Is Microcredit A Debt Trap for the Poor? Sifting Reality from Myth

S. R. Osmani

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Institute for Inclusive Finance and Development (InM)
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An implication of extensive churning is that the intensity at which B2R is practised is not likely to be the same either.

There are thus a number of very good reasons why a household may wish to take recourse to overlapping, i.e., some households abandon overlapping while new ones take it up. This, in turn, relates to asset transition – i.e., change in the status of asset ownership over time. A unique feature of Bangladesh. Working Paper no. 51. Institute of Microfinance: Dhaka.

Indicators of Economic

Table 1

<table>
<thead>
<tr>
<th>MFI</th>
<th>6.07</th>
<th>0.42</th>
<th>2.44</th>
</tr>
</thead>
<tbody>
<tr>
<td>Physical capital</td>
<td>10.98</td>
<td>12.13</td>
<td>11.72</td>
</tr>
<tr>
<td>Livestock, poultry, fishery</td>
<td>4.97</td>
<td>8.25</td>
<td>7.08</td>
</tr>
</tbody>
</table>

As per the InM policy, all the working papers are peer reviewed.
Abstract

There appears to exist a deep-seated scepticism about microcredit in popular perception in Bangladesh. One manifestation of this scepticism is the oft-repeated allegation that microcredit is leading hordes of borrowers into a ‘debt trap’. The empirical basis of this allegation has never been established, though, beyond some anecdotal evidence. The present paper makes the first systematic attempt to empirically investigate the existence, nature and magnitude of debt trap among microcredit borrowers in Bangladesh. The investigation relies on a large-scale nationally representative rural household survey, covering the period 2007-2013. The paper begins by examining the prevalence of two inter-related practices – namely, ‘overlapping borrowing’ and ‘borrowing to repay’, which are often taken as indicators of debt trap in popular discussion of the subject. The paper argues that that although these practices could sometimes lead to a debt trap, neither of them necessarily does so, so that the magnitude of debt traps could not be deduced from the magnitude of these practices. After defining the criteria for identifying a debt trap, the paper finds that debt traps can be said to characterise at most 4.5 per cent of microcredit borrowers who engage in ‘borrowing to repay’ and only about 1.4 per cent of all microcredit borrowers. Furthermore, even in these few cases, microcredit cannot generally be held responsible for their plight. Debt traps occur when extremely vulnerable households are faced with overwhelming shocks; and the role of microcredit here is one of mitigation rather than causation. That is, in most cases, debt trap occurs not because of but in spite of microcredit; as such, its occurrence reflects not so much the failure of microcredit as the failure of the society at large to look after its most vulnerable people.
income-generating activities (IGAs); whereas the non-B2R group spent more than half of their loan


gone towards repayment of old loans during the period 2007-2013 as compared to only a tiny amount

old loans. This can be seen from Table 8, which shows that almost 90 per cent of microcredit

overlapping in the microcredit sector. A couple of summary measures of the prevalence of

answer is, not much. We begin by noting some basic facts about the prevalence and intensity of

Thus, microcredit should be seen as either (a) reducing the prevalence of debt traps to the extent that

Faller 35.4 30.8 30.5

Transition in land assets (% of hh)

World's Poor Live on $2 a Day

by B2R Status and 'Debt Trap' Status

Non-B2R Group

Income-earning activities (IGA) 27.50 52.45 43.56

Condition In Debt Trap Not in Debt Trap

Initial non-land physical assets  40.7 59.4 54.1

Initial land assets (decimal) 30.8 55.6 48.6

See Table 1.

Indicators of Economic  Borrowers Borrowers who All Microcredit

strategy for minimising the debt burden when a new loan will have to be taken in any case in the face

destroy output and assets, or personal shocks such as illness or death of an income-earning member

Finally, overlapping can also occur in the face of large shocks – whether they are climatic shocks that

That debt traps can be said to characterise at most 4.5 per cent of microcredit borrowers who engage

overlapping loans, by far the majority of overlappers are found to use it mainly for income-generating

about of a quarter of them use it mainly for consumption smoothing and only about 10 per cent use

condition was worse, which may have led to worse current economic condition on the one hand and

It is not being suggested that these three case studies exhaust all the various pathways through

It is curious to note, however, that in contrast to the academic assessment of the impact of

There remains the possibility, though, that the 10 per cent of overlappers who do use microloans

dependent variables into logarithms, to allow for non-linearity.

a household borrows from an MFI, and thereby commits itself to make weekly instalments over a

brother-

hostility lies in religious conservatism, which does not take kindly to the fact that many MFIs

convoluted political mores of the country, in which politically motivated hostility towards an individual

It is not being suggested that these three case studies exhaust all the various pathways through

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See Table 1.
Is Microcredit A Debt Trap for the Poor?  
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S. R. Osmani a

1. Introduction

In summarising the findings of his pioneering research on microcredit, Mahabub Hossain wrote the following in a later work: “It is clear from the above assessment that the Grameen Bank has made a positive contribution to the alleviation of poverty in the area of its operations...But the Bank has so far covered only about three to four per cent of the target group households in the country. The question still remains whether it can be expanded to a wide enough scale to have a significant impact on alleviation of rural poverty nationally.” (Hossain, 2002, p.172). As the reach of microcredit has expanded rapidly since he wrote, encompassing by now nearly 60 per cent of rural population of Bangladesh, the question he posed has assumed increasing significance. Not surprisingly, that question has since been a central focus of empirical research on microcredit. In the course of this research, a reasonably clear answer has finally begun to emerge. Despite a number of controversies along the way, the evidence is now quite clear that Mahabub Hossain’s early finding of a positive impact still applies, even though some of the outlandish claims made by many enthusiasts about the transformative power of microcredit may not have been anything more than wishful thinking.1

It is curious to note, however, that in contrast to the academic assessment of the impact of microcredit, popular perception on this issue – at least as projected in the media – has remained deeply sceptical, sometimes even hostile. A familiar refrain one often hears is that microcredit is doing more harm than good because the borrowers are mostly ‘eating up’ the loans and then borrowing from one microfinance institution (MFI) to repay another, with the result that many of them are plunging headlong into a debt trap of never-ending cycles of borrowing and repaying. The empirical basis of this perception has never been spelt out, though, apart from citing some isolated anecdotes of ‘debt-trap like situations’, from which no generalisation can be made.

Truth be told, much of the negative vibe vis-à-vis microcredit in Bangladesh stems from the strangely convoluted political mores of the country, in which politically motivated hostility towards an individual can spill over as hostility towards everything associated with him. Another persistent source of hostility lies in religious conservatism, which does not take kindly to the fact that many MFIs deliberately target women as their clients. These expected sources of hostility find a somewhat unexpected ally in a brand of extreme left-wing ideologues who regard microfinance as a vehicle for ‘capitalist penetration’ of rural economies, and hence, by definition, a bad thing! Finally, and perhaps most paradoxically, hostility sometimes emanates from a strand of feminist writing which, instead of celebrating microcredit as a means of empowering women, looks down upon it as a means of further exploiting them.

a The author is Professor of Development Economics at Ulster University, UK. He is grateful to the Institute of Microfinance (InM) (now renamed as Institute of Inclusive Finance and Development), Dhaka, for providing him the opportunity to carry out the panel survey on Poverty Dynamics in Rural Bangladesh, on which the present study is based, and to the PROSPER (Promoting Financial Services for Poverty Reduction) programme of UKAid, DFID for funding both the survey and its analysis during his tenure as Visiting Fellow at InM. The author also gratefully acknowledges helpful comments from Baqui Khalily on an earlier draft. The author is, however, solely responsible for the views or any errors contained in this paper.

1 For a thorough discussion of the cumulative evidence, including a threadbare analysis of the controversies surrounding them, see Mahmud and Osmani (2017), Chapter 7.
Be that as it may, there is no denying the fact that a deep-seated suspicion of microcredit exists – often manifested through the invocation of the spectre of ‘debt trap’. It is, therefore, necessary to examine whether there is any empirical basis of the notion that microcredit leads to debt traps, and if so, what is the magnitude and nature of the problem. This is the task the present paper undertakes.

For empirical investigation of debt traps in microcredit, we have used a panel survey carried out by the Institute of Microfinance in Dhaka, under the auspices of a study called the Dynamics of Poverty in Rural Bangladesh, in which historical data on loans taken by rural households were recorded in the course of the survey. Two rounds of the survey were carried out – the first in 2010 and the second in 2013. The survey was not concerned with microcredit alone, but with the dynamics of change in the economic condition of rural households generally; and microcredit was seen as one of the factors affecting that dynamics. The sampling methodology of the survey was very similar to the one followed by the Bangladesh Bureau of Statistics (BBS) for its Household Income and Expenditure Surveys (HIES), and the sample size was also close to the rural sample of HIES 2010. It is thus a nationally representative survey, covering all of rural Bangladesh (except Rangamati district, which had to be excluded for logistical reasons). In each the two rounds of the survey, data were collected on loans (from all sources) taken by the sample households in the preceding three years i.e., during 2007-2010 and 2010-2013 respectively. We were thus able to collect detailed records of loans taken over the 6-year period 2007-2013, for a sample of 5978 households drawn from all over rural Bangladesh. Out of this sample, a total of 3389 households (57 per cent of the full sample) were found to have taken microcredit at some stage in the 6-year period. The data set for the present study comprises this subset of microcredit-taking households.

Methodologically, we employ primarily quantitative techniques, but towards the end some qualitative findings are also reported drawing upon an anthropological study of a small subset of the main sample. The quantitative analysis focuses on two inter-related concepts: namely, overlapping credit and ‘borrowing to repay’. Overlapping credit refer to the practice of taking a new loan before paying off an old one fully; and ‘borrowing to repay’, as the name suggests, refers to the case where a borrower uses at least a part of the loan to repay another loan. Since both these concepts have been invoked – sometimes by other names – in the popular discussion of debt trap, we rigorously examine the nature and magnitude of these practices. Section 2 deals with overlapping credit and Section 3 deals with the practice of borrowing to repay. We argue in these two sections that while both these concepts have some relation to the notion of debt trap, their magnitudes do not equal the magnitude of debt trap – for the simple reason that neither overlapping nor borrowing to repay necessarily leads to a debt trap. In Section 4, we develop a methodology for identifying a debt trap and measuring its magnitude, and offer an estimate on that basis. We find that only about 1.4 percent of all microcredit borrowers can be said to have experienced a debt trap at some stage in the six-year period covered by our surveys. Section 5 tries to provide a feel of the real-life stories that lie behind debt traps, using the anthropological counterpart of the main quantitative survey, with a special focus on the role that microcredit typically plays in the dynamics of debt trap. Finally, Section 6 summarises the main findings and offers some concluding remarks.

