Don’t Lend So Close to Me: Payday Lenders and Debt Traps

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Motivation

The Economist - 2.5 M U.S. households take out a payday loan each year

- Median payday loan $350, two-week term (CFPB)
- 2015: more payday lenders in 36 states than McDonald's locations in 50 states

Policy Response

- Dodd-Frank Act following the Financial Crisis placed new restrictions on predatory lending
- **WSJ** (6/24/21) - Congress voted to end Trump-era regulation allowing payday lenders to avoid interest rate caps

Contribution

First empirical evidence of whether payday loans cause debt traps

- Codify a debt trap empirically as an increase/decrease in
  - Number of months payment understress
  - Dollar amount 60 days late
  - Credit card utilization rate ($\frac{totalbalance}{totalcreditlimit}$)
  - Credit score
- Utilize granular monthly data on near universe (28 million) of Canadian credit records
  - Map individuals' addresses to locations where payday lenders enter/exit

Cool off periods are effective at limiting debt traps

- Empirically establish using their metrics for debt trap
- Consistent w/ theory (Allcott, Kim, Taubinsky, Zinman (2021))

How they do it

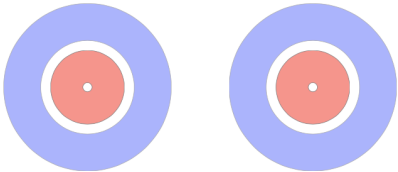
Use a difference in differences analysis following Ang (2021)

- Define rings around a payday lender (both for entry and exit)
  - Inner ring (0-75 meters) treated & outer ring (100-200 meters) control

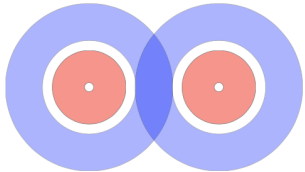
Falsification Tests

- Home-owners with a HELOC ($\downarrow$ liquidity constrained) still experience debt-trap; though not affected by exits
  - Consistent with having other liquidity sources available to substitute for payday lending when a payday lender exits
  - **Comment:** Would be interesting to see if homeowner credit score $\uparrow$ when payday lender exits
- Results insignificant when a “cool-off" period is in place
  - Consistent w/ **debt-trap** $\rightarrow$ driving negative channel

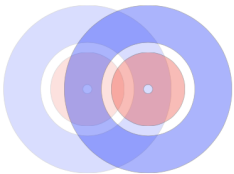
Inner and Outer Rings



(a) Included Case 1



(b) Included Case 2

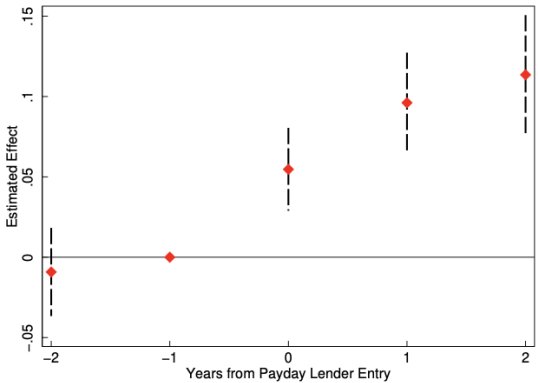


(c) Excluded Case

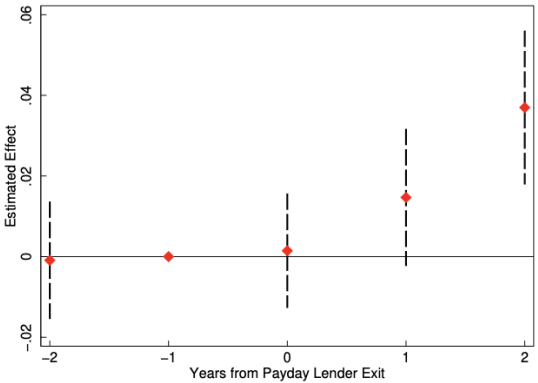
Main Results: Full Sample

$$y_{i,t} = \sum_{\tau=-2}^{2} \beta_\tau InnerRing \times \mathbb{1}\{t - paydayevent_{PC} = \tau\} + \gamma_{DA,t} + \alpha_{PC} + \lambda_i + \epsilon_{i,t}$$

Lender Entry



Lender Exit



Main Comment: Establishing Counterfactual

Assumption: Areas only differ because payday lender moves in close

- Concern that treatment/control areas are systematically different
  - Coefficient plots on a monthly basis to establish a parallel pre-trend (6 mo.)
  - Summary statistics for treated/control areas
- Exogenous Shock: US Event spill over on Canadian payday lenders
  - Dodd Frank (US) $\uparrow$ oversight
  - Trump-era regulation $\downarrow$ oversight on payday lenders
- Abandoned Lender Applications - use abandoned application location as control (runner-up locations for the same payday lender)
  - Inner and outer rings around the actual location and the runner-up location to attenuate the lender selection

Additional Comments: Importance of Lender Exit

What fraction of payday lenders who enter also exit? Split sample:

- Lenders who enter and stay
- Lenders who enter and exit
  - Policy response would be different - focus on making lenders' exit terms as favorable as possible.

Maybe the lenders who exit do so for a reason, ie because the area is bad.

- Look at other indicators of deterioration like unemployment, school education rate, average income, crime rate
  - Were these factors building up prior to the exit $\Rightarrow$ deteriorating economy driving both the exit and the persistent effect on stressed borrowing and credit score (monthly pretreatment trends would help rule this out as well)
- 2011 exits - more than double any other year
  - Exogenous shock - Dodd Frank (passed July 21, 2020 with phase-in)?
  - Are there headquarters that failed and then closed many branches?

Additional Comments: Other

- Callaway Sant'Anna (2020) DiD w/ variation in treatment timing
  - The authors are working on!
- Did advertising also increased in the inner circle for payday lenders?
  - Evidence for salience mechanism
- Do long-term debt traps causes long-term deterioration of the economic environment?
  - Unemployment
  - Crime
  - Education rates
  - Income rates
  - Hospitalization for drug abuse
  - Birth rates

Thank you for the opportunity to discuss:

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