Discussion of:
The Impact of Changes in Credit Availability and Usage

Discussant: Scott Fulford (CFPB)

Scott.Fulford@cfpb.gov

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The Impact of Changes in Credit Availability and Usage

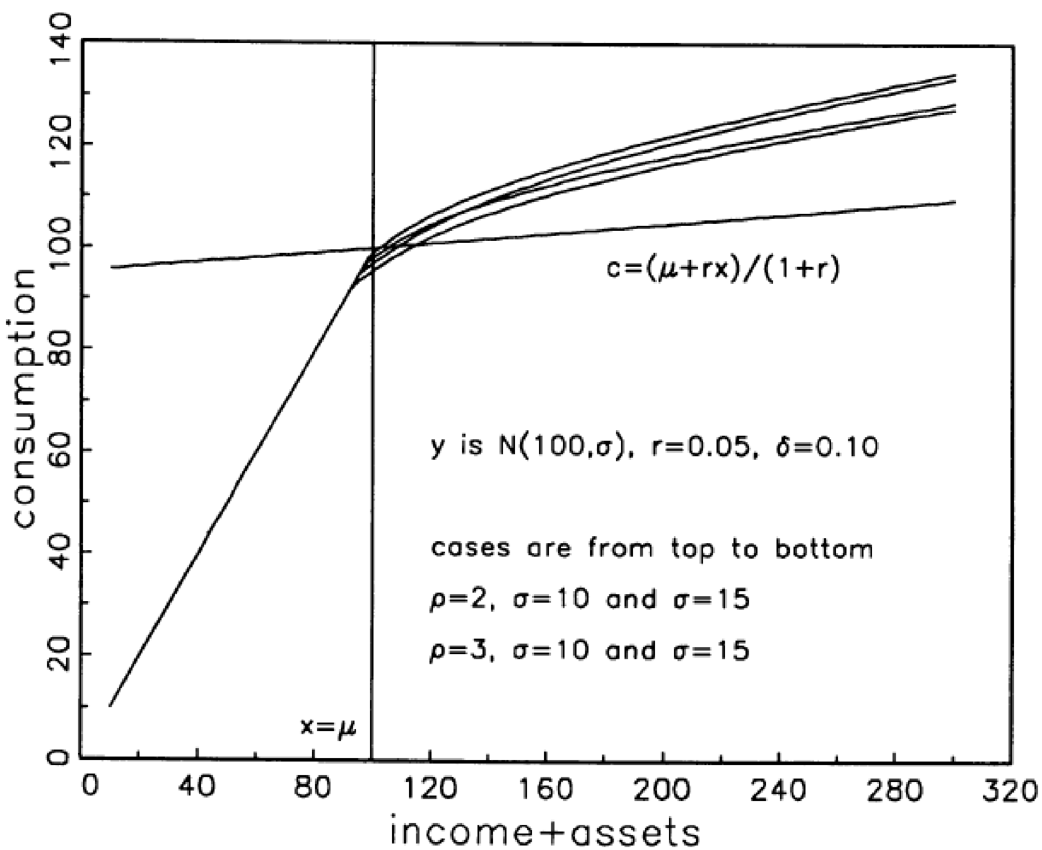
- The Marginal Propensity to Consume Out of Liquidity: Evidence From Random Assignment of 54,522 Credit Lines
- High Cost Debt and Borrower Reputation: Evidence From the UK
- Mitigating the Risk of Financial Inclusion with Loan Contract Terms
- On the Effect of Student Loans on Access to Home Ownership

What have we learned from these papers?

