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Abstract

Microfinance is an emerging important financial subsector in Asian transition countries. Its role is to improve financial access of the poor and small economic players and thus help them to build assets, which means a contribution to poverty alleviation. This paper provides an overview of rural finance and microfinance development in transition countries in Southeast and East Asia—Cambodia, Lao PDR, Myanmar, Vietnam, and Mongolia—focusing on the institutional evolution and the interrelation between policies and institutions. We find diverse potentials that formal and semiformal financial institutions—agricultural banks, microfinance banks, microfinance NGOs, financial cooperatives, and other indigenous financial systems—have to reach out to the rural poor of respective nations. Any monolithic view that expects a single type of microfinance institution to dominate the rural financial markets is to be denied. To develop effective rural financial systems, some policy implications are drawn, such as reforms of agricultural banks, adoption of market-based policy framework, development of retail capacities of microfinance institutions, progressive establishment of legal and regulatory framework for microfinance, improvement in governance of indigenous financial systems, and importance of savings mobilization.

I

Introduction

Socioeconomic diversity among transition countries in Southeast and East Asia is large. The institutional heritage from previous centrally planned economic systems is more uneven compared with that of former Soviet Union transition countries in Europe and Central Asia. The "gradual approach" for economic reforms in Southeast or East Asia has often been cited as a salient characteristic, in contrast with the "shock approach" adopted by many countries in Eastern Europe and Central Asia. This gradualism, however, is to be understood as a consequence of diverse political and economic systems both before and after changes in the national regimes. A country-specific context largely dominates economic reform programs and processes. Thus, financial sector development is not an exception to the gradual process of domestic reform efforts in those countries.

Microfinance is an emerging important financial subsector in Asian transition economies, as it is in many other regions. Its role is to improve financial access of the poor and small economic players and thus help them to build assets, which means a contribution to poverty alleviation. Since rural economy dominates Asian transition countries, microfinance is expected to play a significant role in improving rural financial systems, which are largely deficient in meeting the demand for capital in the countryside.

Considering that the shape of existing financial systems and the degree of institutional development quite differ from country to country, questions arise: Can we expect any particular type of microfinance institution (MFI) to grow and dominate across different countries? What are the *developmental* issues and *transition* issues of microfinance? What policies and institutional reforms are appropriate for microfinance development in transition countries? To answer these questions, one should first look closely at how different institutions are evolving to reach out to the rural poor in Asian transition countries in *the period of microfinance*.

With the abovementioned view, this paper attempts to provide an overview of rural finance and development of microfinance[1] in transition countries in Southeast and East Asia, excluding China[2]—Cambodia, Lao PDR, Myanmar, Vietnam, and Mongolia. It focuses on the institutional evolution and the interrelation between policies and institutions, through exploitation of secondary information in literature and, in some cases, first-hand information. Section II outlines the rural finance and microfinance development in rural areas in each nation. Section III highlights the institutional evolution of agricultural banks. Section IV highlights the evolution by major institution types of microfinance. Section V draws policy implications from the previous sections, though tentative. A chief limitation of this paper is that the arguments remain *sketchy* and each country experience is treated very briefly due to space constraints. However, we hope that the paper would be able to provide a holistic view on the impact of various environments and policies on the development of rural finance and microfinance in the countries concerned.

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[1] This note basically deals with microfinance *as a concept of the financial business model* without differentiating between those in rural and those in urban areas; however, descriptions on microfinance *institutions* are mostly addressed to those operating in rural areas.

[2] China is excluded for two reasons: (i) the knowledge and experiences of the authors in analyzing China's microfinance is insufficient, and (ii) the primary purpose of this paper as presented in the OECD conference on China rural finance is to draw policy implications from experiences in transition economies other than China.

II

Overview of Rural Finance and Microfinance Development in Transition Countries in Southeast and East Asia

Cambodia[3]

Cambodia has a population of 12.3 million, of which about 10 million live in rural areas. The financial sector is still in its infancy. Banks have to this point played only a small role in savings mobilization and financial intermediation and their operations are generally confined to Phnom Penh. Nearly 40 percent of the people have no access to formal bank branches and only 6 percent of total banking sector advances are for agriculture or related activities. Cambodia does not have any specialized public bank, or other financial vehicle, that extends retail services to farmers. Such an institutional *vacuum* in formal financial supply seems to characterize the basic environment of Cambodian rural finance. There is high anticipation for microfinance development to fill the huge gap in the demand for and supply of rural financial services. Nongovernment organizations (NGOs) that became active in the late 1970s with the humanitarian approach have gradually moved out of relief and rehabilitation works and redefined their roles in interventions in the development process. Among those interventions, microcredit undertakings have thrived since the early 1990s, and most of the country's 24 provinces now have microcredit services provided by NGOs (reportedly numbering 72 in total).

