Innovations for Poverty Action

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Timeline
2011-2013

Sample Size
913 households in low- and middle-income neighborhoods

Research Implemented by IPA
Yes

When Commitment Fails: Evidence from an Installment Savings Product in the Philippines

Abstract

Commitment devices – in which people restrict their own choices in the near future to reach a farther off goal – have been shown to help people reach their goals, including savings goals. But are people good at choosing the right commitment contract? This evaluation in the Philippines tested the demand for and impact of a new commitment savings account with fixed regular installments. Clients could choose the stakes of the contract (in form of a default penalty) themselves. The study found that, on average, the account led to a large increase in bank savings for those offered the account: roughly three times that of a conventional withdrawal-restriction product that was offered as an alternative. However, 55 percent of clients defaulted on their savings contract, incurring a default penalty they had chosen themselves. The study suggests that many people underestimate the extent of their self-control problems, and choose commitment contracts which are too weak to be effective. As a result, commitment contracts may be harmful if people choose the wrong kind.

Policy Issue

Commitment devices are voluntary, binding arrangements that people make to reach specific goals that may otherwise be difficult to achieve. When built into savings products, commitment devices have been shown to help address behavioral and social obstacles by providing a mechanism that forces people to save according to their self-set plans. But when presented with the ability to design their commitment contract, are people good at picking a

contract that will benefit them? This research investigates this question, shedding light on the limits of commitment contracts.

Context of the Evaluation

First Valley Bank, the implementing partner, is a rural bank in the Philippines that offers microcredit, agricultural insurance, salary loans, and other financial services.

The study took place in 22 barangays (small administrative units) of Gingoog City, as well as in nine barangays on Camiguin Island. The study population was low- to middle-income households between one and two jeepney (local public transportation) rides from the bank branch, who report having an upcoming expenditure to save for, such as school fees, house repairs, appliance purchase, business expense, or a wedding.

Details of the Intervention

The research team partnered with First Valley Bank to evaluate the demand for a new commitment savings account and to measure the impact of the account on savings rates.

The product studied, an installment savings account, let clients commit to make a fixed savings deposit every week, until they reached their specified goal date and amount. The commitment took the form of an “early termination fee”: If clients fell more than two deposits behind their self-chosen deposit schedule, their contract was considered in default, and the account was closed. They received their savings back, minus this self-chosen penalty. The amount of this penalty was chosen by the clients themselves upon signing the contract and framed as a charity donation.

Households were visited by a financial advisor and received a personal savings plan (duration 3-6 months), and a free standard savings account. In addition, they were randomly assigned to one of three groups: a first group that was offered the new Installment Savings (IS) product, a second group that was offered a traditional commitment savings product with withdrawal restrictions, and a third group that served as a comparison group and was not offered any additional products.

A comprehensive survey was conducted before the financial advisor visit. The survey identified individuals’ time preferences and financial networks, and measured risk aversion, self-control, and financial literacy. A similar survey was conducted six months later. Administrative data on savings was obtained from the bank.

Results and Policy Lessons

The study found that demand for the commitment savings product was high, even in a low-income population with little previous bank exposure: Take-up rates were 27 percent for the installment savings product and 42 percent for the withdrawal-restriction product, in spite of the fact that all individuals were given a free standard savings account immediately before they were offered the commitment products.

Offering the installment savings product was highly effective at increasing savings: On average, those offered the product increased their bank savings by 429 pesos (US$10.20, approximately three days of wages) relative to the comparison group. The group offered the withdrawal-restriction account saved on average 148 pesos (US$3.50, approximately one daily wage) more than the control group. Among those who actually adopted the products; the installment-savings clients saved 1,392 pesos and the withdrawal-restriction clients saved 303 pesos more than those in the comparison group. In addition, those who were offered the installment savings product were more likely to buy the expenditure specified in their savings plan without borrowing for it.

This average effect obscures significant heterogeneity: 55 percent of installment savings clients defaulted on their savings contract, incurring their self-chosen penalty (between US$3.50 and $7). Among withdrawal-restriction clients, 79 percent made no further deposits after their opening balance, losing access to the money for those who had chosen an amount-based withdrawal restriction (45 percent).

Behavioral measures indicate that defaulting clients overestimated their own self-control, and underestimated how hard they would find it to save. Consequently, they chose "weak" commitment contracts with default penalties that were too low to discipline them to save. As a result, many failed to follow their self-chosen installment plans, and were charged the self-chosen penalties.

In summary, despite large positive effects on savings on average, many bank clients appear to overestimate their ability to stick to their commitments, even with self-imposed penalty features. The findings suggest that in some cases, people will choose commitment products that are not welfare-enhancing, highlighting a possible risk of commitment devices.

Read the full published paper here.

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