THE MORAL ECONOMY OF DEBT:

RACE, ETHNICITY AND PERCEPTIONS OF FAIRNESS IN CREDIT MARKETS FOR THE POOR

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Abstract:

In this dissertation, I explore the role of values and moral judgments in credit markets. I focus on the frequenting of "fringe banks," controversial institutions that serve those who have limited access to mainstream credit markets as a result of poverty and/or poor/no credit history. Among other intriguing results, I find compelling evidence that there are persistent statistical differences in payday and pawn loan usage across racial and ethnic groups that cannot be explained by disparities in wealth and credit access. Instead, I argue that they are the result of variations in the perception of the propriety of such loans, variations that have their root in the legacy of racial discrimination in mainstream credit markets in the United States. To make this case, I utilize both quantitative and qualitative data as well as a variety of novel statistical techniques. I analyze cross-site multi-wave survey data collected by The Center for Community Capital, The National Opinion Research Center and The Annie E. Casey Foundation. I strengthen my argument by drawing on excellent focus group data supplied by The Center for Community Capital and The Center for Responsible Lending. This study represents a unique contribution to the sociology of credit and finance and demonstrates the importance of synthesizing structural and cultural approaches to the study of economic activity.

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Introduction:

Even before the credit crisis of 2008 had run its course, members of the media and government had begun to assign blame. Not surprisingly, the identified culprits varied according to the political ideology of the accuser. Thus, free market advocates placed the blame squarely on the shoulders of government for maintaining regulations and subsidized lending programs (e.g. Fannie Mae and Freddy Mac) that distorted incentives and burdened businesses. Some pinned additional responsibility on profligate consumers who knowingly borrowed above and beyond their means. Conversely, liberals focused their ire on greedy, predatory lenders who charged exorbitant interest rates and took advantage of the financial ignorance of the poor, minorities, and immigrants. Liberals further argued that government failed to enact and enforce necessary regulations, pointing to the S.E.C. as a classic, "captured regulator."

The true causes of the recent financial meltdown are extremely complex. The simplistic villains of the current morality play, with their inflated agency, merely serve as comprehensible stand-ins for what was a systemic structural collapse. Nevertheless, social scientists should take interest in the public discourse on culpability and in the attempts to place and deflect blame. Most obviously, the consensus that emerges, if any, can sway the outcome of elections and dictate the course of public policy for years to come. More subtly, the varying heroes and villains of these crisis stories indicate deep-seated underlying beliefs about both the proper scope of market transactions and the rights and responsibilities of actors within the market, merchants and consumers, creditors and debtors alike.

In other words, participants in the world's most advanced industrial economy are continuing to debate the morality of economic action, a subject that is studied primarily by scholars of, "primitive," and developing societies. This may be surprising to neoclassical economists who see self-evident virtue in market exchange and the free movement of supply and demand curves. It may be equally surprising to Marxists, substantivists, communitarians and anyone who fears that moral concerns are swept away by the cash nexus of a fully developed market economy. It should not be surprising to sociologists; economic action is a particular form of social action and thus subject to normative constraints as usual.

Sociologists have, historically, had little to say about the functioning of morality in the economy in general. This may be because ideas about proper behavior in the market most obviously find effect in usury laws, civil suits over, "unconscionable," business practices, dynamic pricing/price discrimination, and public outrage over "price gouging," in the aftermath of a natural disaster. Study of these phenomena requires delving into the economics of credit and financial markets and of price controls. Typically, sociologists have been hesitant to conduct research in these fields, possibly because they see them as the proper domain and purview of economists. Instead, social theorists have focused on "ethnic economies," (Light 1972, Portes 1993) and a subset of market transactions that include "embedded ties," (Uzzi, 1994, 1996). In effect they have carved the economy into separate spheres with only one assumed to be amenable to sociological analysis. This division is unfortunate because the insights garnered from analysis of these special cases are likely applicable to markets in general. Furthermore, such a division only reinforces the erroneous belief that market moralities other than that implicit in neoclassical economic theory are something primitive that erode as markets evolve and, to the extent that they are still present in modern economies, only function temporarily in special, "ethnic," enclaves.

What follows is a study designed to address this gap in our understanding of the functioning of markets. It is an attempt to bring sociological insights to bear on the study of credit and financial markets in particular and to demonstrate the importance of morality in the economy in general in shaping behavior and thus individual and market-level outcomes. Morality in the economy is an immense topic that includes everything from Islamic banking to kid's menus at family restaurants. A full treatment would (will) require a lifetime of research. We can however, make inroads by focusing our attention on particular instances where morality is most obviously active and relevant. Below I describe one such instance: the use of formal and informal sources of credit by the inner city poor to deal with financial emergencies. More specifically I will focus on the frequenting of payday lenders, check cashers, and pawnshops. These, "fringe banks," serve those who are locked out from mainstream credit markets as a result of poverty and/or poor/no credit history. Critics argue that fringe banks are exploitative and cause or exacerbate poverty by trapping users in a cycle of debt. Use of such services has exploded in the last 30 years, leading advocates for the poor to press for regulation and attracting the attention of economists and political scientists. The topic is thus interesting both because of its implications for social stratification and because of the research it is beginning to generate. To clarify the role of morality in this market, I make use of the concept of "moral economy," a term coined by the late historian E.P. Thompson to denote the context-specific role of values in an economy. I argue that a focus on moral economy leads to a better understanding of credit decisions and allow sociologists to improve upon preexisting neoclassical models of fringe banking. I am not however, arguing that fringe banking is a special case, one which requires additional sociological consideration not required when modeling mainstream credit markets. In showing the importance of a sociological perspective in general, and the moral economy framework in particular, to our understanding of fringe banking I hope to show the importance of such considerations when studying all credit and financial markets; current models of fringe banking behavior are insufficient precisely because models of mainstream credit markets are insufficient. This is, in other words, at attempt to demonstrate the advantages of a sociological approach to the study of credit and finance, and to make it the purview of sociologists as well.

Theoretical ambition however, is often stymied by a lack of relevant data. To demonstrate the importance of morality in shaping credit market behavior, we require data sources that contain relevant socioeconomic indicators and variables that capture crucial elements of social structure and that allow for comparisons across communities. I have found several such sources. I detail the features of the data below but first I describe the empirical setting and develop the theory that motivates this research.

Goals:

This study is designed to demonstrate the importance of shame, obligation, and perceptions of fairness and propriety in shaping behavior in credit markets. I argue that many of the effects of morality are context-specific and mediated by social network structure. Thus, the moral economy framework is relevant here. Through use of statistical and qualitative data I show that moral considerations factor into the decision to use pawn shops and/or payday lenders to meet one's credit needs. Furthermore, I explore whether a focus on context-specific moralities can help explain previously observed variations in fringe bank concentration according to the racial and ethnic composition of neighborhoods. I argue that differences in moral perspective can help explain variations in behavior across racial groups that cannot be accounted for by reference to individual and neighborhood-level financial characteristics. This suggests another explanation for differences in lender concentration at the neighborhood level. Before I detail the specifics of the empirical study however, it is important to provide both a more detailed description of the phenomenon of fringe banking and a fuller treatment of the moral economy framework to distinguish it from a simple, "generalized morality."

Chapter 1: Fringe Banking:

The period since the mid-1980s has seen an explosion in the growth of so-called, “fringe banking,” services. This is likely the result of several key banking deregulations that occurred in the early days of the first Reagan administration. Fringe banks are organizations that cater to customers who lack the prerequisites to enter and utilize the mainstream credit market. The oldest of such organizations include pawn shops and check cashers. The former offer small secured high-interest loans and require collateral, usually in the form of a piece of jewelry, a watch or a home electronic device. The latter serve the “unbanked,” poor, those who do not maintain a credit or checking account and cannot benefit from direct deposit. Swarthmore economist John Caskey conducted seminal research on these industries in the early 1990s. Since then there have been two major developments. First, other economists and political scientists have taken note of the fringe banking phenomenon and have begun to produce research aimed both at explaining the behavior of fringe bank customers and, to a much lesser extent, exploring the long-term implications of the use of such services. Second, a “new” type of fringe banking service, “payday loans,” emerged and began to spread rapidly[1].

Payday loans are so called because they allow a borrower to receive an “advance” on their next paycheck. Provided a potential client can show evidence of formal employment (typically by offering pay stubs) and possession of a checking account, payday lenders will offer him, in return for a post-dated check, a short-term high interest loan. If at the end of this period (typically two weeks) the debtor does not have the necessary funds to cover the post-dated check, lenders will typically allow him to, “roll

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[1] In the early 1890s some lenders would “buy” a worker’s next salary at a discount a few days before it was paid out. These early payday loans were structured as salary purchases in an effort to avoid state usury laws (Neifeld 1939). Such loans were subsequently outlawed and did not remerge until the mid-1990s under a new regulatory regime. Thus, payday loans are not technically a new form

over," the debt into the next pay period for another fee. Fees for payday loans usually fall in the range of 15-20$ per $100 loaned. This translates to an annualized interest rate of around 400%

As the industry matured, payday lenders organized into several mega-chains. Such chains represent slightly more than 50% of all payday loan providers operating in the United States. Simultaneously, shops that offered only payday loans became rare. Most fringe banking establishments now offer a variety of services. In addition to payday loans, a customer may wire money, pay bills, and pawn items. Companies that formerly operated chains of pawn shops also began to offer payday loans and other services in response. As a result, many poor neighborhoods now have, "one stop shops," where a customer can partake of a variety of services. John Caskey (2005) has found that the emergence of payday lending corresponded to a concomitant halt in the expansion of pawn shops and check cashing usage. As payday lending continued to expand, these other types of fringe banks began to contract. This suggests that these services are substitutes of sorts. On the other hand, payday loans have additional requirements: a checking account and a series of pay stubs. Therefore payday lenders may serve a slightly wealthier clientele.

All fringe banks require some assets and identification papers, though requirements vary. Illegal immigrants are thus often cut off from these markets. Payday loans, as noted, require a bank account and proof of employment in the formal economy. Thus the unbanked and those employed in the informal economy cannot utilize them and must rely on informal credit if it exists. Ironically this may shield them from the pernicious effects of payday lending. There is a small economic window for payday

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of fringe banking.

lending usage: potential customers must have the formal requirements necessary to take out a payday loan but lack the resources necessary to take out a bank loan or (further) rely on credit cards. This may constitute a, "sour spot," for those unlucky enough to find themselves in this window and without access to informal credit.

Not surprisingly, throughout the last decade fringe banks have faced close scrutiny by both politicians and advocates for the poor. The high effective interest rates associated with pawning and payday loans appeared to violate the spirit, if not the letter of existing usury laws[2]. In addition, many became increasingly concerned with payday loan, "rollovers," which appeared to trap many customers in a downward spiral of debt. Opponents of payday lending argue that the industry targets minorities and immigrants and hides the true costs of the loan by focusing on the short term fees rather than the interest implied by those fees. While payday loans may sometimes be the best among many poor choices, uninformed and uneducated consumers often make mistakes. Industry proponents, they say, do not factor in the risk of falling into a cycle of rollovers when they tout the advantages of payday loans over other alternatives (if any). Furthermore, that the poor may come to rely on payday loans does not, of course, mean the terms are not exploitative. Most critics call for a ban on payday loans accompanied by federal and state programs to provide low-cost/subsidized credit in their stead[3].

Payday lenders have responded to these challenges by pumping tens of thousands of dollars into political lobbying and launching a widespread advertising campaign designed to generate favorable public perception. The largest coalition of payday lenders, the Community Financial Services Association of America, also instituted a variety of

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2 Before revision, most state usury laws were framed in terms of yearly interest rates. Payday lenders could argue that their loans were meant to be short term and that the short term interest rate was far below that allowable under state law.

3 Interestingly, during the medieval era, some cities ran such non-profit "public pawnshops," that offered loans at rates set to just

voluntary limits on payday lending activity among member organizations in order to head off further regulation.

Payday lenders present themselves as offering a reasonable emergency option for those burdened with unexpected financial difficulties like a broken down car, a doctor's visit, or a large heating bill. They argue that the cost of a payday loan is often lower than that of a bounced check or the fee associated with a late payment. Elliehausen and Lawrence (2001), for example, detail instances in which a rational consumer would garner a net utility gain by taking a payday loan. Industry advocates also note that loans have a relatively high fixed cost in paperwork and monitoring. Therefore, at the same interest rate, a small loan is less profitable than a large loan. Combined with the potentially high default rate of impoverished debtors, this, they say, necessitates high interest rates. Limits on these rates will, so they say, drive payday lenders out of business and thus make the poor worse off. As long as debtors are responsible and only borrow what they can safely pay back, they argue payday loans are innocuous.

Opponents of payday lending have won legal victories in many states. Around 35 states now have laws that limit or outright ban payday lending within their borders. Most states have simply placed limits on the fees associated with payday loans. Others include limits to the number of payday loans a customer may receive on a yearly basis and restrict the number of rollovers to four or five. Those who reach the maximum receive a, "cool down" period during which they can attempt to raise the funds necessary to pay off the principal. A handful of states, most notably North Carolina, has outright banned the practice. Some payday lenders have attempted to circumvent these laws by disguising their business model. One study in North Carolina (name, year) found shops offering 2-

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meet operating costs (De Roover, 1967).

week, “internet usage,” packages that replicated exactly the terms of a payday loan. More commonly, payday lenders have attempted to use court rulings to bypass limits on interest rates. In what critics pejoratively describe as the, “rent-a-bank scam,” a payday lender will tangentially ally itself with an out-of-state bank (usually from Delaware given that state’s famously lax financial laws) and then claim the right to import that banks rate and loan prerogatives under the terms of a federal court ruling (ruling number, year). This has allowed some payday lenders to continue operating in states where revised usury laws would make it otherwise unprofitable. Some states (again, North Carolina) have taken additional steps to close these legal loopholes. Recently, the Federal Reserve has taken steps to end this practice as well. At the federal level there is only one law limiting the activities of payday lenders: in 2006, Congress passed a law limiting the interest rates, fees and roll-overs that payday lenders could offer soldiers.

Despite the rhetoric on both sides, there is little actual empirical evidence about payday lending in particular and fringe banking in general. In his study of Wisconsin state records of payday loan use, John Caskey found that the average payday loan recipient takes out 11.9 loans per year and that a quarter of payday loan customers took out 14 or more in a given year. 54.3% of customers reported 4 or more sequential rollovers and 23.6% reported 7 or more. (Caskey, 2005). The best data previously available on the behavior of the poor in fringe credit markets come from the work of Stegman and Faris (2001, 2003) of the Center for Community Capital who organized, conducted and analyzed the government-sponsored North Carolina Financial Services Survey. Their results were instrumental in the passage of laws first limiting and then banning the practice of payday lending within the state. Approximately 6-8% of those low-income people surveyed had taken out a payday loan or pawned an item in the previous 24 months. The authors found that, when holding a variety of neighborhood-level characteristics constant, payday lenders were more likely to locate in areas with a higher proportion of African American residents. Pawnshops, on the other hand, were more likely to locate in areas with more Hispanic residents. They were not able to explain these variations in fringe bank concentration according to the racial composition of a neighborhood. Stegman and Faris do note however, that unlike payday loans, defaults on pawn loans are not reported to credit rating agencies and thus will not result in damaged credit. This may, they theorize, be one reason that some prefer pawn loans to payday loans. Note however that while Stegman and Faris controlled for a variety of financial characteristics (including credit card ownership[4] but not limit), some scholars (e.g. John Caskey) argue that they did not control sufficiently for credit rating/score and total asset value. As these factors may affect access to mainstream credit or provide collateral for unsecured loans they could also affect usage rates of fringe banking services and thus explain variations in payday lender and pawnshop placement. If such factors vary systematically across race then otherwise similar individuals may exhibit differing behavior. In another study in North Carolina (King, 2005), the Center for Responsible Lending found the concentration of payday lenders in predominantly black neighborhoods to be three times that in predominantly white neighborhoods. While King et. al, probably do not adequately control for credit rating and wealth differences, the extreme disparity is nonetheless striking.

[4] A surprising number of those beneath the federal poverty line have one or more credit cards (70% of whites, 55% of blacks, and 50% of Hispanics). Even more surprising is that many who own credit cards do not maintain a checking or savings account (i.e. they are unbanked). These striking results are most likely due to credit card companies' strategy of blanketing consumers with unsolicited "pre-approved" credit card offers. Given this strategy it is not surprising that the credit card industry has faced relatively high default rates, or that they have lobbied for passage of laws to make it more difficult to wash away credit card debt when declaring bankruptcy.

In 2006, Apgar and Herbert conducted a study of, “sub-prime lending and alternate financial service providers,” in the Dallas area for the Department of Housing and Urban Development. Unlike King et al., Apgar and Herbet found no evidence of clustering of fringe banks in general in minority neighborhoods. They did not, however, examine payday lenders and pawn shops separately. On the other hand, the authors find clustering of check cashing establishments in immigrant neighborhoods. This is in part explained by the number of unbanked and undocumented immigrants who may use check cashers and pawn shops. This relationship persists however when these factors are accounted for. The authors theorize that such establishments may offer benefits even to those who maintain checking accounts. Such benefits potentially include longer hours, a variety of bill paying services, and, “greater cultural sensitivity,” compared to mainstream banking institutions. Finally, one group of authors (Elliehausen and Lawrence, mentioned above) conducted a survey of payday loan recipients to determine their satisfaction with the service and their understanding of the associated fees. They found that most were generally happy with their experiences but that while most could recall the fee on their most recent loan, few could calculate or remember its yearly effective interest rate (supposedly provided in documentation with the loan). As this study was funded by the payday lending industry itself, its results should be taken with a healthy dose of skepticism. In addition, due to several sampling issues, one cannot assume the sample is representative of payday loan recipients. Approximately half of those contacted were unavailable because the provided phone number had been disconnected (this should already give us pause). Of the remaining half, approximately 60% refused to take part in the survey or were unable to schedule a time to complete the requisite interview given their work schedule. The authors were surprised that the majority of those surveyed were stay-at-home mothers; we should not be. Still it is interesting that, even in this tendentious account of payday lending, surveyed recipients were unable to correctly identify the interest rate burden they carried.

The literature as it stands is unfortunately quite limited in scope and offers little insight into either the causes or effects of fringe bank usage. No studies have tracked payday or pawn loan recipients to compare their economic outcomes with non-users. Also noticeably absent is a discussion of access to informal sources of credit. Sociologists (e.g. the ethnic economy literature, and Townsend's work. See below) alike have demonstrated the importance of informal credit in meeting financial needs and obligations. Any serious discussion of fringe banking must account for the decision (or lack thereof) to use a fringe bank rather than or in addition to an informal credit source. Furthermore and predictably, beyond occasional conjecture about cultural sensitivities, no attention has been paid to norms, beliefs or social network structure. Below I demonstrate the importance of studying variations in these norms, beliefs and social network structure across relevant working class communities to better understand credit market behavior. The obligations, opportunities, resources and restrictions contained within such communities constitute a context-specific "moral economy," that shapes behavior in both formal and informal credit markets, partly determining the frequency with which community members turn to payday lenders, pawn shops and check cashers to meet financial needs. Not only does a focus on morality in general and context-specific moral systems enrich our understanding of credit market behavior; it helps us to explain the persistent puzzling observed variation in fringe bank concentration according to the racial and ethnic makeup of neighborhoods. In the next section I describe the features of the context-specific moral systems that E.P. Thompson dubbed “moral economies,” before turning to the various ways in which such systems influence credit market structure and behavior.

Chapter 2: Moral Economy

The term moral economy was, as noted, coined by the historian, E.P. Thompson to describe beliefs about proper behavior in a market context. In the paper in which the term was first used, Thompson was concerned with explaining food riots in rural England during the 18th and 19th centuries. The peasants who took part in these sometimes violent uprisings were not, he argued, an irrational mob nor were they simply rational actors motivated by hunger alone. Instead they were motivated as much by moral outrage over perceived disregard for the traditional duties of a merchant to members of his community. In times of dearth, it was thought, a merchant should not export grain to other communities, nor should he raise prices to reflect relative scarcity. Failure to live up to these responsibilities often led peasants to organize to remedy the situation. While this so far seems explicable through rational choice analysis, how the peasants actually behaved should give us pause. Generally, although it was within their capacity, mobs of angry peasants rarely seized foodstuff outright. Instead they paid the merchants what they believed to be a fair or "just" price for the goods. If the merchant refused this offer, peasants, though near starvation, might burn granaries, overturn carts and dump grain into the river to punish him.

What E.P. Thompson described, peasants motivated to punish those who acted unfairly even at cost to themselves, finds its closest modern analogue in the work of behavioral and experimental economists. In 1986, Kahneman, Knetsch and Thaler produced two seminal works in which they described the perceived fairness of certain pricing decisions. Those surveyed strongly objected to price increases that were not accompanied by concomitant increases in the cost of doing business. For example, raising prices to take advantage of increased demand for snow shovels after a blizzard was seen as illegitimate. Kahneman, Knetsch and Thaler proposed the principle of "dual entitlement." Consumers feel entitled to a "reference price," i.e. a stable price unaffected by recent perturbations in the market. Merchants, in turn, are entitled to a "reference profit," and may raise prices to maintain that profit (e.g. to compensate for increases in wholesale prices). The surveyed consumers did not simply object to paying more. Instead, they objected to a subset of pricing decisions viewed as unfair.

