Does Increasing Access to Formal Credit Reduce Payday Borrowing?

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MIT Sloan & NBER

NBER Summer Institute Corporate Finance

July 14, 2020

MIT MANAGEMENT SLOAN SCHOOL

Stage: Contested Literatures

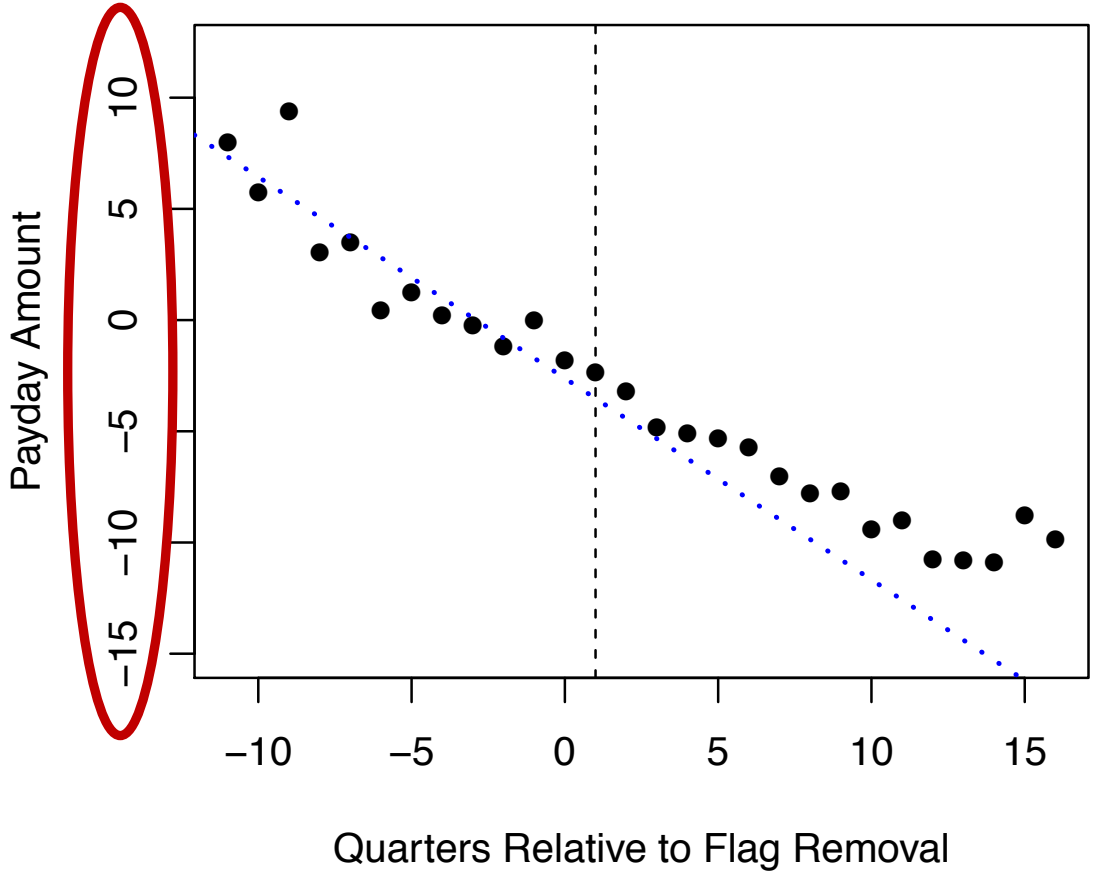
- Is access to payday lending good? Yes! No!
- Does bankruptcy flag removal affect labor outcomes? Yes! No!

- Set all of that aside. Not terrific to have distressed households borrowing at, e.g., 300% APR.
- Why? Debt traps (Karlan et al. 2019), Stigma (Liberman et al. 2020)

- If **credit access** is the reason for payday lending uptake, expect *decrease* in payday lending following increase in credit access.
- Usually think of banking the unbanked, here look at credit limits.

¿ Credit Access ↑ ⇒ Payday Borrowing ↓ ?

- No.



Summary of Findings

- Use bankruptcy flag removal natural experiment
- Use neat Clarity data to observe usage of alternative credit products

  (Impt! Argyle, Iverson, Nadauld, and Palmer (2020 WP) on "shadow debt" Bankruptcy filings contain **75%** more debt than contemporaneous credit bureau records)

- Even though **credit scores**, **limits**, **approvals**, **credit-card borrowing** all go up after bankruptcy flag removal, precise zero effect on payday borrowing

Why doesn't credit access ⇒ payday borrowing ↓ ?

