The Financial Express

Changing social norms and repayment culture

Abdul Bayes | Saturday, 23 November 2019

S. R. Osmani, an eminent Professor of Development Economics at Ulster University, UK, published an interesting and insightful paper about changing social norms and the culture of repayment of credit in rural Bangladesh (The Bangladesh Development Studies, 2016, Numbers 3 and 4). While an avalanche of research issues is documented, Osmani's one seems to drive to a new dimension, hitherto unaddressed, in the discourse on microcredit.

The paper observed an apparent conundrum in the microcredit sector of Bangladesh implying that exceptionally high rate of repayment of loans went hand in hand with declining or relaxing of many disciplinary and incentive devices deployed by the MFIs in the initial years of their operations. In other words, the rigour with which MFIs apply the combination of 'sticks' and 'carrots' has indeed become diluted over time and that dilution hardly damaged the loan repayment rate.

The important questions that the author sought to answer in his paper is: was the earlier regime of providing carrot and stick necessary? And if it was necessary, then how could repayment rates reign high despite dilution of erstwhile practices of incentives and discipline? Readers may be reminded that MFIs in their early years of functioning, imposed upon some devices - such as group lending, joint liability, peer pressure, peer support, weekly instalments etc.- with a view to retaining the culture of repayment of borrowers. One can also argue that the motives behind the devices were to get rid of the problems of adverse selection, enforcement and moral hazard that are assumed to be inherently ingrained in the credit market due to asymmetric information, However, as time elapsed, some of those restrictions were relaxed or replaced to pave ways for new delivery modes.

In an investigation of the question posed above, the author argues that the incentives and disciplinary actions orchestrated earlier were necessary to look for a viable lending to the poor without collateral; otherwise adverse selection and moral hazard would have vitiated a viable system such as microcredit in rural areas. "However, many years of implementation of this system have culminated in a situation where the system has essentially made itself redundant. This has happened because by ensuring that the borrowers keep on repaying, the system has induced a change in social norms, in which people now repay out of sheer habit. The notion that " loans ought to be repaid because it is the right thing to do" has become the social norm, replacing the old one in which evading repayment was more of a norm. That's how the microcredit sector has retained its financial viability despite the dilution of many incentive and disciplinary devices".

The 'hypothesis' of changing norms and repayment was tested empirically drawing upon a relatively large sample of households drawn from all over Bangladesh through a stratified random sampling technique with 60 per cent accessing microcredit at any point in life.

First finding is that of prevalence of disciplinary and incentive devices diluted or weakened over time. Second, and paraphrased, norm-based behaviour can also explain why it is increasingly possible to replace the weekly instalment system by instalment of longer duration. The whole logic of weekly instalment was to trim down the temptation that would prevent the poor from accumulating enough

funds for larger instalment, if necessary. " But once the norm of repayment becomes culturally ingrained, this can help overcome the power of temptation, making it possible to switch over to monthly or even longer instalment periods without jeopardiszing the prospect of repayment." Finally, individual liability loan has slowly emerged because once repayment becomes a culturally accepted norm, individual loan leans less on moral hazard than group loan. In fact, an individual borrower could think that, given his culturally-determined repayment attitude, he would better keep aloof from moral hazard generated by the group in terms of, say, free riding.

The author concludes with the rare observation that Bangladesh can be explained by the emergence of a new social norm, which says that loans are meant to be repaid. The emergence of this norm is by no means serendipitous or a fall from the heaven; rather it owes itself to the sustained use of the disciplinary as well as incentive devices employed by the MFIs over the years in order to ensure regular loan repayment.

By and large, while occasional mitigation measures such as loan re-scheduling and provision of complimentary products have undeniably helped borrowers overcome the woes and thus keep the repayment rate up, the single most important reason is more sociological than economic and financial. First, borrowers believe that defaulting on loans tags a social stigma they are unable to bear. As society is getting more educated, the stigma is getting more denounced. For example, social stigma was 'very important; in the past for about half of households; now about 60 per cent consider it as very important. More specifically, 58 per cent owe the improvement in repayment culture to the habit formation induced by microcredit and 22 per cent adduced to accentuation of social stigma from default.

The paper by S.R.Osmani seemingly points to a positive change in the realm of Bangladesh rural credit market and its repayment modes. There was a time when defaulting on loan was the norm inculcated in the social psyche and was fuelled by government loans that were written off for political reasons. At the very outset, microcredit agencies had to struggle with the culture of default and introduce both carrot and stick policy for decades. Now it can be observed that non-default has become the norm caused by changing attitudes out of mostly social stigma.

A hew points however remain to ponder upon. If attainment of education appears to be an important deterrent to default, as has been pointed out, why should we observe highly educated class in urban areas (or rural educated elites) default on loans for which repayment rate is poor? Second, besides microcredit, what options do we have as delivery mode to minimise default of agricultural, industrial or business loans? Third, do the credit size and delivery modes have any correlation or that borrowers live in a village(s) where things like social capital, social stigma work better?

Accepting the fact that the research was confined to MFIs and their delivery system, it refers to some issues for future investigation.

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Published by Syed Manzur Elahi for International Publications Limited from Tropicana Tower (4th floor), 45, Topkhana Road, GPO Box : 2526 Dhaka- 1000 and printed by him from City Publishing House Ltd., 1 RK Mission Road, Dhaka-1000.

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