

The Economic Impact Of The Payday Lending Industry in South Carolina

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EXECUTIVE SUMMARY

INTRODUCTION

This report evaluates the economic impacts of the payday lending industry in South Carolina and provides an economic perspective of the small loan lending industry. There is considerable debate in the press over the industry and its potential positive or negative impacts on the state's economy. The economic realities of recession and the resulting higher unemployment in South Carolina (3rd highest in the nation at the time of this report) create new challenges in the state's economy. One critical issue is the difficulty families and individuals will encounter as credit availability is increasingly limited and/or more expensive. Payday Lending offers a reliable and stable source of credit that can complement borrowers' limited options. At the same time, several bills have been introduced in the South Carolina Legislature that address various aspects of the industry. While some of the criticisms of the industry have merit and will most likely be addressed by the Legislature, others are of questionable merit. In general, the most vocal criticisms tend to be based more on emotional issues rather than sound economics and market-based business practices.

This report includes an overview of the industry in South Carolina and an estimate of the economic impacts of the industry. In addition, this report addresses some of the more common criticisms of the industry and provides some insight to assist those debating the issues in better understanding the industry and its benefits to the state's economy. During the economic downturns, especially ones as severe as the current one that has impacted the credit markets so severely, it is important that policy makers understand the demand and need for credit alternatives. Payday Lending is one of many options and remains an available and reliable source of credit for many South Carolinians.

The payday lending industry is a substantial employer in South Carolina. As indicated earlier, the industry employs over 3,000 workers in the state with average annual wages of about \$21,000 per employee. The 1,100 or so establishments pay an estimated \$63 million in annual payroll. The industry's total employment compares to the 3,000 jobs in the apparel manufacturing sector, the 3,700 in the forestry and logging sector and 2,900 in the broadcasting industry in South Carolina.

More importantly, as with any industry in the state the direct employment and payroll of the industry have a multiplied impact throughout the state's economy. This section estimates the total impact on the South Carolina economy of the direct employment of the payday lenders.

Table 1 summarizes the annual economic impacts from the payday lending industry in South Carolina. The direct impact on the state's economy is much larger than the direct output and employment of the operations of the lending establishments. For example, the direct jobs supported by the industry (3,080) have multiplied impacts on the state's economy much larger than those directly employed by the establishments. While there

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are an estimated 3,080 direct jobs directly employed by the industry, there would be an additional 939 jobs supported indirectly by the industry and another 1,274 jobs supported by induced effects of the industry for a total of almost 5,300 jobs supported in South Carolina from the payday lending industry every year.

TABLE 1

The Annual Economic Impact of the Payday Lending Industry in South Carolina				
	<u>Direct</u>	<u>Indirect</u>	<u>Induced</u>	<u>Total</u>
Total Output	\$ 365,500,224	\$ 85,105,259	\$ 131,903,231	\$ 582,508,729
Employment	3,080	939	1,274	5,293
Labor Income	\$ 63,000,000	\$ 14,104,683	\$ 17,438,169	\$ 94,542,851

Source: Miley, Gallo & Associates, LLC

As outlined in the accompanying report, it is clear that the payday lending industry provides a substantial economic impact to the South Carolina economy. The industry directly and indirectly supports over 5000 workers in South Carolina. The total industrial output from the industry including direct and indirect production is over \$580 million a year. In addition, the industry generates over \$94 million in labor income in the state.

The industry provides a needed service in the consumer lending market – this is evident by the demand for its products and services. The industry has grown in the last ten years or so, but has been around in some form or fashion for the last 100 years or more. The fees and costs of the loans are higher than traditional lending sources, but many of the borrowers do not have access to those lenders and most lenders do not offer such small, short-term loans. Prices are typically higher when convenience and time are in short supply – this also explains for example, why consumers are willing to pay more for groceries at convenience stores than at their regular grocery store.

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The 3,000-plus jobs generated by the industry today may be more important than ever. The national and state economies are in their worst declines since the 1930's. State revenues continue to lag behind estimates and the state budget has been reduced several times as a result. Job growth in the state has lagged that of the rest of the country. The state's unemployment rate continues to hover above that of the nation. Job creation in South Carolina is facing stiff competition from around the world. To make matters worse, some of the state's most important industrial sectors continue to decline. The state's substantial manufacturing sector continues to struggle. In particular, the textile industry (at one time the state's largest employer) has lost over 40,000 jobs in the last ten years. The industry continues to lose employment and lost another 5,000 over the last twelve months. The payday lending industry provides needed jobs across the state in almost every county.

The industry is frequently criticized for making excessive profits and charging high interest rates, but this analysis provides adequate evidence that both of these claims are questionable. Further the industry does provide some benefit in the form of consumer surplus to the consumers in South Carolina. As the number of lenders increases, economic theory suggests that the price of the service should decline and the consumer will be even better off.

