

A Grounded-Theory Approach to Understanding Regulatory Enforcement, Credit Access, on Debt-Traps

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ABSTRACT

In recent studies, researchers agree that there is a substantial gap in the field of financial management as it relates to debt traps. There is very little empirical evidence of the phenomena of debt traps or the complex process that leads to this. Addressing the lack of empirical research on this phenomenon can help improve both theory and practice in improving anti-poverty measures. The research aims to: (1) examine the cause of debt traps in Trinidad and Tobago and makes recommendations for avenues leading citizens out of debt traps; (2) develop a theory to explain the cause of consumer debt traps in Trinidad and Tobago. This study can help provide policymakers with a tool to help craft policy prescriptions that can effectively address predatory formal and informal moneylending, borrower education, debt traps and, generally, aid the business community with developing affordable credit policies that would help the vulnerable population avoid debt traps. This was done utilizing a qualitative research design. The interviews were done face to face via snowballing with 45 participants, QDA miner software was used for the data analysis. The significant findings of this research show that the Administration of the Process of Lending led to debt traps.

Keywords: Regulatory Enforcement by Government; Credit Access for Borrowers; Informal Lending; Borrower Behavior; Debt Traps; Process of Lending; Financial Policy Reform; Process of Credit, Administration of Personal Lending; Trinidad and Tobago; Credit Process Management; Predatory Lending; Borrower Education.

INTRODUCTION

According to Karlan, Mullainathan, and Roth (2019, 27–42), household debt traps are defined as the process by which households accumulate debt (often high-interest loans) and are unable to pay back the interest and ultimately find themselves perpetually in debt. Debt traps occur in all countries and are usually attributed to various factors depending on a country's development level but are often attributed to predatory informal moneylending (Karlan, Mullainathan, and Roth 2019, 27–42). However, due to the unobserved nature of debt traps and informal lending, it is difficult to explicitly disentangle how or why debt traps exist and under what conditions. Understanding this process and structure was the driving objective of this study. The research recognizes debt traps exist under microfinance and informal lending conditions, but how it operates and how this process can be described is still unknown. While informal lending, such as microcredit or microfinance, holds considerable weight for the promise of development in the extant literature (Yunus 2007) and in the National Entrepreneurship Development Company in Trinidad and Tobago, the literature on debt traps is rare due to its unobserved nature as households are often leery about disclosing the fact that they are in a debt trap.

Despite this, there are antecedents (poverty, low wages, low savings, high debt, poor credit access) and consequences (increases in poverty, evictions, bankruptcies) that point to the existence of this latent phenomenon. Indicators of poverty, household debt levels, credit access, lack of enforcement, and informal lending use in Trinidad and Tobago all suggest that household debt traps exist and are problematic for the country and have likely been made more difficult by the onset of COVID-19.

Several factors were identified in the *literature* that could help to explain this phenomenon:

- consumer behavior that could lead to debt traps (such as spending more money than you make in wages),
- regulatory framework that is ineffective in protecting borrowers from predatory lenders,
- and a general lack of credit access that could help drive borrowers to more formal financing sources with less risk.

Regulatory Enforcement and Credit Access in Trinidad and Tobago

In the case of Trinidad and Tobago, the enforcement of moneylending laws is governed by the Moneylenders Act of 1933 in the *Laws of Trinidad and Tobago*. This act requires any moneylender to obtain a license from the Magistrate's Court, which in turn requires an application and a certificate of good character from the police authorities. The law places an interest rate cap on the amount of interest a moneylender can charge depending on the amount of money lent and the term to repay, but for large loans and long repayment periods, the interest is capped at 24% per annum (the law did not state whether this is simple interest or compound). In addition, the law prescribes jail time and loss of the moneylending license if a moneylender does not adhere to the law. As a result, this law places considerable restrictions (as the prescribed interest rate is high and is not well managed by lenders) on informal moneylending in Trinidad and Tobago. However, informal moneylending does exist, and there has not been a concerted effort to observe how it works within the country.

