

Are payday loans a necessary evil?

By Ron Gilbert

Over the last six days, this paper has explored the impact of payday loans on working Alabamians. You've learned that Alabama law allows payday lenders to charge fees equivalent to an annual percentage rate of 456 percent for small short-term loans. You've learned how Alabama consumers, struggling with rising prices and flat earnings, turn to these legal loan sharks and find themselves trapped in debt for months or years. In hard times like these, are payday loans just a necessary evil?

Clearly, as the payday industry argues, conventional lenders are not filling the need for small, short-term loans. Until these products become available at reasonable rates, minimally regulated "fringe financing" will thrive. Anniston's moratorium on business licenses for payday loan stores is one approach to protecting consumers from this mushrooming industry. Arise members in Lee County have been working for the past year to convince financial institutions in that community to develop low-cost, short-term loan products. They are now developing educational material to let consumers in their area know that there are other, more affordable options than payday loans.

Community responses are encouraging, but substantive change will require action at another level – the Legislature. In each of the past two regular legislative sessions, bills have been introduced that would purportedly "reform" the industry. The bills proposed allowing consumers to cancel payday loans by returning the loan amount by the close of the next business day, to request an extended payment plan, to receive a rebate for early payment in full, and to prohibit payday loans to members of the military service or their families. Interestingly, they made no change to the allowable interest rate of 456 percent.

While some of these changes sound good on the surface, a little research quickly indicates that the payday loan industry itself has been pushing these same proposals across the country, hoping to end further efforts at regulation. According to North Carolina's Center for Responsible Lending, they do nothing to keep consumers from becoming trapped in a cycle of debt to payday lenders. A consumer desperate enough to pay an exorbitant interest rate for a short-term loan is unlikely to see an overnight shift in circumstances that would allow him or her to rescind the loan the following day. An extended repayment plan that costs more to use than taking out a subsequent payday loan is unlikely to appeal to

low-income workers struggling to make ends meet. The same is true for rebates for early payment – they’re good for those consumers who comply, but simple hard-luck arithmetic shows that few would be able to get ahead that quickly. And the prohibition of payday loans to military members and their families? Congress has already taken steps in this direction, capping interest rates on loans to service members at 36 percent and citing the never-ending debt cycle affecting many young military families as a threat to national security.

Advocates across the country will quickly tell you that nothing short of an interest cap will protect consumers. Last month, the Ohio Legislature became the 13th state to cap interest rates by imposing a limit of 28 percent on payday loans. Legislative battles over an interest rate cap have occurred in other states in recent years and without a doubt will ultimately prevail. When Georgia payday lenders ignored administrative prohibitions, the Legislature criminalized the transactions. The Attorney General of Arkansas in March of this year began enforcing a constitutional limit of 17 percent interest on payday loans. New Hampshire, Oregon and the District of Columbia have all moved in recent months to cap the allowable interest rate on payday loans. An analyst for investment banker Sterne Agee has said that the payday loan industry, which earned an estimated \$4.6 billion in fees in 2005, runs “the risk of being shut out of making the loans nationwide.”

Alabama has traditionally lagged behind the rest of the country in protecting low-income workers. We were the last state to guarantee tenants’ rights. We tax our lowest earners more harshly than our wealthiest. And yet, in 1959, Gov. John Patterson championed the Small Loan Act to clamp down on the loan sharks of his day, proving that Alabama can force the pendulum to swing the other way. Only time will tell how long we will continue to allow vulnerable Alabamians to be exploited by legalized usury.

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