Negative: National APR (Interest Rate) Cap

By Katherine Baker

***Resolved: The United States Federal Government should substantially reform its banking, finance, and/or monetary policy***

Summary: AFF plan would set a national Annual Percentage Rate (interest rate) cap on all loans, including loans previously exempt or using loopholes from state usury laws (like payday lending, car title lending, etc.). This would be a bad idea for several reasons. The APR on payday loans, while high, is far better for the poor than the costs they would incur by not getting the loans and being evicted from their housing or bouncing a check. No one is being deceived by these loans, since consumers understand what they’re signing up for. And they’re not trapped in a cycle of debt as AFF will claim. Most of them are paid off, and the poor are better off with these loans than they would be with any alternative. Shutting down the legitimate small loan industry (which is effectively what would happen with a 36% interest rate cap, for example) would send the poor to illegal loan sharks for small borrowing needs. That definitely won’t make them better off.

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OPENING QUOTES / NEGATIVE PHILOSOPHY

36% cap offers fewer and worse choices

Daniel Press, 2019. (policy analyst at the Competitive Enterprise Institute, where he focuses on financial regulation, international development and trade.) “The Economic Illiteracy of a 36 Percent Interest Rate Cap” May 1, 2019. <https://cei.org/blog/economic-illiteracy-36-percent-interest-rate-cap>

You don’t eliminate hardship by taking away people’s choices. You eliminate hardship by offering people more and better choices. A 36 percent interest rate cap will do neither.

400% interest rate unicorn

John Berlau, 2011. (director of the Center for Investors and Entrepreneurs at the Competitive Enterprise Institute.) “The 400 Percent Loan, the $36,000 Hotel Room, and the Unicorn” February 6, 2011. <https://cei.org/sites/default/files/John%20Berlau-The%20400%20Percent%20Loan.pdf>

The 400-percent interest rate is the financial equivalent of a unicorn, yet it has driven public policy regarding short-term credit with destructive results for the neediest of borrowers.

INHERENCY

Payday lenders well regulated

William Isaac, 2013. (former chairman of the Federal Deposit Insurance Corp., is the global head of financial institutions for FTI Consulting.) “Why Payday Loans are Good for Millions of People” August 13 2013. <https://www.americanbanker.com/opinion/why-payday-loans-are-good-for-millions-of-people>

The $15 cost of a $100 payday loan also pales in comparison with the lost income when a car is out of commission and a job lost. Good payday lenders clearly disclose their loan terms and conditions, including the dollar amount of any fees and the APR. Moreover, payday lenders are regulated and supervised by state agencies and also the new federal Consumer Financial Protection Bureau. My firm has worked with payday lenders to get them into compliance with regulations applicable to banks.

A/T “Payday Loans rolled over”: State and industry limits on the number of rollovers

William Isaac, 2013. (former chairman of the Federal Deposit Insurance Corp., is the global head of financial institutions for FTI Consulting) “Why Payday Loans are Good for Millions of People” August 13 2013. <https://www.americanbanker.com/opinion/why-payday-loans-are-good-for-millions-of-people>

Some argue that payday loan portfolios have enormous losses imbedded in them because the loans are never really repaid just rolled over and over again. But most states limit the number of rollovers, and most payday lenders impose similar limits, even in the absence of state laws.

MINOR REPAIR

Minor Repair: Encourage traditional lenders to compete

David Kreutzer, 2008. (Employment Policies Institute economist. The Employment Policies Institute is a non-profit research organization dedicated to studying public policy issues surrounding employment growth.)“Cap on payday loans would hurt those most in need” January 2008. <https://www.epionline.org/oped/o109/>

Instead of killing the payday loan industry, the foundation report recommends encouraging traditional lenders to compete with the payday lenders. As with everything, more choices and more competition are better for the consumer. A January 2007 study by the Federal Reserve Bank of New York confirms this last point. It found the more payday lenders there are per capita, the lower their fees become.

Viable alternatives just as effective for discouraging fringe lenders

Nicola Howell, Therese Wilson and James Davidson, 2008. (Howell: Director, Centre for Credit and Consumer Law. Wilson: Senior Lecturer, Griffith Law School. Davidson: Senior Research Assistant, Centre for Credit and Consumer Law.) “Interest Rate Caps: protection or paternalism?” December 2008. <https://eprints.qut.edu.au/45483/1/CCCL-Interest-rate-caps-report-final.pdf>

It seems likely that a viable, safe affordable alternative to fringe lending may be just as effective in discouraging fringe lenders from entering or continuing in a market, as an interest rate cap.

