



Loan Repayment Behavior of Farmers: Analyzing Indian Households

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Abstract: This paper uses the IHDS 2015-16 to analyze the nature and extent of indebtedness of Indian households. It studies utilization of loans taken from formal versus informal sector and the subsequent loan repayment behavior of these households. By analyzing repayment patterns we identify the characteristics of individuals who are defaulting. We study the source and purpose of borrowing, consumption and production patterns of households taking loan from different sources to gain insight towards the existence of moral hazard problem. We find that people who borrow from formal sources tend to have higher consumption, higher social spending and lower investment as opposed to people who borrow from informal sources. Higher spending, as opposed to investment, in turn has a negative impact on loan repayment. Our findings point towards the differential treatment of formal versus informal loans by the households. We argue that people tend to under-utilize default more on loans that are taken from sources which impose lesser punishment in the future.



Keywords: Loan repayment, behavior, formal sector, consumption, institutional credit.

Introduction: Debt plays an essential role in the lives of the rural households in developing countries in a number of ways. It is an important instrument for smoothing consumption, in a context where incomes typically experience large seasonal fluctuations. [Ghosh et al., 2000] However, credit markets in developing nations especially in rural households do not behave completely like competitive markets. They are dual structured, where formal and informal financial systems operate side by side. Due to the lack of availability of a properly structured debt market in the rural areas of the country, majority of the households borrow from informal sources of finance which charge high interest rates and often lead to informal agents usurping the