Cognizant of the serious lack in rural financial services, the government has adopted a series of policy measures, supported by international donors: (i) establishment of the Credit Committee for Rural Development (CCRD) in 1995; (ii) introduction of a framework in the Banking Law to enable eligible NGOs and other rural finance providers to become regulated MFIs; (iii) creation of a unit in the National Bank of Cambodia (NBC) to supervise and monitor MFIs; and (iv) establishment of an apex institution to provide financing for MFIs, namely the Rural Development Bank (RDB). With these measures

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[3] For sources, see section of Cambodia in the references.

being in effect since the late 1990s, it can be said that among Southeast and East Asian transition countries, Cambodia has put in place the most *supportive* fundamentals as to policy framework for microcredit development (but not necessarily in terms of savings mobilization), though local capacities and institutions are to be yet substantially developed. Currently, specialized banks engaged in microfinance and NGO MFIs are integrated into the regulations of the NBC. With technical and financial supports by donors, the NBC developed banking legislation that includes registration and licensing requirements and some prudential standards for larger MFIs. As of the end of 2001, there were 32 registered NGOs and MFIs, the top five of which dominated more than 80 percent of the aggregated loan portfolio, including ACLEDA Bank (a specialized bank), the EMT and Hatthakaksekar (licensed NGOs), and PRASAC and Seilanithih (registered NGOs). In total, the rural financial institutions reach around 420,000 borrowers, which represent about 23 percent of the rural households. Among them, the rapid growth of ACLEDA Bank is phenomenal: after only about three years in operation as an NGO microfinance project, ACLEDA transformed into a microfinance specialized bank in 1995 and, as of the end of 2002, had 75 branches in 14 provinces and a workforce of 863. Its loan outstanding had grown to US$27 million, serving more than 80,000 borrowing customers.[4] Fully supported by international donors since its establishment, ACLEDA Bank has been expanding its range of products in retail banking to include loans for small and medium enterprises, cash management and money transfer services, and deposit services to the public. Savings mobilized by ACLEDA's deposits are yet small (US$5.7 million in 19,070 accounts as of the end of 2002), but have been growing rapidly in recent years.

As regards the RDB, a governmental wholesale conduit to MFIs, the loan outstanding (to five financial institutions) was US$1.9 million as of January 2002, with an additional US$20 million available in credit from the Asian Development Bank (ADB) to be on-lent to MFIs.

[4] The amount of loan outstanding was at the end of 2002, according to ACELEDA annual report 2002. The number of borrowing customers was reported at 81,453 as of the end of 2002, according to Channy (2002).

Lao PDR[5]

Lao PDR remains largely agricultural and rural. About 85 percent of the workforce is engaged in agriculture, which generates 51 percent of the GDP. The financial sector in Lao PDR is small relative to the size of the national economy (the total banking system assets are approximately 25 percent of GDP) and, in particular, has achieved a very low level of outreach in rural areas. According to the UNDP/UNCDF estimation based on a rural household survey conducted in 1996, only 11 percent of rural people had the ability to access formal financial institutions, and only 1 percent saved in bank deposits. Foreign banks are not allowed to open branches outside the municipality of Vientiane.

The country's current policy to support rural access to finance has been implemented primarily by the Agriculture Promotion Bank (APB), functioning as a policy bank (one of the four state-owned banks established in 1993). The APB is, to date, the only formal credit provider of any significance in rural Lao PDR. Although its financial situation is unclear,[6] the APB has been producing operating losses and has accumulated a high level of problem loans, resulting in periodic recapitalization by the government, according to the Asian Development Bank (ADB). The APB's operations have been reportedly controlled by the government, including the setting of the level of interest rates, and thus responsibility and management autonomy as a financial institution have been limited. However, given the difficult operating environment for rural finance, the government has moved to introduce microfinance projects since the late 1990s. Pilot microfinance projects catering to the rural poor have recently emerged with support by donors and international NGOs; reportedly, the current outreach by the three largest MFIs, including the Lao Women's Union (LWU), has been estimated at about 10,000 clients. Currently, there are no regulations for NGO MFIs in Lao PDR.

There are also traditional credit schemes and revolving funds based at the village level, generally called "village revolving funds" (VRFs), in Lao PDR, which serve as financial and social intermediaries between supporters (the government and donors) and villagers. It is reported that more than 1,600 VRFs serving about 8,000 borrowers are active; however, they are not operating

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[5] For sources, see section of Lao PDR in the references.
[6] APB has never published its financial statements (ADB 2002).

on a financially sustainable basis. Recently, the government established the Rural Micro Finance Committee (RMFC) and prepared to assess the status of rural microfinance so that it could develop a policy statement and action plans for implementing sustainable microfinance. The World Bank reports that the draft is currently under a consultative process including stakeholders such as donors, practitioners, and provincial authorities.

