The Daily Dish

Interest Rate Caps are the Wrong Kind of Cheap Trick

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Eakinomics: Interest Rate Caps are the Wrong Kind of Cheap Trick

Remember my rule of thumb for the policy universe: If it is in the presidential primary, it is unserious policy, a budgetary fantasy, an expansion of government control, or all of the above. Yesterday, Senator Bernie Sanders and Representative Alexandria Ocasio-Cortez added to the silly season menu a proposal to cap credit card interest rates at 15 percent. It will not become law, but I don't doubt that this idea is good politics. Humans have a long and complicated history with financial interest that dates at least to Exodus 22:24: "If thou lend money to any of My people, even to the poor with thee, thou shalt not be to him as a creditor; neither shall ye lay upon him interest." It is easy to imagine some populist rage at credit card bills since the national average rate hit 17.73 percent this month, while the median was 21.36 percent (both according to CreditCards.com).

But does populism really help the populace? In the Sanders-Ocasio-Cortez universe, the notion is that families would get the same access to credit, but lower interest rates. If it takes 17.7 percent, however, to recover the administration, cost of capital, arrears, and defaults, then lowering the interest rate is a losing proposition for the lenders. They will provide less credit at the lower rate of return. This reduced credit will take the form of lower credit limits for some borrowers and denying cards entirely to others. Which price will be higher, the financial cost of interest or the inability to make transactions that previously were possible for borrowers with poor credit scores or nontraditional sources of income?

Over longer periods, fewer firms and less capital will enter the credit card business, and the fallout will push capital to other uses that have less value (if they had more value, the capital would have been there in the first place). And, of course, interest rates respond to economic conditions, but an interest rate cap would not. If the economy continues to grow strongly and rates rise, the size of the affected pool will increase. Finally, if you can't borrow from a legitimate bank, some will borrow on the black market. Simply put, in a gazillion settings price controls have produced rationing and economic harm. This would be no different.

So, don't get too excited one way or another; this is not going to happen. But do be concerned that some sort of ugly Gresham's law of policy proposals is at work, and the "policy-rich" presidential primary is simply a downward spiral into ever less desirable proposals.