Discussion of "Employer Credit Checks: Poverty Traps versus Matching Efficiency" by Dean Corbae and Andrew Glover

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Crime and Punishment

- Credit exists because default is punished
- If there was no punishment for default, all borrowers would default, and no-one would extend credit

- But how harsh should punishment be?
  - Extremely harsh punishments preclude default and allow extensive credit
  - But perhaps default is sometimes a good thing
  - It introduces some state contingency
  - Pay me back unless something really bad happens to you

Punishment Across Markets?

- Should punishment for default extend beyond the credit market?
- Should people be punished in the labor market for poor performance in the credit market?
- Should you be punished in the home rental market? In the dating market?

How the model works

- Why do firms in the labor market care about an individual's credit score?
- Because credit score is positively correlated with worker productivity, which isn't directly observed
- Why would that be?
- Story is that people differ in terms of patience
  - More patient people more likely to invest in schooling / skill acquisition
  - More patient people are also less likely to default
- So firms see high credit score workers as likely more productive, thus more attractive as potential hires

=> firms put more effort into hiring high credit score workers

=> easier for high score unemployed to find jobs

=> extra incentive to protect your credit score by repaying debts

So what is wrong with using credit scores in hiring?

- A worker might be unlucky and be pushed into default by unexpected expenses
- And if they subsequently become unemployed, they will have a hard time rebuilding their score, because you need a job to get credit and build a credit record, and it is hard to get a job with a bad credit score

- So is there a case for banning the use of credit scores in hiring?

Efficiency Argument for a Ban

- Banning employment credit checks might make credit scores more informative
- Unemployed “good” types with bad scores can more quickly get jobs and rebuild credit when ban in place

- Paper suggests this argument fails:
  - Credit scores are more informative about type when employers can use them to screen
  - When they cannot use them, good types default more often and scores become less informative

Distributional Argument for a Ban

- Suppose planner cares more about the low type.
- By banning credit score use in employment, the low type will find jobs more quickly
- That prediction is born out in simulations. And low types also benefit in the credit market, again because ban makes it harder to differentiate types

Is there a better policy?

- Distributional gains for the low types come with large efficiency costs:
  - reduced credit overall (default punishment weakened)
  - inefficiently low job posting for highly productive workers
- There are likely better ways to redistribute toward impatient types
  - e.g., redistributive taxation
- Another concern: if employers cannot use credit scores they might turn to other observables that correlate with unobserved productivity, like height or race

Model Details

- Rich and realistic model of consumer credit markets
- Rest of the model is somewhat stylized
- Could consider alternative labor market models to screen for type
  - Promise increasing wage profiles to attract more patient type
  - Or offer low wage-high job finding probability and high wage-low job finding probability options
- Could allow for saving between periods (a period is a month!)
- Could model longer-lived skill investment (skills depreciate after one period)
- Could allow for longer term credit
  - Credit contracts are one period
  - Braxter, Herkenhoff and Phillips (2022) show that the unemployed borrow through long term credit lines

Conclusion

- Excellent paper!

- We need theory and models to think through interactions between credit and labor markets, and impacts of policies like bans on credit or criminal record checks