The Ethics of Payday Lending

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Article:

I recently spoke to a church group about business ethics, and I discussed Leviticus 19:14, which tells us: "You shall not curse the deaf, nor put a stumbling block before the blind." Following tradition, I interpreted the word "blind" to represent any person or group who is unsuspecting, ignorant, or morally blind.

Therefore, we are prohibited from taking advantage of such people, and in the case of the morally blind of even tempting them to do wrong. The deeper meaning of this Biblical passage addresses many specific issues in the area of business ethics, including shady corporate accounting, insider trading, and misleading advertising. Certainly the executives at Enron and Worldcom put a figurative stumbling block before unsuspecting employees and stockholders.

Then someone asked me whether this would apply to the subject of payday lending, the lending of money at very high interest rates for what are often very short periods of time. After all, aren't the poor and working-class people who tend to borrow from payday lenders morally blind, in the sense that they are doing something that is against their own interests? I didn't have a ready answer.

On one hand, my generally liberal view is that people should be allowed to make personal decisions for themselves. To me, this applies to many activities I choose not to engage in myself, such as smoking cigarettes and parachuting out of airplanes.

Similarly, while I think a state-run lottery is bad idea, I also think that voters should be allowed to decide the issue in a referendum. Voters often elect politicians I dislike; why shouldn't they be allowed to choose bad policy?

But on the other hand, don't we have a responsibility to the "morally blind?"

So is payday lending so bad that we shouldn't let people make up their own minds about it? Shouldn't we be uncomfortable deciding who is and who isn't "morally blind?" Is there a way to promote liberalism without setting up stumbling blocks?

In case you're not familiar with payday lending, here's how it works. A person needing cash but finding herself two weeks short of her next paycheck can write a check and receive somewhat less than the face value of the check as a two-week loan.

When payday lenders were licensed by the state of North Carolina, the maximum fee was 15 percent of the face value of the check, so a $200 check would generate a $170 loan to the customer. But $30 of interest on a $170 loan actually implies a 17.6 percent interest rate. And the annual percentage rate (APR) interest on a two-week loan would be a whopping 460 percent.

In 1999, 2.9 million checks were cashed by payday lenders in North Carolina, for a total of $650 million. The average loan was $190. Over a third of all customers of a given payday lending company borrowed from that company 10 times or more during the year. The number who borrowed infrequently is harder to cull from the data I've seen, but it appears that for perhaps a quarter of all customers, payday lending was only an occasional measure.

In February 2001, the state Commissioner of Banks submitted a report to the General Assembly that recommended various reforms in payday lending, including better monitoring and better provision of information to consumers. It also reported an increasing, though relatively small, number of complaints against payday lenders.

In August 2001 the General Assembly went further than those recommendations. It ended its four-year experiment with payday lending and stopped licensing the activity in the state.

Many payday lenders closed shop, but others found a loophole in federal banking laws. They set up partnerships with out-of-state-banks that lent them their federal charters. As a result, there is still payday lending in North Carolina today, though Attorney General Roy Cooper is trying to close this loophole.

Setting up partnerships with banks elsewhere isn't the only way to extend payday loans to North Carolinians. When I typed "payday lending" into the Internet search engine Google, three ads popped up for out-of-state payday lenders. Whether or not payday-lending customers have ready access to the Internet, this should remind us that our old notions of borders are less relevant in the information age.

The arguments against payday lending are numerous, but they tend to revolve around the central fact that most borrowers are relatively poor. For example, one argument is that the interest rates charged by payday lenders are too high. But the high price of credit isn't the problem *per se*, because richer people pay high prices for goods and services all the time, and that doesn't bother us.

Another argument is that payday lending is most profitable when customers cannot repay the loan. And it is true that repeat loans can cause the interest burden to mushroom. But the same is true of credit cards, which are most lucrative to the issuer when card holders carry balances, and that doesn't bother us either.

The Coalition for Responsible Lending, a non-profit dedicated to fair lending in North Carolina, lists the above and other arguments against payday lending, and adds the following: "Payday borrowers have an income problem, not an access-to-credit problem." However, this really is the fundamental problem with payday lending, not just one of many.

Yes, there are poor people in our society, and poverty often leads people to make choices that richer people have the luxury to avoid. The way to address this fundamental problem would be to do something serious to improve the incomes of poor people. However, American society has shown only sporadic commitment to that goal.

Another approach would be to prohibit poor people from making choices that we richer people don't approve of. That's the approach of the Attorney General and other opponents of payday lending, but it rebels against the liberal impulse to let people decide what's best for themselves.

So if one of these solutions is unrealistic and the other violates liberal principles, perhaps we have to treat the problem as an access-to-credit problem after all. Or as an education-about-credit problem.

A sensible proposal along these lines can be found in that 2001 report by the state Commissioner of Banks, which recommended that licensed payday lenders be required to issue brochures to customers that explain clearly the nature of the loans, the fees to be charged, availability of other forms of credit, the customer's right of appeal, and so on. Is this information being conveyed now that the state no longer licenses payday lenders?

The Coalition for Responsible Lending lists alternatives to payday loans on its website. Some of those alternatives could be promoted as policies that alleviate the pressure on poor people to become customers of payday lenders. One that I hope will be ignored, however, is “cash advances on credit cards.”

Maybe the solution has to go deeper still. Last year the General Assembly authorized a study of the value of teaching “personal financial literacy” in the public schools (the original bill was co-sponsored by Senator Kay Hagan of Greensboro). Presumably such an educational program would cover such topics as consumer credit and the wonders (and horrors) of compound interest.

As with so many other issues, the key to the dilemma of payday lending is information. Even poor people have the right to make decisions about their own finances, and the best public policy will focus on ensuring that those decisions are informed decisions. In that way, we can hope to minimize the number of our fellow citizens who are unsuspecting, ignorant, or morally blind.