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BORROWING REQUIREMENTS, CREDIT ACCESS, AND ADVERSE SELECTION:
EVIDENCE FROM KENYA

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Borrowing Requirements, Credit Access, and Adverse Selection: Evidence from Kenya

We examine the potential of asset-collateralized loans in low-income country credit markets. When a Kenyan dairy cooperative exogenously replaced high down payments and joint liability requirements with loans collateralized by the asset itself—a large water tank—loan take-up increased from 2.4%to 41.9%. In contrast, substituting joint liability requirements for deposit requirements had no impact on loan take up. There were no repossessions among farmers allowed to collateralize 75% of their loans, and a 0.7% repossession rate among those offered 96% asset collateralization. A Karlan-Zinman test based on waiving borrowing requirements ex post finds evidence of adverse selection with very low deposit requirements, but not of moral hazard. A simple model and rough calibration suggests that adverse selection and regulatory caps on interest rates may deter lenders from making welfare-improving loans with low deposit requirements. We estimate that 2/3 of marginal loans led to increased water storage investment. Real effects of loosening borrowing requirements include increased household water access, reductions in child time spent on water-related tasks, and greater school enrollment for girls.

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