Payday Holiday: How Households Fare after Payday Credit Bans

Federal Reserve Bank of New York
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Executive Summary

Federal Reserve Bank of New York Staff Report Finds Consumers Fare Worse under Payday Loan Bans

Preliminary findings from a new staff report, "Payday Holiday: How Households Fare after Payday Credit Bans" by Donald P. Morgan, Research Officer with the Federal Reserve Bank of New York, and Cornell University graduate student Michael R. Strain, conclude that payday loan bans result in increased credit problems for consumers.

The report compares households in states with payday loans with households in both Georgia and North Carolina, states that eliminated payday loans in May 2004 and December 2005 respectively. Households in Georgia and North Carolina bounced more checks, complained more to the Federal Trade Commission about lenders and debt collectors, and filed for Chapter 7 ("no asset") bankruptcy at a higher rate. These findings indicate that households without access to payday loans are forced to use costlier credit and suffer greater financial difficulties.

Noted in report:

Consumers suffer greater credit problems under payday loan bans "Georgians and North Carolinians do not seem better off since their states outlawed payday credit: they have bounced more checks, complained more about lenders and debt collectors, and have filed for Chapter 7 ("no asset") bankruptcy at a higher rate."

"On average, the Federal Reserve check processing center in Atlanta returned 1.2 million more checks per year after the ban. At $30 per item, depositors paid an extra $36 million per year in bounced check fees after the ban."

"Total complaints against lenders and debt collectors [in North Carolina] rose by over a third relative to other states…."

"[Overall,] Chapter 7 filing rates increased… 8.5 percent [under the ban]."

Payday loan bans force consumers into worse options "The contraction in payday credit supply caused former borrowers to bounce more checks, thus aggravating their already marginal circumstances. To stave off bankruptcy, distressed borrowers pawned or sold assets. For those who ultimately succumbed to their financial problems, the loss of assets made chapter 7 [bankruptcy] the natural choice."

"[The] slipping down, with less rescheduling of debts, but more "deadbeats" and "no asset" bankruptcies, seems to fit the picture [of] a marginal payday customer pushed over the edge."

"Banning payday loans did not save Georgian households $154 million per year, as CRL projected, it cost them millions per year in returned check fees."

"…we take our results as evidence of a slipping down in the lives of would-be payday borrowers."

Payday loans alleviate financial distress "Most of our findings contradict the debt trap hypothesis."

"Our findings show that [payday loans] help to avoid more quotidian disasters, like bouncing a mess of checks, or getting hassled at work by debt collectors."