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# CREDIT for CONSUMERS

APR 8 1938

*How, when and where can the consumer use credit to his advantage?*

*How can he tell what rate he is paying?*

*Are new laws needed for his protection?*

PUBLIC AFFAIRS PAMPHLETS
NO. 5 1936

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# Credit for Consumers*

CONSERVATIVE banking practice from the first frowned upon credit for consumers. Credit for production, yes! Credit for consumption, no! The wise words of the elder J. P. Morgan, to the effect that a man's character should be the first consideration in making a loan, were often quoted but seldom acted upon—for consumers. "Show me first your security," said the banking Pieman to the consumer who wanted to taste his wares. Indeed, often the Pieman had no choice, since lending to consumers was unprofitable at ordinary banking rates of interest, and higher rates were illegal.

The requirement of acceptable collateral or high, stable earning power excluded more than 85 per cent of consumers from loans through legal banking channels; so consumers patronized unlawful lenders, despite extremely high rates and oppressive, often outrageous tactics.

The years 1909 to 1916 marked a great change. Previous to that time remedial loan associations—semi-philanthropic agencies with limited dividends—had been organized in a few cities, but had succeeded in serving only a small part of the demand. In 1909 the first credit union was established and the first credit union law was passed. In 1910 the first Morris Plan bank was established. More important than any of these moves, in its immediate effect on the great body of borrowers, was the passage, from 1911 to 1915, of several small loan laws which paved the way for the drafting, in 1916, of the Uniform Small Loan Act under the leadership of the Russell Sage Foundation. On this act and its later revisions is based the personal finance business of today.

Hand in hand with the growth of cash lending agencies have developed institutions which finance instalment sales.

* This pamphlet was prepared by LeBaron R. Foster, in cooperation with the Public Affairs Committee, on the basis of reports by Indiana, Wisconsin and Massachusetts investigating commissions, the Report of the Massachusetts Committee on Consumer Credit, and studies by the Russell Sage Foundation, the Twentieth Century Fund and other agencies.



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In the beginning, retailers themselves carried instalment sales along with charge accounts, and many still do so; but with the rapid rise of instalment selling many retailers, especially automobile dealers, turned over the financing of their instalment sales to companies which specialized in that business.

Thus, in so far as 85 per cent of consumers have been served at all, they have been served by specialized credit agencies adapted to their needs.

In the decade 1920 to 1930, instalment sales finance companies and personal finance companies grew by leaps and bounds; and although they were set back by the depression, they are again increasing the volume of their business. In volume, credit unions have been of minor importance, but at present they are expanding under the active sponsorship of the Federal government. Now the commercial banks, bulging with money to lend, are testing the possibilities. The rapid development of these and other consumer credit agencies is evidence of a continuing, unsatisfied demand for consumer funds.

*Inadequacy of Individual Savings*

No one denies that the easiest way to meet sudden demands for large sums of cash is from savings. The schools are right in emphasizing the value of a cushion against hard times. But evidence shows that for a majority of families large savings are out of the question. Even in 1929, according to a recent Brookings Institution study, seven families out of ten received annual incomes of less than $2500. Those with incomes of $1250 to $2450 saved, in the aggregate, very little, and families with incomes of $1250 or less saved nothing at all.

In any event technological displacement of workers and the casualties of depression make mock of stability. At the end of a year of unemployment, the provident ant may find himself as destitute as the carefree grasshopper. The modest hoards of the most frugal are seldom adequate to meet a succession of misfortunes.



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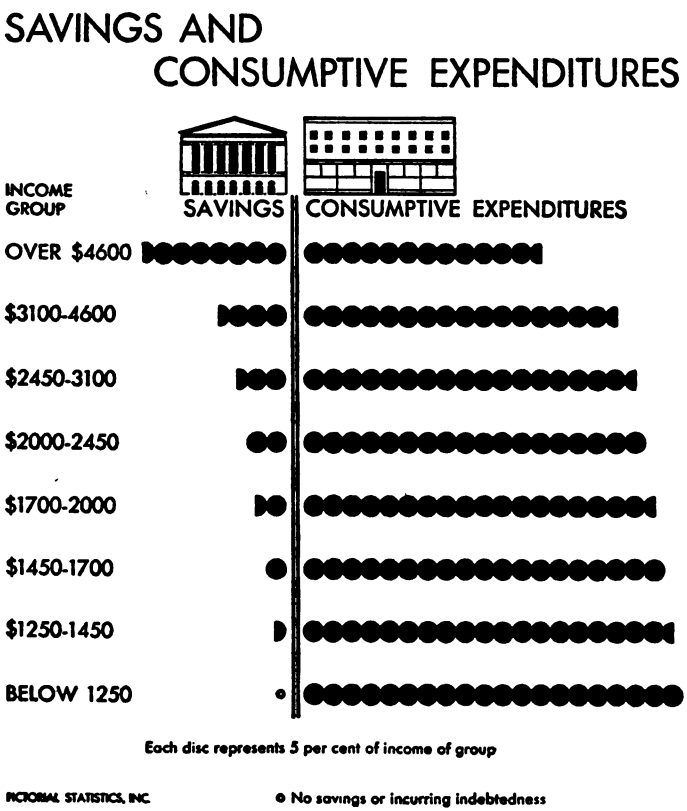
## CREDIT FOR CONSUMERS

The first obligation of the family which is barely getting along is to get along. Money spent for dental care—to use a single example—may do more good than the same amount put in a bank. To save money and lose teeth is not true thrift.




With conditions as they are, rather than as we might like to have them, savings often are not available when they are most needed. On those occasions when a relatively large lump sum of money would be helpful—in sickness, accident, and death, during temporary unemployment, for rescue from a tangle of piled up debts, even for sizable purchases of property—credit is often the only recourse.