- Apparently use the increased credit access for other things.
- Who would do that? Payday loan rates ~300% APR!
- Authors consider several explanations, acknowledge no direct evidence

1. Still credit constrained after flag removal?
2. Payday lenders increase marketing?
3. Payday loans provide **cash** and convenience
4. Use windfall credit to pay back collections agencies?
5. Many payday loans used for essentials: less adjustable?

1. Still credit constrained after flag removal?

- Hypothesis of less payday borrowing has an IRR-logic flavor to it
- Find *the* project with with the highest IRR and do it
  e.g., pay back credit-card debt before investing/saving

- In reality, want to do *all* the NPV>0 projects.
- And if sufficiently credit constrained, high-cost debt could *still* be NPV>0 even after credit access improves (Lagrangian logic)

- Authors: even among people for whom flag removal gives much bigger bump in credit score, no reduction in payday borrowing

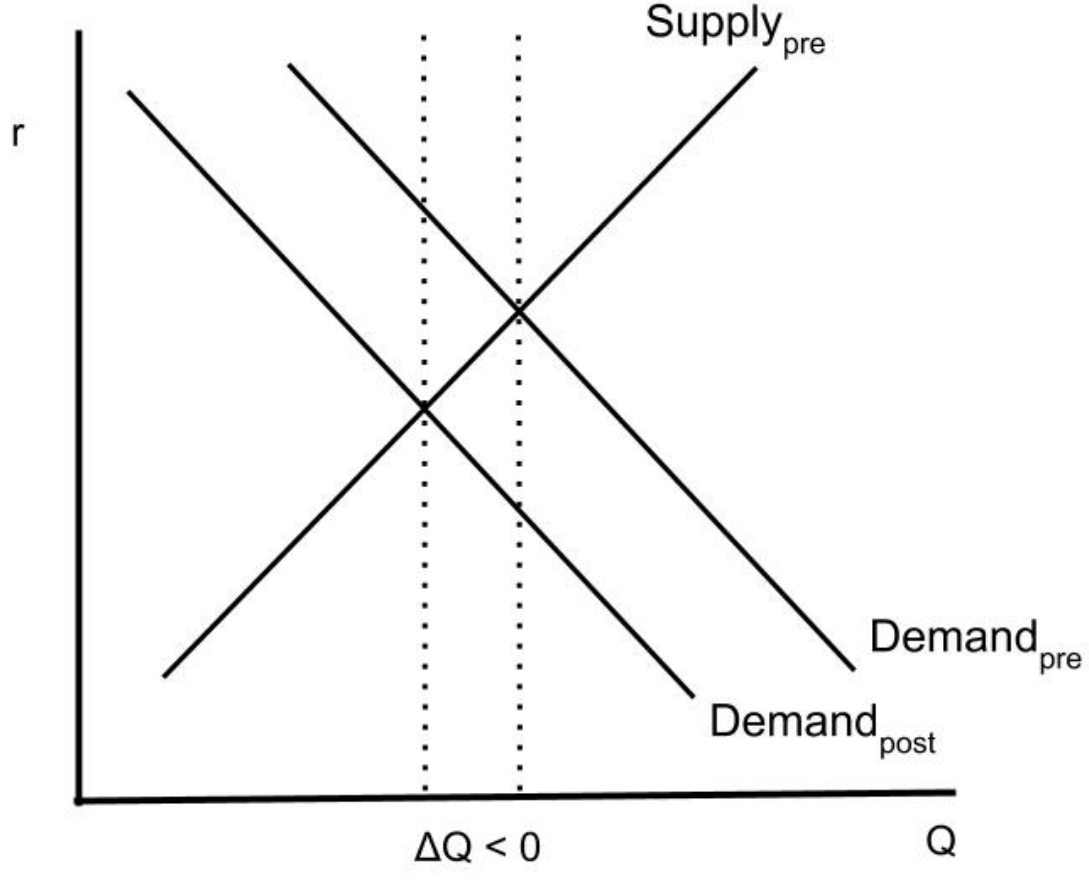
  …but maybe *everyone's* constrained?
- Splits by utilization? Different population from Agarwal et al. (2009).