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2 This Institute has now been renamed as Institute for Inclusive Finance and Development, while retaining the abbreviation InM. Since the Survey was carried out at a time when it was called Institute of Microfinance, we have used the old name in this paper.

3 This study was designed and supervised by the present author when he was a Visiting Fellow at InM.

4 For further details of the sampling methodology, see Osmani (2015), Chapter 1.

5 The original sample size was 6300 households. After attrition, we were left with 5978 households in 2013. At the same time, 241 new households were created as offshoots of the original households in the interval between the rounds, but these newly formed households were left out of the present analysis.
2. Overlapping Borrowing

The idea that microcredit borrowers might fall into a debt trap by taking new loans before repaying old ones is usually captured by two inter-related but distinct concepts – namely, multiple borrowing and overlapping credit. The term multiple borrowing, which historically came first, refers to the case in which the same borrower borrows from more than one MFI. On the other hand, overlapping credit refers to the practice of taking new loans before an earlier loan has been fully repaid. The two concepts converge when a borrower takes a new loan from one MFI to repay an old loan taken from another MFI – in this case, one is engaging in both multiple borrowing and overlapping. However, multiple borrowing can occur without any overlapping because a person who has borrowed from one MFI may subsequently borrow from another after repaying the old loan fully. On the other hand, overlapping can occur without borrowing from multiple sources if a person borrows from the same MFI before an earlier loan has been fully repaid.

The two concepts are thus distinct. In the context of analysing debt trap, overlapping is obviously the more relevant concept. The essential issue here is not the multiplicity of lenders as such but the practice of taking new loans before an old loan has been fully repaid – in other words, the existence of overlapping loans, regardless of whether the loans are taken from different sources or the same source.

A number of features of the concept of overlapping, as employed in the present study, are worth mentioning. First, as just noted, overlapping is not contingent on the identity of the lender; it can occur with the same lender or a different lender. Second, overlapping is defined here at the level of the household, not at the level of individual borrowers. Thus, whenever a new loan is taken by a household before paying off an old loan, it would be counted as an overlapping loan regardless of whether the same member or different members of the household were involved in the two loans, and the household would be categorised as an ‘overlapper’ household. Third, a new loan may overlap not just with the immediately preceding one, but with any past loan, depending on the length of the repayment periods. If an older loan has a longer repayment period than a more recent one, then it is even possible that a new loan might overlap with the older loan but not with the more recent one. Fourth, it is possible that some of the loans taken by a household are overlapping while others are not; such households would still be treated as ‘overlapper’ households. Finally, since popular discussion of microcredit-induced debt trap is based on the notion of ‘borrowing from MFI to repay other MFIs’, we have confined our attention in this section only to the loans taken from MFIs. In other words, the presence or absence of overlap has been checked only among the MFI loans taken by a household; any possible overlap between MFI and non-MFI loans or amongst non-MFI loans has been left out of consideration. We do, however, take a broader view in the next section and consider loans taken by microcredit borrowers from both MFIs and informal lenders, while investigating the practice of ‘borrowing to repay’.

It is obvious that empirical investigation of overlapping is informationally quite demanding; a snapshot of current loans owed by a household will not serve the purpose. It is necessary to have detailed historical data containing information on all the loans taken by a household over a period of time, with details of the dates (at least the month and the year) on which each loan was taken and its repayment period. Looking at the historical data, if the starting date of a loan is found to fall within the repayment period of a previous loan, then it would be treated as a case of overlapping and the household would be treated as an overlapper household. As mentioned in the Introduction, our

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6 Borrowing from formal banking sources is completely left out from both sections, because of the negligible roles such loans have in the portfolio of most microcredit borrowers.
empirical analysis is based on the credit history of 3389 rural households who took microcredit at some stage during the 6-year period 2007-2013.\(^7\)

Our objective in this section is to ascertain how much light the analysis of overlapping can throw on the problem of debt trap supposedly faced by microcredit borrowers. To anticipate our conclusion, the answer is, not much. We begin by noting some basic facts about the prevalence and intensity of overlapping in the microcredit sector. A couple of summary measures of the prevalence of overlapping are presented in Table 1 – namely, the proportion of microcredit borrowers\(^8\) who engage in overlapping and the proportion of microloans that are overlapping in nature. Over the entire 6-year period from 2007 to 2013, just over half of the borrowers (51.7 per cent) are seen to have taken overlapping credit at some point in time. During the same period, about one-third (32.7 per cent) of all microloans have been of the overlapping nature. This shows that overlapping is a significant phenomenon in the microcredit sector of Bangladesh. Furthermore, its significance is increasing over time. The proportion of overlappers increased from 28.2 per cent during 2007-2010 to 39.4 per cent during 2010-2013, while the share of overlapped loans in all microloans almost doubled – from 21.9 per cent to 42.4 per cent – during the same period.

<table>
<thead>
<tr>
<th>Period</th>
<th>Proportion of Overlapper Households</th>
<th>Proportion of Overlapping Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007-2010</td>
<td>28.2</td>
<td>21.9</td>
</tr>
<tr>
<td>2010-2013</td>
<td>39.4</td>
<td>42.4</td>
</tr>
<tr>
<td>2007-2013</td>
<td>51.7</td>
<td>32.7</td>
</tr>
</tbody>
</table>

Source: Estimated by the author from the panel survey on Poverty Dynamics of Rural Households in Bangladesh, 2010 and 2013, Institute of Microfinance (InM), Dhaka.

These figures need to be interpreted with some care, however. When we say that over half the borrowers have engaged in overlapping during the 6-year period, it doesn’t necessarily mean that all of those households have regularly overlapped; it just means that they have taken some overlapping loan at some point in time during those six years. If there is a good deal of churning in overlapping – in the sense that some households stop overlapping while others start afresh – then the average number of overlappers per year would be less than what the figures in Table 1 suggest. That this is indeed the case can be seen from Table 2, where we present annual overlapping figures separately.

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\(^7\) Another nationally representative panel survey carried out by the Institute of Microfinance, under the auspices of a project called Access to Finance, also has a rich data set containing detailed loan history of a large sample of households, covering both rural and urban areas of Bangladesh, and spanning an even longer period than is the case with the present study. This data set has already been used for a comprehensive analysis of the phenomenon of overlapping in the microcredit sector of Bangladesh (Osmani et al. 2015). The present study offers an independent analysis of overlapping, based on a separate but equally representative data set for rural Bangladesh. For the issues that are common in the two studies, the findings are broadly consistent with each other. However, the present study investigates a much smaller range of issues because of its specific focus on debt trap. Readers who are interested in a more comprehensive analysis of overlapping may consult Osmani et al. (2015).

\(^8\) Since our analysis takes place at the household level rather than individual level, throughout the paper when we refer to borrowers we mean borrower households rather than individual borrowers. The same applies when we refer to overlappers – we mean households and not individuals.
for some recent years. The number of overlappers has remained virtually constant over the years—at around 23 per cent. This is in contrast to the figure of 52 per cent of households overlapping in the 6-year period 2007-2013 as shown in Table 1. This contrast implies the existence of a good deal of churning i.e., some households abandon overlapping while new ones take it up. This, in turn, indicates that overlapping is largely a temporary, rather than persistent, practice for most households.

Table 2
Recent Trend in Overlapping in the Microcredit Sector (per cent)

<table>
<thead>
<tr>
<th>Year</th>
<th>Proportion of overlapper households</th>
<th>Proportion of overlapping loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009-2010</td>
<td>23.7</td>
<td>34.6</td>
</tr>
<tr>
<td>2010-2011</td>
<td>23.2</td>
<td>53.4</td>
</tr>
<tr>
<td>2011-2012</td>
<td>17.3</td>
<td>35.3</td>
</tr>
<tr>
<td>2012-2013</td>
<td>23.2</td>
<td>41.7</td>
</tr>
<tr>
<td><strong>Annual average</strong></td>
<td><strong>21.8</strong></td>
<td><strong>41.3</strong></td>
</tr>
</tbody>
</table>

Source: See Table 1.

While the average number of overlappers has remained more or less constant in recent years, the average number of overlapping loans taken in a year shows a rising trend. Thus, in 2009-10 when some 23.7 per cent of households engaged in overlapping, the proportion of overlapping loans was 34.6 per cent, but three years later, in 2012-13, while the proportion of overupper households remained virtually unchanged the proportion of overlapping loans shot up to 53.4 per cent (Table 2). This means that the average number of overlapping loans taken per overupper household has increased sharply in recent years, even as the average number of overupper households has remained more or less the same. Thus, the salient feature of the recent upsurge in overlapping is not so much an increase in the number of households taking to the practice of overlapping as the increasing propensity of overupper households to take up more overlapping loans than before.

The extent of this propensity can be seen more clearly from Table 3, which presents information on the number of overlapping loans taken by an average overupper household. The trend of increasing propensity to overlap is evident from the fact that the distribution of households is tilting over time towards households with larger number of overlapping loans. Yet, it is important to observe that in the most recent period i.e., 2010-2013, about half the overupper households had overlapped only once,

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9 A word of caution is needed in interpreting the sudden drop in overlapping in 2011-12. This is almost certainly a statistical artefact, arising from the fact that it was not possible to get a complete picture of loans taken in the survey year 2010. The survey was undertaken in the middle of the year, which means that the loans taken in the second half of the year, were left out of that survey. The second survey, undertaken in the middle of 2013, should have ideally picked up those missing loans, when the respondents were asked to give details of loans taken in the preceding three years. But a potential problem is that the respondents were not resurveyed exactly three years later – some would have been resurveyed with a gap of a few months longer than three years. In that case, even if the respondents recollected accurately all the loan taken in the preceding three years, some loans taken in the second half of 2010 would have been left out. An important consequence of incomplete information for the second half of 2010 is that the overlapping figures for 2011-2012 are almost certainly underestimated since one would fail to capture the cases in which a borrower in 2011-2012 had overlapped with some loans taken in the second half of 2010. This is what explains the curious drop in the extent of overlapping in 2011-2012.
and over the entire 6-year period as many as two-thirds of them had overlapped no more than twice. In other words, while the propensity to take overlapping loans is increasing over time, the intensity of overlapping i.e., the frequency at which such loans are being taken, is still quite low.

