Payday Loans: An Unethical Financial Solution

Despite the growing popularity of payday loans, there is an ongoing debate on whether they are, as they advertise, beneficial short-term financial solutions for the working poor. The working poor are defined as working people whose income fall below a given poverty line. They have steady jobs and some even have credit. Unfortunately, when this group of people have a need to borrow a small amount of money (i.e. $300-$500), it is difficult for them to borrow such a small amount through the traditional banking system. Therefore, they look to the payday loan industry as a “safety net” that would satisfy their immediate and/or emergency financial need. Unfortunately, due to the excessively high interest rates charged against payday loans, the “safety net” now becomes a question of ethical behavior. “Every year, millions of Americans who need a short-term loan to repair a car, fly quickly to a sick relative’s bedside, or catch up on child care payments find themselves going to payday lenders, either online or through one of the thousands of payday-lending storefronts” (Wherry, 2015). Although payday loans do provide quick cash to solve immediate financial needs, some believe the industry exploits the vulnerability of the working poor and low-income families.

Case Background

In the mid-1990s into the early 2000s, the popularity of payday loans began to rise and borrowers began to use this system as a way to meet emergency financial needs. In order to obtain a payday loan, a borrower writes a post-dated check in the amount of the loan plus interest due on the borrower’s next payday. On the next payday, a borrower may choose to repay the loan, renew the loan by paying the interest again, or default (Carter, 2015). Unfortunately, many borrowers choose to renew the loan and be subject to continue paying a high interest rate on the loan. This process is called “rollovers” and it has become a question of ethical concern. Often this rollover process has led to what some refer to as a “debt trap” because borrowers are unable
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to pay mounting fees and interest rates. For example, a borrower that is paid bi-weekly rolls over a $300 loan with an interest rate of 15% over a 3 month period pays $270 in interest on that loan in interest alone. Research has disclosed that many states do not regulate rollovers which causes the borrower to become stuck in a debt cycle. While most states do not allow payday loans to be renewed, 13 states allow up to six renewals or do not regulate renewals at all (Carter, 2015).

Although, data have shown that high interest rates and rollovers lead to increasing debt for payday loan borrowers, the industry argues that they are fulfilling the need for the borrower that has an emergency financial situation. Additionally, they also argue that the high interest rates protect them against high-risk borrowers. It is true that the payday loan industry does fulfill the borrower’s need for emergency cash. However, the negative impact of the working poor and the low-income borrowers are sorely affected because they “end up unable to pay off immediately and have to renew their loans or re-borrow soon after, which the bureau said can quickly add up to an annual percentage rate equivalent to 390 percent or more. The consumer pays more fees and interest each time they re-borrow, turning a short-term loan over time into a long-term debt trap” (Dinan). Therefore, there is a need for the payday loan industry to develop a code of ethics to ensure that ethical practices are created to benefit themselves, the borrowers, and society as a whole.

**Ethical Analysis (Utilitarian)**

When looking at the payday loan issue through the lens of the utilitarian ethical theory, I would argue that this is not a system that “produces the greatest balance of pleasure over pain for everyone” (Boatright 2012, pg. 53). While it is true that the payday lending industry is in business to make a profit, the utilitarian ethical theory would not support profit-making based on
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an unethical process that exploits the vulnerability of the working poor. Unfortunately, many within this group do not have the financial literacy in order to make better financial decisions for themselves and their families. As a matter of fact, the process is based on unethical and immoral decisions that apply high interest rates, fees, and more rollovers. Therefore, when it comes to payday lending, the only participants enjoying pleasure over pain are the payday lenders. The “return on investment” for the borrower is another loan with high interest rates and fees; in addition to the “unannounced debits from borrowers’ bank accounts, which trigger extra fees and deepen their debt load” (Montlake, 2016). This is not the theory of the utilitarian ethical behavior that should be felt by these borrowers as well as the payday lenders. As Boatright states, “the utilitarianism ethical theory indicates that an action is right if and only if it produces the greatest balance of pleasure over pain for everyone” (Boatright, 2012 pg. 52). Clearly, the borrowers are not receiving the pleasure that this theory supports. Below is a map that shows an example of the interest rates where different states contribute to a “debt trap” for borrowers for payday loans.

“There’s nothing wrong with making a profit. But if you’re making that profit by trapping hardworking Americans in a vicious cycle of debt, then there is a need to find a new way of
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doing business” (Boyer, 2015). This means embracing the utilitarian ethical theory for payday lending borrowers.

Ethical Analysis (Kantian)

If I apply the Kantian ethical theory, I would argue that the actions of the payday lending industry are unethical. Their “way of lending” practice does not align with Kantian’s theory of moral law that is binding for all human beings. Nor does the payday lending practice align with Kantian’s ethical theories on universalizability or respect of person principles. For example, Kantian’s view on “respect for persons” principle cautions us not to use people for a means to an end. Therefore, payday lending practices should not prey on and take advantage of the working poor or low-income families by allowing multiple rollovers that comes with high interest and spiraling fees as the payday lending industry grows. This is clearly a form of unethical reasoning that has the appearance of “treating people only as a means” (Boatright, 2012 pg. 58). Instead, payday lending practices should support a process where borrowers and lenders are autonomous when making financial solutions.

If I apply Kantian’s universalizability principle theory against payday lending practices, I would argue that payday lending practices does not apply ethical reasoning when it comes to applying a rule by which it should become a universal law for everyone involved; borrowers and lenders. For example, if payday lending practices accepts a set of rules that support their conduct regarding the payday loan process, borrowers can act upon a set of rules that support their conduct when applying for a payday loan. Therefore, some may feel that if it is good for the payday lenders, it is good for the borrowers. An example of this would be as such; a borrower
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would apply for a payday loan, promise to pay as per payday lending guidelines, knowing all along that he or she would not be able to repay it as promised under their guidelines. However, they sign this promise to pay by the deadline because no other financial institution would approve, in their opinion, such a small amount of cash. In the book, Kantian refers to this as “a lying promise.” Unfortunately, if everyone conducted themselves by a set of rules that pleases them within a process, what a messed up world this would be! At the end of the day, these are unethical reasoning issues.

Marketing Ethics

When looking at ethical decisions made in marketing or advertising within the payday lending industry, I would argue that their advertising of a short-term financial solution is really not a short term solution. Instead, it is a long-term financial responsibility for the borrower; which includes allowing many rollovers. This action violates the “fairness” marketing ethics that indicate the right for consumers to be provided with adequate information about their lending practices. As Boatright indicated, “promotion is the most visible face of marketing and for this reason it draws the greatest moral scrutiny“(Boatright, 2012 pg. 216).” Therefore, it behooves payday lenders to promote advertising strategies that does not have the unethical appearance of marketing deception.

Conclusion

Given the analysis of the Utilitarian and Kantian ethical theories, there is a need for payday loan regulations that will remove the barriers in making ethical business decisions for payday lending. Regulations could include a “cap” on the amount of rollovers that a borrower can have within a certain time frame. This regulation would relieve the borrower of the stress that comes from the “debt trap” of payday loans.
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References

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