Credit Access and Poverty Reduction*

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1. INTRODUCTION

The financial crisis that occurred in 1997 triggered a sharp economic downturn in Thailand and adversely affected the country's financial system. Lessons learned about the pre-crisis structural weaknesses in the country's economic and financial make-up led policy-makers and regulators to undertake many key structural and institutional reforms in order to restore financial order and macroeconomic stability. One of the most prominent areas of change was the financial system, particularly the financial sector. However, the central bank's restructuring and tightening of controls over banks and financial institutions had some unintended repercussions on both financial and corporate sectors.

Banks which had long been major providers of funds to households and business enterprises were crippled by massive bad debts and spent much time in improving their balance sheets through recapitalization and the settlement of non-performing loans. Although remaining important, the banking sector, especially the commercial banking sector, appeared to have played a much less significant role in credit-extension activities compared with its role in the past. In other words, commercial banks became more prudent in appraising and approving credit. They also become more prudent about risk management activities, becoming reluctant to grant new loans or even to extend outstanding loans. Consequently, the resulting credit crunch in the financial and corporate sectors created spill-over effects on the real economy, especially on poor and illiquid households, and small enterprises.

It was about four years after the financial crisis when the Thai Rak Thai Party won the election of 2001 and began to reshape the Thai political landscape. Owing to the depressing private-sector investment and spending that constituted a hindrance to economic growth, the newly elected government under the Thai Rak Thai Party at that time adopted and implemented populist economic policies to boost local consumption and the production of traditional sectors, including agriculture, rural households, and small and medium-sized enterprises (SMEs). Such stimulus policies were in fact perceived to be one of the best ways to hit two birds with one stone. Although on one hand they targeted poverty at the grass-roots level by increasing income, reducing expenses and creating more opportunities for the people, on the other hand they were specially designed to gain mass public and political support from the vast majority of the people, especially at the grass-roots level.

To stimulate the grass-roots economy, the Thaksin administration initiated many populist schemes relating to the provision of welfare (e.g., the health-care system, social housing), access to finance and capital (e.g., micro-credit programs, debt reduction/debt moratorium for farmers), and other poverty-eradication programs. However, this paper focuses only on financial access-related policies by addressing two questions: (a) do the poor have better access to credit programs initiated by the government? and (b) do the poor benefit from the programs as a means of increasing their incomes.

The paper starts by providing a framework for reducing poverty and increasing the living standards of the people, and briefly describing in section 2 the financial support packages implemented in the past by Thai governments in order to tackle poverty problems. Section 3 analyzes whether the Thaksin administration's financial support programs improved access to credit for the poor and narrowed the income distribution between the rich and the poor, and also to measure economic impacts in terms of income generation. The final section summarizes the lessons learned and closes the paper with a few thoughts on the way forward.

2. DEPENDENCY ON GOVERNMENTAL FINANCIAL SUPPORT

When the credit market operates well, there is no need for government intervention. However, there are in reality several imperfections in the market. Lenders are typically reluctant to provide credit to loan applicants whose quality and type cannot be identified and assessed. In a developing credit market like that of

* *An earlier version of this paper was presented at the 2007 TDRI Year-end Conference on "How Can We Tackle the Poverty?: Liberal, Populism, or Welfare State Approaches" November 10-11, 2007, Ambassador City Jomtien, Chon Buri.*

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Thailand, collateral is normally used by lenders to offset their risk exposure when granting loans to risky borrowers. However, not in every case do loan applicants have sufficient collateralizable wealth to meet the amount of collateral required by the lenders. As a result, credit rationing occurs and there is excess demand for credit. Credit information and collateral problems thus create the need for government intervention.

2.1 Framework for Improving the Living Condition of the People

Based on the experience of many countries, it is recognized that poor and disadvantaged people usually lack assets and thus do not have easy and adequate access to formal credit because they lack the collateral needed to secure loans. Without having alternatives, the poor who are in need of financial assistance have to rely on other means of financing from informal sources.

Practically, there are three important ways that can help to improve the living conditions of the poor (Figure 1). First, the poor can rely on State welfare programs implemented by the government. However, this requires an unviable increase in government budget and definitely exacerbates the fiscal burden in the long run if there is no effective mechanism to make welfare sustainable. For Thailand, although a comprehensive welfare State scheme is increasingly necessary, the move toward the welfare State however should be gradual because it costs a great deal of money. Second, the poor may become paid employees in organizations such as large enterprises and SMEs, and enjoy regular income and predictable work patterns. The third alternative is for them to become entrepreneurs. However, starting up a new business is not an easy task. One needs some money for making the initial investment. Moreover, financing for a business start-up is not a one-shot deal in which one just provides an initial cash investment and then waits for the business to generate revenues.