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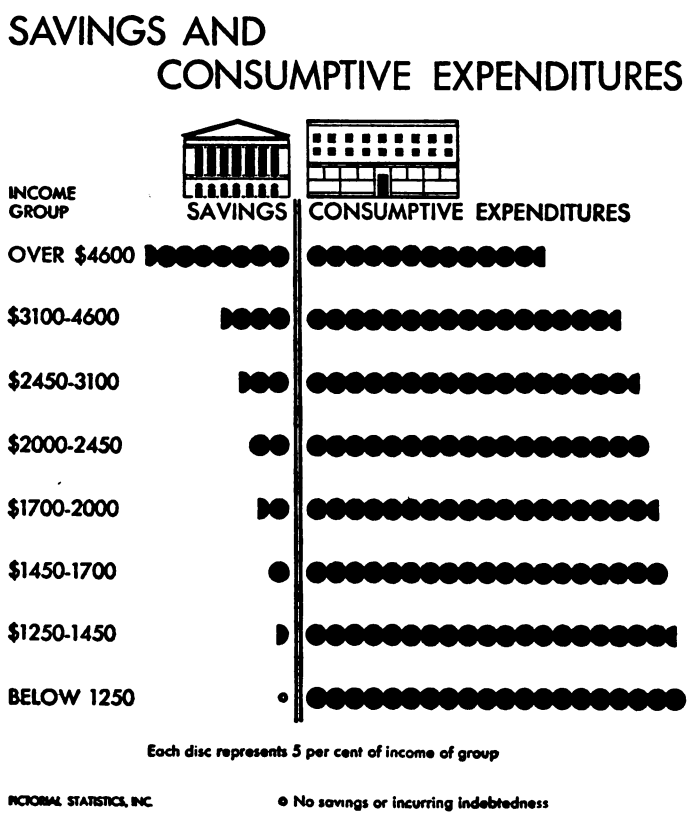


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*Justifiable Uses of Consumer Credit*

The use of consumer credit is justifiable, first of all, to meet emergencies. Son Jerry must have his appendix removed at once. We have no money in the bank and Jerry cannot wait until we save the money. We are self-supporting and self-respecting; we would not appeal to charity even if we could thereby get the kind of service we want. So we borrow what we need.

Now take a case a trifle less urgent. Father, unemployed for six months, has been offered an attractive salesman's job which requires a car. For another man a car would be a luxury; for father it is a necessity. He is sure that he can earn a living at the new job, but his savings are so nearly used up that he has barely enough to cover the down payment. In this emergency he uses credit: he buys the car on time.

Still oftener credit is needed to meet accumulated bills. Perhaps through unforeseeable accidents, perhaps through laxness, the head of the family has allowed a sheaf of bills to pile up. The grocer's account is four months overdue; one-half the winter's coal is unpaid for; the electric light company threatens to cut off the service; and the next instalment on the refrigerator falls due the first of the month. One creditor is threatening wage attachment, an action which might cost the family breadwinner his job. It may be that a temporary lay-off, or a justifiable large outlay for hospital care, or moving expenses, or help to an embarrassed relative has unbalanced his budget. Anyway, here he is. What shall he do?

There are several alternatives. Often the most feasible is the taking of a loan sufficient to pay off all the debts. That means borrowing from Peter to pay Paul; but Peter will wait for his pay and Paul will not. Moreover, if Peter is a legitimate lender, he makes only such loans as pretty surely can be paid without strain on the borrower's income; and the best lenders assist the borrower in working out a budget which provides for repayment. The money which the borrower



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pays for the use of money loaned may be well spent if it saves his job, conserves his investment in the refrigerator, reestablishes his credit at the stores, and maintains his self-respect.

Another common use for consumer credit is also rooted in human weakness, but it has a much more cheerful countenance. It is the use of credit to acquire costly commodities such as automobiles, refrigerators, pianos, houses, radios and furniture, which a man strongly desires and ultimately can pay for; things which he really wants more than many of the inexpensive things which he buys every day. The cheapest way to buy such goods is to save up in advance and pay cash; but, unfortunately, many of us cannot muster the necessary self-denial. We receive our income weekly, and we spend it weekly. We either acquire the costlier things through an automatic, compulsory payment plan, or acquire them not at all.

### *The Risks and the Costs*

The advantages of using credit are real, but the risks are equally real. A borrower who is unable to repay as agreed may lose the assets which he has pledged as security. He may even have his wages seized by an impatient creditor. Some instalment and some loan contracts contain wage assignment clauses; and even without such contracts, a creditor may secure wage attachments through the courts to collect overdue debts. Action of this sort often means the loss of the borrower's job. But if the prospective borrower decides that the benefits are worth the risks and the costs—and no person can decide for him—he may borrow without a sense of guilt and without thought that the lender is doing him a special favor. The borrower is simply making use of business institutions geared to his needs.



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## VARIOUS KINDS OF CONSUMER CREDIT

### *Charge Account Credit*

CHARGE ACCOUNTS are primarily for convenience: it is easier to pay once a month than to make change for every purchase. Perhaps that truth should close the subject, but it only opens it. To start with, the charge privilege is usually found in stores which provide a number of other services, and the cost of these services has to be included in the price of the goods. In such stores, the cash-and-carry customer is often at a disadvantage; he not only pays for a number of services which he does not want and does not get, but sometimes the services he does want are provided to him in poorer measure than to charge customers.

Customary terms are payment by the tenth of the month following purchase, but these terms are seldom enforced. In most department and most clothing stores, charge customers may let their bills run sixty or ninety days, even longer, without penalty. The danger of "charging it" is that expenditures may get out of hand. For that reason, many consumers who could have charge accounts for the asking, make it a rule to buy only for cash. Buying on a pay-as-you-go basis, with hard cash, puts a check on soft spending. Moreover, buying for cash will usually save money if the customer can find the goods he wants in a strictly cash store.

### *Credit Based on Assets*

It is wise, before obtaining any loan or credit, to take stock of your financial cupboard. Borrowing on your material assets is cheaper, as a rule, than borrowing on your mere promise to repay. The use of your savings bank deposits, life insurance policies, building and loan association shares, bonds and stocks, even jewelry and some other personal property, may enable the lender to advance money with small risk of loss and consequently at relatively low rates.



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Often it is advantageous to borrow on accounts in savings banks, instead of withdrawing the needed funds. Thus interest which has accumulated may be partially saved. A similar case is borrowing on building and loan association shares. Loans on insurance policies are easy to obtain, and they are low in cost, as they should be, since there is no risk to the lender. The borrower is in effect borrowing his own money. As these loans are readily renewed, self-discipline is necessary if the loans are to be paid. Borrowing on stocks or bonds may be economical, during periods of low interest rates, if the need for funds is clearly temporary; otherwise. it may be better policy to sell part of the securities.

