

1 Overview of Project

Credit checks are currently widespread- in a 2009 survey by the Society for Human Resource Management, 60% of human resources representatives reported running a credit check on potential employees (Uncredited (2010)). Some observers believe that credit checks can create a poverty trap: a pernicious cycle in which an unemployed worker has bad credit because he cannot find a job, therefore cannot earn enough income to pay his debts, therefore cannot improve his credit score. Policy makers are concerned about this possibility: many states have introduced legislation restricting the ability for employers to run credit checks ¹ and similar legislation has been drafted at the federal level (U.S. Congress (2009), U.S. Congress (2011)).

We have developed a theory in which employer credit checks can create poverty traps. This requires that workers have superior knowledge of their own productivity, but that their credit history provides additional information to prospective employers. We think of credit history as a signal of whether or not the worker has recently filed for bankruptcy, as is standard in the quantitative macroeconomics literature (Chatterjee, Corbae, Nakajima, and Ríos-Rull (2007), Livshits, MacGee, and Tertilt (2007)). Workers are driven to file for bankruptcy for various reasons, some of which relate to their productivity (both current and future) and some of which do not (such as divorces or uninsured medical expenses). Currently, in most states, employers can observe a worker's credit score and use it in hiring and promotion decisions. If enough bankruptcies are due to negative productivity shocks, then bankruptcy will carry a stigma in the labor market- those with bad credit will either get low wages or no job at all. If the cause of the bankruptcy cannot be perfectly observed by the employer, then there are some workers who cannot find a job commiserate with their productivity (those who went bankrupt due to unexpected expenses). These workers find themselves in a poverty trap.

We are now extending the model to address quantitative questions and to use as a computational laboratory in which we can evaluate policy reforms like those being considered at the state and national level. Our model allows us to quantify the welfare effects of restricting employee credit checks for the average worker. Furthermore, we will identify the redistribution effects of the policies-which workers benefit and which lose.

2 Current State of the Project

As mentioned above, we have developed a theoretical model. We have thoroughly studied the static version of the model and are currently writing a computer program to solve the dynamic version. The dynamic model does not have a simple solution, and must be approximated numerically. This is the first step towards mapping the model to the data. Once this is finished, we can perform policy experiments in line with those currently considered at the federal and state level. Specifically, we will ask what happens to employment and wages when employers are no longer allowed to observe whether a worker has previously filed for bankruptcy. This will allow us to answer the question:

¹See <http://www.ncsl.org/issues-research/banking/use-of-credit-information-in-employment-2011-legis.aspx> for a current list of state legislation.

“Who gains if employers cannot use credit histories, who loses, and by how much?”

We have presented preliminary results of a previous iteration of this project at conferences and invited seminars. We are currently incorporating the suggestions we received in a new draft of the paper. The feedback from those presentations was overwhelmingly positive, but also directed us toward more tractable modeling choices. One of these we believe to be a more general technical contribution to the macroeconomic literature. Classical economic analysis is most effective when studying *marginal* decisions. Many household decisions, however, are *discrete* in nature- the default decision being the focus for us. When the shocks that drive these discrete choices affect the budget in a dynamic model, they create a host of technical difficulties and counterintuitive decision rules (for example, default may not have a simple cut-off rule with respect to income shocks, as in Chatterjee, Corbae, Nakajima, and Ríos-Rull (2007)). We have found a specification of the household’s decision making problem with discrete choices that can be solved in nearly the same way as when decisions are marginal. We think this is new to the literature and will allow us to study discrete choice problems that were previously intractable.

References

CHATTERJEE, S., D. CORBAE, M. NAKAJIMA, AND J. RÍOS-RULL (2007): “A quantitative theory of unsecured consumer credit with risk of default,” *Econometrica*, 75(6), 1525–1589.

GLOVER, A. (2012): “A Quantitative Rat-Race Theory of Labor Dynamics,” *Working Paper*.

GLOVER, A., AND J. SHORT (2012): “Bankruptcy, Incorporation and the Nature of Entrepreneurial Risk,” *Working Paper*.

LIVSHITS, I., J. MACGEE, AND M. TERTILT (2007): “Consumer bankruptcy: A fresh start,” *The American Economic Review*, 97(1), 402–418.

UNCREDITED (2010): “Background Checking: Conducting Credit Background Checks.,” *Society for Human Resource Management*.

U.S. CONGRESS (2009): “H.R. 3149, Equal Employment for All Act,” .

———— (2011): “H.R. 321, Equal Employment for All Act,” .

3 Proposed Budget

1. Travel, 2013- \$5000.00
2. Research Assistant, Summer 2013 - \$15000.00

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Education

Ph.D. Economics, University of Minnesota, 2011.

B.S. Mathematical Economics, Ball State University, 2006.

Employment

Assistant Professor, Department of Economics, University of Texas at Austin, July 2011–present.

Research

Research Interests

Macroeconomics, Labor Economics, Entrepreneurship

Publications

"Facts on the Distributions of Earnings, Income, and Wealth in the United States: 2007 Update," with Javier Diaz-Gimenez and Jose-Victor Rios-Rull, Federal Reserve Bank of Minneapolis Quarterly Review, February 2011, Vol. 34 No. 1

Working Papers

"A Quantitative Rat-Race Theory of Labor Market Dynamics", 2011

"Bankruptcy, Incorporation, and the Nature of Entrepreneurial Risk", with Jacob Short, 2011

"Intergenerational Redistribution in the Great Recession", with Jonathan Heathcote, Dirk Krueger, and Jose-Victor Rios-Rull, 2011

"Can Learning About Growth Solve the Allocation Puzzle?", with Gina Pieters, 2010

Work in Progress

"The Effect of Workforce Quality on Firm Value", with Jacob Short, 2012

Teaching

University of Texas

Macroeconomic Theory (PhD)- Fall 2011

Intermediate Macroeconomics- Fall 2011

University of Minnesota

Numerical Methods for PhD Students- Summer 2010

Introductory Macroeconomics- Fall 2007, Spring 2008

Conference and Seminar Presentations

2012- Midwest Macroeconomic Meeting (South Bend), Canadian Economic Association (Calgary), NBER Summer Institute (Aggregate Implications of Microeconomic Consumption Behavior)

2011- Ball State University, Midwest Macroeconomic Meeting (Nashville), Society for Economic Dynamics (Ghent), European Summer Symposia in Financial Markets, University of Montreal

2010- Federal Reserve Bank of Minneapolis, University of Western Ontario, Midwest Macroeconomic Meeting

Professional Activities

Referee

Journal of Monetary Economics, International Economic Review, Economic Inquiry, B.E. Journal of Macroeconomics

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