

Dbusiness News

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Payday Loans Do Not Cause Bankruptcy, Clemson University Study Finds

CLEMSON--Payday loans do not cause bankruptcy, according to a recent study by economists at Clemson University.

Dr. Petru S. Stoianovici and Prof. Michael T. Maloney studied the relationship between payday lending and bankruptcy filings over the period from 1990 to 2006. Using state-level data on the legality of payday lending and on the number of loan stores, the investigators found that neither the legality of payday lending nor an increase in the number of loan stores led to higher rates of consumer bankruptcies.

According to Dr. Stoianovici, he and Prof. Maloney studied the effects of payday-lending legislation and of the numbers of payday-loan stores in early years on personal bankruptcy filing rates in subsequent years. Their study used two different analytical techniques, neither of which found any relationship between payday lending and bankruptcy rates. One of the techniques, called Granger causality testing, is specifically designed to test whether one phenomenon can be said to cause another occurring in a later period.

The findings of the study are consistent with those of other investigators — including Dr. Donald P. Morgan of the Federal Reserve Bank of New York and Prof. Jonathan Zinman of Dartmouth College — that access to high-interest-rate consumer credit correlates with improved household financial condition.

An earlier study by Profs. Paige Skiba and Jeremy Tobacman found evidence that making a first payday loan application is related to increased filing rates for a particular kind of bankruptcy called chapter 13, but only for certain marginal loan applicants. The results of the present Clemson study contradict those findings. Importantly, Profs. Skiba and Tobacman found no causal relationship between access to payday loans and bankruptcy filing rates for all payday loan borrowers as a whole. Chapter 13 is a form of personal bankruptcy that was used, in the period studied by Profs. Skiba and Tobacman, primarily by wealthier debtors to preserve their equity in a personal residence. Chapter 13 filings constitute about one-fourth of all bankruptcy filings. To the limited extent that payday-loan borrowers do file for bankruptcy — about 2% of all borrowers — they generally do not file under chapter 13, Prof. Maloney observed.

Commenting on the study, Prof. Maloney said, "This study has important policy implications for legislators considering restrictions on consumer credit, including the interest-rate limitations put forth by President Obama in his economic stimulus proposal. Despite their high cost, payday loans appear to increase the welfare of consumers by enabling them to survive unexpected expenses or interruptions in income. The study shows that, by a key measure of financial outcomes, payday loans are not harmful to their users."