*Loans from Pawnshops*

Loans on pawnshop pledges are useful mainly when a very small loan will be a real benefit; but much caution is needed. The borrower should make sure that the rates are not much higher than the rates on other available types of loans, that enough time is provided during which the pledge may be redeemed, and that the money is more needed than the possessions which are temporarily given up. Sometimes the borrower, if his chances of redeeming are slight, can do better by selling outright. As a rule, pawnshops lend from 70 to 90 per cent of the auction value of the pledge. Rates in a few cities are as low as 24 per cent a year, but usually the rates are much higher. In the largest cities, 36 per cent a year is common, and in many localities, particularly in the South, rates are from 60 per cent to 120 per cent.

Loans are obtainable from a majority of remedial loan societies on the security of pledged jewelry or other readily-marketable personal property. In making such loans, the societies are like pawnshops, with these differences: loans on the average are larger, rates generally are much lower, and standards of practice generally are higher because the rate of profit is limited and the policies are determined by trustees whose first concern is the welfare of borrowers. But there are remedial loan societies in only 22 cities.



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Pledge loans have unique advantages: since the borrower makes no promise to pay, but in effect sells the pledge subject to repurchase, he runs no risk other than the loss of the pledge; he is not pursued by collectors; and he is in no danger of having his wages attached. Moreover, for families without assured income, pledge loans are sometimes the only available credit source.

## INSTALMENT REPAID CREDIT

In a sense, borrowing of the kinds just discussed involves drawing on past savings. Now we shall consider consumer loans for which the chief security is the earning power of the borrower. Almost without exception, loans of this kind involve instalment repayments.

### *Instalment Sales Credit*

Instalment selling has a legitimate and important place in business, and most instalment sellers intend to give consumers a square deal. The big instalment finance companies, too, are increasingly open in their statements and reasonable in their rates, particularly on new car financing.

Instalment credit is now available for the purchase of nearly everything from bassinets to gravestones. This does not mean that every store will sell on time to every customer; but it does mean that so many kinds of stores, with so many kinds of merchandise, at such widely varying prices, have adopted so many species of "easy payment" plans, with such diverse carrying charges, that a vast majority of families can find at least one seller who is glad to oblige.

Such a variety of credit terms makes for extensive credit, but it also makes for extensive confusion. Consequently, in order to buy intelligently, the shopper must take pains to discover exactly what kind of service he is offered and exactly what it will cost. Here are some of the important



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questions which he should ask and, if necessary, keep on asking until he has definite and satisfactory answers.

1. *To whom will the debt be owed?* The reputation of the dealer may be little protection to the borrower if the dealer turns the debt over to a finance company or bank. Has the financing agency which will actually carry the debt a reputation for fair dealing and for reasonable treatment in case of default?

2. *Is the instalment contract just?* Usually contracts are a maze of legalistic terms, printed in fine type. Hard as they are to read, the consumer may save money and annoyance if he reads them carefully in advance for the express purpose of finding out whether they contain traps for the unwary. Some lawyers who prepare contracts take advantage of the fact that few customers read them. The finer the print the more carefully the borrower should read it.

The usual security for instalment credit is a claim on the goods which are delivered at the time of signing the contract. Is there a claim on goods other than those involved in the particular sale? Does the contract in question allow the creditor to seize the purchaser's wages? Are endorsements of other parties required? Generally the buyer need not furnish any such extra security. Always he should know exactly what he is signing before he takes pen in hand.

3. *Is the creditor given the power to impose fines, penalties and extra charges without limit?* Delinquency, repossession and other irregularities cause the seller expenses for which he is entitled to some compensation; but the purchaser must be on his guard against sellers and finance companies who levy extortionate extra charges. Not infrequently the borrower pays dearly for a few days' tardiness in payment. Some used car dealers do a thriving business in repossession charges. Not long ago, a New York City purchaser was asked to pay a repossession charge of $65 for the return of a car that had been repossessed.

4. *Is the purchaser assured a fair rebate of the carrying charges if the debt is paid before it is due?* If there is a



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possibility that the customer will be able to pay off the contract before it has run its full term, he should make sure that a worth-while refund will be made.

5. *Does the contract require the creditor to give ample notice before repossessing?* Such a clause may protect the buyer from peremptory and costly treatment. Unethical sellers and finance companies wait until the customer has completed all but one or two payments, then repossess, without notice, on the slightest excuse.

6. *Are all the dollars and cents figures which appear in the contract correct?* The time to rectify mistakes is before the contract is signed. Later on may be too late. A few minutes is not too much time to spend in examining an agreement which lays a claim on the family income for one, two, or even three years. A seller who attempts to rush a deal through is a seller whose motives may be suspected.

7. *What will the credit cost?* There are two measures of the money cost, both of which are worth taking into account: the cost in dollars and cents, and the cost in terms of a percentage rate. Neither may turn out to be what at first glance it seems to be.

The first thing for a buyer to do for his own protection is to find out the difference between the *true* cash price and the credit price. This research may take a little of the buyer's time, but it may pay him five dollars or more per hour. Some stores, because they sell all or nearly all their goods on *credit*, have no incentive to advertise a low *cash* price. In effect they include part of the credit charges in the ostensible cash price in order to make the credit charges appear low. The slogan "No Carrying Charges" is misleading. There are always carrying charges, and the dealer always intends to make the customer pay them.

This point may be clarified by a few comparisons:

Store A sells on instalments but makes no separate carrying charge. *All* prices are time prices and the customer pays for credit whether he takes it or not.

Store B makes a carrying charge which is insufficient to



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cover the costs of extending credit. In this store cash customers pay part of the costs of the credit granted to other customers.

Store C quotes prices which are merely a starting point: if the customer buys on time, he pays a carrying charge; if he buys for cash, he is given a special discount.

Store D makes a carrying charge about equal to the cost of granting credit.

Store E sells only for cash.

Certain credit stores do not vary their first-quoted prices; others, on one pretext or another, grant discounts whenever the customer appears to be interested in a cash deal. The shopper can not always tell, except by careful shopping, which store is which.

Having determined what he wants, the shopper should find out which of a number of stores will give him the lowest *cash* price. With this price he should compare the credit price of the instalment sales offer which is best suited to his needs. The difference is, to him, the dollar cost of the credit.