In addition, to provide other funding sources in Trinidad and Tobago, the nascent Credit Union movement was started in 1945 by Malcolm Milne, a San Fernando solicitor and member of the Catholic Laity (Khan 1991). He immediately saw these institutions as a means for the economic emancipation of the masses because Credit Unions were open to all, regardless of colour, creed, or class. Credit Unions provided at this point in Trinidad and Tobago's history a chance to be part of a type of formal savings and loan institution, where the interests were those of its members, and the members could control the decisions taken. According to the Public Service Credit Union Co-Operative Society (2022), 90 new credit unions were registered between 1946 and 1950, "the decade following the passing of the Credit Union Society Ordinance, No. 48 of 1945". Their attraction to public members was so strong that well over 500,000 persons became members of credit unions. The Commissioner of Co-operatives has oversight over the Credit Union movement in Trinidad and Tobago, which is considered a legal lending industry that exercises all the powers and performs all the functions given to them by the laws of Trinidad and Tobago. While Credit Unions have aided the working classes in accessing day-to-day loans and creating savings, managerial competence in some credit unions is low, which threatens their accountability to their customers, sometimes causing the Commissioner to intervene and, in some cases, declare the Credit Union insolvent. This mismanagement is mostly associated with small Credit Unions; however, recently, large Credit unions have found themselves in trouble, prompting the Commissioner to intervene. In the case of the Credit Union, the urgency to regulate is based on the significant financial assets of the major Credit Unions that could potentially hurt the financial well-being of the country if they fail. In Trinidad and Tobago, a relationship exists between household debt, regulatory enforcement, and credit access from a contextual viewpoint. However, the ways this relationship translates into a more generalized phenomenon were also explored in this paper.

Statement of the Problem

The general problem is that informal lending can often lead to households being stuck in debt traps, where they are consistently borrowing to cover expenses, particularly when the interest rates charged on this kind of moneylending are exorbitantly high (Central Bank of Trinidad and Tobago 2019). The main issues of the problem are (1) The lack of financial education, particularly among borrowers, (2) poor credit assessment and advice by lenders in general, and (3) inflexible/inappropriate lending products that are often not aligned with the needs of low-income borrowers – regulation should at least be able to widen the group of borrowers that are less risky for lenders. In many countries where regulatory enforcement is lax, and/or access to formal credit is too strict, and there are no other sources of credit, this can lead to predatory lending practices, e.g., nonbank loans with high-interest rates, that in turn, increase the likelihood that borrowers could be caught in unending cycles of debt and poverty. Given the growing recognition of the vulnerability of the poor, many governments have embraced the social development paradigm and, as part of this new thrust, actively exploring the link between microcredit, microenterprise, and social empowerment like Grameen Bank in Bangladesh (Chavan and Ramakumar 2002, 955-65).

In addition, evidence for debt traps is a significant empirical problem that has been ignored in the literature. Extant literature has often looked at informal lending more broadly from a qualitative perspective but does not specifically or explicitly explore it in relation to household debt traps. In addition, the conditions that influence household debt traps at an organizational/institutional level are also unknown. Understanding how the borrowers, formal creditors, informal moneylenders, and regulators see this phenomenon and how it relates to their decision-making is an important gap in the qualitative literature. While most quantitative research looks at aggregate covariate effects on households or individuals, they ignore the perspectives or motivations of banks, state enforcement, moneylenders, and borrowers and miss the structure and process related to the debt trap phenomenon. In this sense, quantitative research can see associations between variables but cannot extract the complex process that leads to household debt traps. There is documented evidence of poverty, debt levels, increases in informal lending, and a lack of credit access in Trinidad and Tobago that were provided in the background of the problem.

However, there is very little empirical evidence of the phenomena of debt traps or the complex process that leads to them. There is a need to examine the nature of household debt traps more thoroughly in Trinidad and Tobago. It should be noted that while household debt levels do not necessarily lead to or are associated with poverty, this paper takes the position that household debt traps or high debt service payments due to informal lending practices can lead to conditions of poverty. However, as mentioned previously, empirical evidence in this matter is lacking. Addressing the lack of empirical research on this phenomenon can help improve both theory and practice in improving anti-poverty measures. The implemented enhanced policy prescriptions aim to decrease poverty and elevate the well-being of citizens in Trinidad and Tobago in general.

