



“The Insurance Role of Rosca in the Presence of Credit Markets: Theory and Evidence”
(in English)



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Abstract

Rotating Savings and Credit Associations (Roscas) are an important informal financial institution in many parts of the world. Existing models of Roscas assume that their participants do not have access to formal financial markets and predict that the implicit interest rates in bidding Roscas should be declining over their lives. Evidence from survey and field data sets from Wenzhou of Zhejiang Province in Southeastern China shows instead that Roscas are prevalent even in the presence of formal financial markets and more interestingly a large fraction of Rosca participants reported borrowing from the formal credit market to fulfill their Rosca obligations and saving their extra Rosca earnings in the formal credit market. Moreover, we find that the markets and more interestingly a large fraction of Rosca participants reported borrowing from the formal credit market to fulfill their Rosca obligations and saving their extra Rosca earnings in the formal credit market. Moreover, we find that the implicit interest rates observed in a unique Rosca bidding data set are not monotonically declining over its life.

We develop a sequential auction model of risk averse Rosca participants facing income risks to investigate the interaction between formal and informal financial institutions to provide a possible explanation of the above two phenomena in the Chinese data. In this model, a Rosca provides insurance to its participants even in the presence of formal credit markets. The intuition is that while the formal credit market allows individuals to smooth their intertemporal income risks by borrowing and saving, a Rosca provides an additional instrument for its participants to share contemporaneous income. We also show that in this model it is possible that the implicit interest rate in equilibrium may not be declining over the life of a Rosca.

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Biography

Professor Rongzhu Ke is a young economist in applied micro-economic theory. He got Ph.D from the department of economics, MIT (2009) and joined the department of economics, Chinese University of Hong Kong after his graduation. His main research interests are contract theory, including the design of incentive scheme, testing of optimality of contract, and mechanism design under asymmetric information. He is also interested in the organizational economics and political economy.

ALL ARE WELCOME

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