2. Payday lenders increase marketing?

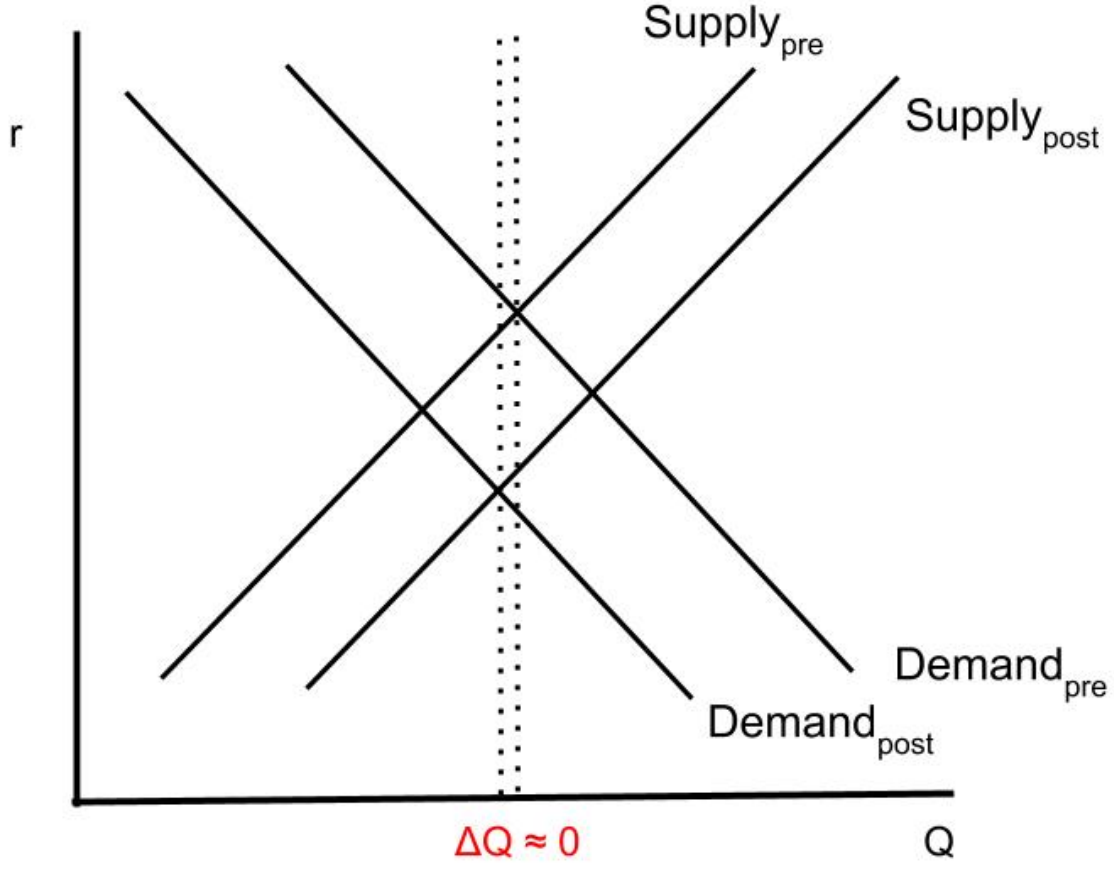
- Maybe at exactly the same time credit access improves, payday lenders step up marketing

- Offsetting supply and demand shocks?

Expect negative shock to payday loans demand



Supply and Demand for Payday Loans



Quite the coincidence?