The dollar cost of credit helps the shopper, particularly when he compares costs of credit purchases which run the same number of months and start with the same unpaid balance. But whenever time and unpaid balance differ—and often they do differ—and whenever it is helpful to compare the cost of paying carrying charges with the cost of a money loan—and usually it is helpful—*a percentage rate is absolutely necessary for intelligent comparison.*

Many dealers say, however, that a majority of customers pay little attention to percentage rates, even when invited to do so. That is a fact. One object of this pamphlet is to induce such buyers to save money by taking the trouble to find out the percentage rates of all available sources of loans.

For an example, let us take actual terms quoted in one Lowell, Massachusetts, store in the fall of 1935. A radio was priced at $100 cash and $104 on time. The terms were $5 down, the balance to be paid in twelve monthly payments of $8.25. According to the dealer, the carrying charge was



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4 per cent. For spot cash, however, he would deduct $10 from the "cash" price. So, in reality it would cost the customer $14 to pay off a debt of $85 over a period of twelve months. The debt would be gradually reduced by the instalment payments, with the result that the purchaser would receive credit, on the average, equal to about half the starting balance. Dividing 14 by half of 85 gives the annual rate of 33 per cent. (Calculated according to a widely-used formula, the rate is 30.4%.) As with nearly all percentages quoted by sellers, the 4 per cent rate quoted in this case does not reveal the true cost.

Now suppose the Lowell customer was also considering a refrigerator, and wanted to know whether it was more economical to pay cash for the radio and buy the refrigerator on time, or vice versa. In a neighboring store, he could have purchased a refrigerator for $180 cash (no discount allowed); or $10 down and the $170 balance, plus a $20 carrying charge, to be paid in 24 monthly instalments. The average amount of credit would be roughly half of $170, or $85. When 20 is divided by 85 the result is, in round numbers, 24 per cent for two years credit, or about 12 per cent per year. Instalment purchase of the radio, therefore, would have cost the buyer more than two and one-half times as much per dollar of credit as instalment purchase of the refrigerator.

Instalment buying from the minority of unscrupulous dealers offers more pitfalls than any other kind of borrowing except borrowing from unlicensed moneylenders. Though most merchants are honest, those who are not cause a good deal of trouble for the unwary. And the majority of the consumers who buy on time are unwary.

Some of the rates on instalment credit are among the lowest in the entire field of consumer finance; some are among the highest. A special commission of the Massachusetts legislature found that among about 500 cases the rates of 56 were in excess of 100 per cent a year. Common terms on automobile tires, for example, are nothing down and a carrying charge of 10 per cent of the price for the privilege



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of paying in 10 weekly payments. Though under this plan the credit charge may be only a few dollars, it results in an annual rate of about 95 per cent. The seller probably little more than covers his costs, but the purchaser pays dearly for a little credit.

There is a growing tendency to make "easy terms" too easy for the financial health of the consumer. In his own interest, the down payment should be as large and the period of the contract as short as his cash on hand and his income readily permit. Thus more of his dollars are used to buy merchandise and fewer to pay for credit. Furthermore, the smaller the debt which he assumes and the shorter the time during which it runs, the less is the danger of losing his equity in the merchandise because conditions arise which prevent him from completing his payments.

The list of danger points could be extended considerably. No contract is likely to be satisfactory in all respects, since most contracts are prepared mainly to protect the creditor. In practice the customer has only one choice: to refuse to sign any contract which contains dangerous provisions. The instalment contract is a strong legal instrument. In signing it the purchaser binds himself to an agreement which may cause him untold trouble and expense.

### *Remedial Loan Societies*

The great majority of remedial loan societies make loans on chattel mortgages or on endorsed notes, as well as on pledges. Rates for these loans, ranging from one and one-quarter to two and one-half per cent a month, often are lower than the rates on similar loans by strictly commercial lenders.

### *Industrial Banks, Morris Plan Banks and Personal Loan Departments of Commercial Banks*

Industrial banks are primarily consumer credit agencies; the word "industrial" is a misnomer. One group of these



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banks operates under the trade name "Morris Plan." Together with the personal loan departments of commercial banks, the industrial banks serve borrowers who are able and willing to get responsible endorsers for their notes. The risks of loss are relatively small and the loans are relatively large.

The requirement of two endorsers or co-makers, or at least one, to share with the borrower the responsibility for payment, is a stumbling block for many who would like to borrow from these institutions. Many customers, including most of those who are in direst need of aid, cannot get acceptable endorsers. Others are loath to ask such a substantial favor because they could not return it. Still others, even if less reluctant about asking favors, are more reluctant about revealing their financial troubles to their friends or employers.

Any self-respecting borrower naturally considers whether his friend or relative can afford to assume such a risk. If the answer is "yes," a Morris Plan Bank, or an industrial bank, or a personal loan department of a commercial bank may be his best source of help. Even if unwilling to supply endorsers, borrowers who enjoy high credit ratings should not overlook this source; some Morris Plan banks now make loans to the best risks on single signatures.

The rates are relatively low; but they are not so low as they seem to be. First, the interest is discounted rather than added. For example, if the total charge is 8 per cent, a borrower who signs a $100 note receives only $92. If he received $100 he would have to pay $8.70. Second, part of the charge for the loan is called "fees." To the stated rate of 6 or 8 or 10 per cent is usually added 1 to 3 per cent for investigation or other expenses—expenses which must be met by all lenders of money whether or not a separate charge is made. Third, the borrower is required to make regular deposits to a special savings account sufficient to pay back the loan at maturity. Thus, in effect, the borrower pays interest on that part of the loan which he has already paid off. Interest at a low rate sometimes is paid on these deposits,



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and in such cases it should be taken into account in figuring the cost of the loan.

The net result of the interest charge and fees, the discount in advance, the repayment by instalments, and the interest allowed on deposits, is actual annual rates ranging from 7 per cent to 34 per cent per annum. The commonest rate—usually advertised as "loans at 6 per cent"—amounts, with the addition of fees, to more than 17 per cent per annum. There are also at times fines for delinquency. Even at these rates, the lenders are forced to demand that the borrower make his payments with strict promptness. Some banks turn loans over to an attorney for collection as soon as any payment is overdue two weeks.