SIGNIFICANCE

1. A/T “High interest rates / fees”

Payday Loan fee is not “Interest” example: ATM fees

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It is also important to note that what is called “interest” includes things like fees charged to cover the cost of doing business—not something that is typically considered to be part of an APR in a credit card or mortgage agreement. For example, what if ATM fees were calculated in the same way? A $3 fee on a $50 withdrawal, in certain circumstances, is equivalent to a 730 APR loan. But we do not think of it in the same way and for good reason.

Payday Loan fees are not an APR

John Berlau, 2011. (John Berlau is director of the Center for Investors and Entrepreneurs at the Competitive Enterprise Institute.) “The 400 Percent Loan, the $36,000 Hotel Room, and the Unicorn” February 6, 2011. <https://cei.org/sites/default/files/John%20Berlau-The%20400%20Percent%20Loan.pdf>

Is a $16 surcharge on a $100 product unfair, unjust, and “predatory”? Hardly anyone flinches, for instance, at a $16 “resort fee” on a $100 hotel room. But when it comes to short-term loans offered by non-bank institutions, mostly payday loans, politicians call for banning the practice, using dubious arguments about such loans’ true cost. Before he was installed in a controversial “recess” appointment in January, the White House issued a report urging the confirmation of former Ohio Attorney General Richard Cordray as director of the new Consumer Financial Protection Bureau (CFPB), “because some studies have found that payday lenders on average charge fees of roughly $16 for a two-week loan … this translates into an annual percentage rate of roughly 400 percent.” How does that work? Quite simply, it does not. The Obama administration and other politicians who make this argument are using a flawed method of calculating interest that is an apples-and-oranges application of annual percentage rate (APR) to loans of a much shorter duration than one year.

A/T “Payday Loans High APR” - No one paid the high APR

John Berlau, 2011. (director of the Center for Investors and Entrepreneurs at the Competitive Enterprise Institute.) “The 400 Percent Loan, the $36,000 Hotel Room, and the Unicorn” February 6, 2011. <https://cei.org/sites/default/files/John%20Berlau-The%20400%20Percent%20Loan.pdf>

A typical payday loan in the U.S. covers a period of two weeks, tracking the interval of time between paychecks. Interest and fees come to $10 to $20 per $100 of the amount of the loan, the total amount of which is usually $500 or less. Such loans are often taken out during emergencies to pay immediate costs that can be covered with the arrival of the next paycheck. Were a borrower to take out a new loan every two weeks for a year, the total would indeed equal 420 percent. The only problem with that scenario is that it does not match reality. State government data on payday loans show that hundreds of thousands of borrowers take out just one loan per year and pay back the loan within the two-week duration. Even staunch critics of payday loans have yet to name a single individual who has paid close to 400 percent over a year from a law-abiding lender.

2. A/T “Consumers deceived / tricked / trapped”

Many high-rate borrowers know what they’re getting into and decided it’s the best option

Daniel Press, 2019. (policy analyst at the Competitive Enterprise Institute, where he focuses on financial regulation, international development and trade.) “The Economic Illiteracy of a 36 Percent Interest Rate Cap” May 1, 2019. <https://cei.org/blog/economic-illiteracy-36-percent-interest-rate-cap>

The economic literature on the impact of the withdrawal of high-rate credit is clear. The authoritative consumer credit textbook, Consumer Credit and the American Economy, extensively summarizes the current literature regarding high-rate credit and finds no evidence of systemic problems with the use of current, legal, high-rate credit products. As the textbook concludes, the use of such products: Indicate that high-rate credit users generally are those who economic theory predicts may benefit from such credit, and many of them are fully aware of what they are doing, even as critics see their choices as outrageously shortsighted.

Respect the poor’s choice, don’t force lawmakers’ preferences

Daniel Press, 2019. (policy analyst at the Competitive Enterprise Institute, where he focuses on financial regulation, international development and trade.) “The Economic Illiteracy of a 36 Percent Interest Rate Cap” May 1, 2019. <https://cei.org/blog/economic-illiteracy-36-percent-interest-rate-cap>

As Milton Friedman famously said: “Underlying most arguments against the free market is a lack of belief in freedom itself.” That is certainly true for high-cost credit. Those who would prohibit small-dollar credit disregard the ability of individuals to live their lives in the way that they see fit. We should treat the less well-off with dignity and respect, not with paternalistic policies that substitute their preferences with those of lawmakers or bureaucrats in Washington.