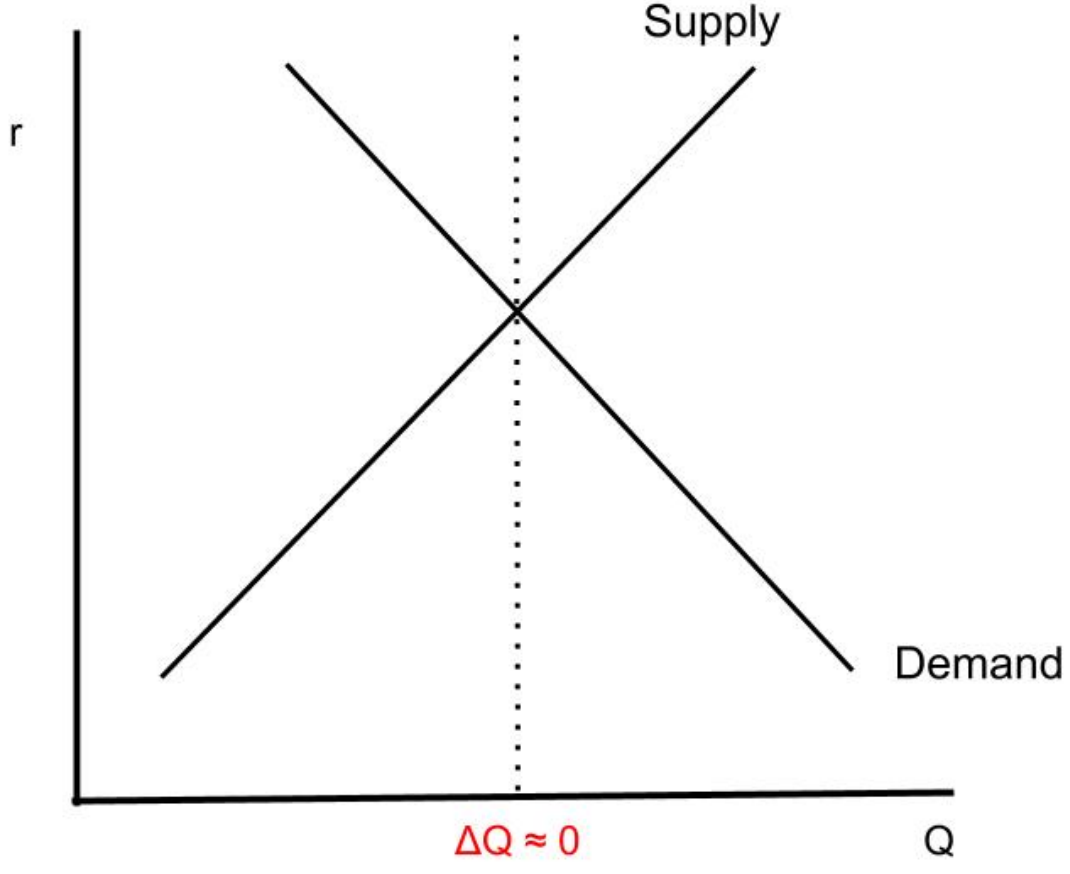
- Always leery when equilibrium effects require offsetting demand and supply shocks. Seems too convenient.

- Totally plausible here: both demand + supply observing same shock (flag removal)

- Flag removal decreases demand: decreases price of a substitute
- Flag removal increases supply: decreased costs (lower perceived risk)

- Evidence for supply shock?
  - Authors: No effect on pre-screened subprime credit offers
  - No data on interest rates in Clarity?
  - Maybe approvals are the intervening variable! Check tradelines per inquiry?

Supply and Demand for Payday Loans



"Well, then I guess there wasn't a supply shift….
and if there wasn't a supply shift and Q didn't move, then I guess there wasn't a demand shift, either."

→ Check other forms of supply shock

4. Use payday borrowing to pay back collectors?

- Certainly plausible using windfall of credit used to pay back collectors
- Finding: Amount in collections goes waaaay down
- Point estimates suggest **$300** reduction in year 1—is this plausible? How are they financing this decrease in collections?
  - Income, credit limits, borrowing, utilization effects all too small to explain

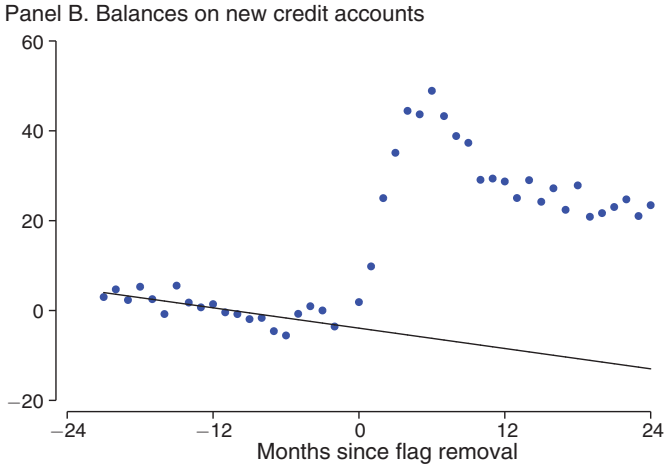
- Alternative explanations:
  - Collectors suddenly displaying leniency? Unlikely.
  - Collections complementarity with bankruptcy flag? Maybe. Still too big.
  - Artifact of GNW (2020 *AEJ: Macro*) spec of pre-trends?