In the experimental economics literature scholars have further demonstrated the importance of fairness through analysis of participant behavior in the "ultimatum game". In an ultimatum game, two "players" are tasked with dividing up a sum of money between them. One player is designated to offer a division (e.g. 70/30, 60/40, etc.). The second player may accept the offer and receive his share or reject it. In the latter case, neither receives anything. Rational choice theory dictates that the first player will offer nothing more than a penny and the second player will accept any non-zero offer; something is better than nothing. In practice, researchers observe two deviations from this prediction. First, most offers are considerably less lopsided than predicted. Even splits are fairly common, as are 60/40 offers. Second, in cases where the first player proposes a lopsided division, the second player often rejects the offer preferring to receive nothing (and presumably punish the first player). These results are robust to numerous variations in the details of the experiment; even strangers engaged in single round games adhere to these unwritten rules of conduct. The results of these studies are suggestive but economists have done little with them, save for an occasional attempt to include a, "taste for fairness," in their utility equations (see for example, Rabin 1993). As Kahneman, Knetsch and Thaler note, many economists are “true believers,” in homo economicus and even those who (rightly) view it as a modeling simplification are hesitant to complicate their supposedly parsimonious models without prior evidence of major outcome ramifications.

While such studies convincingly show the importance of certain types of moral consideration in shaping economic action, there is an important difference between the framework proposed by Thompson and that implicit in these studies. Thompson grounded his analysis in community-level obligations. Merchants had special duties to those with whom they shared a common bond: membership in a particular town or city. While this does not imply that merchants were free to act as rapacious capitalists with consumers/buyers outside of the community it does suggest that there are context-specific aspects to a moral system. In contrast, what the economists have described is more akin to a, “generalized morality.” It is insufficient to look simply at generalized morality when attempting to understand consumer credit market behavior. Perceptions of fairness and propriety of business practices vary across communities. Below I show that analysis of these variations allows us to understand the otherwise puzzling role of race in predicting payday lender concentration.

If morality has additional context-specific aspects, then one can identify various, “axes of solidarity,” that distinguish (perhaps poorly) between in-group and out-group and thus shape perceptions of duty and obligation. One such obvious axis is residential proximity. Another is that of shared national origin and ethnicity. Thus the, “ethnic economy,” literature can provide insights into the workings of context-specific moral systems. The literature on ethnic economy has been heavily influenced by the new economic sociology and by the literature on embeddedness (Granovetter, 1985) in particular.

Alejandro Portes (1993) identifies four pathways through which networks shape behavior in ethnic enclaves. First, network density shapes socialization processes and thus which norms are internalized. Second, when two or more individuals exchange goods and services they often do so to satisfy non-economic needs and goals; status, power, friendship, love and reciprocal obligation shape behavior at the dyadic level. Third, shared circumstances among densely connected individuals can lead to feelings of solidarity and the creation of a group identity sometimes framed as being in opposition to outsiders. Portes refers to this as, “bounded solidarity.” Fourth, network structure determines the monitoring and enforcement capacity of a community. News of deviant behavior passes more quickly and reliably through densely connected networks and the more who hear of it, the more are able to sanction the perpetrator. Furthermore, social network structure determines, in part, the resources available to an individual. The greater one’s reliance on the resources of one’s local network, the greater the loss if cut off from those resources and thus the greater the sanctioning capacity of the network. Those who have multiple group memberships have less to lose in angering members of any one group and thus their behavior is more difficult to control. Portes calls this last effect, “enforceable trust.”

One should note that the sources of control Portes describes are neither fully instrumental nor fully principled. A group member might conform out of rational fear of sanctions (enforceable trust) but he might also conform because he believes that it is proper to do so. This framework thus avoids both under-socialized and over-socialized conceptions of economic actors. Furthermore, the effects of social networks on behavior should not be assumed to be fully beneficial. A community can both impede and enable a member in the pursuit of his economic goals (which are themselves shaped by the community). Portes notes, for example, the presence in some communities of “leveling norms.” Group members are discouraged from pursuing paths to economic gain (e.g. education or small business ownership) that the community has, “decided,” are futile. Those who do so regardless are sanctioned heavily. In addition, those who come out ahead economically and are relatively well-off may be swamped with claims on their resources and thus pulled back down into poverty. Granovetter (1995) notes that in some communities overseas, businesses have a tendency to become aid societies as kith and kin come out of the woodwork and request loans, jobs, and gifts. At best this may limit the profit possibilities of the business; at worst it may sink the endeavor. As the number of friends and family in one’s network increases, so too does the number of potential claims on one’s resources. Finally, while one’s network structure is to a large degree outside of one’s control, actors have some ability to consciously shape ties and extract themselves from a network if necessary. Carol Stack (1997) found that some individuals consciously removed themselves from the web of social obligations that bolstered their community. Granovetter (1995) also recounts stories of merchants changing their dress, manner of speaking and even their religion to avoid being identified as “in-group” and thus subject to special obligations to their customers.

Moral systems are very much mediated by social network structure. General moral principles about economic behavior more easily become informally enforceable standards in the presence of dense social networks. In addition, group-specific obligations can emerge that shape behavior in ways that differ from simple norms of reciprocity and fairness. Of course, knowing that networks are crucial to our understanding of the effects of moral economic principles tells us nothing of the content of these principles. We still need to determine what flows through networks to understand the consequences of an active moral economy. For instance, family is a subjective term and may refer to a nuclear family unit or an extended network that includes second and third cousins. Furthermore, anthropologists have demonstrated the emergence of "fictive kinship" among certain groups, and especially in African American communities. Whether one can call on his alters for aid may depend on whether one is considered, "family."

When constructing a model of factors that affect certain economic outcomes (see below) the above insights are crucial. At the dyadic level, group membership and the perceived group membership of one's alters (merchant/consumer, creditor/debtor) may shape economic behavior in ways unaccounted for in typical economic models of borrowing and consumption. Furthermore, we should expect network structure to, all else equal, intensify/weaken the effects of group membership.

Now that I have more thoroughly defined the relevant factors in a "moral economy" framework, I detail the ways in which moral concerns, mediated by social network structure can influence both credit market behavior and structure. In doing so, I make my case for the importance this framework when attempting to explain the consumer use of fringe banks.

The effects of morality on fringe banking and other credit markets:

I have argued that moral systems contain context-specific elements distinct from simple generalized morality, and that they are mediated by social network structure.

Next, I consider those aspects of morality that shape access to credit and in turn influence credit market behavior. I argue that moral concerns shape credit markets in three main ways. First, they influence both the availability and terms of formal credit like that provided by fringe banks. Second, they analogously influence both the availability and terms of informal credit alternatives. Third, they help create a complex interplay between these credit sources by creating some of the obligations, penalties, and incentives credit seekers face when in need of money. Formal and informal obligations acquired in one market may influence future credit-seeking behavior in another. Debts from informal credit sources may be paid off with formal credit and vice versa.

Availability and Terms of Formal Credit:

At the market level, moral concerns may result in "sticky," prices and wages. In the aftermath of a natural disaster, the media is commonly full of stories of "price gouging." Price gouging though ill-defined, enrages consumers like little else can. In a typical scenario, in the aftermath of a blizzard, a hardware store raises the price of shovels and salt to account for the temporary increase in demand: more consumers now demand these goods and each is now "willing" to pay more to purchase the good (they are relatively "price inelastic"). This is seen as exploitative unless the merchant can establish that his cost of doing business has also increased commensurably. Merchants are, as noted above, entitled to a reference profit.

Economists often argue that price gouging is little more than the healthy functioning of the market. If prices do not increase, they note, there will be excess demand and thus shortages. Price controls lead to extensive queuing and amount to rationing goods according to one's opportunity cost of time (note that this first-come/first-served rationing procedure is relatively beneficial to the poor). They further argue that anticipation of increased profits in the aftermath of disasters will lead merchants to store additional goods they can draw upon in such situations. This will further reduce the possibility of shortages. One perhaps over-zealous free market proponent, ABC reporter John Stossel, has even suggested that price gougers are heroes who save the lives of children. Skeptics of free market ideology can offer articulate rebuttals of each of these points. They might point out, for example, that ability to pay is poorly correlated with need in disaster scenarios and that after a flood or hurricane available quantities are essentially fixed in the short-run regardless of price fluctuation.

This battle of ideas is however, purely moot in the realm of economic norms. The position espoused by free market economists bears little relation to most norms of fair pricing. Whether because of public pressure, belief, or some combination of both, state officials in approximately thirty states have enacted laws to punish price gougers[5]. Most states have tied these laws to a declaration of emergency. Once the governor issues such a declaration, merchants who "gouge," can be subject to both civil and criminal penalties. Though the definition of gouging varies by state, most define it as an increase in price, not tied to an increase in doing business, which exceeds some percentage (often around 125%) of the price average over the thirty days prior to the declaration of emergency. Some states, like Florida, post online the names and addresses of convicted gougers in order to add public shame to their punishment.

In addition to the legal ramifications of price gouging, a merchant who raises his

[5] State anti-gouging laws are all based off section 502-C of the Uniform Commercial Code, which defines "unconscionable business practices," like unfair surprise and oppression. When debating whether to include this clause in the final draft of the UCC. One legal scholar (H. C. C., Jr., 1959) made a telling argument: "Absolute freedom of contract is no more than a nineteenth century ideal; one which has never existed in our law due to areas where investigation of fair exchange has been openly undertaken, as well as further unspoken limitations. We have continued to overtly maintain that such general limitations do not exist while concurrently giving such limitations effect covertly and thus promoting confusion and unpredictability." Thus moral considerations have had an important

prices risks evoking the wrath of his customers. Research in marketing (Bolton et. al., 2003) suggests that angry customers will make do without goods or go out of their way (e.g. drive an extra _ hour) to shop at a competitor's establishment in order to punish a gouger[6.] If the gouger is a member of the community, they may impose additional informal sanctions to punish this slight. This additional sanctioning capacity is, of course, related to network structure; general arguments about enforceable trust apply here. Thus a merchant, especially one with ties to a community, may have rather strong disincentives against raising prices after natural disasters and in times of dearth in general. Of course, a merchant may not do so, not out of fear of sanctions, but out of a general belief that this is improper behavior, or a context-specific belief that this is improper behavior towards members of his community. Therefore we would expect that price increases are more likely to occur and more likely to be steep when a merchant is an outsider both because he is less likely to feel any special sense of obligation toward community members and because community members can not call upon additional informal resources to sanction him. On the other hand, and perhaps ironically, price increases by such individuals may be less likely to be categorized as "gouging" due to the outsider status of the merchant; it is only when such actions were taken by community members, who were held to a higher standard, that Thompson's peasants became outraged.

Kahneman, Knetsch, and Thaler argue that reference prices are malleable and that consumers can adjust their expectations (and thus set a new reference price) after extended exposure to higher prices. Thus they conclude that conceptions of price fairness will lead to short-run price stickiness but that in the long-run, predicted market

effect on American economic law since its inception.

[6] Recall Hirschman's analysis of consumer options, "exit," "voice," and "loyalty."

equilibriums will obtain. I argue however that depending on the sanctioning capacity of a community, such price increases may be "off the equilibrium path." We should not be surprised then to see long-term price stickiness in certain communities; members never have to adjust their expectations. If ideas about particular obligations to a community are strong, it may also be the case that even very small changes in price elicit angry reactions. Thus merchants who only subscribe to a general norm against raising prices under certain circumstances may have more freedom to set rates than those who are enmeshed in a web of community obligations.

This discussion logically extends to usury. While usury originally referred to the charging of interest on any loan, in its modern meaning it refers to charging excessive interest. Thus usury can be seen as a form of price gouging[7]. This is important for the empirical study below; payday and pawn lenders are often accused of usury by legislators, academics, and their own customers.

Most states have limits on allowable interest rates. John Caskey (2005) argues that interest limits result in a net wealth transfer from rural to urban poor communities. Since interest rate caps limit the possible profit per loan, businesses such as pawn shops may compensate by increasing the volume of their loans. In rural areas with dispersed populations this may not be feasible and may result in fewer such establishments (e.g. through collapse or through decision not to locate there). Meanwhile, urban pawn shops can continue to operate and the urban poor benefit from lower interest rates on their

[7] Interestingly, in some strains of Islamic thought, usury retains its original meaning. Thus in some societies it is still considered a serious crime to charge interest on loans or bank deposits. Organizations called, "Islamic banks," have emerged that attempt to profit from deposits and loans without charging interest. Critics argue that many of these strategies amount to little more than disguising the interest as a gift or fee. This recalls the medieval debate over the, "contractum trinius," a financial instrument designed to circumvent the Catholic Church's prohibition on usury. It is fascinating both that creditors in general usually attempt to meet these moral obligations as opposed to simply make a display of it and that such prohibitions continue to exist despite the "inefficiency," they create and despite modern understanding of opportunity costs and discounting. A full treatment of this topic would require a dissertation in its own right. For some interesting work on medieval usury laws see De Roover (1967).

loans. The magnitude of this effect depends on the interest rate elasticity of supply for pawnshops; Caskey does not address this measure. It is further possible that interest rate caps are set above market rates and thus do not constrain rates. Nevertheless, in general, usury laws, a product of moral outrage, affect both the price and availability of formal credit[8].

Evidence of outrage among the poor over exorbitant interest rates is mixed. On the one hand, the poor realize they are being "ripped-off" by organizations like rent-to-own stores (North Carolina focus groups, 2000. See below.). On the other, there is little (recorded) anger at interest rates charged by payday lenders. One could argue that this is because payday loan recipients are often unaware of APR to which they are subjected (see above). Below I produce evidence that this is not the case, and that, depending on the group, there is a great deal of anger directed at payday lenders. Though their resources and sanctioning power are feeble, angry individuals make their voices heard by refusing to use such loans except in extreme emergencies, and denying the lenders the word–of-mouth referrals that are crucial to their businesses.

Usurious loan-providers may be subject to the same types of sanctioning as price gouging merchants. Proprietors with links to the community may offer (or be forced to offer) lower rates than those who can operate as outsiders. This may be one reason why locally owned pawnshops, check cashers, and payday lenders have recently given way to mega-chains like Payday America and Advance America (see above).

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[8] Howard Rosenthal argues that usury laws, debtor-in-possession bankruptcy laws, and other forms of credit market manipulation constitute an ersatz social safety net. He further argues that advocates for the poor settle for such measures when direct redistribution is politically infeasible. These feeble defenses have undergone an assault in recent times. See Nunez and Rosenthal, 2004 for further

Access to informal credit and funding:

Next I look at access to informal credit and funding. The ability to turn to friends and family for aid during an emergency or for help in paying for important goods (consumer durables, small business start-up costs, etc.) is determined in part by moral considerations and by network structure. Different groups have different ideas about the obligations one has toward one's kin. For example, Granovetter (1995) notes that ethnic Malaysians generally view borrowing from friends and family as shameful and thus are unlikely to turn to them when in need of a loan. Such individuals may turn to outsiders for credit. Indeed, Granovetter points out that ethnic Chinese in Malaysia have found a profitable role in surreptitiously lending to them. Even if kith and kin are willing to loan money to each other they may have restrictions on what is seen as a legitimate request. Vermuelen (2001) argues that while native-born white Americans generally disapprove of mixing business with family, immigrant Hindustanis in the Netherlands celebrate this practice. Thus Americans may generally turn to friends and family in times of economic emergency but may be hesitant to request investments in a new company. Furthermore, as noted above, what constitutes family is subjective and in part (along with network size and density) determines how many potential sources of support one can access.

In the ethnic economy literature much attention has been given to the phenomenon of rotating credit and savings associations. It is worth mentioning RCSAs here both because they are an important source of informal credit for some of the immigrant ethnic groups I will be studying and because their existence (or lack thereof) in a community illustrates the interplay between norms, culture and social networks that creates a particular moral economy. RCSAs emerge when individuals pool their money

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details.

for common purposes such as generating start-up capital for a new business or even saving for a daughter's quinceañera (Latin American coming of age celebration); there is enormous variation across cultures in what is seen as a legitimate use of RCSA funds. At each meeting, members contribute funds to a pool and one member takes these funds for his own use. In subsequent meetings a different individual receives the funds while other members continue to contribute to the pool. In this way, each member receives access to funds and each repays the loan he receives. The order in which individuals draw from the funding pool varies according to the group. In many groups the primary organizer of the RCSA gains the first draw. Other groups may determine the ordering by drawing straws or some other form of lottery. RCSAs rely on the informal sanctioning power of the group to prevent default. Those who fail to make payments risk shame, ostracism, and permanent loss of access to funding. There are stories (Granovetter, 1995) of members selling daughters into prostitution in order to avoid defaulting on RCSA debt. Others have committed suicide rather than face the shame associated with failure to repay. Micro-credit, which has recently gained popularity as a form of "ethical" capitalism (see above) harnesses this same informal sanctioning capacity in order to offer loans in situations where asymmetries of information render traditional loans prohibitively risky (given the possibility of massive default rates) except at enormous interest rates.

While RCSAs are a common form of informal credit they are not universal. Ivan Light (1972) has investigated this discrepancy and found two causes. First, some groups simply lack RCSAs in their cultural repertoire. Whether this institution never emerged or whether it was lost to time, they are unable to call upon it to meet credit needs. Second, as noted above, RCSAs (like all sources of informal credit) rely on informal sanctioning capacity to remain viable options. As I noted during my discussion of enforceable trust, this capacity depends on network structure. If deviance (e.g. spending borrowed money on gambling or some other illegitimate aim) is difficult to detect because of low tie density or group cohesion, it is difficult to sanction the perpetrator. If the group in question does not command access to substantial resources, it is more difficult to shape behavior. If individuals are members of multiple overlapping groups which each command differing resources, any one group has diminished enforcement capacity.

Light argues that these reasons explain why native-born African-Americans do not appear to utilize RSCAs. Unlike West Indian blacks (who continue to use RCSAs), native-born blacks lost access to this institutional form, during the era of slavery. Furthermore, they were unable to form a stable axis of solidarity on which to base such an organization. Common ethnicity along is unlikely to form a strong enough bond. Immigrant Chinese and Japanese turned to regional origin (which is, by definition a mutually exclusive category) to augment trust when forming their own RCSAs. Blacks, if they remembered their proximate origins in the American south, had little affection for these places and thus could not utilize them to enhance trust. Furthermore, while black community life was rich with membership in volunteer organizations and churches, multiple overlapping group membership diluted the possible strength of enforceable trust.

Interplay between formal and informal credit:

Finally, I turn to the interplay between formal and informal credit markets. Informal credit sources bear a complicated relationship with formal sources of credit. When formal credit options are prohibitively expensive or absent, access to informal credit may allow for the emergence of new small businesses when this would otherwise be impossible. We should be wary however of falling into functionalist accounts of the emergence of networks of informal credit or of moral economies in general. As previously noted, RCSAs do not automatically emerge to meet the credit needs of individuals and even when they do emerge they may not be used for what are a seen as illegitimate purposes. While Mexicans may freely use RCSAs to pay for parties and celebrations, Chinese Americans may not (Light). The same can be said of sources of informal credit. It might, for example, be beneficial for native-born white Americans to borrow from friends and family when starting a new business. The existing norm however, discourages such behavior.

When formal sources of credit are absent, informal sources of credit may too be absent. When formal sources of credit are well-developed and readily available, informal sources of credit may nonetheless persist and thrive. Robert Townsend has conducted several studies (2003, 2005) on the credit-seeking behavior of individuals attempting to raise start-up capital for a new small business. He found that in one largely Hispanic community, third and fourth generation individuals relied mostly on formal credit while first and second generation individuals relied mostly on loans and gifts from friends and family. In contrast, in a nearby Hmong community, individuals in the third and fourth generation continued to rely mostly on informal sources of credit despite widespread availability of formal sources of credit like bank loans and credit cards. In yet another community, more affluent and mostly black, Townsend found little reliance on informal credit. Townsend concludes that while some may rely on informal credit out of necessity (i.e. because of lack of access to formal credit alternatives), others may simply prefer to utilize it. Thus, informal credit “markets” are not simply ersatz substitutes for formal credit markets and, despite the arguments of scholars like Richard Posner (1980) we should not expect them to simply vanish along with economic development. This suggests that they are important to consider not only when modeling the fringe banking sector but when modeling main stream credit markets as well.

