

Borrowing Culture and Debt Relief: Evidence from a Policy Experiment

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20 December 2013

This paper

- Investigates the effects of the *Debt Relief and Debt Waiver Scheme for Small and Marginal Farmers, 2008* on
 - Debt repayment culture of the borrowers: full waiver recipients (small and marginal farmers), partial waiver recipients (big farmers), and no waiver recipients (middle farmers)
 - Lending practices of the creditors
- Finds that the number of days taken to repay debt increases for all borrowers in the post-waiver period
- The effects are most negative for the no-waiver recipients
- Rationalises the result by saying that this group enjoys the longest extension granted by the creditors due to their credit records.
- This is interpreted as pervasive deterioration of loan repayment culture

The sequence of events

- Loans are overdue at t_1 .
- All these loans are waived off.
- Bank has to give new loans, even if the borrower is a defaulter at t_1 .
- Bank changes the terms of contract - allows a larger grace period (n more than m) for those who were not in default at t_1 .
- Loans are due at t_2 , but everyone can take upto the grace period allowed.
- If loans overdue after $t_2 + n(m)$, then bank can withdraw credit.

The two decision makers

■ Bank

- How many days grace period?
- Whether to give the next loan? How many days grace period for this loan? Does it depend on when the previous loan (but after the debt waiver) was repaid?
- Test whether borrower profile changed?

■ Borrower

- How much time to wait to see if a new debt waiver is announced? Repay just before the end of the grace period? How does that impact the grace period for the next loan?
- If not paid after the m (or n) days, then it makes sense to not repay at all, in the hope that a waiver will be announced at some point.
- Test if the data shows a m or a n threshold for both groups.

How independent is the bank?

- Cole (2009) suggests:
 - Greater lending closer to election years
 - Politicians reward their supporters immediately following elections by causing banks to write off loans to borrowers in constituencies in which politicians enjoyed the greatest support.
- If the bank threat of withholding the next loan is not credible, then the borrower has a different set of incentives to default
- The data-set (2005-2012) does include an election year (2009), and may induce a change in expectation of a debt-waiver.
- The expectation of a debt-waiver may also change the risk profile of investments - if the data shows the purpose of the loan, this could be used.

Definition of deterioration of credit?

- The lender has given a grace period of n days to the no-waiver group, larger than the m days given to the waiver group.
- If $m < n$, then the results might be reflecting the decision to repay just before the grace period runs out.
- Does this constitute deterioration of credit culture? It is by design.

The cost of waiting to see if there is a waiver

- The model shows that the pay-off for the Default - No waiver - Repay tree is V_{bi} , which is the same as the payoff for the No default tree (regardless of the waiver).
- There is a cost to waiting for the waiver. Not sure it is adequately reflected in the model.

Some clarity on waivers

Date loan taken (Date loan due)	Days overdue as of 31 December 2007	Total days overdue
1-Dec-2006 (31-Oct-2007)	60 days	120 days
1 Jan-2007 (31-Nov-2007)	30 days	90 days
1-Feb-2007 (31-Dec-2007)	1 day	61 days
2-Feb-2007 (1-Jan-2008)	0 days	

- Debt overhang will affect different farmers differently
- Uncomfortable with the assumption that all farmers are strengthened by the debt write-off and will achieve a higher productivity in the post-waiver period
- If loan dates, and days overdue are available, can be used to differentiate between repayment of farmers in the post debt-waiver period who just managed to get the waiver (or not).

The dependent variable

- The dependent variable is the number of days a loan remains outstanding.
- Censoring of data for those farmers who have not repaid till the end of the data-set.
- Useful to see loan repayment statistics as well.

Comparing all loans after waiver

- The second and third loan after waiver may be endogenous to the repayment of the first loan after the waiver
- The bank can decide to not extend a new loan: this needs to be accounted for in the regressions. The later regressions do show a differential rejection rate for waiver and no-waiver farmers. So this is an important issue.
- The bank can also change t_2 , m and n , and if these are driving the results, then default is even harder to define.
- The number of new loan accounts after the waiver - this may reflect that the pool has changed considerably.

Use of the panel data

- Use panel data models to also control for individual heterogeneity
- Condition results on the probability of being offered a loan post the waiver, and offered subsequent loans post each loan cycle.

Conclusion

- Very important topic
- A long data-set with years before and after the debt waiver
- Not fully persuaded by the empirical work
- Focus more on selection effects: who is getting the loan?