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[Evaluating High-Cost Credit Targeted at the Poor]

[Jason Lux]

James Madison University

The technological age is a great opportunity to act against poverty. Advancements in money-market technology, if made available to the poor, could both better their lives in the lower class and assist in lifting them out of poverty, but technology and innovation can be a double-edged sword. These advancements could just as easily be taken advantage of by those with wealth and turned to work against the poor.

One such recent innovation in the market for money is the inception of the payday loan. This special type of loan is a small amount of money intended to assist someone until their next payday when that loan can then be paid off. The payday loan is just one tool in the broader fringe banking industry. Other aspects of this business include cash checking, title loans, and pawn brokers. In theory, these loans could be very helpful to the poor, who have a very small amount of disposable income; but in actuality, they are much more complicated than that. These loans have very different terms compared to typical loans given out by banks. Through all of these complex financial tools, the fringe banking industry hurts its customers, primarily the lower class, and takes advantage of the fact that many of the people using these loans are uneducated and financially illiterate.

In their book "Borrowing to Live Consumer and Mortgage Credit Revisited" Nicolas Retsinas and Eric Beslky put themselves in the shoes of a borrower. They guess that you may "wonder why lower-income consumers choose to cash their paychecks for a fee when they could open a bank account instead and have the funds deposited electronically. Similarly, others question why immigrants would use a higher-priced money transfer services when a growing number of banks offer free or reduced-cost transfers via a bank account" (92). Understanding why someone who is at high financial risk and living paycheck to paycheck would take a big gamble in taking on extra debt is key to understanding why this type of industry is skyrocketing in popularity.

The answer may be that the financial tools the middle and upper class populations dismiss as predatory are actually helpful to the poor in a unique way that most do not understand. Carl Packman perfectly explains the negative effects the financial industry is currently having on the poor by saying "The toxic mix of financial deregulation, and the continued financialization of low-income households, expressed in a declining wage share but growing subprime debt profile, had a downward effect on households from which they have never fully recovered" (100). Over time, the financial market has become steadily less regulated; meanwhile the spending power of the poor has declined while they take on more debt. When banks offer loans to people who may not pay back their loans, they classify those loans as subprime. Banks still offer these loans because despite the increased risk, there is a greater payoff and less regulation. Even though they hold unstable jobs, those who take out subprime loans feel pressure from the financial culture in America, and current laws no longer protect the poor like they once did. Our country should not be leaving the poorest of its citizens in such a vulnerable position.

The Fringe Banking Industry

The fringe banking industry is fully aware of its niche position in the economy. It occupies a small space that almost exclusively appeals to the lower class. Not so long ago, banks left the short-term loan market because without charging overly excessive fees, they could not turn a profit. To fill this void, smaller lenders began appearing in impoverished areas, charging the high fees that banks would not. This is potentially very dangerous for consumers because these smaller lenders have near exclusive access to a vulnerable sector of the economy. Their use of this access needs to be evaluated to find out whether these businesses are taking advantage of their customers. Christine Dobridge ascertains exactly who the clients of the fringe banking industry are by saying "Since one generally needs a valid bank account and pay stub as proof of employment to qualify for a loan, payday borrowers are not in the poorest population cohort; still … Twenty-five percent of payday borrowers report income of less than $15,000, while 56 percent have income between $15,000 and $50,000" (8). These people have the least education in our society and they generally live in the same geographic area, making them easy targets for predatory business practices.

One of the simplest ways, in theory, to help the lower class with their financial troubles is to educate them. Teaching them the benefits of a bank, what kind of vocabulary is required to understand finances, and the signals that they are being ripped off would be the easiest way to improve their lives dramatically. A contributing factor to their poverty is their inability to properly navigate their finances, but this is something that can be taught. One explanation for this lack of education is that:

> "Because of the heavy reliance on local property taxation to finance schools in the United States, children growing up in poor neighborhoods are less likely to acquire the human capital needed to advance. Sociologists have also emphasized how the lack of role models can limit the life chances of children growing up in poor neighborhoods. The network effects get built into expectations about future prospects, further inhibiting progress out of poverty." (Packman 427)

This can be applied in the financial sense to the plight of the lower class. They grow up with very little money of their own and do not understand how to manage their finances once they are older. They consume cash as fast as they earn it; they do not consider the advantages that owning and investing in a savings account can bring to them.

The fringe banking industry is very aware of its position in the market. Those involved in this industry understand that their customers do not have much financial experience so they take advantage of that by charging insanely high interest and excessive fees, of which customers are often unaware until after the fact. They advertise their product as a way to get cash in your pocket as fast as within the hour. However, the dangers lie in the fine print. A contributing factor to these loans' popularity is that the fees are difficult to estimate. Unless the borrower reads the entire contract they sign, they won't realize they are incurring fees until they have been charged for them. Customers for any product should not be required to have a college education to understand what they are getting into when they sign a contract. Fringe banking should be no different.

Effects on Consumers

As negative as the fringe banking industry is thought of, their business still continues to grow. The customers that are able to pay back their loans when they are due generally benefit from their access to short term credit. But the data from borrowers of the payday lending industry show that the majority of the people used their loan to pay for recurring expenses, making the use of these loans risky. The borrowers who are the worst off, however, are the people who are unable to pay back their loan on time. This results in continual fees until the entirety of the loan is paid off, which only takes longer the more fees are added on. This often results in a rollover, when one loan is taken out to pay for another. The rollover is why the payday lending industry is so bad for many consumers. It is a very easy trap to fall into that sucks the consumer into a cycle of debt. This is the core problem of payday loans and how customers get themselves into big financial trouble. Before long someone can be holding multiple loans that are all outstanding and gaining fees.

