

Federal Reserve Bank of New York Staff Report: Payday loans do not fit our definition of “predatory”.

A new study, “*Defining and Detecting Predatory Lending*,” by Donald P. Morgan, Research Officer, Federal Reserve Bank of New York, concludes that payday loans are not a “welfare reducing” form of credit. To the contrary, the author suggests that payday lenders enhance the welfare of households by increasing the supply of credit.

Noting the difficulty in defining “predatory,” the author sets out to distinguish predatory lending from “the kind that helps households maintain consumption even as their incomes fluctuate.” He examined differences in household debt and delinquency across states that allow payday lending and those that do not and compared the change in those differences before and after the advent of payday lending. Particular attention was paid to households that are generally perceived as more vulnerable to predation (those with income uncertainty or less education).

Noted in the report:

Payday loans are not welfare reducing, or “predatory”

“We define predatory lending as a welfare reducing provision of credit.”

“Our findings seem mostly inconsistent with the hypothesis that payday lenders prey on, i.e., lower the welfare of, households with uncertain income or households with less education.”

“On the whole, our results seem consistent with the hypothesis that payday lending represents a legitimate increase in the supply of credit, not a contrived increase in credit demand.”

Payday loans may enhance the welfare of households

“...[credit]delinquency rates were marginally lower for risky households in states with unlimited payday loans.”

“Households with uncertain income who live in states with unlimited payday loans are less likely to have missed a debt payment over the previous year...consistent with claims by defenders of payday lending that some households borrow from payday lenders to avoid missing other payments on debt.”

“Those types of households who happen to live in states that allow unlimited payday loans are less likely to report being turned down for credit, but are not more likely, by and large, to report higher debt levels...”

Price does not make payday loans “predatory”; limiting access raises prices

“Higher prices are neither necessary nor sufficient to conclude that a certain class of credit is predatory.”

“We find somewhat lower payday prices in cities with more payday stores per capita, consistent with the hypothesis that competition limits payday loan prices.”

“The problem of high prices may reflect too few payday lenders, rather than too many.”

“Before payday lending...very small, short-term loans may not have been worthwhile for banks. Payday lending technology may have lowered those fixed costs, thus increasing the supply of credit...That version of the genesis of payday lending suggests the payday innovation was welfare improving, not predatory.”