Nudging Consumers to Use Tax Refunds to Repay High-Interest Debt

Researchers:

Jeremy Burke

Dean Karlan

Jonathan Zinman

Sector(s): Finance

Fieldwork: Innovations for Poverty Action (IPA)

Location: United States of America

Sample: 8,364 tax filers

Target group: Urban population Adults

Outcome of interest: Earnings and income

Intervention type: Nudges and reminders

Partner organization(s): Baltimore CASH

While many low-income Americans have costly debt, they typically spend only a small proportion of their tax rebates to repay those debts. In partnership with Baltimore CASH, researchers are introducing postcards that encourage low-income tax filers to use their tax rebates to pay off debt, and varying the timing of postcard delivery, to evaluate the impact of these nudges on debt repayment.

Policy issue

Many Americans, especially those who are low- or middle-income, have costly debt in forms such as credit cards, late utility bills, and payday loans. In 2011, 69 percent of US households held some form of debt, and the bottom quintile had a median unsecured debt of US$5,000.[1], When debt becomes overly burdensome, households may either pay late or fail to pay at all, which adversely affects credit and can have implications for employment, housing, and insurance eligibility.[2], Thus it can be more advantageous for households to focus on reducing their debt before building up their assets.Tax rebates, whether via overpaid taxes throughout the year or programs like the Earned Income Tax Credit, may provide a sum of money that taxpayers can use to pay off part of their debt. Despite many people saying they plan to use some of their rebate to pay off debt, one study suggested that rebate recipients spend only 6 to 10 percent of their rebate on debt reduction (around US$35-50 as of 2008).[3], Procrastination or limited attention might explain in part why taxpayers often do not act on these plans.[4] Can nudges to use tax refunds to pay off debt lead to higher debt repayment rates among low-income tax filers?

Context of the evaluation

Baltimore CASH Campaign is a non-profit that works to increase the financial security of low-income individuals and families. Their Volunteer Income Tax Assistance (VITA) program provides free tax preparation at around 18 different sites around the Baltimore area and serves around 9,000 households per year. This evaluation takes place among Baltimore-area residents who had their taxes prepared by Baltimore CASH in 2014. As part of their programming, Baltimore CASH sends yearly postcard

reminders for clients to return to the VITA site for assistance in preparing their taxes.



Internal Revenue Service Building.

Photo credit: Mark Van Scyoc, Shutterstock.com

Details of the intervention

Researchers partnered with Baltimore CASH to conduct a randomized evaluation that tested the impact of nudges to use tax rebates to pay off debt, in the form of postcards, on debt repayment.

The research team randomly assigned 8,364 clients who filed a tax return with Baltimore CASH in the 2014 tax year to one of two postcards:

1. *Appointment reminder (4,181 people):* These tax filers received the standard postcard sent by Baltimore CASH in early January reminding them: (a) of the services that Baltimore CASH offers and (b) to schedule an appointment to prepare their taxes with Baltimore CASH.
2. *Appointment reminder plus debt payment encouragement (4,183 people):* These tax filers received postcards in early January with the same information as the appointment reminder group, plus a simple encouragement to use a portion of their tax refund to pay off debt.

To examine the importance of timing of the nudges, in addition to the above postcard, 3,325 individuals were randomly assigned to receive an additional postcard in early March (two months later and near the time when tax refunds would be received). This postcard reminded them to use their tax refund to pay off debt and provided them with information about available credit counseling and debt management services.

To measure the impact of these messages, researchers collected credit reports and survey data about a year to a year and a half after the postcards were sent, in December 2016 to May 2017.

Results and policy lessons

Results forthcoming.

---

1. Vornovytskyy, M., Gottschalck, A., & Smith, A. (2013). Household Debt in the U.S.: 2000 to 2011, . United States Census Bureau. Accessed November 2, 2017. |United States Census Bureau. (2013). Debt of Households: 2011. Wealth and Asset Ownership. Accessed November 2, 2017.

2. Benton,Marques, Stephan Meier, and Charles Sprenger, "Overborrowing and Undersaving: Lessons and Policy Implications from Research in Behavioral Economics," Discussion Paper (Federal Reserve Bank of Boston, 2007). Accessed November 2, 2017.

3. Bertrand, Marianne and Adair Morse. 2009. "What Do High-Interest Borrowers Do with Their Tax Rebate?, ," *The American Economic Review* 99, no. 2: 418–23. Acessed November 2, 2017. |Sumit Agarwal, Chunlin Liu, and NicholasS. Souleles. 2007. "The Reaction of Consumer Spending and Debt to Tax Rebates—Evidence from Consumer Credit Data." Journal of Political Economy 115, no. 6: 986–1019. Accessed November 2, 2017.

4. Zinman, Jonathan. 2015. "Household Debt: Facts, Puzzles, Theories, and Policies."*Annual Review of Economics*7, no. 1: 251–76. Accessed November 2, 2017.