To further complicate the relationship between formal and informal credit, remember that one may utilize one form of credit to pay off debts incurred in another form. To avoid the shame associated with default, one may (rather than sell one's daughter into prostitution) take out an additional loan from a different source. The extent to which one uses one or another source of credit may also depend on one's "credit limit." Friends and family may be willing to lend money in times of crisis but have limits to both their willingness and ability to provide additional credit. After one has "maxed out," this source of aid, one might turn to credit cards, pawnshops or payday loans to meet additional needs. The same effect may hold in reverse, especially if there is shame associated with asking friends and family for aid. Finally, note again that banks and family alike have ideas about what constitutes a legitimate use of borrowed funds. For this reason, all else equal, individuals are likely to use a combination of formal and informal means to meet their credit needs

Vivianna Zelizer's work on remittances and earmarked funds is relevant here. To the extent that a monthly remittance payment constitutes a non-negotiable financial obligation, immigrants may turn to both formal and informal sources of credit to avoid "defaulting." Indeed transcripts from focus groups (North Carolina Financial Services Survey 2000), suggest that even in times of crisis Hispanic immigrants would not raid funds set aside for a remittance, choosing instead to borrow money. More generally, earmarked funds constitute financial obligations to friends and family and may not be utilized to pay other obligations. Of course, we should not accept an over-socialized account of behavior regarding earmarked funds. Not every individual creates sharply delineated categories of money and some will tap into earmarked funds when faced with crisis. The extent of earmarking, and the extent of the guilt/shame associated with violating an earmark depend, once again, in part, on the sanctioning capacity of one's social network and the degree to which relevant norms have been internalized. Some, but not all, financial decisions can be kept private and even private decisions can elicit guilt.

The contours of informal credit and aid networks have clear implications for stratification. First, as already noted, informal loans and gifts from friends and family often serve as start-up capital for small businesses. Such small businesses often serve as an avenue for economic advancement and pave the way for entry into the middle class. In the absence of both formal and informal sources of credit, this form of social mobility will be relatively rare. Also, even if credit is available, it may not be enough to allow for the founding of a business or to provide optimal seed funds. In a separate study (2003), Townsend found evidence that many of those relying on informal credit were "credit constrained." In other words, had they been able to secure additional funds their small businesses would have likely generated greater yearly profit. The availability of funds depends on several factors including the size and density of the network, the resources available to one's alters, the willingness to offer help, and the ability to sanction inappropriate behaviors like default and the squandering of procured funds. Success in business once founded also depends on the extent and quality of these informal networks. I have already noted that businesses owners may be swamped with requests for aid from friends and family. This aid may take the form of jobs, store credit, and special discounts. If the number of such requests is great and the degree of aid is severe, such obligations can sink a company. Business owners who cannot portray themselves as outsiders may, find themselves running, “welfare hotels.” This is one proposed reason that immigrants often do well setting up small businesses. Their outsider status limits claims on their goodwill and the total number of family members and close friends that accompany them to the host country and can request aid is itself relatively small. Much has been made (see for example, Light 2000, 2005) of the relative dearth of small businesses owned by native-born African-American entrepreneurs. The above noted factors (difficulty in generating enforceable trust, relatively large need and number of friends and family requesting aid) may explain this. Conversely, if a business owner can call upon friends and family to provide relatively low cost labor, and to build a loyal customer base, he may find his social network connections to be a blessing. Ivan Light has detailed how important these participants in the “informal economy,” are to the success of many businesses in ethnic enclaves.

One less clear implication for social stratification is that the nature and extent of informal credit/gift networks determines the likelihood that one will turn to formal sources of credit that may prove deleterious to economic mobility. This insight is central to my study as fringe banks are often accused of creating or exacerbating cycles of debt. I have already noted that in the absence or unpalatability of informal credit, individuals may turn to formal sources. This includes instances in which friends and family cannot or will not offer further help and circumstances in which the intent for the funds is considered illegitimate (starting a business, paying off a gambling debt, buying a dishwasher, etc.). A few, in these circumstances, turn to loan sharks to meet financial needs. The ramifications of default in these instances are obvious. Some, depending on their available resources, will turn to banks and credit cards. Still others turn to fringe banks like pawnshops, check cashers, and payday lenders. As already noted, there are no studies of the long-term effects of reliance on payday loans and pawn shops for credit. It seems likely that the interest rate and fee burden associated with usage of fringe banks will adversely affect those forced to utilize them by draining resources that would otherwise contribute to savings, educational and job-related expenses, and transportation fees. By sorting resource poor individuals into, “user,” “non-user,” or even, “occasional user” groups, morality may thus play a role in dictating who advances and who does not.

I have argued that morality plays an important role in shaping the scope and nature of the marketplace in modern society. I have further argued that rather than simply look at generalized fairness norms, we must consider the interrelation of both generalized and context-specific normative commitments with particular social network structures. I have focused my attention on the role moral economies play in shaping both formal and informal credit seeking behavior. The complex interplay between formal and informal credit sources that is generated by moral economy has received little attention from sociologists and littler still from economists and political scientists. As noted, economists and political scientists have only recently begun to take interest in the phenomenon of fringe banking and their models lack predictive capacity. I argue that these models (like their models of mainstream credit markets) are limited in that they fail to account for the factors I have detailed above. In focusing solely on individual and aggregate-community level characteristics like income, education, SES and credit rating they have overlooked the crucial influence of moral systems. A focus on these moral systems can enrich our understanding of this phenomenon.

Even if economists and political scientists had been savvy to importance of moral considerations in shaping behavior, the data necessary to conduct appropriate analysis have not been available. I however, have found the necessary data in a variety of quantitative and qualitative studies. Below I discuss the origin and nature of this data and what I do with the information contained within.

Chapter 3: Data and Methods

I use both quantitative and qualitative data in my analysis of behavior in the sub-prime credit markets in question. I have two sources of statistical data. The first comes from the North Carolina Financial Services Survey. The second comes from the Annie E. Casey Foundation's Making Connections Cross Site Survey. I also analyze qualitative data from two sources. The authors of the North Carolina Financial Services Survey commissioned a series of focus groups to augment their analysis and have graciously provided me with the transcripts of these sessions. The Center for Responsible Lending conducted its own focus groups recently and has provided me with both written transcripts and video recordings of the sessions. Below I provide a more detailed description of each of these data sources, as well as the features I utilize.

North Carolina Financial Services Survey:

In 2000, Michael Stegman and Robert Farris of the Center for Community Capital (formerly the Center for Community Capitalism) at the University of North Carolina were asked by the North Carolina Division of Social Services to conduct a study to analyze the financial decisions of the working poor. The study had four main goals:

> "1. Determine the size and composition of the unbanked population of working class North Carolinians, and their reasons for not owning any kind of transaction account at mainstream financial institutions. 2. Identify the factors that limit these households' access to such services. 3. Gain a greater understanding of how unbanked and banked working families meet their financial services needs, and 4. determine the extent to which their choices are market-driven or a function of other factors." (Center for Community Capital, Abstract of Final Report, 2001)

Given the goals of the project, most (approx. 2/3) respondents to the survey were chosen from a pool of recent (within the previous year) and current Work First recipients. Work First is North Carolina's welfare program subsequent to the reforms of the mid-1990s.

Hispanics were consciously over-sampled as were individuals in Meckleburg county (containing the city of Charolotte) and the five-county region surrounding the town of Wilson. The latter over-sampling was done in an attempt to capture differences between those living in urban and rural communities. All interviews were conducted over the phone, and 1501 interviews were conducted in total.

The North Carolina survey includes questions on use of check cashing facilities, pawn shops and payday lenders. For the latter two, it includes a measure of loan frequency. These measures provide the dependent variables (and in some cases important independent variables) for my analysis. Respondents were asked explicitly about whether they had utilized a particular service within the previous 24-month period and then asked about the frequency with this service was used. I use the following questions as the basis for dependent variables:

Payday Loans:

57. In the past two years, have you, or anyone in your family living with you, ever taken a loan or cash advance from a payday lender or check cashing outlet?	YES ....1 NO ....2 DK/REFUSED 3
58. In the past two years, about how often have you taken a loan or cash advance from a payday lender or check cashing outlet? At least once every two weeks, once a month, once every three months, or once or twice a year?	ONCE EVERY TWO WEEKS........1 ONCE A MONTH ....2 ONCE EVERY THREEMONTHS....3 ONCE OR TWICE A YEAR...........4 DK/REFUSED 5

Pawn Shops:

61. In the past two years, did you, or anyone in your family living with you, <u>ever</u> pawn an item at a pawnshop?	YES ....1 NO ....2 DK/REFUSED 3
62. In the past two years, on how many occasions did you pawn one or more items at a pawn shop?	________________ DK/REFUSED 9

The structure of these questions allows me to construct both binary and ordered categorical variables. In the case of pawn shop usage, I have discrete county data which is amenable to analysis with Poisson or negative binomial regression modeling.

As noted, the North Carolina data also includes two questions on how the respondent would deal with an emergency situation.

72. If you needed to borrow $500 for three months, is there some person or place you could borrow it from?	YES .... 1 NO .... 2 NOT SURE/DON'T KNOW .... 3 REFUSED 4

73. Where would you go first? **(ONE RESPONSE ONLY)**

FRIENDS 01
FAMILY 02
FINANCE COMPANY 03
PAYDAY LOAN AT A CHECK CASHING COMPANY OR SOMEWHERE ELSE 04
SOMEONE IN MY NEIGHBORHOOD WHO LENDS MONEY AND CHARGES INTEREST 05
COMMUNITY OR CHURCH LOAN FUND 06
BANK (OR SAVINGS BANK, SAVINGS AND LOAN, OR CREDIT UNION) 07
PAWN SHOP 08
FURNITURE STORE 09
SOME OTHER PLACE 10
NO PARTICULAR PLACE 11
WOULD NOT BORROW 12
DK/REFUSED 13

The respondent was first asked whether he or she had some person or place to which to turn if they needed to borrow money for a period of three months. If the respondent replied in the affirmative, he or she was asked to list the source he or she would turn to first. This allows for the creation of an emergency categorical variable in addition to dichotomous dependent and independent variables. Note that, in this context, the emergency is defined specifically as a need for a three-month, $500 loan. Note also that only the respondent's first source for the emergency support is recorded. This prevents analysis of the patterns of help that respondents utilize in emergency situations. I will return to this issue when I discuss the Making Connections Cross Site Survey Data as it contains a similar question that is not limited to a single response.

The survey includes the standard array of demographic variables, including sex, age, education, race, ethnicity, marriage status, household size (broken down into number of adults and number of children), and presence of a significant other.

The North Carolina data is a particularly strong basis for analysis because of the variety of financial and geographic controls present. It is important in any analysis of payday loan usage to adequately account for the income, assets, debt and credit sources of the respondent. Economists have previously explained differences in payday lender and pawn shop concentration according to neighborhood racial composition with reference to underlying and invisible differences in assets and credit worthiness. As previous studies (e.g. King, et. al. 2005)) may not have adequately controlled for these factors, it is possible that they had simply shown that impoverished Black households in the studies were simply, ceteris paribus, asset-poor relative to non-Black households. The wealth of asset data contained in the North Carolina survey allows us to test this explanation. Below I explain the relevant variables.

The North Carolina data contains a variety of measures of financial strength, including questions on income, savings, debt, total assets and access to credit. Respondents were asked whether they were currently employed and whether they were currently receiving welfare benefits and/or food stamps. If the respondent was employed, they were asked whether they were working part-time or full-time. Respondents were also asked to report their total income, home ownership, and total checking and savings account balances if they possessed such accounts. They were asked whether they held one or more major credit cards (Visa, Mastercard, American Express, etc.) and whether they had store credit cards for locations like Macy's or Sears. Note that these questions are limited; we do not know the number of the cards the individual possesses or their total credit limit. If the respondent possessed a major credit card, they were asked to state the total credit card debt they were currently carrying. This measure gives a sense of the debt burden that the respondent carries but also puts a lower bound on their total credit limit. The potential effect is therefore ambiguous: a high credit card debt may signify distress and credit constraint. It may on the other hand speak to credit-worthiness and greater access to mainstream credit sources. The variable also contains numerous missing values, as respondents were often unable or unwilling to divulge their total credit card debt. To counteract a large loss in sample size and thus degrees of freedom, I interpolated total credit card debt for the missing values using the other available financial and demographic variables. This does not change the results of any models. The models below include interpolated values. While these measures help control for variations in wealth and credit worthiness, they are not perfect. As noted, ideally one would like to know credit limits on credit and store cards. Total credit card debt is an important measure of debt burden but does not capture debt from car or student loans or home mortgage (let alone the terms of these loans). Also, we do not have access to the actual credit scores of the respondents. Still, they serve as reasonable proxies for information that is notoriously difficult to find (e.g. individual credit scores, which respondents often do not know). Furthermore, my analysis of the Making Connections Survey data (see below), which contains much more detailed financial information, suggests that these measures are sufficient for these purposes.

One must also consider differences in neighborhood-level options. Even if we control for individual-level financial differences, we might expect differences in behavior to result from variations in ease of access to banks, payday lenders, etc., and from the increased saliency of an option that comes with familiarity and exposure to advertising and other visual cues. The North Carolina data includes county codes and zip codes for each respondent. This allows for fixed effects analysis, which controls for such factors by subsuming them into area-level panel dummy variables. Depending on the level at which we believe such influences operate, county and zip-codes should provide adequate statistical control. Recall, however, that the authors of the study oversampled in Meckleburg county (containing the city of Charlotte) and the five-county region surrounding the town of Wilson. Approximately 2/3 of the respondents live in these regions. As a result, the counties and zip codes outside these areas have low representation. Ideally, one would want greater variance in the zip code or county variable. Nevertheless these measures do provide some control over the variety of environmental factors that could influence respondents.

The North Carolina data does not include measures of local social network structure or social capital and community embeddedness, and includes only one indirect measure of informal support. It is, however, a strong base from which to begin my analysis. Where there is overlap in questions, the results of that analysis provide for an interesting comparison with those of my analysis of the Making Connections Cross Site

Survey (see below).

<u>The Making Connections Cross-Site Survey:</u>

The Annie E. Casey Foundation is a non-profit organization that works to better the lot of working class families by lobbying for change in public policy, advocating for "human-service reform," and working within communities to build useful community support organizations. One factor that sets the AECF apart from other advocacy and support groups is their special interest in utilizing and strengthening the social networks of the working poor to enhance outcomes. One of their many initiatives to this effect is the, "Making Connections," program. This multi-year effort continues to take place in ten cities across the United States. These are: Denver, CO; Des Moines, IA; Hartford, CT; Indianapolis, IN; Louisville, KY; Milwaukee, WI; Oakland, CA; Providence, RI; San Antonio, TX; and Seattle, WA. As part of the Making Connections initiative the AECF foundation commissioned a ten-city, three-wave survey (2002-2004 and 2005-2007, 2008-2010) to assess the conditions faced by respondents and to gauge the relative strengths and weaknesses of each community located within each city. These data were collected and aggregated by the National Opinion Research Center (NORC), which is headquartered at the University of Chicago. There were approximately 8500 respondents divided more or less equally across the ten cities. These come from random sampling within the focus neighborhoods. The sample is representative of the populations of the focus neighborhoods. The neighborhoods themselves were chosen because of the presence of local grassroots organizations whose missions meshed well with that of the Annie E. Casey Foundation. This means that the neighborhoods are not necessarily representative of all working class neighborhoods in the host cities; they may be, but they were not explicitly chosen in this manner.

The Making Connections survey includes questions on the use of check cashing facilities and pawnshops. Unlike the North Carolina survey, the Making Connections survey does not ask directly about payday loan usage. On the other hand, it includes several useful features. First, respondents were asked explicitly about the type and frequency of support that they give and receive to/from family and friends. This allows for analysis of potential informal alternatives to "fringe banks." Second, there are a variety of questions about ties to the community, trust and shared values, factors that may influence credit market behavior. Third, the Making Connections survey includes an open-ended question on financial emergencies that, unlike the analogous question in the North Carolina survey, allows for multiple responses. This feature allows for a cluster analysis of behavior patterns (see chapter below).

Like the North Carolina survey, the Making Connections Survey includes necessary financial and geographical information for each respondent. Respondents were asked to identify their neighborhood by name. Their responses were used in conjunction with "zip+4" geocode data to assign them to approximately one hundred (100) mutually exclusive neighborhood categories. The survey also records respondents' census tract and block group using Federal Information Processing Standard Codes (FIPSC). These measures allow researchers to control for area and neighborhood-level differences (e.g. payday lender and bank concentration, see above) that could shape individual-level behavior. The Making Connections data includes the same type of income, asset, debt, and wealth information present in the North Carolina data but also includes a break down of the type and amounts of debt, allowing researchers to separate out the effects of holding “good” (e.g. home mortgage) and “bad” debt (e.g. credit card debt).

The Making Connections data lends itself to probit/logit models given the binary nature of the dependent variables. The data itself, as noted, span approximately one hundred respondent-identified neighborhoods across ten cities. While the survey itself is (of course) individual level data, NORC has augmented the data set with a variety of neighborhood-level measures. Since we have individuals nested within mutually exclusive neighborhood categories, which are in turn nested within cities, I run a variety of fixed and mixed effect logit models on the cross-sectional data of each wave. Mixed effect models, which are also known as hierarchical models, used a combination of fixed (dummy) and random (stochastic intercepts and/or beta coefficients) effects. This corrects for the autocorrelation that would occur if the data were run using a simple cross-sectional model. Also, it allows for the identification of differential effects of category membership (in this case, neighborhoods).

As noted above, The Making Connections survey asks respondents how they would deal with a financial emergency. The original text of the question is as follows:

> “Now, we're interested in how people might cope with emergencies. What if you had an unexpected bill that was half of your monthly income and you had to pay the bill in two weeks? There are many different ways people might handle this kind of situation. Please tell me which of the following ways would work for you.”

Respondents were then offered twelve (12) options to which they could answer yes or no. These are as follows:

1. I would use savings
2. I would use a credit card
3. I would borrow from family

4. I would borrow from friends
5. I would sell something
6. I would get a payday loan
7. I would pawn something
8. I would borrow from a bank
9. I would use mutual assistance savings
10. I would borrow from a consumer finance enterprise
11. I would not pay
12. Other

Respondents were free to choose as many options as they like. In the case of the "other" option, respondents were prompted to offer a free form answer. Mutual Assistance Savings is defined as, "an agreement among two or more individuals to contribute a certain amount of money to a pool and then distribute the pool according to an agreement among participants." This is meant to capture participation in a Rotating Savings and Credit Association (RSCA). Consumer Finance Enterprises are defined as companies that, "offer(s) loans, usually with high interest rates, with the person's house deed, car title, or some other valued possession as the collateral." This category includes "title loans," another form of sub-prime credit. The results of this section of the survey are amenable to hierarchical cluster analysis and/or latent class analysis (see discussion below). The decision to take out a payday loan to deal with the defined emergency serves as the dependent variable in a series of logistic regressions designed to tease out the effects of informal networks of support and community embeddedness on credit market behavior.

Independent variables included in the models of pawnshop usage and reliance on payday loans in an emergency can be group into five (5) categories: demographic, income/assets, informal support, community embeddedness, and interaction effects. Below I provide a brief description of the included variables.

Demographic variables include respondent age, sex, race (Black, White, Asian), ethnicity (Hispanic), and level of education. The latter is measured on a nine-point scale with "1" indicating completion of eighth grade or less, and "9" indicating completion of a graduate degree. Models also include the number of years the respondent has lived her current neighborhood, the presence of a spouse/partner, and the number of adults and children present in the respondent's household. The former might be thought to be related to the strength of the respondent's local social network.

In the income and assets category, I include total household income for all sources, as well as the sources of income. These include a private business, salaried work, public assistance, and informal work done around the neighborhood (e.g. hairdressing, car repair, cooking, etc.). We thus have measures of participation in the informal economy. Respondents were also asked whether they maintained checking accounts, savings accounts, and credit cards. The latter measure is unfortunately limited in that it does not account for the number, type or credit limits of these card(s). The survey also includes a measure (reported in dollars) of total household debt as well as the types of debt held. Types of debt include medical debt, credit card debt, home mortgages, home improvement, rent-to-own, card loans, student loans, and "personal loans." The survey did not specifically ask about ongoing payday loan or pawn debt, and these are presumably subsumed into the personal loan category. Total household debt had a large number of missing values since many respondents did not know their total debt burden. To compensate for this, I interpolated results using the available data. The household debt measure appearing in the models below includes this interpolated data, however the results do not depend on these data. There is, unfortunately, no direct measure of medical insurance coverage for the household from all sources. Respondents were asked specifically about employer-provided health insurance. The presence of medical loans/debt can be seen as a proxy for no or inadequate health insurance coverage. While respondents were not asked about the total value of their savings, they were asked what types of savings they currently held. These include savings for an emergency, for retirement, for education, for a home, for furniture/appliances, and for a car. Regarding assets, respondents were asked whether they owned or rented their current home, how much they paid monthly in rent or mortgage fees, whether someone in the household owned a vehicle, whether that vehicle was dependable, and whether they owned/had access to a home computer. The survey also included a variety of measures of financial distress in the previous 12 months: receipt of food stamps, receipt of welfare benefits, incidence of inability to afford food, disruption of utilities, and disruption of phone service. Finally, respondents were asked whether they had used banks and check cashing facilities in the previous 12 months.

