies a redirection of resources toward the sources of greatest systemic risk. SBV is a recipient of donor assistance in upgrading staff skills and modernizing operation of its functions.

Banking for the Rural Poor

2.10 Access to financial services stands out as a severe limitation to increasing agricultural productivity and diversifying rural enterprises as means of poverty reduction, The Viet Nam Living Standards Survey indicated that only 30 percent of the rural households taking loans borrow from formal sources, primarily government banks, while a majority (72 percent) borrow from informal sources at interest rates two to three times higher than those charged by formal financial institutions. The availability of deposit services in rural areas is extremely limited, forcing rural households to save in physical assets, often unsafe and illiquid. The poor conditions of accessibility and communications prevailing in rural areas, which create substantial costs of providing financial services, and the inability of rural households to offer collateral explain the limited access to formal finance by the rural poor.

2.11 The Viet Nam Bank for Agriculture (VBA) is the main supplier of formal financial services in rural areas, with a network of 2,654 branches and about 20,000 staff, of which more than 7,000 are credit officers. In 20 out of 53 provinces in Viet Nam, the VBA is the only formal financial institution. The VBA has made significant progress during the last 3 or 4 years in terms of staff productivity, reliance on self-mobilized capital, and lending to non-state enterprises. From 4 percent of the loan portfolio in 1990, the share of non-state enterprises in the VBA portfolio increased to 76 percent in 1994. As a consequence, the proportion of rural households with access to VBA loans has increased from 9 percent in 1992 to about 30 percent in 1994, with a further increase expected in 1995.

2.12 The recent increase in outreach to the poor by the VBA has been achieved through the establishment of sub-district transaction offices, visits of mobile banking teams to villages, and the use of joint-liability groups in some areas. These new mechanisms have been implemented through the re-deployment of existing staff and the utilization of service agencies such as the Women's Union and non-governmental organizations (NGOs). This has also led to greater operational efficiency. The transactions offices provide better service to rural households by virtue of being physically more accessible. The mobile-banking teams are primarily used to initiate loan applications. Actual loan approvals and disbursements require the borrowers to visit a bank office. While these efforts are able to reduce the transaction costs of loans, the district-based lending still entails some access costs. The use of borrower groups (joint liability, solidarity group) appears to have had the greatest impact on increasing the outreach of the VBA.

2.13 Given the limitations of accessibility and communications indicated above, the VBA's coverage of the potential clientele may be considered remarkable. However, the work of field loan officers, typically based in the district town, is severely restricted by distances and road conditions. As a consequence, the frequency of VBA presence at the commune level is low and the services provided are limited to a minimum of loan-related transactions and procedures. Furthermore, the provision of deposit services by the VBA appears to be below capacity, the number of deposit accounts being only a small fraction of the total number of borrowers, while the branch personnel assigned to service depositors seems to be limited and ill-prepared to perform their role.

2.14 In the absence of other formal financial institutions, the still substantial population not reached by the VBA relies upon informal sources of credit and, in a few areas, on savings and credit schemes promoted and implemented by NGOs associated with mass organizations, notably the Women's Union. These schemes appear to be effective in smoothing cyclical consumption imbalances and creating favorable conditions for small investments, especially among rural women. In addition, the SBV recently created the People's Credit Funds (PCFs) as a means of supplementing the VBA activity in rural areas. The PCFs are expanding rapidly, although their number is still limited by the training requirements associated with their formation.

2.15 Bank for the Poor. The most recent initiative aimed at enhancing the provision of financial services to the poor is the establishment of the Bank for the Poor (BP). The BP was established by Government Decree No.525/TTg of August 31, 1995, and began operations on January 1, 1996 . The objective of this bank is to mobilize capital for lending only to the poor who are defined as having an income less than that considered necessary for subsistence. Village committees cooperate with Government agencies in identifying eligible borrowers. A master list is compiled and passed to the BP which is responsible for credit decisions. Loans are generally limited to the equivalent of $US100 per family and collateral is not required. The Bank for the Poor is a State-owned credit institution operating in the entire country with a head office in Hanoi. During the initial phase it uses the existing infrastructure and personnel of the VBA. Its transactions do not form part of VBA's portfolio nor appear in its financial statements. The Bank for the Poor consolidates in one entity funds from the VBA's existing Fund for Preferential Loans to Poor Households, and several other poverty alleviation funds thus far administered by different government agencies. In addition, the Bank for the Poor seeks capital from government and external sources. It is governed by a Board comprised of representatives from the Government Office, the State Planning Committee, the Ministry of Labor, War Invalids and Social Affairs, the State Bank of Viet Nam, the Ministry of Finance, other governmental agencies in the social sector, and representatives from mass organizations of Government (Women's Union, Farmers' Union).

2.16 While the objectives and rationale for this bank are well founded, several specific features and modalities proposed for the new institution would need to be designed carefully to reflect current best practice in banking with the poor, and prevent the risks of undermining and distorting the financial markets accessible to the poor. The main concerns relate to below-market interest rates to the ultimate borrowers, under-estimation of the administration costs associated with micro-lending, an apparent underemphasis on the role of savings mobilization services, and an overall underemphasis on the minimum conditions required for sustainability of credit institutions based on experiences of other countries in the region.

2.17 In summary, the key constraints in reaching the rural poor with quality services can be stated as: (i) poor accessibility and communications; (ii) shortcomings in group formation and development; and (iii) lack of adequate savings mobilization incentives, instruments, and practices. These constraints are addressed by the technical assistance and training components proposed under the project following a two-prong approach: first, at the institutional level through supporting improvements in outreach and quality of service of the VBA , and assisting in the development of the Bank for the Poor; and second, at the community level through endorsing and leveraging non-governmental efforts in group formation and promotion of savings and/or credit schemes at the village level. The expected medium-term results of this approach are twofold: (i) enhanced and reliable outreach with credit and deposit services to the rural poor, and (ii) the integration of formal finance with village-based financial intermediation. Long-run sustainability and market-priced financial products for the rural poor are the main underlying principles inspiring the proposed approach.

IDA's Financial Sector Assistance Strategy

2.18 IDA is assisting in the development of the financial sector through a variety of measures. Two financial sector reports form the basis of a policy dialogue with authorities on financial sector development issues. The Structural Adjustment Credit (Cr. 2657-VN) is supporting removal of turnover tax and audit of one bank. The Agricultural Rehabilitation Project (Cr.2561-VN) is supporting the institutional strengthening of the VBA and is providing a line of credit to smallholders. IDA has recently approved the Payment System and Bank Modernization Project aimed at improving banking efficiency. IDA has been instrumental in mobilizing bilateral assistance for training and technical assistance in banking and is executing a UNDP-financed technical assistance project for State Enterprise Reform which is assisting Government in legal reform relating to the financial sector and for auditing the VBA with Australian bilateral financing (now completed). In addition, the Economic Development Institute has provided training in payment system issues.

Lessons Learned from Previous IDA Involvement

2.19 IDA is involved in implementation of five effective projects, in agriculture, irrigation, banking modernization, transport, and education as well as one Structural Adjustment Credit. It also assists with macroeconomic management and external aid coordination and carries out analytical work in support of the reform program including studies in poverty, environment, financial sector, transport, and water resources management. The preparation of the project draws upon the analyses and recommendations of these studies especially those on the financial sector and on poverty. In both the Structural Adjustment Credit and the Agricultural Rehabilitation Project where design is not complicated and procurement is relatively simple, disbursements are well ahead of schedule. Under the Agricultural Rehabilitation Project, with the IDA amount of US$52.2 million, loans of about US$70 million have been made, all to the private sector. About 45 percent of these loans are for medium term and 55 percent for short term compared with 15 percent and 85 percent respectively over the total VBA loan portfolio. The 1993 pre-project medium term lending was 1.5 percent of total lending for that year. Under the project, the average short term loan size was US$200 equivalent, enough to grow about 0.5 ha. of irrigated rice. The average medium term loan was US$625, enough for a small motor pump, outtake pipes, and tractor hire for small tertiary canal works. No loans were made above the free limit of US$20,000 equivalent, and in Ha Tay Province alone for example, 1,091 loans for less than US$45 (500,000 Dong) equivalent were made. The cumulative recovery rate on short term loans is 98.7 percent and on medium term loans is 98.4 percent. Overall, VBA is mobilizing some 75 percent of the funds onlent, with less than 25 percent now coming from SBV.

2.20 On the institutional development side, VBA's equity has been increased, the external audit has been completed, a General Inspection Department has been established for internal audit and control, changes have been made in organizational structure and a plan is being prepared for further significant changes, as well as other measures. On the other hand, progress of the Education and Highways projects has been slow because of uncertainty about national procurement procedures and slow approvals of final designs. The main lessons learned from implementation of ongoing projects is the need to complete detailed design and procurement documentation as early as possible in the project cycle and the need for technical assistance at the national level to develop clear operational policies on such matters as resettlement, procurement and local budgetary support for ODA-assisted projects. A number of IDF and other grant-assisted initiatives are under implementation to resolve these issues. This lesson is similar to that from the previous single IDA project in Viet Nam, the Dau Tieng Irrigation Project (Cr. 845-VN) approved in 1978 and closed in 1986, where significant problems were found to be due to incomplete design and delays in procurement. For the ongoing projects, the main lessons learned are the need for decentralized decision making on day-to-day project operations, minimal conditionality to fulfill after Board presentation and simple mechanisms to ensure timely release of counterpart funds to the implementing level.

3. THE PROJECT

Project Objective and Rationale for IDA Involvement

3.1 The proposed project supports several key components of the IDA's Country Assistance Strategy discussed by the Board on November 21, 1995. These are:

a) assist transition to a market economy;

b) strengthen the rural finance system through finance targeted to agriculture and small and medium enterprises in rural areas, accompanied by technical assistance;

c) reduction of poverty through promoting growth and enabling the poor to respond to opportunities to improve their welfare

3.2 IDA is already deeply involved in policy analysis, investment in rural development, and institutional strengthening, and the proposed project is a complement to that work. The Environment Report, the Poverty Report, the Financial Sector Report, and the Agricultural Marketing Report, among others, have made major contributions to policy formulation for rural Viet Nam and provide the contextual basis, both policy and operational, for the proposed project. The Agricultural Rehabilitation Project began IDA's assistance to reform the rural finance sector, and the institutional development program for VBA has provided leadership in banking reform in general. The external audit of VBA is the first for a bank in Viet Nam and has set a precedent for the other state-owned commercial banks and its results will influence further banking reform. The proposed project, particularly a wholesale operation, would take the reform process to a further stage of development in line with the recommendations of the Financial Sector Report. Similarly, IDA involvement in outreach efforts to improve credit access for the poorer half of the rural population would directly address issues raised in the Poverty Report. The experience with both rural finance and lending to the poor would be of value not only to Viet Nam but also to the Bank's work elsewhere and to other development institutions. Similarly, IDA experience with similar operations in other countries would be of assistance.

Project Objective

3.3 The objective of the project is to assist the Borrower in its efforts to improve living conditions in the rural areas through: (a) encouraging private sector investments; (b) strengthening the banking system's capacity to finance private sector investments; and (c) increasing access of the rural poor to financial services. These goals are in line with those of Government and the project would support the ongoing initiatives mentioned above over a four year period. A targeted operation is based on the premise that the financial sector of Viet Nam is too undeveloped and market conditions are still too imperfect to allow and adequate flow of credit to the rural sector. Because of its large size, development of the rural sector is crucial to achieving the social and economic goals of the country as a whole.

Detailed Project Description

3.4 General Rural Credit. The project would be implemented over four years beginning on July 1, 1996 with project completion on March 31, 2000 and credit closing on June 30, 2000, and would consist of a line of credit for rural investment in general, a line of credit restricted to investment by the rural poor, and institution building. The general line of credit would be used to make short, medium and long term credit available through competing Participating Financial Institutions (PFIs) to finance household and enterprise investments in agricultural and other viable rural operations, (both fixed assets and incremental working capital) in accordance with a Policy Manual satisfactory to IDA (para. 4.2). Because SOEs in rural areas remain important in providing essential services and market outlets for farmers, small and medium scale state owned enterprises defined as having no more than US$2 million equivalent in assets and fewer than 500 employees would be eligible to borrow from the proceeds of the IDA Credit allocated to RDF sub-loans but only up to an aggregate equivalent to 5 percent of this amount. The proceeds of the IDA Credit would be used to finance eligible sub-loans made by PFIs with respect to production, processing, trade, services, on-farm development, and other viable investments in medium and small-scale enterprises in areas outside the main cities of Hanoi and Ho Chi Minh City. All provinces would be eligible and no allocation would be made by crop or type of investment. The funds would be onlent to accredited PFIs who have signed a Subsidiary Loan Agreement with SBV acceptable to IDA. Proceeds accrued from the repayment of the principal of the subsidiary loans by PFIs would be used to establish and maintain a revolving fund for onlending for the same purposes and under the same terms and conditions as those for onlending under the IDA Credit. The sum of the proceeds of the IDA Credit and of the revolving fund would be known as the Rural Development Fund (US$111.0 million, base cost, Table 3.1).

3.5 Poverty Targeted Rural Credit. A line of credit would be provided to make short, medium and long term credit available through the Bank for the Poor (BP) for similar purposes to beneficiaries classified as poor as defined in a Policy Manual satisfactory to IDA (para 4.17). This directed credit would be used to overcome imperfections in the rural credit market thereby opening market access to groups previously excluded by reason of remote location, inadequate collateral and limited resources of formal financial institution funds. This line of credit would be released in tranches. The initial tranch would be released upon (i) adoption by SBV of the Policy Manual satisfactory to IDA setting out operational details of the FRP including the method of setting interest rates, client eligibility criteria, subloan supervision, accounting and reporting; (ii) signing of a Financing Agreement between SBV and BP acceptable to IDA; (iii) adoption by BP of an institutional development plan, satisfactory to IDA; (iv) approval of SBV of the BP Charter; and, (v) establishment by BP of a small-savings program satisfactory to IDA.

Subsequent tranches would be released upon reaching performance targets on repayment rates, maintenance of capital adequacy, and other criteria set forth in the Policy Manual. Proceeds accrued from the repayment of the principal of the loans to BP would be used to establish and maintain a revolving fund for onlending for the same purposes and under the same terms and conditions as those for onlending under the IDA Credit. The sum of the proceeds of the IDA Credit and of the revolving fund would be known as the Fund for the Rural Poor (US$16.6 million, base cost).

3.6 Institution Building and Community Development. Technical assistance and training would be given in support of: (i) a program to assist SBV staff in managing and supervising a wholesale operation, new to Viet Nam, and particularly in evaluation and accrediting PFIs; (ii) a program to upgrade the PFIs in loan appraisal, accounting, auditing, portfolio management, resources mobilization, and other banking activities including training in environmental clearance requirements for sub-projects, all in accordance with an agreed institutional development plan. The program would include training at home and abroad, workshops, seminars and consultant assistance in bringing the latest international banking skills to Viet Nam. The PFIs may include the VBA, other State-owned commercial banks, the private Shareholder Banks, and the Joint Stock Banks, among others; (iii) a program to assist the design of operation of the BP in a sustainable manner including strengthening the outreach program to reach the ethnic poor in the uplands and mountains through development of sustainable community-based savings and loan groups for the poor (micro-banking) who typically require loans of less than 500,000 Dong (US$50). The small savers program would consist of technical assistance to the VBA and to the BP in promoting and managing rural savings, and in working with the joint- liability credit group to encourage members to deposit small sums regularly. This approach has been piloted with some success by NGOs and should be supported to increase resources available for lending and increase community responsibility for resource mobilization; and , (iv) technical assistance and training would be given to the village groups and to the sponsoring agency assisting in group formation and promotion of financial literacy. Technical assistance may be provided by grant funding from NGOs, CGAP, UNDP, bilateral agencies or others, in which case the IDA funds would be available for reallocation to the FRP credit (US$9.4 million, base cost).

3.7 Project Management. In addition to technical assistance and training, support would be given to staff and equip the Project Management Unit (PMU) which has been established within the SBV on October 2, 1995 to inter alia, manage the RDF, the FRP and the technical assistance program. The PMU would evaluate the PFIs, make recommendations to the SBV senior management on accreditation of individual PFIs, monitor and supervise PFI performance, maintain project accounts and carry out other duties as detailed in para 4.4 (US$1.2 million, base cost).

Project Costs and Financing

3.8 Total project costs over the four years of the project, including taxes and price contingencies,[4] are estimated at about US$139.67 million (Table 3.1), of which working capital, medium, and long term credit for the RDF credit line would be about US$111 million. Working capital and medium term capital for the FRP credit line would cost another US$16.6 million. Vehicles and equipment for project implementation would cost about US$4.7 million, of which US$3.2 million would be taxes (Annex 1, Table 5). Institution building consisting of local and overseas training, workshops, provision of specialist advisors, and studies would cost US$5.50 million and recurrent cost assistance to project management would cost another US$0.25 million. Price contingencies of US$1.42 million would be included to account for inflation. IDA would finance a total of US$122 million (90 percent) of total project costs, exclusive of taxes and US$72.0 million of foreign exchange (90 percent) (Annex 1, Table 6). Government direct contribution to the project would be US$6.7 million of which US$3.7 million would be taxes, and US$1.6 million would be equity contribution to the BP under the project. The PFI's share would be US$11 million. IDA would finance up to 75 percent of sub-project cost under the credit line for the RDF program (US$100 million) and the PFIs would finance at least 10 percent of sub-project cost (not less than US$11 million), while beneficiaries would be expected to contribute an amount of not less than 15 percent of the cost of the sub-project in cash or kind, including the value of their own labor, but excluding the value of land. IDA would finance up to 75 percent of sub-project cost under the credit line for the FRP Program (US$12 million). The BP would finance at least 10 percent of sub-project costs while beneficiaries would be expected to contribute 15 percent of the sub-project costs. Of the cost of technical assistance, training, and support to project management, IDA would finance US$6.4 million. Bilateral funding of institution building and community development is being considered.

4 IBRD forecasts August 1995, domestic inflation for 1996 given 10 percent and 6 percent thereafter. International inflation for 1996 given as 2 percent and 1.62 percent thereafter during project period.

SOCIALIST REPUBLIC OF VIET NAM
RURAL FINANCE PROJECT
Table 3.1 **Expenditure Accounts Project Cost Summary**

	(VND Million)			(US$ '000)			% Foreign Exchange	% Total Base Costs
	Local	**Foreign**	**Total**	**Local**	**Foreign**	**Total**		
I. Investment Costs								
A. Rural Development Fund								
1. Rural Development Fund - Long Term	334,400	501,600	836,000	30,400	45,600	76,000	60	55
2. Rural Development Fund - Short Term	154,000	231,000	385,000	14,000	21,000	35,000	60	25
Subtotal Rural Development Fund	488,400	732,600	1,221,000	44,400	66,600	111,000	60	80
B. Fund For The Rural Poor								
1. Fund For The Rural Poor - Short term	50,160	33,440	83,600	4,560	3,040	7,600	40	5
2. Fund For The Rural Poor - Medium Term	59,400	39,600	99,000	5,400	3,600	9,000	40	7
Subtotal Fund For The Rural Poor	109,560	73,040	182,600	9,960	6,640	16,600	40	12
C. Vehicles								
1. Motor Cycles	3,104	1,411	4,514	282	128	410	31	-
2. 4WD Vehicles	21,725	9,875	31,599	1,975	898	2,873	31	2
3. 2WD Vehicles	3,879	1,763	5,643	353	160	513	31	-
Subtotal Vehicles	28,707	13,049	41,756	2,610	1,186	3,796	31	3
D. Equipment								
1. Computers	4,655	2,116	6,771	423	192	616	31	-
2. Other Office Equipment	2,832	1,420	4,252	257	129	387	33	-
Subtotal Equipment	7,487	3,536	11,023	681	321	1,002	32	1
E. Training								
1. Workshops /a	5,946	642	6,588	541	58	599	10	-
2. Overseas Training	-	1,693	1,693	-	154	154	100	-
3. Local Training	12,180	2,203	14,383	1,107	200	1,308	15	1
Subtotal Training	18,126	4,538	22,664	1,648	413	2,060	20	1
F. Technical Assistance								
1. Advisory Services	1,058	37,912	38,970	96	3,447	3,543	97	3
Total Investment Costs	653,338	864,675	1,518,013	59,394	78,607	138,001	57	100
II. Recurrent Costs								
B. Incremental Operating Costs /b	1,706	987	2,694	155	90	245	37	-
Total Recurrent Costs	1,706	987	2,694	155	90	245	37	-
Total Baseline Costs	655,044	865,662	1,520,707	59,549	78,697	138,246	57	100
Physical Contingencies	-	-	-	-	-	-	-	-
Price Contingencies	9,234	6,456	15,690	839	587	1,426	41	1
Total Project Costs	664,278	872,118	1,536,396	60,389	79,283	139,672	57	101

\a Workshops on fund management
\b Amount is based on PMU estimates

On-Lending Arrangements

3.9 The Socialist Republic of Viet Nam, would be the Borrower. The proceeds of the Credit would be made available to SBV under a Memorandum of Understanding (MOU), satisfactory to IDA, to be entered into between MOF and SBV. The MOU would form part of the RDF Policy Manual (Para 4.2) and would include at least a grace period of 10 years and return of the principle and interest, minus a fee to cover operating costs of the PMU and loan loss provision, in 20 to 30 years. This would allow the normal function with adequate flow of funds of the RDF and FRP funds. Finance for the RDF Credit line and the FRP Credit line would be made available to the PFIs and the BP, respectively, under subsidiary loan agreements between Government, represented by SBV and the PFIs, and under a financing agreement between the SBV and the BP. <u>A condition of disbursement for sub-loans would be that the relevant PFI or BP had entered into a subsidiary loan agreement or a financing agreement.</u> (paras. 6.3 and 6.4 (a)). SBV would (i) onlend the proceeds of the IDA Credit allocated to the RDF credit line to Participating Financial Institutions (PFIs) to finance eligible sub-projects and, (ii) onlend the proceeds of the IDA Credit allocated to the FRP credit line to BP to finance eligible sub-projects. The SBV would administer the RDF and would bear the credit risk at the level of the PFIs in return for a fee. Funds would be onlent to PFIs either in US$ or in Dong. Maturities would conform to the composite maturities of sub-loans made by the PFIs to sub-borrowers. US$ loans would bear a LIBOR-based variable rate of interest plus a margin to cover full costs including loan loss provision of at least 1 percent. Local currency loans would bear a variable rate of interest adjustable quarterly and equal to the latest available quarterly weighted average actual cost of loanable funds in the banking system or at a fixed rate of interest calculated in a manner satisfactory to IDA (para 4.5). For local currency sub-loans, GOV would bear the foreign exchange risk against a fee payable by the PFIs. For foreign currency sub-loans, either the PFI or the sub-borrowers would bear the foreign exchange risk. Onlending to sub-borrowers would be at the commercial (market) rates and terms of the PFIs for similar lending operations in accordance with a policy manual satisfactory to IDA (para 4.2). The Government would bear the foreign exchange risk on sub-loans under FRP. Onlending to poor sub-borrowers as defined in the FRP Policy Manual would be at a positive rate of interest above the weighted average cost of actual loanable funds in the banking system and covering full costs including loan loss provision and calculated in a manner described in the FRP policy manual satisfactory to IDA (para 4.17). During negotiations, the Borrower undertook that it would, with the proceeds accrued from the repayment of the principal of the Subsidiary Loans and the FRP Loan, establish and maintain a Rural Development Fund and a Fund for the Rural Poor for the purposes of financing on a wholesale basis through the PFIs and the BP rural investments under the same terms and conditions as those financed by the proceeds of the IDA Credit (para 6.1 (c)).

