

OPINION JOURNAL

Welcome, **Shee Wong** Logout

My Account My Journal Help

U.S. Edition Today's Paper Video Columns Blogs Graphics Journal Community

Home World U.S. Business Markets Tech Personal Finance Life & Style Opinion Careers Real Estate Small Business

Leisure & Arts Letters to the Editor Discussion Groups Political Diary Columns Forums

TOP STORIES IN Opinion



1 of 10 Henninger: 100 Days: 'Harry, I Have a...



2 of 10 Gettelfinger Motors



3 of 10 Paul Ingrassia: The UAW in the Driver...

Be

OPINION | APRIL 14, 2009

Congress Takes Aim at Payday Loans

Evidence suggests price controls will make things worse for borrowers.

Article

MORE IN OPINION »

Email Printer Friendly Share: Yahoo Buzz Save This Text +

By ROBERT DEYOUNG

For those who depend on taking out a loan in advance of a paycheck, life may soon get harder if Congress passes the Payday Loan Reform Act.

The bill's sponsors, which include Rep. Luis Gutierrez (D., Ill.), say they want to clean up abuse in credit markets by clamping down on the prices lenders charge for payday loans. In reality, the legislation will reduce the supply of these loans and make borrowing more expensive.

The reform is based on the false premise that consumers take out these loans without realizing how much they are paying. True enough, these loans are expensive. A two-week payday advance of \$300 typically comes with a \$45 finance charge -- an implied annual percentage rate (APR) of 391%. Critics say borrowers could not possibly intend to pay that much for an advance on their paychecks, and that the cost alone is evidence of exploitation of the working poor.

But new research suggests that most payday borrowers are more rational and informed than critics believe. A January 2009 study by Gregory Elliehausen at George Washington University found that payday borrowers make informed choices. About half of the 1,173 payday borrowers he surveyed considered other credit alternatives -- such as bank, credit card, or personal loans -- before taking out a payday loan. Over 80% lacked sufficient funds in their bank accounts to meet their expenses, so by taking out a payday loan they avoided expensive checking account overdraft fees. Nearly 90% said they were either very or somewhat satisfied with the transaction.

A November 2008 FDIC report on overdraft protection provides the context. According to this exhaustive study, the average APR on a two-week checking account overdraft is 1,067%, more than double the rate on the typical payday loan. Worse, a large percentage of banks studied by the FDIC take deliberate measures to increase the frequency of customer overdrafts -- such as displaying account balances on ATM screens only after the overdraft has occurred, and increasing the number of insufficient funds checks by clearing large customer checks before small ones. Compared to these overdraft practices, payday loans are transparent.

Nonetheless, the legislation pending before the House would cap payday-loan finance charges, even though government price limits almost always have negative effects. Price controls are especially harmful when competition is robust, as in payday-loan markets.

Ron Phillips of Colorado State University and I examined seven years of payday-loan prices in 117 Colorado neighborhoods. We found that local markets with more payday stores tend to enjoy lower prices, but that the benefits of competition were largely been washed away when Colorado imposed a cap on finance charges. Over time, the longer a price cap remains in place the more borrowers get charges the legal maximum price. Price caps make these loans more expensive and less available.

In a statement on the legislation, the Democratic leadership of the House Financial Services



Email Newsletters and Alerts

The latest news and analysis delivered to your in-box. Check the boxes below to sign up.

On the Editorial Page Best of the Web Today

SIGN UP

New! To sign up for Keyword or Symbol Alerts click here.

To view or change all of your email settings, visit the Email Setup Center.

People Who Viewed This Also Viewed...

On WSJ.com In My Network

'Say on Pay' and Other Bad Ideas

A Health Tech Monopoly -- II

Weems and Sasse: Is Government Health Insurance Cheap?

Convoys Are an Answer to Piracy

Hiroshima, 2.0

Committee disingenuously said that payday borrowers need special protection because they "do not have access to the mainstream financial system." But in most cases, payday borrowers are required to provide a post-dated personal check as collateral. Payday borrowers have checking accounts and consume mainstream financial services.

John Caskey of Swarthmore University, a leading expert on fringe finance, reports that the typical payday borrower is young, is married with children, has at least a high school education, and has a major credit card. So the characteristic that most differentiates a payday borrower from a non-payday borrower is simply the need for short-term credit.