Myanmar[7]

Myanmar is an agriculture-based country in which more than 70 percent of its 48.3 million population resides in the rural areas and the agricultural sector (including livestock, fisheries, and forestry) accounts for 57 percent of GDP. In rural Myanmar, the Myanma Agricultural Development Bank (MADB), a state-owned bank established in 1953, is virtually the only major source of institutional credit, with the exception of financial cooperative societies; the Myanmar Economic Bank (state-owned) and private commercial banks are mostly confined to the urban areas. The MADB's mandate and funding priority have been for the benefit of farmers, but the scale of loans is severely limited, mainly due to funding constraints. Also, the mountainous geography and poor infrastructure in the rural areas make provision of financial services very difficult. As a result, there is huge excess demand for capital in the countryside.

Microfinance in Myanmar is an exogenous phenomenon brought to the country in 1997 by international NGOs (PACT, GRET, and Grameen Trust) contracted by the United Nations Development Program/United Nations Office of Project Services (UNDP/UNOPS), which are interested in using microfinance as part of an overall package for poverty alleviation in three specially designated regions in the rural areas. Although these microfinance projects are yet at the early stage, the aggregate number of clients has grown quite rapidly. For instance, the estimated number of active borrowers exceeded 100,000 after only about four years of operation. However, the geographical coverage of these projects is still very small (only a few percent of the country's

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[7] For sources, see section of Myanmar in the references. The observations and estimations deriving from the authors' field research on microfinance in Myanmar in 2001-2002 are also included.

townships), which may be explained by the experimental or pilot nature of the UNDP/UNOPS project.

As a result, microfinance in Myanmar is up to now at an embryonic stage—only of *project status,* supported by international donors—but the quick growth in outreach provides encouraging evidence of potentials for future growth. The Myanmar government, including the central bank,[8] has insufficient exposure to microfinance practices, although at least two sensitization seminars supported by donors have been held since 1999.[9] The country lacks the policy framework, legal structure for registering microfinance NGOs, and administrative structure that are needed for dealing with microfinance undertakings. As for indigenous financial systems in Myanmar, savings and credit cooperative societies are run under the auspice of the Ministry of Cooperatives, and small-scale economic players are a large part of their members. The number of such savings and credit societies in operation is said to be about 2,000 throughout the nation, which indicates that the cooperatives form a sector of some significant weight in rural financial activities in Myanmar.

Vietnam[10]

In Vietnam, 75 percent of the population and 90 percent of the poor currently live in rural areas. Agricultural activities account for 70 percent of the income of rural dwellers. Hence, in spite of vigorous industrial growth and economic structural transformation throughout the 1990s, the rural economy is still dominant in Vietnam. Since its establishment in 1988, the Vietnam Bank for Agriculture and Rural Development (VBARD)[11] has been the major source of credit and savings in rural Vietnam. Its growth in size and scope during the 1990s is remarkable: VBARD is regarded as having contributed significantly to the agricultural expansion under the *doi-moi* (renovation) policies in Vietnam. Now the biggest commercial bank, it has a very extensive network (1,568

[8] The Central Bank of Myanmar is not autonomous from the government; it is part of the Ministry of Finance and Revenue.

[9] Microfinance seminars were organized by the UNDP/UNOPS in November 1999 and by JICA in June 2002.

[10] For sources, see section of Vietnam in the references.

[11] VBARD was established in 1988 as the Vietnam Bank for Agriculture, separated from the State Bank. In 1996, its mandate was extended to include the development of the rural economy, rather than only agriculture, and thus its name was changed.

branches) and serves 5.5 million rural households, which represent as large as 45 percent of the total. It had total outstanding loans of US$4 billion and deposits of US$1.8 billion as of 2001. The Vietnamese government established the Vietnam Bank for the Poor (VBP) in 1995 to serve poor households that could not be reached by VBARD, whose major task was to provide subsidized credit through a joint liability group. The VBP used VBARD's extensive network of branches; it had no separate staff members and was not involved in any savings activity. By 2002, the VBP had provided a total of US$452 million in credit to some 2.7 million households, which is a substantial outreach. However, the most crucial issue concerning the VBP was its lack of long-term viability and sustainability. In 2002, one of the financial reforms to separate policy lending from commercial banking included the reorganization of the VBP as a new policy bank. Thus the Vietnam Bank for Social Policies (VBSP) was established in March 2003, integrating all of the operations of the VBP and four other policy lending programs that were extended by the government, including loans to students and "employment generation" programs, i.e., lending to small entrepreneurs.

At the commune level, there used to be thousands of credit cooperatives (about 7,100 in 1985) throughout the country. They, however, collapsed by 1990 and the substantial amount of deposits (reportedly VND100 billion) were not reimbursed to their owners. In 1993, the People's Credit Funds (PCFs) were established—commune-level savings and credit cooperatives modeled after the *Caisse Poplulaire* Credit Union System in Quebec, Canada. They now form another pillar of rural finance in Vietnam, operating under the cooperative law. As of the end of 2001, there were 906 PCFs totaling 807,546 member, loans outstanding of US$168 million, and mobilized savings of US$128 million. PCFs can be regarded as microfinance institutions that, while operating without any subsidies, have been relatively successful in reaching out to the poor and mobilizing savings.

