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THOUGHT LEADERSHIP BRIEF

To Save or Not to Save: Why Do Migrant Domestic Workers Borrow So Much?

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KEY POINTS

- Many migrant domestic workers (MDWs) in Hong Kong appear to finance foreseen expenditures through high-interest loans rather than through savings, thereby incurring a sizable cost.
- MDWs who are financially literate are just as likely to borrow as those who are not; those with savings accounts appear *more* likely to borrow than those without.
- Borrowing to pay for important expenses is attractive because it provides discipline: the severe penalties for default ensure that the migrant repays the loan rather than spending on "unnecessary" expenses, and help her resist demands from her kin.
- Well-designed savings commitment products or "repay-and-save" type loan products can help migrants build their assets and improve their welfare.

ISSUE

Unsurprisingly, in many emerging economies the poor save very little. But what is surprising is that they often save less than they could. For example, Abhijit V. Banerjee and Esther Duflo (2010) argue that the fruit vendors they study in South India could substantially reduce their borrowing, if they would just forego six cups of tea over a two-week period. And yet, even after researchers paid off their debt, most market vendors returned to debt within six months. A financial education program did not change this either (Karlan, Mullainathan & Roth 2019).

In Lim and Visaria (2020), we document a similar phenomenon among Filipino domestic workers in Hong Kong. Although they have regular, predictable incomes, we argue that they save very little, and instead finance major expenditures through interest-bearing loans from moneylenders in Hong Kong. What explains this behavior, and what can be done to reduce the high cost it imposes?

ASSESSMENT

One immediate explanation might be that they are unable to save: their family's subsistence consumption needs are so large that their remittances leave very little over for savings. If there is a sudden expense, such as a medical emergency bill, the migrant would have no choice but to take out a loan. However, the data do not suggest that these individuals mainly borrow to finance unforeseen expenses. When we analyzed the stated loan purpose for all 40 loan applications that members submitted to a savings-and-credit cooperative in the year 2018, we found that two-thirds were for expenses that they could have planned for, such as land purchase, home renovation or school fees for children back home. Only 21 percent of loans were for the medical expenses of relatives. Clearly, emergencies cannot explain the entire phenomenon.

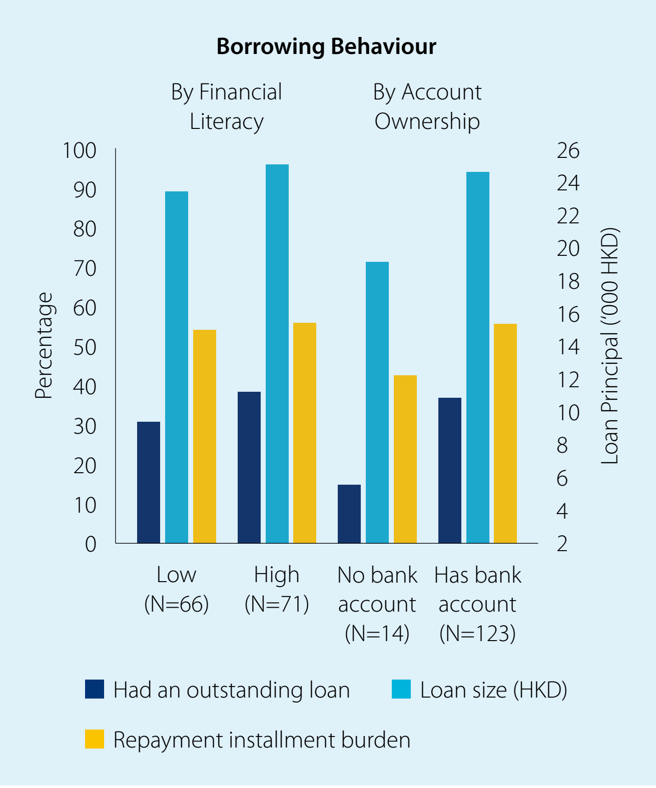
In a survey of 137 Filipino MDWs that my colleagues, students and I conducted in 2017, the average MDW remitted 52 percent of her salary. Even allowing for some personal expenses in Hong Kong, it seems unlikely that they are simply unable to spare any of their salary each month. In any case, once they take a loan, they repay regularly each month from their salaries, and so must necessarily reduce their remittances and/or consumption until the loan is paid off. Instead of borrowing and subsequently lowering remittances and consumption, they could have reduced these ahead of time and avoided paying the interest cost.