Being a paycheck behind on our bills is a situation none of us wishes to find ourselves. But when that situation occurs, the more options we have at our disposal, the better. So long as both sides of the deal have full information, these choices are better left to households and their creditors.

Mr. DeYoung teaches finance at the University of Kansas. He is not an adviser to anyone affected by this legislation.

Please add your comments to the [Opinion Journal forum](#).

Email Printer Friendly Order Reprints

Share:

Sponsored Links

Faster than Personal Loan

Higher approval rate on loans up to \$1,500. Funds in 1 hour or less!
www.1-hour-cash-advances.com

PayOff PayDay Loans Fast

Free Estimate! 30 Second Form
www.EscapePaydayLoans.com

No Fax Cash Advance Loans

Get emergency cash overnight. Bad Credit OK. Low fees. No Faxing.
www.worthington-financial.com

MORE IN OPINION
Article Tools
Sponsored by

Related Articles and Blogs from WSJ.com

Credit Markets Open for Boston Properties, but Terms Are Tough APR 29, 2009

Loan-Modification Plan Revised to Address Second Mortgages APR 29, 2009

Lenders Pull Financing For Massive Resort; Borrower Says "Huh?" APR 24, 2009

Related News From the Web

Wash. state Legislature OKs payday lending rules APR 23, 2009
news.aol.com

Major payday lender is leaving Virginia | Richmond Times-Dispatch APR 23, 2009
timesdispatch.com

Editors' Picks



Champions League Diary: Arsenal-Manchester United



Unease Brewing at Anheuser



Is Obama the 'Sports' President?



L.A. Suburb Drills for Oil



Shanghai Eyes Buyout of Stalled Project

Video

Obama's First 100 Days
3:00

Specter Switches Sides
3:00

Swine Flu's Impact on Mexico
3:30

More in Opinion

[The Liberal Hour](#)

[Fred Barnes: What Specter's Defection Means](#)

[Jenkins: The Truth About Cars and Trucks](#)

[Specter's Switcheroo](#)

[Kent for Rent](#)

Most Popular

Read Emailed Video Commented

1. [Rejection: How Colleges Do It](#)
2. [Microsoft, Verizon Discuss iPhone Rival](#)
3. [To Help Sell Houses, Temps Move In](#)
4. [Flu Moves Toward Pandemic Level](#)
5. [Citi Seeks Approval for Bonuses](#)

[Most Read Articles Feed](#)

Latest Headlines

[L.A. Suburb Drills for Oil](#)

[More Headlines](#)

[BACK TO TOP](#)

[Subscriber Billing Info](#)
[Premium Archive Account Statement](#)

Create an Account:

[Register for Free](#)
[Subscribe Now](#)

Help & Information Center:

[Help](#)
[Customer Service](#)
[Contact Us](#)
[New on WSJ.com](#)
[Tour the new Journal](#)

[Advertising](#)
[Conferences](#)
[About Dow Jones](#)
[Privacy Policy - Updated](#)
[Subscriber Agreement & Terms of Use - Updated](#)
[Copyright Policy](#)
[Jobs at WSJ.com](#)

[Home](#)
[World](#)
[U.S.](#)
[Business](#)
[Markets](#)
[Market Data](#)
[Tech](#)
[Personal Finance](#)
[Life & Style](#)
[Opinion](#)
[Autos](#)
[Careers](#)
[Real Estate](#)
[Small Business](#)
[Corrections](#)

[Video Center](#)
[Graphics](#)
[Columns](#)
[Blogs](#)
[Alerts](#)
[Newsletters](#)
[Mobile](#)
[Podcasts](#)
[RSS Feeds](#)
[Journal Community](#)
[Forums](#)
[My Journal](#)

[WSJ.com](#)
[Marketwatch.com](#)
[Barrons.com](#)
[SmartMoney.com](#)
[AllThingsD.com](#)
[FiLife.com](#)
[BigCharts.com](#)
[Virtual Stock Exchange](#)
[WSJ U.S. Edition](#)
[WSJ Asia Edition](#)
[WSJ Europe Edition](#)
Foreign Language Editions:
[WSJ Chinese](#)
[WSJ Portuguese](#)
[WSJ Spanish](#)