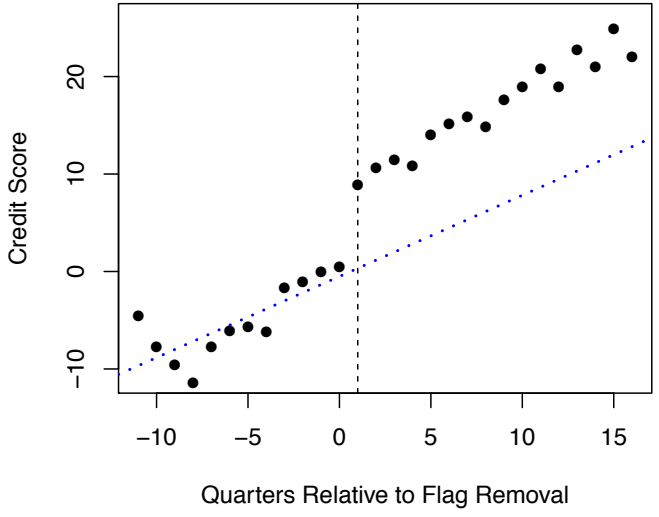
GNW Pre-trends Specification

- Follow Gross, Notowidigdo, and Wang (2020) to allow for pre-trends

$$y_{it} = \alpha t_{pre} + \gamma_y + \gamma_c + \sum_{y=1}^{4} \delta_y \mathbf{I}(r_{it} \in y) + \epsilon_{it}$$

- Clearly useful in GNW: well-defined pre-trend that clearly can't explain the results

