Are Payday Loans Really as Evil as People Say?

April 6, 2016 @ 11:00pm
by **Stephen J. Dubner**
Produced by: Christopher Werth

With annual interest rates around 400 percent, payday loans are called exploitative by critics. But the industry says those rates are necessary. And nearly 90% of borrowers are satisfied customers. (photo: stallio)

Part 2

Jonathan Zinman is a professor of economics at Dartmouth College. Zinman says that a number of studies have tried to answer the benchmark question of whether payday lending is essentially a benefit to society. Some studies say yes …

ZINMAN: But we have other studies that find that having more access to payday loans leads to a greater incidence of detrimental outcomes.

Consider a **study** that Zinman published a few years back. It looked at what happened in Oregon after that state capped interest rates on short-term loans from the usual 400 percent to 150 percent, which meant a payday lender could no longer charge the industry average of roughly $15 per $100 borrowed; now they could charge only about $6. As an economist might predict, if the financial incentive to sell a product is severely curtailed, people will stop selling the product.

ZINMAN: We saw a pretty massive exit from payday lending in Oregon, as measured by the number of outlets that were licensed to make payday loans under the prior regime, and then under the new law.

But Zinman's research went beyond that basic fact. The state of Washington, Oregon's neighbor to the north, had considered passing a similar law that would cap interest rates, but it didn't.

ZINMAN: And so we have a setup for a nice natural experiment there. You have two neighboring states, similar in a lot of ways. One passed a law, another considered passing a law, but didn't quite pass it.

So in the state that didn't pass it, payday lending went on as before. And this let Zinman compare data from the two states to see what happens, if anything, when payday-loan shops go away. He looked at data on bank overdrafts, and late bill payments and employment; he looked at survey data on whether people considered themselves better or worse off without access to payday loans.

ZINMAN: And in that study, in that data, I find evidence that payday borrowers in Oregon actually seemed to be harmed. They seemed to be worse off by having that access to payday loans taken away. And so that's a study that supports the pro-payday loan camp.

That's pretty compelling evidence in favor of payday loans. But in a different **study**, Zinman found evidence in the opposite direction.

MUSIC: Dominik Hauser, "Drumline for Snares"

In that paper, which he co-authored with **Scott Carrell**, Zinman looked at the use of payday loans by U.S. military personnel. This had been the topic of an ongoing debate in Washington, D.C.

ZINMAN: The Pentagon in recent years has made it a big policy issue. They have posited that having very ready access to payday loans outside of bases has caused financial distress and distractions that have contributed to declines in military readiness and job performance.

ELIZABETH DOLE: Predatory lenders are blatantly targeting our military personnel.

Then-Senator **Elizabeth Dole,** in a 2006 Senate Banking Committee **hearing** on payday loans, showed a map with hundreds of payday-loan shops clustered around military bases.

DOLE: This practice not only creates financial problems for individual soldiers and their families, but it also weakens our military's operational readiness.

ZINMAN: And so Scott and I got the idea of actually testing that hypothesis using data from military personnel files.

Zinman and Carrell got hold of personnel data from U.S. Air Force bases across many states that looked at job performance and military readiness. Like the Oregon-Washington study, this one also took advantage of changes in different states' payday laws, which allowed the researchers to isolate that variable and then compare outcomes.

ZINMAN: And what we found matching that data on job performance and job readiness supports the Pentagon's hypothesis. We found that as payday loan access increases, servicemen job performance evaluations decline. And we see that sanctions for severely poor readiness increase as payday-loan access increases, as the spigot gets turned on. So that's a study that very much supports the anti-payday lending camp.

Congress had been so concerned about the effects of payday loans that in 2006 it passed the**Military Lending Act**, which, among other things, capped the interest rate that payday lenders can charge active personnel and their dependents at 36 percent nationwide. So what happened next? You guessed it. A lot of the payday loan shops near military bases **closed down**.

MUSIC: Beckah Shae, "Forever Yours" (from *Rest*)

We've been asking a pretty simple question today: are payday loans as evil as their critics say or overall, are they pretty useful? But even such a simple question can be hard to answer, especially when so many of the parties involved have incentive to twist the argument, and even the data, in their favor. At least the academic research we've been hearing about is totally unbiased, right?