### *Credit Unions*

Credit unions are cooperative organizations which lend the savings of a group to some of its members. These unions have obvious advantages. Usually their lending costs are low because of donated management services and office space, intimate knowledge of members' circumstances possessed by the directing officials, tax exemptions, and limited rates of return on the capital. On account of these advantages, credit unions can make some types of loan at rates lower than those charged by commercial agencies.

Credit unions succeed best in closely-knit groups, such as employees of one business firm or government department, members of a labor union, or of a club or lodge. As a rule, there must be at least fifty members, in order to provide sufficient capital; but four-fifths of the employers in the United States do not employ as many as fifty persons. There are also neighborhood unions; but the chances of success decrease as a union spreads out and the management loses close touch with the affairs of the members. Credit unions therefore are not available to everybody. At present it appears that they are available to not more than one person out of twenty-five.



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A majority of credit unions lend $50 or less without any security other than the borrower's signature and the pledge of any union shares that he may own. Larger loans usually require endorsers. The objections to asking endorsements are akin to those mentioned in connection with industrial banks, but not so weighty since the credit union management seldom forces the endorsers to pay the loans. In some cases wage assignments and real estate mortgages are alternative sources of security.

For the borrower, the chief attraction of credit unions is low rates. A majority of the state credit union laws and the Federal law limit the charge to one per cent per month on actual, unpaid balances. Generally, initial extra fees are not permitted, although fines for delinquency are. The charge is figured each month, not on the amount of the loan at the start, but on the actual amount still unpaid. Thus, the commonest maximum charge amounts to a true annual rate of 12 per cent.

Credit unions are a concrete embodiment of the co-operative ideal. Under favorable conditions, they provide loans at low rates for borrowing members, and liberal returns for investing members.

### *Licensed Personal Finance Companies*

Commercial small loan companies, sometimes called "personal finance companies," although among the most expensive, are in many respects the quickest and most widely available sources of cash loans. Operating under small loan laws devised to eliminate illegal and anti-social moneylenders, the licensed personal finance companies lend to urban borrowers in all occupations, and in all income classes above the poverty level.

The principal security for such loans is the borrower's promise to repay; that is why the loans are called character loans. It is true that security is generally required in the form of chattel mortgages on household furniture, or occasionally



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wage assignments, but these are taken mainly as a protection against borrowers who, though able, refuse to pay. In some localities loans are being made simply on the signature of the borrower.

Loans are limited, under the Uniform Small Loan Law, to $300. This restriction applies to no other consumer credit agency. A large proportion of the loans are less than $100, and some are less than $50. Many of the families which are in most urgent need of small loans find that their only safe sources of help are licensed personal finance companies.

In some states, the maximum that may be charged is 3½ per cent a month on the unpaid balance; in other states, 3 per cent a month; in two states 2½ per cent a month; and in a few other states, still lower maximum rates are fixed by law, but are ineffective. On loans above $100, rates lower than 3 per cent are obtainable in most large cities.

Three per cent a month is a high rate, but not so high as some persons assume. No extras of any description are permitted, the charge is not discounted, and the interest rate is applied each month only on the balance still due after crediting repayments of principal. For example, at the 3 per cent rate a $100 loan, repaid in 12 monthly instalments, would cost not $36, but $19.50. If interest were discounted in advance, on the plan used for industrial bank and Federal Housing Administration loans, the discount would be, not 36 per cent, but roughly 16.5 per cent. A feature which reduces cost to some borrowers is that the balance due may be repaid at any time, with interest charged only for the actual period of use. With most other lenders, little or no reduction of the interest charge is made for early payment.

Under the Uniform Small Loan Law, the lending agencies in most states are carefully supervised. Every loan office is required to post its state license in plain view. If the borrower has a real grievance, he can take his troubles to the state supervisory department with confidence that he will receive fair treatment.

These are good reasons why every consumer should



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insist on having a *workable* small loan law in his own state; but these reasons do not justify him in borrowing from small loan companies if he can avoid borrowing without too great a sacrifice, or if he can borrow elsewhere, under a satisfactory plan, at rates lower than the comparatively high rates which small loan companies are obliged to charge.

*Unlicensed Lenders*

In the 21 states which have no small loan law, as well as in the states which, like New Hampshire, have established a maximum rate too low to permit small loan companies to grant small loans, the unlicensed lenders are the only source of loans for a large majority of all wage-earners. This fact is a condemnation of the states which have not yet protected those of their citizens who most need protection.

The lowest rate commonly charged by illegal lenders is 120 per cent a year; the usual rate is 240 per cent; and the highest rate is above 1200 per cent. The rate, however, is not the worst feature of the business. The usual aim of these lenders is to get the borrower into debt and keep him there. When the borrower attempts to pay off his debt, he is urged to renew his loan. Often, when he cannot pay, he is passed on to a company of another name owned by the same lender; and then he is charged, in addition to interest, a sizable refinancing fee. In case after case, a man borrows, let us say, $50, pays in interest $300, and still owes more than he borrowed. Resort of the victim to the courts is often of no avail. The illegal lenders, operating under a pretense of buying wages or under some other legal dodge, and often in league with officers of the law, thwart all attempts of the borrower to extricate himself. Indeed, illegal lenders use the courts to collect their illegal levies.

There are, to be sure, a few lenders who do their best, in states which have no workable small loan law, to supply the demand for consumer loans at fair rates. As the National Better Business Bureau says, "Anyone who finds that he is



