

Researchers

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Timeline

2015-2018

Sample Size

6997 clients

Research Implemented by IPA

Yes

Can Prize-Linked Incentives Promote Debt Reduction in the United States?

Abstract

Large debt burdens are a significant threat to financial stability for many households. Innovations for Poverty Action worked with researchers to evaluate whether prize-linked incentives can help borrowers reduce their debt burdens more effectively. A randomly selected group of borrowers on debt repayment plans were offered entry into a program that turns on-time debt repayments into entries in a lottery. Researchers studied whether prize-linked incentives influence debt reduction, delinquency and default, programmatic retention, and whether the program can be financially self-sustaining. Researchers found strong take up of the program (74 percent of those offered accepted) and that takers were timelier with repayment and paid off more debt. However, these effects were driven by selection, with no impact found on those randomly offered the incentive program. These results suggest that prize-linked incentives may simply attract individuals who are already more likely to repay their debts, and not causally change behavior.

Policy Issue

As of January 2015, Americans held approximately \$870 billion dollars in outstanding credit card debt.¹ High levels of debt can be financially problematic for consumers, particularly unpaid balances, which compound, growing as they remain unpaid. One approach to help people repay debt is Debt Management Plans (DMPs), in which providers negotiate a repayment plan with creditors on the borrowers' behalf based on their monthly budget. However even with a DMP, those in debt may face repayment obstacles including income constraints, unexpected financial setbacks, and common behavioral tendencies to put off difficult tasks, even when in one's own long-term best interest.

Prize-linked programs are becoming an increasingly popular approach to try to incentivize people to engage in positive financial behaviors. Designed similarly to a lottery, participants

in a prize-linked program are offered a chance to win a prize every time they engage in a specific financial behavior. While prize-linked programs are popular in many countries, they are usually implemented to try to promote savings, and there have been few randomized evaluations investigating whether prize-linked incentives can promote positive financial behavior. In the United Kingdom, for example, data suggests that consumers prefer prize-linked savings products, but there is no evidence that they promote behavioral changes. While there is reason to think that prize-linked incentives might help consumers improve their financial behavior, whether they actually do is still unknown, particularly in regards to debt reduction.

Context of the Evaluation

Innovations for Poverty Action worked with a non-profit debt management provider who serves clients with outstanding debt in all 50 US states. The DMP consolidates non-Mortgage, non-Student, and non-Auto debt. Their average client is approximately 40 years old, earns \$40,000 per year and owes approximately \$17,500 in unsecured debt. A typical DMP plan lasts three to five years, but only approximately a third of clients successfully complete the program.

Details of the Intervention

Innovations for Poverty Action worked with researchers to test whether prize-linked incentives improved debt reduction, decrease defaults and delinquencies, improve programmatic retention, and whether these incentives could be offered in a financially self-sustaining fashion.

IPA and the debt management provider randomly offered selected existing clients and newly enrolled clients a chance to participate in a prize-linked debt repayment program. With each on-time monthly debt payment in 2016, participants were entered into a monthly drawing to receive \$500 to be applied to the balance of their DMP. Each successful monthly payment also granted the participant one entry into the end of the year grand prize drawing; \$10,000 to be applied to the balance of their DMP. Clients received monthly emails about the winners of sweepstakes drawings. The researchers measured the effects of the program on timely DMP repayment, balances on other outstanding debts, bankruptcy, and other indicators of financial health.

Results and Policy Lessons

In total, 74 percent of the treatment group elected to participate in the prize-linked incentives program. While study participants who took up the prize-linked incentives program were more effective in repaying their debt than individuals who did not participate in the incentive program, researchers found strong evidence that these effects were driven by selection (i.e., takers were already more likely to improve their repayment behavior) and very

little evidence the program caused the changes in repayment behavior. Participants offered the prize-linked incentives were no more effective in reducing their debt burdens than individuals in the comparison group. These results suggest that prize-linked incentives may not modify behavior and may simply attract individuals who are already more likely to repay their debts.

Sources

¹Federal Reserve Bank of New York, 2019. Quarterly Report on Household Debit and Credit. <https://www.newyorkfed.org/microeconomics/hhdc.html>

October 09, 2019