Borrowers choose payday loans because they protect a person’s credit rating

John Berlau, 2011. (director of the Center for Investors and Entrepreneurs at the Competitive Enterprise Institute.) “The 400 Percent Loan, the $36,000 Hotel Room, and the Unicorn” February 6, 2011. <https://cei.org/sites/default/files/John%20Berlau-The%20400%20Percent%20Loan.pdf>

Thus, the alternatives most in competition with payday loans are the unattractive options of bounced checks, overdraft fees, and late fees on bills. And if these charges were treated as “interest” rather than “fees,” and measured via the same APR sophistry that has been used to attack payday lenders, their APRs would often well exceed those of payday loans. As Federal Reserve Bank of Kansas City Senior Economist Kelly Edmiston points out, the median interest rate for bounced check fees—if they were measured as interest payments—would be “well in excess of 4,000 percent, or up to 20 times that of payday loans.” Edmiston notes that one other advantage of payday loans is preserving what is called “credit standing.” He writes, “Unlike traditional lenders, payday lenders do not report to credit agencies,” Thus, a person needing a loan might go to a payday lender precisely to avoid a future black mark with a traditional lender or prospective employer.

3. High rates are justified by the risk

Payday lending has high fees because of high risk

William Isaac, 2013. (former chairman of the Federal Deposit Insurance Corp., is the global head of financial institutions for FTI Consulting.) “Why Payday Loans are Good for Millions of People” August 13 2013. <https://www.americanbanker.com/opinion/why-payday-loans-are-good-for-millions-of-people>

The risks of payday lending are ameliorated due to the enormous diversification in the portfolios, and risks are priced into the fees. It's feasible for a reputable and efficient payday lender to maintain high loan loss reserves and substantial capital against payday loans and still achieve decent returns.

High risk equals high rate

Daniel Press, 2019. (policy analyst at the Competitive Enterprise Institute, where he focuses on financial regulation, international development and trade.) “The Economic Illiteracy of a 36 Percent Interest Rate Cap” May 1, 2019. <https://cei.org/blog/economic-illiteracy-36-percent-interest-rate-cap>

Further, credit is priced according to risk. If the risk of default is higher, that will be reflected in the price. A small-dollar loan is typically an unsecured loan to a borrower who has a poor credit history and is unable to access “traditional” forms of credit. Lending to higher risk individuals without collateral means that lenders have a lot to lose. In other words, the higher risk in large part accounts for the higher rate. The market for credit is no different than any other market. The idea that lawmakers, rather than the laws of supply and demand, have the knowledge to set the appropriate price of credit is as absurd as it would be if we were talking about bananas or washing machines. If an interest rate cap is set below the market rate, there will be a shortage of credit. If lenders are prohibited by law from pricing risk accurately, a lender will respond in a number of predictable ways: adjusting the contract terms and length, requiring higher collateral, or restricting access to credit altogether. Lenders will not magically make the same loans to the same consumers at a lower rate of return. Rather, the end result is that consumers will be left with less credit or credit on worse terms than before.

4. A/T “Endless rollovers / debt trap”

CRL Study claiming long-term debt is sloppy, subjective and limited

John Berlau, 2011. (director of the Center for Investors and Entrepreneurs at the Competitive Enterprise Institute.) “The 400 Percent Loan, the $36,000 Hotel Room, and the Unicorn” February 6, 2011. <https://cei.org/sites/default/files/John%20Berlau-The%20400%20Percent%20Loan.pdf>

This argument comes straight from the advocacy group that has led the charge against payday loans, the Center for Responsible Lending (CRL). CRL strongly supports applying APR to payday loans and a federal APR cap of 36 percent, claiming that “longterm payday debt” is “the norm for the industry.” In CRL’s reading of payday loan statistics, 90 percent of loans are made to borrowers who take out five or more transactions per year. But scratching the surface of the group’s methodology, one finds that it paints a distorted picture. CRL’s 2006 report, Financial Quicksand, has provided the basis for much of the group’s assertions before the media, state legislatures, and Congress. The report consists of a sloppy overlay of mostly Washington state data, coupled with subjective estimates and assumptions, onto payday lending in the nation as a whole.

