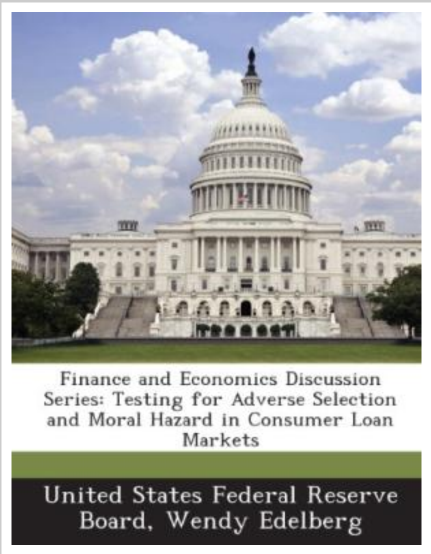

Finance and Economics Discussion Series: Testing for Adverse Selection and Moral Hazard in Consumer Loan Markets

By Wendy Edelberg

BiblioGov. Paperback. Book Condition: New. This item is printed on demand. Paperback. 46 pages. Dimensions: 9.7in. x 7.4in. x 0.1in.This paper explores the significance of unobservable default risk in mortgage and automobile loan markets. I develop and estimate a two-period model that allows for heterogeneous forms of simultaneous adverse selection and moral hazard. Controlling for income levels, loan size and risk aversion, I find robust evidence of adverse selection, with borrowers self-selecting into contracts with varying interest rates and collateral requirements. For example, ex-post higher-risk borrowers pledge less collateral and pay higher interest rates. Moreover, there is strongly suggestive evidence of moral hazard such that collateral is used to induce a borrowers effort to avoid repayment problems. Thus, loan terms may have a feedback effect on behavior. Also, higher-risk borrowers are more difficult to induce into exerting effort, explaining the counter-intuitive result that higher-risk borrowers sometimes pay lower interest rates than observably lower-risk borrowers. This item ships from La Vergne,TN. Paperback.

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