VBARD, VBSP, and the PCFs are thus forming a formal sector for the provision of microfinance and are supervised by the State Bank of Vietnam. In addition to their activities, the various roles of semiformal actors should be noted, in particular those of people's organizations such as the Vietnamese Women Union and international NGO projects, in rural finance. People's or mass organizations, though not financial intermediaries *per se*, are quasigovernmental bodies that are represented at all levels, from national to commune. They often act as "brokers" between VBARD or the VBP and their borrowers, and establish savings and credit groups that enable them to reach many rural poor (1.6 million as of 1998). However, they heavily depend on the government for loan funds. International NGOs are active in Vietnam in bringing in best practices, providing capacity building programs, and implementing savings and credit schemes. Nonetheless, they are yet small compared with those of other Asian countries in terms of size relative to the nation's financial system. Finally, the postal savings have grown rapidly since their establishment in 1999; as of the end of 2002, the total outstanding was over US$250 million among 420,000 accounts, collected by 709 offices throughout the country.[12]

Mongolia[13]

Mongolia is a vast country with one of the lowest population densities in the world. The inhabitants number only 2.4 million and are widely dispersed over the land, the surface of which is equivalent to that of Alaska. About 65 percent of the population reside in rural areas and a large part of them live as seminomadic herders. Agriculture contributes about 30 percent of GDP. The lack of access to financial services in rural Mongolia has been perceived as one of the key constraints to the country's rural development. Until recently, there were only two formal financial institutions that had networks at the *soum* (village) level: the Agricultural Bank of Mongolia (AgBank) and the Post Bank. Financial services diffusion was further hampered by a series of banking crises during the 1990s that caused the whole banking system to suffer from widespread public distrust. As a result, rural finance in Mongolia became a serious need that was very difficult to fulfill. AgBank was founded in 1991, inheriting the rural banking network of the State Bank. AgBank became insolvent after years of accumulated losses and, in 1999, the Bank of Mongolia placed it in receivership. Since then, many programs for remediation have been initiated, supported by international donors, as all of the stakeholders realized the importance of AgBank whose network in rural areas was the most extensive. The management was contracted with a foreign firm, and finally the privatization was successfully finalized in March 2003. The results of restructuring during this process have initially been viewed as successful;

[12] *Nikkei Journal,* March 17, 2003.
[13] For sources, see section of Mongolia in the references.

the rehabilitation of the rural financial infrastructure thus far includes the following increases in 2002: branch offices, from 269 to 356; employees, from 803 to 1,525; loans, to more than 400,000 in number; and deposits, to US$39 million. According to AgBank, one out of every two rural households uses AgBank. As for the client base, it is reported that AgBank is strengthening its focus on wealthier herders, rather than the poor segment.

Also dramatic in the recent evolution of Mongolian rural microfinance was the birth of XacBank[14] in 2001, a product of the merger of the nation's first finance company (XAC Co. Ltd.) that originated from the UNDP-supported MicroStart project and an SME lending institution in the Gobi region (Goviin Ehlel Ltd.) funded by the United States Agency for International Development (USAID). Being owned by seven NGOs through the holding company, XacBank has 15 branches in the rural areas in addition to its six in Ulaanbaater. As of the end of 2002, it had 11,063 borrowers with total loan outstanding of US$4.9 million (of which, "microloans" constituted 51 percent) and savings of US$6.0 million. So far, XacBank has targeted the "vulnerable nonpoor" and the "moderately poor."

Besides the fast-growing AgBank and XacBank, savings and credit unions (SCUs) and NGO microfinance have also emerged in rural microfinance. Backed by active donor supports, the rural finance in Mongolia has been experiencing an ice-breaking moment in its history. The first SCUs outside the capitol were formed in 1999 and, as of the end of 2001, 135 SCUs were registered, of which 69 were located in the rural areas. The ADB has been supporting these undertakings. As to NGO microfinance and donor-supported projects, UNDP reports that about 60 are active, among which is Credit Mongol, a nonbank financial institution functioning as an implementer of an applied research project of the UNDP and the United Kingdom's Department for International Development (DFID), which has been attracting an increased level of attention from the donor community. Other projects have also been implemented, including those under the auspices of the World Bank Sustainable Livelihoods Support Project and the World Vision.

[14] Xac is a Mongolian acronym for "Golden Fund for Development."

