

Case #5: Payday Loans

In recent years, businesses have appeared that offer cash advance “payday” loans in many urban areas and smaller towns. These businesses usually operate out of storefronts in strip malls and offer small advances (\$300-\$500) to people who need money quickly, usually at a high interest rate. Their clientele tends to be employed, but poor or lower middle-class.

In order to receive the loan, the client writes a post-dated check to the company for the amount he or she wants as an advance plus a fee, usually about \$15-\$25 per \$100. So if someone is being advanced \$400, he or she writes a check for between \$460 and \$500. On payday, the client deposits his or her paycheck and the payday loan company deposits the post-dated check, effectively ending the loan. Clients do not always have enough money in their accounts to cover the post-dated check, so they are also offered the option of rolling the loan amount over to the next pay period. In order to take advantage of this offer, the same fee is charged: \$15-\$25 per \$100 borrowed. This effectively doubles the interest rate of the loan, so for the aforementioned \$400 loan spread across two pay periods, the fee would be between \$120 and \$200—half of the amount borrowed in the worst case.

Interestingly, a study by the Center for Responsible Lending found that the vast majority of these loans are not made to one-time emergency borrowers. It found that 91% of all payday loans are made to borrowers with five or more payday loans per year. Furthermore, most payday borrowers go to more than one lender, dramatically increasing their total number of payday loans per year. Only 1% of all payday loans are made to emergency borrowers.

Church groups and anti-poverty organizations claim that these businesses lure people in with offers of quick money to handle important payments, but aim to get people caught up in the system of rolling over loans. They say that such high fees would be immoral to charge to anyone, but it is especially heartless to charge them to people without the financial means to pay the loans back and get back on their feet. These groups have fought for legislation restricting the fees and ability to rollover loans from one paycheck to the other as well as legislation that would crack down on companies’ ability to ignore current outstanding debt when giving out the loans. The payday loan industry is profitable and can afford to devote a percentage of those profits to opposing such legislation. Additionally, those who would benefit from regulation of the industry, the working poor and lower middle-class, are less likely to vote, write their congressperson, or donate to campaigns.

Payday loan advocates counter that they provide a valuable service to those who need money sooner than their employers can provide. It is not their fault that people get caught in the web of escalating fees, but rather the temptation that consumer society creates for people to live beyond their means. Without their services, advocates claim that job terminations, unpaid bills, evictions, and mortgage foreclosures would soar, swelling the welfare rolls and increasing taxes. They claim that existing regulations

already require them to make very clear how much people will pay for the loan and to limit people's ability to freely choose such fees is to treat them as children rather than adults who are capable of reigning in their own spending.