Small entrepreneurs usually encounter at least three main obstacles, including inadequate financial support, entrepreneurship, and marketing. Lack of capital and financial support is often one of the most important hurdles for business start-ups and also a cause of future business failure. As mentioned previously, the presence of credit market imperfections and information asymmetry between financial institutions and aspiring entrepreneurs in particular blocks the entrepreneurs from gaining access to credit. Financial institutions normally refrain from providing loans to risky entrepreneurs or those who do not have sufficient collateral to qualify for a loan. Consequently, the inability of such people to gain access to credit facilities affects their investment, financing, and operating decisions.

For Thailand, Menkhoff et al. (2006) suggested that Thai commercial banks still put great weight on collateral in making loan approval decisions. Specifically, the banks usually ask for collateral from small and new start-up enterprises at a higher proportion than large enterprises. A high level of collateral therefore becomes a big obstacle for very small and start-up entrepreneurs. The literature on the start-up of Thai business enterprises suggests that one's own savings and savings from friends and family usually play an important role in financing the start-up of small entrepreneurs.[1]

Although the government recently initiated support programs to facilitate credit access by the people, especially the poor, it could not ensure that the people will really benefit from the opportunities offered by the government. De Meza (2002) provided a theoretical argument, i.e., that government intervention to subsidize credit and to encourage lending to SMEs may not be the best policy, and could somehow reduce efficiency. Furthermore, according to Ammar (1993), credit programs are useful and supportive in helping the poor escape from the condition of poverty only if they are able to engage in productive economic activities and have a market for their products.

In addition to the information asymmetry problem in the credit market, new entrepreneurs usually do not have adequate business experience. They usually have low educational and skill levels. As most of them are too busy with the day-to-day operations of the business, they do not formulate a plan in advance nor think about the development of better quality products and services. Equally important, in terms of transparency, they fail to keep proper accounting records that are important for checking and monitoring activities. The lack of distributional channels for products and services is another important issue. Without the markets, the entrepreneurs will not be able to survive in the long run and certainly cannot escape from the conditions of poverty.

Therefore, by removing all these obstacles, the entrepreneurs will become better at making investment decisions under changing market conditions. The development of the grass-roots economy will contribute to the overall economy in terms of income-generation and employment opportunities. Eventually, if the mechanisms run well, they should help to alleviate poverty among the poor and contribute greatly to economic development.

2.2 Governmental Financial Support Projects

Although the inception of Thailand's First National Economic Development Plan dates back to 1961, the main emphasis of the plan was placed on economic development and infrastructure development in particular, with the aim of accelerating the country's economic growth. It was not until the Fifth National Economic and Social Development Plan that the policy of rural poverty reduction became part of the government's development agenda. With respect to financial support programs, the Thai government has implemented several different measures to tackle poverty problems (Table 1).