Table 3
Distribution of Overlapper Households by the Number of Overlapping Loans Taken (percentage of households)

<table>
<thead>
<tr>
<th>Number of Overlapping Loans</th>
<th>2007-2010</th>
<th>2010-2013</th>
<th>2007-2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 overlap</td>
<td>57.3</td>
<td>50.6</td>
<td>40.4</td>
</tr>
<tr>
<td>2 overlaps</td>
<td>33.1</td>
<td>16.5</td>
<td>22.6</td>
</tr>
<tr>
<td>3 overlaps</td>
<td>6.4</td>
<td>10.6</td>
<td>12.8</td>
</tr>
<tr>
<td>4 overlaps</td>
<td>2.8</td>
<td>7.2</td>
<td>6.9</td>
</tr>
<tr>
<td>5 overlaps</td>
<td>0.4</td>
<td>5.7</td>
<td>5.9</td>
</tr>
<tr>
<td>6+ overlaps</td>
<td>0.0</td>
<td>9.5</td>
<td>11.4</td>
</tr>
</tbody>
</table>

Source: See Table 1.

In sum, even though the propensity to take overlapping loans by an average household is increasing over time, the vast majority of overlapper households have so far been quite restrained in this regard. The evidence thus goes against the popular perception that hordes of microcredit borrowers are taking overlapping loans one after another in never-ending cycles. By implication, the same evidence also suggests that the likelihood of falling into a debt trap by indulging in overlapping must be quite small.

Further evidence on this last point can be found by looking at the ways in which the overlapping households make use of their loans. In popular perception, the main purpose of taking overlapping loan is to pay off one MFI loan with the help of another, which is why the issue of debt trap gets invariably mixed up with the practice of overlapping. But a little reflection shows that a rational borrower may choose to take overlapping loans for a variety of reasons, and repaying one loan with another is only one of them.

In the first place, many enterprising borrowers might find it necessary to take overlapping loans when they wish to scale up their economic activities but cannot do so because MFIs won’t give them the large amount of money they need. In that case, a borrower might choose to borrow from more than one MFI at around the same time – i.e., by taking recourse to overlapping – in order to achieve the desired scale of operation. In fact, there is a subtle reason why it might be rational to overlap even if a particular MFI were willing to offer a large enough loan. Since large loans also entail large instalments, which the borrowers might find hard to pay, they could be wary of borrowing large sums in one go. If instead they borrow the same amount, but in smaller, overlapping, chunks over a period of time, the repayment burden will be easier to manage since it will be spread out over a longer period. Therefore, taking overlapping loans for income-generating activities can be a perfectly rational strategy for the borrowers who wish to scale up their economic operations but either (a) cannot find an MFI who would offer the required sum, or (b) even if they can find one, they might be wary of borrowing a large sum in one go considering the burden of repayment it will entail.

The same kind of reasoning applies to the borrowers who might wish to augment their assets by way of, say, construction or improvement of dwellings, or acquisition of consumer durables and human
capital (through investment in education, health, etc.). The lumpy expenditures involved in such cases may be difficult to obtain as loan from a single MFI; and even if the requisite loans were easily available, the borrower may prefer to get the money in smaller overlapping chunks so as to spread out the repayment burden. Overlapping would once again be a rational strategy of loan management.

Yet another case where overlapping can perform a useful economic function is that of consumption smoothing. Rural incomes tend to be subject to some degree of seasonality, whereas rational households would prefer to maintain a smooth level of consumption to the extent possible. This could result in a mismatch between the time pattern of income flow and the time pattern of consumption demand. If such mismatches occur more than once a year, it may be sensible to take overlapping loan in order to maintain a steady level of consumption when income flow falls short of demand, without waiting for a previous loan to be paid off fully, and to pay off both the loans when income flow rises again.

Finally, overlapping can also occur in the face of large shocks — whether they are climatic shocks that destroy output and assets, or personal shocks such as illness or death of an income-earning member of the family, or a daughter’s wedding, and so on. Traditionally, rural people would turn to informal sources of credit, quite often moneylenders, in the face of such shocks. In fact, many a household has been ruined over the centuries by doing so — getting into a debt trap with moneylenders, from which there was no escape. Faced with this ominous prospect, households in modern times may sensibly take loans from MFIs, who charge a much lower interest rate compared to the moneylenders, even if they already have an outstanding MFI loan. Overlapping here is a rational strategy for minimising the debt burden when a new loan will have to be taken in any case in the face of shocks.

There are thus a number of very good reasons why a household may wish to take recourse to overlapping as a helpful economic strategy, which if anything would enable them to steer clear of a debt trap rather than lead into one. Of course, overlapping may also be a symptom of desperation as households in economic distress try to stay afloat for as long as possible by repaying one MFI loan with the help of another, which may very well lead to a debt trap. Which of these possible reasons for overlapping dominate in practice is essentially an empirical matter.

Some light on this issue is thrown by Table 4, where we categorise the overlappers by the main use of loans over the six-year period 2007-2013. The first column gives the distribution of overlappers by the main use of all microloans (not just the overlapping ones) taken by them. It shows that the majority of overlappers (45%) use microcredit mainly for income-generating activities. In comparison, about a quarter of them use it mainly for consumption smoothing and only about 10 per cent use it mainly for loan repayment. In case anyone wonders whether the overlapper households use their overlapping loans any differently from microloans in general, we provide the relevant information in the second column of Table 4. It makes very little difference. Even when one looks at just the overlapping loans, by far the majority of overlappers are found to use it mainly for income-generating activities (42%) and only about 10 per cent use it mainly for loan repayment.

The upshot of all this is that, contrary to popular perception, the growing phenomenon of overlapping cannot be invoked to support the contention that microcredit is leading poor borrowers into a debt trap. In the first place, even though the prevalence of overlapping is increasing, less than a quarter of borrowers engage in it in any given year. And even when they do, they do so for brief spells, resulting in a lot of churning — old overlappers stop overlapping while new ones take it up. The intensity at which overlapping occurs is also quite low, as can be seen from the fact that nearly

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10 It should be noted that these are actual uses of loans as reported by households in response to questions asked during the course of the survey rather than the officially given reasons recorded by the MFIs. Recognising that households often use a loan for multiple purposes, respondents were asked for a breakdown of each of their loans into its primary, secondary and tertiary uses (thus allowing at most three uses of a single loan). The uses reported in Table 4 are based on combined figures for primary, secondary and tertiary uses.
two-thirds of overlapper households overlapped no more than twice during the six-year period. Most importantly, overlapping loans are not used primarily for loan repayment, which might have been the route to a debt trap. Some households do take overlapping loans for this purpose (only about 10 percent), but in the order of importance it comes well below other uses, such as income generation, asset augmentation and consumption smoothing. Therefore, when it comes to looking for tell-tale signs that microcredit might be creating debt traps for borrowers, the emergence of overlapping is nothing but a red herring.

### Table 4
Distribution of Overlapper Households by Main Use of Loan (percentage of overlapper households)

<table>
<thead>
<tr>
<th>Main Use Category</th>
<th>For All Loans</th>
<th>For Overlapping Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income generation</td>
<td>45.0</td>
<td>42.0</td>
</tr>
<tr>
<td>Asset augmentation</td>
<td>15.6</td>
<td>15.5</td>
</tr>
<tr>
<td>Consumption smoothing</td>
<td>23.6</td>
<td>24.1</td>
</tr>
<tr>
<td>Loan repayment</td>
<td>9.6</td>
<td>10.4</td>
</tr>
<tr>
<td>Others</td>
<td>6.3</td>
<td>8.0</td>
</tr>
<tr>
<td><strong>All</strong></td>
<td><strong>100.0</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

**Notes:** (1) Loan-use data refer to actual uses as reported by households, not official uses as recorded by the MFIs. Furthermore, the figures are estimated by combining primary, secondary and tertiary uses of loan, recognising that any single loan may be used for multiple purposes; and they represent average figures for the period 2007-2013.

**Source:** See Table 1.

There remains the possibility, though, that the 10 per cent of overlappers who do use microloans primarily for loan repayment might court the danger of debt trap. This possibility needs to be investigated, and we propose to do so. But first it should be noted that in order to examine this route to debt traps, we need to broaden the canvass by considering not just microloans but also informal loans taken by microcredit borrowers. This is because it is conceivable that some of these borrowers might get into a debt trap involving both MFIs and informal lenders – for example, by borrowing from moneylenders to pay an MFI, followed by borrowing from MFIs to pay off the moneylender, and so on, in repeated cycles. The point is simply that if we wish to examine the possibility of debt trap among microcredit borrowers, the relevant practice to watch is not whether a borrower overlaps among MFIs but whether she engages in the practice of ‘borrowing to repay’, regardless of whether an MFI is paired with another MFI or with an informal lender in the cycle of borrowing. This is the task to which we turn in the next section.

### 3. Borrowing for Repayment

Although we maintain that ‘borrowing to repay’ rather than ‘overlapping’ is the right starting point for investigating the presence of debt traps, we shall presently argue that, as in the case of overlapping, the practice of borrowing to repay does not necessarily indicate the presence of a trap nor does it necessarily lead to one. Only a subset of those who engage in this practice could end up in a debt trap, and the principal task of this section would be to identify this subset.

It may be noted that the concept of ‘borrowing to repay’, as defined in this study, is both narrower than the concept of overlapping in one sense and broader in another. It is narrower in the sense that
‘borrowing to repay’ is only one of the reasons why overlapping occurs, as noted in the preceding section. It is also broader in the sense that it encompasses both microcredit and informal loans, whereas overlapping, as we have employed this term, is confined to microloans alone. In both cases, we still focus only on microcredit borrowers, but the difference is that in defining overlapping we confined our attention to the borrowers’ transactions only with the MFIs, whereas in the case of ‘borrowing to repay’, both ‘borrowing from’ and ‘repayment to’ could involve either MFIs or informal lenders.

The reason for bringing informal lenders into our analysis is that, despite the rapid advance of microfinance, informal loans still play an important role in the lives of microcredit borrowers. As can be seen from Figure 1, about one-third of all their loans (in terms of number of loans taken) came from informal lenders during the six-year period 2007-2013, out of which about 13 per cent came from professional moneylenders and 21 per cent from ‘others’ (which mainly include friends and relatives).

**Figure 1**

*Distribution of Number of Loans Taken by Microcredit Borrowers by Sources of Loan*

The distribution of loans by the amount of loan taken is broadly similar (Figure 2). Loans from MFIs still dominate but their share is now slightly smaller (56.5 per cent) than the share in the number of loans (65.8 per cent), reflecting the fact that the average size of MFI loans tends to be somewhat smaller than from other sources. As much as 43 per cent of the total loan amount comes from informal sources.

**Figure 2**

*Distribution of the Amount of Loans Taken by Microcredit Borrowers by Sources of Loan*

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11 Over the six-year period 2007-2013, the average loan size was Tk. 14,337 for MFI loans, Tk. 19,362 for loans from moneylenders and Tk. 22,370 for loans from ‘others’.
The fact that the informal sources account for almost one-third of all loans and nearly 43 per cent of total loan amount signifies that the informal loans still play an important part in the loan portfolio of microcredit borrowers. The analysis of ‘borrowing to repay’ must, therefore, encompass the informal lenders in addition to the MFIs, as the present study has chosen to do.