Could it be that MDWs do not understand the financial costs of their decisions? We believe this is unlikely to be the sole explanation. In our survey, we asked MDWs two simple questions to gauge their financial literacy. In each question we showed them two loan contracts and asked them which loan was cheaper. More than half answered both questions correctly. Regardless of how they answered the questions, they were just as likely to report they had an outstanding loan (See Figure 1, Left Panel).

Could it be that MDWs understand that it would be better to save than to borrow, but they lack access to savings technologies? In fact, more than 80 percent of the sample reported that they had a bank account. However, bank balances were low: the average respondent held only 1.4 months' salary in their bank accounts at the time of the survey. Respondents who had bank accounts were, if anything, more likely to report an outstanding loan than the unbanked (See Figure 1, Right Panel).

Figure 1

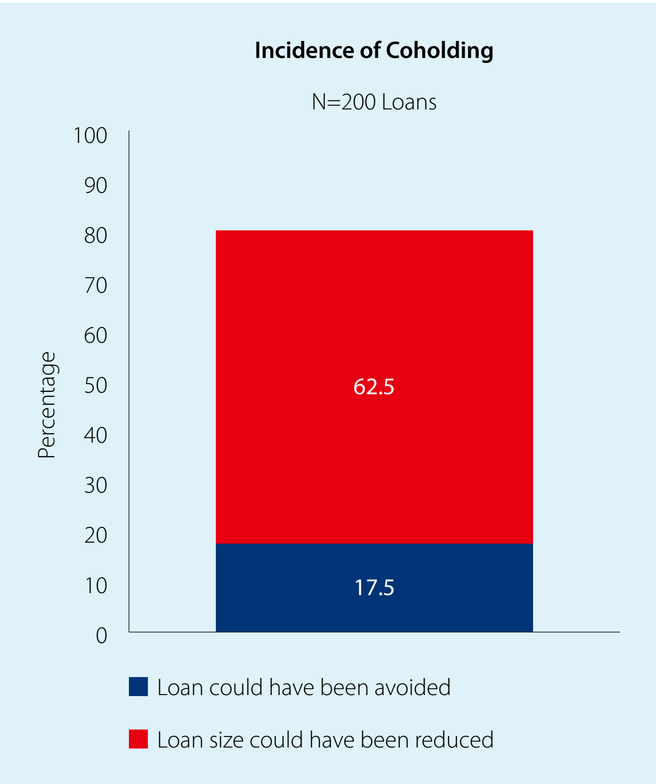
In the left panel, survey respondents are classified as having high financial literacy if they answer both loan contract choice questions correctly, and having low literacy if not. In the second panel, they are classified as having a bank account if they report having a currently open bank account either in Hong Kong or in the Philippines, or both. The first bar indicates the percentage of respondents who said they were currently liable for a loan taken in Hong Kong. Conditional on having a loan, the second bar shows the average loan principal on outstanding loans, and the third bar shows the monthly repayment installment as a percentage of the respondent's monthly salary.



This suggests that the borrowing behaviour is not stemming from the absence of access to savings devices. We are able to verify this by examining the records of the savings-and-credit cooperative. The cooperative allows members to flexibly choose the amount, regularity and frequency of their savings deposits. Six months after they join the cooperative, members become eligible to borrow up to two times their savings balance. Since the interest rate on these loans (1 percent per month) is considerably higher than the return on savings (typical dividend rates are 1-1.5% per year), it is in the member's interest to take the smallest loan necessary to finance her need. Consider a simple example. Suppose a member needs to finance $1000 in expenses. If her savings balance is $1000 or above, she should simply withdraw the $1000, and avoid borrowing altogether. Instead, when we look at the 200 loans that members took over the period 2011-2017, we find that at the time they took the loan, the borrower's savings were larger than the loan they had taken. (See Figure 2).