Procurement for Technical Assistance and Project Management

3.10 Procurement for technical assistance and project management (Table 3.2) would follow IDA guidelines. All procurement by International Competitive Bidding (ICB) would be carried out using IDA standard bidding documents. With respect to each contract for goods estimated to cost the equivalent of US$150,000 or more, IDA would review the bidding packages prior to tendering and award, covering 100 percent of the total contract value procured by ICB, and about 10 percent by national competitive bidding (NCB) by procedures satisfactory to IDA. Selected post review of awarded contracts below the threshold levels would be carried out on about 1 in 8 goods contracts.

3.11 Goods. Most vehicles (US$2.6 million) would be procured by ICB. Computers (US$200,000), and office equipment (US$200,000), consisting of small packages for diverse use over several agencies and years, and a few vehicles (US$150,000) would be procured by NCB procedures acceptable to IDA in contracts not exceeding US$150,000 and equal to US$1.8 million in total. Locally manufactured goods procured under ICB would be eligible for a domestic preference of 15 percent or the applicable customs tariff, whichever is less. For procurement of office equipment in small packages spread across several agencies and over four years not to exceed US$400,000 in total or US$50,000 per contract, procurement by national shopping with a minimum of three price quotations in a manner satisfactory to IDA would be acceptable.

3.12 Consultants would be engaged following IDA's guidelines for use of consultants. Consultant selection arrangements and contracts for amounts above US$100,000 for firms and US$50,000 for individuals would be subject to IDAs prior review.

SOCIALIST REPUBLIC OF VIET NAM
RURAL FINANCE PROJECT
Table 3.2 Procurement Arrangements
(US$'000)

	Procurement Method						
	International Competitive Bidding	National Competitive Bidding	National Shopping	Financial Intermediaries	Consulting Services	N.B.F.	Total
A. Rural Development Fund	-	-	-	111,558	-	-	111,558
				(100,032)			(100,032)
B. Fund For The Rural Poor	-	-	-	16,600	-	-	16,600
				(14,940)			(14,940)
C. Vehicles and Equipment	2,581	1,771	391	-	-	-	4,743
	(807)	(553)	(131)				(1,491)
D. Overseas Training	-	-	-	-	170	-	170
					(170)		(170)
E. Domestic Training	-	-	-	-	2,378	-	2,378
					(2,378)		(2,378)
F. Technical Assistance	-	-	-	-	3,925	-	3,925
					(3,925)		(3,925)
G. Staff Salaries and Incremental Operating Costs	-	-	-	-	-	298	298
Total	2,581	1,771	391	128,158	6,473	298	139,672
	(807)	(553)	(131)	(114,972)	(6,473)	-	(122,936)

Note: Figures in parenthesis are the respective amounts financed by International Development Assn
NBF:Non-Bank Financed

Procurement Under Sub-Loans

3.13 Credit Funds. Procurement of goods and works financed by sub-loans would be on the basis of procedures which are customary for a development finance operation. Most procurement would be of items costing below US$10,000 and would be procured from local suppliers of the sub-borrowers' choice. Subloans above US$150,000 each would be subject to prior review by IDA. For contracts below US$150,000 and above US$20,000 PMUs would have the right to prior review. As with other credit operations, ICB would not normally be required and would apply only on an exceptional basis where the size of contract is above US$1 million. These contracts would follow IDA Guidelines for Procurement and would be carried out using IDA standard bidding documents. No contracts of this size are anticipated.

Disbursement

3.14 The proposed IDA credit of (US$ 122 million) would be disbursed over a period of four years, from FY 97 - FY2000. These estimates are based on experience with the

Agricultural Rehabilitation Project which accounts for almost all the disbursement profile of Viet Nam projects. The disbursement schedule is shown in Annex 1, Table 6. The project would be completed by March 31, 2000, and the expected Credit closing date would be June 30, 2000. Disbursement of the Credit proceeds would finance short, medium, and long term investment in fixed assets, plus associated working capital, in rural areas of Viet Nam, defined as areas outside the municipal boundaries of Hanoi and Ho Chi Minh City. Land purchases would not be eligible. Each eligible sub-project would be financed by a sub-loan comprised of a maximum of 75 percent of the cost of that sub-project from the RDF or FRP plus 10 percent of that cost from PFI's contribution, assuming the sub-borrowers' contribution in cash or labor to be equivalent to 15 percent of the cost of the sub-project excluding land. IDA would finance 100 percent of SBV disbursements to PFIs and the BP for eligible subloans. Disbursements would also be made for vehicles and equipment for the PMU and for the technical assistance program. For these goods, IDA would finance 100 percent of foreign expenditures; 100 percent of local expenditures (ex-factory costs); and 65 percent of other locally procured goods. Consultant services would also be financed 100 percent by IDA, net of taxes. Disbursement for all expenditures above US$100,000 would be based on full documentation except for sub-loans below US$150,000 for which disbursements may be made under statement of expenditures (SOEs) and for other expenditures below US$100,000. Supporting documents for disbursements based on SOEs would be retained by SBV for review by independent auditors and by IDA supervision missions. Disbursements to PFIs would be made in accordance with the RDF policy manual (para 4.2). During negotiations, agreement was reached that because of the recent establishment of the BP, the initial disbursement to the FRP would be made in a tranche of US$2 million after the approval of the BP Charter and adoption by SBV of the FRP policy manual agreed to by IDA and SBV, the financing agreement will have been entered into by SBV and BP (para. 6.4(a) (c)); and the adoption by the Board of the BP of (i) a small-savers program to increase the resources available to the BP and to increase beneficiary participation ; and (ii) an institutional development plan satisfactory to IDA (para 6.4 (b)). Agreement was also reached at negotiations that subsequent disbursements of up to US$7 million cumulative would be confirmed after SBV has certified to IDA that the BP is in compliance with the performance criteria agreed in the FRP policy manual and BP's institutional development plan , and thereafter up to US$12 million cumulative following a final review(para 6.4 (d)). To increase competition, agreement was also reached at negotiations that no PFI will have access to funds from the proceeds of the IDA Credit in excess of US$50 million (6.1(d)(ix)). SBV through the PFIs and BP would onlend to beneficiaries, the proceeds of repayments of the principal of sub-loans to finance sub-projects under the terms and conditions of the RDF policy manual (see Annex 9) and the FRP policy manual to be developed.

3.15 Special Account. A Special Account in accordance with IDA guidelines would be established in SBV to facilitate rapid disbursement of the Credit. An initial deposit of US$10 million into the Special Account would be made by IDA representing about 4 months of the first year's disbursements. However, the authorized allocation for the Special Account shall be limited to an amount equivalent to US$5.0 million until disbursements and outstanding commitments against the credit shall be equal to or exceed the equivalent of SDR20 million. Applications for replenishment of the Special Account, supported by appropriate documentation would be submitted regularly (preferably monthly, but not less than quarterly) or when the amounts withdrawn equal 20 percent of the initial deposit.

Monitoring, Accounts and Audit

3.16 A project supervision plan is presented in Annex 7. The SBV would send to IDA, on the basis of an agreed format, periodic progress reports on project implementation (quarterly reports on the RDF and FRP and semi-annual reports on the institutional strengthening component SBV, the PFIs, and the BP would maintain separate project accounts covering all financial transactions for project activities, and that the project accounts, the Special Account, and Statements of Expenditures would be audited annually by independent auditors satisfactory to IDA and made available (in English) to IDA not later than six months after the end of the fiscal year and that the SBV would be responsible for the preparation of Government's contribution to the Implementation Completion Report. The SBV would also require PFIs, as necessary, to provide auditors' opinions on whether sub-loans under the project are in agreement with the terms and conditions of project lending. In addition, SBV would selectively review project subloans and provide a brief report on the quality of sub-loans and the adequacy of PFIs supervision and recording. <u>During negotiations, agreement was reached (para 6.1(a))</u>, that SBV, PFIs, and BP would maintain separate project accounts and that SBV would transmit to IDA (i) quarterly reports on progress of implementation of the RDF and FRP beginning October 31 1996, (ii) semi-annual reports on progress of implementation of the institutional strengthening program beginning January 1 1997, (iii) audited accounts, including the auditors' report, of the RDF, the FRP, the PFIs, the BP, the Special Account, and the Statement of Expenditures, for activities under the project within six months after the end of the Government's fiscal year (audit of financial statements of PFIs and BP to be furnished within six months after the end of the Government's fiscal year), beginning June 1998, covering FY96 and FY97, and, (iv) part two of the Implementation Completion Report of the project within six months after the Credit closing date.

3.17 <u>Agreement was reached during negotiations</u> that SBV would by December 31 1996, establish and thereafter maintain a monitoring and evaluation system , satisfactory to IDA, for the project components with the objective to identify constraints, initiate corrective measures, and upgrade project performance (para. 6.1(b). The main elements in the monitoring and evaluation system would be: (a) regular reporting on the financial and physical progress within both SBV and the PFIs, including the BP; (b) semi-annual evaluation during project implementation to assess performance of (i) the institutional strengthening and training programs, (ii) typical sub-projects, and, (iii) the project's financial impact on the PFIs and the BP.

3.18 <u>Financial Indicators</u>. Financial indicators to be monitored would include: (i) for the funds, repayments to the RDF and FRP by the PFIs and BP, profitability, and operating costs as a percentage of funds loaned; and (ii) for the PFIs, solvency, liquidity and profitability, among others (annex 8). Detailed indicators would be maintained for accreditation as stipulated in the RDF and FRP policy manuals (para 4.7). Development indicators would measure the effect on living standards of beneficiaries through sample surveys.

4. PROJECT IMPLEMENTATION

A. RURAL DEVELOPMENT FUND

Organization and Fund Management

4.1 Implementation of the credit program would be as a commercial wholesale operation based on three main participants: the apex financial institution (the apex bank) which under this operation would be the SBV (Government Decree No. 5551/QHQT, October 2, 1995); the Participating Financial Institutions (PFIs); and the sub-borrowers - the PFIs' respective clients . The SBV would disburse to the accredited PFIs against eligible expenditures for approved sub-projects from the proceeds of the IDA credit. The PFIs would add their contribution of at least 15 percent of the total project cost. The final client would also be expected to contribute at least 10 percent in cash or in kind excluding land. Repayments by PFIs to SBV would be deposited into a fund (RDF) and SBV would relend the proceeds of the fund to the PFIs provided they continued to meet the agreed accreditation requirements and maintained sufficient client demand. If a particular PFI failed to maintain its accreditation, the repaid funds would be diverted to another PFI maintaining or achieving accreditation. <u>During negotiations, agreement was reached between IDA and Government that the RDF would be operated as a commercial activity (para 6.1 (d))</u>. The SBV would receive a spread to cover its related credit risk at the level of the PFI, and operating costs. It would be responsible for accrediting the PFIs according to agreed criteria of solvency, liquidity, profitability, and management quality. <u>Accreditation of a PFI would be a condition of disbursement for sub-loans to that PFI (para 6.3(a))</u>. The SBV would need to adequately staff and equip the PMU such that it has the capacity to assess credit worthiness of PFIs, and is prepared to monitor, evaluate and supervise PFIs. Training to be provided to PMU staff would fit within SBVs overall institutional development plan.

4.2 <u>RDF Policy Manual</u>. An RDF Policy Manual (the Policy Manual) was agreed to during negotiations to guide operation of the RDF once adopted. The Policy Manual would set out the objectives and management structure of the RDF, define eligible PFIs, specify qualifying criteria for participation in the Fund, define eligible projects for financing, and set out loan terms - including loan size, method of determining interest rates, default measures, collateral and insurance requirements. The manual would also specify sub-loan appraisal, approval, disbursement procedures, conditions for restructuring and rescheduling loans, supervision and reporting, audit requirements, and environmental compliance certification. <u>The approval by the SBV of the RDF Policy Manual, agreed to by IDA, would be a condition of credit effectiveness (para 6.2(a))</u>.

4.3 The following are the main functions of the SBV/PMU as the apex bank:

- accreditation of PFIs through application of an agreed set of criteria;

- assisting in the preparation and the implementation of the PFIs' institutional development plan (IDP);
- preparation of the Subsidiary Loan Agreements and the Financing Agreement;
- approving RDF funded projects (sub-project) applications over US$20,000 equivalent and less than US$150,000 supervising the implementation of all sub-projects;
- draw down of IDA funds including the administration of a Special Account and the disbursement of funds to PFIs for the financing of sub-projects and IDPs;
- maintaining project accounts and arranging for their auditing;
- monitoring PFIs performance vis-a-vis accreditation criteria, use of project funds, and progress of IDP;
- periodic review of onlending terms and IDPs with a view to adjusting them in light of changing conditions; and
- promotional efforts in support of the project.

4.4 Fund Management. A Project Management Unit (PMU) within SBV would handle day-to-day matters related to the implementation of the credit component. The PMU would report to the Board of Management of the SBV. A Steering Committee to review project credit activities and policy matters has been established and includes representatives of SBV (Chair), Ministry of Economy and Planning, the Ministry of Finance, the Office of Government, and MARD. The Steering Committee will meet as necessary but at least once every three months. The objective of establishing the PMU in the SBV is to train a cadre in management of wholesale banking, a new concept in Viet Nam, which would then be transferred intact to a commercial bank or other such institutions. At negotiations agreement was reached that the fund would be transferred by June 30, 1999. The action plan to reach this goal has begun with the audit of one commercial bank and the expected audits of several others. The duties of the PMU are to carry out the functions described in para 4.3 including PFI accreditation, reviewing subloan applications, maintaining project accounts, managing the Special Account, monitoring and evaluating project activities, assisting in institutional development of the PFIs, contracting and supervising technical assistance and training. The PMU with the PFIs would be managing a portfolio of about US$120 million equivalent. About 20,000 sub-loans would be anticipated for amounts below US$20,000 equivalent each together with another 4,000 sub-loans above this amount. The PMU would review sub-loan application and approval documentation on a sample basis and on an ex-poste basis where warranted for sub-project below US$20,000 equivalent, as determined in the RDF Policy Manual. For sub-loans above US$20,000 equivalent per client, PMU prior review would be required except as shall otherwise have been agreed between IDA and the Government. For sub-loans above US$150,000 per client, IDA's prior review would be required except as otherwise agreed by the IDA and Government. The PMU would include a project manager, a PFI accreditation and follow up sub-unit, a project accounting and disbursement sub-unit, a sub-loan review sub-unit, a supervision and monitoring sub-unit, and a technical assistance and training sub-unit (for contracting). The staff of the PMU would be locally recruited and would generally be from within SBV and the commercial banking sector. Technical assistance to the PMU in the initial stages would be provided under the project (para 3.7). The PMU was established by Decision No. 5551/QHQT dated October 2, 1995. The appointment of a qualified and experienced manager and chiefs of the accreditation unit, the accounting and disbursement unit, sub-loan application review and supervision unit would be a condition of Credit effectiveness (para 6.2 (b)).

Interest Rate Policies, Procedures, and Maturities

4.5 Interest Rate Policies and Procedures. IDA funds would be onlent by SBV to the PFIs at a variable interest rate, adjustable quarterly and equal to the latest available quarterly weighted average actual cost of loanable funds in the banking system and equivalent to the price PFIs would pay if funds were mobilized from the market. A fixed rate option would be allowed calculated in a manner satisfactory to IDA. Maturity of PFI loans would conform to the composite maturity of related sub-loans. The weighted average interest rate of time deposits (to be calculated quarterly by SBV) would be used as a reference for setting the cost of funds to the PFIs[5]. This reference rate would be adjusted to take account of the cost associated with the SBVs reserve requirements[6]. PFIs will be free to lend at the prevailing general interest rate. Given the constantly varying conditions in the monetary and fiscal sectors and the need to avoid major distortion due to differences in market determined conditions, an agreement was reached at negotiations that by June 30 of each year, commencing on June 30, 1997, or at such other intervals as the Borrower and IDA may agree, the Borrower, through SBV, would exchange views with IDA on the level of interest rates charged on Subsidiary Loans , the FRP Loan and sub-loans to determine if such rates are positive in real terms and above the weighted average deposit rates prevailing in the market at the time of the review and, with the prior concurrence of IDA, revise such rates, if required. (para 6.1 (d) (ii). The foreign exchange risk would be borne by the Government or the sub-borrowers as discussed in para 3.9. However, given the onlending mechanism described above, it is anticipated that the nominal interest rate difference between GOVs borrowing and onlending rate would adequately cover the foreign exchange risk.

4.6 Sub-loan Maturity. The repayment period for medium and long term sub-loans would be based on the sub-project's cash-flow and would be related to the sub-borrower's overall repayment capacity. Repayment of sub-loans will usually be within five years but will not exceed ten years, or the economic life of the sub-project whichever is shorter. A

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5 As all deposits are currently short-term (less than one year), the weighted average of these time deposits would be used as a reference rate for calculating the cost of loanable funds for short and term lending. PFIs would be free to lend at the prevailing general interest rate taking account of the different credit risk associated with short and term lending.

6 SBV's Reserve Requirement (RR) is currently set at 10 percent of the deposits. The RR, presently, do not bear any interest income. That means that the cost of loanable funds is higher by about 11 percent of the time deposits' interest rate. For example, the RR of a deposit of VND1 million for (say) one month would be VND100,000 and the funds available for lending would be only VND900,000. The cost to the PFI of a deposit of VND1 million for one month (assuming a deposit rate of 1.6 percent per month) would be VND16,000. This cost should be covered by the loanable funds which in this case is VND900,000. VND16,000 over VND900,000 would result in an interest of 1.78 percent per month.

grace period may be granted for repayment of principal based on sub-project's cash-flow and the overall financial status of the sub-borrower. Maturity of short term sub-loans would not exceed 12 months.

Accreditation and Eligibility Criteria

4.7 PFIs Accreditation Criteria. To safeguard the apex bank and the Fund financial assets, and to ensure a successful implementation of the credit component, the PFIs would be approved on the basis of agreed accreditation criteria to be detailed in the Policy Manual of the RDF. SBV would inform IDA accordingly. Criteria to be selected need to be credible, transparent, unequivocal, and compatible with sound financial principles and with banking regulations. The accredited criteria would include the following five fundamental elements: (i) compliance with banking law and audit requirements; (ii) solvency;[7] (iii) liquidity;[8] (iv) profitability, usually measured by a set of ratios such as: (a) return on equity (net profit after tax over equity), and (b) return on assets generating income (net profit after tax over average outstanding loans and investments over the year); and (v) the quality of management and staff. However, a bank can be accredited even if it does not meet all the accreditation criteria provided that an Institutional Development Plan (IDP) along with adequate training program and detailed time table for achieving them would be submitted to, and found to be acceptable by, SBV and IDA. At negotiations, agreement was reached that PFIs performance vis-a-vis the accreditation criteria and the respective IDP would be reviewed semi-annually by June 30 and December 31 of each year commencing on December 31 1996, and thereafter by September 30 and March 31 of each year commencing on March 31, 1997, furnish a report on PFI performance and corrective measures to be followed , if necessary, for IDA's concurrence (para 6.1 (a)(v)). In the event that a PFI loses its accreditation (having failed to: (i) meet one or more of the accreditation criteria; and (ii) satisfactorily implement the agreed IDP). At negotiation it was agreed that SBV through the PMU would instruct the PFI to take remedial actions within a time frame determined in consultation with IDA. If the PFI fails to meet the accreditation within the agreed time frame, SBV would: (i) cancel the uncommitted portion of the line of credit granted to the PFI; (ii) take the necessary actions to safeguard the committed portion extended to the said PFI; (iii) notify IDA; and (iv) onlend the uncommitted amount to other accredited PFIs. SBV would assist the PFIs to prepare and would furnish to IDA for its comment institutional development plans with detailed timetables and staff training programs for

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7 A bank is considered solvent if the value of its performing assets is sufficient to cover its liabilities particularly to its depositors and lenders. Therefore, the quality of its assets (mainly loans) and the adequacy of its net equity (equity minus bad loans and/or provision for loan losses) should be assessed. These are usually measured by a set of financial ratios such as: (i) overdue rate (amount of overdue loans over outstanding loans, and amount of over due loans over loan amount due during the assessed period (lower rates indicate a higher quality of loans and therefore a higher solvency level); and (ii) net equity to risk assets (loans and investments excluding investments in Government securities; higher ratio indicates a higher solvency level).