Figure 1 Alternatives for Improving the Living Conditions of the Poor

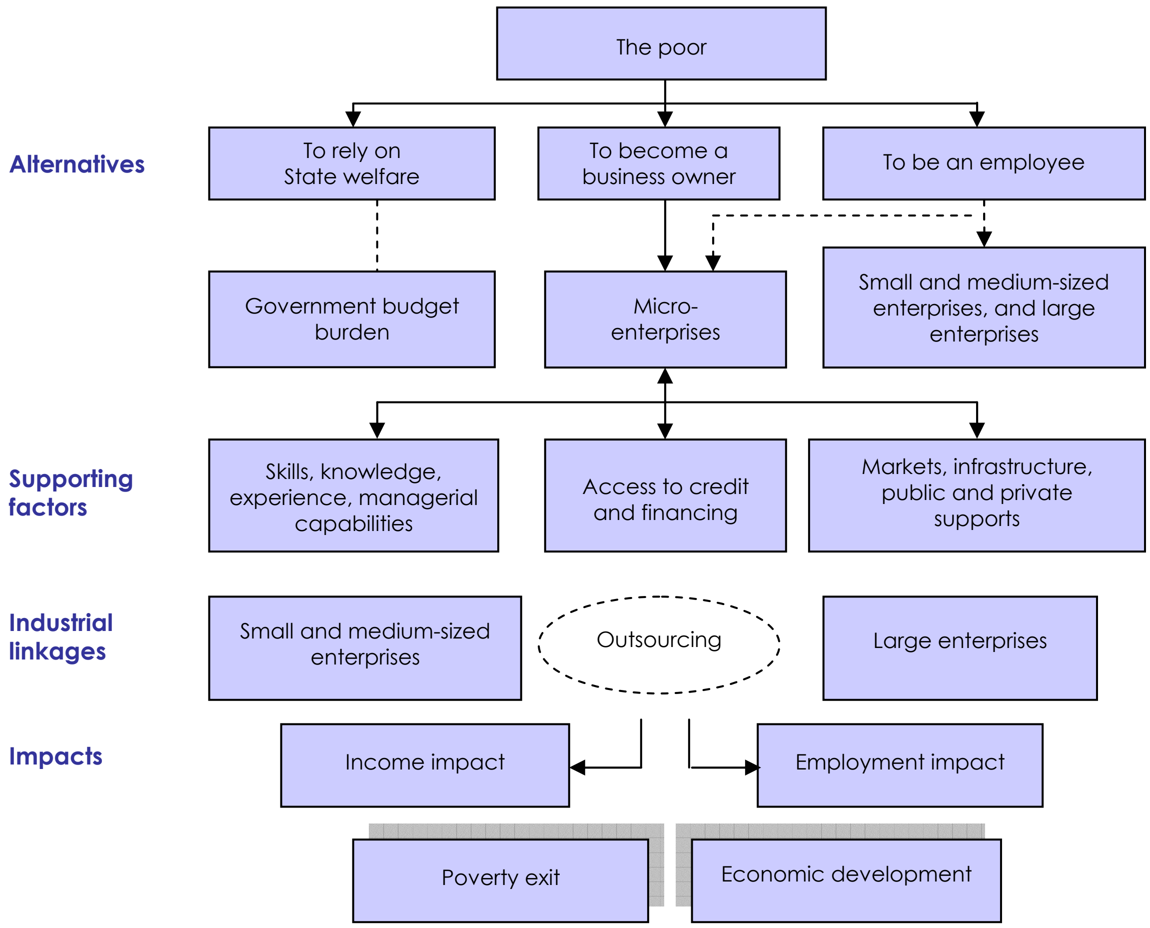

Table 1 Governmental Financial Support Programs

Year	Programs
1975	Money Distribution Program (*ngern phan*): Rural development and job-creation projects during the agricultural off-season period
1984	Rural Development Fund: Targeting villagers and activities within the villages
1992	Urban Community Development Fund: Addressing the urban poverty problem
1993	Poverty Alleviation Project: Raising income and the quality of life of the targeted poor households in more than 18,000 villages
1998	Social Investment Project: Creating job opportunities and providing social services for the unemployed and poor
1999-2000	Financial support under the “Miyazawa” scheme: Reducing the economic and social problems of the urban poor during the 1997 financial crisis
2001	Village and Urban Community Funds: Providing financial support to villages and urban communities, with the aim that the villagers will become self-reliant, have more employment opportunities, higher incomes and better social welfare
2001	Three-year debt moratorium/debt reduction for small farmers (April 1, 2001 – March 31, 2004): Solving the debt and poverty problems of small-scale farmers while offering training
2001	People’s Bank Project operated by the Government Savings Bank: Expanding financial opportunities for small-scale entrepreneurs and encouraging new business development and entrepreneurship

Source: Thailand Development Research Institute. “Poverty Alleviation Programs Implemented by the Thai Government: From Past to Present.” http://www.tdri.or.th/poverty. (in Thai)

The government assistance programs are different in terms of the size of budget allocation and coverage. Among many credit programs, the most prominent one is the Village and Urban Community Fund, which was initiated by the government under the sponsorship of the Thai Rak Thai Party. Under this scheme, a million baht is allocated to each village in the country as a revolving fund. Apparently, the government injected a comparatively large amount of money into the economy, at the grass-roots level in particular. Besides, the program gave wider coverage to the people in rural areas of the country. However, the populist policies initiated by the government have posed additional fiscal burdens on the country.

3. ASSESSMENT OF THE FINANCIAL SUPPORT PROGRAMS FOR POVERTY ALLEVIATION

During the time the Thaksin administration was in power there were a number of financial support programs initiated to alleviate the poverty of the Thai people. Since the private commercial banking system failed to operate well for people considered to be "risky," the Thai government decided to have its government-owned banks act as a special vehicle for financing and making available loans to support the poor and underserved population.