According to (Motherway, Pazzaglia, and Sonpar 2016, 627-41), there are a variety of strategies to deinstitutionalize unethical business practices related to the enforcement of financing and lending regulations. They applied a mixed-methods strategy, using content and theme analysis of historical records pertaining to the important regulatory actors and events that occurred during and before the Irish financial crisis (2004–2009). Researchers discovered that while financial crises occasionally caught regulators off guard, this was not invariably the result of inadequate oversight. The authors recognized three obstacles to the deinstitutionalization of unethical lending practices: 1) an absence of reform advocacy combined with an inability to critically evaluate the dangers of current business practices; 2) an aversion to imposing change by threats, positions of power, or retribution; and 3) contradictions in the institutional setting.

While the literature has concentrated on 'regulations', few studies focus on the enforcement of laws against banks and other financial sectors. Nonet and Selznick (1978) are of the view that enforcement must not primarily be used as a deterrent. In their writings, they stated that enforcement should represent a detailed scope of the corrections that the Government will take in order to run the errant businesses and build the confidence of the citizens. The key factor in regulatory enforcement is the balance between doing enough to run errant businesses and not deterring good businesses that voluntarily comply. For instance, in Britain, inspectors in the Factory Inspectorate made a clear division between firms that complied with regulations and those that did not, making it simple to enforce regulations.

Credit Access

High-interest rates, loan fees, and broker costs may be directly or indirectly borne by consumers. Consumer debtors might be paying significantly more for their credit than they need to because there is evidence that costs rise when consumers do not understand how interest rates, administrative fees, and terms of the loan work.

Borrower illiteracy is a major concern since many consumer debtors are oblivious to the costs associated with using expensive credit, buying household appliances, purchasing motor, travel loans, education loans, vehicles, and house mortgages. This seems to be particularly true for emerging adults and recent immigrants to North America particularly Canada, whose financial literacy and Borrower education are not yet in line with the unique financing requirements of consumer debtors, which are based on their income and several other factors. Additionally, access-only consumers incur substantial administrative costs, according to Sarra (2011, 576-602).

The sole study that directly addressed the Caribbean environment for informal lending was a qualitative case study approach of Black women-founded informal moneylending cooperatives in Jamaica and Guyana (Hosseini 2014, 85-100). The method used for qualitative research combined participant observation of real-world situations, focus groups, surveys, textual analysis of reports, political ethnography, participant filming, and photography. The author discovered that Black women organized themselves as neighborhood informal moneylenders and met the needs of

the community in these nations in reaction to social unrest and financial marginalization. Through these acts, money was made available to local people in need who did not have access to the conventional banking system.

Soleh, Cahyadi, and Rifai (2017, 127-34) explored the impact of the Baitul Maal Tamwil (BMT), a cooperative microfinance organization in Indonesia. This qualitative case study approach found that the government's effort to stop moneylending by establishing cooperatives did not eliminate the moneylenders charging high interest rates, even though the cooperatives set much lower rates. The continued reliance on moneylenders came from the application process that involved a formal written contract. This formality and the time it took to access the money were barriers to increased credit access through the microfinance cooperative.

In Malawi, a case study approach followed informal moneylenders in communities that included an interconnected network of employers, landlords, friends, and relatives of borrowers (Bolnick 1992, 57-68). These moneylenders' interest rates varied, and repayment was facilitated by the borrower, who would often take a loan from a third party at a lower interest to pay off the moneylender, who then paid off the third party in instalments. In Malawi, even though the moneylender's business was unlicensed according to their traditional law, an informal contract was still enforceable by conventional justice, and this enforcement system held down risk costs. Moneylenders would also refuse loans to people who had defaulted, and this was usually known through a local network of credit checks among moneylenders. The author suggested that developing a micro-level provision of secure and remunerative deposit facilities for storing liquidity and accumulating savings would generate direct utility gains in Malawi.

An ethnographic study by Waters (2018, 403-18) also found a similar network of interconnected financing in this examination of the diversity of debt relations/systems in Mongolia. The author found residents of these rural communities often live from loan to loan through a circuit of traditional bank loans and informal loans borrowed from the family in an endless cycle of refinancing. The author pointed to a lack of better-paying jobs and improved infrastructure due to the limited pool of liquidity and the continuation of what David Sneath referred to as the "regime of debt" (Waters 2018, 403).

