

## **Determinants of Credit Market Participation: Evidence from North-Eastern States of India**

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*We examine the extent of households' participation in credit market in general for the North-Eastern states of India. Using data from India Human Development Survey (IHDS, 2011-12) for the formal and the informal credit sectors and using Probit specification to model demand (application) and supply (approval) decisions, this study finds that volume of land ownership and religious group belonging are significant determinants of both demand and supply decisions, while caste is insignificant. Households that have ration card and invested in life insurance are more likely to get credit relative to those that do not. Health insurance increases the probability of application but reduces the chances of approval.*

### **I Introduction**

Credit markets in developing countries are characterized by segmentation, which denotes the coexistence of formal and informal credit sectors<sup>1</sup> (Bell, Srinivasan, and Udry 1997, Conning and Udry 2005, Mohieldin and Wright 2000). The reason most cited for this dual structure is the inability of formal lenders to identify borrower types a priori due to which they usually require would be borrowers to pledge collateral<sup>2</sup> against a loan in order to screen them and this leads to rationing of poor borrowers from formal sector. Consequently, rationed borrowers resort to informal lenders to meet their credit needs (Aleem 1990, Guirkinger 2008). Rationing has been defined by the existing literature in two ways: micro rationing or partial rationing and macro rationing or complete rationing of borrowers (Ghosh, *et. al.* 1999). In case of micro rationing, a lender quotes an interest rate on loans and then proceed to supply a smaller loan size than that demanded by the borrowers (Jaffee and Russell 1976). On the other hand, in macro rationing, among identical loan applicants, some get a loan while others do not, and those rejected ones would not get a loan even if they are willing to pay a higher rate of interest (Stiglitz and Weiss 1981). Rationing in the formal sector has received much attention in the literature and these studies find evidence of pervasive rationing in this sector (Kochar 1997, Pal S. 2002, Pal and Laha 2015). However, a common assumption underlying these studies is that borrowers always prefer a formal loan to an informal loan. Though exclusion from the formal credit market is common in countries like India, more precarious is the situation when a segment of people

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