8 A bank is considered liquid if its liquidity assets (cash in hands, cash in banks, investments in gold and Government securities up to one year) are sufficient to cover its liquid liabilities (deposits up to one year and repayment of borrowing amount due within one year). A higher ratio indicates a higher liquidity level.

those PFIs who are unable to meet the eligibility criteria set forth in the RDF Policy Manual for purposes of their accreditation under the Project.

Sub-loan Eligibility Criteria

4.8 Sub-borrowers under the project will generally be limited to private sector individuals or enterprises, cooperatives and joint-ventures. Because of their role in providing primary processing and other essential services in rural areas, small and medium scale SOE's, defined as having less than US$2 million in assets and less than 500 employees would be eligible to receive sub-loans up to an amount of no more than 5 percent in the aggregate of the proceeds of the Credit for RDF sub-loans. Eligible investment would be medium and long term investments financed for the establishment of new enterprises (or economic operation by individual), expansion of existing economic operation, or reinvestment in existing economic operation. All agricultural and rural industries based projects throughout the country (except Hanoi and HCMC) would be eligible, including fisheries, agro-industries, manufactures, construction activities, and services. Land would be ineligible for IDA financing. To qualify, a proposed sub-project would have to be appraised by the PFI as technically feasible, financially viable, and environmentally sound.

Sub-project Appraisal, Review and Disbursement

4.9 Sub-project Appraisal and Approval. The credit risk associated with PFIs' sub-loans would be borne by the PFIs. Therefore, sub-project appraisal and approval will be the responsibility of the PFIs, whose capability to undertake these activities will be determined by SBV under the project's qualifying criteria. Appraisal of medium and long term sub-projects would be based on the technical and financial characteristics of the sub-project. For each short, medium, and long term sub-loan above the equivalent of US$50,000, a participating bank would prepare a financial plan including the sub-project's cash-flow. For sub-loans below this amount, the character and standing of the borrower and of the willingness of community members to enter into joint liability would suffice.

4.10 Sub-project review and Disbursement. Except for sub-loans under US$20,000 equivalent, the PMU would review the sub-project appraisal work carried out by the PFIs. It would review on an ex ante basis, the documentation of sub-projects above US$20,000 equivalent and if appropriate would authorize disbursements. In order to expedite sub-loan approval, this ex-ante review may be waived for stronger and more experienced PFIs. Such waiver would require IDAs concurrence. SBV, through the PMU, would grant up to 60 days to PFIs to submit or make available required sub-loan documentation and evidence of payment and procurement. The PMU would reverse the sub-loan-- and charge a reversal fee-- if a PFI has not submitted or made available the required documentation within 60 days after PMU disbursements to the PFI. In the case of sub-projects below US$20,000, PMU would review the appraisal work on an ex post disbursement basis. Disbursement to PFIs would be made automatically, although the PMU would also require PFIs to submit or make available all the required sub-loan documentation within 60 days. As in the case above, reversal would be made and penalty fee imposed if PFIs fail to satisfactorily submit or make available required sub-loan documentation within the 60 day period following PMUs disbursements. IDA prior approval would be required for all sub-loans above US$150,000 equivalent for which full documentation of the sub-project would be submitted. No sub-loans shall be committed after October 31, 1999.

Compliance with Environmental Regulations

4.11 It is expected that the overwhelming number of subprojects would be small (less than US$10,000 equivalent each) and would be mainly for on-farm development and for small agro-industries such as rehabilitation or expansion of 10-ton/day rice mills. However, sub-projects must be in compliance with Government Decree No.175/CP on Guidance for Implementation of the Law on Environmental Protection and other relevant decrees, regulations and directives that may be issued from time to time. No RDF sub-loans for sub-projects requiring environmental clearance issued by either the State Ministry or a Provincial Department of Science, Technology and Environment in accordance with the provisions of the Decree shall be approved before the sub-borrower obtains such a clearance. Where the RDF sub-loan is for an amount above US$150,000 equivalent, and the proposed investment falls within the scope of Decree No.175/CP, the sub-borrower would give to the PFI a copy of the environmental impact assessment report submitted to the relevant authorities to secure environmental approval. During negotiations, agreement was reached that sub-projects would conform to the enviromental laws and regulations of Viet Nam. Where the RDF subloan is for an amount above $150,000 equivalent and the proposed investment falls within the scope of the Decree No. 175/CP (Implementation of the Law on Environmental Protection), the sub-borrower shall submit to the PFI a copy of the Environmental Impact Assessment Report submitted to the relevant authorities (MOSTE/DOSTE) to secure environmental approval. (para 6.1(d)(vii)).

Supervision and Reporting

4.12 Supervision of RDF Funded Projects. Supervision of RDF funded projects would be the responsibility of the PFIs, which will designate specific officers for this purpose. PFIs would require sub-borrowers to use project funds for approved purposes only, and they would achieve this through direct payments to suppliers of equipment, inputs and materials, as practicable, and through quarterly or semi-annual field visits to sub-projects. Follow-up reports on each visit would comment on the utilization of project funds, compare actual and planned operations, review management and financial problems of sub-projects, compliance with environmental laws and regulations, and make recommendations. PFIs would also obtain periodic operating and financial reports from sub-borrowers of short, medium and long term loans and would undertake selective field visits to problem projects for assessment of their issues. The PMU would conduct selective end-use verification of sub-projects to ensure that PFIs supervision is satisfactory.

4.13 Reporting Requirements. SBV through the PMU would transmit to IDA, on the basis of agreed format, quarterly progress report on the implementation of the credit component under the project. These reports would be submitted to IDA within two months after the end of each quarter beginning October 31, 1996. The report would include: (i) an assessment of RDF performance, issues and projection for the next six months; (ii) RDF releases broken down by sub-sectors, duration (short, medium, and long term), nature of sub-projects (new or expansion of existing operation), purpose of sub-loans (fixed assets and/or working capital), type of PFIs (government commercial banks or private banks), regions or provinces, and sub-borrowers' asset size, and sub-loans size; (iii) overdue of subsidiary loans[9] and sub-loans broken down by sub-sectors, type of PFIs, regions, sub-loan duration, nature of sub-projects, purpose of sub-loans, and sub-borrowers' asset size; (iv) list of accredited PFIs, the respective line of credit granted, and availments; (v) sub-projects' investment broken down by sub-sectors, financiers (sub-borrowers' equity, PFIs participation, SBV contribution, and IDA), and duration; (vi) RDF interest rates over the reported period; and (vii) progress report on the implementation of IDP and the training program.

B. FUND FOR THE RURAL POOR

4.14 Organization and Fund Management. The FRP would be established within the SBV and would be managed by the same PMU as for the RDF with the same Steering Committee. The SBV would operate the Fund in accordance with an agreed Policy Manual for Lending to the Poor. The SBV would disburse to the BP against eligible expenditures for approved sub-projects from the proceeds of the IDA credit. The BP would add its contribution of at least 10 percent of the total project cost and lend to the final client who would also be expected to contribute at least 15 percent of total project cost including the value of labor or in kind but excluding the value of land. Repayments by the BP to the SBV would be deposited into a fund (FRP) and SBV would relend the proceeds of the fund to the BP provided the BP continued to meet the agreed accreditation requirements and maintained sufficient client demand. If the BP failed to maintain its accreditation, the repaid funds would be diverted to the RDF or canceled. The SBV would receive a spread to cover its operating costs associated with Fund administration. All disbursements would be in VN Dong. The Government would bear the foreign exchange risk and would receive a fee for this purpose.

4.15 Fund Management Duties. The SBV would certify that the BP was properly constituted and operationally secure in terms of a set of performance criteria which have been agreed at negotiations between the Government and IDA. It would assist in preparation and implementation of the BP's institutional development plan, manage the draw-down of IDA funds, administer the Special Account established for the purpose in a commercial bank agreed to by IDA, authorize disbursements from the Special Account, maintain FRP accounts and arrange for their audit, monitor financial performance and progress of the institutional development plan, and carry out a periodic review of onlending terms and conditions of loans from the Fund.

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[9] A subsidiary loan is a loan to be signed between SBV and a PFI.

4.16 Interest Rate Policies, Sub-Loan Size and Maturities. IDA funds would be onlent by SBV to the BP at a fixed or at a variable interest rate, adjusted quarterly and not less than the weighted average actual cost of loanable funds in the banking system or at a fixed rate. This would be used as a basis for setting the onlending rate to sub-borrowers and would be adjusted to include a margin for BP's costs including a provision for bad debt to ensure sustainability of the Fund capital. This rate should be unified and not less than the rate of inflation. The subloan size would depend on the investment to be financed, and is currently about US$200 but would not be more than $1000 per borrower. The maximum term would initially be for three years duration and maturities of the Loan to the BP would correspond to those of the sub-loans. This would be reviewed from time to time as to be specified in the Policy Manual for Lending for the Poor.

4.17 Policy Manual for Lending to the Poor. Since lending for the poor through the Bank for the Poor is a directed program, a special lending manual would be used to guide operation of the FRP. The policy manual would set out the objectives of the Fund, define eligible borrowers and projects for financing and set out loan terms and procedures to be followed. The manual would specify loan size, method of determining interest rates, default measures, collateral and insurance requirements. The manual would specify subloan approval and disbursement procedures, conditions for restructuring and rescheduling loans, supervision and reporting, and audit requirements. The SBV would assist the BP prepare and furnish to IDA for its approval an institutional development plan with a detailed timetable and staff training programs for purposes of assisting the Bank for the Poor to meet the performance criteria set forth in the FRP policy manual. Issuance of the Charter of the BP, adoption by SBV of the FRP policy manual agreed to by IDA and the SBV; the signing of the financing agreement by SBV and BP (para. 3.9); and the adoption by the Board of the BP of (i) a small-savers program to increase the resources available to the BP and to increase beneficiary participation (para. 4.21); and (ii) an institutional development plan satisfactory to IDA would be a condition of disbursement of the first tranch (US$2 million) against this component (para 6.4(a)-(c)).

4.18 Subproject Appraisal. The credit risk would be borne by the BP who would be responsible for project appraisal and approval. The SBV would be responsible for ascertaining that the BP has the capacity to undertake these activities in the locations for which funds would be disbursed. Appraisal of sub-project or type of sub projects would include technical and financial evaluation prepared by the BP who would discuss its implications with the borrower to ensure that the loan repayment obligation was fully understood.

4.19 Disbursement. The funds would be disbursed over the same period as for the RDF (1996-99). Because of the special nature of the Fund, no sub-loans over US$1,000 would be permitted, hence no sub-loans would require prior review and no procurement would be subject to IDA rules. The SBV, through the PMU, would make an ex-post review of appraisal work and report on its quality as part of supervision and reporting. After meeting the conditions for the initial disbursement, disbursements by the BP from the Special Account would be made automatically on submitting or making available required sub-loan documentation within 60 days of payment to the sub-borrower. The IDA proceeds for the Fund would be disbursed until a total of US$2 million was reached at which time a brief report on BP performance would be prepared and discussed with IDA. Following the initial disbursement of US$2 million, a condition of further disbursement up to an aggregate of $7 million for financing FRP sub-loans would be made only after SBV has certified to IDA that BP is in compliance with the performance criteria agreed in the FRP policy manual and BP's institutional development plan (para 6.4 (d)). A similar condition would apply for disbursement of the remaining US$5 million to give an aggregate amount of US$12 million.

4.20 Supervision and Reporting. Supervision of FRP funded sub-projects would be the responsibility of the BP which will designate specific officers for this purpose. The BP would require sub-borrowers to use project funds for approved purposes only, and they would achieve this through direct payment to suppliers, as practicable, and through regular visits to sub-project sites. The BP would maintain reports on progress of sub-projects for selective inspection by SBV to ensure that BP supervision is satisfactory. At negotiations assurances were obtained that the SBV, through the PMU, would send to IDA on the basis of agreed format, quarterly progress reports on the implementation of the FRP component under the project (para 6.1(a)). These reports would be submitted to IDA within two months after the end of each quarter. The report would include: (i) an assessment of FRP performance, issues and projections for the next six months; (ii) FRP releases broken down by sub-sectors, duration, nature of sub-projects, purpose of sub-loans (fixed assets and/or working capital), regions or provinces, and sub-borrowers' asset size, and sub-loans size; (iii) overdues of sub-loans broken down by sub-sectors, regions, sub-loan duration, nature of sub-projects, purpose of sub-loans, and sub-borrowers' asset size; (iv) sub-projects' investment broken down by sub-sectors, and financiers (sub-borrowers equity, BP participation, Government, IDA and other financier contribution,), and duration; (v) FRP interest rates over the reported period; and (vi) progress report on the implementation of IDP and the training program. In the event that the BP loses its accreditation (having failed to: (i) meet one or more of the accreditation criteria; and (ii) satisfactorily implement the agreed IDP), SBV through the PMU would instruct the BP to take remedial actions within a time frame determined in consultation with IDA. If the BP fails to meet the accreditation criteria within the agreed time frame, SBV would: (i) cancel the uncommitted portion of the line of credit granted to the BP; (ii) take the necessary actions to safeguard the committed portion extended to the BP; (iii) notify IDA; and (iv) onlend the uncommitted amount to other accredited PFIs. At negotiations agreement was reached that SBV would assist the BP to prepare an institutional development plan with a detailed timetable and staff training program and would furnish the IDP to IDA for its comment and that BP performance vis-a-vis the accreditation criteria and the IDP would be reviewed semi-annually by June 30 and December 31 of each year commencing on December 31, 1996, and thereafter b y September 30 and March 31 of each year furnish a report on BP performance and corrective measures to be followed, if necessary, for IDA's concurrence (para 6.1 (i).

C. INSTITUTION BUILDING

4.21 The institutional strengthening program would play a major role in the project as part of the overall development of Viet Nam's financial sector. The program would consist of two related parts, one directed at an agreed Institutional Development Plan to meet accreditation criteria for individual PFIs (para 4.7) and would relate to PFI management and reaching financial targets. The other would be in training and technical assistance to improve performance in outreach to the poor, savings mobilization, community based banking, and Fund familiarization and management (para 3.6). The program would be managed by the SBV. In the case of programs to strengthen VBAs outreach and savings mobilization efforts, VBA could manage the program on behalf of SBV, if so agreed. Experience in many countries with extending financial services to the poor gives a clear indication that the inclusion of small-savers programs is a key component of sustainability of financial institutions. Savings programs increase resources available for lending, and more importantly, promote community participation. Because of the importance of rural savings, a condition of disbursement for the FRP would be the adoption by the Board of the BP of a small-savers program (para 6.4 (b).

4.22 The SBV runs two Banking Colleges which offer a college-level curriculum in banking and specialized short courses for banking practitioners. They are the recipients of significant donor assistance including that for an IDA-executed Banking Sector Training Project. The VBA has a Training Department which is receiving assistance under the Agricultural Rehabilitation Project. Training and technical assistance under the project would work through this system using the SBV and VBA facilities.

4.23 The SBV would be responsible for the preparation and implementation of the programs The Training Program would be prepared and would be updated annually. During negotiations, agreement was reached that: (i) a training program would be sent to IDA for review by November 30, 1996, and thereafter updated and sent to IDA by November 30 of each year (para 6.1(f): and, (ii) SBV and VBA would employ consultants whose qualifications, experience and terms and conditions are satisfactory to IDA (para 6.1(g). Government sponsored organizations such as the Women's Union, NGOs, and others already active in formation of and assistance to savings and credit groups for joint liability and related purposes would be eligible to contract with SBV to provide technical assistance under the project.

5. PROJECT IMPACT, BENEFITS AND RISKS

Impact and Benefits

5.1 Financial Sector Reform. The project would further financial sector reform (para. 2.1) by increasing competition between banks in rural areas of Viet Nam and would support the evolution of private sector banks by making resources available for onlending. It would further the reform of accounting, auditing , and other banking practices already begun under other initiatives. It would introduce wholesale banking to Viet Nam thereby lowering the cost of financial intermediation, introduce consistent and upgraded standards for bank accreditation and promote banking modernization in a more effective way than through the alternative of supporting banks individually. It would increase short, medium and long term resources available for investment in the rural areas and would address problems of savings mobilization, outreach to remote areas, and financial literacy. Support to the Bank for the Poor would address market imperfections in delivering financial services to remote areas and to otherwise creditworthy groups lacking collateral and would assist in establishing a sustainable institution delivering financial services directly to the very poor. The project is directly linked to the financial sector strategy outlined in the CAS and elaborated in the Financial Sector Report (para 2.14). Viet Nam is considered ready to undertake the project in terms of institutional capacity and the progress of financial sector reforms. At the level of individual PFIs, the main bank is expected to be VBA which is already involved in an IDA-supported institutional development plan with some success (para. 2.17). Other PFIs would be required to undertake such an activity where required during the accreditation process (para. 4.7).

5.2 Fiscal Impact and Cost Recovery. The RDF would be a fully commercial operation with all costs being recovered directly. The interest rate margins would include a spread to cover Government's foreign exchange risk, SBVs credit risk and cost of managing the Fund, and the PFIs operating costs including loan loss provisions. The interest rates on the FRP would similarly be set at a level to cover full cost of loanable funds, intermediation costs, and loan losses. The cost of the technical assistance and training would be recovered indirectly through lower cost of delivering financing savings and credit services to the poor through group savings and lending mechanisms. In the case of CGAP or bilateral grant funding of technical assistance, the benefit of lower delivery cost and higher coverage would be obtained at little or no cost to Government. Based on the experience with the VBA under the Agricultural Rehabilitation Project (para. 2.16) loan losses are expected to be less than 5 percent (most of VBAs non-performing portfolio is SOE debt being addressed under separate IMF and IDA activities).

5.3 Impact on Rural Poverty. The project would increase the coverage of financial services to the poor which was identified in the Viet Nam Living Standards Survey as being only 20 percent of poor with access to these services. It would bring investment capital into remote areas, particularly uplands and mountains heavily populated by ethnic minorities who are among the poorest in the country. While the FRP would be exclusively for the very poor, the beneficiaries of the RDF would also be expected to be mostly within the poorer half of Viet Nam's population, as borne out by experience with the ongoing Agricultural Rehabilitation Project . Beneficiaries of the FRP are currently defined as those with less than 15 kg of paddy per person per month and would be stated in the Policy Manual. This is absolute poverty and is about half of the amount normally considered to be adequate. Both Funds would be available for non-farm as well as on-farm investment. This would increase creation of non-farm jobs in rural areas consistent with Government's strategy of rural industrialization to increase incomes beyond the level that can be provided by increasing farm productivity gains countered by rising farm population and inelastic land supply(para 1.9).

5.4 Economic Analysis. The RDF and FRP components would finance economically and financially viable investments in rural areas, both on-farm and non-farm. There would be no ex-ante allocation by crop, type of industry or other categorization of investment beyond those given in para 3.4. Since investment composition would not be known, no internal rate of return can be calculated for the project. Loan processing would include analysis of subproject viability. To ensure satisfactory economic impact of the project, uneconomic proposals would be rejected. Training in evaluation would be given as part of institutional support. Market interventions in Viet Nam have generally been dismantled and policy induced divergence between economic and financial values are not substantive for the purpose of the project.

5.5 Risks. For the RDF, the results of the ongoing project indicate that risk of institutional failure would be low. However, the project includes specific measures to reduce this risk through its institutional strengthening component (para 3.4). Potential PFIs have expressed willingness to undertake institutional development plans. Similarly, ongoing experience indicates that loan losses would be low (less than 5 percent of amounts due). Provisioning adequately for loan loss would be part of the institutional development plan for the PFIs.

5.6 For the FRP, both institutional and credit risk are high. The Bank for the Poor is a new institution and its clientele would be largely untested. Directed credit initiatives in Viet Nam have had mixed success and some have had many of the features that have elsewhere led to unsustainability. In fact, part of the Government's reason for creating this bank is to bring some order and consistency into the many targeted credit schemes, usually externally funded, consistent with sound financial sector development. To the extent that the BP uses VBAs existing staff already committed to smallholder lending and procedures, the risk should be lowered. Emphasis, though, will have to be placed on developing sound operational rules, staff training, promotion of financial literacy among the poor, and linking lending to savings mobilization by the BP to lay down the pre-conditions for a financially independent bank with resources not constrained by Government budgetary circumstances. The project includes support to these actions. An added feature to reduce risk is the release of FRP funds to the BP in tranches with releases conditional on meeting and maintaining performance criteria acceptable to IDA (paras 3.5, and 6.3(c)).

