Research

Dodd-Frank’s Impact on Revolving Consumer Credit

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Research from the American Action Forum (AAF) finds that Dodd-Frank financial reform has led to a 14.5 percent drop in consumer revolving credit since 2010. AAF examined the impact of Dodd-Frank on revolving credit, such as credit cards and debt that is paid off periodically, and found significant impacts from the law. Dodd-Frank’s $30 billion in final regulatory costs and 72 million hours of paperwork must be borne by someone and will likely have effects throughout the economy. Based on the latest research, it appears consumer credit access is taking a substantial hit.

METHODOLOGY

AAF performed a linear regression to determine Dodd-Frank’s impact on available consumer credit. Specifically, we estimated the effect of Dodd Frank on total revolving credit, which refers to debt that is paid off periodically and can be borrowed again (including credit card debt). To do this, we employed national-level quarterly data from the Federal Reserve Bank of St. Louis for the years 2005 to 2014.

Our main independent variable of interest was a binary variable to indicate Dodd-Frank’s implementation. As Dodd Frank was signed into law on July 21, 2010, all quarters before Q3 2010 were assigned “0” values and all quarters after were assigned a “1.” We then used a regression to find the effect of Dodd Frank on the natural log of outstanding, inflation-adjusted revolving credit. The regression equation is below:

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Also included in the model are several controls for factors other than Dodd-Frank that may affect revolving consumer credit. We used two variables in particular to control for the Great Recession: The S&P/Case-Shiller U.S. National Home Price Index (HPI) and the Taylor Rule. Because the 2009 recession was directly linked to the housing market, we consider home prices to be an appropriate indicator of economic conditions during that time. HPI may also influence the value of borrowers’ collateral, affecting their access to secured revolving credit. Similarly, the Taylor Rule, a formula created by economist John B. Taylor, estimates what the value of the federal funds rate should be based on real GDP, potential GDP, and inflation. This formula is preferable to the actual federal funds rate as a control for the recession because it is solely driven by market forces and not the Federal Reserve.

While government regulation of banks affects the supply of available credit, the demand for credit is also important to consider. Consumers’ perceptions of the economic climate and their disposable income are especially relevant. We controlled for both of these factors, as they contribute to the likelihood that consumers

incur debt and the amount of debt incurred. To quantify consumer sentiment, we used seasonally adjusted data from the Organization of Economic Cooperation and Development (OECD)'s monthly survey of consumer opinions in the United States. Disposable Personal Income was reported in real 2009 dollars and on a per capita basis.

Finally, we accounted for international trends in credit availability during this time by controlling for the annualized growth rate of total consumer credit in Canada. Canada is a large, developed country similar to the U.S. and an appropriate peer to consider. By controlling for international influences on credit, we can better isolate Dodd Frank as the sole independent variable affecting credit availability in the U.S.

RESULTS

We find that the implementation of Dodd-Frank may have had a significant negative effect on total revolving credit. Table 1 shows its impact.

Table 1: Results

Variable	**Impact on Revolving Credit**
Dodd-Frank	-14.5%***
*** Significant at the 1% Level	

While holding constant home prices, the Taylor Rule, consumer sentiment, and disposable personal income, Dodd-Frank may be associated with a 14.5 percent drop in revolving credit. This is statistically significant at the 1 percent level, indicating a 99 percent likelihood that our results were not obtained by chance.

IMPLICATIONS

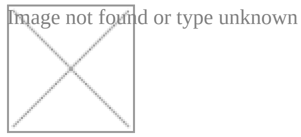
We find empirical evidence to suggest that Dodd-Frank's banking regulations may have significantly reduced the total amount of revolving credit available to consumers. This is not particularly surprising; Dodd-Frank has been met with numerous criticisms for its burdens on American banks. There is also concern over small banks, which may be less equipped than others to comply with the increased regulations and compliance costs.

Members of both the House and Senate have proposed several measures to help smaller banks, such as changing the classification of regional banks from those with under $50 billion in assets to those with under $250 billion. Others propose that regulations be applied differently to different types of banks. Some, including the Chairman of the Senate Banking Committee, pushed to include Dodd-Frank reforms in the end-of-year government funding bill.