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This report includes an overview of the industry in South Carolina and an estimate of the economic impacts of the industry. In addition, this report addresses some of the more common criticisms of the industry and provides some insight to assist those debating the issues in better understanding the industry and its benefits to the state's economy. During the economic downturns, especially ones as severe as the current one that has impacted the credit markets so severely, it is important that policy makers understand the demand and need for credit alternatives. Payday Lending is one of many options and remains an available and reliable source of credit for many South Carolinians.

OVERVIEW OF THE PAYDAY LENDING INDUSTRY IN SOUTH CAROLINA

Basic principles of economics explain the existence of the payday lending industry. In a market economy in which there is no market interference, a market will be established when there is a willing buyer and a willing seller. If there is a good or service produced for the market but there is no willing buyer – the good or service will no longer be supplied to the market. The payday lending industry exists and has grown because there is a demand for its product.

Providing short term loans to consumers is not new. Some form of advanced lending to consumers has been around since the late 1800's and early 1900's. Other forms of small loan lending similar to payday advance lending have been around for a hundred years although known by different names – from salary buying to pawn shops. Aaron Huckstep succinctly summarizes the evolution of the industry in a 2007 publication in the *Fordham Journal of Corporate and Financial Law*.¹

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“In the early twentieth century, “salary buyers” offered to purchase a consumer’s paycheck in advance at a discount. For instance, a lender would give the borrower \$20 today for the right to receive the borrower’s next paycheck of \$24. This market arose for a number of reasons: with many people moving from rural to urban areas, and with a significant influx of immigrants, there was a large supply of manpower for a small number of jobs. As a result, meeting cash-needs was challenging for many people. Banks were not offering small-dollar short-term cash loans because they were considered too “risky.” Additionally, few of the borrowers had assets with which to secure a loan. The salary-buying industry arose to meet the needs of this underserved market.”²

The industry generally makes short term loans (2-4 weeks) and operates in the following fashion: a borrower provides a personal check, drawn on their personal bank account, that they agree to cover with sufficient funds out of their next paycheck. That is, the borrower gives a personal check to the payday lender in exchange for cash, usually between \$100 and \$300.

The typical fee for this loan is about \$15 per \$100 borrowed. The customer’s check is written for an amount equal to the sum of the loan plus the related fee. For example, if the borrower wanted to borrow \$200, they would write a check to the lender for \$230. The payday lender holds the check until the agreed-upon date, at which time it is cashed and covered by the borrower’s payday deposit.

The typical customer is generally low to moderate income -- although not as low as many people think. As opposed to the title lending and pawn shop transactions, payday lending borrowers must have a bank account and a job or other regular income source. The typical borrower most often has poor or no credit history (or they would most likely borrow elsewhere) and frequently have no other legal means of obtaining credit. Recent research by Michael Stegman and Robert Faris (2003) indicates that payday advance borrowers are more likely to have poor credit histories and are more likely to have had one or more bounced checks in the previous five years.³

As stated by Lehman in his 2003 report, “customers who utilize payday lending services most frequently are also more likely to have been called by a collection agency for overdue bills. Thus, payday lending services extend small amounts of uncollateralized credit to high-risk borrowers, and provide loans to poor households when other financial institutions will not. Throughout the past decade, this "democratization of credit" has made small loans available to mass sectors of the population, and particularly the poor, that would not have had access to credit of any kind in the past.”⁴

As in most states in the country, the number of payday lending establishments in South Carolina has increased over the last ten years. It is currently estimated that there are

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approximately 1,100 payday lending establishments in South Carolina.⁵ This is a substantial increase over the estimated 200 locations just ten years ago. Based on industry data, these establishments employ about 3,080 employees across the state and pay approximately \$63 million in total annual payroll.⁶

This substantial growth of the industry has often been criticized and is used as an argument for more regulation of the industry by state government. However, in a later section of this report we demonstrate that the increase in the number of lenders may actually help lower the cost of the service to the borrower and increase the consumers' welfare.

ECONOMIC IMPACT OF THE PAYDAY LENDING INDUSTRY IN SOUTH CAROLINA

The payday lending industry is a substantial employer in South Carolina. As indicated earlier, the industry employs over 3,000 workers in the state with average annual wages of about \$21,000 per employee. (*This estimated average salary does not include the value of employee benefits. Most Payday Lending employees have health care and other benefits.*) While this is below the state average⁷, the annual wage is comparable to wages earned on many industries such as:

Cattle ranching and farming	\$21,372
Child and youth services	\$21,268
Cut and Sew apparel manufacturing	\$22,412
Food and Beverage stores	\$21,112
Museums	\$21,864
<i>Payday lenders</i>	<i>\$21,000</i>
Miscellaneous Store retailers	\$20,956
Grocery stores	\$20,280
Amusement Arcades	\$19,968
Automotive Oil Change Shops	\$19,968
Golf Courses and country clubs	\$19,760
Community Care facilities for elderly	\$19,282
Drycleaning and laundry services	\$19,240
Gasoline stations with convenience stores	\$17,212
Discount Department stores	\$16,952
Department stores	\$16,692
Amusement and theme parks	\$16,588
Clothing Stores	\$15,132
Convenience stores	\$14,976
Leisure and hospitality	\$14,716
Food Services and drinking places	\$13,156

Source: South Carolina Employment Security Commission.