At this point, we note a linguistic convention we have chosen to adopt in the remainder of the paper. In order to avoid excessively repetitive use of the phrase ‘borrowing to repay’, we shall simply use the abbreviation B2R. Recent trend in B2R, as practised by microcredit borrowers, is shown in Table 5. The practice is evidently on the rise. In terms of number of loans, the proportion of loans taken from all sources for the purpose of repaying old loans has gone up from 6.3 per cent in 2007-08 to 13.1 per cent in 2012-13. In the case of microloans alone, the proportion has risen from 6.5 per cent to 18.4 per cent. The upward trend is also visible when we consider the proportion of loans amounts used for repaying old loans. Over the period 2007-2013 as a whole, microcredit borrowers have used 10.1 per cent of all their loans and 12.2 per cent of their microloans for this purpose. In the most recent 3-year period for which we have data, i.e., 2010-2013, these figures were 11.3 per cent and 14.3 per cent respectively. These figures clearly suggest that although the practice of B2R is definitely on the rise, it is not all-pervasive as is often implied in popular discussion.

### Table 5

<table>
<thead>
<tr>
<th>Period</th>
<th>All loans</th>
<th>Microloans</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007-2008</td>
<td>6.3</td>
<td>6.5</td>
</tr>
<tr>
<td>2008-2009</td>
<td>8.2</td>
<td>9.3</td>
</tr>
<tr>
<td>2009-2010</td>
<td>9.7</td>
<td>11.8</td>
</tr>
<tr>
<td>2010-2011</td>
<td>8.2</td>
<td>9.0</td>
</tr>
<tr>
<td>2011-2012</td>
<td>10.5</td>
<td>13.1</td>
</tr>
<tr>
<td>2012-2013</td>
<td>13.1</td>
<td>18.4</td>
</tr>
<tr>
<td>2007-2010</td>
<td>8.7</td>
<td>9.9</td>
</tr>
<tr>
<td>2010-2013</td>
<td>11.3</td>
<td>14.3</td>
</tr>
<tr>
<td>2007-2013</td>
<td>10.1</td>
<td>12.2</td>
</tr>
</tbody>
</table>

Source: See Table 1.

A similar picture emerges when we focus on the proportion of households who take loans for repayment. Table 6 shows that the proportion of microcredit borrowers who borrowed from any sources to repay other loans rose from 15.8 per cent during the 3-year period 2007-2010 to 20.5 per

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12 Since a single loan can be used for multiple purposes, we have defined B2R as all those cases where a loan was used either primarily or secondarily for loan repayment. We deliberately used this broad definition, instead of focusing only on primary use, so as to as give as much latitude as possible to the notion of B2R and thereby avoid the scope for any suggestion that our figures underestimate the true magnitude of this practice, and by implication the prevalence of debt trap.
cent to the next 3-year period 2010-2013. The corresponding figures for borrowing only from MFIs to repay other loans are 13.5 per cent during 2007-10 and 18.2 per cent during 2010-13. The trend is thus clearly upward.\textsuperscript{13}

It is interesting to note, however, that the figures for the six-year period 2007-2013 as a whole is much higher than for either of the two 3-year periods. This suggests that, as in the case of overlapping, there is a high degree of churning in the practice of B2R – some borrowers abandon it while others take it up. If so, the average number of borrowers involved in this practice in any given year must be smaller than the period-wise figures presented in Table 6. This is confirmed by Table 7, which gives the relevant figures on an average per year basis during the periods in question. It may be seen that on the average only about 8 per cent of microcredit borrowers indulged in BTR (from any sources) in a given year during the period 2007-2013, whereas close to 32 per cent of households did so at some stage during this period (as shown in Table 6). The existence of extensive churning is quite clear.

Table 6

<table>
<thead>
<tr>
<th>Period</th>
<th>All loans</th>
<th>Microloans</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007-2010</td>
<td>15.8</td>
<td>13.5</td>
</tr>
<tr>
<td>2010-2013</td>
<td>20.5</td>
<td>18.2</td>
</tr>
<tr>
<td>2007-2013</td>
<td>31.6</td>
<td>28.0</td>
</tr>
</tbody>
</table>

\textbf{Note}: The figures refer to total figures for the respective periods as a whole rather than annual average within the periods; the annual averages are shown in Table 9.

\textbf{Source}: See Table 1.

Table 7

<table>
<thead>
<tr>
<th>Period</th>
<th>All loans</th>
<th>Microloans</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007-2010</td>
<td>6.8</td>
<td>5.8</td>
</tr>
<tr>
<td>2010-2013</td>
<td>9.8</td>
<td>8.6</td>
</tr>
<tr>
<td>2007-2013</td>
<td>8.3</td>
<td>7.2</td>
</tr>
</tbody>
</table>

\textbf{Note}: The figures refer to annual averages within the respective periods rather than total figures for the periods as a whole; the totals are shown in Table 8.

\textbf{Source}: See Table 1.

\textsuperscript{13} Recall that the practice of B2R was defined broadly to include both primary and secondary use of loans. The figures cited here should therefore be interpreted as the proportion of households who used some of their loans either primarily or secondarily for the purpose of repaying old loans.
An implication of extensive churning is that the intensity at which B2R is practised is not likely to be very high, i.e., the majority of households would use only a small proportion of their loans for repaying old loans. This can be seen from Table 8, which shows that almost 90 per cent of microcredit borrowers use no more than a quarter of their loans for the purpose of repayment, and only about 3 per cent of them use more than half of their loans for this purpose. The combined evidence of a high degree of churning and low intensity of B2R already begins to suggest that the practice of B2R would not necessarily lead to a debt trap, whose essential characteristic is sustained and prolonged cycles of borrowing, repaying, borrowing, repaying and so on.

Table 8

Distribution of Microcredit Borrowers by the Intensity of Borrowing-for-Repayment (percentage of borrowers)

<table>
<thead>
<tr>
<th>Quartile Groups of Intensity</th>
<th>2007-2010</th>
<th>2010-2013</th>
<th>2007-2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;= 0.25</td>
<td>89.06</td>
<td>87.77</td>
<td>88.96</td>
</tr>
<tr>
<td>0.25 - 0.50</td>
<td>7.91</td>
<td>8.65</td>
<td>9.03</td>
</tr>
<tr>
<td>0.50 - 0.75</td>
<td>2.01</td>
<td>1.96</td>
<td>1.77</td>
</tr>
<tr>
<td>0.75 - 1.00</td>
<td>1.02</td>
<td>1.62</td>
<td>0.24</td>
</tr>
<tr>
<td>All households</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Note: Intensity is defined as the proportion of B2R (borrow to repay) loans to all microloans taken by a household within a period.

Source: See Table 1.

We shall presently look at the economic consequences of B2R en route our search for debt traps. As a prelude to that enquiry, we need to look at the way loans are generally used by those who engage in the practice of B2R, in comparison with those who don’t, because the way loans are used is likely to have a bearing on the consequence of the practice. This evidence is presented in Table 9, which shows that there is indeed a striking difference in the loan use pattern of the two groups of borrowers.

For the B2R group among microcredit borrowers, as much as 28 per cent of total amount of loan has gone towards repayment of old loans during the period 2007-2013 as compared to only a tiny amount for the non-B2R group (0.61%). The difference is shown up almost entirely in the use of loan for income-generating activities (IGAs); whereas the non-B2R group spent more than half of their loan amount (52 per cent) on IGAs, the BTR group spent only about 28 per cent – the same as they spent on loan repayment. The shares of all other items of use – such as asset augmentation, consumption smoothing and ‘others’ – are very similar for the two groups. We thus find that those who borrow at least partly for the purpose of loan repayment tend to do so almost entirely at the cost of productive activities.

The clear implication is that the practice of B2R is likely to have a negative consequence for the economic condition of borrowers. There is some prima facie evidence that this is indeed so. This can be seen from Table 10 which presents a comparative picture of the economic status of the two groups of microcredit borrowers – those who practise B2R and those who don’t – in terms of a number of indicators.

There are three static indicators and a couple of dynamic ones. The three static indicators are: (a) value of gross assets per household in 2013, (b) value of net assets (gross value minus financial

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14 Some households in the latter group may use a small amount of loans for the purpose of loan repayment – as tertiary use, i.e., as the third item of use in order of importance; that’s why a tiny percentage of loan amount is recorded as having been used for loan repayment for this group of borrowers in Table 11.
liabilities) per household in 2013, and (c) household income in 2013. The two dynamic indicators relate to asset transition—i.e., change in the status of asset ownership over time. A unique feature of the panel survey used in the present study is that we had collected information on the assets owned by a household not only at the time of the survey but also at the time when it was formed—described here as ‘initial assets’. This allows us to trace the change in asset status of a household since it started its journey in life as an independent unit. Two types of initial assets were considered—(a) land, which was measured in terms of quantity (decimal), and (b) non-land physical assets (dwellings, consumer durables, transport equipment, animals, forest resources, etc.), measured initially in terms of historical value but then revalued at current prices by using the GDP deflator for capital formation. For each type of asset, households were split into quintile groups—both for initial

15 Since different households were formed at different times, revaluation at the price of a common base year was essential for ensuring comparability. It should also be mentioned that our data on ‘initial’ assets do not include financial assets because it was felt that such data could not be reliably obtained given the fact that we had to take recourse to recall method for soliciting information on initial assets. While all recall data, relating to a distant past, are subject to error, it was felt that the margin of error in the recall of financial assets (by rural households, who seldom keep any record of assets) would be unacceptably large.
assets and current assets – and then classified into three categories depending on how their asset status had changed over time. Those who moved from lower quintiles to higher quintiles were designated as ‘movers’, those who stayed in the same quintile were called ‘stayers’, and those who fell into lower quintiles were called ‘fallers’.