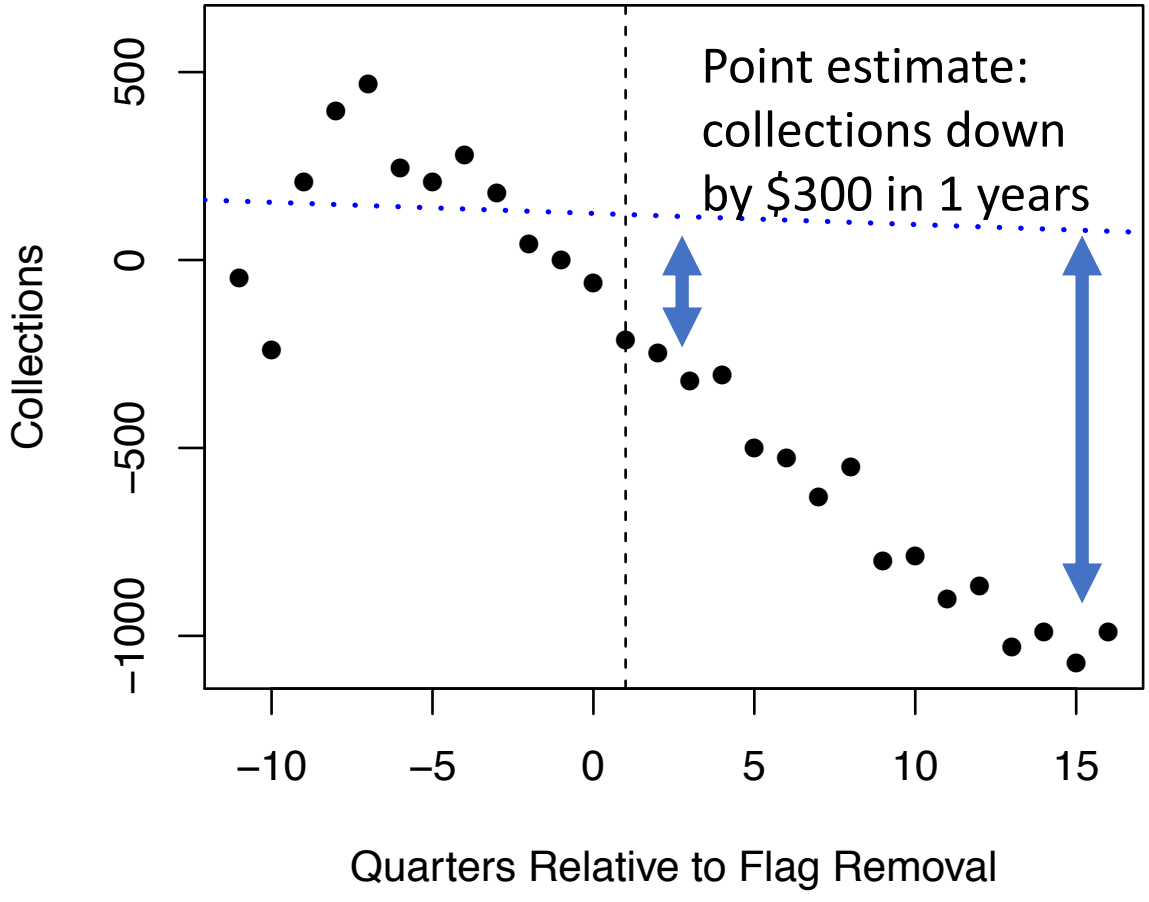


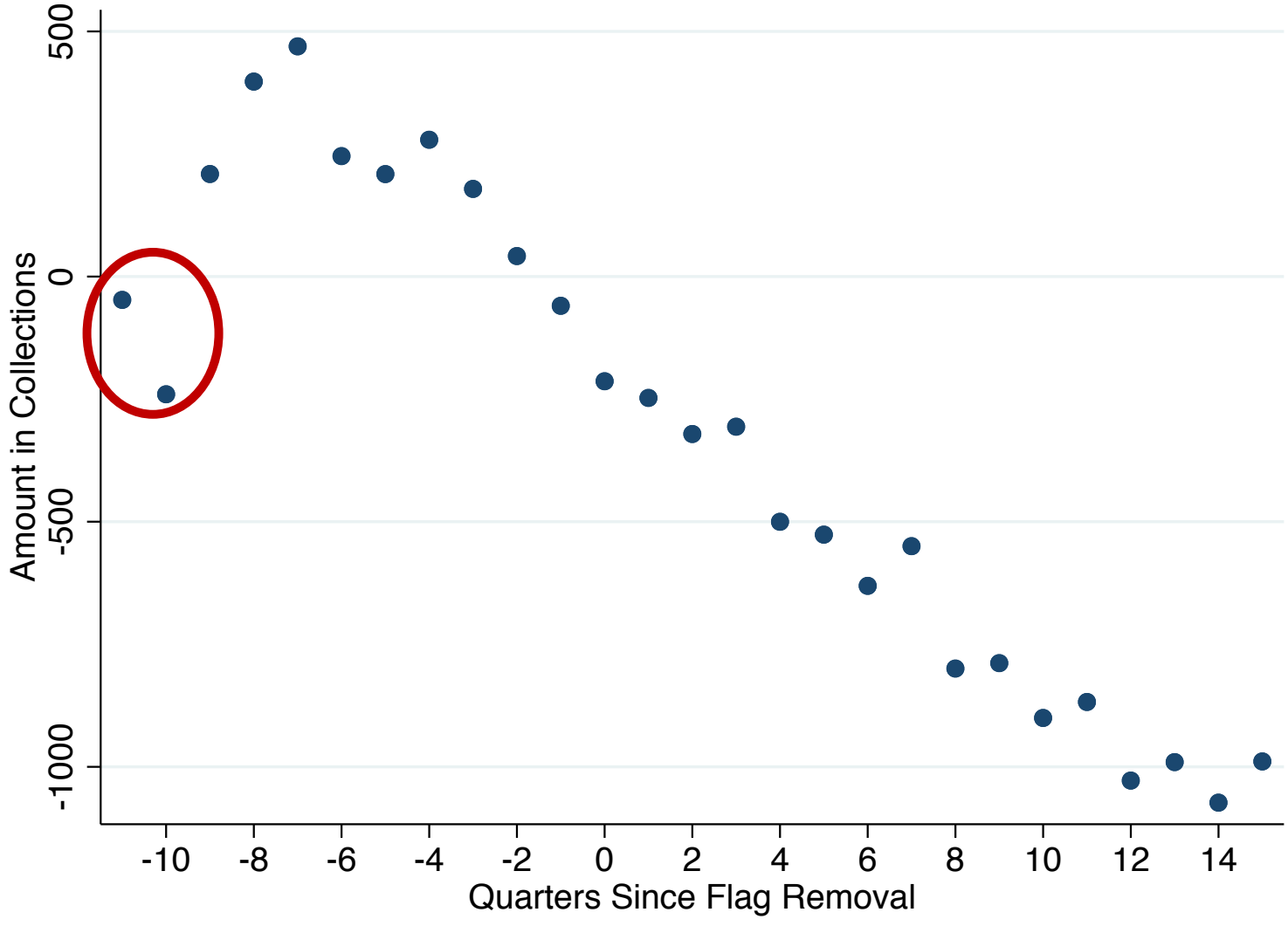


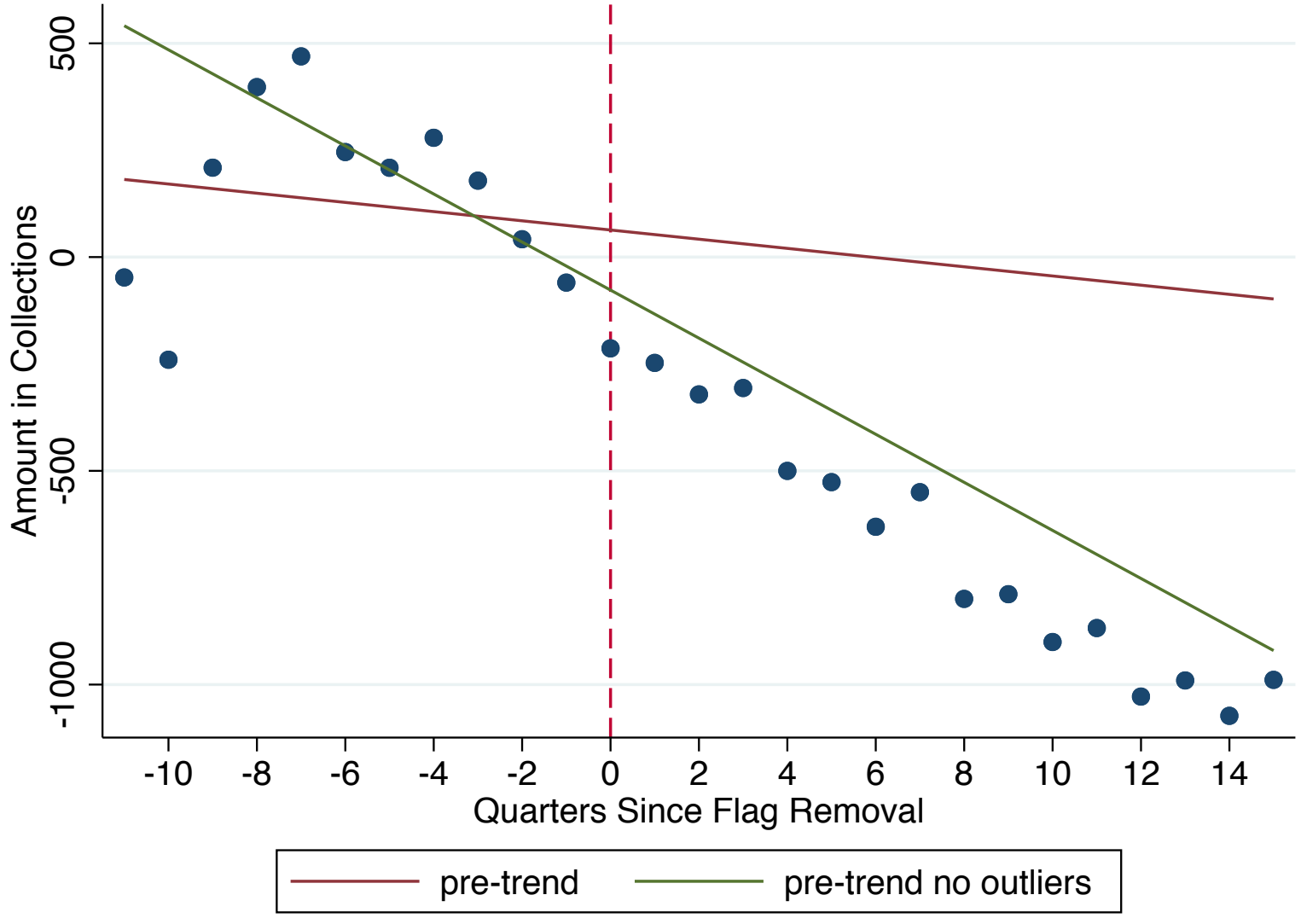
Why do we normally not specify trends this way?

- Usual way to allow for trends: estimate them over the entire sample
- Idea: even though treatment may well affect trend, if a simple trend can explain all of the results, then conservative to honor that explanation before rejecting null of no treatment effect
- At the very least, want to verify visually that pre-trends not leading to estimates that one could easily explain with common trend
- Not a discussant's *gotcha* point! The authors are cautious about attributing their effects to the drop in collections. And after exploring further, magnitudes may well line up in more compelling way

