

EVIDENCE-BASED POLICYMAKING: SMALL-DOLLAR LOANS

Jonathan Zinman

Dartmouth College, IPA, J-PAL

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ipa



Dartmouth

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Scope and Approach for Today

-**Conceptual:** not a literature review

- But happy to address questions about specific studies or literatures

-Focus on **payday loans** to *fix ideas*

- But happy to address other products



The Evidentiary Basis for Rulemaking: Key Questions

1. What do we need to know?
2. What do we know?
3. What should we do, in light of 1 and 2?



Key Takeaways

1. Humility

- We don't know much

2. Restraint

- Hard to improve outcomes if we don't know much

3. Innovation

- Weak motivation for standard “protections”

- Quantity restrictions
- Point-of-sale disclosure

- Many “surgical” approaches hold promise

- Punchline: a 21st-century agency should approach this space with a direct (social) marketing and R&D mindset**

What Constitutes “Evidence” for “Evidence-Based Policymaking”?

-A methodology that convincingly addresses the classic social science problem and plausibly identifies *cause and effect*

-Tempting to abandon this standard in the small-dollar space. So much seems/feels broken:

- [Pew tells “Jennifer’s” Story](#)
- But... everyone has a story: “[This was exactly what I needed...](#)”

-Microcredit serves as cautionary tale of story-based policymaking

- Pro-small-dollar “movement” built on theory, anecdotes, rigged evaluations
- Little causal evidence of transformative impacts
- Now backlash

Insufficient Evidence



- *Ban Enacted and Lending Falls*
 - What happens to consumer well-being?
- *Payday borrowers fare worse than non-borrowers*
 - People who go to the E.R. fare worse...
- *Expensive*
 - So is hiring a plumber
- *Serial borrowing*
 - Should we outlaw serial borrowing in the repo, commercial paper market?
- *Loans finance “recurring expenses”*
 - Money is fungible! Example: borrowing to pay rent today because I paid cash for emergency last week

What Do We Need to Know? To Decide *Whether* Should Intervene

-Does small-dollar do more harm than good?

- Evidence on this from rigorous studies is mixed
 - Even within-Zinman studies!
 - Tilts “good” if include evidence from developing countries
- Why mixed evidence?
 - Substance: true heterogeneity in impacts, studies across different settings reflect this
 - Methods: some flawed

-Punchline: evidence does not move us away from standard priors

- More good than harm (revealed preference)
- “80-20 rule”

What We Need to Know? To Decide *How* Should Intervene

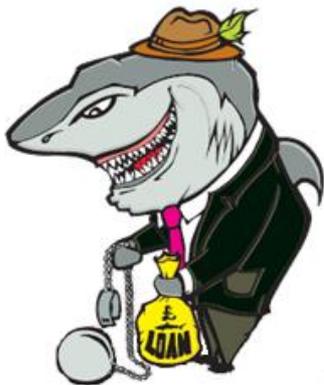
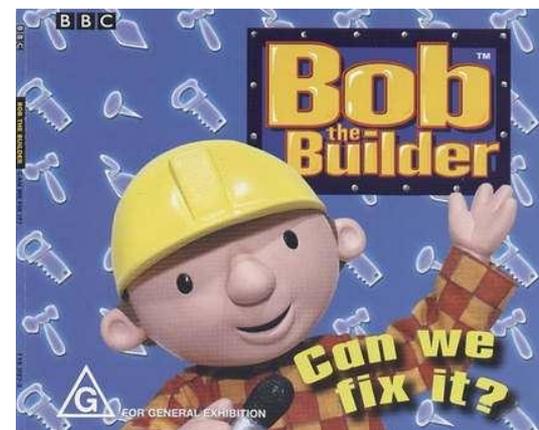
-Why do people go wrong?

- *Repayment expectations: overly optimistic, or inattentive
 - Mann and Pew evidence on this suggestive, but shaky, and neither finds that majority are overly optimistic
- Price perceptions conditional on expectations
 - Problem if interest compounds (e.g., with rollovers)
- *Temptation

-Fixes should *target* these *biases*

What We Need to Know? To Decide *How* Should Intervene

- How effective will fix be at changing behavior?
 - Of consumers
 - Of regulated lenders
 - Of unregulated lenders
- How costly to implement a fix?
 - TILA example: costly enforcement leads to limited enforcement
 - Smaller lenders, loan sharks



Evidence-Based Policymaking in the Shadows: What Should a 21st-Century Agency Do?

Objectives:

1. Reach people early, at decision point
2. Rely on incentive-compatible 3rd parties instead of enforcement
3. Preserve access for those who do themselves no harm



Evidence-Based Policymaking in the Shadows: What Should a 21st-Century Agency Do?

Strategies:

1. Beta-test to generate evidence
 - “Soft” vs. “hard” launches
2. Try scalpels before sledgehammers
 - Identify problems and target fixes



Solving for Asymmetric Information

20th century: subsidies

21st century: “Catalyst”-type approach

- Support evaluation of promising underwriting/business models
- Help solve standards, legal barriers to information gathering and sharing

Solving for Optimism Bias

20th century approaches:

- Restrict rollovers, mandate disclosures
 - Enforcement costs daunting in fragmented market, low entry barriers

21st century approaches:

1. “Engagement”
 2. Beta-testing: iterate to proven solutions
- Outgoing direct (social) marketing:
 - “Have you thought about how to repay?”
 - “Imagine a friend is deciding whether to use a payday loan... what would you advise them to do?”
 - “Smart” disclosures based on prior behavior, predictive modeling

Solving for Temptation

20th century approaches: bans, mandatory cooling off periods

21st century approach: **Beta-test *voluntary* versions of these (“commitment devices”)**.

- (Can think of this as voluntary licensing)
- Self-cooling: “Don’t release \$ for N days after I apply”
- Self-banning: “Cut me offs”
 - After X loans in a calendar year
 - On Fridays

Closing Provocation

How should a 21st-century regulator move forward in small-dollar space?

- Set a high evidentiary bar
- Beta-test: soft vs. hard launches
- Try scalpels before sledgehammers
- Rely less on lawyers, examiners
- Rely more on marketers, researchers

