Our motivation is a private paternalism story

Many institutions restrict choice using built-in commitmemnt mechanisms to overcome self-control problems.

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Usings Laibson's language - beacuse many of these forms of commitmment may be desirable to principals but not demanded by (the right agents), these mechanisms are often shrouded.

We study the benefits of imposing a structured repayment contract, whether there is demand for it, and whether non-takers of such a commitment product would benefit from taking it.

In other word, whether adopting a paternalistic behaviour would be beneficial.

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Our context is that of pawnshops and We examine pawn contracts. Partnered with one of the largest pawn lender in Mexico.

These loans are overcollateralized and collateral is liquid

Because it is overcollateralized the lender MAY gain if the borrower defaults on the loan, especially if the borrower pays towards recovery on the way to default.

For instance for those that default, half paid a positive amount, and paid in average almost half of the loan.

However 74% of the borrowers report a 100% subjective probailty of recovery, and 13%are classified as PB using the standar time inconsistenmcy question.

In such envorinment, it is natural to ask if putting more structure in paymenrts help alleviate this problems.

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Let me anticipate what I consider to be our main contributions.

This is a context of interest in the behavioiural literature

We will be able to respond to the question : How do treatment efects relate to selection? and provide a design that help us to do so

In particular, this design will enable us to identify the following causal parameters with no other than mean exclusion restriction.

And In our discussion of paternalism, this will come to be particularly important when consider PRTE as the TuT - which would answer the question of the effect of imposing commitment for the non-takers.

Finally, we consider the winners and losers from being paternalistic

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Now I will go through the experimental design and our main results.

Then we explore heterogeneity to start digging into the selection effects, and open the discussion on paternalism - what do we gain by being paternalistic?

This is where I would like us to focus and kindly ask you for feedback and comments.

Finally I will conclude.

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Let me explain the status-quo contract.

It is a tree month period contract with a 7% monthly interest rate that compounds daily. To recover the piece the borrower needs to pay the loan and any accumulated interest.

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To overcome the high default rates, we designed a frequent payment contract identical to the status quo BUT where the obligations must be met every 30 days. Paying each month, a third of the loan. Failing to do so incurs in a penalty fee of 2%.

So, note that this is a contract that will provide more structure.

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The small fee was designed manily to make the structured schedule salient, yet not to be a disincentive to be late.

The empirical literature provides guidance that such structured contracts may decrease default and elicit demand.

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We have both administrative and survey data. The admin data consists of all payment records, the value of the item, the amount of the loan, and whether the client lost, or recover the pawn.

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Our main outcome will be the following measure of financial cost of borrowing. Which consists of interest plus fees, and sunk payments toward recovery and the value of the pawn whenever borrowers default.

In other words, we consider all payments but only payments of the principal are considered costs when there is default, and we add on top of that the lost value of the pawn.

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We randomize at the branch-day level

Our unit of analysis will be at the pawn level, and we consider only the first visit, during the experimental phase, of each client in our sample, but allow for multiple pawns during a visit (clustering will take care of the correlations).

Our results are robust if we consider consolidated loans, or if our unit of observation is now at the client level, or if don't restrict to the first visit, and allow for multiple visits.

Control - gives status-quo contract.

Forced commitment- gives structured payment contract.

Choice commitment - allows them to choose between them.

This latter arm will allow us to measure if there is demand for commitment, and also who demands it, more importantly in terms of potential outcomes.

This will help answering if forcing is better than letting borrowers choose.

I will not talk about the experimental integrity for time purpose. But let me just mention that we don't have problems of imbalance, differential attrition, etc. But of course all this details will be properly discussed in the paper.

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Results are straightforward - forced commitment contract reduces financial cost and probability of default.

As I mentioned earlier this results are robust to considering multiple pawns os multiple visits.

The results are also robust to different definitions of financial cost, for example including subjective value of the pawn, or adding the transport cost.

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To shed light on the results behind the ATE we also study how treatment affect a number of intermediate outcomes. For example,

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An interpretation is that FC forces borrowers to think earlier about whether they will indeed be able to eventually recover their pawn.

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It is difficult to argue about the welfare effects of the forced commitment contract. To try to say something we ask wether people in the forced commitment arm are more likely to return (as proxy of having liking the contract). This is the case.

Now, you can argue that they are returning since we are reducing the liquidity, but we see that they are more likely to return when the previous contract has ended, and they usually come back with a different collateral. (even conditioning on having recovered the first pawn).

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So commitment works. Yet, when given the opportunity to choose only 11% does.

In a world of homogeneous treatment effect this says that 89% that didn’t take up, would have benefited (on average) from having chosen it.

But…this is not the case

Is it the case then that the ones that didn’t chose it wouldn’t have benefited from treatment?

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Not really. Bounding the distribution of treatment effects, we find that at least 30% would benefit from commitment.

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By adding more assumptions, we can say even more

In average financial benefit would increase for borrowers that did not choose commitment.

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Actually 72% of this borrower would benefit from commitment.

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Then if commitment works, why don’t people choose it?

We have 3 possible (behavioral) explanations,

I’m not going to dive into them, but only mention that we rule out this two and we try to explain that people are being overconfident.

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So in conclusion

1. Commitment works.

2. We see selection on gains, however large effects on imposing commitment on non-compliers.

3. The low take-up can be explained by overconfidence

4. Policy implication - mandated commitment-based contracts?