"Are High-Interest Loans Predatory? Theory and Evidence from Payday Lending"
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Abstract

It is often argued that consumer lending regulations can increase welfare, because high-interest loans cause "debt traps" where people borrow more than they expect or would like to in the long run. To test this, we ran a field experiment with a large payday lender to elicit borrowers' predictions of their future borrowing and valuations of an incentive to avoid future borrowing. While the most inexperienced quartile of borrowers underestimate their likelihood of future borrowing, the more experienced three quartiles predict correctly on average. This finding contrasts sharply with priors we elicited from payday lending experts, who believed that the average borrower would be highly overoptimistic. However, borrowers believe they are present focused: 90 percent of borrowers say they want motivation to avoid payday loans in the future, and they are willing to pay a premium for the no-borrowing incentive. We combine these experimental data with a novel sufficient statistic-based identification strategy to estimate a model of partially naive present focus, giving average perceived and actual present focus parameters of 0.75 and 0.72, respectively. Using these estimates, we carry out a behavioral welfare evaluation of commonly proposed payday lending regulations. In our model, payday loan bans unambiguously reduce welfare, and limits on repeat borrowing generate at best small welfare gains.