The Making Connection Survey includes several measures of informal financial support and obligation. Respondents were asked whether the family had given or received (separate questions) any monetary aid from friends and/or family in the previous 12 months. These are simple yes/no questions and unfortunately do not capture the frequency of such aid, the amount given/received., or the number of friends and family involved Separately respondents were asked whether they sent remittances abroad to support others. The survey then includes questions about whether the household gives or receives (again separate questions) non-monetary support (e.g. rides, child care, food). In this case, support is broken up into four categories support given/received to/from friends and support given/received to/from family. Respondents are asked about the frequency with which they give/receive non-monetary aid. These questions are scored on a four-point scale (never, rarely, sometimes, often).

The "community embeddedness" category includes a variety of measures meant to capture the respondent's attitudes toward others in the neighborhood, his participation in a variety of community activities, and his use of local social networks. Respondents were asked about whether they volunteer, whether they volunteer within the community, and how often they volunteer. They were also asked whether they were religious, the frequency with which they attended services, and whether they attended services within the neighborhood. Each was asked how they found their current or most recent job. Possible answers include friends, family, acquaintances, help wanted ads, and job placement services. To measure sentiment, respondents were asked a variety of questions about their attitudes toward their neighbors and beliefs about their neighbors probably actions. Each of the following questions is available in dichotomous yes/no format as well as scale format (strongly disagree, disagree, neither agree nor disagree, agree, strongly agree):

1. I live in a close-knit neighborhood
2. People in my neighborhood are willing to help their neighbors
3. People in my neighborhood share the same values

4. People in my neighborhood can be trusted
5. If the fire station closest to their house was threatened by budget cuts, how likely is it that your neighbors would do something about it?

Finally, respondents were asked the following several questions about participation in community improvement projects. Each was asked whether they (or anyone in their household) had spoken to religious leaders, political leaders, or worked together with neighbors to “do something about a neighborhood problem,” or “organize a neighborhood improvement.” If they answered yes to the latter question, respondents were then asked whether there was any progress on the problem or improvement as a result of their work with their neighbors. This allowed me to construct measures of both collective movement participation and collective efficacy. Since all respondents are nested within mutually exclusive neighborhoods, I also constructed aggregate neighborhood-level measures for these responses, utilizing the neighborhood mean.

The final category of variables includes interaction effects between the race dummy variables and measures from the informal support and community embeddedness categories. I also tested the effect of minority status within a neighborhood, i.e. the effect, for example, of being White within a majority Black neighborhood, or Hispanic within a majority White neighborhood. Depending on how in-group and out-group are defined in local social networks, minority status with regard to neighborhood ethnic/racial composition could serve to exclude an individual from important resources or shield him from burdensome obligations.

As noted the Making Connections data includes a variety of “community embeddedness” variables: participation in religious, school, and community groups;

method of finding most recent employment; belief that others in the neighborhood share the same values; trust; and perceptions of collective efficacy. These questions provide the basis for variables that capture the effects of, "structure," on credit market behavior. If I were only interested in showing the importance of, "social capital," these would be sufficient. Note however that I have argued that shame, guilt, perception of obligation, and other moral characteristics directly affect credit market behavior, and that these effects are mediated by social network structure. While such questions are suggestive of an underlying moral system, they do not reveal the content of this system. To get at the content, we have to ask respondents directly about what sorts of behaviors they deem appropriate. The Making Connections survey does not ask such questions and thus analysis of this data alone would be insufficient for my purposes. This is why I augment my analysis with the results of focus groups and interviews specifically designed to probe into questions of guilt, shame, and moral obligation.

I use the Making Connections data then for two main purposes. First, I seek to establish the existence of powerful effects on behavior that are not accounted for by the standard battery of financial and demographic characteristics (which are of course included in the data). If variables that account for both social network structure and sentiment toward the community explain credit market behavior, this speaks to the existence of an underlying web of reciprocal obligation. Second, I attempt to tease out variations in this, "moral economy," across ethnic and racial categories. If differences in behavior across racial groups persist after controlling for relevant financial characteristics, informal support, and area-level effects, we must turn to other explanations like variations in perceptions of fairness and propriety. If morality has context-specific aspects then one can identify various, “axes of solidarity,” that distinguish (perhaps poorly) between in-group and out-group and thus shape perceptions of rights and obligations. One such obvious axis is that of shared origin and ethnicity. While these are not the only possible bases, they are common and form the foundation for the moral economy that functions within ethnic enclaves. If social networks are indeed mediators for effects that originate in moral judgments, then the same structures may also be associated with different effects depending on the content of these judgments. In modeling terms, we would see interaction effects. The obvious variables to use in such interaction terms are, again, those that capture race and ethnicity. The focus groups and interviews conducted during the North Carolina Financial Services Survey and by the Center for Responsible Lending (see below) were specifically designed to identify differences in beliefs and perceptions among non-immigrant blacks, whites, and immigrant Latinos.

Because the data include two waves (with an additional wave to be released later this year), I will, in future research, construct a longitudinal model of outcomes using a variety of included measures of economic well-being. In addition to the standard battery of economic and demographic variables, I can include past usage of payday lenders, check cashers, and pawn shops as additional explanatory variables. Outside of a controlled laboratory setting, such, “treatment,” models are often subject to non-random selection issues. It is thus worth confirming the robustness of the model by using corrective techniques including Heckman’s two-step estimation process. As there are no studies that measure the long term effects of fringe bank usage, this model will represent an important contribution to the literature. When used in conjunction with the previous cross-sectional models, it will also allow us to gauge the indirect effects of variations in moral economy on economic outcomes. In as much as variations in norms, beliefs and social network structure generate differences in credit market behavior (in this instance, the "choice" to use a formal fringe banking service), moral economy becomes a central topic in social stratification research.

<u>North Carolina Financial Services Survey: Focus Groups</u>

In an effort to flesh out their statistical findings, Stegman and Farris commissioned a series of six focus groups that were held in late 2000 and summer 2001. Each session was specific to a particular demographic: Caucasian female welfare recipients, African-American female former recipients, and Hispanic male non-recipients, in October 2000, and female welfare recipients with bank accounts, those without bank accounts, and those who recently left the welfare rolls in July 2001. Each group was comprised of between 8 and 10 participants. To recruit participants, the researchers contacted those who had responded to the original survey.

Questions included opinions on banking including ease of access, comfort and ease of use, use of and opinions on check cashing, rent-to-own, pawnshops and payday lenders, financial literacy, and alternatives to "fringe bank" usage. The researchers were mainly interested in understanding why so many working poor are, "unbanked," despite access to mainstream banking organizations. As such, they focused their questions on participant's feelings about the banking industry. In particular they were curious whether participants felt comfortable at bank braches, whether they felt they were treated respectfully, and whether they believed they were being discriminated against because of class, race, or ethnicity.

I use the transcripts of these sessions to explore the causality behind the correlations I find in my statistical analysis. Since the focus of these group discussions was mainly on the relationship participants held with mainstream banks, they do not appear to speak directly to my claims about the centrality of moral concerns in the fringe banking sector. However, we can, in fact, learn a great deal about the determinants of consumer behavior in fringe credit markets by comparing their perceptions of mainstream banks to those of sub-prime lenders like pawnshops and payday loan establishments. Below I discuss the importance of the distinctions that consumers make or do not make in explaining differences in behavior seen across racial and ethnic groups.

<u>The Center for Responsible Lending:</u>

As its name implies, the Center for Responsible Lending is a non-profit advocacy group working to promote banking and credit industry regulation and put a stop to what it sees as predatory lending practices (e.g. unrestricted payday lending). In December 2009, using a grant provided by the Silicon Valley Community Foundation, the CRL commissioned Goodwin Simon, Inc. to conduct a series of four focus group sessions, drawing respondents from the San Jose, California metropolitan area. Much like those conducted in North Carolina, these sessions were divided up according to race and ethnicity. Unlike those sessions, participants were further divided according to whether they had taken out at least one payday loan in the previous twelve-months. The four groups were: African-American payday loan users, Caucasian payday loan users, Hispanic (native Spanish speakers) payday loan users, and a mixed non-user group. Non-users were recruited from lists of previous focus group participants and from the clientele of the various local non-profit organizations partnered with the CRL and SVCF. Some users were also identified in this manner. Most participating payday loan users were approached as they exited a payday lending establishment. All were offered $50 and a boxed-lunch for their time.

Questions included opinions on banking, informal sources of support and payday loan usage and regulation. The CRL was particularly interested in studying the role that emotions like shame and guilt played in determining the decisions of payday loan users. Thus moderators probed respondents for their thoughts on borrowing from friends and family, using payday loans, and admitting that use to others. There are also questions about the propriety of payday lender behavior. Participants were asked whether they viewed the lenders themselves and the terms of the loans to be fair or exploitative. Finally, CRL was further interested in how well users and non-users alike understood the terms of payday loans (e.g. APR, repayment periods, etc.) and whether they were aware of relevant California state regulation on the lenders. Considering my focus on the influence of morality and moral concerns on consumer credit behavior, these focus groups provide crucial insights. They also allow me to compare individuals a decade and continent apart. The similarities that I find across these gulfs suggest deep underlying effects and provide some assurance that the reports given by participants are representative. I use both transcripts and video recordings of these sessions to flesh out my understanding of credit market behavior.

Chapter 4: Models of Pawnshop Usage

Both the North Carolina Financial Services Survey and the Making Connections Cross-Site Survey ask respondents explicitly about whether they or anyone in their household have used pawnshops recently. The North Carolina survey asks about the previous 24 month period while the Making Connections survey asks about the previous 12 month period. The North Carolina survey was conducted in 2000, while the first two waves of the Making Connections survey were completed in 2002-2004, and 2004-2006. Comparison of results across surveys not only allows for independent confirmation of results, but offers some insight into changes in behavior that have occurred during a period that included a brief economic recession. Tables 1 and 2 show the results from the North Carolina survey of fixed effects logistic regressions of pawnshop usage on a variety of independent variables. Table 1 includes fixed effects at the county-level while table 2 includes fixed effects at the zip-code level. For a detailed description of the variables included, please refer to the previous section.

(Table 1 and 2 about here)

It is interesting to note that Hispanic ethnicity seems to reduce the likelihood of pawnshop usage. Previous studies suggest that pawnshops appear in greater concentrations in working class neighborhoods that have large Hispanic populations. There is reason to believe that pawnshops, like payday lenders, cluster in minority neighborhoods because working class minorities have lower wealth and poorer access to credit than working class whites, ceteris paribus. Pawnshops however do not require the same documentation (e.g. driver’s license, official paystub, checking account information) that payday lenders do. The service may thus be more appealing or more necessary for undocumented immigrants. Indeed, in focus group conversations with working class Hispanics, participants point out that the pawn shops in their communities are used mainly by the undocumented. “People without papers go there.” North Carolina survey respondents are mainly current and former participants in North Carolina’s Work First welfare program and thus possess documentation. Therefore, while I cannot explicitly control for immigrant status, legal or otherwise, using North Carolina data, the sample itself provides a measure of control. Given the extensive controls for wealth, debt, and income, and given the fixed-effects controls for geographical variability, it appears that the argument for “greater cultural sensitivity” falls flat.

The other effects are largely intuitive, with some exceptions. As expected, those with higher incomes and those who own homes are less likely to use pawnshops. We also see that people who list family as their first source of aid when in need of money are less likely to turn to pawnshops. Presumably this variable captures differences in available informal support. Those who cannot turn to family first and instead list friends, church groups, or community support networks are no less likely to use pawnshops than those who are unable to identify any source of aid in an emergency at all. On the other hand, those who list bank loans as their first line of support when faced with an emergency need are less likely to use pawnshops. This finding is somewhat odd given that most banks <u>do not</u> offer short-term loans of the amount noted in the question ($500 over three months). Respondents who listed this as their first option are thus either operating under a faulty assumption or are considering using their account’s “overdraft protection” proactively as an implicit loan. In focus group discussions, some respondents of all ethnic backgrounds note that they occasionally use overdraft protection strategically in this fashion.

> "What happened once is we had bills that had to be paid…it had to be done…so, you know, it was equivalent to a loan so what we did was just go in. Since I had a $400 overdraft limit, this guy gave me $1,000 and we paid the overdraft fees after I put it back in." –African American male, page 11

* * *

> Caucasian female respondent: I said something to the lady at the bank. My God, you know all these fees are more than what I had in the account to begin with. It's like 4 or 5 times as much and now I'm really in a hole. She said well, what people do is they go overdraft the ATM machine for $500 and they only pay one fee for $35 or whatever. You can pay all your bills out of that $500 cash and only have one overdraft. Hey.
>
> Moderator: They let you take money out even though you didn't have it in the account?
>
> Respondent: Yes, I had an overdraft limit of $1,000, so it would actually let me do it twice. Instead of me being obvious and running around paying phone bills, car payments and ending up with 9 or 10 overdrafts.

This, however, appears to be uncommon and unpopular as overdraft protection is routinely listed as the banking "service" to which respondents object most.

> Hispanic female: Because there are times when I know that I'm going to have a certain amount of money and it doesn't matter if I'm going to incur those fees. But I also feel that if the bank has our interest in mind they should automatic . . .
>
> Moderator: Automatically.
>
> Respondent: Yes. Decline us at the moment of the purchase.
>
> Moderator: You feel they should.
>
> Respondent: Because they'd be taking advantage.
>
> Moderator: Expand on that.
>
> Respondent: Well, because I think it's in their power to decline us.
>
> Moderator: Should they do that?
>
> Respondent: Yes.
>
> Moderator: Because then that way they'll be unable to charge you $35.

Respondent: Yes. They do it on purpose to be able to charge you.

* * *

Moderator: Would you rather they decline (than overdraft). . .

Caucasian male: Yes, absolutely.

Moderator: How come?

Respondent: It's a loophole. I can order a Snack-shack $2 or $3 item, order 5 or 6 of them in a few days and I didn't know I didn't have any money left. Then when I went to the bank I said where's my other $130? Oh, that's what you owe us for the $30 worth of stuff you just bought. I only spent $30 and $130 was overdraft.

It seems more likely then that respondents who are relatively better off financially than their peers are aware of this and incorrectly assume that they will have access to bank loans in an emergency situation as result of their financial strength. The question thus most likely captures some underlying variation in financial strength that makes pawnshop usage less likely.

Perhaps the most counter-intuitive finding is with regard to the effect of marriage. All respondents are categorized as single and living alone, single and living with a partner, divorced, widowed, and married. Those who are married are more likely to use pawnshops, and the effect is statistically very strong. As I include controls for household size, income, number of adults and number of children present, this correlation is mysterious. It may simply represent the ability of married individuals to pawn wedding and/or engagement rings. I will return to this effect when discussing payday loans.

Table 3 displays the results of my analysis of the determinants of frequency of pawnshop usage. The question allowed for free answer and responses range from one pawn loan over the course of the previous 24 months, to 52, or one every two weeks for the entirety of the period in question. Most respondents however, reported between X and

Y loans. Discrete count data lends itself to analysis using Poisson or negative binomial regression models. Here I use a negative binomial model. Negative binomial models are similar to Poisson models but make fewer assumptions about the relationship between the mean and variance of the dependent variable. The results of this analysis are similar to those described above.

(Table 3 about here)

As expected, those with higher income and those who own their home use fewer pawn loans.

In this model, Hispanics appear to use pawn loans more often than Whites once wealth and access to credit are accounted for. This is in contrast to the results presented in tables 2 and 3. As the negative binomial model does not include controls for area level (zip or county) effects, this may be due to differential access; we know from previous research (Apgar and Herbert, see above) that pawnshops cluster in Hispanic neighborhoods, presumably catering to undocumented immigrants who cannot access other forms of credit.

In my analysis of the dichotomous pawn shop usage model, I noted that those who listed family as their source of financial aid given the hypothetical emergency presented to respondents, were less likely to use pawn shops. The results from this model suggest that among those that do use pawn loans, those who can count on family in an emergency use fewer loans. On the other hand we saw no benefit over those who listed no source of emergency help afforded to those who listed churches and neighborhood organizations as their primary source of aid in an emergency. Here though we see that those who expect to rely primarily on such organizations use far fewer loans than those who have no one to turn to. While this aid strategy (or last resort) does not appear to stave off occasional reliance on pawn loans, it does appear to effectively prevent chronic usage. This suggests an underlying difference in the way respondents view resort to family aid versus aid from religious or neighborhood organizations. Those with access to family support networks may be more willing to turn to family for smaller, less serious needs. Those that turn to religious and neighborhood organizations, may only do so in particularly severe situations, preferring to deal with smaller crises personally through the use of short terms loans like those provided by payday lenders and pawnshops.

I turn now to respondents' answer to the "emergency" question in each survey. As a reminder, the two surveys define emergency situations in different ways. The North Carolina Financial Services Survey defines an emergency as a sudden need for a $500 loan to be repaid within three months. The Making Connections Cross Site Survey defines an emergency as an unexpected bill constituting half of monthly income that would need to be paid within two weeks. Also, respondents to the North Carolina survey were only able to list one source of emergency aid; respondents to the Making Connections survey were able to choose as many sources as they desired, though these sources are not ranked according to preference.

Logistical analysis of emergency pawnshop usage in the North Carolina data is impossible due to the number of perfectly classified cases. These perfect classifications are themselves interesting however. No males listed pawnshops as their primary source of emergency aid. Analysis of the Making Connections data shows that males do consider pawn loans in emergency situations (see below), so it is entirely possible that males in the North Carolina dataset would turn to pawnshops for aid but only as a secondary or tertiary source. No African-Americans list pawnshops as their primary source of emergency aid. Those that do turn to fringe banks appear to prefer payday lenders. Again, African-Americans in the Making Connections data do turn to pawn shops. This suggests that they simply view pawn loans as a secondary or tertiary source of emergency aid. Similarly, in the North Carolina data, no non-Hispanic listed pawn loans as their primary emergency aid source. This is not entirely surprising since we know that pawn shops cluster in Hispanic neighborhoods and that undocumented immigrants have few formal alternatives to pawn loans. Remember though that these numbers reflect gross correlations. I have already presented evidence that there is no propensity for Hispanics to use pawnshops once we sufficiently control for credit and wealth effects.

Tables 4 and 5 display results of analysis from the Making Connections data. Each is the output of a fixed effects logistic regression of the decision to use a pawn loan to deal with a hypothetical emergency. Fixed effects occur at the census tract level. The tables report results from wave 1 and wave 2 respectively.

(Tables 4 and 5 about here)

Looking first at the wave 1 output, we see, not surprisingly, that those that own their own homes and those that have emergency savings are less likely to go to a pawnshop to deal with an emergency. Those that have emergency savings would likely use these savings before turning to outside sources of money. That many report using emergency savings in conjunction with payday loans, pawn loans, and social network support (see cluster analysis below), suggests that most have only meager savings, insufficient to carry them through a sudden financial crisis. Those who own their own homes may expect to use that equity to secure a bank loan. Alternatively, home ownership may proxy for other factors associated with alternatives superior to pawnshop usage.

Note that those who have received financial support from family and friends are more likely to use pawn loans in an emergency, though this effect is only significant at the 10% level. This is somewhat surprising as one might think that those who receive aid from family and friends would be able to turn to them in an emergency. Indeed, we saw that those who listed family as their emergency aid source in the North Carolina data were less likely to use pawn shops, and used them less often when they did so. There are several factors to consider. First, as noted, the question from which this dependent variable is derived allowed for multiple responses. It is possible that those who turn to pawnshops for emergency aid also turn to friends and family. The correlations here may mean that those who turn to family for support may have informal support networks that simply cannot meet the entire amount required of the hypothetical emergency. See the section on cluster analysis below for further discussion of this point. On the other hand, note that the family/friends support variable in this survey denotes actual financial support received over the previous 12 months as opposed to a hypothetical source of support. These respondents have already received help from their informal support network. It is possible then that they have reached their informal "credit limit" from this source. Family and friends may not be able to provide any additional support. Alternatively, respondents may be unwilling to ask their family and friends for additional aid. Regardless of background, and whether they have availed themselves of such support, focus group respondents often mention the shame of having to admit to family and friends that they (again) need assistance.

"Sometimes it's easier to go to one of those places than to go ask your parents or family. People throw the guilt on. But here is a stranger you are going to pay a fee, so that waives the guilt." –White female

* * *

"(Payday loans) are better than borrowing from somebody else like relatives."- African American female

* * *

Hispanic male: I think that there's it's more embarrassing to ask, for example, my dad, my brother or my sister. That's the type of business. I have a need and I won't see them again. I'll pay and . . .

Moderator: Oh. It's anonymous.

Respondent: Uh-huh.

A common complaint is that each time they turn to a parent, a sibling, an in-law, or a friend, they are forced to sit through a humiliating lecture about money management.

Moderator: A couple of you mentioned not wanting to ask family or friends. Is there anybody in your family that you wanted to tell or didn't tell that this was going on and who is that person and why?

