

Case analysis (please read before coming to class).

With reference to the attached article “Thai Loan Project Benefits Villages But Create Rifts” (see attached), please prepare answers to the following questions:

1. What are – or what *should be* – the objectives of the project? Is there any contradiction or tension between the various goals?
2. Whose support is essential for the project to succeed? Do they have different interests?
3. What capacities are necessary to implement the program well? At present, are those capacities sufficiently present in the system?

**Please be prepared to discuss your response during class.**

## **Thai Loan Project Benefits Villages But Creates Rifts**

By Richard Borsuk and Montira Narkvichien

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NONG BUA, Thailand -- In this impoverished patch of northeast Thailand, Soonthorn Nankam is helping carry out one of the world's biggest experiments in fiscal stimulus.

Early this year, Mr. Soonthorn obtained a loan of about \$470, financed by the Thai government, to upgrade his rudimentary motorcycle-repair shop. With that money, he bought a new battery charger, tools and a cupboard full of parts. Mr. Soonthorn says his income has soared as a result.

Lert Honkravit, however, isn't taking part in this experiment in mass lending. The farmer's application for a loan in nearby Laonokchum village failed, and so he couldn't expand his mushroom crop. The experience has left him bitter and convinced that the committee in his village that decided who gets money is "biased against the very poor."

Across the rest of rural Thailand, an ambitious plan to put cash directly into the hands of villagers -- the brainchild of Prime Minister Thaksin Shinawatra -- is creating a similar division among haves and have-nots.

With no pilot project nor partnership with development agencies, Mr. Thaksin set out to show that giving cash to the country's 74,881 villages can get rural Thailand "on its feet again," spark a consumption boom and cut the country's dependence on foreign investment as its growth engine. The idea: each village gets a million baht (\$23,691) to lend out; borrowers are supposed to repay their local lending committee, with interest, to create a growing pool that others can tap later. Since late last year, 59.3 billion baht has been lent out.

The stakes of the experiment are high for Mr. Thaksin and his populist bid to propel Thailand, where the Asian economic crisis began, to grow more by boosting domestic demand than by luring foreign capital. It won't be clear if the fund is a boon or boondoggle until next year, when the loans are due. But already, some criticize the fund as an expensive ploy to boost Mr. Thaksin's popularity at a time when Thailand is financially strapped.

Meanwhile, outsiders are watching to see if Thailand's Village Development Fund might offer an alternative model for giving microcredits on a mass scale. So-called microlending has drawn the attention of development experts in recent years, some of whom have argued that rural people, who often remain in poverty because they can't get affordable loans, make good credit risks. Grameen Bank in Bangladesh has drawn particular notice for its success in making microloans.

While Grameen has focused on making collective loans to groups of women whose income was below a poverty line, the Thai project makes loans to individuals. It also imposes no maximum-income level for loan recipients. In fact, the Thai government has fixed only a few guidelines as to how the plan should be administered, and has left the rest to villages.

That hands-off approach is unusual in a centralized political system where Bangkok has big clout, but it raises concerns about how well the aid is being used, and by whom.

"Letting the people themselves manage is a good principle," says Paiboon Wattanasiritham, a former Stock Exchange of Thailand president who runs a coalition of nongovernment community groups. But untrained village managers, he adds, face "a large and complex set of issues."

Village committees decide, for instance, what interest rates to charge on their loans, and how they are to be repaid -- in one lump sum or in installments. Committee members are free to extend loans to themselves, and even to award themselves bonuses for their work from interest earned on the loans they make. And in theory, they will continue this activity indefinitely, because repaid loans and earned interest is then used to fund new loans down the road. The result is that, more or less overnight, each village has become a finance company run by untrained financiers.

This lack of training worries even proponents of the program. "Villagers don't have a clue about microeconomic administration," says Anek Nakabutara, a member of the fund's national board, who criticizes government officials for starting the program without sufficient preparations.

Many villagers appear to be using their loans simply to repay costlier debt to moneylenders rather than to start or expand businesses. Most villagers can't borrow from banks and are often in debt to shopkeepers and other moneylenders, whose loans sometimes carry interest of more than 100% a year. Village committees generally charge between 3% and 7.5% a year (Most microcredit projects charge more than 10%, saying it is essential to cover their costs and sustain the program.)

Helping rural Thai borrowers swap into cheaper loans isn't economically productive, critics say, but the national guidelines allow it. "What you can't do is borrow to buy gold or a necklace," says Supot Arevart, a member of the fund's Bangkok secretariat. The Thai media have reported cases of borrowers buying motorbikes and cellular phones.