6. AGREEMENTS REACHED AND RECOMMENDATION

6.1 During negotiations agreements were reached with the Borrower on the following:

(a) SBV, PFIs, and BP would maintain separate project accounts (para 3.16), and that SBV would transmit to IDA the following:

(i) quarterly reports on progress of implementation of the RDF and FRP, beginning October 31, 1996 (paras 3.16, 4.20);

(ii) semi-annual reports on progress of implementation of the institutional strengthening program beginning January 1, 1997 (para 3.16);

(iii) audited accounts, including the auditors' report, of the RDF, the FRP, the PFIs, the BP, the Special Account, and the Statement of Expenditures, for activities under the project within six months after the end of the Government's fiscal year (audit of financial statements of PFIs and BP to be furnished within six months after the end of the Government's fiscal year), beginning June 1998 covering FY96 and 97 (para 3.16);

(iv) part two of the Implementation Completion Report of the project within six months after the Credit closing date, (para 3.16);

(v) by September 30 and March 31 of each year, commencing on March 31,1997, an evaluation of the compliance of each PFI and BP with regard to their eligibility criteria as set forth in the RDF and FRP policy manuals and compliance with the agreed institutional development plan (para 4.7);

(b) The Borrower would by December 31, 1996, establish and thereafter maintain within SBV a monitoring and evaluation system satisfactory to IDA (para 3.17);

(c) Proceeds accrued from the repayment of the principal of the loans to PFIs and BP would be used to establish and maintain revolving funds for onlending for the same purposes and under the same terms and conditions as those for onlending under the IDA Credit (para 3.9);

(d) The RDF would be managed on a commercial basis (para 4.1) and funds would be onlent according to the procedures as described in the agreed Policy Manual (Annex 9) and changes in this manual would not be made without IDA's prior concurrence (para 4.2). The manual would incorporate agreements with IDA on the following:

(i) eligibility criteria for RDF and FRP loans, including minimum funding requirements and equity contribution of PFIs and sub-borrowers, respectively (paras 4.2, and 4.17);

(ii) interest rate structure and principles for determining the interest rates under the project (para 4.5, and 4.16);

(iii) sub-loan maturities (para 4.5);

(iv) PFIs accreditation criteria, including that specific to the BP (para 4.7);

(v) sub-project appraisal and analysis of viability (para 4.9);

(vi) sub-project review and disbursement (para 4.10);

(vii) certification of conformity with environmental laws would be required for sub-projects above the free-limit (para 4.11);

(viii) sub-project supervision (para 4.12) and,

(ix) no PFI would have access to more than US$50 million equivalent from the initial IDA funds made available to the Project except as agreed between IDA and the Borrower (para 3.14):

(e) by June 30 of each year, commencing on June 30, 1997, or at such other intervals as the Borrower and IDA may agree, the Borrower, through SBV, would exchange views with IDA on the level of interest rates charged on Subsidiary Loans , the FRP Loan and sub-loans to determine if such rates are positive in real terms and above the weighted average deposit rates prevailing in the market at the time of the review and, with the prior concurrence of IDA, revise such rates, if required (para 4.5);

(f) the project training programs for 1997 would be submitted to IDA for review by November 30, 1996 and thereafter the updated programs for each fiscal year by November 30 of each year (para 4.23); and

(g) SBV would employ consultants whose qualifications, experience, and terms and conditions are satisfactory to IDA (para 4.23).

(h) by June 30, 1999, the Borrower would transfer the RDF to a suitable commercial bank or other such institution (para 4.4).

(i) SBV would assist the BP to prepare an institutional development plan with a detailed timetable and staff training program and would furnish the IDP to IDA for its comment and that BP performance vis-a-vis the accreditation criteria and the IDP would be reviewed semi-annually by June 30 and December 31 of each year commencing on December 31, 1996, and thereafter b y September 30 and March 31 of each year furnish a report on BP performance and corrective measures to be followed, if necessary, for IDA's concurrence (para 4.20)

6.2 Conditions of Credit Effectiveness would be:

(a) the adoption by the Borrower through SBV of the RDF Policy Manual, agreed to by IDA (para 4.2); and,

(b) establishment within the PMU of SBV, sub-units for (i) PFI accreditation, (ii) accounting and disbursement, (iii) subloan application review, and (iv) supervision, and the appointment of qualified and experienced project manager and core staff, all acceptable to IDA (para 4.4).

6.3 Condition of Disbursement for the RDF Sub-loans would be:

(a) for each PFI, a Subsidiary Loan Agreement acceptable to IDA will have been entered into with SBV (para 3.9) and accreditation will have been obtained and maintained (para 4.1).

6.4 Condition of Disbursement for the FRP Sub-loans would be:

(a) the Charter of the BP will have been approved and the Financing Agreement will have been entered by SBV and BP (para 3.9);

(b) the adoption by the Board of BP of (i) a small-savers program to increase the resources available to the BP and to increase beneficiary participation ; and (ii) an institutional development plan satisfactory to IDA (para 3.14);

(c) the adoption by the Borrower through SBV, of the FRP Policy Manual, agreed to by IDA (para 4.17); and,

(d) following an initial disbursement of US$2 million, subsequent disbursements of up to US$7 million cumulative would be made only after SBV has certified to IDA that the BP is in compliance with the performance criteria agreed in the FRP policy manual and BP's institutional development plan , and thereafter up to US$12 million cumulative following a final review (para 3.14).

Recommendation

6.5 Subject to the above agreements and conditions, the project is suitable for a Credit to the Socialist Republic of Viet Nam in the amount of SDR82.7 million (US$122 million equivalent), on standard IDA terms with 40 years' maturity.

SOCIALIST REPUBLIC OF VIET NAM
RURAL FINANCE PROJECT
Table 1. RURAL DEVELOPMENT FUND
Detailed Costs
(US$'000)

	Unit	Quantities 1996	1997	1998	1999	2000	Total	Unit Cost	Base Cost 1996	1997	1998	1999	2000	Total
I. Investment Costs														
A. FUND CAPITAL														
1. *RDF - LONG TERM*	BASE COSTS								10,000	15,000	15,000	18,000	18,000	76,000
2. RDF - SHORT TERM	BASE COSTS								5,000	8,000	9,000	8,000	5,000	35,000
Subtotal FUND CAPITAL									15,000	23,000	24,000	26,000	23,000	111,000
B. PROJECT MANAGEMENT UNIT														
1. EQUIPMENT /a														
WORKSTATION COMPUTERS AND SOFTWARE	UNITS	10	20	-	-	-	30	14	137	274	-	-	-	410
OTHER OFFICE EQUIPMENT	UNITS	10	20	-	-	-	30	3	34	68	-	-	-	103
Subtotal EQUIPMENT									171	342	-	-	-	513
2. VEHICLES FOR FUND SUPERVISION /b	UNIT	3	2	-	-	-	5	103	308	205	-	-	-	513
Subtotal PROJECT MANAGEMENT UNIT									479	547	-	-	-	1,026
C. INSTITUTION BUILDING														
1. TRAINING /c														
WORKSHOPS IN BANK ACCREDITATION	UNITS	3	3	3	3	-	12	4	13	13	13	13	-	53
LOCAL TRAINING IN WHOLESALE BANKING	COURSES	5	5	5	5	-	20	4	22	22	22	22	-	88
OVERSEAS COURSES IN WHOLESALE BANKING	COURSES	3	3	3	3	-	12	4	13	13	13	13	-	51
Subtotal TRAINING									48	48	48	48	-	192
2. T/A IN IMPROVING RURAL BANKING SERVICES /d														
ADVISORY SERVICES	Consultant Month	12	6	6	6	-	30	18	212	106	106	106	-	529
STUDIES TO IMPROVE RURAL BANKING	Consultant Month	12	6	6	6	-	30	18	212	106	106	106	-	529
Subtotal T/A IN IMPROVING RURAL BANKING SERVICES									423	212	212	212	-	1,058
Subtotal INSTITUTION BUILDING									471	260	260	260	-	1,250
Total Investment Costs									15,950	23,807	24,260	26,260	23,000	113,276
II. Recurrent Costs														
A. INCREMENTAL OPERATING COSTS														
1. CONTRACT STAFF COSTS /e	Staff Month	30	60	60	60	30	240	1	17	33	33	33	17	132
2. O & M, PRINTING, OFFICE SUPPLIES	UNITS	10	10	10	10	10	50	1	11	11	11	11	11	54
Total Recurrent Costs									27	44	44	44	27	186
Total									15,977	23,850	24,303	26,303	23,027	113,461

\a Includes 60% tax on cif price plus excise tax of 100%
\b Includes 60% import tax on cif price plus 100% excise tax
\c For details see Annex 3
\d Includes 10% income tax
\e No incremental permanent staff

SOCIALIST REPUBLIC OF VIET NAM
Rural Finance Project
Table 2. FUND FOR THE RURAL POOR
Detailed Costs
(US$'000)

	Unit	Quantities 1996	1997	1998	1999	2000	Total	Unit Cost	Base Cost 1996	1997	1998	1999	2000	Total
I. Investment Costs														
A. FUND CAPITAL														
1. FRP - MEDIUM TERM	Base Costs								1,000	2,000	2,000	2,000	2,000	9,000
2.FRP - SHORT TERM	Base Costs								1,000	2,000	2,000	1,600	1,000	7,600
Subtotal FUND CAPITAL									2,000	4,000	4,000	3,600	3,000	16,600
B. SUPPORT TO BANK MANAGEMENT														
1. WORKSTATION COMPUTERS AND SOFTWARE	UNITS	3	3	3	3	3	15	14	41	41	41	41	41	205
2. PRINTERS, COPIERS, OTHER OFFICE EQ.	SET	3	2	1	1	1	8	3	10	7	3	3	3	27
3. VEHICLES FOR BANK SUPERVISION	UNIT	2	-	-	1	1	4	103	205	-	-	103	103	410
Subtotal SUPPORT TO BANK MANAGEMENT									256	48	44	147	147	643
C. INSTITUTION BUILDING /a														
1. TRAINING /b														
LOCAL TRAINING OF BANK OFFICERS /c	UNITS	1	1	1	1	1	5	99	99	99	99	99	99	494
LOCAL TRAINING OF SAVINGS AND LOAN GROUPS	COURSES	80	200	240	200	80	800	1	88	219	263	219	88	877
OVERSEAS STUDY IN BANKING FOR THE POOR	COURSES	3	3	3	3	-	12	4	13	13	13	13	-	51
Subtotal TRAINING									199	331	375	331	186	1,422
2. TECHNICAL ASSISTANCE IN BANKING FOR THE POOR														
ADVISORY SERVICES	Consultant Month	6	6	6	6	-	24	16	96	96	96	96	-	385
STUDIES IN BANKING FOR THE POOR	Consultant Month	3	3	3	3	-	12	16	48	48	48	48	-	192
Subtotal TECHNICAL ASSISTANCE IN BANKING FOR THE POOR									144	144	144	144	-	577
Subtotal INSTITUTION BUILDING									344	475	519	475	186	1,999
Total Investment Costs									2,600	4,523	4,564	4,222	3,334	19,242
II. Recurrent Costs														
A. INCREMENTAL OPERATING COSTS														
1. CONTRACT STAFF COSTS	MONTHS	2	2	2	2	2	10	1	1	1	1	1	1	5
2. O & M, PRINTING, OFFICE SUPPLIES	UNITS	1	1	1	1	1	5	11	11	11	11	11	11	54
Total Recurrent Costs									12	12	12	12	12	59
Total									2,612	4,535	4,575	4,234	3,345	19,302

\a Training and workshops at SBV Banking College, and other local institutions
\b For details see Annex.2
\c For Details See Annexes

SOCIALIST REPUBLIC OF VIET NAM
Rural Finance Project
Table 3. IMPROVING FINANCIAL SERVICES TO RURAL AREAS
Detailed Costs
(US$'000)

	Unit	Quantities 1996	1997	1998	1999	2000	Total	Unit Cost	Base Cost 1996	1997	1998	1999	2000	Total
I. Investment Costs														
A. VBA OUTREACH														
1. OFFICE EQUIPMENT FOR OUTREACH MANAGEMENT	set	10	20	20	20	-	70	3	34	68	68	68	-	239
2. VEHICLES FOR MOBILE STAFF IN REMOTE AREAS														
CARS FOR FIELD STAFF IN REMOTE AREAS /a	UNIT	10	20	20	10	-	60	41	410	821	821	410	-	2,462
MOTOR CYCLES FOR FIELD STAFF IN REMOTE AREAS	MOTOR CYCLE	10	10	10	10	-	40	10	103	103	103	103	-	410
Subtotal VEHICLES FOR MOBILE STAFF IN REMOTE AREAS									513	923	923	513	-	2,873
3. TRAINING IN OUTREACH TO REMOTE AND ETHNIC AREAS														
WORKSHOPS	UNITS	3	3	3	3	-	12	4	13	13	13	13	-	53
LOCAL TRAINING IN OUTREACH PROGRAMS /b	COURSES	5	5	5	5	-	20	4	22	22	22	22	-	88
OVERSEAS STUDY TOURS IN OUTREACH BANKING	COURSES	3	3	3	3	-	12	4	13	13	13	13	-	51
Subtotal TRAINING IN OUTREACH TO REMOTE AND ETHNIC AREAS									48	48	48	48	-	192
4. TECHNICAL ASSISTANCE IN BANKING SERVICES FOR REMOTE AND ETHNIC AREAS														
ADVISORY SERVICES	Consultant Month	2	4	4	4	-	14	16	32	64	64	64	-	224
STUDIES IN OUTREACH METHODS	Consultant Month	3	3	3	3	-	12	16	48	48	48	48	-	192
Subtotal TECHNICAL ASSISTANCE IN BANKING SERVICES FOR REMOTE AND ETHNIC AREAS									80	112	112	112	-	417
Subtotal VBA OUTREACH									675	1,152	1,152	742	-	3,721
B. VBA SAVINGS MOBILIZATION PROGRAM /c														
1. OFFICE EQUIPMENT AND MATERIALS FOR SAVINGS CAMPAIGN	SET	4	4	4	4	-	16	1	4	4	4	4	-	17
2. LOCAL TRAINING	COURSES	4	4	4	4	-	16	4	18	18	18	18	-	70
3. TECHNICAL ADVISERS AND STUDIES IN SAVINGS MOBILIZATION	Consultant Month	2	2	2	2	-	8	16	32	32	32	32	-	128
Subtotal VBA SAVINGS MOBILIZATION PROGRAM									54	54	54	54	-	216
C. COMMUNITY DEVELOPMENT PROGRAM IN GROUP FORMATION AND SMALL SAVERS PROMOTION (SBV) /d														
1. CONSULTANTS AND STUDIES (LOCAL AND FOREIGN)	Consultant Month	10	25	25	25	-	85	16	160	401	401	401	-	1,363
2. COMMUNITY TRAINING IN FINANCIAL MANAGEMENT	COURSES	4	10	10	10	-	34	5	22	54	54	54	-	184
Subtotal COMMUNITY DEVELOPMENT PROGRAM IN GROUP FORMATION AND SMALL SAVERS PROMOTION (SBV)									182	455	455	455	-	1,547
Total									911	1,661	1,661	1,250	-	5,483

\a Vehicle specification for this price from VBA
\b For details see Annex 3
\c For details see Annex 3
\d For details see Annex 3

SOCIALIST REPUBLIC OF VIET NAM
Rural Finance Project
Table 4. **Components Project Cost Summary**

	(VND Million)			(US$ '000)			% Foreign Exchange	% Total Base Costs
	Local	Foreign	Total	Local	Foreign	Total		
1. RURAL DEVELOPMENT FUND	500,184	747,892	1,248,076	45,471	67,990	113,461	60	82
2. FUND FOR THE RURAL POOR	128,168	84,149	212,317	11,652	7,650	19,302	40	14
3. IMPROVING FINANCIAL SERVICES TO THE RURAL AREAS	26,693	33,621	60,314	2,427	3,056	5,483	56	4
Total BASELINE COSTS	655,044	865,662	1,520,707	59,549	78,697	138,246	57	100
Physical Contingencies	-	-	-	-	-	-	-	-
Price Contingencies	9,234	6,456	15,690	839	587	1,426	41	1
Total PROJECT COSTS	664,278	872,118	1,536,396	60,389	79,283	139,672	57	101

SOCIALIST REPUBLIC OF VIET NAM
Rural Finance Project
Table 5. **Expenditure Accounts Breakdown**
(US$'000)

	Base Cost				Physical Contingencies				Price Contingencies				Total Incl. Cont.				Base Costs + Price Cont. on Base Costs	Physical Cont. Plus Price Cont. on Physical Cont.
	For. Exch.	Local (Excl. Taxes)	Duties & Taxes	Total	For. Exch.	Local (Excl. Taxes)	Duties & Taxes	Total	For. Exch.	Local (Excl. Taxes)	Duties & Taxes	Total	For. Exch.	Local (Excl. Taxes)	Duties & Taxes	Total		
I. Investment Costs																		
A. RURAL DEVELOPMENT FUND																		
1. RURAL DEVELOPMENT FUND- LONG TERM	45,600	30,400	-	76,000	-	-	-	-	-	-	-	-	45,600	30,400	-	76,000	76,000	-
2. RURAL DEVELOPMENT FUND - SHORT TERM	21,000	14,000	-	35,000	-	-	-	-	-	-	-	-	21,000	14,000	-	35,000	35,000	-
Subtotal RURAL DEVELOPMENT FUND	66,600	44,400	-	111,000	-	-	-	-	-	-	-	-	66,600	44,400	-	111,000	111,000	-
B. FUND FOR THE RURAL POOR																		
1. FUND FOR THE RURAL POOR - SHORT TERM	3,040	4,560	-	7,600	-	-	-	-	-	-	-	-	3,040	4,560	-	7,600	7,600	-
2. FUND FOR THE RURAL POOR - MEDIUM TERM	3,600	5,400	-	9,000	-	-	-	-	-	-	-	-	3,600	5,400	-	9,000	9,000	-
Subtotal FUND FOR THE RURAL POOR	6,640	9,960	-	16,600	-	-	-	-	-	-	-	-	6,640	9,960	-	16,600	16,600	-
C. VEHICLES																		
1. MOTOR CYCLES	128	-	282	410	-	-	-	-	14	-	30	44	142	-	312	454	454	-
2. 4WD VEHICLES	898	-	1,975	2,873	-	-	-	-	97	-	214	311	995	-	2,189	3,183	3,183	-
3. 2WD VEHICLE	160	-	353	513	-	-	-	-	14	-	31	45	174	-	383	558	558	-
Subtotal VEHICLES	1,186	-	2,610	3,796	-	-	-	-	125	-	275	400	1,311	-	2,884	4,196	4,196	-
D. EQUIPMENT																		
1. COMPUTERS	192	-	423	616	-	-	-	-	19	-	43	62	212	-	466	677	677	-
2. OTHER OFFICE EQUIPMENT	129	4	254	387	-	-	-	-	14	1	27	41	143	4	281	428	428	-
Subtotal EQUIPMENT	321	4	677	1,002	-	-	-	-	33	1	69	103	354	4	746	1,105	1,105	-
E. Training																		
1. WORKSHOPS /a	58	541	-	599	-	-	-	-	7	146	-	153	65	687	-	752	752	-
2. OVERSEAS TRAINING	154	-	-	154	-	-	-	-	17	-	-	17	170	-	-	170	170	-
3. LOCAL TRAINING	200	1,107	-	1,308	-	-	-	-	23	296	-	318	223	1,403	-	1,626	1,626	-
Subtotal Training	413	1,648	-	2,060	-	-	-	-	46	442	-	488	459	2,090	-	2,548	2,548	-
F. Technical Assistance																		
1. ADVISORY SERVICES	3,447	-	96	3,543	-	-	-	-	373	-	10	382	3,819	-	106	3,925	3,925	-
Total Investment Costs	78,607	56,011	3,383	138,001	-	-	-	-	576	443	354	1,373	79,183	56,454	3,737	139,374	139,374	-
II. Recurrent Costs																		
B. INCREMENTAL OPERATING COSTS /b	90	155	-	245	-	-	-	-	10	43	-	53	100	198	-	298	298	-
Total Recurrent Costs	90	155	-	245	-	-	-	-	10	43	-	53	100	198	-	298	298	-
Total	78,697	56,166	3,383	138,246	-	-	-	-	587	486	354	1,426	79,283	56,652	3,737	139,672	139,672	-

\a Workshops on fund management
\b Amount is based on PMU estimates

SOCIALIST REPUBLIC OF VIET NAM

Rural Finance Project

Table 6. Disbursement Accounts by Financiers

(US$'000)

	The Government		Participating Financial Institutions		International Development Assn		Total		For. Exch.	Local (Excl. Taxes)	Duties & Taxes
	Amount	%	Amount	%	Amount	%	Amount	%			
1. RURAL DEVELOPMENT FUND	383	0.3	11,142	10.0	100,032	89.7	111,558	79.9	66,774	44,400	383
2. FUND FOR THE RURAL POOR	1,660	10.0	-	-	14,940	90.0	16,600	11.9	6,640	9,960	-
3. VEHICLES & EQUIPMENT	3,252	68.6	-	-	1,491	31.4	4,743	3.4	1,491	4	3,247
4. OVERSEAS TRAINING	-	-	-	-	170	100.0	170	0.1	170	-	-
5. DOMESTIC TRAINING	0	-	-	-	2,378	100.0	2,378	1.7	288	2,090	-
6. TECHNICAL ASSISTANCE	106	2.7	-	-	3,819	97.3	3,925	2.8	3,819	-	106
7. INCREMENTAL OPERATING COSTS	298	100.0	-	-	-	-	298	0.2	100	198	-
Total	5,699	4.1	11,142	8.0	122,831	87.9	139,672	100.0	79,283	56,652	3,737
TOTAL - ROUNDED AND ALLOCATED	6,700		11,000		122,000	87					

SOCIALIST REPUBLIC OF VIET NAM

RURAL FINANCE PROJECT

FINANCIAL SERVICES TO THE POOR

1. This annex reviews the credit and savings mechanisms available to the rural poor in Viet Nam. The objective is to identify and analyze the programs, institutions and modalities that aim at reaching the rural poor with credit and savings services and that appear to be sustainable. The technical assistance support under the Rural Finance Project (Annex 3) focuses on enhancing the outreach of these sustainable programs. An overview of the institutional provision of financial services to the rural poor is presented first, followed by a more detailed analysis of the roles of the SBVs People's Credit Funds (PCFs) and the Viet Nam Bank for Agriculture (VBA), given their relative significance in reaching the poor, and their role in the proposed technical assistance under this project.