- People respond to increases in credit by using it, even those who are not close to their limit. (Paper 1)
- Using high cost credit is a signal, and so may reduce credit in the future, although only for people for whom the signal matters. (Paper 2)
- It's really hard to tell who is a good credit risk with no history, and so establishing a credit history has an externality; contract terms don't help much. (Paper 3)
- Holding income fixed, having a lot of one kind of debt, such as student loans, reduces the use of other kinds of credit to acquire durable goods like houses. (Paper 4)

Some context of changing credit

Angus Deaton (1991 *Econometrica*) “Savings and Liquidity Constraints”



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Some context of changing credit

Chris Carroll (1997 QJE) "Buffer-Stock Saving and the Life-Cycle/Permanent Income Hypothesis"

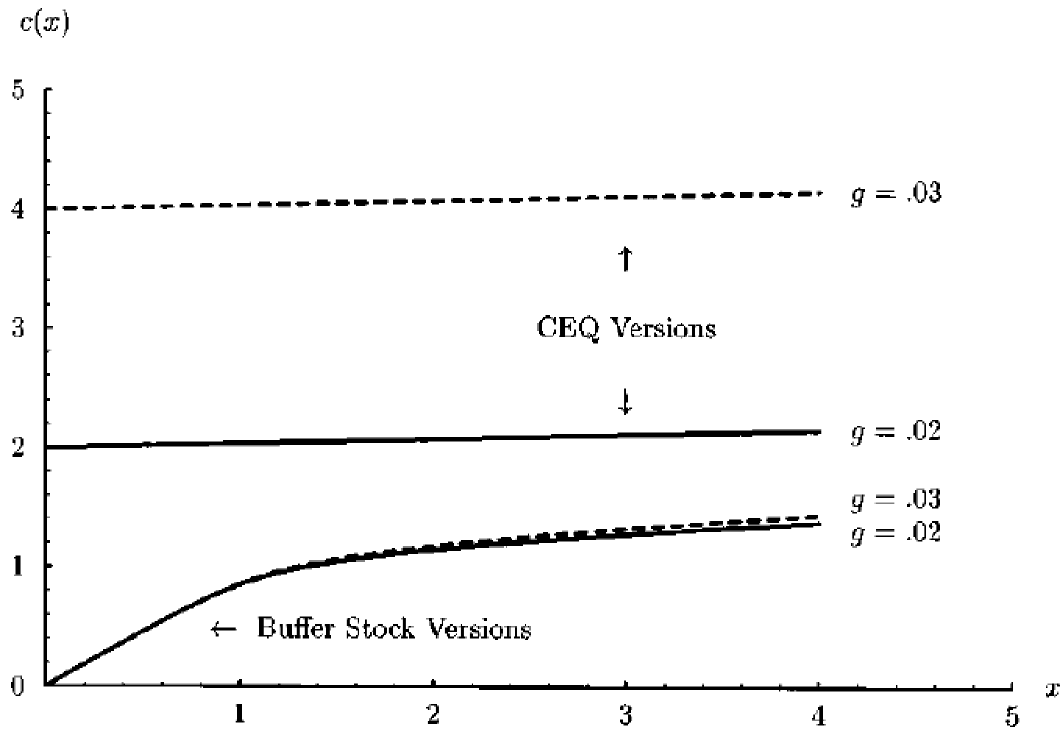
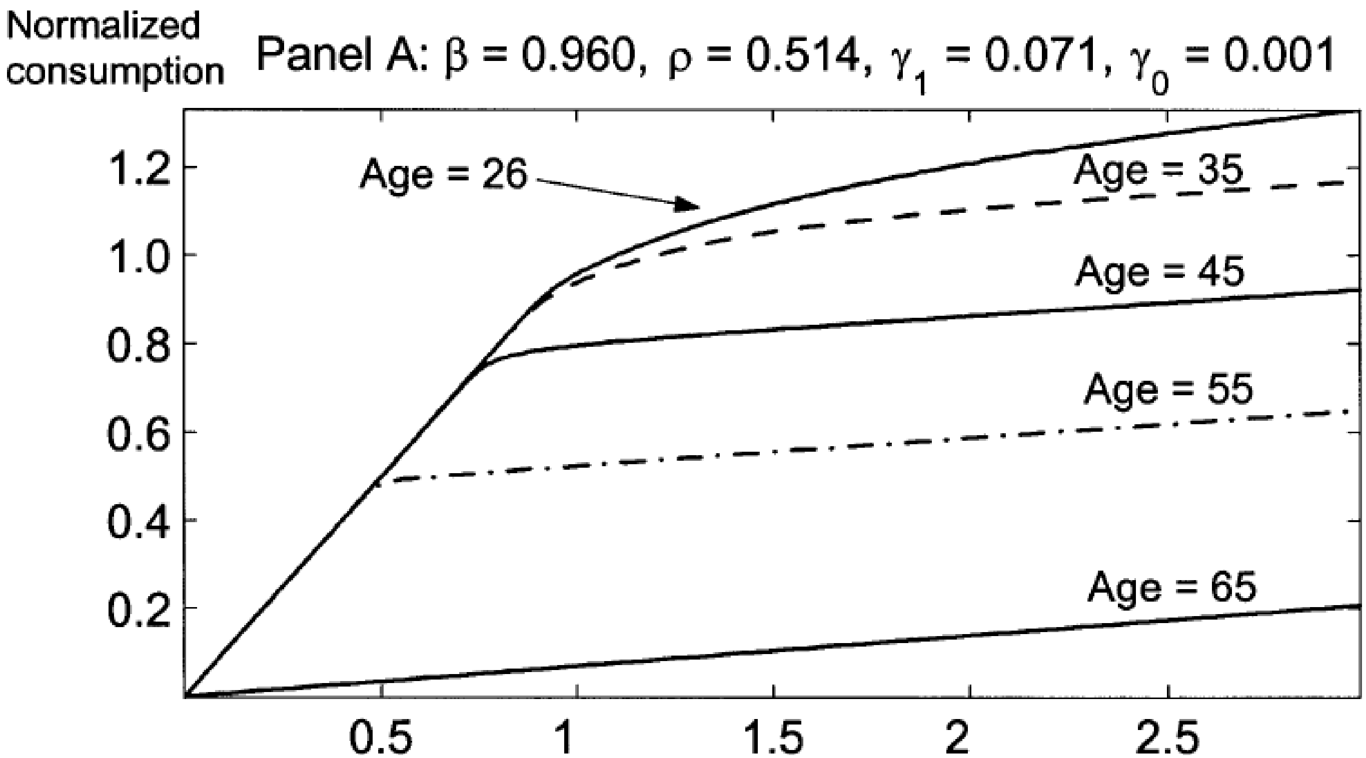