Majority of borrowers take out fewer than 6 loans

John Berlau, 2011. (director of the Center for Investors and Entrepreneurs at the Competitive Enterprise Institute.) “The 400 Percent Loan, the $36,000 Hotel Room, and the Unicorn” February 6, 2011. <https://cei.org/sites/default/files/John%20Berlau-The%20400%20Percent%20Loan.pdf>

An examination of payday lending data from California, the nation’s most populous state, belies many of CRL’s assertions. A 2007 report from the California Department of Corporations contains a comprehensive database of transactions from payday lenders licensed by the state. According to the report, 74 percent of payday loans made in California went to borrowers with five or fewer transactions—an inverse image of CRL’s findings. The report also found that 27 percent of borrowers—nearly 400,000 individuals—took out only one loan per year, paying 15 percent interest.

Center for Responsible Lending (CRL) inflates numbers

John Berlau, 2011. (director of the Center for Investors and Entrepreneurs at the Competitive Enterprise Institute.) “The 400 Percent Loan, the $36,000 Hotel Room, and the Unicorn” February 6, 2011. <https://cei.org/sites/default/files/John%20Berlau-The%20400%20Percent%20Loan.pdf>

The difference is partly explained by the fact that CRL inflates the number of loans based on the assumption that many borrowers go to multiple lenders. But it is a stretch to simply assume that, the most chronic borrowers aside, a majority of individuals would get loans from multiple lenders.

Over half of borrowers don’t take out more than 6 loans, based on better studies than those done by CRL

John Berlau, 2011. (director of the Center for Investors and Entrepreneurs at the Competitive Enterprise Institute.) “The 400 Percent Loan, the $36,000 Hotel Room, and the Unicorn” February 6, 2011. <https://cei.org/sites/default/files/John%20Berlau-The%20400%20Percent%20Loan.pdf>

The validity of the California data is buttressed by a Western Economic Association paper by Edward C. Lawrence of George Washington University and Gregory Elliehausen of the University of Missouri at Saint Louis. Using a data set of 427 payday customers, and taking into account those who went to more than one lender, the study found results that were similar to the California and in contrast to that of the CRL. The Lawrence-Elliehausen study found that, “almost 52% of customers used advances six or fewer times per year,” and that, “a quarter of borrowers did not renew any payday advance in the previous 12 months.”

5. Payday lender fees are not excessive considering their costs

36% APR limit would mean payday loans run on a $12.51 loss

Daniel Press, 2019. (policy analyst at the Competitive Enterprise Institute, where he focuses on financial regulation, international development and trade.) “The Economic Illiteracy of a 36 Percent Interest Rate Cap” May 1, 2019. <https://cei.org/blog/economic-illiteracy-36-percent-interest-rate-cap>

A relatively high-interest rate for small dollars loans makes sense for a number of reasons. First of all, due to the fixed costs of running any business—including the costs of operating a storefront, paying employees, the cost of capital, and the cost of bad debts—lenders must charge a price that enables them to turn a profit. As seen in the chart below, a $15 fee on a $100 loan turns $1.11 of pretax profit. On the other hand, a 36 percent interest rate on the same loan results in a loss of $12.51.

Chart: APR limit means payday loans operate on a loss. Details of how numbers are calculated

Daniel Press, 2019. (policy analyst at the Competitive Enterprise Institute, where he focuses on financial regulation, international development and trade.) “The Economic Illiteracy of a 36 Percent Interest Rate Cap” May 1, 2019. <https://cei.org/blog/economic-illiteracy-36-percent-interest-rate-cap>



Free market theory proves payday lenders not running on abnormal profits

Daniel Press, 2019. (Daniel Press is a policy analyst at the Competitive Enterprise Institute, where he focuses on financial regulation, international development and trade.) “The Economic Illiteracy of a 36 Percent Interest Rate Cap” May 1, 2019. <https://cei.org/blog/economic-illiteracy-36-percent-interest-rate-cap>

Further, for the abnormal profits theory to hold true, small-dollar lenders must hold significant market power to be able to charge a rate of interest that is “artificially” higher than what would be charged in a competitive market. And yet the small dollar lending market is highly competitive, with more storefront payday locations than either McDonald’s or Starbucks, and numerous other substitute products, such as check cashing, pawnbroking, personal finance companies, banks, and more.

