Economics Seminar, Indian Statistical Institute, New Delhi.

SPEAKER: Sankar De, Shiv Nadar University

TITLE: **Borrowing Culture and Debt Relief: Evidence from a Policy Experiment.**

TIME: 11:30 AM - 01:00 PM

DAY & DATE: Friday, 11th October, 2013

PLACE: Seminar Room 2

Abstract:

Using a model as well as extensive empirical tests, the present paper investigates the effects of a large-scale debt relief program on the post-waiver debt repayment behavior of borrowers in a rural credit market where the farmers borrow from banks at a subsidized rate and from informal sources at a substantially higher rate, debt contract enforcement is imperfect, and political interventions in the credit market in the form of debt relief can happen even in normal states of the economy. Our model includes all classes of borrowers: those who receive full debt relief, those who receive partial debt relief, and those who do not benefit at all from the program as they do not have overdue loans. The effects are negative for all groups. Following a debt relief program, the number of days taken to repay debt increases for all borrowers who behave strategically, causing ex post inefficiency in the credit market. Interestingly, the effects are the most negative for the group that do not benefit at all. Expectations about similar debt relief in future coupled with extensions on loan repayment granted by bankers who find debt recovery difficult drive our results. Further, rationally anticipating adverse borrower behavior, the lending institutions ration credit, generating ex ante inefficiency as well. Ironically, access to finance for poor households declines following unconditional debt relief. We confirm the predictions of the model with extensive tests using loan accounts data for a large sample of rural borrowers before and after a nation-wide debt relief program undertaken by the Indian government in 2008, one of the largest such programs in history.

Keywords: bank credit; borrowing culture; debt relief; credit market interventions.

JEL Classifications: G21, O2, Q14

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