White male 1: My mother.

Moderator: How come?

White male 1: Because she's a bookkeeping and accountant.

White male 2: Mother-in-law.

White male 3: Mom would kill me.

White female 1: Poor money management, speech.

White female 2: My dad. I wouldn't ask him.

White female 1: The cat is in the bag (sic). Everybody knows.

White female 2: You just never stop hearing about it.

Thus, this variable may be capturing some of that unwillingness to repeat what is apparently an excruciating experience. It is interesting to note that those who do not report current payday loan usage seem more willing to ask friends and family for support and do not report the same sense of shame in their predicament. Indeed, among White payday loan users, such encounters are seen as so unpleasant as to make payday loans, which they otherwise despise, seem bearable.

> "People are just passing a lot of judgments on you and how you got in that position without knowing. It's easier not to even bring it up and ask the people you know because some of the people you know are hurting just as much and that's out in the open. You can't ask your boss for money because that doesn't look good. You don't want to ask relatives because it's not good to do the family money thing. Your friends are tapped out and so you don't have much recourse left except these places." –White female

A third, related, possibility concerns the nature of the emergency in question. A bill equal to half of one's monthly income is a particularly large burden, and one that some may feel uncomfortable turning to friends and family to deal with. Some focus group participants note that, while they ask for financial aid from friends and family, they do not ask for enough to cover their debt. This is partly because it is embarrassing but also they would be uncomfortable placing such a large burden on their loved ones.

> "I've asked mine (family) but the bills are way more than what I wanted to ask them for. At the time it was can I borrow $100 for PG&E and water and phone. Meanwhile, I've got thousands in outstanding credit cards just keep accumulating. I wasn't comfortable hitting them up with the huge ones, but they knew. Things were bad." White female

Finally, note again that these variables do not capture the frequency or amount of the aid, nor the number of participants in the aid exchanges.

The other included "neighborhood embeddedness" variables do not seem to have an effect on emergency behavior. For at least one of the variables, participation in effective collective action with neighbors, this is a little surprising. One might think that this sort of participation would be associated with stronger linkage to informal networks of support, which might provide an alternative to a pawn loan in an emergency. On the other hand, we saw evidence in the North Carolina survey that such networks are less helpful than support from friends and family, and that those who turn to them do not generally do so to deal with the smaller crises of everyday life. Direct support from friends and family appears to be a more important factor.

Finally, note that race has no identifiable correlation with pawnshop usage in an emergency for respondents in wave 1. This is not the case in wave 2.

The wave 2 data presented in table 5 tells mostly the same story as the wave 1 data with some exceptions. First, note that the effect of receiving help from family and friends is now quite strong statistically while maintaining the same magnitude. Note also that, as a result of more detailed questioning in wave 2, we can now analyze the frequency with which a respondent gives and receive both monetary and non-monetary help, though we still do not know the amount or the number of participants. We can also separate out aid given and received to/from friend and family, offering some further insight. While the effects are only significant at the 10% level, they appear to show that the more often one gives non-monetary aid (e.g. rides, repair work, cooking, childcare, food, etc.), the more likely one is to use pawn loans to deal with an emergency. This is curious, as one might expect such aid to engender reciprocal obligations that can be called on in an emergency situation. One explanation is that those who give non-monetary aid are relatively poorer than those around them (otherwise they would give money) and thus are more likely to have to rely on pawn and payday loans to weather an emergency. Another is that, in giving constantly, these respondents have depleted their reserves and will have no choice but to turn to loans to handle a financial emergency. Given the extensive controls present in the model, neither is likely. It is possible instead that those who give more often have poorer friends and family that cannot be relied upon to help in an emergency. Since we do not have any information on the resources available to respondents' alters, we cannot directly test this hypotheses. Focus group participants do however sometimes describe using payday loans to bail out children and other family members who have fallen on hard times or have sudden expenses like bills.

> "I had to take out a loan because I helped a daughter co-sign for a car that she never decided to pay for 3 months. I was in between my own bills, so I had to do that and I ended up repossessing the car myself and taking it back to the dealer. Then I bought myself a car." – White female
>
> * * *
>
> "My situation was different because I received a phone call about a family member that was ill. They needed money at that moment. I could've gotten the money in about 4-5 days, but the money was needed right away." –Hispanic male
>
> * * *
>
> "Mine was my daughter needed school books, so it was an avenue of I had given her money for her school fees and rent and another class came up where she needed books that cost pretty close to $300. Daddy didn't have it but the bank said you can have this capability to get money in advance towards your next pay check. So I took advantage of it. Only owed them $30 back. I told them to take it the next pay check." –African American male

Even extremely poor individuals have still poorer loved ones for whom they will incur debt. Furthermore, the question regarding the hypothetical emergency does not specify the source of the bill. Those who often give aid to friends and family may consider them to be likely sources for said bill, and may adjust their expectations of emergency behavior to reflect this likelihood.

Those that send remittances abroad to support family and friends are less likely to use pawnshops in an emergency. Again, this may signify an individual of relative financial strength, though this can only be true in as much as the included controls fail to capture relevant aspects of wealth, assets, debt, and credit access.

The most major change between the wave one and wave two data is the statistical significance of the Black and Hispanic variables. Neither is statistically significant in wave one. In wave two, both are statistically significant and positively correlated with using pawn loans to deal with an emergency. The Black variable has approximately the same magnitude in each wave. This suggests that the larger sample size (approx. 1400 more respondents) simply uncovered a hidden correlation. On the other hand, analysis of the emergency scenario data from the North Carolina survey showed that no Blacks listed pawnshops as their primary source of aid. Remember however, that the Making Connections survey allows for multiple options. Despite initial appearances, this result does not contradict the previous finding. In the North Carolina data Blacks were no more likely than whites to use pawnshops or to use them more often. Combined with the emergency scenario results, this suggests that Blacks do not have any particular affinity for this service but that they consider a wider array of options than Whites when faced with a sudden crisis. Results from analysis of emergency behavior clusters (see below) support this interpretation.

The results for Hispanics are more difficult to explain. In the North Carolina data we saw that Hispanics were much less likely to turn to pawnshop than Whites, ceteris paribus, and used pawn loans less frequently when they did so. Wave one Making Connections data showed no difference between Whites and Hispanics in emergency loan usage. Wave two data shows a strong positive correlation with very high statistical significance. Note also that most of the individuals surveyed in wave one were surveyed again in wave two. It is possible that the increased sample size has simply revealed an underlying relationship. It is also possible that there was an underlying shift in awareness or perception of pawnshops in Hispanic neighborhoods during the time between waves one and two; the early 2000s was a time of rapid expansion of pawn and payday loan industry in the United States. On the other hand, three years may not be enough time for such a change to occur. The North Carolina survey implicitly controlled for documented status by largely limiting its sample to current and former public welfare recipients. The Making Connections survey did not do the same. It is thus possible that we are seeing the effect of undocumented status conflated with Hispanic ethnicity. This appears unlikely however given the controls present in the model. I explicitly control for bank account, credit card, and home ownership, as well as employment in the informal economy (which is, not surprisingly correlated with reliance on pawnshops). It may be that the explanation mirrors one given above for the correlation with the Black variable; Hispanics may simply be more willing or able than Whites to turn to a variety of options in an emergency, even if they use a particular option less frequently ceteris paribus. As a result of less frequent pawnshop usage they may have more objects left to pawn and/or may not have developed the same distaste for the option that Whites report.

Discussion:

My analysis of determinants of consumer behavior with regard to pawnshop usage has revealed several features not accounted for in the standard model. First, social networks appear to play a role in minimizing pawnshop usage. Those that can, or are willing to, turn to family for aid in an emergency are less likely to report any pawn loans over the previous 24 month period. They also report fewer such loans than those who report no source of support. Those that instead list churches/charitable organizations as their primary emergency support are no less likely to report payday loan usage than those who report no emergency source. They do, on the other hand, take out fewer loans than members of this group. These are individuals who likely have no family and friends to turn to, or, who have already tapped these sources dry. Taken together this suggests that individuals turn to friends and family for both day-to-day needs and emergencies, but that those who turn to churches/charity organizations only do so in emergency situations.

Second, analysis of emergency pawn usage from the Makings Connections data provides evidence that support from family and friends has limits. Those that reported more frequent aid from friends and family (as opposed to the hypothetical aid in the North Carolina data) were more likely to turn to pawn loans in an emergency. Such individuals may be unwilling or unable to deal with financial emergencies solely through their informal support networks. Indeed, focus group conversations bear this out. Individuals who have previously asked for help often appear unwilling to ask again for fear of being subject to the, “money management speech.” Some list sub-prime loans as an alternative to asking for more from family: they are anonymous and guilt-free. Those that continue to ask their family and friends for support may avoid revealing the true extent of their need. This is partly because of embarrassment but partly because they feel uncomfortable burdening their loved ones with large loans. Such individuals include payday and pawn loans as part of their emergency strategy, utilizing a variety of formal, informal, and fringe resources. In a section below, I detail the classes of strategies respondents utilized and their determinants.

Third, there is some evidence that those who support family and friends may rely more often on fringe banking sources to deal with financial emergencies. Such support could indicate the relative poverty of a respondent's alters. This would simultaneously cut off a potential avenue for support and provide additional drain on one's resources. Some payday loan users report taking out such loans to help family in trouble: missed car payments, lack of money for books, and unspecified emergencies. In the former two cases, focus group participants were responding to the needs of their children. They felt an obvious responsibility to help them. In the latter, the respondent clearly felt it was his responsibility to help the individual in need because he was, "family." This, incidentally, demonstrates the limitations of the social capital approach to network analysis. An isolated individual may have no one to turn to in an emergency; an individual with numerous connections to family and friends may find that his alters *generate* emergencies.

On the other hand, we see little evidence that Hispanics use pawnshops more frequently than Whites once we account for wealth, formal employment, and other demographic and geographical characteristics. It appears that these factors, in conjunction with undocumented status (implicitly controlled for in the North Carolina data) explain the higher concentrations of pawnshops in neighborhoods with large Hispanic populations. There is no need to invoke "greater cultural sensitivity" to explain this differential.

The moral economy framework suggests that it is important to look at both moral considerations and social network structure in predicting consumer behavior in markets. I further argued that we should look for three main effects: on the terms and availability of formal credit, on the terms and availability of informal credit alternatives, and on the interplay between the two. Overall, my findings suggest that this framework is productive in interpreting behavior. Shame appears to limit the availability of informal credit alternatives for some focus group participants. They would rather do without or turn to fringe banking services to meet their needs than ask for further help. The alters described in these hypothetical interactions appear to express disapproval about the way respondents manage their money and would perhaps be unwilling to provide further support anyway. For others, obligations to their loved ones appear to compel them to take out loans from fringe banks, putting them at risk of falling into dangerous cycles of debt. Networks matter in as much as they connect respondents to financially strong alters wiling to loan money, financially weak alters who have claim to their resources, or no family and friends at all. These connections, the shame, and the duty combine to construct the interplay between formal and informal credit. Some avoid informal sources of credit all together in favor of discreet, anonymous loans. Others use a combination of the two to avoid burdening their loved ones with too much debt, demonstrating indirectly their informal credit limit. And still others find themselves entering the fringe credit market to support their family and friends. On the other hand, we find no explicit differences across racial and ethnic groups in the way family is defined, or in the emotional content of these relationships. The shame in borrowing from friends and family does not appear to vary by race or ethnicity. And, though such differences may be present, we see no evidence that different groups are applying their rights and obligations regarding family and friends to larger or smaller pools of acquaintances. Of course, the available measures of race and ethnicity are crude (for example, "Hispanics" encompass individuals from a variety of national and ethnic origins) and such differences in perception need not be tied to race and ethnicity; they supply only one potential axis of solidarity.

There is, however, little evidence of differences in moral considerations about pawn loans themselves, that these affect the market for pawn loans, or that pawn lenders are held to different standards depending on their identities as community insiders or outsiders. This is largely because pawn lenders and pawn loans are seen as morally neutral by the majority of individuals in all focus groups conducted in North Carolina and San Jose. A few respondents expressed disappointment at the small amount of money they received in exchange for the valuables they turned over but no one felt they were treated unfairly by the lenders, and no one felt the loan terms were exploitative. In the next section, I provide evidence that such considerations are very much a factor in the payday lending market. There are differences across groups in ideas about the propriety of payday loan terms and the moral character of payday lenders. This outrage or lack thereof appears to manifest in differences in borrowing behavior at the aggregate level that have likely effects on industry profitability. Furthermore, for one group, Spanish-speaking Hispanics in San Jose, the outsider status of the loan providers is very much a factor in shaping their perception of lender behavior and their ideas about appropriate industry regulation.

Chapter 5: Models of Payday Loan Usage

I now turn to the determinants of payday loan usage. I present modeling results on use of payday loans, frequency of use, and stated intent to use payday loans in an emergency. The largest finding from these models concerns persistent racial variation in payday loan usage. I treat this subject in a separate section below. First, I provide an overview of the models and discuss relevant findings from each. Tables 6 and 7 display the results of fixed effects logistic regressions on the use of payday loans by respondents to the North Carolina survey. As a reminder, the dependent variable includes any use of payday loans by household members in the previous 24 month period. I provide results for panel effects at the county and zip code-level. For a detailed account of the included variables, see the data section above.

(Tables 6 and 7 about here)

Note first that each model loses a number of observations due to perfect prediction at the county or zip code level (176 at the county level and 387 at the zip level)This speaks again to the importance of area effects in determining access to and salience of credit market options. When we look within areas we see that race remains a significant determinant of payday loan usage. I explore this in detail below.

We also see that older individuals use payday loans less frequently. Typically age acts as a proxy for wealth accumulation; older people have greater resources available and thus have less need for pawn or payday loans. These models however, include extensive controls for wealth accumulation. One possibility is that we are seeing a cohort effect. Older respondents may have very different attitudes toward debt accumulation or, alternatively, lesser familiarity with this form of credit. On the other hand, we see the same strong negative effect on use of pawn loans (see above), which are an ancient and relatively well-understood form of credit. Of course, as this is cross-sectional data, I cannot distinguish between age and cohort effects. Analysis of focus group provides no evidence that attitudes toward and use of payday loans varies according to age.

Those individuals who report their first source of emergency support to be churches or community groups are more likely to take out payday loans than those who report that they would turn to family or friends. They are even more likely to use payday loans than those who report no source of emergency support at all. The results on the "family" variable are similar to what we found when we looked at pawn loans: those who can turn to family in an emergency are less likely to use payday loans regularly. Note though that the effect is not statistically significant in either model. Those that can count on friends and family in an emergency are likely part of a social network that can provide support in daily life. Such support can reduce payday or pawn loan usage. It is not surprising that those who list churches or neighborhood support groups as their primary source of emergency aid would fare no better in daily life than those who have no recourse. As I argued in my discussion of pawn loans, resort to churches or neighborhood groups in an emergency suggests a weak network of social support. Such individuals likely have few or no family members or friends to which to turn when dealing with the minor crises of daily life. This may be because such alters are few or geographically distant, because they are poor relative to the respondent and thus cannot contribute, or because they have already offered all the help they are willing to give. People may generally only turn to churches and community groups to deal with "emergencies." The day-to-day struggles to pay bills or put food on the table may not constitute a need serious enough (in the eyes of the respondent) to ask for charitable aid. It is, however, strange that such individuals would use payday loans more often than those who report no source of emergency support. Such a difference could stem from underlying differences in approach to borrowing or begging. Those who list no emergency support options may be unwilling to ask for help in most situations. Those who turn to charity in an emergency may be more willing to seek external support to deal with problem both major and minor. Such individuals would most likely turn to friends and family if that were an option. If this is the case, then it is interesting that "rugged individualists," would fare better than those who seek charitable aid but worse than those who are willing to ask family and friends for help.

Finally, note the effects of relationship status. Those who live with a significant other (i.e. those who live together without benefit of legal marriage) are more likely to use payday loans than those who are single/divorced, or married. This result is in contrast to what we found when we analyze pawn shop use, namely that married individuals are more likely to use pawnshops than those who are single or simply living with a partner. This suggests a different clientele for the two types of service.

(Table 8 about here)

Table 8 includes results of an ordered logistic regression on frequency of payday loan use over the previous 24 month period. The data is again from the North Carolina survey. Note that this model does not include true count data. Instead, payday loan recipients were divided into four categories: once or twice a year, once every three months, once a month, and once every two weeks. Payday loans are typically taken out in two week increments, so the final category represents individuals who have taken out the maximum possible number of payday loans during the period in question. Other than the obvious racial effect on frequency of payday loan usage, there is little else to report on this model. The results are consistent with the findings in Tables 6 and 7.

(Table 9 about here)

Tables 9, 10, and 11 include models of respondents' stated intent to take out a payday loan to deal with a hypothetical emergency. Table 9 displays results from analysis of the North Carolina data, while Tables 10 and 11 depict results from the first and second waves of the Making Connections data respectively. As a reminder, the question on the hypothetical emergency is structured quite differently in each survey. In the North Carolina data, the emergency is conceptualized as a need for a $500 loan that would need to be paid off within three months. Only the first response given is recorded. In contrast, the Making Connections survey asks respondents how they would deal with an unexpected bill equaling one half of total income that must be paid within two weeks. Respondents were given a list of twelve options (including "other" and "would not pay") and were free to choose as many or few as they liked. The models in Table 9 include fixed effects at the county-level. The models in tables 10 and 11 include fixed effects at the census tract-level.

(Tables 10 and 11 about here)

As the Making Connections survey includes rich data on informal support networks and "community embeddedness," I provide more detailed analysis of independent variable clusters in tables 10 and 11. In each table I detail five models of the decision/stated intent to use payday loans to deal with a defined financial emergency (see above). These are a basic model including only demographic and financial characteristics, an "informal support" model that adds only variables from the informal support category, a "community embeddedness" model that adds only variables from the community embeddedness category, a "full" model that includes measures from each of the four categories, and an "interaction" model that also includes racial interaction effects. For a more detailed overview of the variables included, please refer to the materials and methods section. Variables that are not statistically significant and that serve no obvious role as controls have been omitted from the results. The results in Tables 10 and 11 are robust to a variety of model specifications: results hold for neighborhood-level fixed effects models, standard random effects, and three-level (city-> census tract->respondent, and city->neighborhood->respondent) hierarchical mixed effects models (not reported here).

Table 9 indirectly shows the importance of area-level effects. Over 550 observations were dropped from the analysis because they belonged to counties in which <u>all</u> respondents answered yes or no. I do not report results using the zip code-level data because the number of observations lost renders the model effectively useless. Even in the model presented in Table 9, the large loss in sample size creates a loss in statistical significance. We see no correlation between race and choice of payday loans as one's primary form of emergency support. This could be because there is no relationship. It may also be an artifact of the question structure; even those who regularly use payday loans may not rank them as their primary means of emergency support. Finally, it may be because of the diminished sample size. To test this, we need a much large sample that can handle the loss of some observations due to perfect classification. The Making Connections dataset provides this.

One feature of the models in Tables 10 and 11 that stands out is what is not significant. Notably, most financial and informal support characteristics do not contribute to the decision to use a payday loan in an emergency. The former is perhaps not so surprising; as these respondents come from poorer neighborhoods, there is limited variance in many of the financial and asset variables. The later, however, is somewhat mysterious. One might think that current support from friends and family would influence respondents to turn to their friends and family alone for support during the hypothetical emergency, whether out of increased salience or the simple availability of informal support, as opposed to payday loans or some combination of the two. Analogously, current support to friends and family may generate reciprocal obligations that can be called on during an emergency. On the other hand, current reliance on friends and family could indicate that the respondent is already at his “credit limit” and unable/unwilling to turn to them for help in an additional emergency. There is also evidence from focus group results (see section on pawn lending) that individuals are uncomfortable asking family and friends for large amounts of aid, preferring instead to receive smaller amounts. In addition to the embarrassment that comes with such a request, respondents were unwilling to burden their loved ones in such a manner. It may be that we do not see statistical significance because these types of conflicting effects cancel out in aggregate.

We do find however, that those who <u>provide</u> aid to family are more likely to turn to payday loans in an emergency. Giving aid out can deplete one’s resources and leave one vulnerable to sudden financial crises. That could force a household to turn to pawnshop and payday lenders rather personal savings or credit cards. To the extent that the included savings, debt and asset variables capture variations in financial strength, I have already controlled for this effect. Instead, the correlation likely indicates that the respondent does not have many financially secure family members to whom to turn in an emergency. This may seem puzzling given that I have also included a variable to capture whether the respondent's household has received financial aid from family in the previous 12 month period. Remember that these variables do not capture the amount of aid given/received, the number of transactions, or the number of alters involved. A person who received a small cash gift from a relatively well-off family member but who regularly supports five or six relatively poor family members would receive a "yes" score for both the "give" and "receive" variables.

