Observing Unobservables: Identifying Information Asymmetries with a Consumer Credit Field Experiment

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* Views expressed are those of the authors and do not necessarily represent those of the Federal Reserve System or the Federal Reserve Bank of New York.

Substantive Motivations

- Extensive theoretical literature on information asymmetries in credit markets
  - Credit market failures often assumed to exist, yet little direct evidence (other than the poor not having credit).
  - We have relatively little empirical evidence on existence & impacts of specific private information problems
    - In credit markets especially (Chiappori and Salanie)
    - Nobel Committee citation in 2001
  - Do adverse selection & moral hazard matter in practice?
- Do lending relationships mitigate asymmetric information problems?
- Are there gender differences?

Solving Credit Constraints

- 3 necessary steps for policy prescriptions for credit markets for credit constrained
  - First: establish if there are indeed information asymmetries (this is what this paper does)
  - Second: assess whether certain interventions (e.g., group liability) help alleviate information asymmetries
  - Third: assess the impact of relaxing credit constraints.

Our Approach

- A field experiment that:
  - Is motivated by specific models of private information.
  - Is designed to identify separately “selection” (ex-ante) from “incentive” (ex-post) effects.
  - We randomize interest rates along 3 dimensions:
    - “Offer” Interest rate (selection)
    - “Contract” interest rate (repayment burden/moral hazard)
    - Interest rate on future loans (moral hazard)

Key Findings

- Adverse selection on interest rates
  - important for women
  - non-existent for men
- Repayment burden on interest rates
  - strong for men
  - non-existent for women
- Moral hazard on dynamic incentives (men)
- Economic significance? yes
  - Perhaps 20% of default due to info asymmetries.