

Comments on:
“How do Payday Loans Affect Consumer Finances?”
by John Gathergood, Ben Guttman-Kenney and Stefan Hunt

Justin Wolfers
University of Michigan
also Brookings, CEPR, CESifo, IZA, PIIE and NBER

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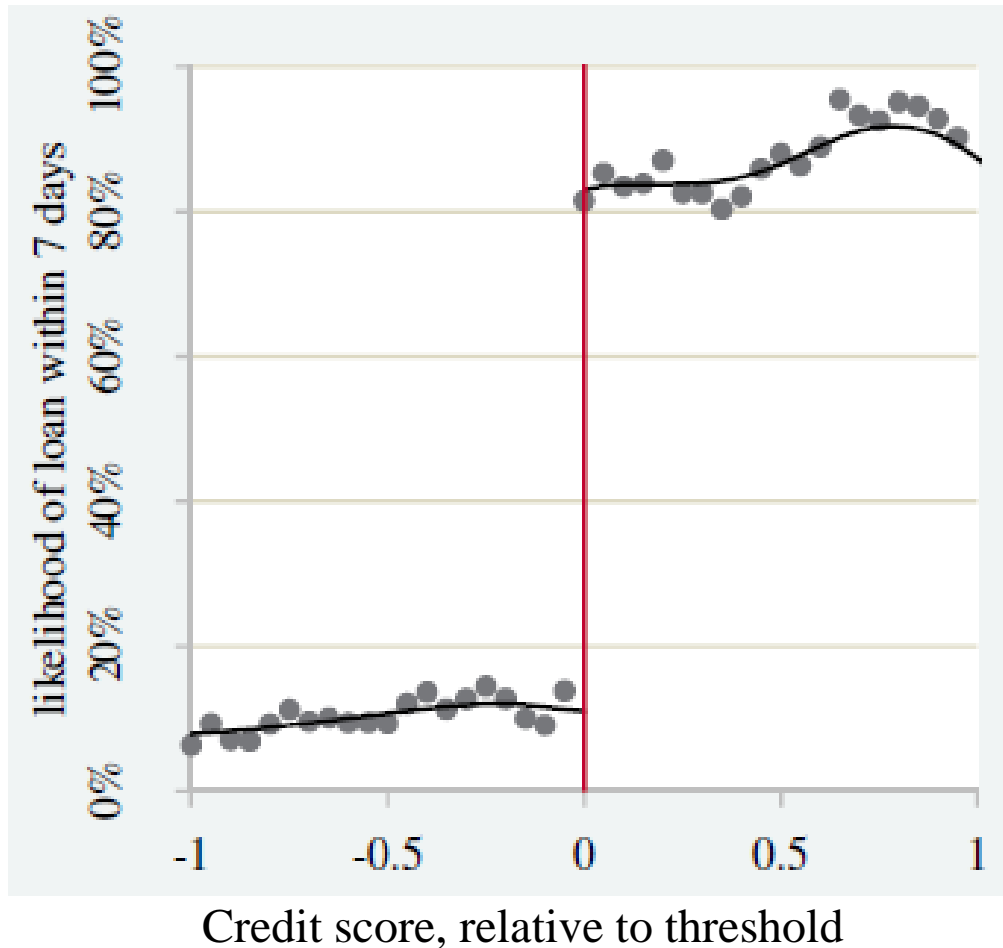
Recipe for a Killer Paper

1. Use your statutory authority to put together a novel dataset

Our dataset comprises exceptionally detailed records for the near-universe of UK payday loans obtained from payday lenders using formal legal powers by the Financial Conduct Authority, the regulator of the financial system in the UK. It includes information on all payday loans granted in 2012-13 by the largest 37 lenders, together comprising approximately 99% of loans issued. For 11 large lenders, covering 89% of loans issued, the dataset also contains details of all applications, denied and accepted, including lender credit scores and cut-off thresholds for loan decisions. Individuals are matched across all payday lenders and to their credit bureau files. These files contain up to six years (2008-2014) of data on mortgage and consumer credit applications, product holdings, balances, loan performance and credit bureau credit scores. We therefore have a dataset where we can track an individual over time and across payday lenders observing nearly every successful and unsuccessful payday loan application between 2012-13, the details of the applications, subsequent loan performance and the credit history for a minimum of two years before, during and after applications.