Figure 2

The data consist of all 200 loans that the Asian Migrants Credit Union had disbursed until April 2018. The blue bar indicates the percentage of loans where at the time the loan was issued, the member's savings balance was larger than the loan principal. The red bar indicates the percentage where the loan was larger than the savings balance, but the member held excess savings that could have been withdrawn in order to reduce the loan size.



Suppose instead that the expense is $1000 and the member's balance is $700. Then a loan is unavoidable, but interest costs can be minimized by reducing the loan size: withdraw as much savings as possible while leaving just enough to guarantee the loan. In our example, the member should withdraw $400 of the $700 balance, so that the remaining $300 guarantees a $600 loan. Remarkably, we find that 62.5% of loans were too large: at the same time they took the loan, the members held savings in excess of the amount necessary to guarantee the loan.

Why might an individual behave in this way, and is this truly a puzzle? Firms often finance investments through debt rather than retained earnings. An important distinction though, is that firms use debt to transfer risk to the lender: if their project fails, they can renege on the loan. Instead, we would argue that domestic workers in Hong Kong are unlikely to use loans to transfer risk to the moneylenders. This is because the costs of defaulting on the loan are large. Moneylenders do not forgive loans; instead when a loan is delinquent they chase the domestic worker, her guarantor and even her employer for repayment. Once a collector contacts her employer, a domestic worker who is in difficulty with a moneylender is likely to be fired – further adding to her problems by also cutting off her source of livelihood. It seems unlikely that the average domestic worker borrows without the intention to repay.

In fact, our proposed explanation is that migrant domestic workers may actually find the strict repayment schedules and heavy penalties for default *desirable*. Perhaps the migrant worries that once she draws down her savings balance, she will be unable to build it up again. Voluntary saving can be difficult: if each month she can flexibly choose whether and how much to save, she may well end up not saving enough. If instead she has an outstanding loan and default is costly, she is likely to repay. In the words of Jonathan Morduch (2010), the poor may be "borrowing to save".

What exactly are the compulsions that make it difficult for migrant domestic workers to save? If she lacks self-control, then in the moment she may spend the money even though she knows that in the longer term she will wish she had saved instead. Alternatively, when she has surplus income her friends or family may request that she gift or lend some to them. If she has a loan she may be able to resist this demand. Indeed, Baland, Guirkinger and Mali (2011) present ethnographic evidence that credit cooperative members in Cameroon borrow so that they can "pretend to be poor" and therefore unable to help their relatives and friends. It is common to hear from migrant domestic workers that their friends and family rely on them for financial assistance, and that is it difficult to refuse them.

RECOMMENDATIONS

Hong Kong's vast and otherwise well-developed banking sector largely disregards the domestic worker segment, offering them only no-frills savings accounts. On the other hand, loans from moneylending companies are easily accessible, at 25 percent annual interest on average. Against this backdrop, migrant domestic workers appear to have fashioned their own solution to the particular challenges they face: they invest and build their assets through borrowing rather than saving. In the process they incur a substantial financial cost.

What interventions could help to reduce these costs? Some financial education courses in Hong Kong coach women to skillfully refuse demands from their social network and focus on building their savings instead. In other contexts, commitment savings products have helped poor households increase savings by preventing the account holder from withdrawing funds until she has reached a target savings amount or a target date. However, there is also a cost to using such products because by their very nature, they reduce liquidity and the ability to respond flexibly to unanticipated needs, either one's own or those of one's kinship network. In contrast, contractual savings accounts allow flexible withdrawals, but require the account-holder to commit to rebuilding her savings.

The financial industry in Hong Kong might generate considerable social impact if it offered such products. It is worth remembering that interventions that benefit domestic workers also benefit their Hong Kong resident employers, who rely heavily on this population for childcare, elderly care and domestic work.

Reference:
Lim, Wooyoung and Sujata Visaria (2020), "The Borrowing Puzzle: Why do Filipino Domestic Workers in Hong Kong Borrow Rather than Dis-save?", *Asian Development Review,* Volume 37, Number 2, pp. 77-99.

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