Amount in Collections Event Study




Amount in Collections
500
0
-500
-1000
-10
-8
-6
-4
-2
0
2
4
6
8
10
12
14
Quarters Since Flag Removal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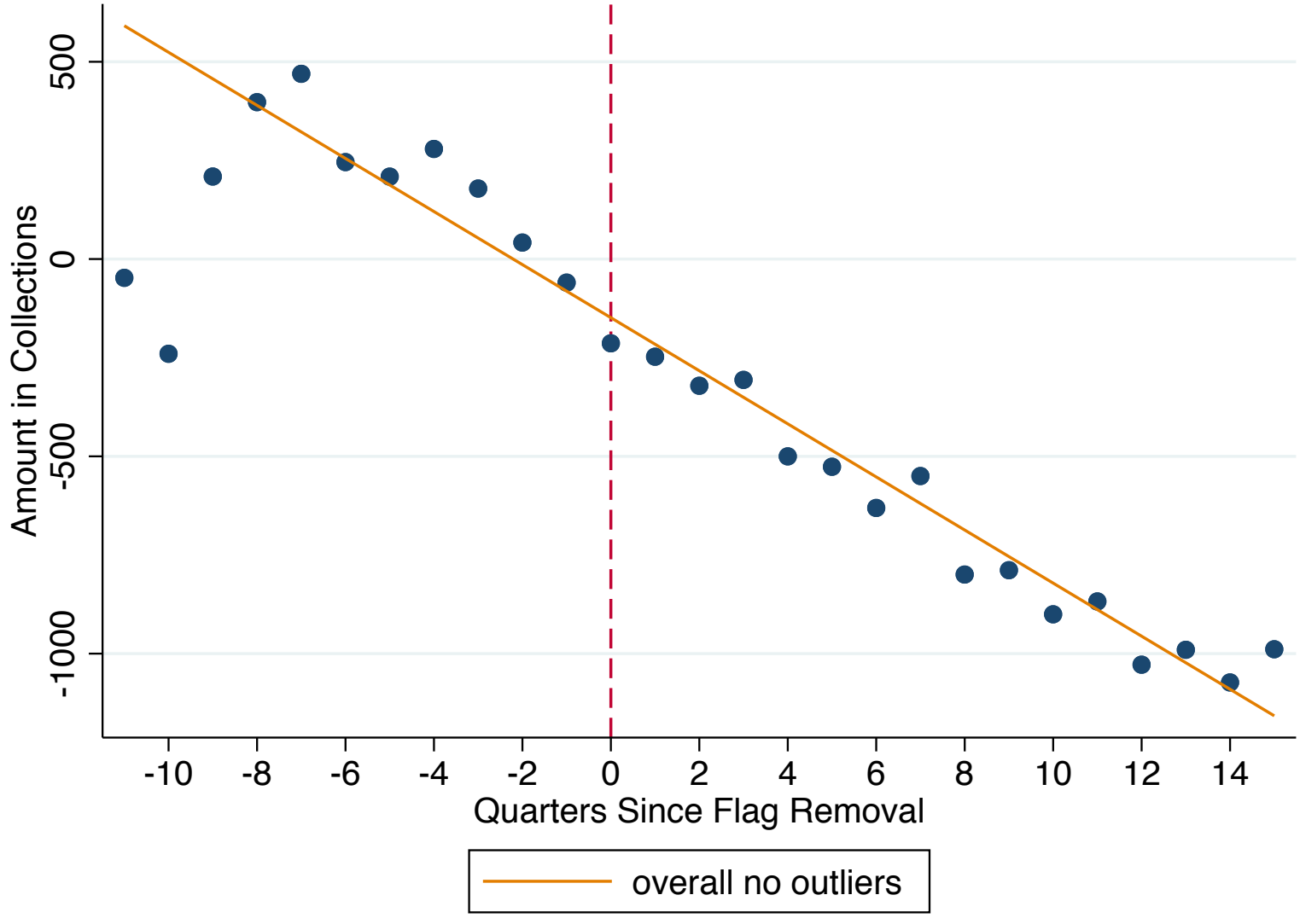
12
14
Quarters Since Flag Removal
pre-trend
pre-trend no outliers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8
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12
14
Quarters Since Flag Removal
overall no outliers

Collections Takeaways

- Hard to know how much collections actually go down and how much is due to pre-trends specification
- Certainly intuitive people use a credit windfall to pay down collections
- AINP (2020) find 45% shadow debt used to pay back formal debt
- Possible that alternative specifications will yield magnitudes that line up with raw data to strength that case

Segmented mental accounts?

- Trends suggest there is some substitution but not from windfall. Effects of windfall credit different from anticipated credit?

- Segmented mental accounts explanation
- Use payday loans for expense-type *A* and credit cards for expense *B*.
- cf. Argyle, Nadauld, Palmer (2019) “Monthly Payment Targeting”
- Windfall in auto loan debt service capacity spent entirely on car

- Alternatively: Allcott et al. (2020) self-control challenges

Conclusion

- Valuable to understand drivers of payday borrowing given high costs
- After bankruptcy flag removal, windfall of credit access…
- …but no reduction in payday loan access

- Why?
  1. Credit constrained even after windfall?
  2. Payday products differentiated from traditional products?
  3. Windfall effect different from other effects?
  4. Segmented monthly accounts?
  5. Self-control issues?