Based on the report of the household socio-economic survey, the overall results in Table 2 show that the village fund and debt moratorium programs were the first two schemes widely used by the people. For example, about 10.8 percent and 1.22 percent of the total population in 2004 gained access to the village fund and debt-suspension programs, respectively. This section focuses on these two widely used support programs. There are two issues to be discussed here: whether poor people actually gained access to these two financial support programs, and whether the financial opportunities offered by the government helped the people to improve their earning ability.

The government had often claimed that these support programs were designed to help reduce the poverty conditions of the underserved and poor people. To be effective, it is expected that the poor and under-served who benefit from the programs should constitute the largest portion over time, unless there are some leakages. Moreover, the programs should positively affect their livelihood (i.e., provide them with higher income). Table 2 shows that, in all the programs except for the people's bank scheme, there was an increasing percentage of the non-poor gaining benefits over time. Specifically, nearly 85 percent and 91 percent of the people who borrowed from the village fund in 2002 and 2006 respectively were non-poor, leaving only a small number of the poor who benefited from the program. Similar results are found for the debt suspension program.

Table 2 The Number and the Proportion of Thai People Who Benefit from the Governmental Financial Support Programs

Programs	2002			2004			2006		
	Non-poor	Poor	All	Non-poor	Poor	All	Non-poor	Poor	All
All	52,036,862	9,135,362	61,172,224	55,881,181	7,018,592	62,899,773	57,375,140	6,053,632	63,428,772
	(85.07)	(14.93)	(100.00)	(88.84)	(11.16)	(100.00)	(90.46)	(9.54)	(100.00)
Three-year debt moratorium*	1,014,240	202,782	1,217,022	679,162	85,826	764,988	-	-	-
	(83.34)	(16.66)	(100.00)	(88.78)	(11.22)	(100.00)	-	-	-
Other farmer assistance funds*	295,900	66,542	362,442	444,786	58,856	503,642	161,652	23,494	185,146
	(81.64)	(18.36)	(100.00)	(88.31)	(11.69)	(100.00)	(87.31)	(12.69)	(100.00)
Education loan program**	359,673	34,935	394,608	221,940	7,388	229,328	333,331	3,996	337,327
	(91.15)	(8.85)	(100.00)	(96.78)	(3.22)	(100.00)	(98.82)	(1.18)	(100.00)
People's bank**	119,496	4,733	124,229	64,299	935	65,234	230,268	18,758	249,026
	(96.19)	(3.81)	(100.00)	(98.57)	(1.43)	(100.00)	(92.47)	(7.53)	(100.00)
Village fund**	3,963,820	722,639	4,686,459	6,014,195	758,548	6,772,743	5,921,697	596,653	6,518,350
	(84.58)	(15.42)	(100.00)	(88.8)	(11.2)	(100.00)	(90.85)	(9.15)	(100.00)

Notes: The poor are those people whose consumption expenditures lie below the poverty line.
Figures in parenthesis indicate the percentage of the poor and non-poor in each program.
* The survey question relating to government benefits allowed each respondent to choose only one of the various programs.
** The survey question relating to credit facilities allowed each respondent to choose only one of the various programs.

Source: The Report of the Socio-economic Survey conducted by the National Statistical Office.

Even when we analyze the situation from another angle by comparing the ratio of the number of the poor in each program to the total number of the poor with the same ratio for the non-poor, we should find a higher ratio for the poor group to ensure that a particular program is bringing more opportunities to the poor. However, the result shows that the ratio for the poor group is smaller than the ratio for the non-poor groups as time passed. Thus, we cannot be sure that the programs are effective in reaching the poor. The design of programs could be an important obstacle. For example, based on the in-depth interviews with several members of the village fund committee, it was often found that nobody was willing to grant a loan or to make a personal guarantee on loans that poor people wanted to take out. Thus, the poor could not access the fund on equal terms as other people (TDRI 2007a).

3.1 Income Distribution

In order to analyze differences in wealth, data on per capita household income based on the Household Socio-economic Survey were used and divided into five quintiles. Inequality in income distribution is investigated by assessing the income share. The first and fifth quintiles refer to the poorest and the richest income groups respectively. Table 3 suggests that the proportion of people in the poorest income group is much higher than that of the richest group under both the village fund and debt suspension programs. Although the richest income group constitutes only a small portion, it is observed that the proportion of people that borrowed from the village fund increased somewhat, from 9.98 percent in 2002 to 11.73 percent and 11.12 percent in 2004 and 2006 respectively, while the proportion of people that received the debt suspension benefit also increased, from 7.13 percent in 2002 to 8.57 percent in 2004.