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The 1,100 or so establishments pay an estimated \$63 million in annual payroll. The industry's total employment compares to many familiar industrial sectors in South Carolina. For example, the following industries had comparable employment levels in 2007:

Crop production	4,873
Securities, commodity contracts & investments	3,583
Furniture and related product manufacturing	3,570
Forestry and logging	3,141
<i>Payday lending</i>	<i>3,080</i>
Broadcasting, except internet	2,838
Apparel manufacturing	2,790
Motion picture and sound recording studios	2,449
Museums, Historical sites, zoos & parks	1,222

Source: South Carolina Employment Security Commission.

More importantly, as with any industry in the state the direct employment and payroll of the industry have a multiplied impact throughout the state's economy. This section estimates the total impact on the South Carolina economy of the direct employment of the payday lenders.

These multiplied impacts are derived from the IMPLAN modeling system. IMPLAN is a nationally recognized system of local economic models that are specifically designed to represent local and state economies such as the South Carolina economy.⁸ The IMPLAN models are modifications of the national input-output models developed by the Bureau of Economic Analysis, US Department of Commerce. The IMPLAN models incorporate the most recent data available and are generally 2007 unless otherwise noted.⁹ The estimates are based on constant dollars and assume no inflation during the impacts. This assumption applies to all estimates in this analysis, including: property values, incomes, sales, construction materials, etc.

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In terms of the multiplied impacts of the industry, the process is as follows: as the dollars are spent and re-spent in South Carolina, additional income is created for those companies and individuals that supply goods and services to the industry. The recipients of this income will spend this income on other goods and services. Each time, some of the purchases will be for goods and services inside the state and some will be for goods and services from outside the state (referred to as “leakages”). The well-known “multiplier effect” estimates the aggregate amount of buying and selling that occurs.

The multipliers used in this analysis estimate three components of total change within the local area:

- * *Direct effects* represent the initial change in the industry in question.
- * *Indirect effects* are changes in inter-industry transactions as supplying industries respond to increased demands from the directly affected industries.
- * *Induced effects* reflect changes in local spending that result from income changes in the directly and indirectly affected industry sectors.

This cycle of spending continues until leakages from the region (spending on goods and services outside the area) stop the cycle. Due to these multiplier effects, the initial, direct expenditures of the industry result in indirect and induced impacts of many more dollars.

Table 1 summarizes the annual economic impacts from the payday lending industry in South Carolina. The direct impact on the state’s economy is much larger than the direct output and employment of the operations of the lending establishments. For example, the direct jobs supported by the industry (3,080) have multiplied impacts on the state’s economy much larger than those directly employed by the establishments. While there are an estimated 3,080 direct jobs directly employed by the industry, there would be an additional 939 jobs supported indirectly by the industry and another 1,274 jobs supported by induced effects of the industry for a total of almost 5,300 jobs supported in South Carolina from the payday lending industry every year.

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TABLE 1

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Source: Miley, Gallo & Associates, LLC				

Likewise, the total impacts on the economy in terms of total output and labor income also have multiplied impacts. As seen in Table 1, the total direct output of the industry is estimated to be \$365 million. However, there are indirect and induced effects of this direct activity and the total impact on the state is estimated to be over \$582 million a year.

The direct and indirect employment impacts of the Payday Lending industry affect other industries across the state. Of the 400+ sectors included in the IMPLAN model, the Payday Lending industry would indirectly impact over half of them. The 30 sectors that are impacted the greatest in terms of the magnitude of the estimated employment impacts are listed below in Table 2. These include food services, real estate, accounting and bookkeeping services, legal services, hospitals and motor vehicle and parts dealers to name a few.