III

Agricultural Banks/Rural Development Banks

Institutional Forms

As was overviewed in Section I, agricultural banks are currently playing a central role as formal providers of financial services in rural areas in Asian transition countries. A good part of their operation is to serve small farmers, and in some cases, nonfarmers, in the countryside, even though microfinance methodology has not necessarily been built into the system. The most sizable outreach has been achieved by VBARD (Vietnam), which serves as much as 45 percent of the nation's total households. The MADB (Myanmar) is the second largest agricultural bank in terms of workforce, serving about 1.6 million rural households. Although its recent operational and financial status is unknown, the APB (Lao PDR) remains the only formal supplier of credit of any significance in Lao PDR. These three banks basically follow a policy bank model of being fully owned by the government and are thus given the major mandate of supporting agricultural expansion and related activities in the countryside of their respective countries. However, their banking licenses differ depending on the country context. For example, VBARD is given the status of a full-fledged commercial bank that serves farming and nonfarming individuals and enterprises, whereas the MADB is mandated by a special law to limit its scope mostly to seasonal crop loans to farmers. AgBank (Mongolia) is an example involving institutional transformation from the governmental policy bank model. After it was established as a state-owned commercial bank holding an extended outreach in rural areas, subsequent managerial failures caused its insolvency, which necessitated the authorities to initiate a comprehensive restructuring of the bank's operations and financial base. The Mongolian government pursued the AgBank's organizational rehabilitation and improvement of governance by adopting a management contract with a foreign party and, eventually, privatization involving foreign investors. While these four banks are financial service retailers in the rural areas, the RDB (Cambodia) is a small apex organization that exists for the purpose of channeling (on-lending) funds to financial intermediaries specialized in microcredit. This formation originated from, on one hand, a serious lack of any significant formal outreach by any existing financial institution and, on the other hand, the government's determination to use microfinance systems to reach the rural areas rather than aiming for commercial banks' networks to expand.

Targeted Borrowers and Credit Extension

As regards recipients for banking services, VBARD (Vietnam) and AgBank (Mongolia) deal with both individuals and enterprises since they are committed to becoming effective rural commercial banks, whereas the APB (Lao PDR) and MADB (Myanmar) target mostly small farmers. The RDB (Cambodia) channels on-lent funds through microcredit intermediaries to farmers and microenterprises. Among these banks, VBARD's and AgBank's management directions, targeting clients, and lending methodologies merit particular attention. The experience indicates that directed credit, when done in a nonflexible manner or when it is forced, is not an effective means for rural finance. Traditional types of directed credit extended by retail agricultural banks include either short-term loans to farmers and herders or other agricultural extension, as well as some specific mid- or long-term loans to capital investment for the agricultural sector. It is well documented that inflexible directed credit to specific production activities, accompanied by provision of very low interest rates to end users, has experienced many failures in terms of operational and financial performance across the world. VBARD's and AgBank's ongoing experiences, however, may fall into different models. Although VBARD still involves directed credit and its lending has been at interest rates too low to cover its financial costs, it has not been providing "cheap credit."[15] AgBank has been more freely charging interest rates that will enable them to recover their costs.

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[15] See World Bank (2002c) and Izumida (2003). In Vietnam, the interest rate regulations on banking services have been gradually removed since the mid-1990s and currently there is no ceiling on rates for credit provision. However, VBARD is not seemingly very flexible in changing lending interest rates compared with other state-owned commercial banks; to what extent this practice has been imposed by the government policies remains to be clarified. As to directed credit, Izumida (2003) estimates that approximately 20 percent of lending is still directed by the state and reports that the policy for rescheduling payment schedules for existing clients is also influenced by the state.

Savings Mobilization

To date, mobilization of savings by agricultural banks is more successful than that by any other financial organizations involving microfinance undertakings, in relative terms, in Asian transition countries. However, more traditional types of agricultural banks are less successful among the five countries referred to in this paper. The APB (Lao PDR) has been dependent on borrowing from the government or the central bank for its financial resources. The MADB (Myanmar), in which the major finance is provided by short-term borrowing from the central bank, mobilizes yet a limited amount of savings from farmers, though its outreach in terms of the number of savings accounts is fairly sizable. In contrast, VBARD (Vietnam) has mobilized savings of US$1.8 billion, at a rapid growth rate. In the case of AgBank (Mongolia), the deposits collected from herders were already the major financial resources for banking operations even prior to the organizational restructuring; after implementing the rehabilitation programs, the savings amount from herders and agricultural businesses has been growing rapidly, and now constitutes 76 percent of the total liabilities in addition to equity capital of the bank. The relative success in mobilization of savings in rural commercial banks in Vietnam and Mongolia can be attributed largely to the following factors: (i) stable macroeconomic management to keep positive real interest rates; (ii) extended branch networks throughout the respective countries; and (iii) more or less flexible financial products for clients in rural areas.

