Does the Arrival of a Formal Financial Institution Alter Informal Sharing Arrangements? Experimental Evidence from Village India

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Abstract

How do processes of development, in particular the arrival of formal financial institutions, influence the risk-sharing capacity of village social networks? To shed light on this question, this paper exploits the randomized branch roll-out by a large rural bank in India. Improved formal financial access leads villagers to increase formal borrowing and reduce informal borrowing and gift exchange within the village. The substitutability of formal for informal borrowing is, in turn, associated with a decline of informal trust-based institutions: the risk-sharing capacity of informal networks falls and villagers are less likely to share resources with network members in non-anonymous dictator games. An overall decline in transfers is accompanied by a shift in transfers away from financial network links and towards social links, suggesting that the availability of formal financial services enables households to shift network investments towards members for whom they feel greater altruism.

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