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RESEARCH NOTE

Informal Credit in Vietnam
A Necessity Rather Than an Evil

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The state of knowledge about finance and credit in Vietnam remains fragmentary despite the interest that economists have shown in the topic over the past fifteen years. This paper explores why informal finance continues to enjoy great popularity among rural households despite its high price and risks in Southern Vietnam. This research note examines in detail three modes of credit, and shows that borrowers' perception of informal credit does not always correspond to that of government financial and international institutions. The social dimension of informal finance is crucial to understanding its prevalence, adaptability and continuity in Vietnam. From the point of view of the borrowers, informal credit is not perceived as an evil but rather an economic necessity.

Keywords: Informal finance, credit, household, Vietnam.

I. Introduction

The state of knowledge about finance and credit in Vietnam remains fragmentary despite the interest that economists have shown in the topic over the past fifteen years. A number of studies have focused on the effects of macroeconomic and institutional reforms (Dollar and Litvack 1998; Lelart 2007). This research has examined the financial institutions that have emerged during the Renovation era (*Doi Moi*), in particular their establishment, mission and operations (Gironde 2007; Quach 2005). In particular, studies show that informal finance remains entrenched in Vietnam. Currently, a third of all credit transactions take place informally, consisting mainly of loans from relatives and friends, credit from pawnshops and professional moneylenders, and savings from Rotating Savings and Credit Associations (Barslund and Tarp 2008; Gironde 2007; Pham and Izumida 2002; Truitt 2007). Other work has examined the exclusion of certain segments of the population from formal finance in relation to collateral (Kemper and Klump 2010; Pham and Lensink 2007), gender of the borrower (Pham and Lensink 2007), his or her educational level (Barslund and Tapp 2008) and reputation (Pham and Izumida 2002). Practical and administrative considerations also play a part in the exclusion of certain sectors of the community (Tran 1999). This economic research highlights the social dimension that characterizes informal finance, but stops short of examining the perception of credit from a sociological perspective.

My study aims to address this gap by discussing three types of informal loans accessible to borrowers in a small provincial town in the Mekong delta. Despite the high cost and the risk of over-indebtedness, borrowers perceive private lenders in a positive way. This paper explores why informal finance continues to enjoy great popularity among rural households despite its high price and risks. The data used derives from an ethnographic study I conducted for my doctoral research in Chau Doc district, An Giang Province (Western Mekong Delta) in 2008–09. The study covers an urban low-income population in a rural setting that does not generate income from agricultural production. This population's economic status is precarious, and it has little or no assets that can be used as collateral. I conducted interviews with ten indebted families, three informal moneylenders, three social workers and two officials from local credit institutions, including the director of the Vietnam Bank for Social Policies for Chau Doc.

II. Formal and Informal Finance in Vietnam

At the peak of the economic crisis in the 1980s, Vietnam began its transition to a market economy by applying macroeconomic and institutional reforms (*Doi Moi*) in 1986. Adopted at the Sixth Congress of the Communist Party, the reforms consisted of redistribution of land and restoring the rural household as the unit of production, privatizing public enterprises, attracting foreign investment, encouraging private savings and developing the private sector that was officially banned in 1958 in the North and in 1975 in the South.

Since the end of the Vietnam War, finance and credit have undergone major changes. Until the second half of the 1980s, the Vietnamese banking system consisted of sectorial banks under the command of the Central Bank and the State Bank of Vietnam. After *Doi Moi*, the State Bank of Vietnam was restructured and public banks were created, including the Vietnam Bank for Agriculture and Rural Development (Agribank). Founded in 1988, its mission consisted of financing public enterprises. In 1992, the Agribank started to finance rural households and agricultural production. By 1996 the total amount of loans had surpassed US$1 billion and reached 3.5 million households (Creusot and Quynh 2003, p. 9). Up to 7 million had received loans by 2002 (Lelart 2007, p. 8). The success of the Agribank was partly due to a strategy which consisted of partnering with mass organizations that monitored the population — and continue to do so. Mass organizations such as the Women's Association, the Farmer's Association and the Veteran's Association disseminated information, recruited clients, facilitated procedures, performed financial transactions and alleviated collateral requirements. In subsequent years, the Agribank started to progressively target solvent clients who could provide property as collateral.