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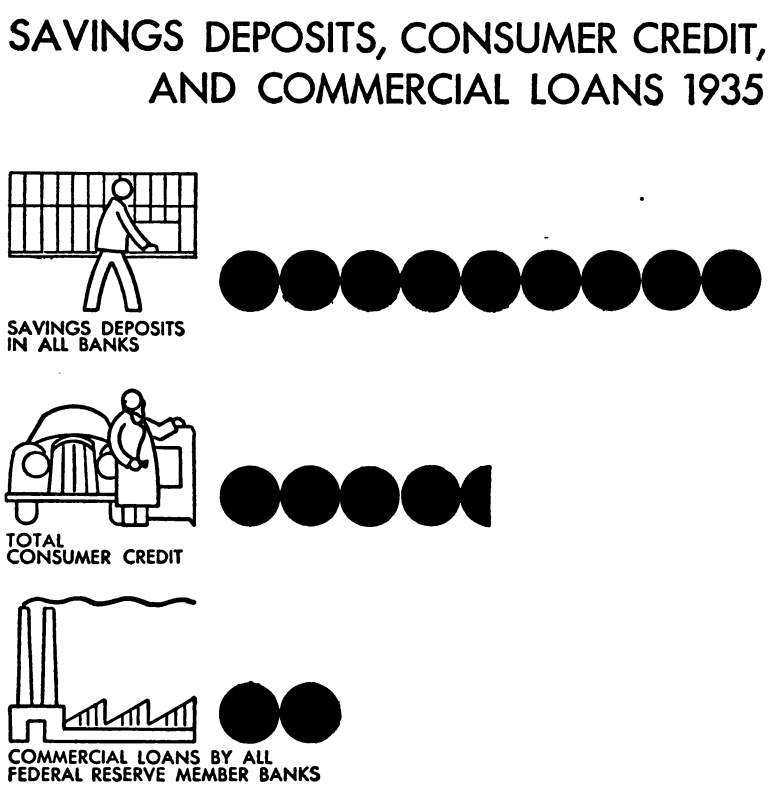
dealing with an illegal lender who is charging unbearable rates should report his case at once to a Better Business Bureau, a welfare agency or a legal aid society. If none of these is available it should be reported to the prosecuting attorney."

## VOLUME OF CONSUMER LOANS

We now venture estimates of amounts. For some divisions, such as remedial loan association loans, the data are reliable. For some others, such as personal finance companies, credit unions and personal loan departments of com-

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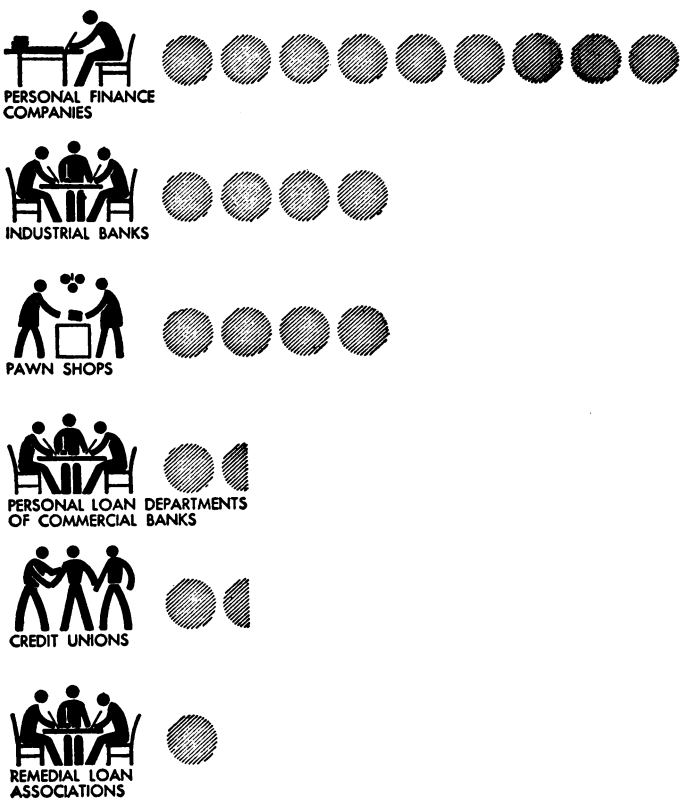
mercial banks, the data are estimated from a body of known fact. As for the figures on charge accounts, instalment sales credit, axias, illegal lenders, pawnshops, loans among friends or relatives, and informal personal loans by commercial banks —well, it would be rash to call these figures more than informed guesses. The eleven billions of consumer credit are about half the size of our total savings deposits and are larger than the commercial loans of all member banks in the Federal Reserve system. Credit for consumers is a major timber in our credit structure.

## CONSUMER LOANS BY VARIOUS AGENCIES, 1935



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## CONSUMER DEBT BY TYPES OF LENDING AGENCIES [1]

| | *Estimated Outstanding, End of 1935 (Millions of dollars)* |
|---|---|
| *Credit Based on Personal Property and General Credit* | |
| Retailers' Open Accounts | $ 2,800 |
| Retailer and Finance Company Instalment Sales Credit | 2,100 |
| Advances by Relatives and Friends | 1,000 |
| Commercial Bank Personal Loans (not segregated) | 500 |
| Personal Finance Companies | 225 |
| Illegal Lenders | 119 |
| Industrial Banks (including Morris Plan) | 110 |
| Pawnshop Loans | 110 |
| Personal Loan Departments of Commercial Banks | 40 |
| Credit Unions | 40 |
| Remedial Loan Associations | 26 |
| Axias | 6 |
| Philanthropic, Employer, Student and Other Special Loan Funds | 25 |
| *Credit Based on Savings and Other Reserves* | |
| Life Insurance Policy Loans | 2,300 |
| Veteran Borrowings on Life Insurance and Adjusted Compensation Certificates | 1,666 |
| Building and Loan Association Share Loans | 105 |
| Savings Bank Loans on Pass Books | 8 |
| Loans by Other Savings, Loan and Investment Companies | 50 |
| TOTAL | $11,230 |

[1] As explained in the text, estimates where adequate data are not available are necessarily rough. All estimates are net, after deducting loans for business purposes. Money loans include virtually no rural credit, and no real estate debt. For some items, use has been made of earlier studies by Dr. M. R. Neifeld and Dr. F. W. Ryan, and of current estimates by Mr. Rolf Nugent.



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## HOW TO USE CREDIT TO ADVANTAGE

Now, let us say, having gathered the facts, you have decided that you can wisely use your credit. What is the best security that you are willing and able to offer? Generally speaking, the better the security, the lower the cost of borrowing.

What is the smallest loan that will solve your problem? It is foolish to pay for more credit than you need; conversely, a loan which only partially solves your problem may soon leave you face to face with the same difficulty all over again.

What service features do you want? Are you reasonably certain of your ability to reshape your finances without assistance and to meet all payments on the dot? Or do you want counsel on budgeting, and lenient treatment in the event that you find yourself unable to make a particular payment? Extra services may be valuable to you, but you will have to pay for them.