One of the problems that those living in poor urban areas have to face is their lack of choices when looking for financial institutions. Bank branches are a rare sight in lower income neighborhoods. Instead, fringe banking locations have swarmed geographic areas where the poor typically live. In their paper, *Fringe Financial Services, Inner-city Banking & Community-based Solutions*, Jerry Buckland, Blair Hamilton, and Brendan Reimer argue that the availability of a variety of financial institutions is helpful to poor communities. However, their research uncovered that this is not the case for the people that need it most. They say that “there is evidence that low-income people and neighborhoods face a limited assortment of financial services that are expensive and do not allow people to build personal savings or credit-rating” (110). Without regular access to a bank, it is very difficult to build up credit, save any amount of money for the future, and gain experience in dealing with personal finances.

The only reason that payday lending has grown so much is because of its desperate customer base. Once individuals turn to a payday lender, they are at the final stop in their hope for finding money. The more desperate these customers are, the less likely they are to understand what they are signing away to get their quick cash. Carl Packman, the author of “Payday Lending Global Growth of the High-Cost Credit Market,” reports that:

> “Pew in their research on payday loan borrowers found evidence to suggest that even when some borrowers fully comprehend the terms and conditions of payday loans and know they will be difficult to repay they will still take them; 37 percent

> of borrowers responded in their survey saying they would have taken a payday loan on any terms offered" (103).

It is frightening that over a third of the industry customers do not give a second thought to how much taking out a loan will cost them.

Government Intervention

It is undisputed that capitalism is an essential part of what America is, but at some point the government has to step in to protect its citizens. The government is aware of the affect this industry has on its customers. Retsinas and Belsky said that "Many policymakers across the country agree that subprime loans are an important vehicle for making credit available to consumers; however, concerns about abuses in the subprime market have led the federal government and most states to enact laws that place limits on subprime lending" (139). They are right to think that these loans are important to the poor because without access to money, many people would be unable to meet short term emergencies or worse, have to turn to underground markets for cash.

What our government needs to do is effectively protect borrowers from allowing the industry to do excessive harm to their customers while allowing lenders to continue to turn a profit. In his podcast on Freakonomics, Stephen Dubner takes a look at what areas of government can be effective in helping contain the problems of the payday loan industry. He says "The CFPB [Consumer Financial Protection Bureau] doesn't have the authority to limit interest rates. Congress does. So what the CFPB is asking for is that payday lenders either more thoroughly evaluate a borrower's financial profile or limit the number of rollovers on a loan, and offer easier repayment terms. Payday lenders say even these regulations might just about put them out of business — and they may be right." (Dubner 10:59 – 11:21). Obviously a significant profit margin is required to keep the lights on in a business. Both the business owners and regulators know that this is coming at the expense of the poor.

The government's goal should not be to shut down the entire industry but to educate everyone on how to manage their finances effectively and make the right decisions that help themselves out the most. This will have far-reaching effects beyond just the payday industry. Once the public better understands the financial tools they have at their disposal, they will be more inclined to make better decisions. The core problem that the poor population faces is that as they grew up, they never had good role models to teach them the value of saving money and investing. They do not encounter bank branches in their daily lives because the areas that they live in have none; therefore, they do not understand the benefits they bring. In their article *The Geography of Fringe Banking* the writers Christopher Fowler, Jane Cover, and Rachel Kleit evaluate what options the relatively poor and relatively wealthy have for their financial needs. They describe the current situation as an "increasingly bifurcated … two-tiered system: the traditional banking system serves primarily middle and upper income individuals, whereas a less-regulated and more expensive alternative financial service sector serves many lower income households" (688).

As a result of where different communities have established themselves based upon income, the financial industry has established its presence tactically to serve the customers it wants. As a result, the authors of *The Geography of Fringe Banking* claim that "An estimated 60 million individuals in the United States either do not use banks or credit unions at all, or use them only sporadically for essential financial transactions like writing and cashing checks, wiring money, paying bills, and obtaining short term credit" (Fowler et al. 688). The only reason that some of these people even have a checking account in the first place is to have access to payday loans. They do not even bother with a savings account because they either do not understand the benefits that it has or they do not have any money to be saved. These are all problems that can begin to be solved by teaching the lower class financial literacy. A practical way to implement this would be to offer free classes at libraries specifically in locations where financial problems are the worst.

Another potential solution is enabling United States Post Office branches to act as very simple banks, offering straightforward checking and savings accounts as well as financial consulting and short term loans. While the first solution is more short term, the second solution has a chance to have a lasting impact on the finances of the lower class. Post offices are already established in most areas of the country and are accessible to many. With increasing financial inequality, an effective and long-term solution is needed to help those in the lower-class population to get a better foothold to boost themselves out of poverty.

Conclusion

The working poor in this country must constantly fight for their survival in our nation's economy. Obtaining a job is only the first step. After that comes rent, utilities, and groceries and that does not even cover all of the necessities. The poor need assistance from the government because capitalism is taking advantage of them. When someone is living paycheck to paycheck and needs money in a bind, they should not have to pay "Annual interest rates …[that] typically run between 391 and 521 percent … and most people who use them end up paying more in fees over the course of the year than they originally received in credit. Nationally, borrowers spend roughly $8.7 billion per year on payday-loan fees" (Wherry). That is nearly 9 billion dollars primarily from the most strapped for cash sector of the economy. If this problem can be alleviated through government intervention, then those affected the most will have a major burden lifted off their shoulders. The government needs to be helping the poor on every front to lift them out of poverty. One of those fronts is being disguised as a good thing and it is payday loans.

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