Overview

2. About 51 percent of the Vietnamese population is classified as poor, i.e., at or below the national average poverty line of VND1.1 million (US$100) per person per year. Poverty is most prevalent in rural areas where 80 percent of the population and 90 percent of the poor live.[1] Among the many constraints to increase agricultural productivity and diversify rural enterprises as means of poverty reduction, access to financial services stands out as a severe limitation. The Viet Nam Living Standards Survey indicated that only 20 percent of the rural households taking loans borrow from formal sources, primarily government banks, while a majority (72 percent) borrow from informal sources at interest rates two to three times higher than those charged by formal financial institutions.[2] On the other hand, the availability of deposit services in rural areas is extremely limited, forcing rural household to save in physical assets, often unsafe and illiquid. The poor conditions of accessibility and communications prevailing in rural areas, which create substantial costs of providing financial services, and the inability of rural households to offer collateral explain the limited access to formal finance by the rural poor.

3. Formal credit is severely rationed because banks are unable to mobilize sufficient savings, due in large part to the interest rate structure set by the SBV. The deposit rate for medium term (2-5 years) funds is set at a higher rate (currently 2.1 percent) than the lending rate for the same term (currently 1.7 percent). This inverted structure discourages

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1 World Bank. *Viet Nam: Poverty Assessment and Strategy*. January 1995.

2 World Bank. *Viet Nam: Public Sector Management and Private Sector Incentives. An Economic Report*. September 1994. Interest rates charged by informal lenders range from 6% to 10% per month, while formal sector rates vary between 2.5% and 3.5% per month.

institutions from raising longer term deposits and thus limits the ability of households to borrow, particularly for periods longer than 3 to 6 months.

4. Savings are estimated to have increased from 3.2 percent of GDP in 1989 to 16.3 percent in 1992. This development confirms that households have the same strong predilection to save that is observed throughout East Asia. Stabilization of the economy, strengthening of property rights, and improvements in the banking system combined to bring forth these savings and to channel them to productive uses. In 1993, however, national savings declined to 11.2 percent of GDP. Of this five point decline in the savings rate, about one fourth can be attributed to a decline in government savings and three-fourths to a decline in savings outside of the government sector. Reversing this decline is an immediate and important task for economic policy that will require actions both on the government budget and on the incentives that encourage households and firms to save and invest.

5. Encouraging the mobilization of savings will reduce the shortage of funds currently affecting financial intermediation in Viet Nam. In addition, the ability to save in currency rather than gold or livestock benefits the poor, especially in times of emergency.

6. The total number of formal financial units serving the rural population in Viet Nam (excluding NGOs) at the end of 1994 was 2,821, made up as follows :

2,564	Viet Nam Bank of Agriculture branches
16	Rural Shareholder Banks
172	People's Credit Funds
69	Credit Cooperatives

7. The outstanding balance of formal credit to the rural population was US$5,487 billion at the end of 1994, of which 23 percent was funded from SBV and 77 percent from deposits. In general, the formal financial markets are more developed in the south, while the poorest regions in the central area and the Northeast provinces have little access to formal savings and credit.

8. It was found during project preparation that the current level of outreach to the poor by the formal credit sector was better than expected. To measure outreach, average loan sizes and lending methodologies were considered. Average loan size of approximately VD500,000 (US$45)[3] and less was used as an indicator of outreach to the lower half of the population. Lending methodologies such as joint liability and savings and credit groups, as well as mobile banking units, are also indicators of outreach in rural areas. In reviewing the outreach of credit and savings to the poor, formal banks,

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3 Average loan sizes of approximately $50 are considered appropriate for reaching the poorer half of the population in countries where average per capita income is less than US$200. Average loan sizes for organizations such as the Grameen Bank and Bangladesh Rural Advancement Committee (BRAC) are US$40 to US$50. The level of poverty in Bangladesh is considered similar to that in Viet Nam.

cooperatives, service organizations, and international organizations were examined. A summary is provided below of the activities of each.

9. The SBV recently created PEOPLE'S CREDIT FUNDS (PCFs) to supplement the VBAs activities in rural finance. PCFs are approved by the SBV and managed by local villagers. In spite of their stated objective to provide access to credit and savings for the rural poor, it was found that they do not significantly utilize group lending methodologies (although group lending is more common in the south), and generally require collateral (50 percent to 70 percent) for loans. Average loan size appears to be greater than VD2 million (US$180) and in some cases as high as VD5 million (US$450), which is generally too large for the poorer half of the population. If PCFs are to supplement the VBAs activities, they must reduce their collateral requirements and encourage more outreach through group lending. However, further training and technical assistance is required to ensure appropriate mechanisms are in place prior to expanding the system.

10. Other than the PCF system, the VIET NAM BANK OF AGRICULTURE is the only state-owned formal financial institution active in rural finance. In 1992, the VBA claimed to reach 9 percent of rural households with credit and savings services; by the end of 1994, it claimed to provide credit to approximately 30 percent of rural households. This increase is the result of establishing sub-district offices and mobile banking teams, and using joint-liability groups. The VBA utilizes group lending for about 35 percent of their loans and seems to be reaching thereby the poorer segment of the population. Loan sizes appear to be between VD500,000 (US$45) and VD1 million (US$90) per group member. However, there is some question as to whether or not the smaller loans actually reach the poorer villagers as some interviews highlighted the possibility that village leaders choose the group members and often include family members or other favored people. The VBA is actively lending through service organizations and NGOs, a practice which is working well to develop a linkage between the informal and formal sectors.

11. Cooperatives and credit societies now represent a small share of the formal financial market in contrast to the large number of cooperatives operating in 1988-1990. Currently there are 69 cooperatives, down from 7,900 in 1987. RURAL SHAREHOLDING BANKS are replacing many of the credit cooperatives in rural areas. In March 1995, there were 16 rural shareholding banks in Viet Nam. Average loan sizes were VD1-3 million which indicates that they may have greater outreach to the poor than the PCF system, but they still claim to meet only 10 percent-30 percent of the estimated credit needs of the rural population.

12. SERVICE ORGANIZATIONS such as the Women's Union, Farmer's Association, or Gardener's Association (VACVINA) are effective in reaching the poor due to their reliance on group lending and mass membership. Generally, the service organizations either borrow from the VBA or work with the VBA to provide savings and credit services to their members. In addition, they often work with NGOs to deliver these services. NGOs have very good outreach as they generally focus all their efforts on providing services to the poor in a sustainable manner. Average loan size through NGOs appears to

be VD200,000-300,000 (US$18-27). These NGOs, however, are operating on a relatively small scale compared to NGOs in other parts of the world, which are growing significantly and reaching levels of scale and sustainability that allow them to create formal financial institutions to serve the poor. With the infusion of funds from the World Bank project, NGOs may be able to increase their activities to a point where a formal financial institution is possible, but this will likely take a number of years.

13. The WOMEN'S UNION appears to be the most active mass organization in micro-credit. Their plans to set up a Women's Union Bank require more study but from the initial discussions, it appears that they may have sufficient scale and national outreach to make a bank feasible. Training the Women's Union staff in financial management and reporting is also required prior to the formation of a Women's Union bank.

14. Since 1990, a number of MULTILATERAL ORGANIZATIONS have supported credit activities in Viet Nam. Programmes implemented by UNICEF, IFAD, World Bank, European Economic Community, UNFPA, ADB, and others all appear to be improving access to credit and savings services by the poor. A positive element discovered during project preparation was that in many programs interest rates and fees charged appear to be high enough to cover all expenses, including operating costs, loan losses, financial costs and inflation, assuming that the loan portfolio quality is as high as that reported. It should be noted, however, that poor loan quality generally shows up over the longer term, and since credit and savings organizations in Viet Nam are still quite young, the quality of the loan portfolios should be monitored carefully. In addition, tight cost controls are required to ensure that the interest and fees collected continue to cover all expenses. To date, most of the PCFs have reported a profit after one year in operation and the VBA has reported a profit for the last two years. This indicates a positive trend which will hopefully continue as volumes grow.

15. The biggest problem facing all financial organizations seems to be a lack of funds, particularly medium to long-term. Since larger loans earn relatively more interest than smaller loans, profit-motivated organizations will tend to lend to larger clients, thus reducing any efforts to reach the poor. In addition, to overcome the lack of longer-term funds, many lenders roll over short-term loans without the principal being repaid in order to provide medium-term loans. Therefore, although the poorer half of the population generally take short-term loans, the lack of medium to long-term funds ultimately affects their access to credit since short-term funds are not truly available for short-term loans.

16. Throughout Asia it has been found that the poor value access to savings as much as they value access to credit. Due to the recent bankruptcies of cooperatives, and a general mistrust of the banking sector, as well as historically high inflation rates, there is a lack of confidence in saving in currency. This confidence needs to be restored to increase savings. Firstly, the inverted interest rate structure set by the SBV needs to be corrected. Then, savings products must be made available with terms (short-term or demand) and minimum deposit sizes (VD1,000 and above) suitable to the poor. Ultimately, the service provided to savings customers must be improved.

17. Technical assistance is required to help the SBV, the VBA, and service organizations improve their capacity and outreach to the poor, particularly with regard to financial reporting, monitoring and group formation. Specifically, technical assistance should be provided in the design of reports to include various measures of loan portfolio quality. For example, all organizations should be reporting overdue loans as soon as they become one payment period past due. These amounts should then be categorized by age of overdues (including the full amount of the outstanding loan balance, not just the amount overdue) and loan loss provisions based on these "aged" amounts.

18. Group lending and correspondingly smaller loans are key to providing access to credit and savings services for the poor. In addition to monitoring the size of loans, however, it is useful to periodically rank clients in terms of their wealth. Periodic wealth-ranking allows project management to determine if the credit and savings services are in fact reaching the poor. For loan disbursement, it is sufficient to use loan size as a proxy for poverty.

19. Many successful pilot projects have been instituted in Viet Nam and the findings appear to be quite consistent: the poor are able to repay loans bearing interest rates that make it profitable for organizations to lend; the poor do save; and there is tremendous demand for credit and savings services amongst the poor which is not being met currently from formal sources. A study of the savings and credit activities of NGOs could result in a better design and implementation of the Rural Finance Project through the adoption of their more successful features, particularly their savings components. Specifically, it will be most useful to examine those NGOs that have the vision to create large, sustainable micro-credit programmes.

20. The linkage that has been created between the informal sector and formal institutions like the VBA and PCFs is a positive finding and should be encouraged. Although this Rural Finance Project seeks to strengthen the formal financial sector, because so many service organizations and NGOs use VBA funds for lending purposes, it is worthwhile to examine and encourage these linkages. Also, service organizations and NGOs have developed effective outreach mechanisms which benefit the formal financial sector. Finally, NGOs and service organizations sometimes also provide training as part of their programmes. This training ultimately benefits the formal financial sector in lower loan losses and more effective usage of credit and savings products.

Outreach activities of banks - the SBV and the VBA

21. Until 1988, the State Bank of Viet Nam (SBV) discharged both central and commercial banking functions. The Bank for Foreign Trade of Viet Nam (VIETCOMBANK) handled trade finance and foreign exchange management, and the Bank for Investment and Development of Viet Nam (BIDV) provided long-term finance for public works and infrastructure projects. In 1988, two additional state-owned commercial banks were created: the Industrial and Commercial Bank (Incombank), from SBVs industrial and commercial loan department; and the Viet Nam Bank for Agriculture

(VBA), from the agricultural credit department. Legislation put in place after 1990 extended banking services to include shareholding joint stock banks, joint venture banks, branches/offices of foreign banks, and credit cooperatives. Early 1994 regulations allowed savings and loans institutions-- called popular credit funds-- to be established. Only one of the four state-owned commercial banks lends to rural households or small-scale agricultural enterprises, the VBA. Therefore, this section focuses on the State Bank and the VBA and will not discuss the other state-owned commercial banks.

STATE BANK OF VIET NAM

22. The State Bank of Viet Nam (SBV) is responsible for refinancing commercial banks; providing guarantees and re-guarantees on government loans; controlling credit limits; setting reference interest rates; and managing and monitoring credit operations and performance. The SBVs strategy for increasing the availability of rural credit and savings is to license new institutions that will supplement the efforts of the VBA.

23. The SBV is currently piloting Popular Credit Funds (PCFs) to fill the void created by the failure of rural credit cooperatives in 1990-91. PCFs are based on the Canadian model of credit unions with the objective of increased access to production credit for small farmers. Approval for PCFs was granted in July, 1993 and in March, 1994, operations began in 14 provinces with 78 districts operating 153 PCFs.

24. Each PCF is a legal, autonomous economic unit, operating independently, with the SBV maintaining the solvency and liquidity of the whole system. Currently, PCFs are active at the local and national level (Central Credit Fund) and plans are to set up regional funds as necessary. The Central Credit Fund is responsible for safeguarding the local PCFs against the covariant risks to which they are exposed due to the local and specialized nature of their loan portfolios. The Central Fund receives 40 percent of its capital through the SBV and the balance through shares held by the local and, in future, regional units. Regional funds will be set up to examine and supervise the operation of local funds and to distribute capital between local funds by receiving deposits and granting loans. Technical assistance to develop the PCF structure is currently being received from Quebec, France, and Germany. In addition, the Asian Development Bank (ADB) and the SBV have a Memorandum of Understanding to finance the PCF system. By the end of April 1995, the ADB project was to have been implemented with $300,000 provided for technical assistance and training and US$80 million for loan capital (to be confirmed).

25. PCFs are voluntary member-based organizations and are 100 percent rural. Each credit fund must have at least 12 founders. PCFs have two kinds of share capital: qualification shares and permanent shares. Qualification shares have a minimum nominal value of VD30,000 and bear no interest. Permanent shares are those purchased by the founders, and they are generally of much higher value than the qualification shares. There are also two types of members: official members who are eligible to vote (one vote per person regardless of the number of shares) and to stand for leadership of the credit

fund; and unofficial members who are allowed to deposit and borrow money but are not eligible to vote or to stand for the leadership.

26. Loans are made to PCF members only. The minimum loan size is VD300,000. Deposits are accepted from non-members as well as members. The maximum deposit term is 3 months and the minimum deposit is VD10,000. Interest and deposit rates cannot be higher than those at the State Commercial banks as set by the SBV. In March 1995, interest rates ranged as follows: from 2.3 to 2.5 percent in the North; 2 to 2.3 percent in the central region; and 3 to 3.5 percent in the South. Loan interest rates depend on deposit rates. A spread of 0.5 to 0.7 percent per month between the two is accepted. The SBV states that the spread can be as high as 1 percent over the PCFs average cost of funds. The Central Credit Fund lends at 2 to 2.2 percent/month to PCFs. Local PCFs lend to other PCFs at 1.6 percent (funds go through Central Fund). The SBV pays 2.0 percent to PCFs that have idle funds on deposit. This variance encourages PCFs to maintain idle funds with the SBV rather than onlending to other PCFs. This needs to be clarified and, if necessary, corrected.

27. The growth rate of PCFs is high, as the following table shows:

	March 1994	May 30, 1995
Number of PCFs	153	207
PCF members	12,000	65,268
Capital	VD4.8 billion (US$435,000)	VD15.7 billion (US$1.4 million)
Deposits	VD9 billion (US$820,000)	VD108.7 billion (US$9.9 million)
Outstanding loans	VD14 billion (US$1.27 million)	VD123.3 billion (US$11.2 million)

28. The size of the PCFs differs depending on the area. In the North, average capital per PCF is VD50 million (US$4,500); in the South VD100-300 million (US$9,000-27,000); and in central Viet Nam VD30 million (US$2,700). Each local PCF can borrow up to one-tenth of its capital and must have minimum capital of VD20 million (US$1,800). Capital is provided by the PCF founders and the State Bank (up to 40 percent). The Credit Union in Quebec, Canada provided VD27 million (US$2,500) in capital to 28 original PCFs.

29. There are no required reserves for PCFs at the local level although they do reserve 10 percent to 20 percent of profit each year. In addition, each PCF must set up a professional and technical development fund, a welfare fund, and a bonus fund. Remaining profit is distributed to shareholders as dividends and/or rewards to depositors and borrowers. Regional and central funds must have reserves according to SBV regulations. Local PCFs can lend out up to 75 percent of their deposits.

30. PCFs have now been approved in 34 provinces. By the end of 1995, the SBV estimates there will be 1,700 PCFs based on 35 per province in 50 provinces. This seems too ambitious a target based on a short testing period of less than 1 year for most PCFs and a maximum of 2 years for any. In general, the PCF system appears as an appropriate

mechanism to supplement the activities of the VBA and provide credit and savings to the rural population. In practice however, average loan sizes appear to be relatively too large (VD3 to 5 million or US$270 to 450) for the poor. The requirement for collateral further restricts access to the poor; and the need to physically go to the branch office limits outreach. It seems advisable that collateral requirements for smaller loans be reduced or eliminated, group lending be encouraged in order to increase access to village members and reduce time required to visit the branch, and that further training and technical assistance be provided prior to rapid expansion of the PCF system.

VIET NAM BANK OF AGRICULTURE

31. The Viet Nam Bank of Agriculture (VBA) was created in March 1991 under the reforms of the SBV. The VBA is a state-owned enterprise with capital allocated by the SBV. Interest and deposit rates are determined within the state interest rate framework. The VBA selects its own investments and economic activities.

32. The VBA is the largest formal credit institution in rural Viet Nam. It has an extensive rural branch banking system which serves as a direct lender, as well as an indirect lender through cooperatives and other rural financial institutions. As of February 1995, the VBA had 2,564 branches, averaging one banking facility per four communes. Staff has been reduced by one-third over the past three years. There are currently 20,000 staff including 1,870 managers, 7,185 credit officers, and 1,022 business operations personnel. Staff productivity increased from 100 loans per person in 1992 to 300 loans per person in 1994 although the technical skills of staff members remain weak due to inappropriate educational backgrounds and insufficient exposure to modern banking methods. The VBA plans to undertake a detailed staffing analysis in 1995 leading to the development of a staffing plan, a staff development strategy and long-term training programme.

33. The capital source structure of the VBA has evolved significantly since 1990 as follows:

Year-End	**1990**	**1991**	**1992**	**1993**	**1994**
	%	%	%	%	%
Loans from State Bank	80	73	70	28	23
Self-Mobilized Capital	20	27	30	52	77

34. Loans from the SBV to the VBA are primarily through refinancing and rediscounting soft loans for natural disasters, diseases, force majeure and for purchasing import and export commodities, such as rice and coffee. The VBA also participates in joint-venture banks and borrows capital from international financial institutions. At December 31, 1994, VBAs assets totaled VD12,000 billion (US$1 billion), an increase of 6.5 times over 1990.

35. The VBA estimates that rural household demand for credit has increased twofold since 1992 when 22.6 percent of households required credit, and by 1994, 45.2 percent

required credit. The proportion of lending to non-state enterprises has increased from 4 percent of the loan portfolio in 1990 to 76 percent in 1994.

Year-End	1990	1991	1992	1993	1994
Loan Portfolio (VD billion)	1,524	2,393	3,213	5,139	9,186
State-Owned Enterprises	1,461	2,148	1,782	1,580	2,166
Non-State Enterprises	63	245	1,431	3,559	7,020*
% Share Non-State Enterprises	4.1	8.6	35.8	60.3	76.4
Profit/(Loss) VD billion	--	(82)	(52)	2.7	24.0

*5,766 or 62.7 percent of total loans were to production households

36. The VBA is primarily an agricultural bank with a loan portfolio dominated by short-term (3 to 12 months) production loans to farm households. Average loan size is VD122 million (US$11,000). In 20 out of 53 provinces in Viet Nam, the VBA is the only formal bank. This results in both a high level of credit risk exposure due to the concentration of agriculture loans, and a lack of effective competition for the VBA in rural areas. In 1992, the VBA provided credit to about 9 percent only of the potential rural households in Viet Nam. Based on end of year 1993 loans outstanding, the corresponding percentage of households receiving credit through the VBA had increased to about 20 percent. At the end of 1994, the VBA provided credit to about 30 percent of rural households and official statistics show that about 40 percent of Viet Nam's farmers have received VBA loans. Plans in 1995 are to provide 282,000 loans of VD500,000 (US$45) to rural households.

Borrower Groups

37. The recent increase in outreach to the poor by the VBA has been achieved through the establishment of sub-district transaction offices, visits of mobile banking teams to villages, and the use of joint-liability groups. These new mechanisms have been implemented through the re-deployment of existing staff and the utilization of service agencies such as the Women's Union and non-governmental organizations (NGOs). This has also lead to greater operational efficiency. The transactions offices provide better service to rural households by virtue of being physically more accessible. This allows for more frequent savings deposits and withdrawals as well as loan repayments. The mobile-banking teams are primarily used to initiate loan applications. Actual loan approvals and disbursements require the borrowers to visit a bank office. While these efforts are able to reduce the transaction costs of loans, the district-based lending still entails some access costs. The use of borrower groups (joint liability, solidarity group) appears to have had the greatest impact on increasing the outreach of the VBA.

38. Joint liability groups are formed either by VBA staff directly or through service organizations or NGOs. Loans made through joint-liability groups generally do not require collateral, provided the loans are for VD500,000 (US$45) or less. The VBA has established 157,000 groups in Viet Nam to date, the majority of which are in the south.

Branches we visited in the south claimed 97 percent of their lending is through groups, formed primarily by the Women's Union and Farmer's Association. In the north, the use of borrower groups is less prevalent. VBAs Head Office in Hanoi believes that, overall, between 30 percent to 35 percent of VBA loans to households are made through groups. The mission is waiting for data, including loan sizes, from the VBA to verify this.