6. Should get a Nobel Prize, not criminal sanctions

National APR cap would penalize businesses for lending to the poor. Others have gotten a Nobel Prize for doing that

Daniel Press, 2019. (policy analyst at the Competitive Enterprise Institute, where he focuses on financial regulation, international development and trade.) “The Economic Illiteracy of a 36 Percent Interest Rate Cap” May 1, 2019. <https://cei.org/blog/economic-illiteracy-36-percent-interest-rate-cap>

Earlier this week, the House Financial Services Committee held a hearing on a draft bill that proposes to set a national 36 percent annual percentage rate (APR) cap. That is to say, for daring to provide credit to people who would otherwise be unable to access it—something considered to be Nobel Prize-worthy in other parts of the world—you could face up to one year in prison and a $50,000 fine for each violation.

Example: Muhammad Yunus and Grameen Bank got a Nobel Prize for lending to the poor

Norwegian Nobel Prize Committee 2006. “The Nobel Peace Prize for 2006” <https://www.nobelprize.org/prizes/peace/2006/press-release/>

[The Norwegian Nobel Committee](http://nobelpeaceprize.org/) has decided to award the Nobel Peace Prize for 2006, divided into two equal parts, to **Muhammad Yunus** and **Grameen Bank** for their efforts to create economic and social development from below. Lasting peace can not be achieved unless large population groups find ways in which to break out of poverty. Micro-credit is one such means. Development from below also serves to advance democracy and human rights. Muhammad Yunus has shown himself to be a leader who has managed to translate visions into practical action for the benefit of millions of people, not only in Bangladesh, but also in many other countries. Loans to poor people without any financial security had appeared to be an impossible idea. From modest beginnings three decades ago, Yunus has, first and foremost through Grameen Bank, developed micro-credit into an ever more important instrument in the struggle against poverty.

Grameen Bank charges 69% interest to poor borrower in Sri Lanka. Under AFF plan, a Nobel Prize winning lender would go to jail

Dr. Eric Toussaint and Nathan Legrand 2018 (Toussaint – PhD; historian and political scientist who completed his Ph.D. at the universities of Paris VIII and Liège, is the spokesperson of the Committee for the Abolition of Illegitimate Debt, International. Legrand is also with Committee for the Abolition of Illegitimate Debt ) “Damning testimonies of microcredit abuse” 25 Apr 2018 <http://www.cadtm.org/Damning-testimonies-of-microcredit>

In order to pay both the rent and the six months’ advance rent that the landlord of their new address wanted as guarantee Manbasa borrowed 142 000 rupees (737 euros) from [HNB Grameen](http://www.hnbgrameen.lk/), microcredit specialists. Manbasa is expected to repay 3 800 rupees a week for 52 weeks - [interest](http://www.cadtm.org/Interest) and principal. Over the year that works out at 197 600 rupees (1023 euros), this means that HNB Grameen are charging her an annual interest rate of 69%.

DISADVANTAGES

1. Black markets

APR cap means withdrawn options and black market explosion

John Berlau, 2011. (director of the Center for Investors and Entrepreneurs at the Competitive Enterprise Institute.) “The 400 Percent Loan, the $36,000 Hotel Room, and the Unicorn” February 6, 2011. <https://cei.org/sites/default/files/John%20Berlau-The%20400%20Percent%20Loan.pdf>

Imagine how much worse things would be if a rent control statute intended to put the rent ceiling at $2,000 per month, but thanks to a typo, ended up capping it by this amount per year. Existing landlords, unable to cover maintenance and other costs, would withdraw apartments for rent, and black markets would explode. Yet this is roughly analogous to the APR caps for short-term credit enacted in several states and proposed at the federal level.

British Study: APR Cap harms the poor by sending them to loan sharks instead of legitimate lenders

Nicola Howell, Therese Wilson and James Davidson, 2008. (Howell: Director, Centre for Credit and Consumer Law. Wilson: Senior Lecturer, Griffith Law School. Davidson: Senior Research Assistant, Centre for Credit and Consumer Law.) “Interest Rate Caps: protection or paternalism?” December 2008. <https://eprints.qut.edu.au/45483/1/CCCL-Interest-rate-caps-report-final.pdf> (“UK”=United Kingdom = Britain)

Key arguments against the introduction of an interest rate cap can be summarised as follows:- 1. A cap will exacerbate financial exclusion, by removing an option for people who cannot access credit through mainstream services. This argument has been articulated as a warning that: Policy makers and regulators must be mindful that setting caps on fees or setting implied interest rates arbitrarily low could easily curtail or eliminate the flow of credit to the high-risk borrowers who need it most. The argument was accepted by the UK government when it introduced the Consumer Credit Act 2006 without a cap: The government analysed independent research and decided not to introduce an interest rate ceiling in the UK. Introducing caps would harm the very consumers they are supposed to help. Caps would reduce the range of credit products available, force vulnerable consumers to use inappropriate alternative products or even to go outside the regulated market to loan sharks.

