Decision Processes Colloquium

Monday, October 24, 2011

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Borrowing High vs. Borrowing Higher: Sources and Consequences of Dispersion in Individual Borrowing Costs (with Victor Stango, Graduate School of Management, University of California, Davis)

For many households, paying lower borrowing costs is the surest, fastest way to increase net worth. Using administrative, credit bureau and survey data on U.S. credit cards, we find pervasive and systematic cross-individual variation in borrowing costs. Credit risk, product differentiation and debt (mis)allocation conditional on cards held explain less than one-quarter of that variation. Rather, most variation comes from the fact that similarly risky borrowers often hold cards with very different contract APRs. Several results suggest that this is driven by heterogeneity in consumer search behavior. The impact of price dispersion on wealth accumulation is large: conditional on outstanding balances, moving heavy borrowers from the 75th to the 25th percentile of risk-adjusted borrowing costs increases their savings rates by more than a percentage point.