Another qualitative case study examined the Nigerian Crisis of 2009 and the government's response (Omede 2020, 519-42). The author found that after the financial crisis, as capital and liquidity requirements became more stringent due to international financing rules, this inadvertently undermined financial inclusion in developing countries and forced many borrowers to engage in more informal moneylending. This created a two-tier lending system, where elite borrowers could draw from traditional banks, and the poor could only remove from informal moneylenders that were often predatory.

Karaivanov and Kessler (2017) used a quantitative correlational approach to explore the advantages and disadvantages of informal loans in an analysis of rural households in Thailand. They indicated that a form of near-zero interest loans (called Everyday loans) was mainly transacted between friends and family that utilized underlying social capital. The authors found that informal loans adversely affected interest rates and collateral size, and the loan-to-wealth (LTW) ratio positively predicted collateral size. In addition, the LTW ratio and loan size both negatively predicted the likelihood of obtaining an informal loan. This issue suggests that informal loan terms are still more favourable than traditional loans for the same borrower. Everyday loans would always be chosen because they were less contractually risky in terms of pledging capital.

Banerjee et al. (2019) employed a quantitative crossover cluster randomized control trial in Hyderabad, India, that randomized neighbourhoods to treatment and control groups - the treatment being microfinance opportunities for entrepreneurs. The outcomes of interest were being exposed to borrowing from microfinance institutions or informal sources, the extent of borrowing, business indicators, labor market outcomes, consumption, and measures of well-being. The treatment effect by itself was inconclusive. The findings showed that households were remarkably heterogeneous, with some families having the potential to move up into a more efficient, higher-fixed-cost mode of operation while others were unable or unwilling to do so. However, it was found that the interaction of the treatment effect with so-called "gung-ho entrepreneurs" (GEs) or households that were already running a business before microfinance entered showed endless benefits that increased over time (Banerjee et al. 2019, 25).

Using a quantitative cluster quasi-experimental design of households, Das (2019, 252-70) undertook a study in rural Assam, India, to assess the effects of credit access microfinance interventions on income and multidimensional poverty. The study revealed that treatment households of semiformal and informal borrowers had a much higher poverty rate. By assisting those households that were most in need of assistance, the authors found that traditional

sources were more successful in lowering the number of poor households. Semiformal and informal sources were more successful in reaching the poor and lifting them above the poverty line. The authors speculate that among semiformal and informal borrowers, there may be a vicious cycle of income and multidimensional poverty. Additionally, this research emphasized how borrowers describe the structure and process of lending as it relates to debt traps in Trinidad and Tobago.

Debt Traps

Ansari (2017, 107-30), using data from a primary survey, conducted a quantitative correlational study to better understand the relationship between farmers and moneylenders in West Bengal, India. Borrowers in this region were often subject to what was called a trade-loan nexus, where the farmer was compelled to sell his produce to the moneylender at a pre-arranged low price immediately after harvest, with the proceeds going towards an outstanding loan with the moneylender, who would then trade in the output crop at a higher price. The result of this arrangement placed farmers in debt traps. Attempts by the government to address this issue with farmer subsidies (Kisan Credit Cards - KCC) may have had some limited success. The findings indicated that if a farmer had suitable housing, access to the KCC loans, immediate sales, collateral, and higher education, all reduced the likelihood of seeking informal loans. Conversely, existing crop sales to lenders (the trade-loan nexus variable) positively predicted the possibility of seeking everyday loans.

Moreover, Balachandran and Dhal (2018, 330-47) continued Ansari's work using survey data and conducted a quantitative correlational study to explore further the trade-loan nexus in West Bengal, India. Attempts by the government to address this issue with farmer subsidies have not resulted in much success. Regression analyses were conducted to determine factors that predicted whether a farmer borrowed an informal loan, immediate sale of a crop, and default on loans. The findings indicate that the trade-loan nexus increases defaults on agricultural loans and increases farmers' dependence on the moneylenders. The author suggests that to properly implement policy prescriptions, the moneylenders, their sources of finance and political control over local economies, and the existing social hierarchies within the rural context should be studied in more depth.