I specifically asked Bob DeYoung about that when I was talking to him about his New York Fed blog post that for the most part defended payday lending:

DUBNER: OK, Bob? For the record did you or any of your three co-authors on this, did any of the related research on the industry, was any of it funded by anyone close to the industry?

DEYOUNG: No.

But as we kept researching this episode, our producer **Christopher Werth** learned something interesting about one study cited in that blog post — the study by Columbia law professor Ronald Mann, another co-author on the post, the study where a survey of payday borrowers found that most of them were pretty good at predicting how long it would take to pay off the loan. Here's Ronald Mann again:

MANN: I didn't really expect that the data would be so favorable to the perspective of the borrowers.

What our producer learned was that while Ronald Mann did create the survey, it was actually administered by a survey firm. And that firm had been hired by the chairman of a group called the**Consumer Credit Research Foundation**, or CCRF, which is funded by payday lenders. Now, to be clear, Ronald Mann says that CCRF did not pay him to do the **study**, and did not attempt to influence his findings; but nor does his paper disclose that the data collection was handled by an industry-funded group. So we went back to Bob DeYoung and asked whether, maybe, it should have.

DEYOUNG: Had I written that paper, and had I known 100 percent of the facts about where the data came from and who paid for it — yes, I would have disclosed that. I don't think it matters one way or the other in terms of what the research found and what the paper says.

MUSIC: Mohkov, "Sun Love" (from *Future Hope*)

Some other academic research we've mentioned today does acknowledge the role of CCRF in providing industry data — like Jonathan Zinman's paper which showed that people suffered from the disappearance of payday-loan shops in Oregon. Here's what Zinman writes in an author's note: "Thanks to Consumer Credit Research Foundation (CCRF) for providing household survey data. CCRF is a non-profit organization, funded by payday lenders, with the mission of funding objective research. CCRF did not exercise any editorial control over this paper."

Now, we should say, that when you're an academic studying a particular industry, often the only way to get the data is from the industry itself. It's a common practice. But, as Zinman noted in his paper, as the researcher you draw the line at letting the industry or industry advocates influence the findings. But as our producer Christopher Werth learned, that doesn't always seem to have been the case with payday-lending research and the Consumer Credit Research Foundation, or CCRF.

*DUBNER: Hey Christopher. So, as I understand it, much of what you've learned about CCRF's involvement in the payday research comes from a watchdog group called the **Campaign for Accountability**, or CFA? So, first off, tell us a little bit more about them, and what their incentives might be.*

*CHRISTOPHER WERTH: Right. Well, it's a non-profit watchdog, relatively new organization. Its mission is to expose corporate and political misconduct, primarily by using open-records requests, like the **Freedom of Information Act**, or FOIA requests, to produce evidence.*

DUBNER:From what I've seen on the CFA website, most of their political targets, at least, are Republicans. What do we know about their funding?

*WERTH:Yeah, they told me they don't disclose their donors, and that CFA is a project of something called the **Hopewell Fund**, about which we have very, very little information.*

DUBNER:OK, so this is interesting that a watchdog group that will not reveal its funding is going after an industry for trying to influence academics that it's funding. So should we assume that CFA, the watchdog, has some kind of horse in the payday race? Or do we just not know?

WERTH: It's hard to say. Actually, we just don't know. But whatever their incentive might be, their FOIA requests have produced what look like some pretty damning e-mails between CCRF — which, again, receives funding from payday lenders — and academic researchers who have written about payday lending.

