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# Payday Loans Are a Scourge, but Should Wrath Be Aimed at the Lenders?

**By ROBERT H. FRANK**

When a lion achieves alpha male status, one of his first acts is to kill all unrelated cubs in the pride. Is that a bad thing?

As biologists have long realized, the question makes little sense. In the bitterly competitive environments in which lions evolved, the dominant male's behavior was favored by natural selection because it brought females into heat more quickly, thus accelerating the transmission of his genes into the next generation. His behavior appears brutal to human onlookers and surely makes life less palatable for lions as a group. In the Darwinian framework, however, it is a simple fact of existence, neither good nor bad. In any event, such judgments have little practical significance, since moral outrage alone cannot prevent a dominant lion from killing cubs.

In contrast, when humans prey on weaker members of the community, others are quick to condemn them. More important, such denunciations often matter. Because complex networks of voluntary association underlie almost every human transaction, the bad opinion of others can threaten the survival of even the most powerful individuals and organizations.

But the supply of moral outrage is limited. To maximize its usefulness, it must be employed sparingly. The essential first step is to identify those who are responsible for bad outcomes. This is often harder than it appears. Failure at this stage steers anger toward people or groups whose behavior is, like the alpha lion's, an unavoidable consequence of environmental forces. In such instances, moral outrage would be better directed at those who enact the rules under which ostensibly bad actors operate.

A case in point is the outrage currently directed at lenders who extend credit at extremely high rates of interest to economically disadvantaged groups. Among these lenders, so-called payday loan shops have come under particularly heavy fire of late.

This industry, which didn't exist in the early 1990s, now has approximately 10,000 retail outlets nationwide (more in some states than either McDonald's or Burger King). Industry revenue, less than $1 billion in 1998, reached $28 billion last year. Concentrated in low-income neighborhoods, payday lenders typically offer short-duration loans of several hundred dollars secured only by a post-dated personal check from the borrower. Fees on a two-week loan often exceed $20 per $100 borrowed, which translates into an annual interest rate of more than 500 percent.

Occasional borrowing on such terms can make sense, because it sidesteps the cumbersome process of taking out a traditional bank loan. Many borrowers, however, quickly get into financial trouble once they begin to roll over their payday loans. A recent report by the Center for Responsible Lending, for example, estimated that a typical payday borrower ends up paying back $793 for a $325 loan.

Payday lenders have been condemned as ruthless predators whose greed drives hapless borrowers into financial ruin. Without question, the proliferation of payday lending has harmed many families. And since lenders surely know that, the moral outrage directed at them is understandable.

It may even have some effect. Economic studies suggest, for example, that employees demand premium wages for performing tasks that are considered morally objectionable. Outrage directed at payday lenders thus raises their hiring costs, which may inhibit their growth. But given the appetite for easy credit, this inhibition will be modest at best.

Those concerned about the growing culture of consumer debt need to recognize that it stems far less from the greed of lenders than from recent liberalizations of lending laws. Since biblical days, societies have imposed limits on the terms under which people can borrow money. A wave of deregulation in the financial industry has eliminated many of those limits. Liberalizing credit access may have made many mutually beneficial transactions possible, but its adverse consequences were completely predictable.

The problem is that many people have difficulty weighing the trade-off between immediate benefits and future costs. When confronted with easy credit access, some inevitably borrow more than they can reasonably expect to repay. Once they get in over their heads, they borrow more, if the law permits. It was thus all but certain that millions of society's most economically vulnerable members would borrow themselves into bankruptcy if confronted with easy credit access. If we are unhappy about that, the only recourse is to change the rules.

Each society must decide whether the costs of easy credit outweigh the benefits. This entails trade-offs similar to those we confront when deciding whether to regulate drugs. For example, alcoholic beverages, like payday loans, inflict considerable harm on a small percentage of people, but prohibiting alcohol appears to create more serious problems than it solves. Prohibiting cocaine and heroin entails troubling side effects, too. Even so, concern for those most vulnerable to these drugs has led most societies to prohibit them.

Evidence suggests that easy credit access is more like heroin and cocaine than alcohol. This evidence recently led Congress to cap the annual interest rate on payday loans to military personnel at 36 percent. In New York and 10 other states, similar restrictions apply to loans to the general public, in each case making payday lending effectively illegal.

Those who feel that payday lending is a bad thing are inclined to vent their anger about the hardships it has created. But outrage directed at payday lenders cannot prevent those hardships, just as outrage directed at alpha male lions cannot prevent them from killing cubs. A more deserving target would be legislators who supported lax credit laws in exchange for campaign contributions from lenders — or, better still, those who have steadfastly resisted campaign finance reform.

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