

Applying the Model of Focus Weighted Utility on Loan Decisions

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Abstract

In this paper we apply the model of focusing recently introduced by Kőszegi and Szeidl (2013) on loan repayment schedules. Using this framework we show that a consumer might take out a loan even when it yields her a negative utility. We claim however, that consumers might be less likely to take out such a loan when the usual fixed-installment plan is coupled with a decreasing-installment option. The idea is that when a loan in a fixed-installment repayment plan is presented alongside a decreasing-installment repayment plan, the great focus on the immediate benefit of having the loan is dampened by the increased focus on the repayments. This in turn makes the decision-maker more prudent in taking out loans. We argue that consumption of loans which might lead to negative utility could be reduced if a policy would prescribe presentation of loan repayment schedules in a way that employs this effect.