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TABLE 2

Top 30 Impacted Industries	Total Jobs Supported
Food services and drinking places	219
Other Federal Government enterprises	116
Real estate	106
Employment services	101
Offices of physicians- dentists- and other health	73
Accounting and bookkeeping services	71
Legal services	59
Securities- commodity contracts- investments	49
Couriers and messengers	49
Food and beverage stores	48
General merchandise stores	47
Nursing and residential care facilities	46
Hospitals	46
Monetary authorities and depository credit interme	43
Wholesale trade	43
Private households	40
Automotive repair and maintenance- except car wash	40
Motor vehicle and parts dealers	36
Maintenance and repair of nonresidential buildings	36
Business support services	35
Civic- social- professional and similar organizati	34
Hotels and motels- including casino hotels	30
Warehousing and storage	29
Miscellaneous store retailers	28
Clothing and clothing accessories stores	27
Child day care services	23
Nonstore retailers	23
Colleges- universities- and junior colleges	23
Management consulting services	23
Social assistance- except child day care services	21

The industry generates substantial labor income – both proprietor’s income and direct employee compensation. As seen in Table 1, the direct labor income generated by the industry is estimated to be \$63 million with indirect and induced impacts adding another \$31 million for a total impact on the state’s labor income of \$94 million per year.

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To summarize, the payday lending industry is a substantial employer and producer in the South Carolina economy. It directly and indirectly supports over 5,000 workers. It generates directly and indirectly over \$94 million in labor income per year in the state.

The 3,000-plus jobs generated by the industry today may be more important than ever. The national economy is in a severe recession. State revenues continue to lag behind estimates and the state budget has been cut several times over the last six months. Job growth in the state has lagged that of the rest of the country. The state's unemployment rate continues to be the third highest in the country. Job creation in South Carolina is facing stiff competition from around the world. To make matters worse, some of the state's most important industrial sectors continue to decline. The state's substantial manufacturing sector continues to struggle. In particular, the textile industry (at one time the state's largest employer) has lost over 40,000 jobs in the last ten years. The industry continues to lose employment and lost another 4,000 over the last twelve months. The payday lending industry provides needed jobs across the state in almost every county.

Questions to consider in the Payday Lending Debate

Does the industry reap excessive profits?

One of the criticisms of the payday lending industry is that they are reaping huge profits from their businesses. High profits are not normally criticized but the payday loan industry is usually alleged to make these huge profits by exploiting their customers. However, there is substantial evidence in the literature to make a strong argument that the industry is not making abnormal profits nor or they exploiting their customers.

There is no dispute that payday lenders make profits. However, all industries must make profits or they eventually go out of business. Stegman and Faris in a 2003 report point out that the industry generates large revenues and is highly profitable. For example, fees generated by payday loan stores are estimated at \$6.5 billion a year (\$7.9 billion including Internet loans ("Industry Report", Stephens Inc. Investment Bankers, March 27, 2007).¹⁰

However, the important issue is whether these profits are unjustified or too large. Huckstep (2007) in the Fordham Journal of Corporate Law found that "The study shows that, despite the common belief, payday lending firms do not always make extraordinary profits. In fact, when compared to many other well-known lending institutions, payday lenders may fall far short in terms of profitability. If that is the case, then the call for regulation should be based solely in principle, moral or other subjective reasoning-not on high fees".¹¹

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The findings of Huckstep are based on two central financial aspects of the payday lending industry. Referencing Flannery and Samoyk (2005), it is concluded that “fixed operating costs and loan loss rates do justify a large part of the high APRs charged on payday advance loans”.¹²

Smaller loans require fixed costs to be higher per dollar lent. Flannery and Samoyk (2005) argue that since payday lenders are typically lending to consumers that are not price shopping but looking for convenience, they have added costs of more employees and longer hours to serve and retain their customers. Second, it is reported that the ratio of mean loan losses to total revenue amounted to 15.1% and as high as 24.8% for newer stores (1 to 4 years of operation). The authors state that these loan losses are “substantially” higher than those for mainstream financial institutions.¹³ And they state that they “find that fixed operating costs and high loan loss rates justify a large part of the high APR charged on payday advance loans.”¹⁴

To conclude, in light of the more recent work done on the financial status of the payday loan industry, one should be cautious of accepting out of hand the conclusion that firms are making extraordinary profits at the expense of mislead consumers. A more careful look at the cost structure and default rates in this industry may help resolve this issue. It is thus worth repeating the warning found in Huckstep (2007) “the call for regulation should be based solely in principle, moral, or other subjective reasoning-not on high fees”.¹⁵ And finally, Huckstep states, “High profits for payday lenders, however, may be more myth than reality.”¹⁶

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Other Economic Factors Influencing Payday Lender Fees

The previous section points to the fact that fees charged by firms in the payday lending industry may be at least partially explained by the high costs associated with these short term, high risk unsecured loans. The other side of this coin is that consumers may be willing to pay these higher prices because of the unique features of the product.