### Table 10

**Current Economic Condition of Microcredit Borrowers by ‘Borrowing-for-Repayment’ Status**

<table>
<thead>
<tr>
<th>Indicators of Economic Condition</th>
<th>Borrowers who Borrowed for Repayment</th>
<th>Borrowers who did not Borrow for Repayment</th>
<th>All Microcredit Borrowers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross assets in 2013 per hh (Tk)</td>
<td>759346</td>
<td>1296592</td>
<td>1146150</td>
</tr>
<tr>
<td>Net assets in 2013 per hh (Tk)</td>
<td>703294</td>
<td>1244248</td>
<td>1092768</td>
</tr>
<tr>
<td>Household income in 2013 per hh (Tk)</td>
<td>107430</td>
<td>128510</td>
<td>122607</td>
</tr>
<tr>
<td>Transition in land assets (% of hh)</td>
<td>31</td>
<td>30</td>
<td>31</td>
</tr>
<tr>
<td>Faller</td>
<td>44</td>
<td>45</td>
<td>44</td>
</tr>
<tr>
<td>Stayer</td>
<td>25</td>
<td>25</td>
<td>25</td>
</tr>
<tr>
<td>Mover</td>
<td>37</td>
<td>30</td>
<td>32</td>
</tr>
<tr>
<td>Transition in non-land assets (% of hh)</td>
<td>31</td>
<td>31</td>
<td>31</td>
</tr>
<tr>
<td>Faller</td>
<td>31</td>
<td>31</td>
<td>31</td>
</tr>
<tr>
<td>Stayer</td>
<td>32</td>
<td>39</td>
<td>37</td>
</tr>
<tr>
<td>Mover</td>
<td>32</td>
<td>39</td>
<td>37</td>
</tr>
</tbody>
</table>

**Notes:**

1. Gross and net values of assets and household income are in the prices of 2013.

2. Transition in assets means movement between initial asset quintiles and current asset quintiles. For definition of transition categories, see text.

**Source:** See Table 1.

Using these indicators, it can be seen from Table 12 that those who borrowed to repay were decidedly worse off compared to those who didn’t. On the average, the gross assets of the B2R group are almost 40 per cent lower, net assets 44 per cent lower and annual income 16 per cent lower. They have also fared worse in terms of asset transition, especially in the case of non-land physical assets. They have more ‘fallers’ and fewer ‘movers’ among them in comparison with the non-B2R group. As many as 37 per cent of B2R borrowers are classified as ‘fallers’ as compared with 30 per cent among non-B2R borrowers, and only 32 per cent among them are found to have been ‘movers’ as compared with 39 per cent among the non-B2R group.\(^{16}\)

But before one jumps to the conclusion that the practice of B2R is responsible for worse economic outcomes, one must consider the reverse possibility – namely, that perhaps it was the experience of dire economic condition that led some households to resort to the practice of B2R in the first place. In order to check this possibility, we compared in Table 11 the two groups of microcredit borrowers – viz., B2R and non-B2R – in terms of some exogenous indicators of economic condition i.e., indicators that are unlikely to be affected by the practice of B2R. These indicators include initial assets of households, educational status of the household head, the gender of the household head and the size of labour force in the household.

\(^{16}\) All these differences are statistically significant. The t-values are not reported so as not to clutter the tables.
As can be seen from Table 11, in terms of several of these indicators the households who borrowed to repay were clearly at a disadvantage in comparison with other microcredit borrowers; in particular, they started their journey in life with fewer initial assets (both land and non-land physical assets) and their household heads had less opportunity to acquire education.\footnote{17} Evidently, their initial economic condition was worse, which may have led to worse current economic condition on the one hand and to the decision to ‘borrow to repay’ on the other. In other words, the practice of B2R and poor economic condition at present may be joint outcomes of a common cause – namely, initial economic disadvantage – instead of one of them causing the other.

Of course, one cannot rule out the possibility that, in addition to being joint outcomes of a common cause, the practice of B2R also plays a causal role – leading to further worsening of current economic condition. In order to check whether this was so, we carried out several regression exercises, in which we regressed some indicators of current economic condition on a dummy variable representing the practice of B2R, after controlling for initial economic conditions. The dummy variable takes the value 0 for households who did not engage in B2R and 1 for those who did. Some additional control variables were also used – such as the age of the household (and its square) in order to allow for any life cycle effect on economic condition, and some village-level characteristics as well as a set of division dummies so as to allow for location-specific effects on economic outcomes.

Four dependent variables were considered as indicators of economic outcome – namely, current household income, net assets currently owned by the households, transition in land assets, and transition in non-land physical assets. For the first two variables, the regression was carried out by the ordinary least squares method, after taking logarithm of the dependent variables so as to allow for possible non-linearities. For the latter two dependent variables (asset transition), first an ordinal variable was created in which higher values were attached to better transition outcomes – 0 for ‘faller’, 1 for ‘stayer’, and 2 for ‘mover’ – and then the ordered probit method was used to estimate the regression. The results of the regression exercises are reported in Tables 12 and 13 (leaving out the coefficients of the locational variables).

\footnote{17} Once again, these differences are statistically significant.

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**Table 11**

Profile of Microcredit Borrowers by ‘Borrowing-for-Repayment’ Status

<table>
<thead>
<tr>
<th>Characteristics of Households</th>
<th>Microcredit Borrowers Who Borrowed to Repay</th>
<th>Microcredit Borrowers Who did not Borrow to Repay</th>
<th>All Microcredit Borrowers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial land assets (decimal)</td>
<td>30.8</td>
<td>55.6</td>
<td>48.6</td>
</tr>
<tr>
<td>Initial non-land physical assets ('000 Tk)</td>
<td>40.7</td>
<td>59.4</td>
<td>54.1</td>
</tr>
<tr>
<td>Education of the household head (yrs)</td>
<td>2.9</td>
<td>3.4</td>
<td>3.3</td>
</tr>
<tr>
<td>Size of household labour force (no.)</td>
<td>1.4</td>
<td>1.4</td>
<td>1.4</td>
</tr>
<tr>
<td>Proportion of female headed hh (%)</td>
<td>5.5</td>
<td>6.8</td>
<td>6.4</td>
</tr>
</tbody>
</table>

**Notes:**
1. Initial assets refer to the assets owned by a household when the household was formed.
2. Initial non-land (physical) assets were revalued at the prices of a common base year (2010) using the GDP deflator for capital formation.
3. Female-headed households are defined as households headed by single females – namely, unmarried, widowed, divorced or separated.

**Source:** See Table 1.
The first point to note here is that the estimated coefficients of all the control variables have expected signs, and in most cases they are also statistically significant. Thus, initial assets, education of the household head and the size of the household labour force all have the expected positive effect on economic outcomes and the presence of a single female as the head of the household has a negative effect. There is also a non-linear life cycle effect – with economic outcomes improving in the early stages of the life cycle and deteriorating later in life (as indicated by the negative sign of the age-squared variable).

Table 12

Consequence of ‘Borrowing to Repay’ on Current Income and Assets

<table>
<thead>
<tr>
<th>Explanatory variables</th>
<th>Income (log)</th>
<th>Net assets (log)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Coefficient</td>
<td>t-value</td>
</tr>
<tr>
<td>Dummy for ‘borrowing to repay’</td>
<td>-0.04376*</td>
<td>-1.65</td>
</tr>
<tr>
<td>Initial land assets (decimal)</td>
<td>0.00072***</td>
<td>3.33</td>
</tr>
<tr>
<td>Initial non-land physical assets ('000 Tk.)</td>
<td>0.00023***</td>
<td>3.06</td>
</tr>
<tr>
<td>Age of the household (years)</td>
<td>0.01832***</td>
<td>5.01</td>
</tr>
<tr>
<td>Age of the household squared (years)</td>
<td>-0.00036***</td>
<td>-4.12</td>
</tr>
<tr>
<td>Schooling of the household head (years)</td>
<td>0.02954***</td>
<td>7.69</td>
</tr>
<tr>
<td>Gender of the household head (dummy)</td>
<td>-0.22428***</td>
<td>-4.34</td>
</tr>
<tr>
<td>Size of household labour force (no.)</td>
<td>0.22391***</td>
<td>13.22</td>
</tr>
</tbody>
</table>

**Notes:**
1. Both regressions were carried out by using the OLS method, after converting the values of the two dependent variables into logarithms, to allow for non-linearity.
2. The dependent variables are in current prices of 2013.
3. The dummy for ‘borrowing to repay’ takes the value 0 for households who never used microloans even partially for repaying other loans at any time during the period 2007-2013, and value 1 for those who did.
4. Initial assets refer to the assets owned by a household at the time the household was formed.
5. Initial non-land (physical) assets were revalued at the prices of a common base year (2010) using the GDP deflator for capital formation.
6. Age of household refers to the number of years ago the household was formed.
7. Gender dummy attaches value 1 to households headed by single females (unmarried, widowed, divorced or separated) and 0 to households headed by either males or married females.
8. In addition to the explanatory variables listed above, a number of other variables reflecting village-specific characteristics as well as a set of division dummies were also included in the regressions, but their results are omitted.
9. The symbol * denotes statistically significant at 10 per cent level, and *** denotes significant at 1 per cent level.

**Source:** See Table 1.

The most important variable in the present context is of course the dummy variable representing B2R. The coefficients of this variable are found to be negative in all cases, and statistically highly significant for net assets (Table 12) and for transition in non-land physical assets (Table 13), while being marginally significant for household income (Table 12). Thus, on the whole, the practice of B2R does appear to lead to worsening of economic condition even after controlling for initial conditions.

It should be recognised, however, that the households who borrow to repay do not constitute a homogenous group. This is because the circumstances that motivate someone to engage in B2R may not be same for everyone, and as a result the consequence for their economic outcomes may not be same either.
The clear implication is that the practice of B2R is likely to have a negative consequence for the least partly for the purpose of loan repayment tend to do so almost entirely at the cost of productive income-generating activities (IGAs); whereas the non-B2R group spent more than half of their loan

It must be acknowledged, though, that even 1.4 per cent cases of debt trap should be seen as too much worse than those not in trap, who in turn fare worse than non-B2R households. It is thus to have a bearing on the consequence of the practice. This evidence is presented in Table 9, which

MFIs. Therefore, to hold microcredit responsible for the debt traps that exist is to completely

Notes and sources:

Table 6

Table 13

Consequence of ‘Borrowing to Repay’ on Asset Transition

<table>
<thead>
<tr>
<th>Explanatory variables</th>
<th>Land</th>
<th>Non-land Physical Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Coefficient</td>
<td>t-value</td>
</tr>
<tr>
<td>Dummy for ‘borrowing to repay’</td>
<td>-0.01580</td>
<td>-0.34</td>
</tr>
<tr>
<td>Initial land assets (decimal)</td>
<td>-0.00125***</td>
<td>-5.34</td>
</tr>
<tr>
<td>Initial non-land physical assets ('000 Tk.)</td>
<td>-0.00026*</td>
<td>-1.81</td>
</tr>
<tr>
<td>Age of the household (years)</td>
<td>0.00980</td>
<td>1.24</td>
</tr>
<tr>
<td>Age of the household squared (years)</td>
<td>-0.00013</td>
<td>-0.58</td>
</tr>
<tr>
<td>Schooling of the household head (years)</td>
<td>0.01008</td>
<td>1.61</td>
</tr>
<tr>
<td>Gender of the household head (dummy)</td>
<td>-0.01351</td>
<td>-0.17</td>
</tr>
<tr>
<td>Size of household labour force (no.)</td>
<td>0.03198</td>
<td>1.28</td>
</tr>
</tbody>
</table>

Notes: (1) Both regressions were carried out by using the ordered probit method.