The Bank for Social Policies (VBSP) was founded in 1996 to service clients who were not eligible for Agribank loans. Renamed "Bank for the Poor" in 2003, it targeted the poorest of rural households that found themselves excluded from the services provided by Agribank. It offered flexible credit at an interest rate of 0.5 per cent per month. The VBSP relied on the Agribank network infrastructure to recruit its clients; and in particular it strengthened partnerships with the Women's Association Union and the Veteran's Association. Despite reaching four million customers in 2005 (Lelart 2007, p. 8), its financial results were unsatisfactory. Its low productivity obliged the Vietnamese government to subsidize it, and international donors progressively withdrew their financial support.

In the 1990s, as a result of the government's programmes, the credit supply in Vietnam increased sharply, interest rates dropped and borrowing conditions became standardized. The use of property certificates and the red book (that certifies the right of use, possession and transfer of agricultural land) as collateral became commonplace. At present, the credit market has expanded even more due to the consolidation — under the supervision of the State Bank of Vietnam — of rural credit cooperatives that survived the crisis of the late 1980s, the proliferation of microfinance programmes supported by international organizations (Gironde 2007) and the rapid expansion of private banking (Truitt 2012).

Despite the expansion of the financial landscape, many households from Chau Doc are denied access to formal credit. Why? The first reason resides in the rigidity of procedures, the long waiting periods and the long distances from the borrowers to the Agribank and VBSP offices in the province. The second reason is the need to provide collateral (red book, land title) and administrative documents (permanent residence certificate, poor household card), which borrowers do not necessarily possess. The VBSP implements a policy that excludes consumption credit, in particular for health and education expenditures. The director of the VBSP from Chau Doc explained to me that his institution provides loans for income-generating investments, house repair in response to natural disasters, education for disadvantaged children (particularly those belonging to ethnic minority groups) and for the improvement of living conditions of vulnerable populations within the framework of poverty reduction programmes. These policies exclude the families from my study, as they do not belong to the poorest nor to the most disadvantaged ethnic minority groups. In sum, the exclusion of credit results from the rigidity of the system, the lack of collateral and the restrictive use of loans. Public institutions and the banking system ignore the demand for credit of certain segments of the population, which encourages many people to turn to informal finance.

Despite the rapid economic growth that Vietnam has undergone over the past two decades, the informal economy remains strong and there is no prospect for its reduction in the short term. Despite its predominance, the informal economy remains largely neglected by public policy. In the euphoria generated by the outstanding success of the *Doi Moi*, the Vietnamese authorities have acted as if the informal sector did not exist or was bound to disappear in the transition to a market economy (Cling, Razafindrakoto and Roubaud 2012). Today, formal and informal finance coexists in Vietnam, as in many other developing countries. I use Michel Lelart's definition of the informal sector of the economy as "non-declared activities, performed with little capital and lots of unskilled labour, in a very small scale, with no respect for regulation" (Lelart 2006, p. 3, my translation). The concept emphasizes the absence of forms of financial transactions. In this context, the creditor-debtor relationship is personal and based on trust, and embedded in pre-existing social relations. The fact that lenders and borrowers operate credit transactions that do not respect the standard rules governing formal finance, explains the condemnation of certain types of informal transactions, especially "high interest loans" (*su cho vay nang lai*), also called "cut-throat loans" (*cho vay tien cat co*). The term "informal sector" has a negative connotation in the economics discipline. It implies that the informal finance is underdeveloped, when in fact it is widely practised in developing countries. It is embedded in indigenous practices that offer flexibility, efficiency and adaptability; qualities that match the expectations of the demand (Lelart 2006).

Many economists have calculated the prevalence of informal finance in Vietnam. Current research shows that macroeconomic reforms have provoked its decline since the 1990s. According to Lelart, 77.5 per cent of Vietnamese households relied on friends, private lenders and rotating credit associations in 1992 (2007, p. 11). This figure dropped to 54 per cent in 1996 (ibid.), and to a third of all credit transactions in the 2000s (Barslund and Tarp 2008, p. 488; Gironde 2007, p. 165).

