CONSUMER CREDIT: LEARNING YOUR CUSTOMER'S DEFAULT RISK FROM WHAT (S)HE BUYS

By Annette Vissing-Jorgensen

A Discussion by Michael Haliassos
Goethe University Frankfurt, IMFS, NETSPAR, CEPR

There is a lot to admire

- The topic:
  - *Pioneering and strange in 2009*
  - *Central in 2021*
- The data and its meticulous construction:
  - *US CEX*
  - *Mexican Chain Store*
- The insights and the clarity of presentation and discussion
- The importance of consumer debt:
  - *First book: MIT Press Volume 2006 (Bertola, Disney, Grant, eds)*
  - *Guiso-Sodini review paper (2013): a couple of pages*
  - *Gomes, Haliassos, Ramadorai (2020): 11/100 pages of pure text*
- My comments: Pushing further on the interpretation of the findings

What does the paper do? 1

- The paper's key message can be restated as:
  - *Tell me what you buy and I will tell you how financially reliable you are.*
- **Financially reliable** in terms of:
  - *Tendency to pay interest/finance charges/late charges (CEX)*
  - *Tendency to default on an instalment loan (Mexican retailer)*
- Why do we need this when there are credit records/FICO scores?
  - *In both cases, controlling for other/past loans and financial activity does contribute, but*
    - spending categories provide extra contribution
    - they help avoid the tautology of serial offenders

What does the paper do? 2

- The paper finds that spending on entertainment and other goods that provide instant gratification but entail longer run (repayment) costs contributes to paying interest/finance/late charges or to defaulting, respectively.
- So, is it about the goods themselves? Do they push you to financial misbehavior?
- The paper argues that it is about your type and not about your products:
  - ***CEX:*** *Your product categories predict two characteristics: smoking and low education*
  - ***Mexico****: The role of your product categories for default shrinks dramatically when individual fixed effects are included*
- So, what does this tell us about your type?
  - ***US:*** *Conjecture that both indicators are related to impatience*
  - ***Mexico:*** *No further analysis is possible*

What does the paper do? 3

- Testing the conjecture in CEX:
  - *Regress smoking (years of education) on household demographics and controls, product categories, quarter of observation dummy, exactly as was done for payment of interest/finance/late charges*
  - *Very similar pattern of coefficient estimates and of standard errors.*
  - *Thus, your product categories predict types of behavior consistent with impatience.*
- **Good to have:** surveys of time preference that either include consumption data or can be combined with bank data.

(Nurdy) Comment 1: The spending categories and the dependent variable

- Controlling for total spending and income, demographics and time dummies, 16 significant categories are entertainment-related:
  - *Video/audio, magazines/press, pets, toys/games/tricycles, lotteries, camera film, telephone service*
- Could these be proxies for wealth?
- Also: the interest in “interest/finance/late charges”:
  - *Is it a penalty or normal interest paid on loans?*
  - *My reading of CEX seems to suggest the latter*
  - *It is also consistent with the bank product controls being significant*
  - *Is there a way to separate out penalty payments?*

Comment 2: Smoking
Is it impatience or something else?

- Smoking has been used as indicator of lack of self control
- Possibility:
  - *Those who lack self control tend to overspend on entertainment*
  - *They also tend to pay fines and fail to stick to financial plans*
  - *They are more likely to smoke*
  - *Hyperbolic discounting; temptation preferences; myopia; or differential impatience between an accountant and a shopper*

Comment 3: Low education
Is it impatience or something else?

- Low SES (education and income) has been linked to greater pessimism about wealth returns (Kuhnen and Miu, 2017; Das, Kuhnen, Nagel, 2019)
- Based on this link, here is a possibility:
  - *Pessimism about returns to wealth can discourage saving and encourage (frivolous) consumption*
  - *Pessimism can create a psychological need for entertainment*
  - *Overspending on frivolous items, but also failure to recognize financial opportunities due to pessimism can cause financial trouble*

Comment 4: Low education as an outcome of innate ability

- Recently documented positive correlation between education and returns to wealth and its components (Girshina, 2019; Fagereng, Guiso, Holm, Pistaferri, 2020; Barth, Papageorge, Thom, 2020)
- Evidence that low net wealth and low education are joint outcomes of limited innate ability (Fagereng et al, Bart et al)
- Recent evidence that the low educated, unlike the educated, tend to be unresponsive to opportunities for wealth mobility (Haliassos, Jansson, Karabulut, 2021)
- Based on those, possibility:
  - *Low innate ability to handle financial (and other planning issues) can lead to both financial trouble and a tendency to consume even frivolous items for gratification*
  - *Fixed effects in the Mexican sample are entirely consistent with innate ability playing a big role*

Comment 5: Policy implications

- What to do about impatience?
  - *Maybe interventions in school to postpone gratification (a la Alan)*
  - *But grownups? Avoid entertainment, controlling for your income and other loans, as this provides a signal that may deny you future loans?*
    - A Big Brother element in Big Data?
- Limited ability to manage things, including finances could invite help: programs, advice, loan product simplification