(2) The dependent variables – namely, transition in land and non-land physical assets – are both ordinal variables taking values 0 for ‘faller’, 1 for ‘stayer’ and 2 for ‘mover’. For definition of these categories, see text.

(3) For definition of explanatory variables, see notes to Table 12.

(4) The symbol * denotes statistically significant at 10 per cent level, and *** denotes significant at 1 per cent level.

Source: See Table 1.

The obligation to repay debts while mired in a debt trap is of course the standard explanation of why households borrow to repay; and in these circumstances the effect may indeed be negative. But there are other circumstances where the effect could be benign, or even positive. For many households, borrowing to repay could simply be a matter of prudent cash-flow management. When a household borrows from an MFI, and thereby commits itself to make weekly instalments over a year, the potential mismatch between the need for cash and the flow of cash is never too far away, especially in view of inherent short-term variability in many sources of rural incomes. When a negative cash-flow balance occurs, i.e., cash flow is low relative to needs, and persists for several weeks, the borrower might be faced with two unpleasant prospects: either to sell or mortgage whatever meagre assets they own, or to get blacklisted and vilified as a loan defaulter. It could be a wise decision in those circumstances to borrow from another MFI or informal lenders, knowing that the new loans can be paid off, along with the old, when the cash-flow balance turns positive again. The effect of B2R can be quite benign in these circumstances.

There are other circumstances where, paradoxical as it may sound, B2R may be a very sensible strategy to reduce one’s debt burden! Poor households being forced to borrow from moneylenders at exorbitant rates of interest when faced with shocks, has been a common enough story in the rural life of Bangladesh for centuries. With the emergence of microcredit, an alternative source of loan now exists, but because of the modalities and scale of their operation MFIs cannot fully substitute the moneylenders in these circumstances. Many MFI borrowers, therefore, still have to turn to moneylenders at times of crises; others join an MFI while already indebted to a moneylender – in fact, for many this could be the primary motivation behind going to an MFI in the first place. In either case,

18 One should not underestimate the ability of poor rural households, even those with very low levels of literacy and numeracy, to manage their cash-flows with a great deal of competence and imagination. See the wealth of evidence on this score presented in Collins et al. (2009).
it would make eminent sense for a household to borrow from an MFI to repay the moneylender. The principal it borrows would be cancelled by the principal it repays to the moneylender, and all that would happen is that the household would end up paying less by way of interest, thus reducing its overall debt burden.\textsuperscript{19} This will not only help the household in the short run by reducing its debt servicing liability, but might also help in the long run by enabling it to hold on to the assets it might otherwise have been compelled to sell or mortgage in order to meet the much higher debt servicing obligation to the moneylender.

Thus, the nexus of B2R that goes from MFI to informal lenders could actually be beneficial for microcredit borrowers. It may not be a coincidence, therefore, that the vast majority of B2R cases do belong to this particular category. As can be seen from Figure 3, nearly two-thirds of B2R cases during 2007-2013 were cases of borrowing from MFIs to repay informal lenders (65.2%); by contrast, the MFI-to-MFI nexus accounted for about a quarter (24.6%), and the rest was accounted for the reverse flow from informal lenders to MFIs (10.2%). While some of the cases of B2R from MFI to informal lenders may well involve debt trap, some may also entail helpful reduction in debt servicing burden.

\textbf{Figure 3}

\textit{The Flow Pattern of B2R by Microcredit Borrowers: 2007-2013}

The upshot of all this is that cases of debt trap would most likely be a proper subset of B2R – i.e., not all cases of borrowing to repay would involve a debt trap. It is thus necessary to develop a methodology for identifying the cases of debt trap. This is what we attempt to do next.

\section{4. Identifying Debt Traps}

Debt trap is inherently a dynamic concept; it describes how a household is struggling over time to stay afloat through repeated acts of borrowing, repaying, borrowing again and so on. The dynamics of this process may be so complicated and so varied in nature that it may be hard to capture it fully through quantitative data. Perhaps, the best way to find out whether a household is in a debt trap or not is to learn about its life history, preferably through ethnographic research. We have indeed undertaken such research and reported the findings in Section 5. The problem with ethnographic research, however, is that while it can illuminate the dynamics of the process in a way that mere quantitative data never can, it cannot be used to measure the prevalence of the phenomenon in the population as a whole. Quantitative approach is essential for this purpose, however imprecise it might be.

We have used the six-year credit history of our sample households to obtain a quantitative measure of the prevalence of debt trap among microcredit borrowers in rural Bangladesh. As noted in the

\textsuperscript{19} Refer to the case studies 1 and 2 in Section 5 to see how this strategy works in real life.
preceding section, the practice of borrowing to repay is the route through which a household gets into a debt trap, but not all households who engage in this practice will necessarily get into a trap; only a subset of them will. This implies that in order to identify debt trap, certain conditions must be imposed on the nature of B2R. A moment’s reflection will show that the very notion of debt trap suggests a couple of necessary conditions – namely, cyclicity and repetition.

The first obvious condition is that there must be cycles of B2R going back and forth between different lenders as distinct from a one-way flow from one lender to another. To characterise these cycles more precisely, we need to distinguish between two types of cycles – one involving only MFIs and the other involving both MFIs and informal lenders. For MFI-MFI cycles to exist, a necessary condition is that successive B2R loans must be overlapping in nature. If there is an unbroken sequence of B2R loans, this condition will be automatically satisfied. If, on the other hand, the sequence is interspersed with non-B2R loans in-between, then the two B2R loans straddling a non-B2R one must be overlapping with each other. The reason for imposing this condition is clear enough. If the B2R loan following a non-B2R loan overlaps with the preceding B2R loan, it ensures that the cycle of borrow-repay-borrow-repay continues despite the intervention of a non-B2R loan in-between. Without such overlap, however, the cycle would have been broken, and one can no longer talk of a debt trap.20

In the case of cycles involving both MFI and informal lenders, the overlapping criterion cannot be applied for the simple reason that the vast majority of informal loans do not have a specified repayment period.21 In this case, we use the criterion of proximity in time. The intuitive logic of this criterion is obvious. Suppose an MFI loan was used to repay an informal lender some five years ago, and today an informal loan is used to repay the MFI, with no other transaction taking place in-between; it would be hard to describe the two loans as part of the same cycle. Clearly, proximity in time is essential, but the problem is that there is no purely logical way of defining what length of time should count as proximity in this context. As a compromise, we use a maximum of one-year as the criterion of proximity on the ground that most MFIs have a one-year repayment period.

The second condition for the existence of debt trap is that B2R must be a repeated phenomenon – a few isolated cases would not make a trap. The difficult question, however, is: how many times does B2R need to be repeated for a cycle of B2R to qualify as a debt trap? In the extreme case, one might conceive of debt trap as a never-ending cycle of B2R; but this will not work as an operational criterion because it would imply that once a borrower gets into a trap she can never get out of it, which is not only unrealistic but also an unduly restrictive definition of debt trap. In practice, one must allow for the possibility that a borrower could come out of a trap at some stage, which necessarily entails that a finite number of B2Rs must be specified as a minimum cut-off point. The choice of this cut-off point has to be somewhat arbitrary, however. We have imposed the cut-off point of a minimum of 4 B2Rs as part of the same cycle, which in our view is large enough to have the feel of a trap but small enough to allow for a generous definition of debt trap.

On applying these conditions, we find that only 49 of our sample of microcredit borrowers could be said to have been caught in a debt trap at some stage in the six-year period 2007-2013. Since there are 3389 microcredit borrowers in our sample, and out of them 1071 households engaged in B2R at some point time, the cases of debt trap account for just 4.5 per cent of B2R households and a meagre 1.4 per cent of all microcredit borrowers. This is a far cry from the impression one might get from the criticism of microcredit in some quarters – including some influential ones.

20 Strictly speaking, all we are claiming is that without overlapping the two B2R loans on either side of a non-B2R loan cannot be part of the same debt trap. In principle, though, they can be parts of two different debt traps – one preceding the intervening non-B2R loan and one following it. Our definition allows for such multiple debt traps (but separated in time) for the same household.

21 In our sample, almost 52 per cent of loans from informal lenders had no specified repayment period.
It must be acknowledged, though, that even 1.4 per cent cases of debt trap should be seen as too many because the economic consequence can be devastating for those who have the misfortune of experiencing it. This is quite evident from Table 14, where we present some indicators of current economic condition of households caught in debt trap, in comparison with both B2R households who are not in a trap and non-B2R households.

Table 14
Current Economic Condition of Microcredit Borrowers by B2R Status and ‘Debt Trap’ Status

<table>
<thead>
<tr>
<th>Indicators of Economic Condition</th>
<th>B2R Group</th>
<th>Non-B2R Group</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>In Debt Trap</td>
<td>Not in Debt Trap</td>
</tr>
<tr>
<td>Gross assets in 2013 per hh (Tk)</td>
<td>507382</td>
<td>773064</td>
</tr>
<tr>
<td>Net assets in 2013 per hh (Tk)</td>
<td>445502</td>
<td>717329</td>
</tr>
<tr>
<td>Household income in 2013 per hh (Tk)</td>
<td>94770</td>
<td>108120</td>
</tr>
<tr>
<td>Transition in land assets (% of hh)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Faller</td>
<td>35.4</td>
<td>30.8</td>
</tr>
<tr>
<td>Stayer</td>
<td>39.6</td>
<td>44.1</td>
</tr>
<tr>
<td>Mover</td>
<td>25.0</td>
<td>25.1</td>
</tr>
<tr>
<td>Transition in non-land assets (% of hh)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Faller</td>
<td>38.1</td>
<td>36.9</td>
</tr>
<tr>
<td>Stayer</td>
<td>33.3</td>
<td>30.5</td>
</tr>
<tr>
<td>Mover</td>
<td>28.6</td>
<td>32.6</td>
</tr>
</tbody>
</table>

Notes and sources: See Table 10.

We saw earlier that B2R households as a group fare much worse than non-B2R households in terms of most indicators (Table 10). We can now see that, among the B2R households, those in trap fare much worse than those not in trap, who in turn fare worse than non-B2R households. It is thus evident that those who are caught in a debt trap are in the bottom of the pile. On the average, they possess 38 per cent less net assets compared to non-trapped B2R households and a whopping 60 per cent less compared to non-B2R borrowers. Their household income is 12 per cent lower compared to non-trapped B2R households and 24 per cent lower compared to non-B2R households. They also fare the worst among the three groups in terms of asset transition, especially in the case of non-land physical assets.