III. Informal Credit in Chau Doc

Informal loans — defined in this paper as including loans from private lenders, accessorily from relatives and friends[1] — play an important role in the informal financial sector. Researchers Barslund and Tarp (2008, p. 488) found that these loans cover 22 per cent of the volume of informal credit in rural areas. My observations confirm that relatives and friends are crucial sources of credit. Borrowers often consider this option first. Loans to relatives and friends are advantageous insofar as the transactions are based on trust, interest is not applied and the terms are flexible. The reimbursement period may last for weeks or months, or it may not be stipulated at all. However, the amounts that may be borrowed depend on the lender's financial capacity, which is limited for low-income families; therefore, they can only lend small amounts to their close relatives and friends.

The majority of households in my study borrow from private lenders. According to Vietnamese law, a loan is considered exploitative when the interest rate exceeds that established by the State or by custom. The Vietnamese Penal Code fixes this rate. Article 163 on usury stipulates that "Those who provide loans at an interest rate ten or more times higher than the maximum interest rate prescribed by law, which is of an exploitative nature, shall be subject to a fine of one to ten times the interest amount or to non-custodial reform for up to one year."[2] For the 2000–2010 period, the annual rate set by the State Bank of Vietnam varied between 7.5 per cent and 14 per cent. Offenders are at risk of being sentenced to between six months and three years of imprisonment, and subjected to a fine of one to five times the amount of the illicit profits.

An array of private lenders serves the families from Chau Doc. A dozen of them work in the area close to the central market. Their organization is pyramidal. Wholesalers, called *chu lon* (big master) provide credit to retailers or *chu nho* (small master) at a favourable monthly rate of 3–5 per cent. Retailers may sell this money to smaller retailers or to borrowers. The price of the money increases when it is loaned out consecutively; for example, the third time the money is loaned out costs more than the second time. Most lenders work independently and dedicate themselves solely to this activity. Wholesalers are prosperous and invisible, whereas small retailers are vulnerable and visible. While retailers enjoy lower rates of interest than common borrowers, the rates are still high enough for them to incur significant risks. The profits are attractive but the venture is risky. The retailer who lacks investment or working capital is forced to borrow to maintain his/her activity. An accumulation of bad debts can quickly weaken or ruin him/her, a situation that happened frequently during the time I was conducting my research.

The physical and social proximity between lenders and borrowers facilitates the collection of information by the former about the creditworthiness, reputation, level of indebtedness, the use of the loan and the repayment capacity of the latter. This proximity reduces information costs, which are lower than those in formal finance. The terms depend on the purpose and on the amount of the loan. The amounts borrowed are small, often tens or hundreds of thousands of dong to be repaid over a few days, and more rarely a few million to be repaid over several weeks or months. The moneylenders usually ask for collateral on higher loans or if the relationship between the lender and the borrower is not firmly rooted in trust. Collateral can include land certificates and assets such as jewellery, televisions, motorcycles and mobile phones. The loan is typically repaid on a daily basis. The lender meets the borrower to collect the amount agreed. While the duration of the loans is in theory short term, the repayment period may be extended, putting the debtor in difficulty.

Private lenders from Chau Doc finance the demand for credit that both formal and informal credit providers do not provide, mostly credit for consumption. Often they provide finance in times of economic shocks such as the rapid increase of prices due to the privatization of basic services, or the devaluation of the dong and rise in inflation (which occurred during the economic crises, especially those between 2008 and 2011). They also provide loans in times of personal shock such as sickness or accidents, and to a lesser extent death — because households often plan funeral expenses in advance (in addition, these expenses may be covered by the system of donated "envelopes" from friends or relatives). And finally, loans are often sought in times of shocks brought about by natural disasters (deterioration or destruction of housing due to weather conditions, especially during the monsoon period) and shocks caused by political decisions (land confiscation, forced relocation). Loans also finance expenses such as schooling (purchase of uniforms and school supplies, registration fees, etc.), which are high given the income of households. Some lenders provide professional credit to lottery sellers. Few households borrow for their livelihood, as this expenditure is ensured by their labour. It is important to note that the indebted households of my study were not always close to the poverty line as defined by the Ministry of Labor, War Invalids and Social Affairs (MOLISA). For the 2005–10 period, the poverty threshold was adjusted to VND200,000 (US$12.80) per person per month in rural areas, and VND260,000 (US$16.60) in urban areas. It has since risen to VND400,000 (US$21.90) in rural areas and VND500,000 (US$27.30) in urban areas to take into account inflation from the late 2000s. However, while households may not be poor, their economic stability is fragile. This fragility results from low wages, poor risk assessments, vulnerability and/or exposure to economic, personal, natural or political shocks.

