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

Jonathan Heathcote
Minneapolis Fed
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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