Unfortunately their condition as it is, it will be a mistake, however, to hold microcredit responsible for their lot, for the fact is that the ‘debt trap’ households not only have the worst economic outcomes at present, they also had the worst initial conditions. As can be seen from Table 15, their initial land and non-land physical assets were much lower than those of the other two groups of borrowers and their household heads also have the lowest level of education among them.

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22 All these differences are statistically significant.
23 These differences are statistically significant.
Table 15
Profile of Microcredit Borrowers by B2R Status and ‘Debt Trap’ Status

<table>
<thead>
<tr>
<th>Indicators of Economic Condition</th>
<th>B2R Group</th>
<th>Non-B2R Group</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>In Debt Trap</td>
<td>Not in Debt Trap</td>
</tr>
<tr>
<td>Initial land assets (decimal)</td>
<td>21.2</td>
<td>31.3</td>
</tr>
<tr>
<td>Initial non-land physical assets (‘000 Tk.)</td>
<td>24.6</td>
<td>41.6</td>
</tr>
<tr>
<td>Age of the household head (years)</td>
<td>43.9</td>
<td>45.2</td>
</tr>
<tr>
<td>Education of the household head (years)</td>
<td>2.7</td>
<td>3.0</td>
</tr>
<tr>
<td>Size of household labour force (no.)</td>
<td>1.3</td>
<td>1.4</td>
</tr>
</tbody>
</table>

Notes and sources: See Table 13.

Thus, the reality is that households who are caught in a ‘debt trap’ were at the bottom of the pile to begin with and they are still at the bottom. It is their precarious initial conditions that can be said to have made them susceptible to falling into a debt trap. To hold microcredit responsible for their plight would be to misdiagnose the source of their misfortune.

On the contrary, it is possible to argue that that microcredit may have helped many of them to soften the impact of debt trap. Given their vulnerability, as indicated by the precariousness of their initial conditions, most of them would have been thrown into a debt trap in any case, at the slightest push from some exogenous shocks. In the absence of microcredit, the resulting debt trap would have involved only moneylenders, as it has done over the centuries in rural Bangladesh. The emergence of microcredit has enabled these households to transform a potential debt trap involving only moneylenders into a debt trap involving MFIs by substituting moneylenders either partially or wholly. The outcome may still be a debt trap, but to the extent that the interest burden would have been reduced through this process of substitution, it would be a less onerous trap than one involving moneylenders alone.24

5. An Ethnographic Account of Debt Trap

To be caught in a debt trap can be one of the most devastating experiences for any family, making one despondent for ever and sapping any zest for life. Cold statistics, of the kind we have presented so far, can offer a broad overview of the magnitude and nature of the problem but they cannot convey the sheer pathos of human tragedy that it involves. Nor can they fully capture the complicated dynamics of the ways in which a family becomes mired in a debt trap. The nature of the dynamics can itself be of varied nature as there can be myriad of pathways leading to a trap. Ethnographic research can illuminate these pathways in a way that sheer numbers can never do. In this section, we have tried to give a flavour of some of the pathways and a feel of the pathos they generate, by drawing upon an anthropological study carried out by the Institute of Microfinance (InM) in 2012.

This study was undertaken to supplement the quantitative study on the Poverty Dynamics in Rural Bangladesh from which the data for the present paper has been drawn. The ethnographic research involved 300 case studies, taking a sub-sample from the sample for the Poverty Dynamics study. These case studies were not necessarily concerned with microcredit as such, nor were all the sample households microcredit borrowers. The objective of the study was to throw light on the dynamics of economic change experienced by rural households under various circumstances. As part of this general enterprise, the impact of microcredit on economic dynamics was also studied, for the

24 See the case studies in Section 5 for real-life illustration of these points.
households that had taken microcredit at some stage in their lives. From these case studies, we have identified a few households who got into debt traps.\textsuperscript{25} Here we have picked up three of them and narrated the stories of how they came to be caught in a debt trap.\textsuperscript{26}

It is not being suggested that these three case studies exhaust all the various pathways through which a household can get into a debt trap. But, taken together, they do highlight some of the most important ones. The main messages that, in our view, come out of them can be summed up in the form of the following propositions.

First, debt traps can occur when households with fragile initial conditions are buffeted by shocks they are unable to withstand.

Second, shocks are endemic in the rural life of Bangladesh, and they can emanate from a myriad of sources – climatic, demographic, social, personal health, and so on. In the worst cases, a household may face multiple shocks at the same time or in quick succession, which can be very difficult to handle, especially by those who are already in a vulnerable position.

Third, when faced with shocks, households invariably put up a fight in order to stay afloat, by employing various kinds of coping strategies, one of which is to try to borrow their way out. While many households would succeed in this strategy – especially those who are able to pay off the loans with the help of future income or by selling assets if they have to, not all would be able to do so. Those with meagre income and precious little assets to sell would find it a slippery slope – leading to a downward spiral of repeated borrowing merely to repay old loans, making life worse, not better.

Fourth, while some microcredit borrowers can and do fall into a debt trap, there is no meaningful way in which microcredit can be deemed responsible for it. Taking microcredit is one of the ways in which households actually try to fend off the prospect of suffering in the face of shocks. If they fail, and fall into a trap, it's not because of but in spite of microcredit; the shocks would have been too overpowering to withstand with the meagre resources possessed by vulnerable households, even with the support of microcredit.

\textsuperscript{25} Six, to be precise.

\textsuperscript{26} The names of the characters have been changed; all other details are factual.
Case Study 1

_Banarashipur_ is a small village located in the district of Sunamganj in the north-east of the country. Akbar Ali and his wife Jobeda have lived in this village for over a decade, eking out a livelihood and raising a family. When Akbar Ali set up his own household, all he got from his father by way of bequest was a small room to live in, and that is where he still lives with his wife and five small children. With no land to till, and no other asset to use, he had no choice but to take up his parental occupation – working in others people’s fields as a wage labourer. But work was very hard to find for at least a couple of months a year; during those hard times, he invariably became indebted to local moneylenders in trying to keep his family fed, and paid off the loan later when work became available again.

Buffeted year after year by seasonal distress, he decided at some stage to do something about it. Considering his own skills and experience, he felt that his best option was to lease in some farm land and cultivate it himself, to supplement his income from wage labour. Through his wife, Jobeda, he obtained a loan of Tk. 5000 from the Grameen Bank in 2009, and immediately leased in 120 decimal of farm land. But alas! Just when they were beginning to look forward to better days, disaster struck. Untimely flood wiped away his standing crop, leaving him with no means to either feed his family or to pay the instalments. Reluctantly, he turned to the moneylender again and borrowed Tk. 3000 at an exorbitant rate of interest. Since his income was nowhere near enough to repay the moneylender, Jobeda borrowed again next year from the Grameen Bank a sum of Tk. 8000, which was used in part to pay off the moneylender. With the remainder, they purchased a calf, which is now worth Tk. 10,000 and remains their only asset to date. But the family kept getting indebted to moneylenders again and again because of seasonal distress. Out of desperation, they turned yet again to the Grameen Bank in 2011 to borrow a sum of Tk. 12000, and used it entirely to repay the moneylender.

But that was to not be the end of their woes; little did they know that a disaster of even more monstrous proportion was lurking just around the corner. Jobeda developed a serious gynaecological complication while trying to adopt birth control measures with advice from a village quack. Akbar Ali took her to the town for treatment, where she was partially cured but it cost them a hefty sum of Tk. 60,000. Friends and relatives helped as generously as they could, but most of the money had to be borrowed from moneylenders. As the interest charged by the moneylenders was very high, Akbar Ali and Jobeda decided to pay them off as much as possible with further loans from Grameen Bank, which carried much lower interest rates. They took out two overlapping loans – to the tune of Tk. 12000 and Tk. 13000 respectively. As a result, their immediate debt servicing burden came down a little, but they were still left with a huge outstanding debt, which they found extremely hard to service with their meagre income.

Matters became even worse soon afterwards as Akbar Ali himself became chronically ill and could not work with the same intensity as before. In consequence, their cycle of debt continued unabated – forcing them to turn once to an MFI to fend off the moneylender and then go back to the moneylender to pay off the MFI, but in the end escaping from neither.
Case Study 2

Sirajuddin is a middle-aged businessman from village Bibichina in Borguna, a district located in the riverine south-eastern region of the country. His father was a small farmer, but Sirajuddin chose a different life for himself, as he felt that the small amount of land he had inherited from his father (12 decimal) would not afford him a viable living as a farmer. So, he decided to lease out the land and take up business as his own occupation. After trying his hands at various things, he eventually settled upon the business of buying and selling betelnuts, a common tree-crop of his region. For a while, he was doing quite well. But misfortune struck in 1995, when he sold Tk. 60,000 worth of betelnuts on credit to a party in Rangpur, who never paid up. Unable to withstand a loss of such magnitude, Sirajuddin gave up the betelnut business altogether and sought his fortune elsewhere. But his life was never to be the same again.

In 1997, he set up a small tea stall in the local bazar, with the help of Tk. 20,000 borrowed from ASA. But as the income from the tea stall was too small to keep his family afloat, he kept getting indebted to moneylenders in trying to make the two ends meet. He soon realised that he needed to expand his business if he were to earn a viable income. So, through his wife, he borrowed Tk. 30,000 from Grameen Bank in 2005 to expand his business, and another Tk. 20,000 from a local MFI in 2006 to help feed the family while business was still struggling to find its feet. Meeting the repayment burden of multiple loans was not easy, but Sirajuddin was somehow trudging along by carefully managing his finances. But all his careful planning and hard work were blown away in the twinkling of an eye in a dreadful night in 2007, when cyclone *Sidr* hit the south-eastern region of Bangladesh. His shop was flattened by an uprooted tree and destroyed beyond recovery; it was as if his life had been flattened too.

But Sirajuddin was not one to give up. Rising again Lazarus-like from the ashes, he sought to start his life afresh by setting up a grocery store – in a different location, far from home, in *Niamati* bazar in Bakerganj upazila. To find the money, he went to Grameen Bank again, but was refused as he still had an outstanding loan to pay off. He then turned to an assortment of local MFIs and NGOs as well as moneylenders to both support his business and meet the day-to-day needs of the family. But in the process, his woes have only multiplied as he has fallen deeper and deeper into cycles of debt, from which he now finds no way of escape.
Case Study 3

Shahidul Islam is a 60-year old brick-layer, who lives in village called Vebra in Bogra, located in the north-eastern region of the country. He and his wife Aleya Begum were blessed with six daughters but no son. Four daughters have been married off so far, and so currently the family consists of four people: the couple and the two younger daughters.