IV. Three Types of Informal Credit

The study has unveiled three main credit models in Chau Doc.[3] The most popular is "collected money" (*tien gop*). Lenders typically provide loans of between VND100,000 (US$5.60) and VND500,000 (US$28). Collateral is not requested for these amounts. The borrower repays the principal and interest each day during a specified period, usually twenty-four days. This system allows a gradual repayment of the principal and the interest. The rate varies between 10 and 30 per cent, the standard rate being 20 per cent for a cycle of twenty-four days, or 25 per cent per month. Debtors rarely calculate the annual interest rate of 300 per cent. They usually need an urgent sum of money that they intend to repay soon after, therefore calculating the annual rate is unnecessary. For a loan of VND100,000 (US$5.60), the borrower pays VND5,000 (US$0.28) per day, or VND120,000 (US$6.70) over twenty-four days at 20 per cent. If the borrower repays 75 per cent of the loan, he may be eligible for a second loan. The rule of "premature accumulation" (*don non*) provides that the new loan is added to the remaining outstanding debt. Interest is then calculated on a new cycle. For example, if a debtor borrows VND100,000 at 20 per cent, and repays VND75,000 (US$4.20) after fifteen days, then borrows a further VND50,000 (US$2.80) the new principal is VND95,000 (US$5.30) and the total amount to be repaid is VND114,000 (US$6.40) at 20 per cent. This system allows the borrower to borrow more money, but at a higher price, as he will pay VND189,000 (US$10.60) at 26 per cent, instead of 20 per cent.

The second model is "standing money" (*tien dung*), also called a "hot loan" (*tien nong*) in Ho Chi Minh City. It is a short-term loan, reimbursable within a few days. The borrower pays interest on a daily basis until he or she has recovered the principal. For a loan of VND100,000, the daily interest is VND3,000–5,000 (US$0.16–0.28). The lender recovers the amount invested from the interest after twenty or thirty days, depending on the rate. The "standing money" credit is risky for the lender to the extent that the borrower may find him/herself unable to repay the principal on the agreed date, which obliges him/her to continue paying interest at the same rate. Borrowers rely on this credit when lenders refuse to offer new lines of "collected money", or when they need money for a purchase and believe that they are able to repay it within a few days. The price of "standing money" exceeds that of "collected money". It generates high profits to the lender as long as the borrower delays the reimbursement of the principal, a situation that happened frequently in my sample of respondents. Here also the borrower does not calculate the monthly (90–150 per cent) or annual (1,080–1,800 per cent) interest.

The third model is called "lottery money" (*tien ve so*). It is professional credit for lottery sellers, an income-generating activity that is highly popular — especially among children — because it requires no physical force. It is imperative for the vendors to sell their coupons before the official radio announcement of the results every day at 4 p.m. Any unsold coupons result in a loss to the seller. In Chau Doc, a small vendor generates a daily profit of VND30,000–50,000 (US$2–4). Therefore even one or two unsold coupons at VND4,000 (US$0.22) are considered a significant shortfall. In the morning, the seller advances the coupons on his or her working capital. However, he or she often lacks cash, as the money earned during the day may be spent for subsistence requirements. The retailer can buy the coupons on credit from a wholesaler who sells envelopes of twenty coupons worth VND100,000 for VND85,000–88,000 (US$4.77–4.93). The seller may also approach a lender who buys envelopes at VND85,000 and sells them for VND90,000 (US$5.04) on credit. If the retailer is unable to repay after 4 p.m, the lender imposes a daily penalty of VND5,000 (US$0.28), known as "the money that covers the loss" (*tien dap lo*).