Recipe for a Killer Paper:

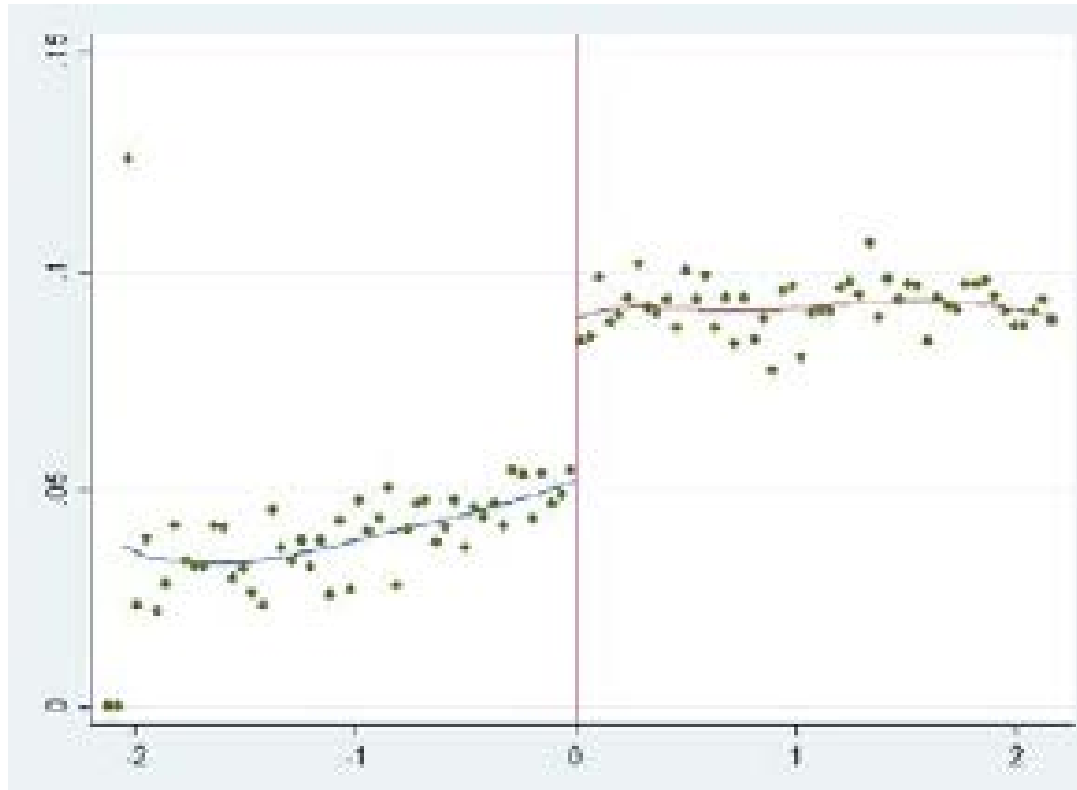
2. Exploit a sharp natural experiment



Recipe for a Killer Paper:

3. Find convincing and large effects

Probability of exceeding overdraft
limit, 6-12 months later

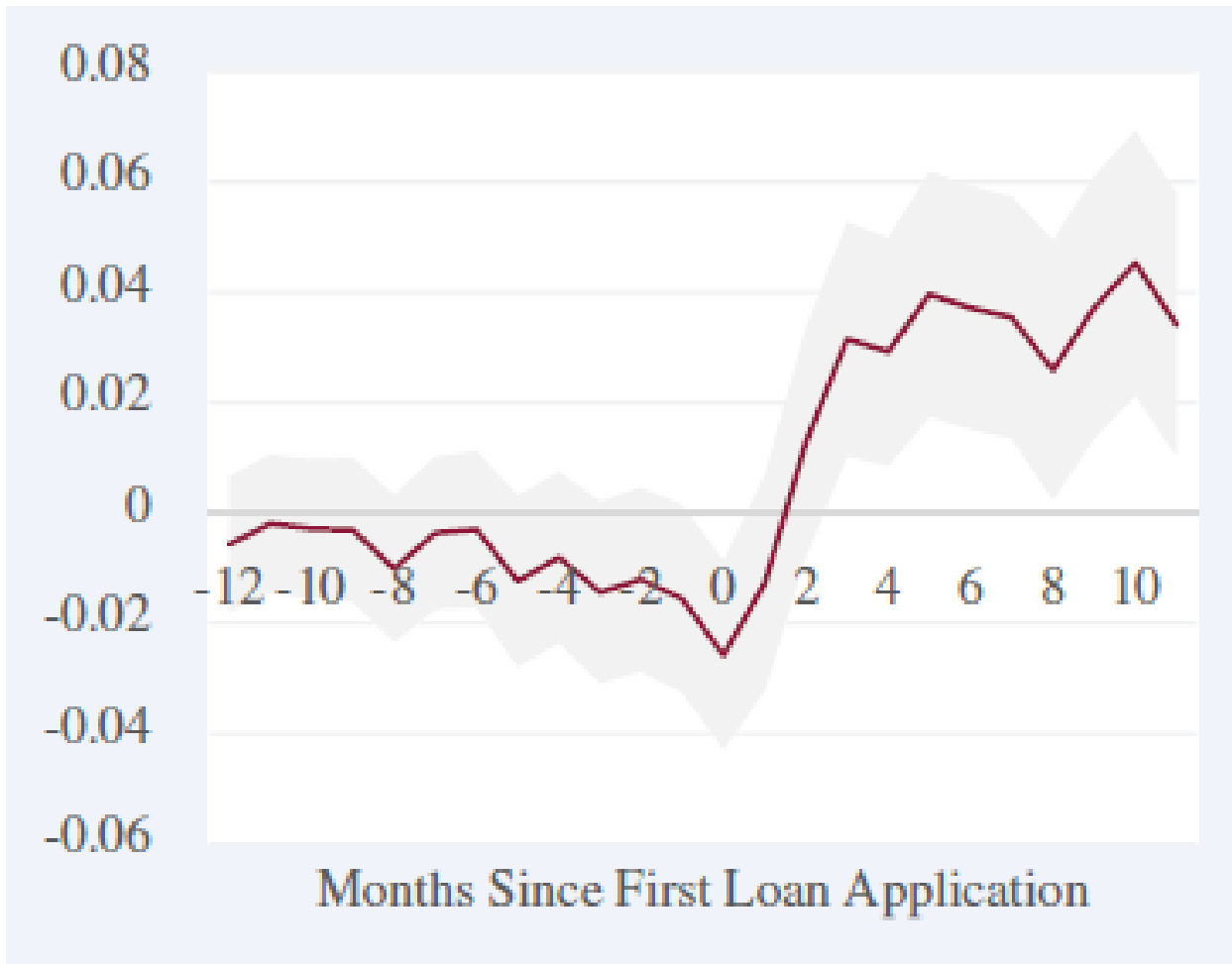


Credit score, relative to threshold

Recipe for a Killer Paper:

4. Credible crosscheck of identification

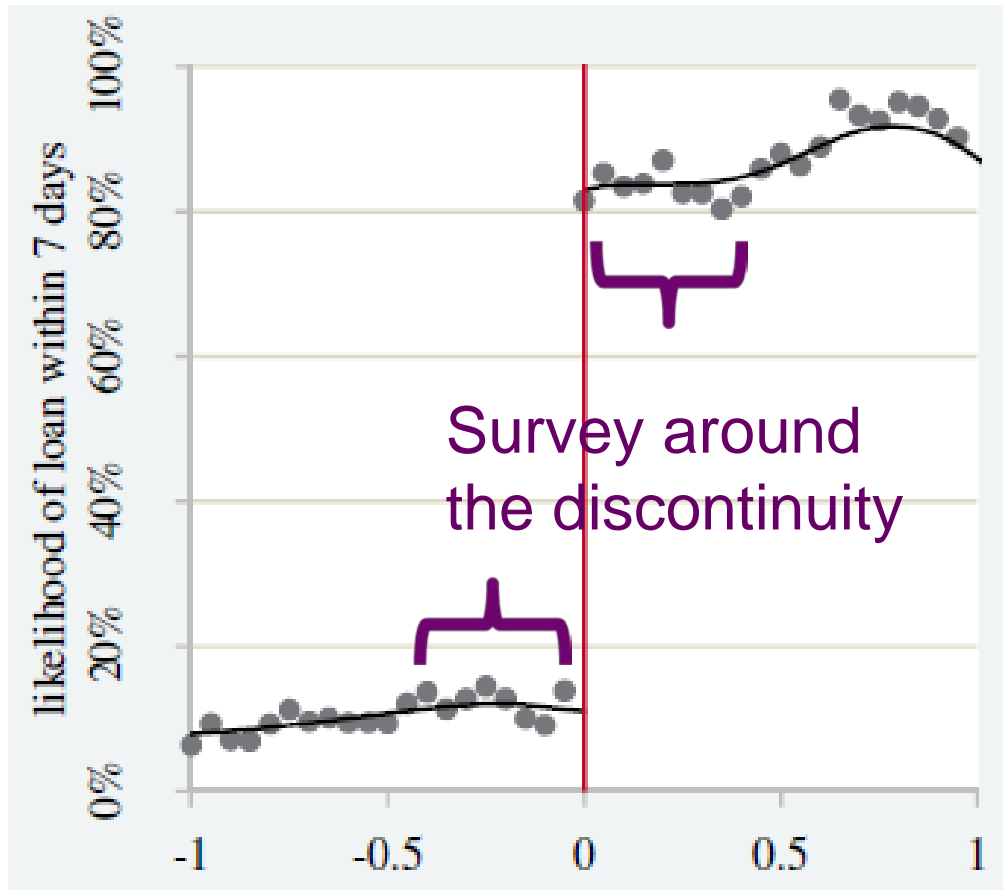
Exceeding Overdraft Limit



Recipe for a Killer Paper:

5. Collect data specific to the question

- ❑ Carefully-targeted survey



Recipe for a Killer Paper:

6. Supplement objective analysis with subjective data

- ❑ Ask people about their wellbeing:
 - ▶ Happiness, anxiety, angst, satisfaction
- ❑ Why they took the loan
- ❑ What the consequences were
- ❑ Whether they regret taking the loan

Recipe for a Killer Paper:

7. Use research to guide policy change

In December 2013 the UK parliament gave the Financial Conduct Authority a duty to put a price cap on payday loans, to be in force by 2 January 2015. This research and related analysis to extrapolate the estimated effects to consumers with higher credit scores provided a key part of the evidence base to trade off the various cost and benefits of policy designs.

Results

Getting a pay day loan causes:

- ❑ More loan applications
 - ▶ Credit cards, and especially personal loans
- ❑ Changed portfolio of credit products
 - ▶ *More* payday loans (duh!), personal loans
 - ▶ *Fewer* mortgages (and small effects on credit cards)
- ❑ More consumer credit
 - ▶ Mainly payday loans
 - ▶ Personal loans and overdrafts (six months later)
- ❑ More missed payments
 - ▶ On payday loans
 - ▶ On personal loans and overdrafts (six months later)
 - ▶ More delinquencies and defaults

Interpreting the results

❑ What is the experiment?

- ▶ Literally: Whether your first payday loan application succeeds
 - But many things follow from this
- ▶ Mapping to structural parameters?
- ▶ Mapping to program evaluation?

❑ Economic interpretation of the results

- ▶ Reveals patterns of complements and substitutes to payday loans

❑ What are the welfare implications?

- ▶ Benefits: Consumption smoothing
- ▶ Costs: Poor choices
- ▶ The data don't speak directly to either of these

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Trying a new kind of food causes

Try other new foodstuffs

Changed portfolio of
food you eat

Eat more food

More food poisoning

(Or is it:
More missed meals?
More free meals?)

No effects on subjective well-being

□ But these are very low power tests

Table 10: IV Regression Estimates For Effects of Payday Loan Use On Self-Reported Wellbeing			
Dependent Variable	Instrumental Variable Regressions		
	1) No controls	2) Controls, no weights	3) Controls, priority weights
<i>Wellbeing scales (0-10)</i>			
Happy	0.0307 (0.0352)	0.0378 (0.0127)	-0.0709 (0.0436)
Anxious	-0.0576 (0.0457)	0.0127 (0.0570)	0.0539 (0.0582)
Life Worthwhile	0.0206 (0.0342)	0.0555 (0.0429)	0.0517 (0.0402)
Satisfied	0.0593* (0.0346)	0.0509 (0.0418)	0.0389 (0.0402)

Subjective assessments

	Didn't Get Payday Loan	Got Payday Loan
Intended use of Payday loan		
Regular living expenses	47%	54%
Car repairs	16%	11%
Luxury spending	16%	19%
Response to being declined		
Forego consumption	20%	20%
No substitute available	23%	26%
Borrow from friends/family	25%	17%
Need for Loan		
Definitely couldn't go without	25%	55%
Possible to go without	47%	33%
Easily to go without	28%	12%

Subjective assessments

	Didn't Get Payday Loan	Got Payday Loan
Reflecting on use of payday loan		
Happy with decision		53%
Regret decision		41%
Reflecting on being declined		
It was for the best	63%	
Better to have been approved	28%	
Repayments		
Repaid less than expected		5%
Repaid expected amount		56%
Repaid more than expected		39%

Conclusions

- ❑ Careful and convincing empirical work
- ❑ Important policy-relevant issue
- ❑ Great paper
- ❑ Still unsure what the right policy conclusion is