IV

Microfinance Banks/NGOs and Financial Cooperatives

Microfinance Banks

In the five transition countries covered in this paper, two privately owned microfinance banks are operating: ACLEDA Bank (Cambodia) and XacBank (Mongolia). Although they exist in different country contexts, the following institutional and environmental similarities are recognized:

- (i) Their origins are as an NGO or a private company with a strong stake in rural areas and a clear vision to cater to small economic players and the poor.
- (ii) Their operations have been fully supported by international donors since their establishment, and the rapid transformation into regulated banks specialized in microfinance and small finance was achieved through the involvement of such strong support.
- (iii) The governments and monetary authorities in the two countries have been exposed to microfinance practices and are on the way to developing enabling legal and regulatory frameworks.
- (iv) Because their respective monetary authorities have not limited them with ceilings on their interest rates, those microfinance banks are charging sufficient levels to be sustainable entities.
- (v) They are achieving rapid growth in loan portfolio through extension of their branch networks.
- (vi) They aim at offering more full-fledged retail bank services, including provision of loans to small and medium enterprises and other financial services to the public as commercial banks.
- (vii) Mobilization of savings is yet limited in relative terms to credit extension, though rapid growth has been seen recently.

The VBP (Vietnam), VBSP's predecessor, was unique as a governmental bank in that it provided unsecured small credit to the poor. As was stated in Section I, its character was virtually more of *a loan fund* than of a bank since it did not have its own organizational structure or staff members and its operations were entirely dependent on the branch network of VBARD. The VBP was heavily subsidized by government funds and charged lower lending rates than those of VBARD; thus, the VBP lacked the financial base for sustainability. Moreover, nonseparation of such policy lending from commercial banking evoked criticism from both society and the donor community as it severely undermines financial discipline in borrowers. The VBP's transformation into the VBSP is an attempt to segregate policy lending and establish the bank's own organizational structure, including a branch network; however, the institutional and financial viability is uncertain at this moment.[16]

Microfinance NGOs and Projects

It is estimated that more than 230 projects involving microfinance, either in full scale or as a component of their other activities, are being carried out by local or international NGOs in the five transition countries. Considering that many of them started operations in the last decade or so, this emergence is an encouraging proof of the potential of microfinance development in this region. Microfinance seems to offer a viable alternative to traditional moneylending to poor people and small-scale players who have been shut out from the formal banking system. The most sizable outreach achieved by NGO microfinance, to date, is seen in Cambodia, where the total estimated number of borrowers of all rural MFIs has reached about a quarter of the rural households, according to NBC. Generally speaking, local capacities to run microfinance programs in a professional way are yet very weak in many aspects, such as implementation of adequate lending methodologies, achievement of sound financial management, and establishment of appropriate governance in spite of active support by international NGOs specialized in microfinance. Nonetheless, some good examples of institutionalization, based

[16] According to Izumida (2003), the newly established VBSP is exempted from holding capital reserves and the clients' deposits at the VBSP will be fully guaranteed by the state. The lending interest rates to the poor (0.5% per month) are set below the six-month term deposit rates at VBARD and the PCFs, indicating that subsidized credit would distort rural financial markets as was the case in the former VBP. Izumida also warns that the VBSP's establishment of its own branch network, which would probably incur operational inefficiencies, would bring about huge social costs.

on reliable track records in outreach and financial sustainability, have emerged in the region.

As to the impact of policy framework for NGO microfinance, the following are observed:

(i) Each country's legislative framework in some way provides for the registration of NGOs involved in microfinance, but with quite diverse authorizing activities. Cambodia has established a set of standards to register microfinance NGOs under the regulations of the NBC, whereas the other four countries do not have such explicit regulatory frameworks. Among them, Myanmar's is the least developed; microfinance undertakings are only allowed as part of humanitarian projects that require special agreement with line ministries on a project-by-project basis.

(ii) In Cambodia, as a result of its central bank's regulatory framework, "licensed" NGO MFIs have emerged, in addition to a microfinance bank (ACLEDA). The MFIs are making progress in terms of information disclosure, which will significantly contribute to the establishment of industry standards and risk management of the monetary authorities.

(iii) Formal and informal associations or forums among NGOs and projects that involve microfinance have thrived and are contributing to the establishment of a base for dialogue among practitioners and policymakers. Examples of formal committees on rural finance and microfinance are found in Cambodia and Lao PDR, and informal dialogue has widely emerged in the region, including opportunities driven by donors as part of financial sector or rural finance projects.

Financial Cooperatives and Other Indigenous Systems

The experiences in these five Asian transition countries provide some indication of the potentials of financial cooperatives and other indigenous financial systems to become important subsectors of their domestic financial systems. Together with other microfinance undertakings, the mutual financial systems running at the small community level are contributing to enable poor and small economic players to switch from informal finance (borrowing from relatives or moneylenders in villages) to formal or semiformal means. Also, given the "savings first" mechanism, one of the salient advantages of the financial cooperatives is their effectiveness in mobilizing savings, and, once appropriate governance is in place, the financial demand of their members can be expected to contribute toward healthy development.