Link: Lending disappears. 36% cap wouldn’t let payday lenders pay employees, cover business expenses or make a profit

John Berlau, 2011. (director of the Center for Investors and Entrepreneurs at the Competitive Enterprise Institute.) “The 400 Percent Loan, the $36,000 Hotel Room, and the Unicorn” February 6, 2011. <https://cei.org/sites/default/files/John%20Berlau-The%20400%20Percent%20Loan.pdf>

Many states have imposed APR limits of 36 percent or lower. While that may sound high, the key word is annual. Divided into 26 two-week periods, the usual duration for most payday loans, this means that payday lenders could only charge $1.38 on a loan of $100. Expressing a sentiment that has been echoed by many in the industry as well as independent researchers of short-term credit, a spokesman for the Utah Consumer Lending Association says, “Payday advance lenders could not even meet employee payroll at that rate, let alone cover other fixed business expenses and make a profit.”

Impact: Black market lenders charge even higher rates and use violence

Daniel Press, 2019. (policy analyst at the Competitive Enterprise Institute, where he focuses on financial regulation, international development and trade.) “The Economic Illiteracy of a 36 Percent Interest Rate Cap” May 1, 2019. <https://cei.org/blog/economic-illiteracy-36-percent-interest-rate-cap>

A responsible policymaker would at least attempt to reckon with the problem of what happens when you eliminate the choices of those who have little or no other options. Eradicating alternative financial products through a binding 36 percent interest rate cap will, at best, result in people defaulting on other loans and obligations such as rent, working a second job to make ends meet, or going without essential goods and services. To be clear, these are options that people have always had but decided against, presumably because it is not in their best interest. At worst, they will be pushed into the hands of illegal, predatory lenders who charge even higher rates of interest and enforce them with violence—a practice sadly common throughout American history.

2. Poor would be worse off financially

Link: 36% cap kills payday loan industry

David Kreutzer, 2008. (Employment Policies Institute economist. The Employment Policies Institute is a non-profit research organization dedicated to studying public policy issues surrounding employment growth.)“Cap on payday loans would hurt those most in need” January 2008. <https://www.epionline.org/oped/o109/>

A $100 payday loan costs $15, or 15 percent. Whether the cost is called a “fee” or “interest” doesn’t matter to the borrower. But, according to regulators it is “interest.” This means the 15 percent is multiplied by 26 to get an annual percentage rate, or APR, of 390 percent. Similar math shows the proposed 36 percent cap translates to 1.4 percent for a two-week loan. Though the 36 percent cap might be an outrageously profitable APR for a six-year $30,000 car loan, it won’t cover the disbursement and collection costs for a two-week $100 loan. In every state that implemented this cap, the payday loan industry shut down — eliminating one choice for the cash-strapped.

Link: 36% camp means zero supply of small loans. They have to make bigger loans to stay profitable, and fewer customers will qualify

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As Thomas Miller, a Professor of Finance at Mississippi State University, noted in his excellent new book, How Do Small-Dollar, NonBank Loans Work?: Economic theory predicts that a 36 percent interest rate cap will result in zero supply of payday loans. As Miller further details, even longer term installment lenders that offer loans of around $1,000 cannot cover their costs under a 36 percent rate cap. For example, one study that looked at the breakeven APRs of installment loans, in 2013 dollars, found that a $1,000 loan has a break-even APR of 77.86 percent, a $2,100 loan has a break-even APR of 42 percent, while only a $2,600 loan has a break-even APR of 36 percent. As Miller concludes, lenders must increase the dollar size of the loans they make so that the increased revenue from the bigger loans exceeds the cost of making the loans. To make these larger loans, lenders engage in more rigorous underwriting, which means that fewer customers qualify as the loan size grows