One of the “market structure” models found in microeconomic theory is referred to as monopolistic competition. As the name would imply, this refers to markets which have a combination of competitive and monopoly (single seller) market characteristics. In this case, the market is assumed to have a large number of firms which offer a differentiated product. Many products and services that are in the market fit into this market classification – banks, beer, automobiles, athletic shoes, grocery stores, fast food restaurants, etc. Firms are thus able to distinguish their product from those of other firms. This could be differences in performance levels, appearance, or even the location of the firm (e.g. a busy intersection). It is this differentiation characteristic which gives some “monopoly” power to the seller since consumers may be willing to pay a premium for what they see as an advantage one product has over another. Indeed, the major idea of advertising is to convince consumers that say one type of beer is preferred to another because of either a real or imaginary difference (e.g. improving your social life if you drink XYZ beer).¹⁷

This basic economic model may help understand why consumers are willing in a market situation to pay the perceived high fees charged by payday lenders (this model also explains why consumers are willing to pay higher prices for goods at convenience stores than grocery stores, etc.). If one thinks of the financial market as a large number of firms selling somewhat similar products of various types, this broadly defined market tends to fit the concept of a monopolistically competitive market. What then differentiates payday lenders from other firms in this broad financial industry?

A prior section of this report outlines the basic nature of the payday loan industry and highlights some of its unique features. First, the loans are very short term in nature. Thus, consumers who need financial assistance for a week or two would find such a product attractive and pay for that feature.

Second, the loans are relatively easy and hassle free to obtain. All one needs is a checking account, a recent pay stub and valid identification. So, unlike the lender, the fixed “cost” for the consumer is relatively small. Other forms of borrowing involve more extensive paper work, long waiting time for approval, and a higher probability of being denied credit. The payday loan firms work hard to make the process as easy as possible with extended hours and a relatively uncomplicated application procedure.

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A third and perhaps the most important factor that differentiates payday lenders from others is that for some they may be the most reasonable alternative in a difficult situation. As indicated above, while the typical borrower is in the lower to lower-middle income categories, many have had financial difficulties and have limited choices to deal with financial emergencies or cash shortfalls. Some alternatives, like overdraft fees, may be more expensive than payday lender charges. For example, typical overdraft fees can be \$25-\$35 per overdraft. If an individual writes a check for \$100 but is only \$1 overdrawn, the resulting fees are \$25. Based on the amount of the check of \$100, this results in an interest rate fee of 25%. If this were on a two-week term, the annual percentage rate paid by the “overdrafter” is about 650%.

To conclude, in examining the fees charged by payday lenders, one should carefully examine the motives of consumers in their willingness to pay these fees. Traditional economic consumer theory begins with the assumption that consumers are rational. That is, they will make decisions which are logical and in their best interest. While it is certainly true that consumers are not perfectly “rational” in all their consumption decisions, it is probably a viable assumption when dealing with how consumers tend to behave in general. There is also no reason to assume that payday lender consumers are for some reason “irrational” as a group and are behaving in a way that is counter to their well-being.

Does the Industry generate benefits to South Carolina consumers?

While there is considerable discussion of the high profits and practices of the payday lending industry, there is little discussion of whether the industry benefits the consumer in South Carolina. In this section we use elementary principles of economics to demonstrate that indeed, the payday lending industry provides benefits to consumers and in fact, additional lenders in the state could increase the benefits to consumers by increasing the borrowers’ consumer welfare.

One of the first “tools” taught in a beginning economics class is supply and demand. This simple representation of a competitive market provides many insights into the working of our economy. With a few simplifying assumptions (lots of buyers and sellers, a standardized product and free entry and exit) it can be shown that such a market will move toward what is referred to as an equilibrium, or at a point at which the amount consumers want to buy exactly matches the amount producers wish to sell. This occurs at one and only one price often referred to as the “equilibrium price” or the “market clearing price”.

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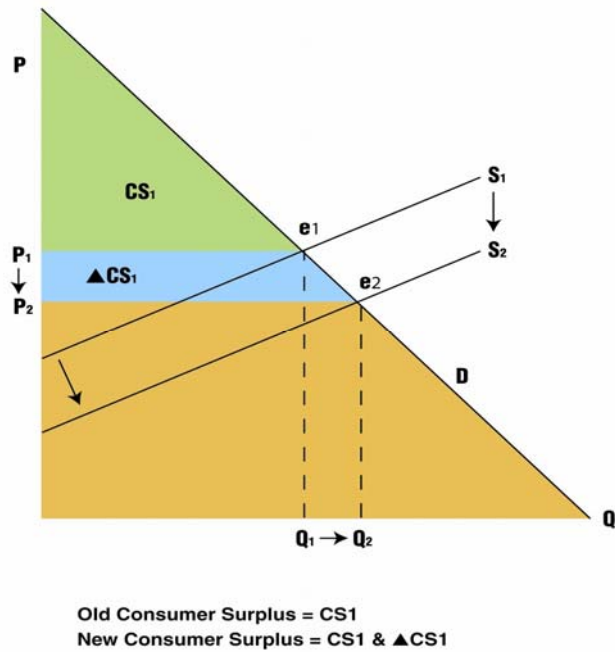
This price will be maintained until some basic underlying factor (e.g. the income of consumers change or the number of producers increases or decreases) causes a shift in either the supply and/or demand curve. The resulting adjustment leads to a change from the initial equilibrium price and output. For example, an increase in the number of producers results in a decrease in the price of the product and an increase in the equilibrium level of consumption/production. The supply and demand model is thus a simple but powerful tool in understanding how markets work. (For a further explanation, see Mankiw, 2004, Chapter 4).¹⁸