39. Usually the service organization or NGO administers the loans and monitors the borrowers, and in turn receives a commission from the VBA. Some schemes require the service organization or the NGO to guarantee the loan funds as well.

40. The VBA pays commission to groups as follows:

- groups are formed with a mass organization; VBA makes the final loan approval; the mass organization supervises the activities of the group and negotiates with VBA and the People's Committee; then either:
  - (i) the group leader completes the loan application and brings it to the VBA branch, receives the total group loan and disburses it; the VBA credit officer then goes to the next group meeting to ensure everyone has received their loans; or
  - (ii) the VBA credit officer delivers loans directly to the members.

Loans are repaid by the borrowers at the branch or transaction office. In this case, no commission is paid. Each group must go through this stage before being eligible for the next stage in which commission is paid to the NGO.

- the VBA gives authorization to the mass organization that formed the group to complete all loan documents as well as disbursing, supervising, and monitoring the loans; collection is done by the borrower going to the VBA branch. Groups are eligible for this method once they have a history of repayment of 5 cycles; group leaders receives 20 percent of the VBAs spread as commission.
- the VBA authorizes the group leaders to complete all loan documentation, loan appraisal, disbursal, supervision, *as well as collection.* The VBA supervises all activities and pays the group leader 30 percent of spread as commission.

41. When setting up a group, the VBA staff visits the local authorities to work with the commune representative of Women's Union and People's Committees. VBA staff instructs the groups on how to operate. VBA policy states that there should be rich, average and poor households in each group in order to "exercise the principle of joint liability" in case of default. If one or several members default on their loans, the VBA requests the whole group to repay the loan or members cannot receive additional credit.

42. Groups are made up of 10-50 people (average 15-20) and in each village there are normally 2 to 3 groups. When a group applies to the VBA for a loan, they must present: approval of the commune People's Committee; by-laws of the group; list of members; business plan of group, if applicable; and signatures of the group representatives who will deal with the bank on behalf of the group. Loan repayment is made monthly either by borrowers going directly to the branch, paying during group meetings, or by the group leader collecting from all the members and meeting with the VBA representative. Loan terms are determined by the economic sectors and investment objectives of the borrower. They generally range from 3 to 12 months.

43. There are generally no savings requirements in groups formed by the VBA. Loan repayment appears to be good within the groups although VBA staff are authorized to reschedule loans at the District without approval from a higher level. Rescheduled loans are routinely used to provide borrowers with a longer effective loan maturity period than is possible under current bank policy. This makes it difficult to ascertain clearly the quality of group loans.

44. The VBA plans to continue with the strategy of reorienting its branch network and using group lending programmes to serve rural households. These plans offer an opportunity to selectively assist the bank in improving its institutional capacity and outreach effectiveness for rural households. Assistance is needed in several areas. For example, the VBA has so far not followed a systematic approach in developing its outreach and customer services. In particular, there has not been any formal evaluation of the different mechanisms employed for the delivery of financial services which can be used to guide further investment decisions. Also, innovations in lending such as the use of borrower groups have not been accompanied by innovations for mobilizing household savings. The latter is extremely important since savings mobilization constitutes the key to sustainable banking operations. Savings have been found to be as effective and necessary a service as credit in alleviating poverty. In addition, savings mobilization will help to correct the funds shortage problem so prevalent in Viet Nam.

SOCIALIST REPUBLIC OF VIET NAM

RURAL FINANCE PROJECT

INSTITUTION BUILDING, TECHNICAL ASSISTANCE AND TRAINING

1. The proposed technical assistance extends over a period of five years. It emphasizes institution building, adaptation and adoption of methods and practices in sustainable outreach found successful in other countries, as well as expansion of successful programs currently operating in Viet Nam. In addition, it encompasses extensive formation of local expertise, through training programs at all levels, from the Project Management Unit (PMU) in the SBV, to the PFIs, the Bank for the Poor, and the village savings and credit groups. It also promotes financial market integration through fostering linkages between microfinance savings and credit programs with banks and non-bank financial institutions.

2. The overall responsibility for training and technical assistance would reside at the Project Management Unit (PMU) in the State Bank of Viet Nam (SBV), under the direction of the PMU manager (see Annex 4). However, in the case of programs strengthening the VBA, the VBA may manage the program on behalf of the SBV, if so agreed. The components of the proposed TA are outlined below, organized according to their institutional focus. A summary table follows with the estimated costs of each component, and the institutions responsible for the corresponding activity.

Institution Building Program at the SBV Project Management Unit (US$1.25 million).[1]

3. It is anticipated that a Senior Advisor for the outreach program will be responsible for designing and implementing the program work plan, for the contracting of services, for controlling the quality of the program, monitoring and supervising the progress of the program components, and reporting regularly on the outcomes and performance of these TA components. The senior advisor will also allocate and oversee the use of funds set aside for studies and evaluations associated with the program. The senior advisor will be recruited by SBV with IDA agreement.

4. **Training Program**. The training program would concentrate on the training needs of project related staff in SBV. i.e., the staff of the Project Management Unit and the Participating Financial Institutions (PFIs). The program will aim at improving the competence of PMU and PFI staff in loan appraisal, accounting, auditing, portfolio management, and other banking activities. The program will include training at home and abroad, workshops, seminars, and advisory services to bring the latest international banking skills to Viet Nam.

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1 Institution building only. This amount does not include $1,026,000 budgeted under "Project Management Unit" for equipment and vehicles (see Annex 1, Table 1).

5. The SBV, through the PMU, would review the broad range of tasks to be performed under the project by the PMU itself, and the PFIs at different levels; the skill already available within the institutions; and the skill gaps to be addressed by the project training program, taking account of other ongoing training programs. The findings with this review would be used to design the course modules, identify the clients to be trained, and determine the frequency of the courses. Based on a preliminary assessment, the following represents a broad outline of the program.

6. Training Objectives would be to remedy the skill gaps of officers and staff associated with the Rural Development Fund (RDF) lending in SBV and the participating banks. Training will be directed at three staff levels - senior, middle, and operating. This will be achieved through the following:

a) pooling and training of potential trainers who will assume the lead role in teachers' training. This priority training activity would be carried out by technical assistance;
b) senior level officers would be given a familiarization briefing on the decision-making and policy formulation requirements of the RDF lending program;
c) middle level officers would receive training in sub-loan appraisal, accounting, monitoring, loan documentation, and environmental matters;
d) operation staff would be trained in sub-loan processing, collateral valuation and custody, record keeping, bookkeeping and reporting;
e) loan team members of participating banks would be trained under the same program as the PMU staff, focusing on medium- and long-term sub-project appraisal and supervision, credit risk evaluation, inflation implications on sub-borrowers cash-flow, value of collateral, profit and loss accounts, sub-loan repayments, and environmental matters;
f) PMU staff responsible for PFIs accreditation would be trained in conducting appraisal of financial institutions, with special emphasis of reviewing the quality of loan portfolio, liquidity, and profitability of the participating banks; and
g) upgrading the skills of the PMU staff in various procedures associated with sub-loans processing, accounting, monitoring, and reporting of RDF transactions.

7. Teachers Training Course would train and develop prospective trainers who will be constituted into a pool to provide skills and expertise to RDF related staff in the PMU and the PFIs. SBV will assume a lead role in carrying out this course. The teachers' training program would be carried out by technical assistance and would include the following specialties: wholesale- apex operation, banks' performance evaluation, sub-project appraisal, cash-flow and credit risk analysis, accounting, monitoring, loan documentation and reporting, and collateral evaluation.

8. Selection of participants for the project training program. A standard requirement would be that Course Participants would be those of staff who most need the skills, by

virtue of being involved in RDF lending. Participants in the teachers training course would be in a position to continue with the program until basic staff requirements are met.

9. Senior officers of the PMU and the PFIs would be provided with information mainly through lecture-discussions and open forums. For middle-level officers, training would emphasize case studies and situations, loan appraisal, lending decisions, portfolio management and control reports. For operating staff, training would consist of lectures and simulation of loan application processing and collateral evaluation. For loan team members and credit supervisors, a combination of lecture, discussions and case studies would be undertaken.

10. Evaluation of Training Activities. The training program would be evaluated at two stages. The first stage would involve an assessment of knowledge, skills, and attitude acquired from the training. At the second stage a review of the impact of training of job behavior and institutional functioning would be carried out. While the impact of the first stage can be observed almost immediately, the assessment of the impact of the second stage would require much longer observation period.

VBA - Outreach Program (US$3.11 million)

11. Mobile banking The VBA has already initiated (March 1996), on a pilot basis, a mobile banks program with 200 "mobile bank units" (MBUs), i.e., vehicles especially equipped to provide transaction services in areas where market conditions, weak infrastructure and poor communications do not justify or enable the establishment of a permanent locale. The pilot program expands and improve outreach in selected districts of the provinces surrounding Ho Chi Minh City (55 MBUs), the central provinces (33 MBUs) and the Northern provinces (110 MBUs, especially around Hanoi). Mobile units are assigned to specific district branch offices in these provinces. The entire program expects to reach 1,000 MBUs and a countrywide coverage in areas with road access.

12. Each mobile unit consists of a four-wheel drive vehicle, with a safe installed in the back. It is staffed with four employees: one treasury officer, one credit officer who would be able to appraise loans on site up to a certain amount, an accounts clerk in charge of deposit transactions, and a driver also able to assist in financial services when parked in the village. Training for this staff involves driving, vehicle maintenance, and special procedures for handling accounting practices, lending and deposit transactions in a mobile unit. It is hoped that a portable computer could be added in the future to the basic equipment of each MBU (currently a calculator and office supplies), so that transaction and accounting entries will not need to be recorded manually in the MBU to then be entered in the bank's system upon return to the branch office.

13. The VBA has established a task force headed by a Deputy Director to implement and oversee the pilot stage. The task force has issued a document establishing procedures for management, accounting, and assessment of performance of the MBUs, and has determined the assignment of units to the district branches in the pilot program.

14. The mobile units will increase the frequency of service to under-served communes, and will provide a more complete set of financial services, especially deposits. The MBUs will serve villages according to a schedule determined by the local market conditions, with a frequency between 2 and 4 times per week. It is anticipated that each unit will provide services to about 40 rural households per day, performing lending transactions and procedures (applications, disbursements, collections) and, more importantly, mobilizing deposits from clients that otherwise would need to travel 5 to 10 kilometers to deposit small sums of money (50 to 100 thousand VND in the estimate of the VBA).

15. The VBA estimates that each MBU will mobilize about 4 million VND per day. A large proportion of this amount, one could assume, would not have been saved in financial form were not for the service of the MBU. In addition, it is expected that loan collection will improve by having a regularly scheduled service, and that the overall quality of attention to the rural households will be substantially enhanced. Other services may be introduced once the pilot stage has been evaluated. This evaluation is planned for June 1996 and, if the pilot is judged to be successful, a second stage would be launched in August.

16. The level of support proposed here under the project would contribute an estimated 200 MBUs to the second stage of the VBA mobile bank program (assuming the VBA can obtain them at the same cost of the initial 200). The project would also provide funds for a contingent of motorcycles to improve services in areas not reachable by four-wheel vehicles.

17. Training. Funds for training the equivalent of one staff per vehicle are included in the proposed project support (see cost table). Training contents would include, in addition to that currently provided in the VBA program (see above), instruction on group lending, training of group leaders, and reducing transaction costs through group-based financial intermediation. This training will help VBA officers in their work with the Women's Union, other service organizations and NGOs at the commune and district level. Also, it will allow increases in officer productivity where group-based services have not been implemented.

18. Overseas training and workshops (study tours and short courses) are contemplated in the training program, to familiarize bank technical and managerial staff with outreach experiences and techniques known to be successful in other countries. Participation of VBA staff in international workshops to share the bank's experience in outreach to the poor with other institutions is also foreseen under this component.

VBA - Rural Savings Mobilization Program (US$0.42 million)

19. The VBA recognizes the importance of establishing a savings mobilization program that enables the institution to substantially improve its deposit services. A

proposal or plan to his effect, however, has yet to be developed. A savings-mobilization long-term advisor funded by the Rural Finance project would have as a first order of responsibility that of assisting the VBA in developing such a program.

20. The long-term advisor will also be responsible for the design of instruments, strategies, and incentives aimed at expanding deposit mobilization among rural households and businesses. Special attention will be given to capturing small deposit accounts with low transaction costs for both the institution and the client. The items foreseen under this component are: staff training, and accounts management equipment and software (see table).

21. Staff training in savings mobilization, local and overseas, will focus on deposit mobilization techniques, services and instruments, management of small accounts, and savings campaigns. Selected staff may be sent abroad for short courses in specialized institutes, to create internal expertise in this area.

SBV - Bank for the Poor (US$1.98 million)[2]

22. This component of the technical assistance will proceed along specific lines defined by the joint World Bank/UNDP/CGAP short-term technical advice provided during the start up of the Bank for the Poor. At this stage, the TA elements foreseen for the first stages of the Bank for the Poor are assumed similar to those indicated above for the VBA outreach, given the objectives and philosophy of the new entity.

23. The costs estimated for this component correspond, therefore, to training and equipment associated with enhanced outreach to remote areas, and active promotion of group-based lending mechanisms. The estimates derive from the current plans formulated by the BP, and their assessment of resource requirements. Special consideration has been given to the equipment needs foreseen for countrywide management and accounting, and the requirements associated with some 100 district branches the BP expects to receive in transfer from the VBA in under-developed areas.

24. The training program includes:

- Local training and workshops for BP staff on credit, savings mobilization, loan supervision, savings and credit groups, accounting, computer operation, and foreign language

- Overseas training and workshops (study tours and short courses) to familiarize technical and managerial staff with outreach experiences and techniques known to be successful in other countries

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2 Institution building only. Does not include $643,000 budgeted as "support to bank management" in the FRP (see Annex 1, Table 2).

- Training of savings and credit group leaders in basic group accounts management, lending, loan collection, and deposit mobilization procedures.

SBV - Community Development Program in Group Formation and Financial Intermediation (US$1.98 million)

25. A special long-term technical advisor based at the PMU will direct this effort under the supervision of the PMU manager. This area of the proposed TA requires special expertise and a long-run perspective given its institution building focus and the paucity of generalized rules and practices in the promotion of sustainable village-based savings and/or credit mechanisms.

26. The special advisor will be responsible for contracting with service and non-governmental organizations for the development of financial intermediation schemes in under-served areas. These schemes must follow (comply with) a core set of principles, practices and standards including but not limited to:

a) a business plan aiming at long-run sustainability;
b) demonstrated ability to effectively reach the poor;
c) commitment to market pricing of financial services and products, to the extent allowed by the law;
d) focus on introducing and enhancing financial literacy, financial discipline, and compliance with contractual obligations among the affected population; and
e) current or potential integration with, or evolution into, formal financial intermediaries (i.e., banks, PCFs or other regulated financial institutions).

27. Pre-existing programs identified during project preparation as meeting the requirements outlined above will be eligible for consideration under terms of reference satisfactory to IDA. In addition, the Community Development program will issue terms of reference and invite proposals from prospective contractors, identifying priority areas and target groups among the under-served population. The special advisor will interact with existing programs' managers and advisors, as well as with mass organizations and the donor community, to identify these priority areas and target groups, and determine alternative models to follow, or test as pilot programs as the case may be, in the promotion and development of savings and/or credit mechanisms that effectively reach the poor.

28. The special advisor will also be responsible for contracting advisory services to carry out assessments and studies of microfinance activity, institutions and organizations in the country. Likewise, consulting services will be sought for the development of a database and a performance monitoring system for microfinance programs.

29. The special advisor will be recruited with IDA agreement. Contracts for the development of financial intermediation schemes and programs will also be reviewed by IDA prior to SBV issue.

SOCIALIST REPUBLIC OF VIET NAM
Rural Finance Project
Institution Building, Technical Assistance and Training Costs

	Unit	Qty.	US$/ unit	Total US$	Exec.Institution SBV	VBA
SBV Project Management Unit (a)				**1250000**	1250000	
VBA - Outreach Program				**3110000**		3110000
Advisory services	person month	12	16000	192000		
Studies in outreach methods	person month	8	16000	128000		
Vehicles: cars	unit	200	12000	2400000		
motorcycles	unit	40	6000	240000		
Training & workshops, local	No. staff	100	500	50000		
Training & workshops, overseas	No. staff	20	5000	100000		
VBA - Savings Mobilization Program				**421000**		421000
Advisory services	person month	6	16000	96000		
Equipment and software	set	50	3000	150000		
Training & workshops, local	No. staff	150	500	75000		
Training & workshops, overseas	No. staff	20	5000	100000		
SBV - Bank for the Poor (b)				**1982000**	1982000	
Advisory services	person month	24	16000	384000		
Studies in outreach methods	person month	8	16000	128000		
Vehicles: motorcycles	unit	40	6000	240000		
Equipment	set	240	3000	720000		
Training & workshops, local	No. staff	240	500	120000		
Training & workshops, overseas	No. staff	30	5000	150000		
Training, group leaders	No. leaders	6000	40	240000		
SBV - Community Development Program in Group Formation and Financial Intermediation				**1980000**	1980000	
Long-term advisor	person month	18	16000	288000		
Studies and assessments	person month	12	16000	192000		
Development of financial - - intermediation programs (c)	programs	10	150000	1500000		
TOTAL				**8743000**	5212000	3531000

(a) Vehicles and equipment included under support to PMU (Annex 1, Table 1)
(b) Other vehicles and equipment included under support to bank management (Annex 1, Table 2)
(c) Technical assistance and institution building services contracted by the SBV with organizations and specialized agencies.

SOCIALST REPUBLIC OF VIET NAM

RURAL FINANCE PROJECT

TENTATIVE COMPOSITION AND STRUCTURE OF THE PMU

1. SBV is the executive administrator, on behalf of the Government, of the Rural Finance Project. A Project Management Unit (PMU) within SBV has been established (under Government decision No. 5551/QHQT dated October 2, 1995 and decisions No. 269/QD-NH9 dated September 23, 1995 and 1641/QD-TCCB dated November 27, 1995 of the Governor of the SBV). The PMU will be responsible for implementing the Project. It would handle day-to-day matters related to the implementation of: (i) the credit component, i.e., the Rural Development Fund (RDF) and the Fund for the Rural Poor (FRP)[1]; and (ii) the Institutional Building, including training and Technical Assistance (TA) to address skill gaps of project-related activities in SBV and the Participating Financial Institutions (PFIs). The PMU shall operationally be independent and would maintain a separate account (or accounts) for all project activities which would be audited annually.

2. The main duties of the PMU are as follows:

(a) accreditation of PFIs through the application of an agreed set of criteria (to be spelled out in the Policy Manual);

(b) assigning a line of credit to each of the PFIs. The size of the line of credit would be based on the respective PFI financial strength (solvency, liquidity, and profitability) and its rural outreach capacity;

(c) assisting in the preparation and the implementation of the PFIs Institutional Development Plan (IDP);

(d) approving RDF and FRP funded sub-projects applications in line with the respective lending policy manual and supervising their implementation;

(e) draw down of IDA funds including the administration of a Special Account, and disbursement of funds to PFIs for financing of sub-projects and IDPs;

(f) maintaining project accounts and arranging for their auditing;

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[1] The PMU is the manger (not the owner) of the RDF and the FRP.

(g) monitoring PFIs performance vis-a-vis accreditation criteria, implementation of the respective IDPs, and the use of project funds;

(h) periodic review of lending terms and conditions and IDPs with a view to adjusting them in light of changing conditions;

(i) carrying out the training and TA activities;

(j) undertaking environmental examinations and providing consultancy services to selected sub-projects; and

(k) promotional efforts in support of the project, including marketing of the RDF in order to increase investments in the rural areas and enhance financial competition through the participation of as many as possible private and government banks.

3. Project success to a large extent depends on the capability of the PMU management and staff. Our experience has been that the presence of a well staffed, well equipped, adequately budgeted with timely release of funds, operationally independent PMU are essential to ensure proper progress and a satisfactory outcome of the project.

4. The proposed PMU composition and structure is based on the following assumptions:

(a) the functions of the PMU would be as described in paragraph 2 above;

(b) sub-loans of up to US$5,000 equivalent would account for 40% of IDA credit or US$40 million equivalent;

(c) the balance of about US$60 million equivalent would comprise of about 6,000 sub-loans - average of sub-loan size assumed to be US$10,000 equivalent; and

(d) project funds would be disbursed over a four year period with about 2,000 sub-loans per annum.

5. Based on the above assumptions, the initial PMU staff strength would be 48. However, since the PMU is also managing the Banking Modernization Project, some economies of scale could be obtained and the incremental staff strength required could be reduced to 35 as follows:

(a) project manager plus one assistant/secretary (2 persons);

(b) PFIs accreditation and follow-up unit - 3 persons (2 bank analysts plus 1 assistant/secretary;

(c) accounting, disbursement of project funds to the PFIs, and managing the project Special Account and its replenishment - 6 persons (3 accountants plus 2 assistants and 1 secretary);

(d) review loan applications and documents below the free-limit, and approve loan applications above the free-limit - 13 persons (8 officers, mainly economists or financial analysts, plus 3 assistants, and 2 secretaries);

(e) supervision and monitoring - 8 persons (6 officers plus 2 assistants/secretaries.

(f) review and provide, on selective basis, environmental impact of, and related consultancy services to, sub-projects - 6 persons (one officer plus 1 assistant/secretary and 4 environmental experts).

6. Based on the duties and responsibilities of the PMU as stated in para. 2 above, the PMU as established by the SBV is capable of meeting its requirements. However, to ensure successful implementation of the project, the PMU should be provided with qualified staff and adequate training support, equipment, and budget allocation.