With respect to the village fund, the average monthly income increased over time for all income quintiles, with the richest persons experiencing the largest increase whereas the poorest persons found their income increased only slightly. This confirms that the poorest people might not benefit much from this program, but conversely the richest gained consistently. The income share of the wealthiest income group increased, from 50.38 percent in 2002 to 51.76 percent in 2006, while the income share of the poorest group declined, from 5.03 percent in 2002 to 4.38 percent in 2006 (Table 4).

Moreover, the average monthly income for the poorest group was just about one-tenth that of the richest group. In other words, the ratio of the mean income of the poorest group to that of the wealthiest group declined from 0.1 in 2002 to 0.08 in 2006. Similar results are observed for the debt suspension program, meaning that we still find an increase in average monthly income over time, a higher income share for the wealthiest income group, and a lower share for the poorest group (Table 5). In summary, regardless of whether it is the village fund or the debt suspension scheme, the overall results indicate that the income share of the top (richest) quintile increased at the expense of the poorer groups of people, suggesting a worsening in income distribution.

Table 3 The Proportion of People Who Benefited from the Village Fund and Debt Moratorium Programs, Classified by Income Quintile (%)

Income level	Village fund			Debt moratorium/debt reduction	
	2002	2004	2006	2002	2004
1st quintile (poorest)	22.10	21.44	23.51	26.49	23.12
2nd quintile	25.23	24.22	24.65	26.79	27.23
3rd quintile	24.05	23.74	23.21	22.72	24.55
4th quintile	18.64	18.87	17.51	16.88	16.52
5th quintile (richest)	9.98	11.73	11.12	7.13	8.57
All	100.00	100.00	100.00	100.00	100.00

Source: Author's calculations, based on the Report of the Household Socio-economic Survey conducted by the National Statistical Office.

Table 4 Average Monthly Income per Capita and Income Share Classified by Income Quintile (Village Fund)

Income level	Average monthly income (baht)			Income share (%)		
	2002	2004	2006	2002	2004	2006
1st quintile (poorest)	857	1,002	1,028	5.03	5.10	4.38
2nd quintile	1,492	1,740	2,003	8.76	8.86	8.53
3rd quintile	2,329	2,682	3,151	13.67	13.66	13.41
4th quintile	3,777	4,285	5,150	22.16	21.81	21.92
5th quintile (richest)	8,586	9,934	12,160	50.38	50.57	51.76
All	2,687	3,247	3,721	100.00	100.00	100.00
Ratio (poorest/richest)	0.10	0.10	0.08			

Source: Author's calculations, based on the Report of the Household Socio-economic Survey conducted by the National Statistical Office.

Table 5 Average Monthly Income per Capita and Income Share Classified by Income Quintile (three-year debt moratorium/debt reduction for small-scale farmers)

Income level	Average monthly income (baht)		Income share (%)	
	2002	2004	2002	2004
1st quintile (poorest)	859	1,009	5.14	4.62
2nd quintile	1,478	1,719	8.83	7.86
3rd quintile	2,362	2,697	14.12	12.33
4th quintile	3,778	4,186	22.58	19.14
5th quintile (richest)	8,255	12,258	49.34	56.05
All	2,386	3,106	100.00	100.00
Ratio (poorest/richest)	0.10	0.08		

Source: Author's calculations, based on the Report of the Household Socio-economic Survey conducted by the National Statistical Office.

3.2 Impacts on Incomes and Expenses

Using the data based on the Household Socio-economic Survey only for those households that were surveyed in 2002 and 2004, this paper takes a step further to analyze the growth rate of real incomes and expenses in various sub-groups. The data are clustered into different groups by the dimensions of time and type of support schemes, such as the people who relied solely on the village fund in 2002 and 2004, those who gained access to both the village fund and the debt moratorium programs in both years, and those who had never used any of these financial support schemes, etc. The study starts with an analysis for each individual program. However, the village fund and debt suspension programs are not mutually exclusive when used in practice, for instance a small-scale agricultural household can ask for debt suspension, and at the same time apply for village fund loan. The study is therefore followed by the investigation of income and expenditure growth by combining the two events (Table 6).