While these measures did not make it into the final bill, there is good reason to support reform. Data from the

Federal Deposit Insurance Corporation (FDIC) show there was a 20.5 percent drop in banks with less than $1 billion in assets since Dodd-Frank became law. This is a noticeable difference from the 13.1 percent drop that occurred in the same time period leading up to Dodd-Frank.

FDIC data can also be analyzed to find how revolving credit offered by small banks has been affected in recent years. The chart below shows this trend.



It is apparent that average revolving credit has been on the decline. And while it may seem like revolving credit started to rebound after Dodd-Frank was signed, the actual number of small banks decreased considerably during that time. For instance, the stark rise in average revolving credit after 2013 can be explained by a modest increase in available credit, 3.3 percent, accompanied by an 11.6 percent drop in small banks. This is a concerning trend for both consumers with less access to revolving credit and small banks unable to survive under the current regulatory environment.

DISCUSSION

In AAF's recent update of Dodd-Frank, we noted how the Federal Reserve's final rule for "Margin and Capital Requirements" could cost up to $46 billion, with a more central figure of $5.2 billion. The stream of capital, oversight, and reporting rules has imposed tens of billions of dollars of costs on the U.S. financial system. Although crafters of the law will want large banks to bear these costs, the reality is typically far different.

Dodd-Frank's regulatory burden must be borne by someone: financial institutions and their employees, shareholders, or consumers in the form of higher prices or less access to credit. It appears the law has affected all three entities. We know Dodd-Frank imposes a regressive impact on smaller financial institutions, has driven up the price of obtaining a mortgage, and now has decreased revolving credit by approximately 14.5 percent.

This figure is massive, at least compared to AAF's previous work on the intersection of regulation and the economy. For example: higher regulatory burdens can increase the number of businesses with 500 or more employees by two to three percent; ozone regulations can reduce county wage earnings by 0.4 percentage point; and, $1 billion in new regulatory burdens can reduce industry employment by 3.6 percent. All of these effects have been relatively small, less than four percent. However, the research on revolving credit, significant at the one percent level, suggests Dodd-Frank's impact on consumer credit is profound and we are only starting to untangle its effects.

Indeed, if the results appear too stunning, consider how regulators have acknowledged that Dodd-Frank rules could increase prices for consumers and restrict access to certain credit. The following language is a small sample taken directly from federal rules implementing Dodd-Frank, all of which are from the Consumer Financial Protection Bureau:

- "[C]reditors might consider adjusting the terms and conditions of loans to pass some or all of the price increase through to consumers."

- “The final rule could increase the cost of credit or curtail access to credit for a small share of … consumers and purchase-money consumers.”
- “[T]he final rule could impose costs on a small number of consumers by raising the cost of credit or curtailing access to credit if creditors choose not to make loans that meet the revised thresholds.”
- “[T]his additional expense could increase the cost of credit or restrict access to credit for self-employed consumers.”

And reduced credit availability doesn’t just affect those consumers who are unable to gain access to credit. Rather, it affects the economic well-being of the country as a whole. A 2014 study by the World Bank and the Consultative Group to Assist the Poor (CGAP) shows a strong correlation between expansive financial inclusion and economic growth and employment. Further, a 2015 study by the Asian Development Bank shows a positive relationship between a country’s level of financial inclusion and its level of development. For example, the top four financially inclusive countries are Spain, Portugal, Luxembourg, and the United States, whereas the bottom four are Madagascar, Cameroon, Guinea-Bissau, and the Congo. Bottom line: the greater the access to credit and other financial products, the more opportunities for consumers and the more prosperous an economy. It makes no sense that a financial regulation would restrict financial services in such a way as to hurt both the economy and the consumers and citizens it’s intended to serve, but that’s exactly what Dodd-Frank is doing.

CONCLUSION

We know the impact of Dodd-Frank is both broad across the economy and profound for certain affected industries. This research reveals that the effects are also pronounced for consumers. A 14.5 percent drop in revolving credit likely wasn’t an intended consequence of the law, but tightened capital standards and billions of dollars in new regulatory costs must appear somewhere in the economy. Based on this research, it appears consumers are carrying a heavy load from Dodd-Frank regulation.