There is also some evidence in the interaction models that Blacks (but not Asians or Hispanics) who give and receive aid to friends and family are less likely to turn to payday loans in an emergency than Whites. This suggests possible differences in the way that African-Americans utilize their social networks, and/or differences in the perceived propriety of turning to friends and family in emergency situations. Next, we look at the community embeddedness variables. Most of these showed no statistical significance. These include: volunteerism, participation in religious community, individual-level participation in collective action and individual reports of collective efficacy. It is perhaps surprising that active participation in a neighborhood church (not reported) does not have an effect on the decision to take out a payday loan in an emergency, as church groups may provide (additional) financial support to needy parishioners. In the North Carolina Data, the "church" variable captures individuals who list churches and community organizations as their primary source of aid in an emergency. I argued that such individuals are unwilling or unable to turn to family and friends and thus resort to charitable aid. Here however, we have measures of participation in informal exchange networks with friends and family so any effect of this "church" variable would be in addition to potential aid from kin. That we find no such effect suggests that for most people, churches and charitable organizations do not play a major role in combating financial crises; those that have access to formal or informal credit do not usually augment that aid with charitable contributions.

Finally note that the effects of employment and checking account ownership are quite intuitive; proof of employment and possession of a checking account are both prerequisites for payday loan usage.

Payday Lending and Race:

The most striking result of these models is the strong, statistically significant correlation between payday lending and race. African Americans are more likely to use payday loans than Whites, use more payday loans when they do so, and more likely to turn to payday loans in a hypothetical emergency situation. It is worth exploring this finding in great detail. Economists have argued that observed differences in concentration of payday lender placement by neighborhood racial composition are the result of differences in wealth and credit-worthiness. In other words, payday lenders were simply locating or flourishing[9] in areas with greater concentrations of working class individuals with lower wealth and poorer credit relative to their peers. This is a reasonable hypothesis given what we know about racial disparities in wealth and access to credit. Furthermore,

[9] Note that the "intent to exploit" often alleged by payday lending opponents is irrelevant to this argument. The same pattern of payday lender concentration could occur even if lenders were not aware of the racial wealth disparity or actively seeking to take advantage of it. If payday lenders simple located randomly in working class neighborhoods, the underling disparities in wealth and credit worthiness could presumably cause variations in business mortality and expansion rates that would reproduce the pattern in location actually seen.

the "redlining" of Black neighborhoods by mainstream credit organizations is a well-documented phenomenon that leaves many African American without access to "good" credit and its associated benefits (e.g. larger loan amounts, lower interest rates, and opportunity to build crucial credit history), even if they are not subject to individual-level discrimination. At the gross level, this makes African Americans more likely to have to rely on payday loans, both because of additional need (because of lack of collateral, savings, etc.) and lack of local alternatives. Unfortunately the same conditions make African Americans payday loan users most likely to fall into cycles of rollovers and become hopelessly mired in debt. This hypothesis does not, however, explain the racial differences we see in the above models. First note that I have, in each model, extensive controls for income, assets, home ownership, total monthly housing expenses (rent/mortgage payments), credit card ownership, total debt, types of debt, total savings, checking and savings accounts, bank access, and a variety of measures of financial stress including welfare and food stamp use, failure to pay phone bills and utility bills, and trouble putting food on the table. At the individual level, I have controlled for the lion's share of differences in wealth and access to credit that may result in differing propensity to use payday loans. Next, I have taken pains to control for area-level effects using controls for city, county, census tract, zip-code, and subjective assessment of neighborhood membership. As the payday lender concentration studies show, location produces differences in access to both payday lenders and mainstream credit providers like banks and credit unions. Ease of access as well as the increased salience of an option that comes with constant exposure to its advertisements and storefronts can influence use decisions. My analysis shows that African Americans use payday lenders with greater frequency than whites even when we take this into account. Put another way, the argument over payday lender concentration concerns itself with cross-neighborhood variation. My models find racial differences in propensity to use payday loans <u>within</u> hypothetical neighborhoods. To give a sense of the effect, note that the coefficient on the "Black" variable in zip-code-level fixed effects model in Table A translates to a 272% greater likelihood for African Americans to use payday loans than otherwise identical Whites. Imagine two working class neighborhoods, one composed of only Whites and the other composed only of African Americans. Each has identical distributions of wealth and credit-worthiness, and each has the same concentration of banks, pawnshops, payday lenders, and credit unions. If Whites used payday lending at national averages, approximately 5%-10% of the population would partake. According to my model, 13.5%-27% of African American would do so. This suggests that economists' model of the geographic concentration of payday lenders is underspecified.

If the racial differences present in the model cannot be explained by underlying differences in demographic and financial characteristics, or by current variations (see below) in neighborhood characteristics, what other possibilities exist? One is that what we are seeing is not an actual difference in behavior but a difference in willingness to report payday loan usage. In the previous section I discussed the embarrassment and shame that focus group participants reported when forced to reveal their financial situation to their friends and family. This embarrassment appears to extend to revelations to bosses, coworkers, and neighbors. Thus it is reasonable to expect survey respondents would be hesitant to divulge sensitive financial data like payday loan usage to those conducting survey research. Indeed, Goodwin Simon, the organization that conducted the

CRL's focus groups in December 2000 encountered so much deceit when contacting known payday loan users that they decided to include inquiries into the cause of this prevarication as a central part of the focus group program. Participants universally laid the blame on personal pride.

> No one wants to say that I had to go to a check cashing place to get a pay day loan. –African American male
>
> I think a lot of people don't talk about it because of the judgment. You get in a trap; you get caught and you are trying to pay off, the loans you are trying to pay off but as soon as people hear you're in the hole or you're behind or you need money or you are hurting or whatever, then you are not good person to manage (your) money. (You're) just buying stuff, or throwing it away and not doing a good job. – White female
>
> I think it's in part because you feel irresponsible because you were not able to manage your own money and you feel guilty. –Hispanic male

We might think then that a large number of survey respondents are lying about not using payday loans or at least underreporting their usage. Is there any evidence however, that there are racial differences in the rate at which people lie? As we will see below, there are strong differences across racial groups in the perception of payday loans regarding fairness, dignity and basic meaning so there is reason to be suspicious of these self-reports, at least initially. But, there is strong, direct statistical evidence that there is no racial difference in lying about payday loan usage between Whites (the base category) and African Americans. In 2007, the California Department of Corporations conducted a study of payday loan providers and recipients. They used the internal records of payday lenders themselves to compile a list of previous payday loan users and proceeded to conduct a phone-based survey using this sample. Respondents were asked to identify themselves and verify all relevant information. They were then asked a variety of questions regarding general finances and policy opinions in order to mask the actual intent of the survey. When asked whether the individual had ever taken a payday loan, fully 53% of the respondents denied ever having taken one. 47.3% of Caucasians and 50.2% of African Americans denied having ever taken out a payday loan (California Department of Corporations, Payday Lending Survey, Table 23). This difference is not statistically significant, but even if it were it would not call into question our findings; Blacks reported using payday loans at much higher rates than Caucasians in the North Carolina data and were much more likely to state intent to use payday loans in an emergency in the Making Connections data. On the other hand, 61% of Hispanics lied about payday loan usage. The number is statistically different from both the Caucasian and African-American rates. This suggests that we should view findings regarding Hispanic payday loan usage and even pawnshop usage with some caution; while there is substantial underreporting across racial groups, Hispanics underreport at a much greater rate.

Everything I have noted thus far suggests that we have uncovered a real difference in racial use of payday lending that cannot be accounted for with resort to the typical explanations. When statistical methods fail to explain the mechanism underlying a strong correlation, it is often useful to analyze qualitative data like interview and focus group transcripts to get a sense of what is occurring. In this regard, the focus group data from both the North Carolina and Making Connections surveys prove particularly helpful in providing some answers.

Simply put, there appear to be large differences across racial and ethnic lines in the way payday lenders and payday loans are perceived. North Carolina focus group data shows that the African American female participants generally viewed payday loans as convenient, and a good service to which to have access. They do stress however personal responsibility in taking out loans. I will return to this shortly.

> Moderator: Do these places, pay day lenders, do they meet people's needs or do you think it gets people in trouble?
>
> Respondent 1: I think it meets your needs.
>
> Respondent 2: It depends on the person.
>
> Respondent 3: It goes with the self-discipline again.
>
> Respondent 4: It depends on the person. You got to know you got to pay it back.
>
> * * *
>
> Moderator: Do you think it gets people in trouble or do you think it meets people's needs?
>
> Respondent: No. When you go over there and get money you know you gonna have to pay it back. There ain't nothing for free. If you sign your name on this dotted line you are going to have to pay them back interest. That's just the bottom line.
>
> * * *
>
> Moderator: How is the interest rate, is it good?
>
> Respondent 1: If you got $100, you have to pay $17 back.
>
> Moderator: So 17 percent?
>
> Respondent1: Yeah
>
> Moderator: Is 17 percent good?
>
> Respondent 1: It's good if you need the money, I'm telling you.
>
> Respondent 2: If you need the money, it's wonderful.
>
> Respondent 3: Yeah.

Caucasian women on the other hand, viewed payday lenders with suspicion and considered the loans themselves to be quite dangerous.

Moderator: You think it is getting money in advance of a paycheck?

White female: I think so. You see the commercials. I have never done it, but you go in and write a check and get cash for it. Then you go in two weeks later and pay it. That way you never get out of debt.

Moderator: Why do you never get out of debt?

White female: Because every two weeks you are going to pay off that check that you wrote two weeks before, and then have to write another one to get by those two weeks.

* * *

Moderator: Do people agree? Do you think that these pay day lenders meet people's needs or do you think it gets people in trouble?

White female: I think it gets people in trouble.

Moderator: Why do you say that?

White female: That one week where you have got to have that extra, like the gas bill, winter is coming and gas is going up. People have to pay that extra for gas, and if they have to pay what they have already borrowed and the gas bill comes in and it is higher, then they have to borrow more when you put in the money that you are supposed to pay back.

* * *

The Center for Responsible Lending conducted focus groups that explicitly segregated respondents into four groups of eight to ten: Caucasian payday loan users, African American users, Hispanic (native Spanish speakers) users, and a mixed non-user group. The latter group included seven African-Americans and three Caucasians. Starting with the (mixed) non-user group, we see that there is little difference in opinion about payday lenders and payday loans across racial group. Black and White non-users alike view payday lending as "legalized loan sharking," and the loans themselves as dangerous and exploitative.

Moderator: Has anybody else ever gotten one at any point?

Caucasian female: I was scared to.

Moderator: You were scared to?

Caucasian female: Yes.

Moderator: How come?

Caucasian female: I've heard so many horror stories. People can never get out. It's kind of like an legal loan shark in a way.

African American male 1: That's exactly what it is.

African American male 2: Yes.

* * *

Moderator: You said you (took out payday loans before)?

African American male 1: I did not. There are certain things that I put into a certain category and the pay day loans I put them in the same category as the rent to own and loan shark. Some reason I feel that they are there to help you, but I think that it's going to cost you more than its worth.

African American male 2: They're better than a credit card.

African American male 3: The bad thing is I don't think they're there to help you.

African American male 1: They're there to help themselves but if you're going to them, you're asking for help. They are here to help you but it will cost you. That's how it works.

* * *

Moderator: (name redacted), when you were in hard times did you consider doing a pay day loan?

African America male:

Yes, but I remember the first pay day loan that I ever saw as a kid and it was Joey Rocco's. These guys were not playing. They

> owned the corner store. They were the last Italians in my neighborhood. Hey, you be back Friday or I'm going to bust your legs, you hear me. You hear me. Those guys were not joking. That always kind of stuck with me. [laughter] I see a real nice place with chrome and lights and I'm like Joey Rocco with that spot, okay.

* * *

Moderator: Let me ask about the companies that these stores that do the pay day loans. What do you think about the companies? Are they responsible businesses that are helping people who need them? Are they exploiting people? What do you think about the companies?

Caucasian male: They're exploiting people.

Moderator: Exploiting people.

African American female: That's a billion dollar business.

African American male 1: They're preying off people that really need it.

African American male 2: Yes.

African American male 3: It's legal but it's entirely too much interest. Too large of a percentage of the money [inaudible]

Whites are perhaps a bit more strident in their language, but there is a general consensus on business practices and the value of this "service." Regardless of race, participants wanted to see the industry heavily regulated or outright banned, though the later was a minority position.

Before I turn to differences across racial and ethnic groups in perception of payday loans for users, I want to stress what is not different. Regardless of background, participants generally expressed shame and embarrassment at asking friends and family for help. Indeed, it appears to be a motivating factor for taking out payday loans for Black, White and Hispanic users alike. One factor that may set apart users and non-users is their ability to stomach the negative emotions surrounding requests of aid from family and friends. Non-users seemed more willing to go to family and friends for aid. Users detail the lengths to which they go to avoid having to hear “the speech.” For a more detailed discussion of this point, see analysis in the pawn loan chapter.

The majority (6 out of 8) of Caucasian payday loan users reports their experiences with obvious disgust. Payday lenders are referred to as “rapists,” “loan sharks,” and generally unethical.

> “It’s to the point where it’s actually – it would be cheaper to go to the mob, to pay the mob for the money.” Caucasian female, December 2009

> “They are raping you because they know you’re in a hard spot and you need it. What can you do? If you’re faced with having your lights and heat turned off and water, what are you supposed to do? You can sell so much blood. Literally, what can you do?” –Caucasian female, December 2009

> “I think they’re exploiting people, for the most part. I think they see an opportunity to make money, especially in these hard times. I don’t think there is enough regulations on them. They just pop up everywhere. If the high profit margin wasn’t there, there wouldn’t be so many around. I think they’re making an exorbitant amount of money given what kind of liabilities they have involved in the transaction. Obviously, it’s a necessary evil but I feel myself that the whole industry is an exploitation. It’s almost falls in the realm of tow truck companies. That’s how I consider them.” –Caucasian male, December 2009

Each views him or herself as a victim of exploitation, and their bitterness at their situation is palpable. When asked about the nature of their previous payday loan, each described it as an emergency, last resort maneuver to deal with a crisis in the form of unexpected bills. This is interesting considering that they were asked, as noted above, to list alternatives they considered. Asking family and friends was an alternative often noted but few were willing to do so. As bad as payday loans are, they are still apparently preferable to turning (yet again) to informal support networks for some of the respondents. When asked about their thoughts on regulation of the payday lending industry, one participant suggested that the current regulatory framework was so loose as to allow payday lenders to act as if they were in the, “Wild West.” All were in favor of strict regulation of the industry, and, despite their continued reliance on these loans, a significant minority favored an outright ban.

> “I think they should make a law nationwide to stop this because it doesn’t matter where it is. This is still our country whether it’s a state or not. They need to stop this crap.” –White male

> “I mean banks got regulations and laws on what they can do on loans. Why not these people.” –White male

> “They run amuck as it is.” –White female

When asked where such a ban would leave them, proponents claimed that they would find a way to make do and that such a ban would encourage further self-discipline.

> Moderator: If there were no more pay day loans in California – if they banned them and there were no more in the state, would that be good or bad for you personally?
>
> White female: It would be good for me in the sense that I would crunch. It would be difficult for a couple weeks or whatever, but I think for me it would get me out of the whole. I’m hoping to get out of this mess within the next couple of weeks.
>
> White male: I’d be forced to find another way. Eat less or drink less. I already gave up cigarettes. It’s money.
>
> White male: Yes, you’d find another way. I’m looking at other second jobs and I’m looking at selling some things.

When then asked whether they would recommend payday loans to friends and family who consulted them, respondents overwhelming (and not surprisingly) said no.

Moderator: We talked a lot about these loans and your experiences with them. Imagine that a friend or a family member is facing cash shortfall emergency crisis and they come to you and they ask for advice. They say I need money. Should I take out a pay day loan or not? What would you say to them?

White male: No, run away.

White male: I’d probably tell them how I got stuck and what kind of fees I pay, and are they willing to do that? Is that what they want or can they hang off a little longer?

White male: Yes, exhaust all options. Like they were saying if you have a set income that you have every month and you take out a loan and you have to pay x amount on top of that loan and you’re right at the point where everything has gone up except your income, then you are going to be in the hole each month just to repay that loan back. That’s when it becomes a vicious cycle. If you don’t have the extra money to cover that amount, you do get trapped. Exhaust every avenue possible or sell something or whatever.

White male: Look elsewhere to find the money; I wouldn’t do it there.

Hispanic payday loan users are quite similar to White payday loan users: they report the same distrust of payday lenders, the same feeling of exploitation, and the same desire to steer their friends and family away from payday lending. (relevant quotes).

“They charge too much for paying it off.” –Hispanic male

* * *

“Obviously, it's that person's responsibility to inform themselves, but the charge that they impose - as I've said, sometimes a person goes into that business and takes the money but you do it because you need it. Now, is the charge fair? I don't think so” –Hispanic male

One important difference in perspective appears to be that some Hispanics frame their distrust and disgust with payday lenders in terms of community insiders and outsiders, while Whites view payday lending as a form of generalized exploitation. For example, Hispanics unhappy with payday lenders note that the shops are often run by “Hindus” and White people who are essentially interlopers in the Latino Community.

“It's like White people who are the ones that are weighing down this community with fees.” –Hispanic male

* * *

> Male respondent: "I have a few opinions about this. The bank - I think with these businesses it depends on the community. I know it's helping the economy but who are the owners. A lot of the people are not Latinos and in the community we need to support the businesses with Latino owners.
>
> Moderator: So if the owners of those businesses . . .
>
> Respondent: They're Hindu. A lot of them are Hindu."

Part of their anger comes from the perception that payday lenders are siphoning off money that legitimately belongs to Latino business owners and community members. The identification of "Hindu" villains speaks to classic tensions between working class and "middleman" minorities. In contrast, Whites do not identify racial or community insider/outsider dimensions in the improper behavior of payday loan providers; payday lenders are seen as villains who indiscriminately prey upon the financially compromised.

While African Americans reported the same discomfort in turning to friends and family as Caucasians, their opinions on payday loans couldn't be farther apart. Payday loans were described as a "convenient," and good service to have in their neighborhoods.

> "You know what you're getting up front. You have the option of saying no, I don't want this or yes, I do want this. I accept it for whatever fee you are going to charge or I don't accept it. That's what I like about it. You can accept it or not." – African American female, December 2009
>
> "I think of them as they're there when you need them, because let's face it you have the choice whether you want to take that fee." African American male, December 2009

When asked about the ethical character of the payday lending industry, most participants (8 out of 10) dismissed claims of exploitation or unfair business practices.

> "I do think it's fair because you go in there knowing. You know what you need; you know what you're going to pay. They're taking a risk. They're not doing credit checks." –African American female, December 2009
>
> "I think it's a personal choice, so I don't think it's a negative. I think it's more of a helpful." African American male, December 2009

> “And at the same time, it is a business and they're out to make money. It's up to you to be the responsible person to take care of that.” African American male, December 2009

“It’s just business,” became a common refrain for the remainder of the session. One participant noted that it was a great business and that he would open a shop himself if he could ever raise the capital! Another participant described the payday loan industry in analogy to a liquor store. It was not the responsibility of a liquor store to withhold alcohol sales to problem drunks, even if it is clear which customers fell into that category.

> Male respondent 1: It's like walking into a liquor store. You've got every liquor store in every hood, they know you've got a problem when you're walking in there and you're buying that 48, you know what I'm saying -- something to drink at 10 or 11 o'clock in the morning. As long as you are not staggering in there, they're going to keep selling it to you.
>
> Male Respondent 2: Even if you are staggering.
>
> Male Respondent 1: Staggering in there, knock the stuff down, they're still going to give you something. As long as you've got the money.
>
> * * *
>
> Male respondent: Like I said, it's a bit of a business. People abuse it; just like with alcohol, people can abuse it. Some people need it and take advantage of it. Go ahead, so be it. But other people that abuse it and if things -- from what I'm hearing today is it's a problem in the black community and with immigrants and people of minority. Some people can abuse it just like alcohol.

In the same way, payday lenders did not have any obligation to refuse loans to chronic borrowers. Another respondent objected to this idea, claiming that an ethical businessman would not take advantage of someone who is clearly sick.

> “I think if they had some type of tracking to where this person [inaudible] job he's doing this, something is wrong here. Let me do a little bit more homework on his background, or contact someone that he put down as an emergency follow up person and they confirm that this person is just loves to have a good time. He's okay and he is paying us back consistently because of that. But if he has a problem, then we're contributing to his delinquency. I think there should be some ramifications to support the

> person that has fallen in that track." –Male respondent
>
> * * *
>
> "I'll put a word that (name redacted) said, relationship. So you are coming in there and you build a relationship with the person behind that counter. It's that person's job to say I think something is wrong with [inaudible]. He's been in here 3 times this week. I'm being overly demonstrative but it's just my opinion." –Male respondent

While the two participants in question disagreed about business owners' moral obligations in this particular case, they, along with the others, agreed on a more general idea: the problem with payday lending lay not with the lenders or terms of the loans, but with profligate and abusive borrowers. Participants were quite aware of the risk of falling into cycles of debt but laid the blame squarely with themselves if and when this occurred (and it did for some); this was a matter of personal responsibility. Most Whites, as noted above, believed that the loans were rigged to create such cycles. While African-Americans were more sanguine about loans than Whites, they did favor some regulation of the industry. Participants generally saw less need for regulation and few thought an outright ban was necessary or even beneficial. Not surprisingly, most participants would recommend payday loans to their friends and family provided that they were unable to help at the moment; they would simply caution the loved-one about the dangers of falling behind.