### RATES ON CONSUMER CREDIT

| | *Common Charge* | *Range of Charges* |
|---|---|---|
| Savings Bank Accounts | 6 | 5-6 |
| Building and Loan Ass'n. Shares | 6 | 6-12 |
| Insurance Policies | 6 | 3-6 |
| Credit Unions | 12 | 8-18 |
| Personal Loan Depts. of Banks | .. | 7-23 |
| Remedial Loan Ass'n. (Pledges) | .. | 10-36 |
| Remedial Loan Ass'n. (Chattel Mortgages and Co-maker Notes) | .. | 15-30 |
| Industrial Banks | 17 | 12-34 |
| Pawnshops | 36 | 24-120 |
| Personal Finance Companies | 36 | 30-42 |
| Illegal Lenders | 240 | 120-480 |
| Instalment Sellers and Finance Companies | .. | 0-500 |



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Taking into account the answers to these questions, what is the lowest cost loan that will serve? Rates of charge differ from state to state, from city to city, and from lender to lender. The preceding table gives only a general summary of rates, which should be checked by the individual borrower in his own community.

Let us emphasize the fact that the above table is merely a rough guide to the widely varying rates of charge in various parts of the country.

*How to Finance Yourself*

Many a family with money in the bank nevertheless buys on the instalment plan in order to keep its savings intact. It fears getting behind; if savings are spent, the family may neglect to replace them. In such cases instalment buying is employed not as a means of putting off the day of reckoning, but as an accounting device which compels the family to live within its income.

Commendable as the motive may be, the needless resort to such credit wastes time and money. By devising a self-made plan, you can finance yourself at a cost of three or three and a half per cent (whatever interest you forego on your savings) as against many times as much for credit obtained elsewhere.

Careful budgeting is a great help, and there are many excellent guides to assist you. All you really need to do, however, is to set up a schedule of payments identical with those you would have to make to the instalment seller. Then regularly, on each pay day, deposit the payment in a savings account. In the end you will have paid back not only your withdrawal, but also an added amount equal to your saving in carrying charges. Whether you use your own funds or funds supplied by a lender, it is the rigid adherence to regular payments that prevents you from falling behind.



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## *Paying off Old Debts*

Clearing up a pile of overdue debts is a real job. The sooner it is faced, the better. Here is a sensible approach:

1. Leave out all bills, if any, which are not just claims. If any creditor who is thus ignored makes trouble, consult your lawyer. If you cannot afford to pay a lawyer, consult a Legal Aid Society.
2. Make a list of the remaining bills which are due and those which are soon to become due.
3. Study your income and irreducible expenses carefully to see whether you can pay off the total in a few months. If it appears that you can do that, make out a definite dollars and cents plan for paying each creditor his share each pay day. Then show the plan to those of your creditors who are pressing for payment. Most creditors will be happy if you show them that they will be paid in two or three months.
4. If your debts are so large that you cannot work out your own adjustment plan, take a loan that is large enough to pay off all your overdue debts. You will have to pay interest, but this will enable you to spread payments over a longer period of time. Most agencies lend for at least a year, and the small loan companies ordinarily allow twenty months or more. The lender usually will assist you in making out a budget and, if necessary, may even help you to work out compromise settlements which will scale down the total.
5. If there is no reasonable prospect of getting out of debt by borrowing, do not borrow even if you can find a willing lender. Instead, work out a scaling down of debts with your creditors, or have a competent person or a social agency do it for you. If you are really in such dire circumstances that you cannot pay, your creditors may accept part payment as full payment.
6. Bankruptcy is the last resort. Unfortunately, there are shortsighted creditors who, insisting on everything or nothing, secure wage attachments rather than agree to a fair settlement. For many sorely pressed debtors, bankruptcy is the only means of freeing one's wages and one's job from the persecution of harsh creditors. Beware, though, of the shyster lawyer who drums up trade in this field.



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## WHY CONSUMER CREDIT IS EXPENSIVE

ANY consumer who bought flour by the carload would get a low price; but no consumer wants wholesale lots. The householder wants only a few pounds delivered at her home or her neighborhood store. Similarly, the consumer wants credit in small lots, to fit his circumstances; and as with flour or coal or cotton cloth, he must pay more at retail than at wholesale.

There are several reasons why credit for consumers is more expensive than credit for business. First and most important is the fact that service costs per dollar of loans to consumers are higher than the costs per dollar of loans to industry. An experienced investigator must contact several references to check the consumer's credit standing. He must verify the title to any goods that may serve as security. The necessary documents must be prepared, duplicated, filed and recorded. The cashier must receive numerous weekly or monthly payments, issue receipts and keep track of them on the books. When routine notices fail, collectors must be sent out to exert pressure. All these expenses often amount to more dollars on a retail $100 consumer loan than on a wholesale $5,000 producer loan.

Second, the cost of capital is relatively high. It is only in recent years that the large financing concerns have been able to float their securities in the open market and to borrow at low rates from the banks. Even now the Federal Reserve Banks refuse to rediscount consumer paper.

Third, there are losses. They are smaller than one might suppose in view of the risks accepted, but they are by no means inconsequential. Particularly in times of subnormal employment, cash lenders must cancel or compromise considerable amounts of interest and principal, and instalment sellers must either repossess a considerable proportion of sales or write off numerous bad debts. Even in good times, actual



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losses are kept small mainly by spending much money in persistent collection effort.

There is still another risk factor. With the exception of instalment financing agencies, most consumer credit grantors operate under laws which limit rates of interest and other charges, and legislatures frequently change their minds as to what constitutes fair rates. Until a mature social philosophy has been developed, lenders will constantly have to spend money in some states to show lawmakers and the public why rates must be allowed which permit the business to survive, or else have it destroyed in those states.

## A PROGRAM FOR SOCIAL PROTECTION

THE CONSUMER is at a special disadvantage in his dealings with credit agencies. If his need for money is urgent, he is in no position to bargain; and when he buys on the budget plan, he is inclined, since he is interested primarily in the merchandise, to accept whatever terms are offered.

