Misfortune and Mistake: The Financial Conditions and Decision-making Ability of High-Cost Loan Borrowers

The appropriateness of many high-cost loan regulations depends on whether demand is driven by financial conditions ("misfortunes") or imperfect decisions ("mistakes"). Bank records from Iceland show borrowers have especially low liquidity just before getting a loan. Borrowers exhibit lower decision-making ability (DMA) in linked choice experiments: 45% of loan dollars go to the bottom 20% of the DMA distribution. Standard determinants of demand do not explain this relationship, which is also mirrored by the relationship between DMA and an unambiguous "mistake." Both "misfortune" and "mistake" thus appear to drive demand.