

In Harm's Way?
Payday Loan Access and Military Personnel Performance*

Scott Carrell
UC Davis and NBER

Jonathan Zinman
Dartmouth College

August 2008

Abstract

Does borrowing at 400% APR do more harm than good? The Pentagon asserts that payday loans harm military readiness and successfully lobbied for a binding 36% APR cap on loans to military members and their families (effective October 1, 2007). But existing evidence on how access to high-interest debt affects borrower behavior is inconclusive. We use within-state variation in state lending laws, and exogenous variation in the assignment of Air Force personnel to bases in different states, to estimate the effect of payday loan access on personnel outcomes. We find significant average declines in overall job performance and retention, and significant increases in severely poor readiness. These results provide some ammunition for the private optimality of the Pentagon's position. The welfare implications for military members are less clear-cut, but our results are consistent with the interpretation that payday loan access causes financial distress and severe misbehavior for relatively young, inexperienced, and financial unsophisticated airmen. Overall job performance declines are also concentrated in these groups, and there are several pieces of evidence suggesting that these declines are welfare-reducing (and not the result of airmen optimally reducing effort given an expanded opportunity set); e.g., performance declines are larger in *high* unemployment areas with payday lending.

Keywords: credit access, subprime credit market, predatory lending, military readiness, behavioral economics, psychology and economics, financial sophistication, financial literacy, household finance, consumer finance, behavioral finance

* Carrell: UC Davis, Department of Economics, One Shields Ave, Davis, CA, 95616 (email: secarrell@ucdavis.edu). Carrell is a part-time reservist in the US Air Force assigned to the USAF Academy Department of Economics and Geosciences. Zinman: Dartmouth College, Department of Economics, 314 Rockefeller Hall, Hanover, NH 03755 (email: jzinman@dartmouth.edu). Thanks to Pat Cirillo, Bob Hunt, Chris Knittel, Don Morgan, Anna Paulson, Rich Rosen, and lunch/seminar participants at Dartmouth and the Federal Reserve Banks of Chicago, New York, and Philadelphia for helpful comments. The views expressed in this paper are those of the authors and do not necessarily reflect the official policy or position of the US Air Force, the Department of Defense, or the US Government.

