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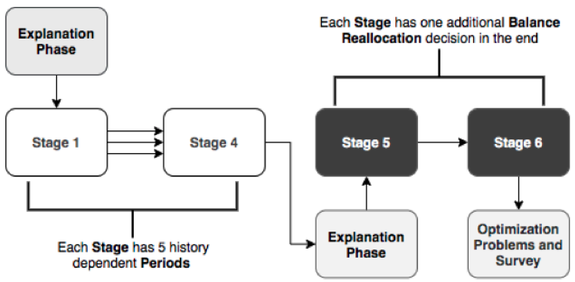
THIS PAPER

- We study people's debt repayment decisions in a controlled lab environment with clearly defined optimal rules and real incentives.
- We find about 20% of the payments are made optimally, and subjects rely on Balance information as much as Interest Rates. We then ask the following questions:
- Can standard explanations such as **Financial Literacy**, **Limited Attention on Prices**, or **Incentives** explain this failure? No.
- Do people rely on balance information in **Investment setting**? No.
- Can **Mental Accounting** (i.e., preference for separate evaluation) explain our findings? Yes.

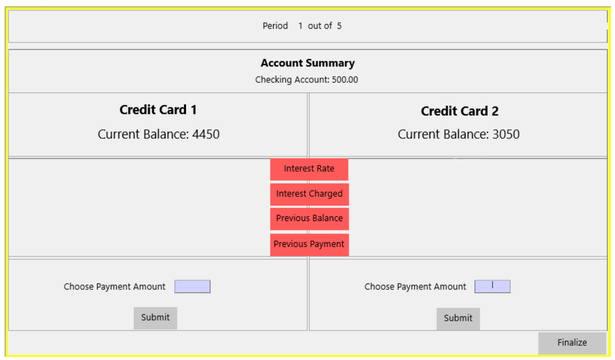
EXPERIMENT DESIGN

Figure 1: Experiment Timeline



Notes: The balance reallocation decision asks subjects to transfer their balances between two accounts at the end of stages 5 and 6.

Figure 2: Experiment Interface



Notes: Apart from Debt Balance, only one sets of information (e.g., Interest Rate) can be displayed at the same time. Subjects have to use up the entire 500 every period.

RESULTS OVERVIEW

- **Standard Explanations** do not fully explain the puzzle.
- **Investment Frame** removes balance dependence.
- **Mental Accounting** can explain 50% of the behavior

> Mental Accountant: has a well-defined preference over debt levels on each card (i.e., allocations pass a strict GARP test), but treats debt on each card as non-fungible (i.e., how the total debt is distributed over two cards matters)

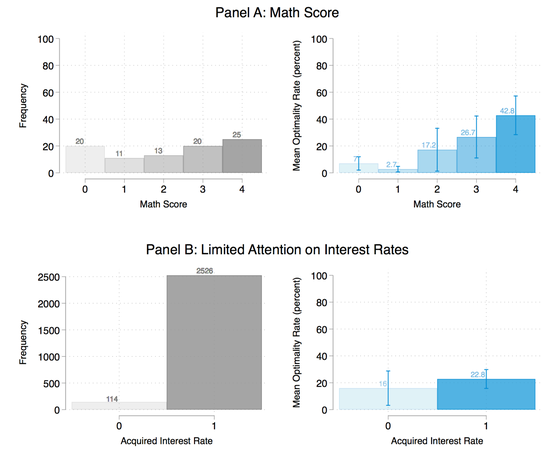
The Debt Payment Puzzle: An Experimental Investigation

People still make mistakes and rely on **debt balance information** when making repayments in our simplified setting.

However, this reliance on irrelevant balance information does not exist in **investment decisions**.

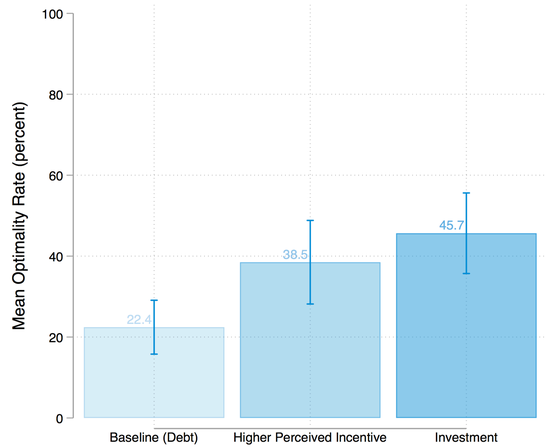
We find **mental accounting** rationalizes balance dependence in the debt domain.

Figure 3: The Roles of Attention and Financial Literacy



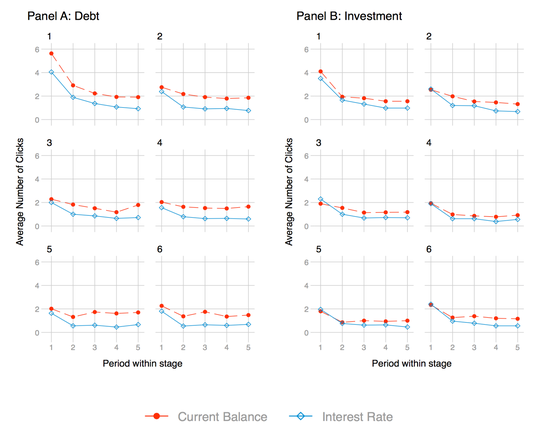
Notes: A combination of Financial Literacy and Limited Attention on Prices do not fully explain this failure.

Figure 4: Optimality Rate Across Treatments



Notes: Although both Higher Perceived Incentive and Investment improve allocation decisions, subjects still heavily rely on balance information under Higher Perceived Incentive.

Figure 5: Average Click Counts Across Frames



Notes: From our choice processing data, we find consistent evidence that subjects on average click balance information more frequently under the Debt Frame (Panel A, our Baseline Treatment).