Moreover, even if he attempted comparisons, his effort might be poorly rewarded. Often credit terms are a jumble of percentages added, percentages deducted in advance, flat dollar charges and cash discounts, percentages applied to cash prices, to original unpaid balances and to declining unpaid balances, special charges for investigation, insurance, registration, and what not. As Evans Clark says: "The present complicated maze of differing rates and ways of charging for instalment credit and small loans should be reduced to a single, simple, and easily comparable basis which would show the borrower at once precisely how much he has to pay for the money or credit of which he has the actual use. Every agency should be required by law: (1) To calculate its rates in terms of this single standard; (2) to publish this calculation in all its loan contracts; (3) to submit it to the state supervisory agency as part of its regular public accounting."



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A second major objective is the elimination of outright dishonesty and racketeering. In the money lending field, the problem is most acute in states which have no workable and ably enforced small loan law. Salary buyers not only levy extortionate interest charges, but resort to the cruelest measures to collect them. Where other means fail, illegal lenders have employed armed thugs to beat up delinquent victims. The obvious remedy is the replacement of antiquated usury statutes with a Uniform Small Loan Law, which makes the rates sufficiently high to attract legitimate capital, and the use of credit unions wherever conditions are favorable.

The remedy for racketeering in instalment selling is not so clear. Abuses range from the levying of unreasonable fees for delinquency, repossession and refinancing, to fraudulent sales of merchandise, the main purpose of which is to burden the purchaser with debt and thereby collect extortionate financing charges. A study in Chicago of wage assignments showed the annual filing of one wage assignment for every five employees in the street railway, and one assignment for every one and one-half of the laborers in a packing plant. The bulk of these were filed by retailers who, to judge from the records of the Legal Aid Society, were for the most part instalment houses. A similar situation was disclosed in New York City. While the major part of instalment selling today is done by reputable firms at reasonable rates, the part conducted by unethical and racketeering organizations is considerable. Strong legal instruments necessary to protect the seller are easily converted, in unscrupulous hands, into devices for oppressing imprudent debtors.

Two steps appear necessary to remedy these abuses: (1) Full disclosure in plain language, in every instalment contract, not only of the regular instalment terms, but also of the exact amount of fines and penalties, if any, that may be imposed in case of delinquency or default, and the exact conditions under which repossession may be made; (2) Regulation by law of unethical or abusive practices which should either be prohibited or rigidly limited in operation. The most



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effective method of regulation probably will be developed only through trial and error. The courts have held that credit extended in connection with a sale of goods is not subject to usury laws; so the finance companies are free to charge any interest rates they choose. A few states, including Utah, for example, have passed laws which make the legal rate of charge so low that nobody obeys the law. The comprehensive regulatory law adopted by Indiana in 1935 is now being applied by the state banking department; but the law is to have a further test in the courts. A Massachusetts Special Commission recommended licensing and supervision of finance companies by the state banking department. The Governor's Committee on Consumer Credit in the same state concluded that control would be difficult unless extended to include retailers. The two bodies agreed, however, that state regulation of some sort is urgently needed for the protection of the public.

*Rates Determine the Extent to which Credit is Granted*

The cost of providing credit rises rapidly as the service is made available to a larger and larger proportion of the population. Commercial bank rates permit lending only to the highest type of risk; in fact, a large proportion of personal loans at commercial rates are made as special favors or as business builders for the more remunerative departments.

Next in the scale of risk are the institutions which lend primarily on the security of notes endorsed by responsible co-makers: industrial banks, Morris Plan banks, personal loan departments of commercial banks, and a few others. A large proportion of consumer borrowers, however, are either unable or unwilling to obtain such endorsements. Also in a preferred class as to risk are pledge loans of remedial loan associations, of some credit unions, and the accounts of instalment sellers which are adequately protected by the resale value of the property which serves as security.

Credit is extended by these institutions, however, to the minority of consumers who can provide strong security. The



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needs of other consumers are met by those instalment sellers who bank on the earning power of their customers, and by personal finance companies operating under the Uniform Small Loan Law, and by pawnshops; or these consumers are exploited by unlicensed lenders in states which have failed to enact workable small loan laws. Rates for this type of credit are necessarily much higher than for well-secured credit.

The smaller the loan and the greater the risk, the higher must be the charge for credit.

*The Test of Social Benefit*

The ideal, from the social standpoint, is a full loan service on a business basis for every self-supporting family that can make good use of it. As long as the purpose is constructive, the cost not unduly high, and the payments within the ability of the borrower, a loan is as well justified in the case of a $15 a week clerk as a $50 a week machinist. Indeed, those who want the smallest loans are often in the direst need of temporary assistance. But costs rise rapidly as the size of the loan decreases. Only because loans of one to three hundred dollars carry part of the expense of loans of less than $100, can the smaller borrowers be served under existing legal rates.

Each state legislature, by setting the maximum rate, determines who shall and who shall not be served with small loans. Too high a rate permits unsocial, careless lending. Too low a rate denies the service to those who would be benefited by it. Under the pressure of competition the credit agencies extend their lending service as broadly as possible within the limits set by the rates.

Not all legislatures, to be sure, appear to understand what they are doing. In passing the old usury laws, they apparently thought they could restrict rates for all types of credit to the level of rates for business credit. The laws were evaded or ignored. Recently, in some states where work-



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able small loan law maximums had been in effect long enough to foster a legal lending business, legislators suddenly lowered the maximums to 2 per cent a month or less. But in New Jersey, West Virginia and New Hampshire the result was to extinguish the major part of the legal business and to cultivate illegal lending at rates of 20 per cent a month and higher. In New Jersey and West Virginia this created situations which the legislatures promptly cured by increases in the permitted rates. A rate that is ample in one state may be too low for another. Maximum rates should be fixed upon careful investigation of local conditions.

Impossibly low legal rates always open the way for illegal lenders. That is why they recently fought—though unsuccessfully—against the passage of the small loan law in Kentucky; and that is why the illegal lenders, under cover, and with the aid of well-meaning but misguided reformers, try to make the Small Loan Law a dead letter by substituting impossibly low rates. For many years, the personal finance companies, operating for their own profit under the rigid provisions of the Uniform Small Loan Law, have been the chief protection of millions of necessitous borrowers against the extortions of the bootleg lenders.

Whether the loan be large or small, responsibility for determining social usefulness rests upon the lender. He must weigh all the pros and cons for each case and decide whether the purpose of the loan is constructive. The problem of regulation, therefore, extends beyond interest rates to the fostering, by state supervisors and trade associations, of a lively sense of social responsibility.



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