FIGURE III
Marginal Propensity to Consume out of Human Wealth

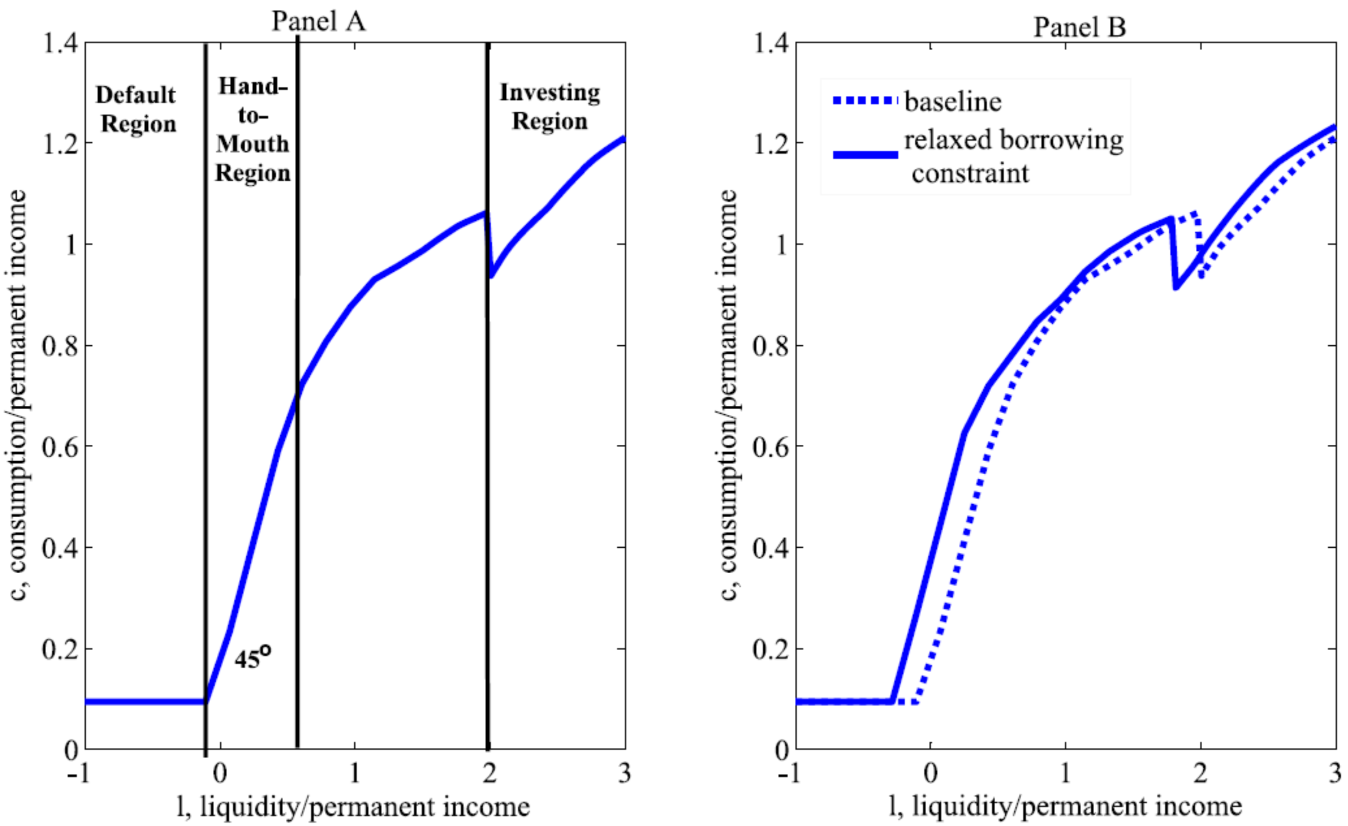
Some context of changing credit

Gourinchas and Parker (2002 *Econometrica*) "Consumption over the life-cycle"



