Authors
Erica Field
Duke University

Rohini Pande
Yale University

John Papp
Research Institute for Compassionate Economics

Jeanette Park

Natalia Rigol
Harvard School of Public Health

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Repayment Flexibility Can Reduce Financial Stress: A Randomized Control Trial with Microfinance Clients in India

Erica Field, Rohini Pande, John Papp, Y. Jeanette Park

Abstract

Introduction

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Financial stress is widely believed to cause health problems. However, policies seeking to relieve financial stress by limiting debt levels of poor households may directly worsen their economic well-being. We evaluate an alternative policy – increasing the repayment flexibility

of debt contracts. A field experiment randomly assigned microfinance clients to a monthly or a traditional weekly installment schedule (N = 200). We used cell phones to gather survey data on income, expenditure, and financial stress every 48 hours over seven weeks. Clients repaying monthly were 51 percent less likely to report feeling ‘‘worried, tense, or anxious’’ about repaying, were 54 percent more likely to report feeling confident about repaying, and reported spending less time thinking about their loan compared to weekly clients. Monthly clients also reported higher business investment and income, suggesting that the flexibility encouraged them to invest their loans more profitably, which ultimately reduced financial stress.

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