V. The Critical Role of Informal Lenders

The interest charged on these loans is significantly higher than that applied by credit institutions. So why do borrowers accept them? Private lenders fill a void left by credit institutions and informal providers (relatives, friends, etc.). In addition, the Vietnamese government does not meet the demand for credit by the entire population, which grows as basic services are privatized and globalized consumption is standardized in Vietnam. In addition, informal credit is a risky business for borrowers insofar as borrowing creates and reinforces debt. A "collected money" or "standing money" loan of a few hundred thousand dong can indeed reach millions in a few weeks or months, driving the debtor into a dangerous spiral that forces him or her to borrow elsewhere under the same conditions in order to repay the interest. This proliferation of sources of credit generates new interest and splits the debt, a strategy that may lead to over-indebtedness. This cycle leaves the borrower no option but to juggle with deadlines, interest rates and lenders (Guerin, Morvant-Roux and Villareal 2014). Yet, despite the high cost of informal credit and the risk of over-indebtedness, borrowers depend on lenders who are often the sole source of credit available. This is why the former perceive the latter in a favourable light and praise their availability, efficiency, flexibility and rapidity. However, they fear the violence that lenders use in cases of dispute or payment default. In other words, the lender is perceived as a "good person" (*nguoi tot*) as long as the reimbursement goes as planned.

Borrowers deploy two arguments to justify their rates. The first refers to the market logic: "we charge the same price as others", "prices adjust to the demand". From this perspective, rates should be low when capital abounds, and high in the opposite case. However, the terms of "collected money" and "standing money" hardly vary. When asked to define "collected money", all the borrowers I asked replied spontaneously "100,000 borrowed becomes 120,000 — you pay 5,000 every day". The second argument relates to risk. Of the three lenders I met in Chau Doc, two abandoned their lending activities following an accumulation of unpaid debts. All deplore the difficulties inherent to their profession, mainly ensuring that borrowers meet their commitments. From this point of view, the risk justifies the price. Only the borrowers who show flexibility on the one hand and determination and a heavy hand on the other manage to stay in business.

The reality of the small lender contrasts with the stereotype of the greedy and unscrupulous usurer who exploits poor people by providing short-term loans at a high price. Credit institutions, development agencies and micro-finance organizations disapprove of private lenders and often tag them as usurers. However economists, such as Fritz A. Bouman, call into question this simplistic view. Bouman takes the example of an African or Asian peasant who borrows $2 to buy four watermelons in the morning, a loan he must reimburse in the evening by adding 20 cents. The daily rate is 10 per cent, the annual 3,650 per cent. The lender is condemned for his greed and manipulation of the helpless poor. But let us suppose that the borrower cuts ten slices for each melon that he sells for 10 cents each to the poorest who cannot afford to buy entire melons. The transaction produces a net profit of $2 a day, ten times the profit of the lender. The seller is not condemned, but praised for his/her entrepreneurial spirit and concern for his/her family's welfare (Bouman 1990, p. 160). The production of money out of money in a deregulated system — although highly structured socially — clearly poses a moral problem to financial institutions and development agencies that aim to regulate and control credit markets. Vietnam is no exception to this.

VI. Conclusion

The social dimension of informal finance is crucial to understanding its prevalence, adaptability and continuity in Vietnam. This research note has examined in detail three modes of credit, and has shown that borrowers' perception of informal credit does not always correspond to that of financial government and international institutions. It is likely that informal finance will remain a significant force in the Vietnamese credit market, given the exclusion of certain groups from formal credit institutions. These groups will continue to turn to private lenders. The costs of such a service are the high price and the risk of over-indebtedness, a price that they appear willing to pay. It is clear that, from the point of view of the borrowers, informal credit is not perceived as an evil but rather an economic necessity.

NOTES

1. My study does not cover two other sources of credit: pawn broking (*cam do*) and savings and revolving credit associations (see Pannier 2012).
2. Chapter XVI, Economic Crimes (http://www.vietlaw.biz/bldisplay/db1/show_tm1.php?doc=1644#).
3. Further investigations conducted in Ho Chi Minh City among sex workers and within the Vietnamese community of Phnom Penh reveal the existence of the same types of credit (*tien gop*, *tien dung*) where similar conditions prevail.

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