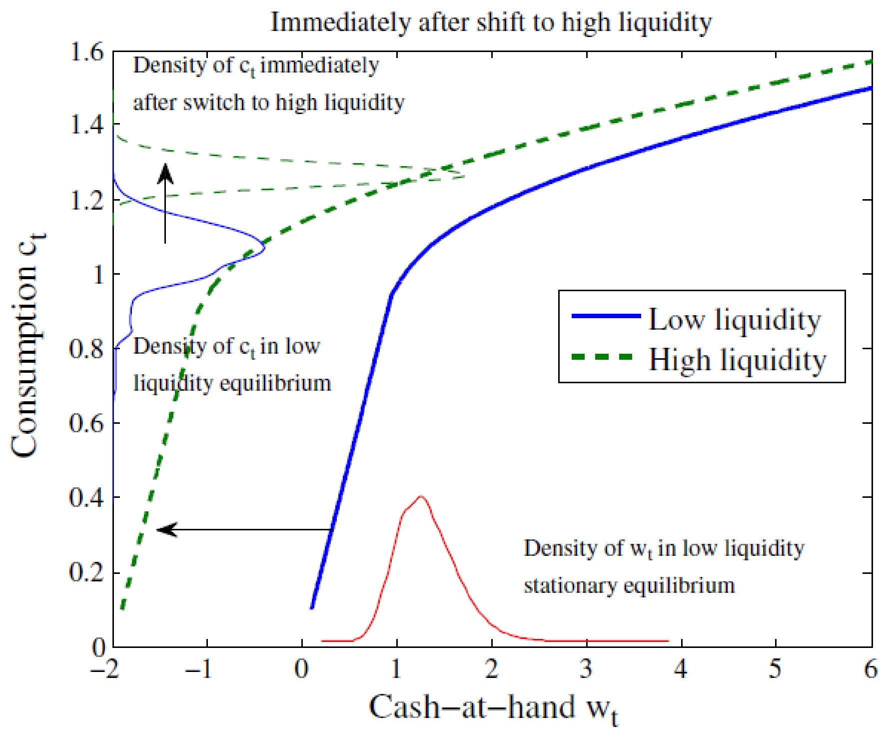
Some context of changing credit

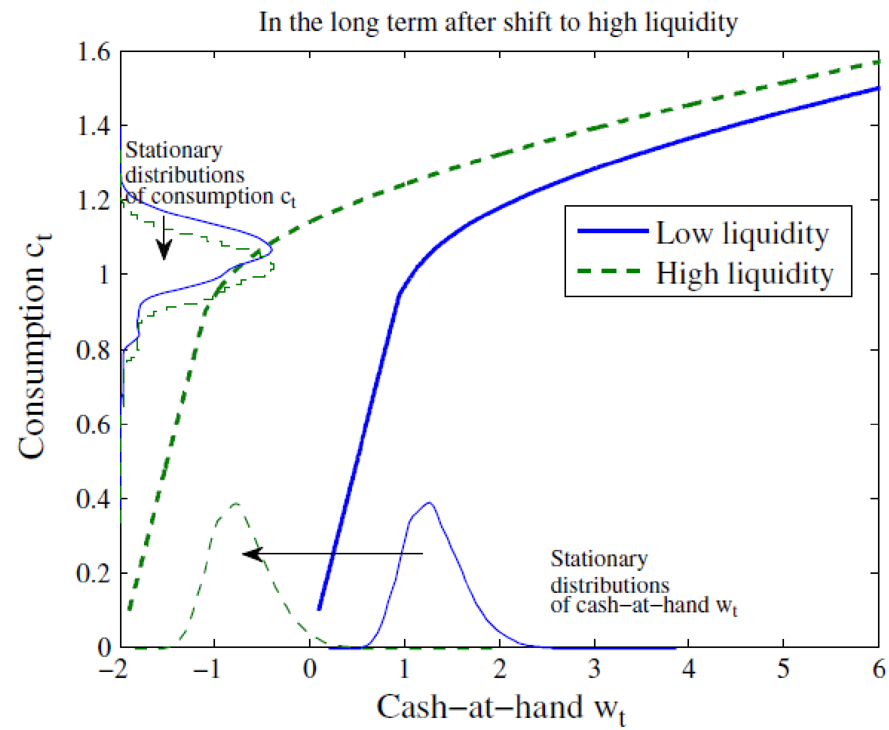
Kaboski and Townsend (2011 *Econometrica*) “A Structural Evaluation of a Large –Scale Quasi-Experimental Microfinance Initiative”



Some context of changing credit

Fulford (2013 *Journal of Development Economics*) "The effects of financial development in the short and long run: Theory and evidence from India"





What has this line of work taught us?