With respect to the overall borrowers from the village fund, those who borrowed money from the village fund program in both years had an average inflation-adjusted growth rate of their incomes that was higher than that of their expenses. However, in the poor income group, it happens that the real growth rate of incomes and expenses is many times higher than that of the non-poor group. Also, the poor enjoyed a rise in income at a rate higher than a rise in expenses. In the case of the debt suspension scheme, no matter whether the farmers were poor or not, those who left the program before it ended in 2004 on average experienced a larger real income growth rate compared with the growth rate in expenses. It is also noted in the rights of participants that those who leave the program and repay their debt completely within the designated period will further benefit by being rated higher so that they could move up to a higher-rated group. Somsak (2004) also shows that the farmers in the program made smaller investments than those who did not apply for debt suspension. This occurred probably because they could not apply for additional loans from the Bank for Agriculture and Agricultural Cooperatives (BAAC).

Table 6 Real Income and Expenditure Growth of the Poor and Non-poor (% per annum)

	Poor		Non-poor		All	
	Income	Expense	Income	Expense	Income	Expense
Village fund (all) :	20.93	20.89	1.95	3.40	3.55	4.89
- Records in both years	20.99	20.35	3.43	3.38	4.89	4.71
- Records in either year	22.27	22.00	0.17	3.26	1.95	4.88
Not borrow from village fund	15.05	22.52	2.41	4.19	3.47	5.77
Debt moratorium (all) :	18.39	22.17	2.15	3.89	3.44	5.38
- Records in both years	19.31	26.74	-5.18	3.51	-2.82	6.15
- Records in either year	21.20	17.08	3.57	1.69	5.46	3.28
Not apply for benefits	21.61	21.20	1.81	3.32	3.44	4.79
Village fund & moratorium – both	14.15	33.16	-7.16	4.03	-5.98	5.85
Village fund & moratorium – either	7.63	5.62	3.08	1.66	3.67	2.15
Only village fund – both years	17.98	19.96	4.59	3.61	5.70	4.89
Only debt moratorium – both years	28.88	17.92	5.54	14.50	12.69	15.67
Others	23.57	22.10	0.46	3.18	2.36	4.80
Not apply for benefits from both	15.45	23.12	2.25	4.12	3.31	5.69

Source: Author's calculations, based on the Report of the Household Socio-economic Survey conducted by the National Statistical Office (only for the same households that were surveyed in 2002 and 2004).

Furthermore, it happened that the farmers who took on multiple obligations by borrowing from the village fund inevitably had their debt obligations with the BAAC suspended for two years and they experienced a sharp decline in their real income but an increase in their total expenditures, which might be due to a careless spending behavior. However, for those who relied only on the village fund loans, without having their debt suspended, their real income increased at a relatively higher rate than the growth rate of their expenditures.

Overall, the government should be careful in implementing these financial support programs because doing so might adversely affect the effectiveness of the programs as people may gain access to several support schemes and might start borrowing money from one source to repay an existing loan. This is troublesome, especially for the programs serving people who lack financial discipline or do not know how to use money for more productive activities.

4. CONCLUSION AND RECOMMENDATIONS

Although the government has good intentions in implementing several financial support programs to reduce conditions of poverty among the people, it appears that the vast majority of the poor still could not enjoy the benefits offered by the government while the proportion of non-poor people who participated in the programs increased over time. The data also exhibit a worsening in income distribution between people in different income categories. With worsening inequality, the poverty-reducing impacts of the programs may be reduced. With regard to the impacts on incomes and expenses, the borrowers with multiple debt obligations, on average, experienced unfavorable financial conditions, i.e., negative income growth but positive expenditure growth. This suggests that the behavior toward multiple debt obligations should be carefully considered. Overall, although the governmental financial support programs may be successful in terms of meeting their implementation targets, the ultimate objective toward poverty reduction however has not yet been fulfilled. There are still some challenges of which policymakers and implementors should be aware and make some improvement to the on-going programs so that poverty reduction objectives could be achieved more effectively:

a) To widen the coverage of vulnerable groups which include the poor and the people in the low-income bracket while minimizing leakage to the non-poor.

b) To redesign the program by formulating clear guidelines and regulations about the use of loans to avoid the intentional use of loans for the wrong purposes.

c) To enhance the borrowers' capacity so that they are able to engage in more productive economic activities.

d) To develop alternatives to the formal banking system by incorporating the advantages of semi-informal and informal practices.

e) To improve the financial discipline of the poor and underserved people so that they would be able to access formal credit channels.

f) To develop effective mechanisms that make welfare sustainable instead of just emphasizing the populist policies that are not sustainable in the long term.

ENDNOTE

[1] See Paulson and Townsend (2004) and TDRI (2007b) for a survey of Thai micro-enterprises undertaken in September 2007.

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