

Payday Lending Does not Lead to Bankruptcy; No evidence of “Cycle of Debt”

In “*Restriction on Credit: A Public Policy Analysis of Payday Lending*,” Petru S. Stoianovici of The Brattle Group and Michael T. Maloney, PhD of Clemson University use data from 2000 to 2006 to investigate the relationship between payday lending and personal bankruptcy filings. They find “no empirical evidence that payday lending leads to more bankruptcy filings,” and cast further doubt on the so-called “cycle of debt” argument used by industry critics. In sum, they conclude that restrictions on the industry hurt consumers by driving up fees and that banning the industry entirely reduces access to much needed credit.

Read study at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1291278.

Noted in the study:

➤ **Payday lending does not lead to more bankruptcy filings**

“Using state-level data between 1990 and 2006, we find no empirical evidence that payday lending leads to more bankruptcy filings.”

“If anything, the presence of payday stores in a state is associated with a smaller number of chapter 7 bankruptcy filings.”

“The presence of payday stores does not seem to have any significant effect on chapter 13 and total personal bankruptcy filings.”

➤ **The “cycle of debt” argument against payday lending is not supported by evidence**

“There is no statistical evidence to support the ‘cycle of debt’ argument often used in passing legislation against payday lending.”

“The ‘cycle of debt’ argument works only if the costs that the default borrower has to bear are hidden and disproportionately high, and if the lenders would impose a high minimum amount loan that would make the borrower less likely to be able to repay it, which is not supported by the evidence.”

“It is hard to make a principled argument that the consumer is deceived in a payday lending contract because it is very simple in terms of the costs and structure: there are no hidden costs.”

“The very small default rate for these small, unsecured loans would suggest that borrowers value the option to come back.”

➤ **Restricting payday loans harms consumer welfare, reduces access, increases cost**

“Restrictions on credit diminish the ability of individuals to smooth their consumption in the presence of income or expenditure shocks (like loss of employment, medical emergency).”

“The likely outcome of state restrictions placed on payday lenders is an increase in costs of doing business which will lead to higher prices than otherwise, leaving consumers worse off. In addition, especially if the restrictions are as extreme as in Georgia (where payday lending is explicitly banned), they are likely to reduce the access to credit.”