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Referrals: Peer Screening and Enforcement in a Consumer Credit Field Experiment

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Abstract

Empirical evidence on peer intermediation lags behind many years of lending practice and a large body of theory in which lenders use peers to mitigate adverse selection and moral hazard. Using a simple referral incentive mechanism under individual liability, we develop and implement a two-stage field experiment that permits separate identification of peer screening and enforcement effects. We allow for borrower heterogeneity in both ex-ante repayment type and ex-post susceptibility to social pressure. Our key contribution is how we deal with the interaction between these two sources of asymmetric information. Our method allows us to cleanly identify selection on the likelihood of repayment, selection on the susceptibility to social pressure, and loan enforcement. We estimate peer effects on loan repayment in our setting, and find no evidence of screening (albeit with an imprecisely estimated zero) and large effects on enforcement. We then discuss the potential utility and portability of the methodological innovation, for both science and for practice.

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1 Introduction

Economic theory assigns credit market failure a central role in explaining poverty and underdevelopment. Borrowing constraints reduce efficiency, increase inequality and can lead to poverty traps (Banerjee and Newman, 1993; Galor and Zeira, 1993). Credit rationing also appears to be empirically important. Making use of experimental or quasi-experimental supply shocks, several

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