

The impacts of payday loan use on the financial wellbeing of the OASDI and SSI beneficiaries

Haydar Kurban

Center for Race and Wealth (CRW)
Department of Economics
Howard University

Nyanya Browne

Center for Race and Wealth (CRW)
Department of Economics
Howard University

Bahareh Eftekhari

Center for Race and Wealth (CRW)
Department of Economics
Howard University

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This project explores whether the use of payday loans among social security income receivers and supplemental security income receivers affect their financial wellbeing. Specifically, it studies the borrowing behaviors of low-wealth OASDI and SSI beneficiaries who rely on alternative financial services, such as payday lending, check cashing, rent-to-own and pawn shops. A significant share of low-income and low-wealth population experience financial hardship, and pay exorbitant fees and interest when they borrow from the alternative financial service providers. In 2009 17% of households in the U.S. were considered under-banked because they both maintained bank accounts and relied on alternative financial services (FDIC, 2009). Since social security (SS) and disability payments are considered as an income source by the industry, to have access to payday loans, consumers use their next checks from the social security administration as collateral. The use of high cost payday loans and other alternative financial services has significant long-term ramifications on the financial wellbeing of SS beneficiaries.

The main goal of this paper is to explore how payday loans affect the financial wellbeing of social security income beneficiaries. It uses multiple public datasets to investigate the following research questions: 1) Are SSA beneficiaries more likely to use payday loans than non-SSA beneficiaries? 2) How does payday loan use vary by income, age, and education among SSA beneficiaries? 3) How does receiving income from SSA affect payday loan use? Specifically, this paper (i) studies the borrowing behaviors of SS beneficiaries who rely on alternative financial services; and (ii) how financial literacy affects the intensity of payday loan use among the SS beneficiaries.

This study draws information from the CPS unbanked & underbanked supplements, Survey of Consumer Finances (SCF) and National Financial Capability Study (NFCS) to control for a richer set of demographic variables and incorporate other relevant demand factors that explain why consumers use alternative financial services and how they view AFS versus bank services. Our empirical methodology also allows us to use information on financial literacy and credit scores to perform robustness checks.

Payday loans are small, unsecured, short-term, easy to get, and high-cost credit products (Stegman, 2007). If payday loans or other alternative financial service products are used only rarely, their long-term impacts could be negligible or even positive since payday loan fees are usually lower than the late fees of utility bills or the cost of a bounced check (Campbell et al 2010). Although some consumers use payday loans sparingly, most of users get multiple loans in a year and, occasionally, a loan from one lender is used to pay another (Elliehausen, 2009). Most payday loan users are in fragile economic status. Almost 90% have outstanding credit balances, many do not have credit left in their existing cards, and most do not have home equity to tap into (Elliehausen, 2009). A widely cited study (Melzer, 2011) documents that access to payday loans increased financial hardship. For instance, those who had access to payday loans had difficulty paying mortgage, rent and utility bills; experienced higher rate of foreclosures, evictions; and had to delay needed medical and dental care. It is also documented that payday loans are predatory and rather than mitigating financial hardship, they increase the likelihood of bankruptcies (Melzer, 2011).

States, federal agencies and consumer advocate groups have designed and implemented various regulations and pilot programs, ranging from state level bans, efforts to increase financial literacy among payday loan consumers to providing new small credit loans for vulnerable populations. Recent studies show that in payday loan permissive states the concentration of payday lending stores and the concentration of poverty are highly correlated (Campbell et al 2010). The literature mostly focuses on whether payday loans are beneficial or harmful and whether more restrictive or more permissive payday lending regulations have positive effects on the wellbeing of the borrowers.

Data & Methods

To investigate the payday loan borrowing behaviors of social security income beneficiaries, this study utilizes multiple data sets¹. The SCF provides specific information on credit history and reasons for payday borrowing; and the NFCS has data on financial literacy, credit scores and use of alternative financial services such as pawnshops. Previous studies suffer from the biases that may arise from the variations in financial literacy and credit history across the observations. By using multivariate regression analysis, this paper improves on the existing empirical studies by explicitly

¹Current Population Survey unbanked & underbanked supplements. Reserve's Survey of Consumer Finances (SCF), and the National Financial Capability Study (NFCS). These data sets are publicly available, cross-sectional data sets and they are not always available for the same years. The SCF data are available for 2010, 2013 and 2016. The NFCS samples are available for 2009, 2012 and 2015. The CPS data are annually available.

incorporating the variables that directly measure financial hardship, financial literacy, and the availability of alternative credit options, including alternative financial services, into the analysis.

Findings

Preliminary results from the SCF data analysis show little to no demographic variation in SS and non-SS recipients who borrow payday loans – borrowers are mostly African-American, Hispanic, low-income, lacking college education, and had previously been denied credit. However, the results from the SCF data analysis suggest that in 2013 SS recipients were more likely to borrow payday loans, while in 2016 there was a positive relationship between receiving Social Assistance and payday borrowing – SA recipients were more likely to use this borrowing option. Compared to older respondents, payday consumers were approximately 3 times more likely to be SS recipients. In 2013, the top three reasons cited by SS recipients for their payday borrowing were “emergency”, “convenience”, and “only option” while “pay other bills/loans” was the third most cited reason among non-SS recipients. These results suggest that SS beneficiaries use payday loans slightly for different reasons than the non-SS payday loan users.

Results from the NFCS data regression analysis show that SS recipients with credit scores below 710 were more likely to borrow payday loans – 1.6% more likely for recipients with scores less than or equal to 620 and 1.1% more likely for recipients with scores between 730 and 710. Additionally, SS recipients with higher financial literacy – as determined by the number of correct answers to financial literacy questions – were

less likely to take out a payday loan. Our results from NFCS data also show that SS recipients who use pawnshops are more likely to borrow payday loans.

The analysis of CPS unbanked and underbanked supplements show that there is little to no demographic variation between SS and non-SS recipients who use payday loans. A surprising result from our analysis is that higher-income SS recipients more likely to engage in payday loan borrowing. Compared to higher income SSA beneficiaries, lower income SSA beneficiaries use payday loans more intensively.

Borrowing behaviors of lower income SSA beneficiaries, especially from alternative financial services, are understudied in the literature. Our study attempts to fill this gap. From the payday industry point of view the SSA beneficiaries are seen as very attractive customer base because they have steady income and geographically they are less mobile². Our results show that the SSA beneficiaries use payday loans for various reasons, including paying for emergency expenses, not having other financial service options. It seems like both demand and supply factors are at play here. The SSA beneficiaries could find payday loans more convenient because of lack of regular banking services and/or the industry may specifically target the neighborhoods with higher density of lower income population and most the SSA beneficiaries tend to reside in these places. For future work we will try to incorporate the supply factors (payday loan store location or density) into our analysis.

² Carrel and Zinman (2014) indicate that expensive loan products such as payday loans are labeled “predatory” because lenders can use borrowers’ income checks as collateral. Having steady income checks make SSA beneficiaries less risky borrowers.

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