An encouraging example of cooperatives' responsiveness to rural financial needs is indicated by the PCFs in Vietnam that have been rapidly expanding at the commune level through the delivery of microcredit and the mobilization of savings in only less than 10 years of operation. Another example of rapid growth is observed in the savings and credit unions in Mongolia since 1999. The institutional forms and linkages of financial cooperatives with the formal sector vary and this bears future studies. In Myanmar, savings and credit societies are one form of many kinds of cooperatives, which are registered under the Ministry of Cooperatives.

III

Policy Implications

An overview of rural finance and microfinance development in Asian transition countries shows us the diverse potentials that formal and semiformal financial institutions have to reach out to the rural poor and small economic players in the countryside. (Table 1 provides a summary of the findings.) Any monolithic view that expects a single type of MFI—either NGO or specialized bank—to dominate the financial market for microcredit and microsavings is neither healthy nor realistic. Existing formal and semiformal financial systems should be reformed to overcome the constraints deriving from their old models to deliver financial products, and emerging innovative microfinance NGOs have still many tasks ahead before being institutionalized and eventually integrated into the formal financial sector. The following policy implications are drawn by the previous sections:

(i) **Reform of Agricultural Banks.** The extensive branch networks of agricultural banks are invaluable socioeconomic infrastructure for rural finance; however, inefficient management, often in the form of inflexible directed credit, not only undermines such assets but also inhibits borrowers' development of financial discipline. Effective reforms are being undertaken in the region: retail services can be developed by strengthening commercial banking with more varied financial products by market-based pricing (VBARD and AgBank). The core issue to cover the social costs is managerial autonomy from political decisionmaking rather than the argument that state ownership is disruptive. Existing agricultural banks, regardless of the ownership structure, should challenge to reconcile their mandate of contributing to the rural economy with the achievement of financial sustainability.

(ii) **Financial Sector Vision and Market-Based Policy Framework for Rural and Microfinance**. This is a basic requirement for developing an efficient rural financial system, as it is far easier to start with a set of enabling policies rather than modifying policies after they become a practice or norm. The Cambodian experience clearly shows that the government's and the monetary authorities' understanding and support to market-based approaches to rural finance enable MFIs to grow fast. On the other hand, co-existence of the market-based microfinance undertakings and the provision of heavily subsidized microcredit by the governmental schemes is to be resolved (e.g. Vietnam).

(iii) **Development of Retail Capacities of MFIs.** The further development of rural finance and microfinance is constrained by the insufficient capacity of current institutions, e.g., local NGOs, to expand and become strong institutions. There is an obvious need to develop retail capacities of MFIs.

(iv) **Legal and Regulatory Environment for MFIs**. Over the world, most MFIs grow outside the regulatory system at the early stage of development and so are the Asian transition countries studied in this paper. This basically provides favorable conditions for MFIs to adopt nonconventional methodologies to deliver financial services to the poor. However, if severe restrictions for microfinance operations exist or if the existing legal framework discourages NGOs to start microfinance undertakings, those restrictions should be urgently removed. In a country like Myanmar, the registration system for NGOs to lawfully deliver microcredit is to be established. Another indication from this overview is that there is a clear need to develop or improve regulatory capacities in the monetary authorities to understand particular risk profiles of microfinance. Capacity building of regulators should, generally speaking, prevail to drafting particular laws and regulations for microfinance.

(v) **Improvement in Governance of Indigenous Financial Systems**. Each country has developed indigenous financial systems that have some potential for being mainstreamed to or linked with the formal financial system in the future. The foremost challenge of indigenous groups for sound expansion is the achievement of good governance. There is a need to study those systems to draw lessons and identify tasks and action plans, under the specific context of each country, to be mainstreamed or linked with the formal system.

(vi) **Savings Mobilization and Financial Sustainability.** Savings mobilization cannot be overemphasized, since it benefits both the MFIs and the small depositor clientele and thus contributes to financial deepening in the rural economy. There is a need to ensure that the savings of poor people entrusted to MFIs are safe and sound.

Table 1. Rural Finance and Microfinance Development in Transition Countries in Southeast and East Asia

	Southeast Asia				East Asia
	Cambodia	**Lao PDR**	**Myanmar**	**Vietnam**	**Mongolia**
Country Profile[i]					
Population (rural portion)	12.3 million (85%)	5.3 million (76%)	48.3 million (72%)	78.7 million (75%)	2.4 million (63%[ii])
Population density (000/sq. km)	68	23	73	241	2
GNI per capita (US$)	260	320		410	410
Gross domestic investment/GDP	17.9	22.1	12.4	30.9	30.0
Gross domestic savings/GDP	9.8	15 [e]	12.3	28.9	14.1
M2/GDP		16.4	25.7 (1999)	51.8	38.2
Year economic reform started	1988	1986 (New Economic Mechanism)	1989	1986 (*doi-moi*)	1990
Banking Reforms					
Two-tiered banking system	National Bank of Cambodia (NBC) separated commercial banks in 1991	The Bank of Lao PRD (BOL) established in 1990	Central Bank of Myanmar (CBM) established in 1990	State Bank of Vietnam (SBV) separated commercial banks in 1988	Bank of Mongolia (BOM)
Interest rate regulation (explicit)	No	No	Yes	No	No
Total assets of the banking system	$644 million (20% of GDP) (2000)	$408 million (25% of GDP) (1999)	n/a	Estimated total bank loans/GDP is 44% (2000)	$206 million (22% of GDP) (2000)
Private banks (excluding rep. offices of foreign banks)	12 local banks; 5 foreign branch banks; 2 specialized banks	10 private banks	20 private banks	39 joint stock banks; 4 joint venture banks; 26 foreign bank branches	11 private banks
Banking crises	-	-	2003 bank run at leading private commercial banks	-	1992, 94, 96, 98/99 Banking crises or failures
Financial sector vision statement	Financial Sector Blueprint for 2001-2010 (ADB)				
Rural credit policy	Credit Committee for Rural Development (CCRD) in 1995	Rural Microfinance Committee (RMFC)			