Annex 5

SOCIALIST REPUBLIC OF VIET NAM

RURAL FINANCE PROJECT

ESTIMATED CREDIT DISBURSEMENT

(US$millions)

IDA FY	Semester	Disbursement	Cumulative	Profile %[1]
1997	31-Dec-96	7.00	7.00	0
	30-Jun-97	10.00	17.00	6
1998	31-Dec-97	15.00	32.00	18
	30-Jun-98	20.00	52.00	34
1999	31-Dec-98	20.00	72.00	54
	30-Jun-99	20.00	92.00	70
2000	31-Dec-99	20.00	112.00	78
	30-Jun-00	10.00	122.00	90

[1] Standard Disbursement Profile for Financial Sector Operations East Asia and Pacific Region, January 23, 1996.

SOCIALIST REPUBLIC OF VIET NAM

RURAL FINANCE PROJECT

PROJECT SUPERVISION PLAN

IDA's Supervision Inputs into Key Activities

1. The staff inputs indicated in the table below are in addition to the regular supervision needs at headquarters for review of progress reports, procurement actions, and other requirements. During the project implementation period, it is estimated that total IDA supervision staff and consultant resources would be 77 staff weeks, of which 57 staff weeks would be in the field and the balance at headquarters. An indicative supervision plan is given in Table 1.

TABLE 1: INDICATIVE SUPERVISION PLAN

Approximate Date	Activity	Skill Requirement	Staff Input
July 1996	Launch Workshop PFI Accreditation Review Finalize Tors for Studies Institutional Development Review for BP	Task Manager Banking Specialist Micro-Finance Specialist Financial Institutions Analyst	8
October 1996	Implementation Progress Review Training	Task Manager Banking Specialist Training Specialist	6
March 1997	PFI Accreditation Outreach Program Review Progress of Studies and Training	Task Manager Banking Specialist Microfinance Expert Training Specialist	8
August 1997	Overall Progress Bank for the Poor Review Accreditation Review	Task Manager Microfinance Specialist Bank Specialist	6

Approximate Date	Activity	Skill Requirement	Staff Input
December 1997	Overall Progress	Task Manager	6
	Progress of Studies and Training	Training Expert	
	Review Audit Quality	Audit Specialist	
April 1998	Overall Progress	Task Manager	5
	Review Fund Projections	Financial Analyst	
	Data Collection and Analysis	MIS Expert	
September 1998	Overall Progress	Task Manager	5
	Accreditation Review	Banking Specialist	
	Outreach Program Review	Microfinance Specialist	
January 1999	Overall Progress	Task Manager	3
	Progress of Studies and Training	Training Specialist	
May 1999	Overall Progress	Task manager	3
	Institutional Development	Banking Specialist	
October 1999	Overall Progress	Task Manager	3
	Outreach Program Review	Microfinance Specialist	
March 2000	Overall Progress	Task Manager	4
	ICR	Banking Specialist	

SOCIALIST REPUBLIC OF VIET NAM

RURAL FINANCE PROJECT

Project Implementation Plan
(Prepared by the Borrower)

1. To implement the project the SBV would have to establish and maintain its Project Management Unit to administer and coordinate day-to-day implementation of the IDA credit. SBV would appoint the Head of all sub-units under the management of PMU to carry out the work. The appointment of these required Heads would be taken place in April 1996. Other staff would include accounting officers, loan processing officers and others as necessary should be completely recruited and ready to work in May 1996.

2- SBV would complete the establishment of Rural Development Fund (RDF) in late July or early August. This Fund will be managed by the PMU with full obligations and provisions in compliance with its Operational Policy ManuaL

3. SBV would coordinate with the Vietnam Bank for the Poor (VBP) to develop a Manual for the operations of the Fund For the Rural Poor (FRP). This Manual should be made available in late May I 996 and be submitted to IDA for approval in July 1996. To operate the Fund for the Rural Poor, SBV should complete the establishment of this FRP by September 1996-

4. The PMU should establish the accreditation criteria and have it approved by the State Governor in late August in order to start accrediting all PFIs in September. The list of qualified accredited PFIs should be submitted to IDA for review and approval in December 1996. Meanwhile the PMU has to develop and obtain an agreement with PFIs a Subsidiary Loan Agreement and with VBP a Financing Agreement in January 1997. The Subsidiary Loan Agreement is subject to be reviewed by IDA in February 1997.

5. To ensure the project would be implemented smoothly and successfully, the PMU has to establish a monitoring and evaluation system to supervise the activities performed by PFIs and VBP. This establishment would be completed and put into operation in November or December 1996.

6. PFIs would obtain a Subsidiary Loan Agreement with SBV in January 1997 and could start processing its sub-project proposals in early March 1997 (including obtaining PMU's approval on sub-loans with the value is more than $20,000 and less than $150,000 equivalent as the case may be).

7. PFIs would establish their own interest rate for its sub-loans with accordance with the published interest rate policy enforced by SBV/ PFIs would have to submit, from time to time or as requested, to SBV/PMU and thereafter its successor and IDA all necessary documents in respect to its onlending operations.

8. The Vietnam Bank for the Poor (VBP) would obtain a Financing Agreement with SBV not later than Mid-January 1997. A small-saver program would be prepared and submitted to IDA for review in January 1997. Adoption of this small-saver program will be taken place by February 1997 upon the receipt of Bank's "no-objection" communication. VBP also would prepare its Institutional development Plan (IDP) and submit this IDP to IDA for review and approval in December 1996.

10. During the implementation of FRP sub-component the Vietnam Bank for the Poor has to submit, from time to time or as requested, to IDA and SBV/PMU and thereafter to its successor all necessary documentation in respect of its onlending operations.

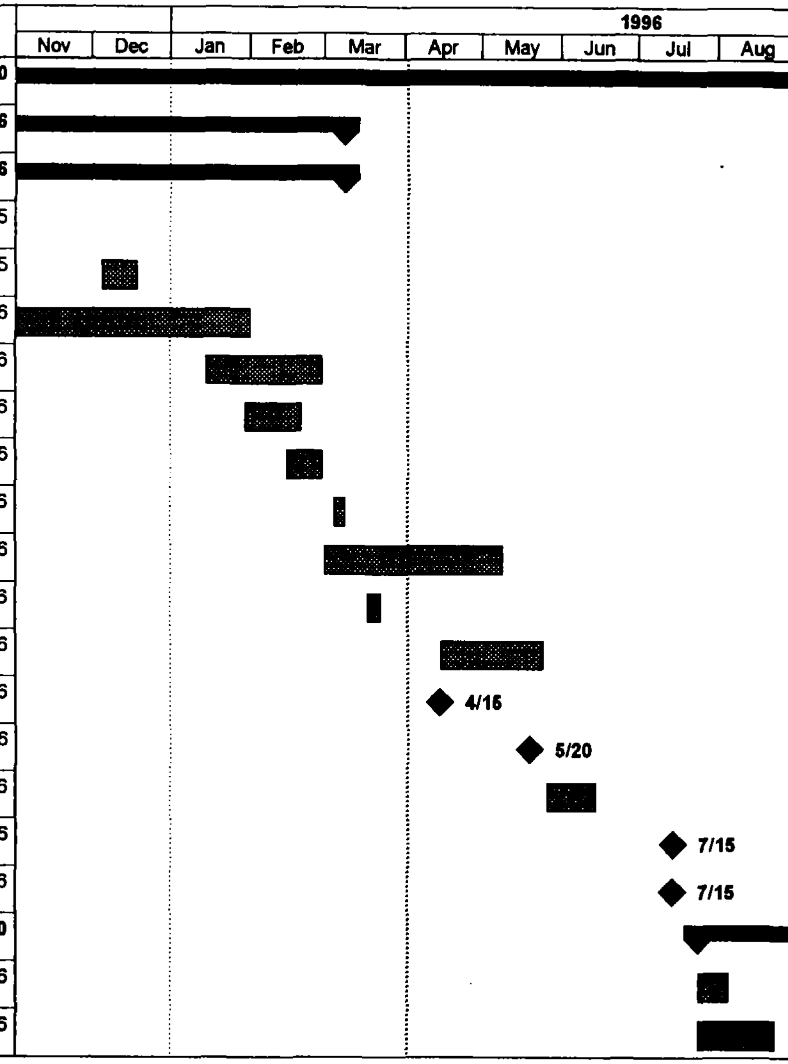
11. During the implementation of the project the PMU has to carry out its regular supervision missions to PFIs and VBP and/or supervisions on the random check basis or when PMU recognizes a problem with a specified PFL Any actions relating to the problem to be taken by PMU to the failed PFI should be reported to IDA accordingly.

A detailed Project Implementation Plan is reflected in the attached bar-chart as attached to this annex.

Annex 7
Attachment

VIETNAM RURAL FINANCE PROJECT
Project Implementation Plan

ID	Task Name	Duration	Start	Finish
1	**Vietnam Rural Finance Project**	**1395d**	**2/27/95**	**6/30/00**
2	**Preparation**	**270d**	**2/27/95**	**3/8/96**
3	**IDA: Project Preparation**	**270d**	**2/27/95**	**3/8/96**
4	Identification mission	14d	2/27/95	3/16/95
5	Appraisal mission	10d	12/5/95	12/18/95
6	SAR Preparation	85d	10/5/95	1/31/96
7	Pre-feasibility Report Preparation	33d	1/15/96	2/28/96
8	SAR and MOP Review Process	16d	1/30/96	2/20/96
9	Finalization of RDF Manual	10d	2/15/96	2/28/96
10	Invitation to Negotiation	4d	3/5/96	3/8/96
11	**PMU staffing**	49d	3/1/96	5/8/96
12	**Negotiation**	5d	3/18/96	3/22/96
13	**Coordination with VBP on preparation of FRP Manual**	30d	4/15/96	5/24/96
14	**Board Presentation**	1d	4/15/96	4/15/96
15	**Project Signing**	1d	5/20/96	5/20/96
16	**Finalization of FRP Manual and Submission to IDA**	15d	5/27/96	6/14/96
17	**IDA acceptance on FRP Manual**	1d	7/15/96	7/15/96
18	**Project Effectiveness**	1d	7/15/96	7/15/96
19	**Project Implementation**	**1027d**	**7/25/96**	**6/30/00**
20	Establishment of RDF	8d	7/25/96	8/5/96
21	Establishment of Accreditation Criteria	22d	7/25/96	8/23/96

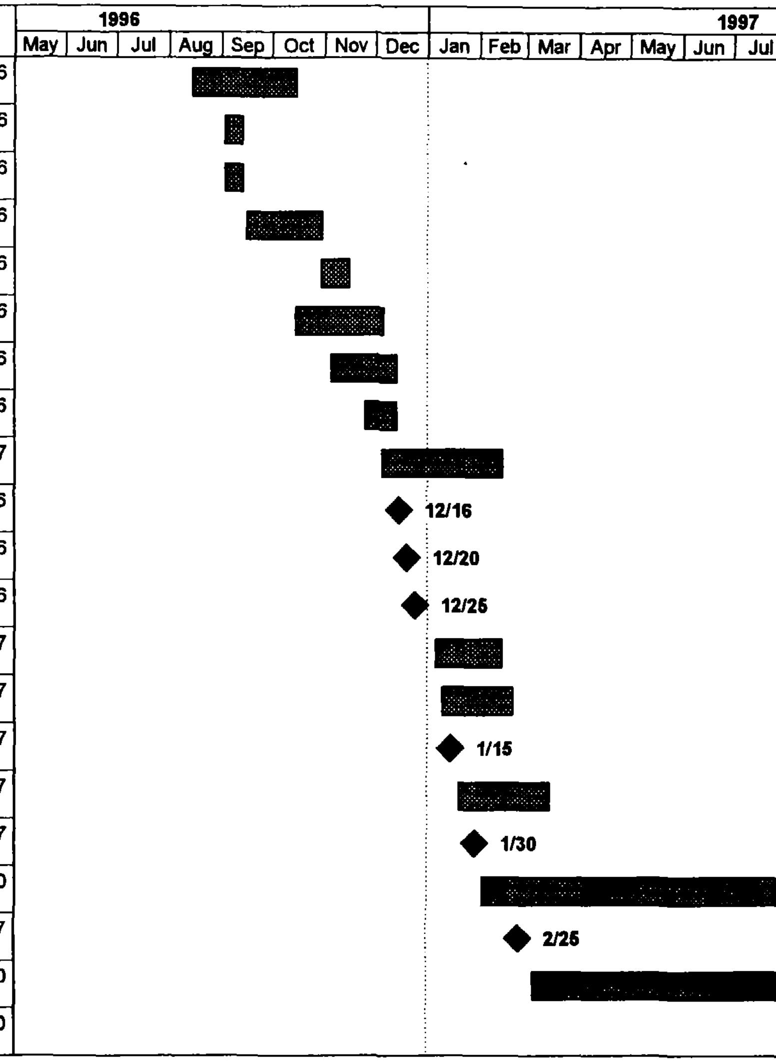


Project: Rural Finance Project Cr...... -
Date: 4/2/96

Task		Summary		Rolled Up Progress	
Progress		Rolled Up Task			
Milestone	◆	Rolled Up Milestone	◇		

VIETNAM RURAL FINANCE PROJECT
Project Implementation Plan

ID	Task Name	Duration	Start	Finish
22	TORs for consultants	44d	8/15/96	10/15/96
23	Establishment of FRP	9d	9/3/96	9/13/96
24	Workshop on Bank Accreditation	9d	9/3/96	9/13/96
25	Acceditation of PFIs	33d	9/16/96	10/30/96
26	Finalization of list of accredited PFIs and Submission to I	13d	10/30/96	11/15/96
27	Letter of Invitation to consulting firms	38d	10/15/96	12/5/96
28	Establishment of monitoring and evaluation system	29d	11/5/96	12/13/96
29	Finalization of IBPs and Submission to IDA	15d	11/25/96	12/13/96
30	ICB for consultancy	52d	12/5/96	2/14/97
31	Entering into Financing Agreement (FA) with VBP	1d	12/16/96	12/16/96
32	Submission of FA to IDA	1d	12/20/96	12/20/96
33	IDA acceptance of list of accredited PFIs	1d	12/25/96	12/25/96
34	Entering into Subsidiary Loan Agreement with PFIs	30d	1/6/97	2/14/97
35	Submission of SLAs to IDA	30d	1/10/97	2/20/97
36	IDA acceptance of FA	1d	1/15/97	1/15/97
37	IDA acceptance of SLAs	40d	1/20/97	3/14/97
38	Submission of small-savers program to IDA	1d	1/30/97	1/30/97
39	Disbursement to PFIs	890d	2/3/97	6/30/00
40	IDA acceptance of small-savers program	1d	2/25/97	2/25/97
41	Disbursement to VBP	802d	3/5/97	3/30/00
42	Project Completion/Closing	1d	6/30/00	6/30/00



Project: Rural Finance Project Cr...... -
Date: 4/2/96

Task | Summary | Rolled Up Progress
Progress | Rolled Up Task
Milestone | Rolled Up Milestone

SOCIALIST REPUBLIC OF VIET NAM

RURAL FINANCE PROJECT

PROJECT PERFORMANCE INDICATORS

1. The project key performance indicators are based on the nature and the basic objectives of the project as agreed with the government. These objectives are as follows: (i) assist transition to a market economy through encouraging private sector development; (ii) strengthen the rural financial system by financing, through the banking system, agriculture and small and medium size enterprises in rural areas; and (iii) reduce rural poverty through promoting growth and enabling the poor to respond to opportunities to improve their welfare.

2. The project key performance indicators are as follows:

(a) Encouraging Private Sector Development:

* number of private sector beneficiaries;

* volume of loans granted to small, medium and large sized beneficiaries and the proportion of each as a percentage of total lending under the project;

* number of participating private banks and their share in total lending under the RDF;

(b) Strengthening the Rural Financial System:

* number of accredited banks for participating under the project;

* number of actively participating banks under the project;

* accomplishment of IDPs; this would include the following indicators: (i) capital adequacy ratio (equity to risk assets ratio); (ii) liquidity ratio (liquid assets to short-term liabilities ratio); (iii) profitability and efficiency which would include the following financial indicators: interest spread between loans and deposits, net income/average equity, net income/average total assets, and net operating income/ gross income; (iv) quality of loan portfolio (over-due loans/total loans, restructured loans/total loans, over-due loans/total loans that were due, i.e., collection rate); (v) adequacy of provision for loan losses (total provision/over-due loans plus restructured loans, and total provision as a percentage of total loan portfolio); and (vi) number of training courses and participants.

(c) Poverty Alleviation: a household income and expenditure survey on a sample basis would set a baseline against which impact on rural poverty would be regularly measured. The survey would pay particular attention to ethnic groups and the relatively poorer districts, including the northeastern upland and the central highlands.

SOCIALIST REPUBLIC OF VIET NAM
Rural Finance Project
Key Performance Indicators

Project Objective

		End Yr1	Mid term	ICR
1. Encourage Rural Enterprise				
No. of Beneficiaries		5,000	25,000	50,000
Loan Size Distribution % (a)	- small	75	75	75
	- medium	24	24	24
	- large	1	1	1
Loan Amount Distribution % (b)	- small	50	50	50
	- mt/lt	50	50	50
Term Length Distribution % (c)	- short	75	50	25
	- mt/lt	25	50	75
2. Strengthen Rural Finance System				
Number of Accredited PFIs		3	6	9
Number of Active PFIs		3	6	9
IDP Indicators		d	d	d
Savings Mobilization as % of Total Lending per PFI		25	50	60
3. Poverty Alleviation				
Impact on Living Standard of Beneficiaries		e	e	e

Notes:
(a) Up to US$5000 equivalent
(b) From $US5001 to $US20,000
(c) Above $US20,000
(d) Institutional development plan indicators would be prepared for each PFI at accreditation
(e) Multi-year sample survey of control and beneficiary populations

SOCIALIST REPUBLIC OF VIET NAM

Rural Development Fund

Policy Manual

Section A

Background

1. The Socialist Republic of Viet Nam has negotiated with the International Development Association (IDA) a Credit for a Rural Finance Project with the objective of assisting the Vietnamese Government (GOV) in its efforts to improve living conditions in the rural areas, through: (a) encouraging private sector investments; (b) strengthening the banking system's capacity to finance private sector investments; and (c) increasing access of the rural poor to financial services. A part of the proceeds of the Credit will be loaned (subsidiary loans) to accredited participating financial institutions (PFIs) for onlending to clients (RDF sub-loans) to finance goods and services for approved investment. The repayment of RDF sub-loans for this purpose will be used to establish a revolving fund, the Rural Development Fund (RDF). Under the Decision 5551/QHQT dated October 2, 1995, the Prime Minister designated the State Bank of Vietnam (SBV) to administer the RDF on a wholesale basis. This policy manual is intended to assist in management of the RDF and in all cases the provisions of the DCA will prevail.

SECTION B

Rural Development Fund Management

1. The Government established the Inter-ministerial Steering Committee for the Rural Finance Project under Decision 5551/QHQT dated October 2, 1995, which consists of representatives from Ministry of Planning & Investment, Ministry of Finance, Ministry of Agriculture and Rural Development and Government's Office, and is chaired by SBV . The Inter-ministerial Steering Committee will be responsible for supervising the operations of the RDF and reviewing policy-related matters in the utilization of the RDF financial resources.

2. SBV shall administer and run the operation of the RDF through the Project Management Unit (PMU of the SBV) which was established under Decision 269/NH-QD dated September 23, 1995, of the Governor of SBV. PMU will be operationally independent, adequately budgeted, well equipped and adequately provided with qualified staff in order to perform the wholesale function, and to select and accredit PFIs in accordance with the principles specified in this Manual.

SBV would retain a percentage of the interest income paid by the PFIs under the Subsidiary Loan Agreements to cover the costs of the PMU in managing the RDF.

SECTION C

Financial Institutions Subject to PFIs Accreditation Process

1. State-owned Commercial Banks.
2. Commercial joint-stock Banks.
3. Other financial institutions

SECTION D

Qualifying Criteria for Participating Financial Institutions

1. Participating Financial Institutions shall be financial institutions who meet accreditation standards on the following criteria for the last two years:

   a) Legality
   b) Solvency
   c) Liquidity
   d) Profitability and Efficiency
   e) Management quality of staff

2. **Legality of financial institutions.**

   Legal financial institutions are financial institutions established, organized and operating in accordance with regulations of SBV and other law-making institutions in Viet Nam and who are in compliance with all prevailing laws, rules and regulations in Viet Nam.

3. **Solvency of financial institutions.**

   A financial institution is considered solvent if its performing assets are sufficient to cover its liabilities, especially those to its depositors and creditors.

   The assessment of solvency of financial institutions would be based on the following financial ratios: net overdue rate not to exceed 10% of the loan portfolio (net overdues is defined as overdues less provision for expected loan losses) and the capital adequacy ratio must not be less than 10% (defined as own capital or net equity over risk assets, where risk assets means loans and investments excluding investments in Government securities).

The lower the overdue rate and the higher the adequacy ratio, the more solvent the financial institutions will be.

4. **Liquidity of financial institutions**

A financial institution is considered liquid if it can quickly convert its assets into cash or its liquid assets (cash in hand, deposits at other banks, investments in gold or in short-term Government securities) are sufficient to cover its short term liabilities (defined as demand and short term deposits and debt service on borrowings due within one year).

The liquidity ratio, defined as liquid assets over short term liabilities must not be less than 40%.

The higher the rate of liquidity, the more liquid the financial institutions will be.

5. **Profitability and Efficiency of financial institutions.**

The profitability and efficiency of a financial institution shall be measured by the following financial ratios:

* Return on equity (ROE), defined as net profit after tax over equity or own capital.