An extension of the use of the supply and demand model moves into the area of welfare economics. This is concerned with the study of how the allocation of resources affects economic well being. It has long been argued that the allocation of resources associated with the equilibrium supply and demand model maximizes the total benefit of consumers and producers. This argument is based on the concepts of consumer and producer surplus. Our focus here is on the concept of consumer surplus.

Consumers are not all the same. Different people have various maximum prices that they would pay for a particular product -- that is, their willingness to pay. (In fact, the demand curve is a representation of this relationship between the price a consumer is willing to pay and the corresponding quantities of the good or service demanded at the various prices).¹⁹ Since the equilibrium price is paid by everyone, some will be paying a price which is less than the maximum they were willing to pay. This difference is referred to as a consumer surplus. So, if Jane is willing to pay \$5 for a large pepperoni pizza, and the market clearing price is \$3, she will not voluntarily pay \$5, she will only have to pay \$3 -- and she will receive a consumer surplus of \$2.

Every consumer who has a willingness to pay above the market clearing price will experience such a benefit. The sum of these amounts is taken to be a measure of the total benefit to consumers for this particular market solution and is graphically represented as the area under the demand curve above the market clearing price (shown below in the green color).²⁰

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What would happen if the market clearing price declines? Let's return to Jane in the previous paragraph. Assume that for some reason (e.g. an increase in the number of pizzerias) the market clearing price for pizzas falls to \$2. Jane still has her willingness to pay of \$5 but now only pays \$2. Her consumer surplus thus increases by \$1 as a result of the price decline and is now \$3 instead of \$2. The same can be said for all consumers who have willingness to pay values above the price of \$2. Thus, lower prices tend to increase total consumer surplus.²¹ The increase in total consumer surplus is depicted in the graph above as the area in blue. Clearly the decline in equilibrium price due to the increase in the number of producers has resulted in an increase in consumer surplus.

The above Economics 101 review demonstrates the basic economic concept that price declines in competitive markets tend to result in an increase of overall benefits derived by consumers. It benefits those who were consuming the good at the previous price (larger consumer surpluses) as well as those that enter the market because they are now willing to buy the product at the lower price. As a refresher, in the above example prior to the decline in price, there were customers willing to buy the pizza at \$2 (but unwilling to pay \$3) but there were no pizzerias offering it at that price. So those customers did without any pizza.

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The final issue is whether the concept of consumer surplus applies to the payday lending industry. Morgan (2007) provides some recent data that would support this application. Morgan states: “Using a small set of data, we find that payday loan rates and fees decline significantly as the number of payday lenders and pawnshops increase.”²² This finding would be consistent with the conclusion that competition does exist among payday lenders and that more suppliers results in lower prices. If this is true, it would seem logical to conclude that consumers benefit from (not harmed by) increases in the number of lenders and the competitive effect on prices. To end with a quote: “The problems of high prices (in the payday lending industry) may reflect too few payday lenders, rather than too many.”²³

Additional evidence of the benefits to consumers from the industry can be seen in a recent study of North Carolina and Georgia. Morgan and Strain (2007) analyze whether consumers in North Carolina and Georgia are better or worse off since the payday lending industry was banned in those states. Morgan and Strain examine patterns of returned (bounced) checks at the Federal Reserve check processing centers, complaints against lenders and debt collectors filed by household with the FTC, and federal bankruptcy filings. They argue that FTC complaints are an appropriate measure of changes in welfare levels than are high interest rates and repeat borrowing.²⁴

The analysis conducted in their study leads them to conclude that “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.”²⁵

It may be that without payday lenders, consumers of short term credit find it necessary to resort to existing alternatives which also have high (if not higher) costs. These include overdraft fees from banks and merchants, bounce “protection” fees, and over limit fees on credit cards. This would then result in higher rates of bounced checks, more complaints about lenders and collectors, and more cases of bankruptcy.