DUBNER: OK, so Christopher, let's hear the most damning evidence.
WERTH: The best example concerns an economist named ***Marc Fusaro*** *at Arkansas Tech University. So, in 2011, he released a* ***paper*** *called "Do Payday Loans Trap Consumers in a Cycle of Debt?" And his answer was, basically, no, they don't.*
DUBNER: OK, so that would seem to be good news for the payday industry, yes? Tell us a bit about Fusaro's methodology and his findings.
WERTH: So, what Fusaro did was he set up a randomized control trial where he gave one group of borrowers a traditional high-interest-rate payday loan and then he gave another group of borrowers no interest rate on their loans and then he compared the two and he found out that both groups were just as likely to roll over their loans again. And we should say, again, the research was funded by CCRF.
DUBNER: OK, but as we discussed earlier, the funding of research doesn't necessarily translate into editorial interference, correct?
WERTH: That's right. In fact, in the author's note, Fusaro writes that CCRF, "exercised no control over the research or the editorial content of this paper."
DUBNER: OK, so far, so good.
WERTH: So far, so good. But I think we should mention two things here: one, Fusaro had a co-author on the paper. Her name is ***Patricia Cirillo****; she's the president of a company called* ***Cypress Research****, which, by the way, is the same survey firm that produced data for the paper you mentioned earlier, about how payday borrowers are pretty good at predicting when they'll be able to pay back their loans. And the other point, two, there was a long chain of e-mails between Marc Fusaro, the academic researcher here, and CCRF. And what they show is they certainly look like editorial interference.*
DUBNER: Wow, OK. And who from CCRF was Marc Fusaro, the academic, communicating with?
*WERTH: He was communicating with CCRF's chairman, a lawyer named****Hilary Miller****. He's the president of the* ***Payday Loan Bar Association****. And he's testified before Congress on behalf of payday lenders. And as you can see in the e-mails between him and Fusaro, again the professor here, Miller was not only reading drafts of the paper but he was making all kinds of suggestions about the paper's structure, its tone, its content. And eventually what you see is Miller writing whole paragraphs that go pretty much verbatim straight into the finished paper.*
DUBNER: Wowzer. That does sound pretty damning — that the head of a research group funded by payday lenders is essentially ghostwriting parts of an academic paper that happens to reach pro-payday lending conclusions. Were you able to speak with Marc Fusaro, the author of the paper?

WERTH: I was, and what he told me was that even though Hilary Miller was making substantial changes to the paper, CCRF did not exercise editorial control. That is, he says, he still had complete academic freedom to accept or reject Miller's changes. Here's Fusaro:
MARC FUSARO: The Consumer Credit Research Foundation and I had an interest in the paper being as clear as possible. And if someone, including Hilary Miller, would take a paragraph that I had written and re-write it in a way that made what I was trying to say more clear, I'm happy for that kind of advice. I have taken papers to the university writing center before and they've helped me make my writing more clear. And there's nothing scandalous about that, at all. I mean the results of the paper have never been called into question. Nobody had suggested I changed any other results or anything like that based on any comments from anybody. Frankly, I think this is much ado about nothing.
DUBNER: Well, Christopher, that defense sounds, at least to me, like pretty weak sauce. I mean, the university writing center doesn't have as much vested interest in the outcome of my writing as an industry group does for an academic paper about that industry, right?
WERTH: I think that's a fair point to make. Fusaro does maintain though, that CFA, this watchdog group, has really taken his e-mails out of context and just made false accusations about him.
FUSARO: This is a group with an agenda that doesn't like the results of academic research. And they are opposed to payday loans.

If you want to go way deeper into this rabbit hole, check out **this article** written by Christopher Werth about payday industry connections to academic research.
MUSIC: Torches, "Light Goes On"
So we are left with at least two questions, I guess. Number one: how legitimate is any of the payday-loan research we've been telling you about today, pro or con? And number two: how skeptical should we be of any academic research?
There is a long and often twisted history of industries co-opting scientists and other academic researchers to produce findings that make their industries look safer or more reliable or otherwise better than they really are. Whenever we talk about academic research on this show — which is pretty much every week — we do try to show the provenance of that research and establish how legitimate it is. The best first step in figuring that out is to ask what kind of incentives are at play. But even that is only one step.
Does a researcher who's out to make a splash with some sexy finding necessarily operate with more bias than a researcher who's operating out of pure intellectual curiosity? I don't think that's necessarily so. Like life itself, academic research is a case-by-case scenario. You do your best to ask as many questions as you can of the research and of the researchers themselves. You ask where the data comes from, whether it really means what they say it means, and you ask them to explain why they might be wrong, or compromised.

You make the best judgment you can, and then you move forward and try to figure out how the research really matters. Because the whole idea of the research, presumably, is to help solve some larger problem.

The problem we've been looking at today is pretty straightforward: there are a lot of low-income people in the U.S. who've come to rely on a financial instrument, the payday loan, that is, according to its detractors, exploitative, and according to its supporters, useful. President Obama is pushing for regulatory reform; payday advocates say the reform may kill off the industry, leaving borrowers in the lurch.

I went back to Bob DeYoung, the finance professor and former bank regulator, who has argued that payday loans are not as evil as we think.

DUBNER: Let's say you have a one-on-one audience with President Obama. We know that the President understands economics pretty well or, I would argue that at least. What's your pitch to the President for how this industry should be treated and not eliminated?