Brink: No cheap alternatives for Payday Loans

John Berlau, 2011. (director of the Center for Investors and Entrepreneurs at the Competitive Enterprise Institute.) “The 400 Percent Loan, the $36,000 Hotel Room, and the Unicorn” February 6, 2011. <https://cei.org/sites/default/files/John%20Berlau-The%20400%20Percent%20Loan.pdf>

Payday Loans Are often the Most Affordable Alternative. In evaluating the pricing of payday loans, it is useful to identify the alternatives. Most of the time, they are not loans from a federally insured depository institution. Banks are not in the habit of making loans of $500 or less to individuals with marginal credit, and even if they did, the loan approval process would be too cumbersome for people in need of emergency cash.

Link: Only for two-week terms, and still cheaper than the alternatives, like bounced check or late payment

William Isaac, 2013. (former chairman of the Federal Deposit Insurance Corp. is the global head of financial institutions for FTI Consulting) “Why Payday Loans are Good for Millions of People” August 13 2013. <https://www.americanbanker.com/opinion/why-payday-loans-are-good-for-millions-of-people>

Critics of payday lending cite the high interest rates they charge. A $15 fee on a $100 advance for two weeks amounts to a 391% annual percentage rate, or APR. That's high when expressed as an annual rate, but keep in mind that the typical term of these loans is a couple of weeks. It's also notable that the annualized interest rate on the average payday loans is much lower than it would be for the fee on a bounced check or a late mortgage or credit card payment.

Impact: Lost income or lost job is far worse than payday lending APR

William Isaac, 2013. (former chairman of the Federal Deposit Insurance Corp. is the global head of financial institutions for FTI Consulting) “Why Payday Loans are Good for Millions of People” August 13 2013. <https://www.americanbanker.com/opinion/why-payday-loans-are-good-for-millions-of-people>

The $15 cost of a $100 payday loan also pales in comparison with the lost income when a car is out of commission and a job lost. Good payday lenders clearly disclose their loan terms and conditions, including the dollar amount of any fees and the APR. Moreover, payday lenders are regulated and supervised by state agencies and also the new federal Consumer Financial Protection Bureau.

Impact: Far higher costs for the poor. “APR” on a bounced check is over 4000 percent

John Berlau, 2011. (John Berlau is director of the Center for Investors and Entrepreneurs at the Competitive Enterprise Institute.) “The 400 Percent Loan, the $36,000 Hotel Room, and the Unicorn” February 6, 2011. <https://cei.org/sites/default/files/John%20Berlau-The%20400%20Percent%20Loan.pdf>

Thus, the alternatives most in competition with payday loans are the unattractive options of bounced checks, overdraft fees, and late fees on bills. And if these charges were treated as “interest” rather than “fees,” and measured via the same APR sophistry that has been used to attack payday lenders, their APRs would often well exceed those of payday loans. As Federal Reserve Bank of Kansas City Senior Economist Kelly Edmiston points out, the median interest rate for bounced check fees—if they were measured as interest payments—would be “well in excess of 4,000 percent, or up to 20 times that of payday loans.”

Impact: Killing payday loans in Georgia and North Carolina increased bankruptcy and bounced checks

David Kreutzer, 2008. (Employment Policies Institute economist. The Employment Policies Institute is a non-profit research organization dedicated to studying public policy issues surrounding employment growth.)“Cap on payday loans would hurt those most in need” January 2008. <https://www.epionline.org/oped/o109/>

Recent legislation in Georgia and North Carolina killed their payday loan industries. What happened? When compared to other states, a November 2007 study by the Federal Reserve Bank of New York found Chapter 7 bankruptcy filings and the number of costly bounced checks both rose in North Carolina and Georgia. Calculations for Georgia showed that the additional bounced check fees totaled $36 million and Chapter 7 filings went up nearly 9 percent.

Impact: Withdrawing high-rate credit increased bankruptcy in New York

Daniel Press, 2019. (policy analyst at the Competitive Enterprise Institute, where he focuses on financial regulation, international development and trade.) “The Economic Illiteracy of a 36 Percent Interest Rate Cap” May 1, 2019. <https://cei.org/blog/economic-illiteracy-36-percent-interest-rate-cap>

A recent natural experiment in New York, for instance, showed that withdrawing access to certain high-rate credit products led to an eight percent rise in personal bankruptcies, particularly among households on low incomes. This result should not come as a surprise, as these products are commonly used to consolidate debts and provide household liquidity, which reduces the likelihood of bankruptcy.