The authors’ final comment on this subject is the obvious economic conclusion that banning payday loans is not going to motivate competitors to lower prices or invent new products.²⁶

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SUMMARY

Economic analysis and empirical research have found that, while the payday lending industry is controversial, it serves an important purpose in the market: it provides relatively small immediate loans when other sources of financing are either unavailable or the alternatives are either more expensive than payday loans or otherwise not acceptable to the borrower. These loans are either more favorable or cheaper than the most likely alternatives -- such as bounced checks and late fees, which can be as costly or more so and can further damage a poor credit history. When analyzed on an annual basis, overdraft fees and late credit card payment fees can far exceed those fees charged by the payday lending industry.

As outlined in the accompanying analysis, it is clear that the payday lending industry provides a substantial economic impact to the South Carolina economy. The industry directly and indirectly supports over 5000 workers in South Carolina. The total industrial output from the industry including direct and indirect production is over \$580 million a year. In addition, the industry generates over \$94 million in labor income in the state.

The industry provides a needed service in the consumer lending market – this is evident by the demand for its products and services. The industry has grown in the last ten years or so, but has been around in some form or fashion for the last 100 years or more. The fees and costs of the loans are higher than traditional lending sources, but many of the borrowers do not have access to those lenders and most lenders do not offer such small, short-term loans. Prices are typically higher when convenience and time are in short supply – this also explains for example, why consumers are willing to pay more for groceries at convenience stores than at their regular grocery store.

The 3,000-plus jobs generated by the industry today may be more important than ever. The national and state economies are in their worst declines since the 1930's. State revenues continue to lag behind estimates and the state budget has been reduced several times as a result. Job growth in the state has lagged that of the rest of the country. The state's unemployment rate continues to hover above that of the nation. Job creation in South Carolina is facing stiff competition from around the world. To make matters worse, some of the state's most important industrial sectors continue to decline. The state's substantial manufacturing sector continues to struggle. In particular, the textile industry (at one time the state's largest employer) has lost over 40,000 jobs in the last ten years. The industry continues to lose employment and lost another 5,000 over the last twelve months. The payday lending industry provides needed jobs across the state in almost every county.

The industry is frequently criticized for making excessive profits and charging high interest rates, but this analysis provides adequate evidence that both of these claims are questionable. Further the industry does provide some benefit in the form of consumer surplus to the consumers in South Carolina. As the number of lenders increases, economic theory suggests that the price of the service should decline and the consumer will be even better off.

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METHODOLOGY

This study estimates the economic impacts of the payday lending industry on South Carolina's economy. The methodology used in this study is the IMPLAN regional input-output modeling system developed by MIG, Inc. of Stillwater, Minnesota.

IMPLAN was developed by MIG, Inc. as a cost-effective means to develop regional input-output models. The IMPLAN accounts closely follow the accounting conventions used in the "Input-Output Study of the US Economy" by the Bureau of Economic Analysis (1980) and the rectangular format recommended by the United Nations.

The IMPLAN Input-Output Model mathematically describes commodity flows from producers to intermediate and final consumers. Purchases for final use (final demand) drive the model. Industries producing goods and services for final demand also purchase goods and services from other producers. These other producers, in turn, purchase goods and services. This buying of goods and services (indirect purchases) continues. Leakages from the region eventually stop the cycle.

The IMPLAN input-output model mathematically derives the indirect and induced effects. The resulting multipliers describe the change in output for every regional industry caused by a one-dollar change in final demand for any given industry. The notion of a multiplier rests upon the difference between the initial effect of a change in final demand and the total effects of that change. Total effects are the direct effects plus indirect effects, plus induced effects. Direct effects are the production changes associated with initial final demand changes. Indirect effects are production changes in backward-linked industries caused by the changing input needs of directly effected industries. Induced effects result from the household expenditures from the directly or indirectly generated labor income.

In essence, the multipliers estimated by this methodology represent the consecutive rounds of buying and selling that ripple through an economy. To produce one dollar of new product, employees must be hired and paid. The wages paid to these workers will then be spent on goods and services, such as food, gasoline, clothes, housing, etc. within the region and outside the region. As these cents are spent, they become income to the recipient, and the spending continues over and over again. The induced effect is the cumulative amount of spending.

The economic activity of the project also requires intermediate inputs to be purchased such as electricity, raw materials, transportation services, labor etc. These expenditures become income to the recipient and pay for the purchases of raw materials, labor, etc. They, in turn, are then spent over and over again in the economy. Purchases made from outside the region are considered "leakages" from the economy. The consecutive rounds of selling goods and services continues until these leakages from the region end the cycle. The indirect effect is the cumulative amount of such spending.

The IMPLAN databases consist of two major parts: national-level matrices and tables and economic and physical data at the county and/or state level. The national matrices are used with regional data to create a regional model.