DeYOUNG: OK, in a short sentence that's highly scientific I would begin by saying, "Let's not throw the baby out with the bathwater." The question comes down to how do we identify the bath water and how do we identify the baby here. One way is to collect a lot of information, as the CFPB suggests, about the creditworthiness of the borrower. But that raises the production cost of payday loans and will probably put the industry out of business. But I think we can all agree that once someone pays fees in an aggregate amount equal to the amount that was originally borrowed, that's pretty clear that there's a problem there.

So in DeYoung's view, the real danger of the payday structure is the possibility of rolling over the loan again and again and again. That's the bathwater. So what's the solution?

DeYOUNG: Right now, there's very very little information on rollovers, the reasons for rollovers, and the effects of rollovers. And without academic research, the regulation is going to be based on who shouts the loudest. And that's a really bad way to write law or regulation. That's what I really worry about. If I could advocate a solution to this, it would be: identify the number of rollovers at which it's been revealed that the borrower is in trouble and is being irresponsible and this is the wrong product for them. At that point the payday lender doesn't flip the borrower into another loan, doesn't encourage the borrower to find another payday lender. At that point the lender's principal is then switched over into a different product, a longer term loan where he or she pays it off a little bit each month.

DUBNER: Do you think the president would buy?

DEYOUNG: Well, I don't know what the president would buy. You know, we have a problem in society right now, it's getting worse and worse, is we go to loggerheads and we're very bad at finding solutions that satisfy both sides, and I think this is a solution that does satisfy both sides, or could at least satisfy both sides. It keeps the industry operating for folks who

value the product. On the other hand it identifies folks using it incorrectly and allows them to get out without you know being further trapped.
DUBNER: Well, here's what seems to me, at least, the puzzle, which is that repeat rollovers — which represent a relatively small number of the borrowers and are a problem for those borrowers — but it sounds as though those repeat rollovers are the source of a lot of the lender's profits. So, if you were to eliminate the biggest problem from the consumer's side, wouldn't that remove the profit motive from the lender's side, maybe kill the industry?
DEYOUNG: This is why price caps are a bad idea. Because if the solution was implemented as I suggest and, in fact, payday lenders lost some of their most profitable customers — because now we're not getting that fee the 6th and 7th time from them — then the price would have to go up. And we'd let the market determine whether or not at that high price we still have folks wanting to use the product.
DUBNER: Obviously the history of lending is long and usually, at least in my reading, tied to religion. There's prohibition against it in Deuteronomy and elsewhere in the Old Testament. It's in the New Testament. In Shakespeare, the Merchant of Venice was not the hero. So, do you think that the general view of this kind of lending is colored by an emotional or moral argument too much at the expense of an economic and practical argument?
DEYOUNG: Oh, I do think that our history of usury laws is a direct result of our Judeo-Christian background. And even Islamic banking, which follows in the same tradition. But clearly interest on money lent or borrowed has a, has been looked at non-objectively, let's put it that way. So the shocking APR numbers if we apply them to renting a hotel room or renting an automobile or lending your father's gold watch or your mother's silverware to the pawnbroker for a month, the APRs come out similar. So the shock from these numbers is, we recognize the shock here because we are used to calculating interest rates on loans but not interest rates on anything else. And it's human nature to want to hear bad news and it's, you know, the media understands this and so they report bad news more often than good news. We don't hear this. It's like the houses that don't burn down and the stores that don't get robbed.

There's one more thing I want to add to today's discussion. The payday-loan industry is, in a lot of ways, an easy target. But the more I think about it, the more it seems like a symptom of a much larger problem, which is this: remember, in order to get a payday loan, you need to have a job and a bank account. So what does it say about an economy in which millions of working people make so little money that they can't pay their phone bills, that they can't absorb one hit like a ticket for smoking in public?
Whatever you want to call it — wage deflation, structural unemployment, the absence of good-paying jobs — isn't that a much bigger problem? And, if so, what's to be done about that? Next time on *Freakonomics Radio*, we will continue this conversation by looking at

one strange, controversial proposal for making sure that everyone’s got enough money to get by.

EVELYN FORGET: I think a guaranteed annual income could do a very nice job of addressing some of these issues.

Pros and cons, the history and future, of a guaranteed annual income. That’s next time, on*Freakonomics Radio*.