* Return on earning assets where earning assets is defined as loans plus investments. This ratio (net profit for the year/ earning assets) would be greater than 5%

In the review of this criteria, attention would be placed on profitability in both nominal terms and real terms to ensure that the equity of the financial institution is not eroded due to inflation i.e., Return on Equity > Annual Inflation rate.[1]

6. **Management quality of staff of financial institutions.**

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1 As an approximation of ROE in real terms, net profit for the year/(equity minus fixed assets) at the beginning of the year > annual inflation rate for that year,

A financial institution must have staff with managerial and professional skills in accordance with regulations stipulated by SBV.

7. **Provisional Accreditation**

The above accreditation criteria for Participating Financial Institutions as well as the rates and ratios defined in Parts 2, 3, and 4 of this Section are derived from international standards. In case a financial institution does not meet all of the above criteria it may be provisionally accredited. To participate in the project, these financial institutions must submit their Institutional Development Plans (IDP) along with adequate training programs and detailed time table for achieving these criteria to PMU for review and approval in concurrence with IDA. PMU will be responsible for monitoring and supervising the implementation of these plans through a semi-annual review for the periods ending June 30 and December 31 each year and for transmitting the results of these reviews to IDA by September 30 and March 31 each year.

8. **Failure to Comply**

In case a Participating Financial Institution ceases to comply with the accreditation criteria and/or its approved IDP, and fails to carry out remedial actions proposed by PMU, PMU shall have the right to call the uncommitted balance of the subsidiary loan and take necessary actions to protect the committed balance. The PMU will promptly notify IDA of the situation.

SECTION E

Eligible Sub-Projects

1. The Rural Development Fund (RDF) will be available to finance short, medium and long term viable rural investments plus associated working capital carried out by individuals and enterprises throughout the country, except Hanoi and Ho Chi Minh City, in accordance with the project objectives. Sub-projects in the following areas shall be reviewed to be eligible for RDF financing :

a) Any viable activity relating to agriculture, forestry and fishery and other rural industries such as aqua-culture, agro-industries, goods manufacturing, construction, food and fruit processing, packaging, and oil milling; and

b) Any viable investment to be carried out by service-oriented enterprises to support rural economic activities, to promote employment and export such as transportation, post harvest facilities, garments, embroidery, and handicraft.

2. Investments in land would be ineligible.

3. To be eligible, sub-projects must be technically feasible, financially viable and conform to the environmental laws and regulations of Viet Nam.

4. The participation of State-owned enterprises shall be limited to medium and small scale enterprises up to a total amount equal to 5% of the proceeds of the Credit allocated from time to time to the RDF sub-loans. Small and medium scale enterprises means enterprises with total assets not exceeding US$2 million equivalent and having not more than 500 employees.

5. The sub-borrower's enterprise must meet a minimum Vietnamese ownership of 70%.

Section F

Loan Terms

Sub-project Approval and Disbursement.

1. All risks inherent to RDF sub-loans made by PFIs for sub-projects will be borne by PFIs. Therefore, evaluation and approval of sub-projects will be the responsibility of PFIs. The evaluation of any sub-project shall be based on the technical and financial characteristics of sub-projects, and in accordance with regulations on evaluation and assessment of projects in Vietnam.

2. For RDF sub-loans of less than US$20,000 equivalent, PMU would disburse to PFIs from the Special Account on the basis of Statements of Expenditures (SOEs). For RDF sub-loans above US$20,000 equivalent but less than US$150,000 equivalent, PMU would review and approve the sub-project appraisal documentation submitted by the PFIs prior to approval of disbursements from the Special Account. However, based on the performance of a particular PFI in appraising sub-projects, PMU may request the Association to exempt future RDF sub-loans to be made by such PFI over US$20,000 equivalent but less than US$150,000 equivalent from the prior review and approval of the sub-project appraisal documentation by PMU. Where the Association concurs with this request, disbursements would be made on the basis of SOEs with post-review by PMU. In all cases, PMU would grant PFIs up to 60 days after the date of approval

to submit or make available sub-loan documentation and evidence of payments and procurement. Reversal of RDF sub-loans would be made and a penalty fee imposed if a PFI fails to satisfactorily submit or make available the required RDF sub-loan documentation within the specified period.

3. For sub-loans above US$150,000 equivalent (over the free-limit), IDA approval of the sub-project will be required prior to PMU authorizing disbursements from the Special Account or making withdrawals from the Credit Account.

Currency

4. SBV will onlend to PFIs in either US dollars or local currency based on the nature and requirements of eligible sub-projects and in accordance with regulations on foreign exchange control in Vietnam.

Interest rates

5. Loans in Dong lent by SBV to PFIs would bear a variable rate of interest adjustable quarterly and equal to the weighted average actual cost of loanable funds in the banking system. The weighted average interest rate of deposits would be used as reference for setting the cost of funds to the PFIs. This reference rate would be adjusted to take account of the costs associated with the SBV reserve requirements.[2] Reference rates for short term loans (up to twelve months) and for medium and long term loans (above one year) would be the weighted average of demand and time deposit rates for three months and time deposit rates for six months and above in the banking system, respectively.

6. Loans in US dollars lent by SBV to PFIs would bear a variable rate of interest adjustable quarterly and not lower than the LIBOR rate for six months plus a margin of at least 1% per annum to contribute to PMU's operating costs in respect to the subsidiary loans including loan loss provision.

7. The loan rates to the sub-borrowers will be in accordance with the interest rate policy of each PFI and within the range of rates of interest set by SBV. Sub-borrowers would be given a choice of a fixed rate (prevailing variable rate as defined above, plus a premium) for the life of the loan or a certain period of time, or a variable rate periodically adjusted. In the case of a fixed rate sub-loan made

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2 SBV 's reserve requirements (RR) is currently set at 10% of deposits. The RR, presently, do not bear any interest income. This means that the cost of loanable funds is higher by about 11% of the deposit rate. For example, the RR of deposits of VND 1 million for, say, one month would be VND 100,000 and the fund available for lending would be only VND 900,000. The cost to the PFI of a deposit of VND 1 million for one month (assuming a deposit rate of 1.2% per month) would be VND 12,000. This cost should be covered by the available loanable funds which, in this case, is VND 900,000. VND 12,000/VND 900,000 would result in an interest rate of 1.33% per month.

by a PFI, the SBV would set a corresponding fixed rate of interest on the subsidiary loan to the PFI in a manner acceptable to IDA.

Maturity

8. The maturity of subsidiary loans made by SBV to PFIs would conform to the maturities of sub-loans made by the PFIs. RDF sub-loans would not finance sub-projects for which the projected period for recovery of the sub-project cost exceeds 10 years. Repayment of the principal of the RDF sub-loans shall not exceed the shorter of the period projected for recovery of the sub-project costs or ten years, including a grace period determined on the basis of the sub-project's cash flow projections and the beneficiary's repayment capability. Maturity of short-term RDF subsidiary loans shall not exceed twelve months.

Default

9. Upon the failure of a PFI to repay the principal and or interest due under subsidiary loans, SBV/PMU has the right to call on either the uncommitted outstanding balance of the PFI's entire RDF portfolio or the specific subsidiary loan or loans in default (based on the circumstances of that default and the financial conditions of the PFI) and suspend the right of the PFI to obtain further subsidiary loan releases of the Fund to the respective PFI. In addition, SBV would charge a penalty interest fee of 150% of the applicable interest rate or such other rate as may be set from time to time on the outstanding balance and take other necessary legal actions as required.

Prepayment

10. In case of prepayment of an RDF sub-loan, PFI would prepay that portion of the subsidiary loan. SBV would have the right to impose a penalty fee on prepayment of part or the entire amount of the subsidiary loan.

Collateral, Mortgage and Insurance.

11. All activities relating to collateral, mortgage of RDF sub-loans and subsidiary loan and to insurance for assets so collateralized or mortgaged must be in compliance with regulations on collateral, mortgage and insurance activities in Vietnam.

Sub- Project Financing

12. The PFIs would be required to lend for each sub-project at least 10% of the sub-project cost from their own funds. The minimum contribution of the sub borrower to the sub-project cost would be determined by the PFI on the basis of each sub-project's appraisal, but would not be less than 15% in cash and/or in

kind, excluding land. RDF sub-loans for any single sub-project will not exceed, in any case, 75% of sub-project costs.

Section G

Rescheduling and Restructuring of Loans

1. A PFI may reschedule an outstanding RDF sub-loan made to a sub-borrower upon receiving a specific proposal by the sub-borrower at least 30 days prior to the due date of the RDF sub-loan. However, the PFI will repay the subsidiary loan in accordance with the original repayment schedule set forth in the subsidiary loan agreement. Rescheduling or restructuring of Subsidiary Loans would require IDA's prior concurrence.

Section H

Environmental Protection

1. Sub-projects must be in compliance with Government Decree No.175/CP on Guidance for Implementation of the Law on Environmental Protection and other relevant decrees, regulations and directives that may be issued from time to time. No RDF sub-loans for sub-projects requiring environmental clearance issued by either the State Ministry or a Provincial Department of Science, Technology and Environment in accordance with the provisions of the Decree shall be approved before the sub borrower obtains such environmental clearance. Where the RDF sub-loan is for an amount above US$150,000 equivalent, and the proposed investment falls within the scope of the Decree No.175/CP, the sub-borrower shall submit to the PFI a copy of the environmental impact assessment report submitted to secure environmental approval. No environmental certification will be required for sub-projects which do not fall into the above categories.

Section I

Audit, Supervision and Reporting

Audit

1. Annually, and not more than six months after the end of each fiscal year, PFIs will submit to SBV/PMU their financial statements audited by an independent auditor acceptable to SBV/PMU.

Supervision

2. Supervision of RDF funded sub-projects would be the responsibility of the PFIs, which will designate specific officers for this purpose. PFIs would require sub-borrowers to use on lent funds for approved purposes only, and they would achieve this through direct payments to suppliers of equipment, inputs and materials, and providers of services, as practicable. PFI would also carry out quarterly or semi-annual field visits to sub-projects. Follow-up reports on each visit would comment on the utilization of onlent funds, compare actual and planned operations, review management and financial problems of sub-projects, compliance with environmental laws and regulations, and make recommendations. PFIs would also obtain periodic operating and financial reports from sub-borrowers of medium and long term loans and would undertake selective field visits to problem projects for assessment of their issues. The PMU would conduct selective end-use verification of sub-projects to ensure that PFIs supervision is satisfactory.

Reporting

3. PMU will prepare a quarterly progress report on the implementation of the sub-projects financed by RDF sub-loans and reflows (the RDF). This report would include: (i) an assessment of RDF performance, issues and projections for the next six months; (ii) RDF releases broken down by sub-sectors, duration (short, medium, and long term), nature of sub-projects (new or expansion of existing operation), purpose of sub-loans (fixed assets and/or working capital), type of PFIs (government commercial banks or private banks), provinces, and sub-borrowers' asset size, and sub-loans size; (iii) overdue of subsidiary loans and sub-loans broken down by sub-sectors, type of PFIs, provinces, sub-loan duration, nature of sub-projects, purpose of sub-loans, and sub-borrowers' asset size; (iv) list of accredited PFIs, the respective line of credit granted, and availments; (v) sub-projects' investment broken down by sub-sectors, financiers (sub-borrowers' equity, PFIs participation, and RDF), and duration; (vi) RDF interest rates over the reported period; and , a semi-annual progress report on the implementation of the IDPs and the associated training program.

Annexes: Forms

1. **Accreditation Form.**
2. **Form for Opening Account**
3. **Form for Reporting.**
4. **Form for Statement of Expenditure**
5. **Form for Subsidiary Loan Agreement**
6. **Memorandum of Understanding (MOF/SBV).**

SOCIALIST REPUBLIC OF VIET NAM

RURAL FINANCE PROJECT

ENVIRONMENTAL MANAGEMENT APPROACH

Environmental Implications

The only investments likely to have any significant adverse environmental impact potential are the larger loans made through the Rural Development Fund. It is not expected that funds provided through the Fund for the Rural Poor could result in adverse environmental impact sufficiently significant to justify any procedure designed to environmentally assess them.

Since the larger investments to be made through the RDF will only be identified progressively through the project implementation phase, it will be necessary to establish procedures and processes to achieve the following three objectives:

a) to environmentally screen and, as required, evaluate loan proposals during the appraisal processes being implemented by the PFIs;

b) to provide training to the PFIs regarding the governments environmental assessment procedures and the way in which loan appraisal procedures should be linked to them; and,

c) to monitor the effectiveness of the procedures as they apply to this project in particular and, more generally, to carry out research and other activities related to environmental issues, including the enforcement of the Government of Vietnam's environmental laws and regulations, as they relate to the operations of financial institutions generally within the country.

This Annex sets out the procedures and approaches proposed under the project to achieve these objectives. Primary responsibility for implementation of the activities outlined in this Annex will rest with an **Environmental Group** to be established within the SBV's Project Management Unit which will be responsible for project implementation. At the completion of the project, it is envisaged that the Environmental Group would be incorporated into SBV's permanent institutional structure and extend the scope of its operations to cover all financial sector activities within Vietnam.

The Environmental Group will be the unit responsible for ensuring that the previously stated environmental objectives are achieved. The **Terms of Reference for the Environmental Group** are contained in **Attachment 1** to this Annex. The principal means by which the objectives will be achieved are:

a) **environmental screening of loan applications** - the Policy Manual governing lending procedures to be followed by PFIs will include provisions requiring that, for applications relating to developments listed in the Government's Decree on Implementation of the Law on Environmental Protection (Decree No.175/CP), loans shall not be approved before the applicant presents a copy of the environmental clearance issued by the State Ministry or Provincial Departments of Science, Technology and Environment in accordance with the provisions of the Decree. Where the application is for a loan in excess of US$150,000 (i.e. which requires prior approval by IDA) and the proposed investment fell within the ambit of Decree No.175/CP, the applicant will also be required to submit to the PFI a copy of the environmental impact assessment report submitted to secure environmental approval.

b) **training of PFIs** - training on the environmental provisions in the Policy Manual will the responsibility of the Environmental Group within the SBV's Project Management Unit;

c) **monitoring effectiveness and related activities** - these activities will also be the responsibility of the Environmental Group who will be assisted, during the initial stages of the project, by a technical adviser. The **Terms of Reference for the Environmental Adviser** are contained in **Attachment 2**. to this Annex.

Annex 10
Attachment 1

Terms of Reference of Environmental Group

The primary responsibilities of the Environmental Group are:

- to ensure that the environmental safeguards incorporated into the project design are understood by the PFIs;
- to prepare relevant instructions and provide on-gong advice to the PFIs regarding the environmental requirements;
- in association with the National Environmental Agency of the Ministry of Science, Technology and Environment, to develop suitable information and training materials and carry out training programs for PFIs to familiarize them with Government of Vietnam environmental protection procedures;
- to monitor the effectiveness of the environmental safeguards incorporated into the project through the periodic inspection of PFI lending procedures and follow-up in the field of environmentally significant investment projects;
- to carry out other relevant environmental research activities, as required; and,
- to advise SBV on the development of environmental guidelines for all lending institutions within Vietnam.

Within the last category of activities, consideration would need to be given to practices being developed or already under implementation in other comparable countries (e.g. China, India) and to recent trends in the structure of loan portfolios in Vietnam, from an environmental point of view. To make these assessments, visits to relevant countries should be undertaken and portfolio research carried out within Vietnam. As one example of the scope of guidelines which might be developed, the People's Bank of China recently issued a directive to all financial institutions in China which requires that:

a) loans will not be made for certain specified types of projects which are considered to be too environmentally hazardous;

b) suitable financial provisions have been made in the sub-project feasibility study to cover construction and operation of the environmental protection facilities specified in the environmental authority's clearance and that the designated funds are actually used for that purpose; and,

c) funds borrowed for working capital are not released unless the pollution control facilities have been commissioned and are operating in accordance with relevant standards and regulations.

Annex 10
Attachment 2

ENVIRONMENTAL TECHNICAL ASSISTANCE TO THE STATE BANK OF VIETNAM

Terms of Reference

Introduction

The proposed Rural Finance Project will be supported by the International Development Association (IDA) and implemented by the State Bank of Vietnam (SBV). Part of the project will involve establishment of a Rural Development Fund (RDF) which will provide credit through Participating Financial Institutions (PFIs) to finance household and private enterprise investments in agricultural and other rural activities including loans for production, processing, trade, on-farm developments and related activities. It is expected that the overwhelming bulk of loans made through the RDF will be for amounts less than US$10,000 although there are provisions for PFIs to extend loans for amounts in excess of US$150,000. Some of these larger loans might have adverse environmental impact potentials and procedures have been developed to ensure that loans for such developments will not be approved until applicants demonstrate that they have received an environmental clearance through procedures set down in relevant Government laws and regulations.

To supervise monitor and supervise the environmental aspects of the project, SBV proposes to establish an Environmental Group which will work within the Bank's Project Management Unit (PMU); the unit responsible for overall project implementation. The particular responsibilities of the Group will be:

- to ensure that the environmental safeguards incorporated into the project design are understood by the PFIs;

- to prepare relevant instructions and provide on-going advice to the PFIs regarding the environmental requirements;

- to develop suitable information and training materials and carry out training programs for PFIs to familiarize them with Government of Vietnam environmental protection procedures;

- to monitor the effectiveness of the environmental safeguards incorporated into the project through the periodic fields inspections;

- to carry out other relevant environmental research activities, as required; and,

- to advise SBV on the development of environmental guidelines for all lending institutions within Vietnam.

Scope of Work

Since the Environmental Group (EG) will only be newly established within the SBV, a suitably qualified and experienced consultant will be required to provide training and technical assistance to EG staff.

Training. The specific tasks required are:

- to assist the EG in development of an environmental training program and associated documentation to be delivered to PFI staff as part of wider training and development activities to be carried out under the Institutional Development component of the project;

- to assist EG staff to deliver the training program and, through this assistance, train EG staff to deliver the program independently;

It is envisaged that the training program, which would be developed in consultation with the National Environmental Agency of the Ministry of Science, Technology and Environment, will cover:

- general overview of environmental issues and problems in Vietnam;

- environmental policies, laws and regulations in Vietnam - the identity and content of the laws and regulations and the scope of their application;

- administrative responsibilities for environmental regulation - the role of and distribution of responsibilities between the Ministry and Departments of Science, Technology and Environment;

- the role of PFIs in supporting the activities of environmental authorities as provided for in the Policy Manual for the Rural Development Fund and the administrative procedures required to satisfy these requirements;

- general overview of the main environmental issues arising due to the establishment and operation of small, medium and large scale industrial enterprises in Vietnam.

Monitoring and Evaluation. The consultant will assist staff of the EG to develop standard, ex-post inspection procedures to provide a basis for assessing compliance of PFIs with the environmental approval procedures, to carry out such procedures on a pilot or demonstration basis and modify and finalize the procedures in the light of this experience.

Study Tour. The consultant will organize visits for three staff of the environmental group to China and India to study comparable developments in both countries. In China, contact will be made with the National Environmental Protection

Agency, the People's Bank of China (PBC) to discuss the recent Decree issued by the PBC governing the environmental responsibilities of financial institutions and the Agricultural Bank of China, to discuss environmental assessment procedures being established under the World Bank-financed Rural Banking Commercialization Project and to assess the relevance and potential application of these developments and activities to the situation in Vietnam. In India, contact will be made with the National Bank for Agriculture and Rural Development (NABARD) to study the institutional arrangements it has developed to deal with environmental aspects of its lending operations, to assess the issues facing NABARD and to assess the relevance of its strategies to the situation in Vietnam. An allowance of one week each in China and India should be provided for.

Research and Development. The experience gained in implementing the environmental management and control procedures being supported under the Rural Finance Project should be supplemented by a general environmental review of recent trends in industrial and development lending in Vietnam. The consultant will assist staff of the EG to design and carry out this review, to combine the results with the findings and conclusions of the visits and, in consultation with the National Environmental Agency, to prepare a policy paper for senior management of the SBV regarding actions which should be taken by the Bank to harmonize financial sector operations in Vietnam with the Government's environmental protection and management laws and regulations and to identify a role and responsibilities for the EG within the SBV hierarchy after closure of the Rural Finance Project.

Consultant Time Commitment and Technical Background

A total of six person months of technical assistance will be required, to be delivered by one person in two periods of three months. The first three month input will be required during at the commencement of the project to organize the training and monitoring and evaluation procedures. The second three month input will be required at the end of the second project implementation year to organize and conduct the study tour and assist in research and preparation of the environmental policy paper.

The consultant will be an environmental scientist or engineer with no less than 10 years post-graduate experience in related field(s) of work, at least five of which should have been spent in or in work relating to developing country environmental problems and at least some of which should be related to the environmental aspects of financial sector activities.

Annex 11

SOCIALIST REPUBLIC OF VIET NAM

RURAL FINANCE PROJECT

SELECTED DOCUMENTS AVAILABLE IN THE PROJECT FILE

1. Government of Viet Nam Decree No. 525/Ttg on Establishment of the Bank for the Poor, August 31,1995

2. Government of Viet Nam Decree No.5551/QHQTT on Establishment of a Steering Committee for the Rural Finance Project and Nominating SBV as the Project Apex Bank, October 2, 1995.

3. Government of Viet Nam Decree No. 2729/QHQT on Assigning SBV as Counterpart Agency to IDA in Preparation of Rural finance Project, May 20, 1995.

4. State Bank of Viet Nam Decision No. 269/QD-NH9 on Establishment of the Banking Projects Management Unit within the SBV, September 23, 1995.

5. Policy Statements on Establishing the Bank for the Poor, December 12, 1995.

6. Detailed Project Cost Tables

IMAGING

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