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The Payday-Loan Controversy

by Matthew Hisrich

Popping up in shopping centers across the country, payday-loan stores, or cash-advance shops, are one of the fastest growing phenomena of the financial sector. At the same time, they are reviled by many as parasites that feed on the poor and, along with instant bingo and dollar stores, signal the decline of quality retail in many communities.

This contempt is prompted by the high interest rates these stores charge for short-term loans. The question is, are these businesses taking advantage of people who have fallen on hard times or who place a higher value on the present than the future, or are they providing a valuable service that others are unwilling to offer?

To be sure, the interest rates charged for taking out a payday loan are sobering. As financial writer Michelle Leder points out, with an annual interest rate of up to 500 percent, taking out a $200 loan can require a person to pay back $240—assuming, that is, the loan is paid back in a week.[1] It is easy to see how someone could spiral deeply into debt under such circumstances. Nonetheless, the mere risk of engaging in a business transaction hardly justifies eliminating it as an option.

This is especially the case when conventional banks don't offer such services. Major banks clearly recognize the profit potential of cash advances; they are backing the initial public offering of at least one of the main payday-loan chains. The problem is, as Leder points out, they have their good names to protect. So while competing against the loan stores might reduce interest rates, the banks stay out of this market for fear of being labeled predatory lenders. For those with poor credit or in a financial tight spot, this means there may be no better alternative.

Rather than assuming that consumers are unable to make informed financial decisions on their own, those opposed to the stores' spread ought to consider the numbers behind the numbers. Even at the current high interest rates, Leder notes that consumers may still find cash advances cheaper than credit-card late fees or bounced-check bank fees.

Indeed, payday-loan stores may be expanding so rapidly precisely because consumers are performing such calculations. According to Leder, last year there were over 20,000 loan stores in the United States, twice the number of three years earlier. The Ohio-based Check 'n Go, one of the nation's top three chains, opened 100 storefronts last year and plans to do the same this year.

Another aspect worth considering is the role these firms play in bringing out in the open what was once the exclusive province

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of organized crime. What many who wish to advance social agendas through legislation fail to understand is that removing a legal option does not remove the demand. To the extent that "mainstreaming" this service has eliminated the many negatives of loan sharking, payday-loan stores have achieved a significant success.

The role of the entrepreneur in providing services demanded by the public is crucial to the economic advancement of everyone. Claims that this particular service is predatory belie this fact and discount the benefits obtained by those who use it. As John L. Rabenold, a Check 'n Go spokesman, explained, "Our customers don't think they're making a bad financial decision."[2]

John Stuart Mill warned that efforts to "save people from themselves" through legislation are fraught with peril. "[T]he strongest of all arguments against the interference of the public with purely personal conduct," Mill said, "is that when it does interfere, the odds are that it interferes wrongly, and in the wrong place."[3]

In his book *Liberalism*, Ludwig von Mises went even further. Not only are efforts at intervening in the marketplace ineffective, but also they necessitate either a repeal of the initial action or further intervention to address the failures that follow. According to Mises, "There is simply no other choice than this: either to abstain from interference in the free play of the market, or to delegate the entire management of production and distribution to the government. Either capitalism or socialism: there exists no middle way."[4]

Strong words, to be sure. But the debate over payday-loan stores raises large questions about the role of government in our everyday lives. In the name of defending the poor, those seeking a regulatory clampdown may do little more than take away another option from those who have few to begin with. □

1. Michelle Leder, "How the Other Half Banks," *Slate*, May 10, 2004, http://slate.msn.com/id/2100276.
2. Ibid.
3. John Stuart Mill, *On Liberty* (New York, N.Y.: E.P. Dutton & Co., 1957), p. 140.
4. Ludwig von Mises, *Liberalism: The Classical Tradition* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1996), p. 79.