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Why Use Debit Instead of Credit? Consumer Choice in a Trillion-Dollar Market

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Abstract

Debit cards are overtaking credit cards as the most prevalent form of electronic payment at the point of sale, yet the determinants of a ubiquitous consumer choice - debit or credit? - have received relatively little scrutiny. Several stylized facts suggest that debit-card use is driven by behavioral factors. The popular view is that debit-card use presents a puzzle for canonical economic models. However, we should not overlook standard cost-based motives for using debit cards. Principally, the 50 percent of debit-card users who revolve credit-card balances would pay interest to charge purchases on the margin and hence might rationally choose to use debit rather than credit to minimize transaction costs. Debit-card use might also be rational for consumers lacking access to a credit card or facing a binding credit limit. I document robust effects of these types of credit-card use on debit use and show that such effects are consistent with a canonical model of consumer choice. This paper also shows, however, that it is difficult to distinguish sharply between canonical and behavioral motives for debit-card use in publicly available data. More generally, I develop analytical frameworks for testing competing canonical and behavioral models and find evidence consistent with important roles for both pecuniary and psychological motives.

Keywords: consumer choice, retail payments, behavioral economics

JEL Classification: D14, D91, E41, G29

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