- If people use credit, either to smooth shocks or to make investments in durable goods, then credit is valuable, and changes in credit will change behavior.
  - Substantial heterogeneity in response depending on how close to liquidity constraint
  - Expect little heterogeneity by overall (“permanent”) income, so people in Thailand, Mexico, and US behave similarly
- Increases in credit allow people to do things now that they couldn’t do before.
  - But in the long term, debt is still costly.
  - Using credit has costs for future consumption, and expect changes to occur over time

The Marginal Propensity to Consume Out of Liquidity

- Provides precise experimental evidence that helps map out how the consumption function changes when credit changes
  - Increases in credit limits affect all borrowers, not just those currently constrained
  - Effects accumulate over time
- Credit card contracts at this European institution have interesting feature that combine:
  - Payments ("Convenience" or "Transaction" use)
  - Revolving
  - Instalment: can choose to put some large purchases on instalment with a set repayment schedule
    - (But mainly notional since it appears can turn instalment payment into revolving debt without cost)

High Cost Debt and Borrower Reputation: Evidence From the UK

- High cost debt has even higher costs than just the interest rate.
  - Not only does borrowing require high interest
  - It also might reduce future credit, whose loss is costly
  - Raises the "price" of already expensive debt, especially if borrowers are aware
- Much debate how best to explain willingness to borrow at high rates
  - High discount? Present bias? Lack of knowledge?
  - Added cost makes it harder to explain

High Cost Debt and Borrower Reputation: Evidence From the UK

- Note the particulars are relevant to UK where credit score partly depends on information from high cost lenders
  - Currently US does not have such an integrated system, although that may be changing, as new “sub-prime” credit bureaus open
  - But using more of credit card limit may have similar consequences on score
- Question about Regression Discontinuity:
  - Are borrowers aware of eligibility cut-offs?
  - If so, may introduce intentional, non-smooth sorting based on who applies---some borrowers know will be denied and so don’t apply.
  - Unlikely to be a problem, but useful to know

Mitigating the Risk of Financial Inclusion with Loan Contract Terms

- Credit doesn't just appear out of thin air, this paper helps us understand how we go from no formal credit to some credit
- Profit seeking firms offer credit and may not always find it profitable to offer credit
- People without credit histories may be good risks or poor risks and as firms find out they can profitably increase credit
  - As people get experience with credit, they may become better risks
  - But firms learn, they also benefit competitors, suggesting there may be too little risky lending
- There do not appear to be easy changes in contracts that would reduce risks and hence increase credit.

On the Effect of Student Loans on Access to Home Ownership

- Increasing the costs of education, and so the loans to acquire it, means less income is left over in the future
- Unless default, any debts plus interest have to come out of income eventually
  - This *Intertemporal Budget Constraint* is why changes in credit matter even for those who are not at their credit limit
- Student loan payments reduce disposable income, may increase borrowing costs for housing
  - Perhaps less willing to commit to large, fixed payments in return for the certainty of housing consumption that ownership offers

On the Effect of Student Loans on Access to Home Ownership

- Welfare consequences of the shift in portfolio may be small
  - Hold more of one debt, less of another, consumption of housing more uncertain, but less constrained
  - Both housing and student loans imply required “saving” of paying down debt, not obvious reduction in long-term assets
- Consequences of increase in student loan debt possibly larger
  - First Stage of Estimation:
    - 1% increase in cost of tuition->1.3% increase in student loan debt (log-log)
  - What would we expect? Does a $1 increase tuition -> More than $1 in student loan debt?

Use of large data sets

- Administrative data from credit bureaus or banks gives great evidence on individuals and their uses of credit
- Combining administrative with other data gives even greater insight
  - Experiment with a bank to change contract terms, background from bureau data
  - Merge of credit bureau and education records
  - Experiment with a bank to change credit limits, also observe other holdings and transactions with bank
  - Merged records from “The Lender” with credit bureau data in UK
- Very exciting since these sources are much larger and have panel dimension (compare to PSID)
- Private-sector and research partnerships

Similarities between users of credit

- Different settings
  - Mexicans getting formal credit for the first time
  - Student loan borrowers in the United States
  - High cost debt borrowers in UK
  - European credit card usersc
- Yet basic framework and uses for credit surprisingly similar
  - Within each study, effects may be different because on different parts of the curve (higher or lower MPC)