Table 1 (continued)

	Southeast Asia				East Asia
	Cambodia	**Lao PDR**	**Myanmar**	**Vietnam**	**Mongolia**
Agricultural Banks or Rural Development Banks	Rural Development Bank (RDB) established in 1998	The Agricultural Promotion Bank (APB) established in 1993	Myanma Agricultural Development Bank established in 1953	Vietnam Bank for Agriculture and Rural Development (VBARD) established in 1988	AgBank established in 1991 (privatized in March 2003)
Network	[wholesale organization]	17 provincial branches and 50 subservice units	15 regional offices and 204 branches (2000)	1,568 branches (2001)	356 offices (2002)
Employees	n/a	n/a	3,357 (2000)	22,372 (2001)	1,525 (2002)
Outreach	wholesale organization	(APB reports it served 15% of all villages, containing 14% of all households in 1996 and had 12,000 depositors)	1.6 million borrowers; 2.0 million savings accounts (2000)	Serving 5.5 million households; the total loan outstanding of US$4 billion and savings mobilization of US$1.8 billion	(the number of loans made in 2000-2002 was 400,000; AgBank reports one of every two rural households uses AgBank)
Donors	AFD, ADB	EU, IFAD, ADB	none	WB, ADB, AFD, KfW, etc. (53 foreign projects)	USAID
Balance sheet	12/2000	1996, estimated by UNDP/CDF	3/2000	12/2001	12/2002
Assets (composition, %)	-Loans 24 -Deposits with NBC 71 -Others 5	n/a	-Loans & advances 36 -Investment 2 -"Adjustment a/c" 51 -Others 11	-Loans 77 -Placement in banks 11 -Balance in SBV 5 -Others 7	-Loans 51 -Investment 28 -Others 21
Liabilities/Equity (composition, %)	-Deposits (customers) 9 -Capital/reserves 85	-Borrowing from BOL and donors 92	-Deposits 33 -"Borrowing a/c" 52 - Capital/reserves 9	-Deposits (customers) 46 -Deposits/borrowing from SBV and treasury 25 -Capital/reserves (1)	-Deposits (customers) 76 -Gov't deposits, etc. 15 -Capital/reserves 7

Table 1 (continued)

		Southeast Asia			East Asia
	Cambodia	Lao PDR	Myanmar	Vietnam	Mongolia
Microfinance Institutions					
Microfinance banks	ACLEDA Bank: more than 80,000 borrowers; loan outstanding of US$27 million	None	None	Vietnam Bank for Social Policy (March 2003): state-owned	Xac Bank (March 2002): 11,063 borrowers; loan outstanding of $4.9 million (12/2002)
Estimated Number of NGOs & Projects involving microfinance	72 local and international NGOs	15 international NGOs (1997)	25 local & international NGOs/projects involving microfinance (2002)	60 international NGOs involving savings and credit schemes (1997)	60 local and international NGOs
Leading NGOs / Projects	Hatthakaksekar, EMT, Seilanithih, UNICEF, MOWA	UNDP/UNCDF (microfinance project), Lao Women's Union (LWU)	GRET, PACT (UNDP/UNOPS)		Credit Mongol, World Vision
Outreach of MFIs	4,000 (1991) 420,000 borrowers (235% of rural households (12/2001)	Three largest MFIs reach about 10,000 clients	Estimated borrowers of NGOs/projects exceeds 100,000	n/a	n/a
Financial Cooperatives and Other Indigenous Financial Systems (incl. urban area)		Only one official (CCSP); network not yet emerged, Approx. 1,600 village revolving funds (VRFs): credit $5 million	Estimated number of credit and savings cooperative societies is 2000.	906 People's Credit Funds (PCFs) have 807,546 members	135 registered savings and credit unions (2001)
Note				Postal savings: total outstanding $250 million	

[i] Sources: World Bank, *Country at a Glance*; International Monetary Fund, *International Financial Statistics*.

[ii] Asian Development Bank.

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