Neil Bhutta
Federal Reserve Board

Access to payday loans and household balance sheets

Disclaimer

- This is research in progress… the results are preliminary

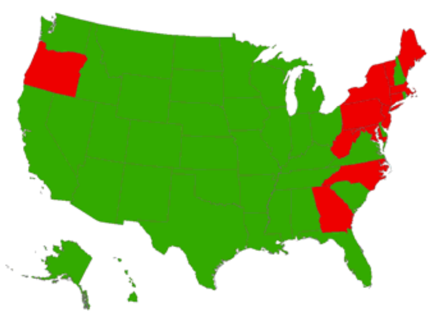
What is a payday loan?

- Small, short-term loan
  - $100-$1000 loan
  - 2-4 week term
  - Typical cost: $15-$20 per $100 borrowed
- Requirements
  - Proof of ID
  - Bank statement
  - Pay stub/proof of income
  - Post-dated check

Is access to payday loans good for consumers?

- **Yes** (i.e. welfare improving)
  - Voluntary transaction between two parties
  - Loan structure is clear and simple
- **No** (i.e. welfare reducing)
  - Lenders have better information about consumers' likelihood of rolling over the balance
  - Payday borrowing stems from self-control issues →constraint on ability to borrow would be beneficial

Several states prohibit payday lending (in red)



Previous research yields mixed results on the benefits of access to payday loans

POSITIVE

- Morgan & Strain (2008)
- Morse (2009)
- Zinman (2009)

NEGATIVE

- Skiba & Tobacman (2009)
- Melzer (2011)

Two primary sources of data

- **ZIP Code Business Patterns**: annual count of business establishments by ZIP and detailed industry code (6-digit NAICS)
- **Consumer credit records**
  - 1% national random sample
  - Outcomes (June 30, 2008):
    - Credit score (similar to FICO)
    - Probability of having a past due credit account
    - Probability of having an account in collections

Empirical analysis

- **Step 1:** Identify ZIP socio-economic characteristics associated with high concentration of payday lenders (*use states that permit payday lending*)
- **Step 2:** Predict payday lender concentration in *all* states
- **Step 3:** Compare outcomes of individuals that live in ZIPs with high predicted payday concentration, but some do not actually have access due to state law

Result: no impact detected

- **None of the outcomes** (credit score, likelihood of a delinquency and likelihood of a collection account) **appear to be related to the availability of payday loans**
- Result differs from earlier research which finds that access worsens people's financial well-being

Caveats

- Results are preliminary
- I've assumed that state laws actually reduce or prevent access to payday loans. If not, then it's not a fair test.
- Results do <u>not</u> necessarily reject the notion that payday loans cause harm (on net)
  - Rather, payday borrowing might be too far on the fringe for its effects to be picked up in this analysis