SURF Spotlight: "Minimum Wages and Consumer Credit: Impacts on Access to Credit and Traditional and High Cost Borrowing" [1]
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We select for our SURF spotlight a paper by Lisa Dettling and Joanne Hsu examine how state-level minimum wage changes affect availability and use of credit among lower-income households:

https://www.federalreserve.gov/econresdata/feds/2017/files/2017010pap.pdf

Using data derived from direct mailings of credit offers, debt recorded in credit reports, and survey-reported usage of payday loans, the study finds that a rise in the state minimum wage is associated with beneficial impacts on availability and cost of credit to lower income households.

Impacts on credit offers are analyzed using data on direct mail advertising from 1999 to 2015 compiled by Mintel Comperemedia. Mintel collects data from a sample of about 1,000 households each month, surveying household demographic and income characteristics in addition to compiling information from all credit card, mortgage, auto, student loan, and unsecured loan offers received by the household during the month. The data also include the terms of credit for credit card and mortgage offers, including interest rates and credit limits. Conditional effects of changes to state-level minimum wage are estimated by isolating the impact of the minimum wage on households identified as sensitive to it (those with incomes sufficiently close to the minimum), in a regression equation that also includes the indicator for minimum wage sensitive; state and month fixed effects; household education, age, and race/ethnicity; and the state unemployment rate.

Impacts on credit scores and payment delinquency are analyzed using the Federal Reserve Bank of New York Consumer Credit Panel/Equifax (CCP/Equifax), an individual-level panel dataset of consumer credit reports, collected quarterly since 1999. The dataset consists of a five percent random sample of individuals with credit histories, and include detailed information drawn from the credit reports along with the individual's Equifax risk score (a type of credit score). The sample is restricted to borrowers residing in a census-block group with a relatively high fraction of low-skill workers, defined as more than 50 percent of the census-block having below a high school education (a proxy for income close to minimum wage). The dependent variables (the individual's credit score, and an indicator for at least one delinquent account) is then regressed on the (one-quarter or one-year) lagged minimum wage; borrower age; state, month, and person fixed effects; and neighborhood characteristics.

Data on usage of payday loans are drawn from the Current Population Survey Unbanked and Underbanked Households Supplement, conducted biennially since 2009 by the Federal Deposit Insurance Corporation in partnership with the U.S. Census Bureau. The data include demographic and economic characteristics of households and information on usage of non-bank, high-interest credit products, including payday loans. Indicators for household usage of these products in the past year are merged in with state-level minimum wage information for 12 months prior to the survey. Conditional effects of changes to state-level minimum wage again are estimated by isolating the impact of the minimum wage on households identified as sensitive to using a regression equation similar to that used in the credit offer analysis.

Results indicate a variety of beneficial impact of minimum wage laws on consumer credit. For instance, lower-income households receive 7 percent more credit card offers per dollar increase in the minimum wage, with higher limits and improved terms. Further, there is a drop in usage of high-cost borrowing: payday borrowing falls 40 percent per dollar increase in the minimum wage. Of

[1] This commentary was written by Paul Calem, vice president in the Supervision, Regulation, and Credit Department of the Federal Reserve Bank of Philadelphia. The views expressed here are solely those of the author and do not necessarily reflect the views of the Federal Reserve Bank of Philadelphia or the Federal Reserve System.

particular interest from the perspective of retail credit risk is the impact on repayment performance: credit card delinquency rates fall by 7 percent per dollar increase in the minimum wage.

The paper has important policy implications, as it provides evidence of beneficial spillover effects of minimum wage policy on consumer credit. We select it for our SURF Spotlight because it also highlights an important but understudied aspect of retail credit risk: how developments in labor markets may impact patterns of household borrowing and delinquency rates. Legislative or public policy developments such as minimum wage rules; technological innovation; and demographic trends affecting labor markets may have implications for sources and patterns of consumer credit risk. Understanding such relationships can contribute to improved default modeling and risk identification.