Impact: Increases APR paid by the poor due to other fees and charges they will face instead

David Kreutzer, 2008. (Employment Policies Institute economist. The Employment Policies Institute is a non-profit research organization dedicated to studying public policy issues surrounding employment growth.)“Cap on payday loans would hurt those most in need” January 2008. <https://www.epionline.org/oped/o109/>

What options are left? Though not considered loans, bouncing checks and paying bills late are frequently used options. Because the regulators ruled that bounced-check charges and late fees are not “interest,” these fees are exempt from the 36 percent APR cap. However, if calculated as interest (like the $15 cost of a payday loan), bounced- check fees generate APRs in excess of 2,700 percent and late fees can easily exceed an APR of 600 percent.

Impact: Bounce-check and nonsufficient-fund fees higher than payday loans APR

David Kreutzer, 2008. (Employment Policies Institute economist. The Employment Policies Institute is a non-profit research organization dedicated to studying public policy issues surrounding employment growth.)“Cap on payday loans would hurt those most in need” January 2008. <https://www.epionline.org/oped/o109/>

A report done for the Annie E. Casey Foundation recognizes that borrowers are helped when they have more choices. The author, currently head of the Federal Deposit Insurance Corporation, notes the very high effective APRs that banks generate from bounced-check and nonsufficient-fund fees are much worse for the borrower than those on payday loans.

Impact: Alternatives to high-APR lending much worse

William Isaac, 2013. (former chairman of the Federal Deposit Insurance Corp., is the global head of financial institutions for FTI Consulting.) “Why Payday Loans are Good for Millions of People” August 13 2013. <https://www.americanbanker.com/opinion/why-payday-loans-are-good-for-millions-of-people>

Millions of middle-income Americans live paycheck to paycheck. They do their best to manage their finances so that all their obligations are met. But when something unexpected crops up, such as a blown transmission, an unexpected doctor's bill or a badly needed roof repair, their financial schedules are thrown off and the need for short-term credit may arise. Some turn to relatives or friends for help in a crunch. But many may face the Hobson's choice of deciding between having their electricity turned off, their car repossessed, their job lost, their rent or mortgage unpaid or their check bounced. Payday lenders offer a better way out.

Impact: Shortage of credit and worse terms

Daniel Press, 2019. (policy analyst at the Competitive Enterprise Institute, where he focuses on financial regulation, international development and trade.) “The Economic Illiteracy of a 36 Percent Interest Rate Cap” May 1, 2019. <https://cei.org/blog/economic-illiteracy-36-percent-interest-rate-cap>

If an interest rate cap is set below the market rate, there will be a shortage of credit. If lenders are prohibited by law from pricing risk accurately, a lender will respond in a number of predictable ways: adjusting the contract terms and length, requiring higher collateral, or restricting access to credit altogether. Lenders will not magically make the same loans to the same consumers at a lower rate of return. Rather, the end result is that consumers will be left with less credit or credit on worse terms than before.

Impact: Cap leaves poor with fewer and worse options

Daniel Press, 2019. (policy analyst at the Competitive Enterprise Institute, where he focuses on financial regulation, international development and trade.) “The Economic Illiteracy of a 36 Percent Interest Rate Cap” May 1, 2019. <https://cei.org/blog/economic-illiteracy-36-percent-interest-rate-cap>

Eradicating alternative financial products through a binding 36 percent interest rate cap will, at best, result in people defaulting on other loans and obligations such as rent, working a second job to make ends meet, or going without essential goods and services. To be clear, these are options that people have always had but decided against, presumably because it is not in their best interest.

Impact: Increased bounce checks and late payments, reduced credit scores, and increased bankruptcy

John Berlau, 2011. (director of the Center for Investors and Entrepreneurs at the Competitive Enterprise Institute.) “The 400 Percent Loan, the $36,000 Hotel Room, and the Unicorn” February 6, 2011. <https://cei.org/sites/default/files/John%20Berlau-The%20400%20Percent%20Loan.pdf>

Finally, Edmiston and researchers from Dartmouth and the Federal Reserve Bank of New York find that banning or severely restricting the ability to obtain payday loans has several pernicious effects. States that passed restrictive payday legislation experienced a substantial increases in bounced checks and late payments, a reduction in credit scores, and higher rates of bankruptcy.

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