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Over-indebtedness and its persistence in rural households in Thailand and Vietnam

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A B S T R A C T

This study analyzes the determinants of household over-indebtedness and its persistence for rural household borrowers in Thailand and Vietnam. A household is considered to be over-indebted if it is in default or arrears on a loan or if its ratio of debt service to income exceeds 50 percent. The persistence of over-indebtedness was tested using a Heckman random effects dynamic probit model controlling for the effect of household demographic, socioeconomic, and behavioral characteristics. For Thailand, but not for Vietnam, past experience of over-indebtedness increases the probability of being over-indebted in the present, controlling for other household characteristics. Village support systems in Vietnam may be more effective in delivering households out of over-indebtedness than in Thailand where heavy debt burdens are taken more for granted. Household characteristics that significantly increase the probability of over-indebtedness include poverty, household size, low education, overly optimistic forecasting of income, and a sense of being less well off than other villagers.

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1. Introduction

Financial debt is a major problem for poor households in developing countries. Many countries, including Nicaragua, Morocco, Pakistan, and India, have experienced financial crises in connection with the rapid expansion of microfinance (Chen et al., 2010; Lascelles & Mendelson, 2012). These crises have been marked by widespread over-indebtedness, rapid growth in defaults, and in India, even default-related suicides (Bateman & Chang, 2012; Chen et al., 2010; Lützenkirchen & Weistroffer, 2012).

Research on micro-borrower over-indebtedness in Ghana (Schicks, 2013a, 2013b), Cambodia (Liv, 2013), Thailand (Siripanyawat, Sawangngoenyuang, & Thungkasemvathana, 2010), and Bangladesh (Khandker, Faruqee, & Samad, 2013) has shown that poor households often borrow large amounts relative to their incomes. For the poor, over-indebtedness usually co-exists with economic and social exclusion and a high incidence of poverty (Bateman & Chang, 2012; Schicks, 2013a, 2013b). Thus, understanding the factors that can lead to over-indebtedness is important for designing better micro-credit policies in developing countries.

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This study contributes in a number of ways to an understanding of rural household over-indebtedness in Thailand and Vietnam. First, we discuss the definition of over-indebtedness and identify two dummy variable indicators for use in this study. The "default" indicator takes on a value of one when a household experiences a default or an arrear on a loan commitment. The "debt service" indicator takes on a value of one when a household's ratio of debt service to income exceeds 50 percent. We measure the extent of household over-indebtedness in both countries based on these indicators. Second, we analyze the influence of demographic and economic characteristics on the probability of over-indebtedness. Third, we analyze behavioral biases that cause households to make suboptimal and unsustainable borrowing decisions. And fourth, exploiting the panel nature of our unique dataset, we analyze the persistence of over-indebtedness.

We make use of a balanced panel of nearly 1600 rural households from one province in Thailand (Ubon Ratchathani) and one in Vietnam (Thua Thien-Hue) for four survey waves in 2007, 2008, 2010, and 2011. We apply Heckman's random effects dynamic probit model (Stewart, 2007; Stewart, 2006) to estimate the probability of a household experiencing over-indebtedness as a function of household characteristics.

We find that for Thailand the evidence supports true state dependence for over-indebtedness such that being over-indebted in the current period is significantly related to being over-indebted in the previous period even when other observed and unobserved household characteristics are controlled for. This is not so for Vietnam, where the persistence of over-indebtedness is explained by observed and unobserved household heterogeneity without significant influence of prior over-indebtedness. Vietnamese households may be less prone than Thai households to becoming mired in over-indebtedness once they fall into such a state due to better community support systems that facilitate recovery from debt problems.

We further find that in both countries, over-indebtedness shows a strong negative association with income, households in the bottom quintile being more likely to exceed the 50 percent debt-service-to-income threshold than those in the top quintile by 37 percentage points in Thailand and 25 percentage points in Vietnam. Demographic factors associated with over-indebtedness in both countries include household size and the head of household being middle aged and poorly educated. Psychological factors associated with over-indebtedness include overly optimistic forecasting of income and a sense of being less well off than other villagers. A number of other factors are found to be significant only in one country or the other.

The remainder of the paper is organized as follows. Section 2 presents information on rural credit markets in Thailand and Vietnam. Section 3 discusses definition and measurement of over-indebtedness and reviews relevant theories of household borrowing behavior. Sections 4 and 5 discuss the data and present descriptive statistics on the incidence and extent of household over-indebtedness and its persistence. Section 6 lays out the econometric framework. Section 7 presents model results, while Section 8 contains robustness checks. Finally, Section 9 concludes.

2. Rural credit markets in Thailand and Vietnam

During the past two decades, Thailand and Vietnam have achieved high economic growth and impressive reductions in poverty. In part, this is attributable to the development of rural microcredit markets to facilitate investment in agriculture and small businesses. To provide the rural poor with access to affordable credit, both Thailand and Vietnam have established specialized financial institutions and credit programs. In Thailand, the most notable microfinance institutions are the Bank for Agriculture and Agricultural Cooperatives (BAAC) and the Village Fund (VF). In Vietnam, they are the Vietnam Bank for Social Policy (VBSP) and the Vietnam Bank for Agriculture and Rural Development (VBARD). Other semi-formal and informal microfinance institutions also exist, similar to those found in most developing countries (King, 2008; Menkhoff, Neuberger, & Rungruxsirivorn, 2012). Beyond this, governments in both countries have introduced state-run or government regulated financial institutions to facilitate growth of larger rural enterprises that are more sophisticated, innovation-driven, and technology intensive (Bateman, 2013; Bateman & Chang, 2012).

The financial systems of Thailand and Vietnam are similar in the level of government involvement and the enforcement of regulation. However, the countries differ in financial depth, credit outreach, and the range of credit programs introduced in rural areas. While the Thai government began to support homegrown non-bank financial institutions and develop the BAAC in the mid-1970s (Menkhoff & Rungruxsirivorn, 2011; Menkhoff & Suwanaporn, 2007), Vietnam's establishment of the VBARD and VBSP did not occur until the early 1990s (Dufhues, Heidhues, & Buchenrieder, 2004).

The Thai institutions have enhanced household access to financial services, especially in non-municipal areas. However, some argue that government facilitation of borrowing in Thailand has shifted the attitudes of poor households toward indebtedness. Siripanyawat et al. (2010) argue that some households have come to perceive being indebted as a norm and regard not paying back their loans on time as acceptable since the money came from the government. Consistent with this, Kaboski and Townsend (2011) found that instead of investing in income generating activities in response to the introduction of the "million baht village fund", households increased their borrowing and consumption almost equally. These authors further found that, compared to a direct transfer program, a large-scale microfinance program is less beneficial for some households due to the enduring burden of debt service.

Vietnam is a lower income country with a shorter history of rural credit development. It also differs from Thailand in being a country that has transitioned from socialism with strong rural community organization thus evolving from very different origins. Rural financial institutions rely heavily on customary norms and peer pressure in rural communities to encourage loan repayment. The whole village participates in social activities together and takes on a role in loan monitoring,

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