> "I'd tell them to go to the pay day loan."-African American male
>
> "I'd put them in that direction and tell them to go to pay day loan." – African American male
>
> "If they have exhausted all other, then do it but be aware that you have to pay it back in a certain amount of time. You don't want to get stuck in that -- extending your loan or getting new loans every week or so. If that was the only other option for them, yes I would advise it." –African American female

When asked to explain the reason for their most recent loan, most African American participants used the provided term, "cash crunch," to differentiate their use from the "emergency," option. This is quite different from all Whites and most Hispanics, who claimed they used payday loans to deal with serious financial emergencies. The direction of causation here is ambiguous. Assuming they are being honest (and there is no reason to suspect systematic deceit given the statistical results presented above), it is possible that the African Americans interviewed had more positive views of payday lenders because they were not desperate when they last sought a loan. On the other hand, their more positive and accepting attitude about payday loans may be the reason they were willing to take out such loans to deal with more minor emergencies where Whites reserve them for emergency situations. At this point, I will remind the reader that these focus groups do not necessarily contain representative samples of African American, Hispanic and White payday loan users. They also do not speak to underlying numbers. Imagine, for example, two hypothetical groups A and B. Individuals in group A use payday loans rate their experiences poorly and feel cheated. Individuals in group B rate their experience positively and are happy with the service. Both groups however may have an identical percentage of payday loan users. We should keep these limitations in mind when using the data to theorize. Still, it does appear that underlying differences in perception account for some of the observed difference in usage rates. The responses from African Americans suggest that they are more comfortable with the business practices of payday lenders and thus are less likely to go out of their way to avoid transacting with them. Furthermore, they suggest that they are willing to use payday loans in a wider variety of circumstances than Whites and Hispanic, who reserve their use for emergencies. Combined, this helps to account for some of the observed statistical differences. Furthermore, Whites and Hispanics were unwilling to recommend the service to friends, family or coworkers looking for avenues of financial support. Blacks were. The California Department of Corporations 2007 Payday Lending Survey lists the three primary sources of information before taking one's first payday loan as follows: "Saw a location and went inside" (24.1%), "Heard about it from Family and Friends" (21.7%) and "TV Advertisements" (16.8%). The first speaks to the importance of the increased salience of the option that comes with great payday lender concentration in a neighborhood. The second speaks to the importance of word of mouth advertising in shaping behavior. If the differences in perception among payday loan users found in the focus groups are representative or at least statistically significant it suggests major differences in the information potential first time users are presented with when making their choice. The alters of White and Hispanic payday loan users will hear horror stories about, "loans from hell," and exhortations to avoid the loans at all costs. In contrast, the alters of African American will hear generally positive accounts of the loan experience coupled with a few admonishments to be responsible with the debt. To the extent that racial homophily dictates local social network structure, the potential payday loan user will hear similar accounts. The effects on the shape and size of the pool of future payday loan users could be rather large.

Before we move on, it is important to note that I am not arguing that Whites, Blacks, and Hispanics have fundamentally different cultural viewpoints in aggregate. As I noted, White and Black non-users alike spoke with disdain for payday lenders and viewed the loans more as a deliberate trap than as a service. The majority of African-American, Caucasians, and Hispanics do not use payday loans, and if the focus groups are accurate, share the same basic understanding of the propriety of the industry. I argue instead that there is a certain viewpoint that is more prevalent among African-Americans than Caucasians and Hispanics that payday lending is “just business” in other words, a legitimate, convenient, morally acceptable form of credit that may be superior to alternatives for a variety of reasons (see below). Those who hold this view appear to be more comfortable taking out loans in a wider variety of circumstances, and more likely to provide positive word-of-mouth advertising to potential customers within their social networks. While holders of this viewpoint may be a minority in each racial and ethnic group studied, differences in the size of that minority appear to be the proximate cause for the observed differences in payday loan usage and willingness to use payday loans in dealing with emergencies. The next question then is why the prevalence of this viewpoint appears to vary according to race and ethnic origin.

One possibility is that differences in perception of payday lenders and payday loans stem from simple differences in understanding of the terms of the loans. It is possible that those who see nothing wrong with payday lending do not understand the interest rates and fees they are subjected to, the relevant laws, or the potential alternatives to payday lending as well as those who are outraged by the practice. In the statistical analysis, I control for educational attainment. The problems of using schooling to proxy for underlying intelligence and ability are well-documented. If I am to argue that educational and intelligence variations are not to blame for the observed discrepancy, I need additional support. Fortunately the focus groups provide such support. The authors of the North Carolina and CRL focus group studies were particularly concerned with capturing variations in financial literacy. It is an open question as to how well the poor understand the options they are presented. The CRL was further interested in detailing payday loan users' understanding of their loan terms. Analyses of both datasets show no variation in understanding of lender terms across racial and ethnic groups. No respondents in any focus group (including non-user groups) could accurately describe the interest rates payday lenders charged. Caucasian payday loan users who believed they were paying 30-40% APR on payday loans expressed outrage at the terms, while African American users expressed satisfaction with higher (but still incorrectly low) perceived rates. Regardless of racial and ethnic background, respondents generally thought of payday loans in terms of dollar fees and showed difficulty understanding interest. When confronted with the reality of 465% APRs, most found no meaning in those terms; they had no reference point by which to judge the size of the number. Furthermore, in the CRL study, Whites, Hispanics, and Blacks alike were surprised to learn that many of the business practices they had come to expect from payday lenders were, in fact, illegal under California law. Some had, for example, been offered two or more simultaneous payday loans from the same lender, a practice explicitly outlawed. There is, in other words, no evidence that White and Hispanic payday lenders are simply savvier than African-American users; perception of the propriety of the payday loan industry among payday loan users does not seem to have any relation to their financial literacy or knowledge of relevant law.

The easy explanations for this variation in perception of payday lending have been thrown out. We now must consider more difficult questions of the historical origin of such outlooks. One overall difference in the way African Americans and Caucasians talk about their experience is with regards to personal responsibility. I have already noted that African Americans locate all potential problems with payday lending in profligate or possibly unhealthy users. The focus on personal responsibility, agency, and choice suffuses discussions on the nature and cause of their financial difficulty, and the propriety of business behavior. African Americans tend to blame themselves for their financial difficulty and often discuss reevaluating their behaviors/strategies as the main pathway out of poverty.

> "I just learned that I have to start managing my money better, and I put myself in those situations before. I was down on my luck at one point and I figure out it's got to be me in control." –African American male

Whites and Hispanics are more likely to see themselves as victims of circumstance, and a broken system.

> "I think it's an exploitation, but I think it's definitely part of the bigger whole. Looking at our economy, we're a capitalistic economy and I don't really expect much difference. Of course, they are there to make a profit. They're there to make money and they've got to do whatever they've got to do to make that money. I understand that aspect of it. I think its part of the bigger whole, exactly why our country is in such huge debt, because we don't have a lot of systems to help people who need money in the moment. Then there is all this guilt of why you should or shouldn't be in that situation. I know there are lots of people who are in this situation." –Caucasian male

Like Whites and Hispanics, African-Americans are negative about their treatment by banks. Black negativity is often explained in terms of lack of choice. Banks are deceptive in signing up individuals for "overdraft protection," without their knowledge, and then for assuming that each overdraft should go through. African American respondents feel cheated out of the decision to take on overdraft protection (most actually do want it) and the right to decide whether a particular overdraft should go through or be denied.

> "I want it to go through and I'll pay the overdraft. But if it is for a 12-pack of soda, deny me. I don't need that." – African American female

> "If it was an emergency [inaudible], yes I would go ahead and pay the overdraft fee. But then I would make it worth it. Instead of getting $20, I would [inaudible] You see what I mean?" –African American male

> "How about the bank -- if like you say, if it's for your mortgage, why can't the bank contact you regarding that and say look, [inaudible] cash a mortgage check coming through. Before we put this through, you know we charge an overdraft fee. I know this is a situation where you've got to pay your mortgage. You've got to pay your rent. Do you want us to go ahead and let this through? This is how much the charge is going to be." –African American male

In contrast Whites and Latinos focus on the exorbitant fees associated with an overdraft.

> "I can order a Snack-shack $2 or $3 item, order 5 or 6 of them in a few days and I didn't know I didn't have any money left. Then when I went to the bank I said where's my other $130? Oh, that's what you owe us for the $30 worth of stuff you just bought. I only spent $30 and $130 was overdraft… They think they did me a favor putting it through." –Caucasian male

As the size of the fees are themselves a moral issue, Whites and Hispanics see little difference between the banks and payday lenders in this regard.

> Hispanic female: "…they know that you don't have the cash and that's why they have a field day. And, as I said, the banks are taking advantage.
>
> Moderator: Well, we're not talking about banks. We're talking about . . .
>
> Hispanic female: Yeah. But I'm simply saying what I said about the banks. They're also taking advantage."

In contrast, African Americans see a relevant distinction between banks and payday lenders that makes the latter morally superior: payday lenders are upfront about their fees and about loan participation, and always offer, "choice" to continue using them. There is perhaps some irony that African American descriptions of moral culpability for poverty and “by one’s own bootstraps,” remedies to personal financial hardship mirror free market enthusiasts’ talking points about the personal responsibility for one’s economic position. How could such a viewpoint become more prevalent in Black communities where the evidence is greatest for systemic failure than in White and Hispanic communities?

Also of note is that some African American payday loan customers see dignity in using payday loans over other alternatives. One woman expresses this dignity such:

> “…what we're doing is great because at least we're not going to Sacred Heart Little Orchard and taking money from these other organizations. I have friends who are on welfare, who have been on welfare for years. I don't want to go on welfare if I don't need to. I don't want to go into Little Orchard and say I need a hand out for a $300 electricity bill when I know I'm collecting a pay check twice a month. I'd rather go in there and pay them (payday lenders) $45 rather than take money from the community or people who need it. So I don't look down on it, and anybody who does that, who has approached me with that, look at least I'm not on welfare. I'm not taking money from the county or the community. I'm paying my dues regardless.”
> –African American female

In allowing for at least the illusion of financial independence, payday loans allow some to distinguish themselves from those who leech off of society. Indeed, as someone with a full-time job, the woman would be ashamed to turn to welfare or charity. Payday lenders first emerged in the early 1990s during the battle over welfare reform. At that time, conservatives and moderate liberals alike decried the supposedly lazy, inveterate welfare recipients who no longer deserved indefinite support. These individuals were often depicted as “welfare queens,” inner city Black women taking advantage of the public largess and producing waves of new dependents. That stigma may have proved upsetting within the Black community as well. Clearly this woman sees payday loans as a superior alternative to the public dole, one that allows her to maintain the dignity of independence and avoid associating herself with a hurtful stereotype. I cannot but speculate on this point, but desire to avoid appearing to confirm unfair stereotypes about African American working class people could explain part of the appeal of payday lending; there is an additional psychic benefit to such loans that Latinos and Caucasians do not experience.

One could argue that, after generations of discrimination and lockout, African Americans simply have diminished expectations about proper treatment by credit providers. What payday lenders do, might not seem any worse than what others have done to the Black community in decades past. Instead of the white-hot rage experienced by Caucasians and Hispanics, African Americans may simply respond to payday lenders' terms and business practices with a resigned sigh or even relief that they were not bilked even further. While this is an appealing hypothesis, it does not seem to be supported by focus group data. First, African Americans do express anger and resentment at some businesses and business practices. As I noted above, Blacks feel that banks rip them off and treat them unfairly. They also express anger and annoyance at credit card companies for their perceived eagerness to raise rates and levy fees for minor infractions committed by otherwise loyal and dependable customers. At the storefront-level, the same African-American respondents who view payday loans as convenient and fair, view rent-to-own stores as unfair and rip offs. There is no evidence that Blacks have simply lowered their expectations across the board. It is clear that they not only prefer some options to others due to convenience, but also due to varying perceptions of the fairness and propriety of loan providers' behavior.

Those generations of discrimination and lockout may, however, still hold the key to explaining these variations in perceptions of fairness and propriety. As I noted above, Whites and Hispanics do not see any distinction between their treatment by payday lenders and by banks and credit card companies. Each charges excessively high fees, and each seems ready to pounce on a customer in a bind. African Americans see a distinction between banks and payday lenders. The latter are up front about their fees, the former hide them in the fine print. A further distinction emerges when respondents discuss discrimination. In the North Carolina focus groups, African American females noted that they feel uncomfortable in banks and discriminated against.

> "They treat you different if you are Black or White coming in that bank. That's a fact. I have a friend that got account there, and the way you be treated at that bank, if you go to the Bank of America or something, you treated different."
>
> "Another thing I notice, too, bank tellers, they treat certain accounts different ways. They look at what kind of check you are cashing, too. Because with my check it comes from the federal government, so it looks like either income tax check or disability check, but it's our paycheck. Every time we get paid they are like, "Oh, you get a check twice a month?" You know what I'm saying?"
>
> * * *
>
> Moderator What I would like you to do is write the answer to this statement, "Imagine a minority man or woman goes into a bank. Describe what you think happens." [Pause.] Okay. Once you are finished writing that, I would like to hear what a couple of you wrote. What did you write, (name redacted)?
>
> Respondent 1: They are watched until they exit.
>
> Moderator: Okay. Now turn the paper. "Imagine a white man or woman goes into the bank. Describe what you think happens." Okay. What did you put differently, was there any difference?
>
> Respondent 2: The teller is friendly, "Hey, how are you doing?" "How can I help you today?" And they start your transaction.

African American focus group participants did not note any discrimination from payday lenders. They instead perceived payday lenders as willing to lend to anyone who had money (including the aforementioned problem users). While Hispanic and White respondents accepted it as fact, some African American participants objected to the idea that poor and minority neighborhoods were being targeted by payday lenders.

> They just place these pay day loan places in convenient locations and they make it convenient for you to take out a loan. It's not like they are knocking on doors saying hey, do you need a loan. –African American female
>
> * * *
>
> African American female: They try to say they target these people. It's not targeting those people.
>
> African American Male: Right.
>
> African American male 2: It's there; it's for everybody. What is happening, they are looking at the fact that a lot of people that are in this category goes there and they try to turn around and say it is targeting them but it's not.
>
> * * *
>
> African American female: the pay day loan places that I go to is in San Mateo and that's not a low income area.
>
> African American male: And they're in upper middle class areas. That's where I went to get my money.
>
> African American male: In upper middle class areas they make them more glamorous so you can't tell it's -- that's how they do it.
>
> * * *
>
> African American male: It's business. If I can get everybody here at the table [inaudible] $50 a week by my own service, you can't be mad at that.
>
> African American female: And you shouldn't specify who you are after. I'll take anybody's money.
>
> African American male: Exactly.
>
> African American female: Because they will.

These opinions may reveal one reason why payday lenders are more popular with African American users. Payday lenders are thought of as offering their services to everyone, rather than singling out a group for differential treatment. Payday lenders locate everywhere. Anyone can enter a payday lending establishment and receive a loan, and at the same terms and interest rate offered to everyone else. Contrast this with the historical treatment of African Americans by banks. At the community level, large portions of the African American community were denied access to credit by the statistical discrimination of redlining. At the individual level, African Americans looking for loans found themselves rejected outright or offered loans at sub-prime rates. Against this historical backdrop, payday lending practices might seem fair and ethical. While Whites and Hispanics focus on the “just price” aspect of fairness in transaction, African Americans, because of the history of racial discrimination in the United States, focus instead on price discrimination and transparency and on the perceived courtesy of treatment they receive (see above).

Finally, note that payday lending emerged as an industry in the early 1990s. If lenders did indeed initially locate and cluster in African American neighborhoods, the African American community has had almost twenty years to adjust to their presence. My data is cross-sectional. While I can use geographical fixed effects to control for current payday lender concentration, I cannot control for the effects of payday lender concentration near respondent’s previous residences. Those who grew or spent a great deal of time in areas with high payday lender concentration may become more comfortable with or at least inured to their presence. They could carry this attitude with them to their current location, and this would affect the statistical results. Future studies of payday lending markets should include longitudinal data to facilitate investigation of the development of consumer perceptions.

It is surprising that African-Americans do not report the same sort of annoyance with interlopers in their communities that Hispanics report. The conflicts between the

African American working poor and middlemen minorities are well-documented. Scholars have written extensively on the tension between Koreans and African Americans in Los Angeles. It is thought that during the L.A. riots in 1991, Korean-owned storefronts were targeted by participants venting their frustration with community problems. Hispanics in the San Jose area identified “Hindu” payday lenders as opportunistic outsiders, yet there is no mention of this in the African American focus group. As the industry is dominated by large chains and there are few, “mom and pop,” payday lenders, it is unlikely that these two groups frequent different organizations with different ownership and employee demographics. It is certainly possible that African Americans are confronted with the same sorts of faces but find no fault in this. On the other hand, it may speak to differences in tactics by payday lenders, who may, in Black-majority neighborhoods, staff their stores with locals in order to better fit into the community. In general, as I noted in my theory section, lenders are not passive participants in moral economy and are often quite savvy to the perceptions of borrowers. Staffing a location with locals is but one of a variety of strategies lenders may utilize to increase comfort and ensure payback, including the development of “friendships,” through small talk, and manipulating informal social pressure through use of debtors’ social networks (i.e. calling friends, family and employer to notify them about failure to pay). I unfortunately do not have any data on the payday lenders themselves (the supply side) so I cannot answer this question definitively. This suggests an interesting avenue for further research.

Discussion:

My analysis of the determinants of payday loan usage reveals several important factors. First, much as with pawn loans, informal support networks play an important role in determining who takes out payday loans. Those who do not list family or friends as sources for emergency support are more likely to take out payday loans. This includes those who list churches and community organizations as sources of emergency aid. While such individuals may turn to those organizations for help in emergencies, they cannot turn to them for the day-to-day help that family and friends can provide. The alternative may be to take out a payday loan. Turning to the decision to take out a payday loan to cope with an emergency, we see that those who give frequently to friends and family are more likely to take out payday loans. These individuals, poor as they are, may be relatively wealthy compared with their alters. This leaves them with fewer options when faced with a crisis. The claims of family and friends also drain resources that could otherwise be employed in financial emergencies.

Unlike in pawn markets, race and ethnicity play and important part in determining who uses payday loans. African Americans were more likely to take out a payday loan, used such loans more frequently, and more likely to state intent to use payday loans in an emergency than otherwise identical White respondents. Analysis of focus group videos and transcripts reveals a corresponding difference in usage (for emergencies or convenience), perceptions of the fairness of payday loans, and ideas about the propriety of payday lenders' business practices. It appears that moral considerations about fairness and propriety shape consumers attitudes about the payday lending and that this translates into differences in usage patterns across racial and ethnic groups.

The moral economy framework again appears to offer additional insights into consumer credit behavior. Informal support networks and moral concerns are both at work in shaping decision making. There is additional evidence that moral beliefs vary according to race and ethnicity. This suggests the importance of context in shaping such beliefs. Through socialization and the reinforcement that comes with social interaction, different ideas about fairness and propriety take hold in communities. I have presented evidence that African Americans identify fairness in the payday lending industry in equality of access and absence of price/interest rate discrimination. Whites and Hispanic instead see the size of the fees/interest rates as morally problematic elements of the transaction. The data suggest that these differing ideas about what constitutes fairness in lending originate in the very different historical experiences of each group.

Moral outrage can bring informal sanctioning. We see some evidence of that in the behavior of White and Hispanic payday loan users. These individuals are poor and have command over few resources. As such, their sanctioning power is limited. Nevertheless they make their disapproval known in two main ways. First, unlike African American users, White and Hispanic payday loan users claim to only use such loans in emergency situations. They have obvious disgust for the loan providers and would rather not give them their business when it is merely convenient to do so. African American users generally feel they are treated fairly and seem to be comfortable using payday loans for, "credit crunches," in addition to emergency situations. Second, Whites and Hispanics express their outrage by warning friends and family about their experiences. Focus group participants were, on the whole, unwilling to recommend the service to those asking them for advice. In fact, they would explicitly recommend that they steer clear of such loans. African Americans, on the other hand, were overall willing to recommend payday loans to family and friends. They would caution them to borrow responsibly but were otherwise happy to recommend what they saw as a fair and convenient option. Remember that word-of-mouth referral was the second most common way that first-time payday loan learned about the service. By refusing to refer loved ones to payday lenders and by relating their negative experiences through, "horror stories," dissatisfied payday loan users limit the business of their creditors. If this has contributed to the lower concentration of payday lenders in working class White and Hispanic neighborhoods, it is a testament to the power of social networks in shaping industry profitability.