Son of a poor family, Shahidul received nothing whatsoever by way of inheritance. In the year in which he separated from his father’s household, he purchased a small piece of land in the same village with the hope of building a home for his family someday. The purchase was funded entirely by borrowed money, with Aleya taking a loan of Tk. 80,000 from a local Mahila Samity (Women’s Association). The loan was paid off in five years, mainly out of Shahidul’s earnings to time by time by short-term borrowing from various sources. Soon afterwards, their dream finally came true as they built a small home on that land, and gradually began to acquire a few modest pieces of furniture and utensils to adorn the home.

All this happened when their daughters were still living with them. Their fortune began to change drastically, however, as the daughters began to get married one by one. When the oldest daughter married in 1995, Shahidul was obliged to pay a dowry of Tk. 30,000; but a saving grace was that he was allowed by the in-laws to spread out the payment over a period of five years. Shahidul took this opportunity to borrow from BRAC in several rounds to pay the dowry in a few instalments, while using his regular earnings to pay off BRAC. By the time the second daughter got married in 1999, Shahidul and Aleya had been so chastened by the rigours of repaying loans week after week for several years that they were determined not to pay any more dowry. But they still had to meet the wedding expenses, though, which cost them Tk. 20,000 for the second daughter and Tk. 25,000 for the third. After many years of paying off the loans that Shahidul and Aleya had incurred while acquiring their home and paying the dowry for the eldest daughter, they were left with no savings whatsoever with which to defray these expenses. As a result, even though they wisely refused to pay any more dowry, they still had to incur new loans, which they did partly from MFIs and partly from moneylenders.

They are still carrying the burden of some of those loans. Meanwhile, as Shahidul is getting old, the demand for his services is declining, and even when he gets the opportunity to work he sometimes cannot take up the offer because of his infirmity. Unable to keep up the level of earnings, Shahidul has been obliged to take new loans from time to time even as the old loans continue to be serviced. It has become increasingly difficult, however, to keep repaying all the loans as the debt servicing liability is going up while income is going down, pushing the family deeper and deeper into a debt trap. No wonder Aleya shudders to think what will happen to her, with two more daughters to look after and to marry them off, if something happens to Shahidul.
Fifth, once one appreciates the genesis of debt traps it becomes clear that most cases of debt trap involving MFIs would have remained cases of debt trap in any case in the absence of microcredit, with the only difference being that these would have then involved only the informal lenders. This is an important difference, however. Since the interest rates charged by moneylenders are several multiples of those charged by MFIs, a debt trap involving only moneylenders is economically much more draining than a debt trap involving MFIs. That is why, as we observe in case studies 2 and 3, when in trouble households try desperately to borrow from MFIs to pay off the moneylenders. In the process, a debt trap involving MFIs can surely emerge, but by replacing a deadlier trap involving only moneylenders it actually enables the households to soften the impact of debt trap even if it cannot extricate them out of it.

6. Summary and Conclusions

This paper has been concerned with a curious divide that seems to exist between academic research and popular perception on the contribution of microcredit in Bangladesh. Despite some controversies along the way, academic research has convincingly demonstrated that microcredit has on the whole had a positive impact on various aspects of the lives of the rural poor, without however transforming their lives completely as some of the enthusiasts might have hoped. Yet, there exists a deep-seated suspicion of microcredit in popular perception – at least as projected in the media – which often manifests itself by invoking the spectre of a ‘debt trap’. It is suggested that microcredit borrowers tend to use up most of the loans for household consumption, and are then compelled to repay the loans by further borrowing – thereby entering into a cycle of borrowing and repaying which leads inexorably to a debt trap. Although this is a popular story, its empirical basis has never been established, beyond the citation of some anecdotal evidence. The present paper makes the first systematic attempt at empirically investigating the existence, nature and magnitude of debt trap among microcredit borrowers in Bangladesh.

The paper has made use of a large-scale nationally representative household panel survey carried out in two rounds (2010 and 2013) by the Institute of Microfinance (InM) in Dhaka under the guidance of the present author. The data base for the present study consists of the loan history of 3389 microcredit-taking rural households over the six-year period 2007-2013. The quantitative analysis has been supplemented by ethnographic research on a small subset of the main sample.

In search of debt traps, the paper first investigates two inter-related concepts, which figure prominently in popular discussion on the subject. We describe them as ‘overlapping credit’ and ‘borrowing to repay’ (B2R) respectively. Overlapping refers to the practice of taking a loan from an MFI before fully repaying an earlier MFI loan; and ‘borrowing to repay’ refers to the practice of using at least a part of the loan to repay another loan, a practice that could involve either an MFI or an informal lender at either end of the transaction. There is a widespread perception that both these practices are on the rise, and that these are the routes through which hordes of microcredit borrowers are plunging into a debt trap.

Our investigation confirms the first part of the perception but not the second. Both practices are indeed on the rise but they are by no means all-pervasive. In an average year, no more than a quarter of microcredit borrowers engage in overlapping. Furthermore, overlapping is only thinly connected to the possibility of a debt trap, if at all. This is because most of the loans taken by overlayer households are used for productive purposes (income-generating activities and asset augmentation), which accounts for about 60 per cent of the total loan amount; by contrast, repayment of old loans accounts for only about 10 per cent. Indeed, we find that overlappers spend a larger share of their loans on income-earning activities in comparison with non-overlapappers, and suggest reasons why this might be so. We conclude that the practice of overlapping is nothing but a red herring when it comes to discussing the existence of debt trap among microcredit borrowers.
More relevant in this context is the practice of ‘borrowing to repay’, because the very concept of debt trap implies repeated cycles of borrowing and repaying. Our investigation confirms that this practice is also on the rise, but it is even less pervasive than overlapping. In an average year less than 10 per cent of microcredit borrowers use their loans either primarily or secondarily for repayment of old loans. Furthermore, we argue that even this small percentage does not represent the magnitude of debt trap because there are a variety of reasons why households may rationally choose to engage in the practice of ‘borrowing to repay’ even when they are not inside a debt trap or sliding towards one.

We, therefore, argue that only a subset of the cases of ‘borrowing to repay’ can qualify as debt trap, and we propose that this subset should be identified by two criteria – namely, cyclicality and repetition. The importance of cyclicality can be seen by noting that if ‘borrowing to repay’ consists of a unidirectional transfer from one lender to another, it cannot be a case of debt trap. For a trap to occur, the loans must go around in cycles – from one lender to another and back again. Furthermore, these cycles must be repeated a number of times – an isolated cycle does not make a debt trap. By applying these two criteria, we find that debt traps can be said to characterise at most 4.5 per cent of households who engage in the practice of ‘borrowing to repay’ and a meagre 1.4 per cent of all microcredit borrowers. Thus, debt traps do exist among microcredit borrowers but its prevalence is quantitatively very small – a far cry from the impression one might get from popular discussion of the subject or statements emanating from some powerful political quarters.

It should be acknowledged, though, that the effect of debt trap can be so devastating for any family that even a single instance of debt trap is one too many. One should, therefore, be seriously concerned with the occurrence of debt traps even if the number is small. The relevant question, however, is: what role does microcredit play in the dynamics of debt trap? In contrast to popular perception, we argue that there is no meaningful sense in which microcredit can be held responsible when the borrowers fall into the trap. Microcredit does have a role to play in the dynamics of debt trap, but that role is one of mitigation rather than causation.

Our evidence shows that those who have fallen into debt trap have been at the bottom of the pile to begin with – they started their journey in life with far fewer assets and less education compared to both non-trapped households who also engage in ‘borrowing to repay’ and other microcredit borrowers who do not engage in this practice at all. It could be plausibly argued, and ethnographic research vividly demonstrates, that it is this initial vulnerability that leads some hapless households towards the slippery slope of debt trap when their lives are buffeted by some exogenous shock. These traps may involve borrowing from MFIs, but this is because borrowing is one of the coping strategies through which households try to fend off the prospect of suffering in the face of shocks. Sometimes this strategy will succeed, in which case microcredit would have helped the borrowers to avoid a debt trap.  

Sometimes, the strategy will fail and the borrowers might fall into a trap; but if they do it’s not because of but in spite of microcredit; the shocks would have been too overpowering relative to the meagre resources possessed by vulnerable households, even with the support of microcredit.

In the face of overpowering shocks, vulnerable households, who have precious little assets to sell or mortgage, would have fallen into a debt trap in any case. In the absence of microcredit, they would have fallen into a trap involving only moneylenders, and since the interest rates they charge are several times higher than what is charged by the MFIs, such traps would have been much more onerous than those involving MFIs. Not surprisingly, our evidence shows that when in trouble households try desperately to borrow from MFIs to pay off the moneylenders. In the process, a debt trap involving MFIs can surely emerge, but by replacing a deadlier trap involving only moneylenders it actually enables the households to soften the impact of the trap even if it cannot extricate them out of it.

27 For evidence that access to microcredit enables vulnerable households to withstand the shocks better, see Osmani (2015, Chapter 6). For the specific case of health-related shocks, see also Islam and Maitra (2012).
Thus, microcredit should be seen as either (a) reducing the prevalence of debt traps to the extent that households faced with shocks can successfully use borrowing as a coping strategy to ride out a temporary crisis, or (b) softening the impact of debt traps when the coping strategy fails, by transforming a potentially deadlier trap involving only moneylenders into a less onerous one involving MFIs. Therefore, to hold microcredit responsible for the debt traps that exist is to completely misunderstand the role of microcredit in the dynamics of the trap.

The reality is that the occurrence of debt trap is not so much a failure of microcredit, nor even of credit market in general, as it is a failure of the society at large to look after its most vulnerable people. The failure is two-fold: the first failure is that the society allows a significant minority to live under exceedingly vulnerable conditions year after year, which sap their ability to withstand shocks that would almost invariably occur at some stage in life; and the second failure lies in not providing an umbrella of social protection when vulnerability conspires with shocks to push these people inexorably towards a debt trap. These are the areas to which policymakers should turn their attention, instead of blaming microcredit, if they are serious about eradicating debt traps – for all borrowers, not just those who take microcredit.

References


The Institute for Inclusive Finance and Development (InM) is working since 1 January 2016 as a non-profit organisation established primarily to meet the research and training needs of national as well as global financial sector including microfinance institutions (MFIs). Its predecessor, Institute of Microfinance, was established at the initiative of the Palli Karma-Sahayak Foundation (PKSF) on 1 November 2006. The InM is registered as an independent non-profit institution under the Societies Registration Act 1860. The Institute works for developing the overall capacity of the financial sector and strengthening the links between the financial and real sectors through undertaking research, training, education, knowledge management and other programmes in priority areas including microfinance, inclusive finance, poverty and development.

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