How some states help residents avoid costly debt during hard times

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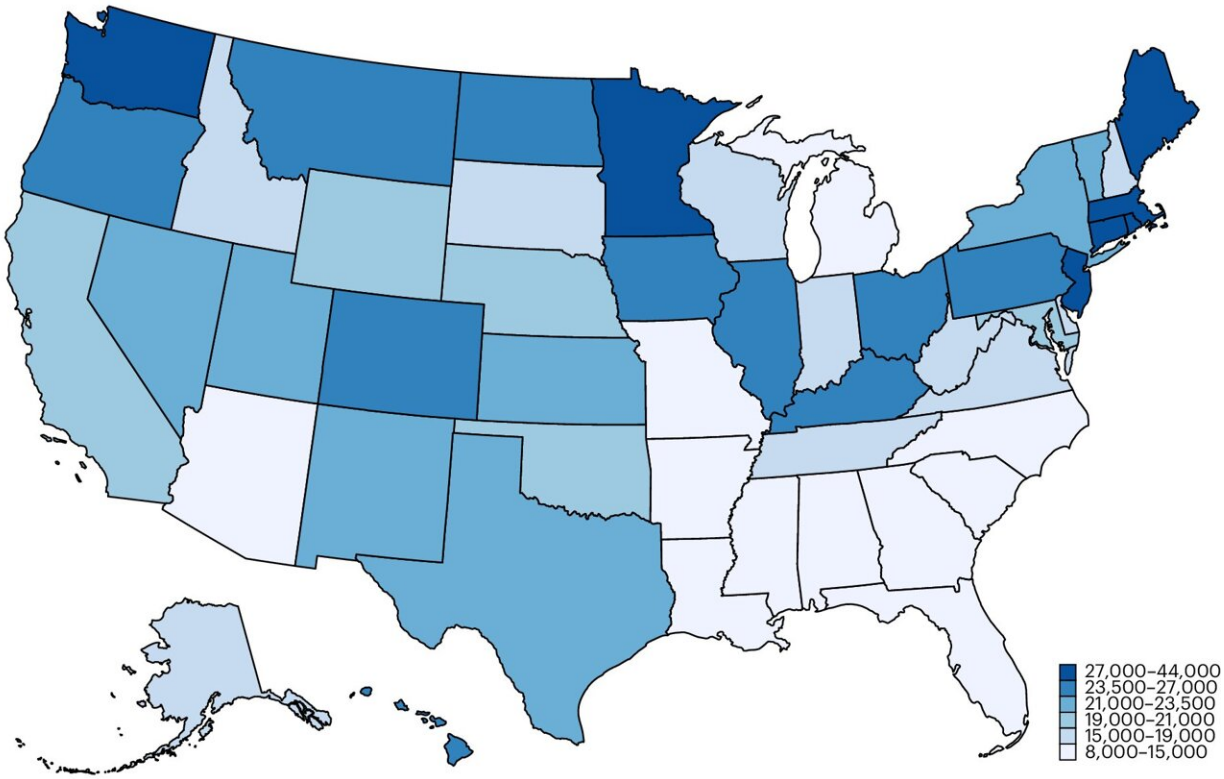

State variation in maximum UI benefits, average across states during Q2 2020–Q4 2021. Credit: *Nature Human Behaviour* (2024). DOI: 10.1038/s41562-024-01922-8

A new national study provides the best evidence to date that generous unemployment insurance benefits during the COVID-19 pandemic

helped reduce reliance on high-cost credit use.

Researchers found that lower-income residents of states with more generous benefits were significantly less likely than those living in less-generous states to take out new credit cards, personal finance loans and payday loans or other alternative financial service offerings.

The study, published recently in the journal *Nature Human Behaviour*, was led by Rachel Dwyer, professor of sociology at The Ohio State University, and Stephanie Moulton, professor in Ohio State's John Glenn College of Public Affairs.

The findings provide evidence that programs like unemployment insurance can play a powerful role in keeping low-income Americans from falling further behind financially, said Moulton.

"Providing more generous unemployment benefits helps people avoid these really expensive types of debt that are costly not only for individuals, but eventually for society," Moulton said.

A key strength of the study was its large sample of 2.3 million Americans, who were studied from the end of 2019 through the end of 2021. The researchers used data from the consumer credit bureau Experian to determine if those in the study took out a credit card, personal finance loan or an alternative financial service (AFS) loan during the time of the research.

The researchers took advantage of the fact that some states were more generous in how much unemployment insurance benefits they provided to residents than others as well as differences in the timing of benefit expansion and contraction within a state. This variation allowed them to see if the level of benefit generosity had an impact on whether Americans avoided costly debt.

"Unemployment insurance is a key part of the safety net in the United States, and it affects a lot of people," Dwyer said. "We were able to test how it affected people of various income levels during the COVID recession."

Results showed that more generous unemployment insurance benefits did indeed result in less use of costly credit use, mostly among those in the lowest-income households.

There was a 9.7% lower probability of the lowest-income consumers taking out a new credit card when unemployment insurance benefits in a state were the most generous compared to when benefits in a state were the least generous, the study found.

The difference was even more stark when the researchers examined AFS loans. These are loans outside the traditional banking institutions, such as payday loans, where interest rates may be significantly higher than traditional forms of borrowing.

"A lot of these are online loans, and they're quite accessible because of that, but they are not regulated in the same way as traditional financial institutions," Dwyer said. "And they have very high interest rates."

The study found that the lowest-income consumers were 24% more likely to take out AFS loans when state unemployment benefits were the least generous compared to when state unemployment benefits were the most generous.

When high and middle-income households lost their jobs because of the pandemic, they were able to rely on savings, or they could use credit cards, to help them get through for a few weeks or months of unemployment, Moulton said. But the lowest-income consumers often don't have savings and aren't eligible for credit cards, or have already

maxed out their credit limit.

"For low-income consumers, AFS loans may be the only place they can go as their last resort, so they turn to these very expensive ways to make ends meet," Moulton said.

"We found that more generous benefits really seemed to save at least some low-income consumers from having to make that choice."

In addition to their main analysis, the researchers also examined alternative measures of how consumers may have been coping with the COVID recession, such as spending on existing credit cards or applying for loans regardless of whether or not they were approved, Dwyer said.

"Our results were quite consistent, with lower-income consumers faring better in states when benefits were generous," she said.

One question that taxpayers often ask is whether government programs like unemployment insurance provide society with a good return on investment. These findings suggest another benefit that should be considered, Moulton said.

"If we are preventing some share of this really high-cost borrowing from happening, we are preventing a cost that might ultimately be borne by society," she said.

"There are domino effects where consumers might end up in bankruptcy if they have to use high-interest loans to make ends meet, which isn't just bad for their own credit, it can raise the cost of credit for others as well."

More information: Lawrence M. Berger et al, Inequality in high-cost borrowing and unemployment insurance generosity in US states during the COVID-19 pandemic, *Nature Human Behaviour* (2024). DOI:

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