E. P. Thompson's work suggests that when we see moral outrage we will also see distinctions between community outsiders and insiders, with the latter held to a higher standard. In the case of Hispanic payday loan users, we do see that some make such a distinction. Payday lenders are identified as community outsiders, Whites and "Hindus" who are preying on the Latino community. However, where Thompson's peasants saved most of the ire for community insiders who shirked obligations to the community, Hispanic payday loan users express their anger at predatory outsiders. Of course, we cannot determine how such individuals would react to Latino payday lenders from their communities. It may be that such individuals would receive stronger condemnation. Furthermore, Whites and African Americans make no insider/outsider distinction. Payday lenders are culpable or not based on differing moral principles but not based on differing origins.

Chapter 6: Latent Class and Cluster Analysis of Emergency Strategies

The analysis thus far has focused on the decision to use a particular "fringe banking" service such as a pawn or payday loan. The reality is that people rely on a combination of formal and informal aid sources to make ends meet. In this section I explore the bundles of informal and formal aid that constitute the strategies respondents would use to deal with a hypothetical emergency. Using hierarchical cluster and latent class analyses, I sort individuals into groups according to the strategies they employ, and then explore the determinants of group membership through statistical modeling. This approach is superior to simply including information about other sources of aid as independent variables in models of pawn or payday loan usage and noting the correlation. That tactic introduces the implicit assumption that the decision to use a particular source of aid is an ordered process, i.e. that the household/individual decides whether it can or should use a particular source of aid before moving on to a lower rank/less desirable source. While this may certainly be the case (especially if one is seeking to avoid asking for help from friends and family, as discussed above), many such aid decisions may instead be made simultaneously in parallel. The techniques employed in this chapter do not introduce any assumptions about the order of decisions, leaving that instead as an empirical question

The Making Connections Cross Site Survey asks respondents how they would cope with an emergency scenario[10]. Respondents were given a choice of twelve options including, "would not pay," and "other," and, unlike in the similarly worded question in the North Carolina survey, were allowed to choose as many options as they liked. As a

[10] As a reminder, the "emergency," consists of a bill equaling half a month's salary that must be paid off within two weeks.

result, we have information on the constellation of strategies employed by participants when faced with a sudden financial crisis. The following sections detail my analysis of the responses to this question.

Hierarchical Cluster Analysis:

Hierarchical cluster analysis is a technique designed to sort observations into groups according to their scores on a variety of *continuous* measures. As our indicators are yes/no dichotomous variables, it would seem that the technique is not appropriate. It is however, relatively simple to convert discrete variables into the appropriate form using Jaccard or Russell-Rao similarity measures. These transform the data into proportions amenable to analysis with clustering algorithms. Below I present results from a hierarchical cluster analysis of data on emergency strategies using Ward's Linkage

After running a clustering algorithm, researchers determine the number of distinct clusters using a "stopping" rule. The two most common are the Calinski-Harabasz pseudo F index (1974) and the Duda-Hart Je(2)/Je(1) index (1973). Analysis of the clustering results suggests either six or seven distinct clusters. The results using the Calinski-Harabasz stopping rule are as follows:

1. use of: savings, credit cards and family loans/gifts (1393 observations)
2. use of: savings, family loans/gifts, and sale of personal property (2616 observations)
3. use of: family loans/gifts and loans/gifts from friends (381 observations)
4. those who would not pay (950 observations)
5. those who chose the "other" option (487 observations)
6. use of: family loans/gifts (594 observations)

7. use of: savings (644 observations)

Clusters are ideal types in that they identify the overall "theme" of the group. For example, individuals in groups one or two may have also used pawn loans or payday loans but these individuals would be in the minority; their use of these options would not be representative of the other respondents in the cluster. Just from eyeballing the data we can see the importance of family support in coping with financial emergency. Family aid is part of the strategy employed in four of the seven clusters. The largest cluster of respondents employs such family aid along with savings and the sale of personal property, which underscores the importance of accumulated wealth in staving off disaster. We also see that pawn loans, payday loans, and other sub-prime options like car-title loans do not constitute the basis for any coping strategy captured in the cluster analysis. While individuals do turn to these options, they do not form a coherent group. Perhaps surprisingly, we also see that "I would not pay," is a fairly common response to financial crises. 950 of the 7065 (about 13.4%) respondents captured in the analysis would not pay the hypothetical bill. This is either because they are unwilling or unable to gather the necessary resources. Social scientists do not adequately understand the factors that determine one's willingness to walk away from a debt. The topic is timely given the recent collapse of the U.S. housing market and the decision by some to continue to pay home mortgages despite negative equity, a decision that clearly incorporates moral considerations.

While hierarchical cluster analysis gives us some insight into the strategies respondents employ, we can improve upon our grouping by turning to latent class analysis. Latent class methods use analysis of variance to uncover the classes to which observations belong. The method is quite similar to that used in factor analysis. It has the advantage over hierarchical cluster analysis of being specifically designed to deal with dichotomous data. As a result, it may provide more precise information on underlying patterns in the responses. I present results of latent class analysis of the same response data below.

In determining the number of clusters above, we used stopping rules. Here we use well-known "information criteria" to determine the number of latent classes. We have a choice of the Akaike Information Criterion (AIC) or the Bayesian Information Criterion (BIC). The AIC suggests at least 14 latent classes[11], while the BIC clearly suggests 9. See the appendix for results. While the criteria recommend different class numbers, they capture the same broad patterns. The classes can be organized into approximately seven "super classes." These are as follows:

1. Those who would not pay, approx. 5% of the population
2. Those who chose "other," approx. 4% of the population
3. Those who would rely primarily on some combination of support from family and friends, approx. 34% of the population
4. Those who would rely primarily on some combination of savings, credit card use, bank loans, and sale of personal property, approx 32% of the population
5. Those who would rely primarily on a combination of aid from family/friends and savings/credit, approx. 9% of the population
6. Those who would rely primarily on pawn loans with some combination of

[11] Above 14 classes, the class algorithm does not converge given the large number of observations.

support from family/friends and credit/savings/sale of property, approx. 12% of the population

7. Those who would rely pawn and payday loans along with a combination of support from family/friends and credit/savings/bank loans/ sale of property, approx. 4% of the population.

Remember that these categories are ideal types and thus do not describe behaviors engaged in by a minority of class members. Thus, while payday loans only appear as part of a coherent strategy in the 7th super class, a minority of respondents in the other classes (except, "no pay") also used payday loans. In fact, 9.5% of respondents in the North Carolina survey report taking out at least one payday loan in the previous 24 month period, and 10.7% of Making Connections (second wave) respondents reported that they would take out a payday loan in an emergency.

Analysis of the latent classes shows that most respondents fall into just two categories: those that rely primarily on family and/or friends with little other aid, and those that would rely primarily on mainstream formal credit (bank loans, credit cards) and personal wealth (savings and the sale of personal property). About 9% of the population relies on a combination of wealth/mainstream credit and informal sources, and about 16% relies on a combination of wealth/mainstream credit and fringe banking sources like pawn shops and payday loans. Fringe banking thus appears to be utilized mainly by people who are willing to use <u>any</u> source of aid in an emergency or who must turn to multiple sources to raise the necessary funds; there are few individuals who rely only on pawn or payday loans (or the rarely mentioned title-loans) to survive a crisis. As noted, it appeared in focus group reports that some individuals turned to payday loans to avoid having to ask family and friends for help. This attempt to substitute payday loans for aid from family and friends may appear to contradict the above. Remember however, that these individuals were often attempting to avoid asking friends and family for help *again.* In an emergency situation, they might be forced to swallow their pride and ask for further assistance. Some also noted that they asked their family for aid but were uncomfortable asking for large amounts. These individuals borrowed (or were gifted) small amounts from friends and family but would not reveal the full extent of their need. If this left them unable to raise enough money purely from their informal support networks, they might then turn to other sources of funding like payday loans or pawn shops.

It is perhaps surprising that only about 9% of the sample population primarily uses a combination of wealth, mainstream credit and informal support from friends and family. It appears instead that there are two distinct groups of individuals who use only (or mainly) one or the other type of support. There are several possible causes for this. One is that formal mainstream credit is preferred over informal sources of support and used if possible. This would suggest that individuals in the mainstream credit only category are simply richer and thus have the resources necessary to avoid turning to friends and family. As I found in my analysis of focus group transcripts that individuals from all backgrounds felt shame turning to family and friends for help, this is a reasonable hypothesis. On the other hand, Townsend (see theory section) noted that some individuals seemed to simply prefer relying primarily on friends and family regardless of their income/wealth and the availability of more formal options. To investigate this further, we need to construct a statistical model predicting class membership. In the following section, I present results of a multinomial logistic regression of class membership.

Multinomial Logistic Regression:

Table 12 displays results from a multinomial logistic regression of the seven "super class" categories on a variety of demographic, financial and community characteristics. The default reference category is the one that includes the most observations. In this case, that is the class that includes those who would rely primarily on some combination of savings, credit card use, bank loans, and sale of personal property. The coefficient/variable combinations describe the likelihood that a respondent with the given characteristics will appear in that category rather than in the reference category. Thus one should interpret the results as speaking to relative probabilities.

(Table 12 about here)

Turning first to financial characteristics, we see that as income increases, one becomes less likely to be in the "no payment," "payday loan," pawn shop" and "family and friends only," categories. The latter result means that, overall, people prefer to use savings and formal credit to deal with their financial emergencies if possible. That individuals with higher incomes are less likely to be in the "friends and family only" category, suggests that they view this form of support as inferior to formal credit. Increased income does not however, make one less likely to appear in the class that captures those who use a combination of formal credit and support from family and friends. This suggests that individuals with higher income are still willing to augment their crisis strategies with aid from family and friends. The coefficients on the various savings and wealth variables back up this assertion. Those with savings accounts, savings for an emergency, and credit cards appear to employ them to avoid falling into a situation where they must rely on family and/or friends.

When we examine informal aid to/from friends and family we see a few trends. Those who receive monetary aid are more likely to be in each category (including "no payment," and "other") other than the reference. Those who are willing or able to take advantage of sources other than savings and credit cards in everyday life appear willing or able to do so in emergency situations as well. Their presence in the "no payment," category is harder to explain given the extensive controls for income and personal wealth. When we look at in-kind aid (e.g. rides, cooking, babysitting, etc.) we see an interesting correlation. The more often one received non-monetary help from family, the more likely one is to appear in the, "friends and family only," or the, "formal credit and support from family/friends" category. Increased non-monetary help from friends, on the other hand, only increases one's likelihood to be in the latter category. Whatever a friend offers, it does not appear to be enough to cause a respondent to rely exclusively on these individuals for aid in an emergency. On the other hand, a subset of those who receive extensive non-monetary aid from family expects to rely exclusively on family and friends in an emergency. These variables capture the frequency of non-monetary aid alone. We do not know anything of the "value" of the favors/support traded or the type. The results suggest that individuals receive different types or "amounts" of non-monetary aid from family and friends.

The results on race are also of interest. Blacks are more likely to appear in the "no payment," "family and friends only" and "payday loans plus" categories than Whites. This is even after controlling for income, wealth and access to credit. The increased likelihood to appear in the “no payment” category rather than the “savings and formal credit” category is surprising given these controls. It is possible that there are important aspects of personal wealth that are not captured in my controls. On the other hand, it may represent a certain segment of the African American population that feels no obligation to pay a bill despite ability to do so if it would drain vital resources. This result suggests once again that race determines experiences that shape one’s understanding of rights and obligations in credit market behavior. The greater likelihood that African Americans appear in the “family and friends only,” category, suggests that at least some African Americans prefer to use networks of informal support even when they have formal options available. This may be related to black perceptions of how courteously they are treated by formal financial institutions (see previous chapter).To get a better idea about why this is the case, we would have to know a bit more about respondents’ family histories. Those who grew up relying on the aid of friends and family may continue to do so out of habit or preference even after obtaining access to greater financial resources. On the other hand, those who grew up with access to formal credit may prefer it. Unfortunately we cannot say more given the limitations of the data.

African Americans are less likely to find themselves in the, “formal credit and support from family and friends” category. Thus they appear less likely to mix these forms of support than Whites. Note however that they are more likely to find themselves in the “payday plus,” category. If an African American respondent utilizes more than one form of support (e.g. formal credit, informal support networks, fringe banking), he is likely to use all available forms of support.

Asians, like Blacks, are more likely than Whites to end up in the “family and friends only," or the "payday plus," categories than the "formal credit," category. Unlike Blacks, they are also more likely to appear in the "formal credit and support from family/friends" category. This suggests that Asians employ a variety of strategies to deal with financial crises but that they are less likely to rely on formal credit alone. Since Asian is a broad category that can include individuals from a variety of national origins, it is not surprising that we see such variation. Unfortunately, without more specific statistical data or qualitative interview data, there is little more that we can see about this.

Hispanics in the dataset are more likely to be found in the, "pawn shop," "payday plus," and "other" categories than White respondents. This is despite my finding that Hispanics are no more likely to actually use pawnshops or payday lenders in everyday life than Whites. This suggests that in emergency situations, Hispanics are likely to use a wider variety of options than Whites, even if they are otherwise indistinguishable in behavior during "ordinary" circumstances.

Discussion:

The cluster analysis reveals more about the strategies employed by working class individuals to deal with emergencies. Most respondents ((about two-thirds) rely on credit, personal savings, and bank loans on the one hand, or aid from family and friends on the other. Ordered logistic regressions show that wealthier people and those with greater incomes are more likely to appear in the former category than the latter. Thus overall, respondents appear to prefer using formal, mainstream sources of credit exclusively if possible. Given the obvious displeasure focus group participants expressed at turning to family and friends for aid, this is not surprising.

Only about 9% of respondents relied on a combination of informal support and mainstream credit sources alone. Those that relied on a variety of sources were more likely to augment their emergency funds with payday and pawn loans; every pawn loan or payday loan reduces the money one must request from friends and family. Blacks are less likely than Whites to be in the informal/mainstream credit category and more likely to be in the "everything" categories that include pawn and payday loans. This result is consistent with accounts given by focus group participants. While White payday loan users clearly disliked asking friends and family for help and were clearly willing to use payday loans under desperate circumstances, they held a strong distaste for the loans and did what they could to avoid giving additional business to the providers. African American payday loan users expressed greater comfort using payday loans in emergency situations as well as in less serious, "cash crunch," scenarios. When White respondents are unable to meet an emergency need through use of mainstream credit and savings alone, they are likely to ask family and friends for help. When Black respondents are unable to meet an emergency need through use of mainstream credit and savings alone, they are more likely to turn to fringe banks in addition to asking family and friends for support. Note however that this model is unable to control for area-level effects. To some extent then, the results may speak to the availability of fringe banking options in an area, as well as to the salience of said options.

When I proposed the moral economy framework, I argued that expectations, obligations, and beliefs about the propriety of business practices create an interplay between formal and informal sources of credit. Individuals use a variety of sources to meet their emergency needs. Those who object to their treatment at the hands of creditors may rely more heavily on family and friends for support. Those who cannot stomach further assistance from friends and family may turn to potentially pernicious forms of credit like payday lending. The results of the cluster analysis show that the differences we see in preference/willingness to use one form of credit translate into different portfolios of credit sources and different emergency management strategies. Those who find little objectionable in the terms of payday lenders and pawn shops expand their pool of aid. Presumably they ask for/receive less from their family and friends as a result. This may spare them the embarrassment of revealing their difficulties to loved ones or the shame of hearing the "money management" speech but at a cost; the 400% plus APR associated with payday loans destroys what little wealth the loan recipients may have had and leaves them vulnerable to further shortages.

We must consider the long term effects on social stratification of these patterns of aid. Networks of informal support can spread the costs of a financial shock across many individuals. Each absorbs part of the emergency with gifts and loans. Those who minimize this support by turning instead to fringe banking suffer the effects of a financial shock more acutely in the form diminished savings, less money to spend on other necessary goods, and longer repayment periods. This essentially disables such individuals in the long term and leaves them vulnerable to future shocks. What happens at the network level in aggregate is an interesting empirical question. In turning to short term, high-interest loans, such individuals prove less of a drain on alters' resources in the short run. This may diminish the leveling effect associated with networks of reciprocal exchange, allowing some to get ahead at the expense of others. Poverty then would become more concentrated in a smaller group of individuals within a community but far more severe. On the other hand, in the long run, such loans may place borrowers in particularly desperate situations. If they then to turn to alters, they may create a drain on resources far greater than if they had asked for help during the crisis that precipitated the downward spiral. We must also remember that informal support comes from networks of *reciprocal* obligation. If friends and family offer aid to a loved one in need, there may be an understanding that there will be a time when the roles are reversed. By taking out a short term loan instead of asking family and friends for support, a borrower may, in a sense, be limiting their options if and when they are faced with a similar need. They may then find themselves taking out payday and pawn loans, creating another cycle of debt. As a next step, researchers should consider longitudinal studies of payday loan recipients and their friends and family. By tracking outcomes, we can get a sense of the ramifications individual credit decisions for broader social networks.

Conclusion:

My dissertation research focuses on how moral considerations about debt, familial obligation, and the propriety of business practices affect consumer behavior within credit markets for the poor. It is an attempt to bridge the gap between the normative/cultural and structural/relational approaches to economic sociology using both quantitative statistical modeling and qualitative analysis of focus group transcripts and video. I find compelling evidence that there are persistent statistical differences in payday and pawn loan usage across racial groups that cannot be explained by disparities in wealth and credit access. Instead, they appear to be the result of variations in the perception of the propriety of such loans, variations that may have their root in the legacy of racial discrimination in credit markets in the United States. Furthermore, I find that, regardless of racial or ethnic background, those who use such loans often do so to avoid the shame and embarrassment of turning to friends and family for support. Indeed, in focus group interviews, willingness to ask for help from parents, in-laws and friends appears to be the main distinguishing feature between those working poor individuals who regularly rely on payday lending to get by and those who don't. My findings suggest that this willingness has an important impact on economic outcomes. In future research, I will explore cross-cultural and cross-group variations in the extent to which it is considered normal or shameful to ask for help from close friends and relatives. Both Granovetter (1995) and Stack (1997) touch upon this theme.

My work provides a good foundation for further research into the functioning of morality in markets. I have only briefly touched on the moral debate about such markets and have not yet considered the beliefs and strategies of the lenders themselves. Also, the insights garnered from my analysis of these credit markets have clear application in other contexts. This suggests several avenues to expand my research into such markets.

One extension is to focus on the competing efforts of lobbyists, advocacy groups, and media to shape the debate over the propriety of the payday lending, pawn, and check cashing industries, impose their preferred frame, and shape policy at the state and federal level. Rather than treat the markets as static arenas within which borrowers and lenders interact, I would focus on the continual evolution of the regulatory regime that defines the terms of exchange. A structural approach to a moral debate calls for the identification of important interest groups, the isolation of crucial ties between relevant parties, and a focus on resource mobilization. Further attention must be paid to the nature and number of relevant social ties as power differentials, information flow, and peer influence are crucial to our understanding of structural mechanisms.

The purveyors of payday and pawn loans are a logical focus for further analysis. Participants in the focus groups I analyzed occasionally mentioned tactics used by such creditors to ensure repayment. Those late in repayment found that lenders would contact their friends and family to let them know that the debtor was in arrears. They would then be faced with the embarrassment of having their financial situation exposed to loved ones and pressure from these same individuals to repay. This suggests that lenders are savvy and actively use informal social pressures as part of a profit-maximizing strategy. I also find that Latino payday loan users are suspicious of payday lenders and cast them as outsiders (mainly Indians) intent on pillaging their community (i.e. the classic tension between the working poor and so-called “middleman” minorities). African Americans in the same region, perhaps surprisingly, do not share this assessment. As these store fronts are owned and operated by the same small group of individuals, this suggests that payday lenders have employed strategies to integrate into communities that have only partly succeeded. What these strategies are, and why they were apparently effective in winning over African Americans but not Latinos, is a question that deserves further attention.

Another promising extension is to apply this form of analysis within other markets where need and desperation make the moral component of decision making obvious. Markets for essentials in the aftermath of a natural or man-made disaster provide a nice example. In such markets, consumers often have to deal with, "price gouging," merchants. That such merchants have raised their prices above some previous average is rarely in question. Instead there is a debate as to whether that price increase is justified, whether by a concomitant rise in cost, some special considerations, or by reference to the fairness/moral superiority of supply-and-demand-based rationing. As Kahnemann et. al. (1985) demonstrated, people are less likely to consider prices set by change in demand to be fair if they deviate too far from previously set, "reference prices." There are fascinating questions of how community members determine that a merchant has violated some general obligation or obligation specific to fellow community members, and how they go about formally or informally sanctioning that merchant. It is clear that network structure plays a crucial role in these determinations, by shaping perceptions of in-group/out-group, by determining monitoring and enforcement capacity, and by partly determining which norms hold in which communities. Models that consider both moral and structural aspects of behavior thus hold great promise. Moreover, they provide a basis from which to begin analysis of how the moral concerns of community shape legislative efforts.

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