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The following national-level matrices are included with each IMPLAN database:

1. The *National Absorption Table* is a coefficient form of the National Use Table derived by dividing each element of the Use Table by the respective industry's total dollar output. The resulting Absorption Table shows how an industry spends each dollar of outlay on goods and services to produce a dollar of output. Each column is an industry's production function reflecting the proportions of commodities used to produce one dollar of output.
2. The *National Byproducts Table* is a coefficient form of the National Make Table derived by dividing each element by the Make Table row (industry) totals. Each industry can produce more than one commodity. The Byproducts Tables shows what percentage of an industry's total output each commodity represents.
3. Deflators are used to adjust values from one time period to another.
4. Margins split a purchaser price into the appropriate producer values.

The local economic data in an IMPLAN database include Industry Output, Employment, Value Added and Final Demands. The value-added components are employee compensation, proprietors' income, other property type income, and indirect business taxes. The final demands components in the initial Final Demands Table are personal consumption expenditures, state and local education and non-education purchases, federal military and non-military purchases, inventory purchases and capital formation. Regional data is applied to the national matrices to create a set of regional accounts.

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Endnotes:

¹ Huckstep, Aaron, "Payday Lending: Do Outrageous Prices Necessarily Mean Outrageous Profits?", *Fordham Journal Of Corporate & Financial Law*, 2007.

² Huckstep, page 205

³ Stegman, M. A. and R. Faris, "Payday lending: A business model that encourages chronic borrowing," *Economic Development Quarterly* 17 (1): 8–32.

⁴ Lehman, T., "In Defense of Payday Lending", *The Free Market*, Volume 23, Number 9, September 2003

⁵ Bolton, W., "SC must rein in payday lenders before they run over state's consumers", *The State Newspaper*, March 23, 2006.

⁶ Data from interviews by authors with industry employers.

⁷ South Carolina Employment Security Commission, *Quarterly Census of Employment and Wages*, Third quarter 2007.

⁸ IMPLAN is regional modeling system developed by MIG, Inc., Stillwater, MN.

⁹ The latest data available for the IMPLAN modeling system are for the 2007 calendar year. However, the final dollar impacts estimated in this analysis reflect 2008 prices.

¹⁰ Stegman, M.S. and Faris, R. Payday Lending: A Business Model that Encourages Chronic Borrowing, *Economic Development Quarterly*, Volume 17 No. 1, February 2003, page 10.

¹¹ Huckstep, page 204.

¹² Flannery, M. and Samolyk, K. *Payday Lending: Do the Cost Justify the Price* (2005) FDIC Center for Financial Research Working Paper, No. 2005/09, page 221.

¹³ Huckstep, page 221.

¹⁴ Flannery, M. and Samolyk, K. page 2.

¹⁵ Huckstep, page 231.

¹⁶ Huckstep, page 231.

¹⁷ O'Sullivan, Sheffrin, Perez, Survey of Economics, Third Edition, Prentice Hall, Upper Saddle River, N.J., 2008, page 181.

¹⁸ Mankiw, N.G, Essentials of Economics, South Western Publishing, Mason Ohio, 2004

¹⁹ Mankiw, Chapter 4.

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²⁰ Mankiw, page 140.

²¹ Mankiw, page 140-141.

²² Morgan, D.P., Defining and Detecting Predatory Lending, Federal Reserve Bank of New York Staff Reports, Staff Report no. 273, January 2007, page 22.

²³ Morgan, page 22

²⁴ Morgan, D.P. and Strain, M.R., (2007, November) Payday Holiday: How Households Fare after Payday Credit Bans, *Federal Reserve Bank of New York Staff Reports*, Staff Report no. 309, page 3.

²⁵ Morgan and Strain, page 25.

²⁶ Morgan and Strain, page 26.

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GENERAL LIMITING CONDITIONS

This economic impact analysis is not a budget or forecasting document and is not intended to depict a definitive course of action. Moreover, economic impact analysis is not designed as a space or facility-planning document. Many assumptions underlying fiscal and economic impact analyses are based on policy decisions which, if modified, would affect the overall results.

This study is based on estimates, assumptions and other information developed by Miley, Gallo & Associates, LLC from its independent research effort, consultations with the client and its representatives, and primary and secondary sources. We have utilized sources that are deemed to be reliable but cannot guarantee their accuracy. Moreover, estimates and analysis are based on trends and assumptions and, therefore, there will usually be differences between projected and actual results because events and circumstances frequently do not occur as expected, and those differences may be material. No responsibility is assumed for inaccuracies in reporting by the client, the client's agent and representatives or any other data source used in preparing this study.

This report is based on information that was current as of January 2009, and Miley, Gallo & Associates, LLC has not undertaken any update of its research effort since that date. We have no obligation, unless subsequently engaged, to update this report or revise this analysis as presented due to events or conditions occurring after the date of this report.

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