A quantitative randomized experimental design was employed by Karlan, Mullainathan, and Roth (2019, 27-42) to evaluate small-scale entrepreneurs and debt levels in metropolitan India and the Philippines. Debt payments, financial education, debt payoff, and control were the four equally sized treatment arms employed in the intervention.

The majority of borrowers returned to debt with moneylenders six weeks, one, or two years following the intervention, according to the authors' findings; those receiving treatment were borrowing at the same rate as controls. These findings demonstrated that, in order for households to escape debt traps, structural concerns relating to the economy must also be addressed. Closing or limiting informal loan markets may result in spirals of debt worse than endless borrowing, forcing households to go into debt traps.

According to the extant literature, persons with low levels of education, such as primary education or no education at all, are more likely to become trapped in debt; this contrasts with persons with higher education, such as a degree. Moreover, children are said to be a determinant of debt traps. However, this statement may not be entirely true as there are persons with two or more children who are not debt-trapped. In contrast, single persons and divorced persons have more debts than married persons with children. As a person's finances, age, and education increase, debts tend to lessen, thus reducing the likelihood of being debt-trapped (Madeira 2023). According to Attanasio and Weber (2010, 693-751) and Badarinza, Campbell, and Ramadorai (2016, 111-44), education proxies for financial literacy notwithstanding, several educated persons are themselves in debt.

Furthermore, Melzer (2011, 517-55) conducted a multilevel, longitudinal correlational study using geographic differences in the availability of payday loans (high-interest moneylending) to estimate the real effects of credit access among low-income households in the United States. Regression analysis was employed to observe whether payday loan access predicts postponed household care due to lack of insurance or money, difficulty paying bills, and family hardship. The author found no evidence that payday loans alleviate economic problems; instead, payday loan access leads to increased difficulty paying the mortgage, rent, and utility bills. This study counters the view that improving credit access to moneylending facilitates essential expenditures; the results suggest that the debt service burden imposed by borrowing inhibits their ability to pay essential bills. Moreover, how do formal lenders describe the process and structure of lending as it relates to debt traps in Trinidad and Tobago?

Theory and Conceptual Framework

The theory behind moneylending and borrower debt traps is still in its infancy due to the informal and unobserved nature of the moneylending-borrower transaction and household debt traps. Most of the extant literature involves case studies specific to a country's context. Literature varies in theme and perspective; however, there is no apparent theoretical coherence across them.

Several model articles do represent a path forward: a theory of debt traps (Karlan, Mullainathan, and Roth 2019, 27–42), a theory of credit access organization (Hossein 2014, 85–100), and a theory of institutional enforcement or deinstitutionalization of bad business practices (Motherway, Pazzaglia, and Sonpar 2016, 627–41). However, what is needed to fill the gaps in knowledge surrounding informal lending and debt traps is to better understand the process of informal moneylending for people who are stuck in debt traps. This phenomenon requires understanding the perspectives of borrowers who find themselves stuck in debt traps and may face barriers to obtaining formal lending. In addition, understanding the appeal of getting informal lending for borrowers in debt traps is also needed as to what might be the reasons that led a borrower in a debt trap or out of a debt trap. Last, it would be important to know the perspectives of all stakeholders involved in the informal borrowing process: formal lenders such as banks or credit unions, informal moneylenders, and government regulators enforcing moneylending laws.

METHODOLOGY

The research design selected for this study is a qualitative exploratory technique combining qualitative components with grounded theory data collecting and analysis to understand the structure and process of stakeholders involved in the phenomena of interest (Creswell 2013).

This grounded theory method drew participants from the four main parties involved in loan financing: regulators, formal lenders, informal lenders, and borrowers. The literature classifies these participants as parties to financial transactions, including official or informal lending, in which it operates.

CONCLUSION

This grounded theory qualitative study explored the impact of Regulatory Enforcement, Credit Access, Borrower Behavior, and Informal lending on debt traps in Trinidad and Tobago. This study used a questionnaire and focus group approach to collect data from persons identified in the literature as part of the credit process. This research and its recommendations are an academic approach combined with the words of interviewees involved in the lending and borrowing sector, those identified in the literature as part of the process of lending. Moreover, the findings point to the fact that the administration of the process of lending needs to be revised to create a more sustainable credit industry and avoid borrowers from getting into deeper debt traps

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