

## THE IMPORTANT ROLE OF RURAL CREDIT DURING THE GLOBAL FINANCIAL AND ECONOMIC CRISIS IN CAMBODIA

LUN Pidé<sup>1</sup>

There is a flourishing literature suggesting that the rural credit market plays a major role in times of crisis (Udry 1994; Besley 1995). In theory and practice, rural people use credit not only for livelihood investment but also for weathering shocks such as natural disasters and family deaths and sickness, as well as addressing consumption shortages due to reduced income.

This brief informs policy makers of the important role of rural credit in Cambodia during the global financial and economic crisis. The paper briefly reviews rural credit in Cambodia specifically during 2008, analyses rural households' formal and informal credit demand during the crisis and proposes policy options.

### THE RURAL CREDIT MARKET DURING THE GFEC

Shocks to credit markets can be discussed in two scenarios. First, shocks often drive farmers to default, causing lenders to tighten or cease lending. Therefore, credit supply declines. On the other hand, shocks may not affect credit supply if lenders' loan portfolios are diversified, i.e. spread across sectors not affected by the shocks. However, after such a widespread shock as the GFEC, which affects everyone, credit may have been limited despite loan diversification.

In Cambodia, despite the global financial and economic crisis, the supply of rural credit increased. Data on outstanding loans of micro-finance institutions (MFIs) reveal that between 2008 and 2009, the outstanding loan amount increased

Table 1: Cambodian MFIs' Outstanding Loans

Outstanding loans	2007	2008	2009
Amount in million USD	272.00	277.06	299.30
Number of borrowers	777,481	825,238	878,559

Source: CMA 2008 and CMA 2009

by about 8 percent and the number of borrowers jumped by 6.5 percent (Table 1). Nevertheless, in the aftermath of the crisis the portfolio at risk ratio and the number of multiple loans rose substantially (CMA 2008, 2009). To cope with the income shock, already indebted households sought further loans from other sources thus, accumulating several loans and increasing the risk of default (*ibid*).

These data partly suggest that rural credit markets in Cambodia do help during crisis. It is also noteworthy that the continued credit supply in Cambodia was due to the government inducing bank lending in order to encourage investment and support growth.

### RURAL HOUSEHOLD DEMAND FOR CREDIT DURING THE GFEC

Rural households seek credit from both formal and informal sources. Informal sources refer to two groups: relatives, friends or neighbours, and private moneylenders. The former often charge no or minimal interest while loans from the latter generally carry higher interest rates. Formal sources include banks, MFIs and NGOs.

There is evidence that during the crisis in 2008, Cambodian households incurred more debt. Faced with declining income, people borrowed more from MFIs, private moneylenders and social networks (Jalilian *et al.* 2009). Theng and Kem

<sup>1</sup> Lun Pidé is a research associate for Economy, Trade and Regional Cooperation Programme at CDRI.

(2009) suggest that the number of MFI borrowers increased by as much as 50 percent during the first half of 2009.

Lun (forthcoming) in his empirical study of role of rural credit during the GFEC reveals the following. First, the crisis increased the probability of households borrowing more. Second, self-reported income shocks—arguably partly a product of the crisis—also have a positive relationship with the probability of households borrowing more.

The paper also finds that the crisis induced households to borrow more both formally and informally, but the effects on formal loans were bigger. This suggests that formal credit such as MFI loans was even more important during the crisis period. The data on the number of outstanding MFI-sourced loans during the crisis, which was higher than in the pre-crisis period, verify this claim.

Interestingly, during the crisis, credits were used by rural households not for food consumption but for farm investment and debt repayment. In practice, households not only need to ensure that their income covers daily consumption but must also allocate some of their income for farm investment to secure future consumption. They also have to use some income to repay debts. While credit allows households to cope with crisis, severe indebtedness does have an implication for poverty.

## POLICY OPTIONS

The study findings can contribute to policy interventions in Cambodia. Below are some areas to consider.

- As formal credit is important in rural settings at times of crisis, expanding the outreach of formal credit should be a focus.
- Rural credit should be geared towards agriculture, upon which the majority of the rural population heavily depend.
- Social insurance schemes need to include micro-credit programmes that aim directly at the poor and vulnerable groups and do not require collateral. Cambodia has performed

well in that area, and this needs to be continued and expanded.

- Subsidised credit programmes should be avoided in efforts to expand access to rural credit. The success of credit programmes lies in a coherent system of incentives as well as strong enforcement procedures.
- Expanding alternative sources of credit should be the way to drive down high interest rates charged by private moneylenders. New suppliers need to address information problems, which are often a factor prohibiting entry.

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