Repayment is another issue. Around the world, microcredit programs often report very high repayment rates -- but it can be hard for programs to sustain them. In December, The Asian Wall Street Journal reported that default rates at Grameen Bank were about 10%, or double the rate the Bangladesh group stated on its Web site.

The Thai program hasn't set a repayment target. Education Minister Suwit Khunkitti, the project chairman, contends the repayment rate will be "much, much higher" than 50%. Some Thai economists say they believe far fewer than half of borrowers will pay on time.

A key concern is that money isn't reaching the "poorest of the poor" who didn't get elected to committees and won't be judged bankable. In Mr. Lert's village, headman Mai Dankammee says committee members "cut the big piece of cake for themselves."

"Politically motivated massive microcredit schemes generally end up as disasters," says David Gibbons, a Malaysia expert on microfinance. Politicians usually "aren't all that serious about repayment, and a lot of the loans are captured by local elites," he adds.

On the other hand, this project appears to be successful in one respect. Villages have been given both money and authority to disburse it, rather than one or neither. "We heard the name of past [aid] funds, but we never saw the money," says Tongmuan Tanonghee, headman in Phue, about 450 kilometers northeast of Bangkok. Villages account for most of the country's 62 million people but only a tiny fraction of national wealth.

In the Thaksin program, villages get the money after electing a committee of nine to 15 adults that fixes the interest rate, sets the criteria borrowers should meet, acts on loan applications and eventually collects repayments. Aspiring borrowers must say how they will use the money "productively" and name two guarantors. Loans of as much as 20,000 baht require majority approval, while loans of between 20,000 baht and 50,000 baht need a village's unanimous consent.

It isn't clear what will happen to borrowers who can't or don't repay their loans, and their guarantors. Thai officials say they will take legal action against bad borrowers, but others are doubtful the committees or the government can seriously chase debtors. Mr. Suwit, the education minister, says he is confident payments will be on time as villagers are "very careful with their image." But even in a village where the project is going smoothly -- Nong Bua, where Mr. Soonthorn repairs motorcycles -- committee members say some borrowers will need more time to pay if bad weather hurts the extra crops they have planted.

The committee in Nong Bua, 10 kilometers from the provincial capital of Khon Kaen, gave loans with 3% interest to 76 people who met its criteria (which include being a "good person in society"). Prasop Saengsutthi, a committee member and teacher, says she and most committee members didn't seek money. Committee work is volunteer, though Ms. Prasop says her group hopes to give itself a bonus from the interest when loans are paid.

Ms. Prasop says the committee can ensure borrowers generally use loans as promised. "I'm the checker," she declares. "We're in the same village. I can see if the extra corn has been planted."

At Mr. Soonthorn's shop, new equipment bought with his 20,000 baht loan have allowed him to expand. The result is that more bikes come to him rather than ride into the provincial capital. "Before, I earned about 100 baht a day, and now it's 300," Mr. Soonthorn says. Extra work means he sometimes hires one or two day laborers -- thus further spreading the loan's economic benefits.

Other residents have used loans to buy pumps for irrigation, higher-quality cotton for weaving textiles and plastic containers for chili sauce previously sold in bags. Ms. Prasop believes these ventures will generate enough demand so borrowers can repay. The project's only weakness is the one-year payback, she says, which is too short for some agricultural pursuits such as raising cows.

Things haven't gone so well in Laonukchum, where Mr. Lert the farmer is angry and without a loan.

Friction inside the committee over who should get how much money meant meetings that lasted until midnight produced no decisions -- except for the group's unanimous move to quit en masse. It took 45 days to elect a new committee. "Nobody wanted to be on it," says the current treasurer, Sawai Wannoi. "These are hot seats."

The new group eventually approved loans with 6% interest. Among the first group of families getting money were those of all 12 committee members -- including Ms. Sawai, whose family has businesses selling noodles, groceries and bottled cooking-gas. She borrowed 20,000 baht to buy two cows and a sprinkler to water mint leaves.

She says Mr. Lert didn't get a loan because he didn't comply with requirements to apply in writing and to have guarantors. Ms. Sawai shrugs off flak from Mr. Lert and the headman, Mr. Mai. "Even when criticism is storming, I just ignore it," she says.

In Bangkok, project chairman Mr. Suvit doesn't let criticism alter his view that the fund is a "learning process" that is going well.

In Laonokchum, Ms. Sawai is less sanguine, despite being one of the fund's beneficiaries. After the million baht came to her community, she says, "I see a better flow of money and more unhappiness."