THE HIGH COST OF SMALL LOANS

BY *SAM SHULSKY & DON HASSELL*

THE middle-class working people of this country — the families with incomes between $2000 and $4000 a year — are rushing into debt at a greater clip than ever before in history. Since the end of World War II their borrowings have doubled. Their total indebtedness, which is now close to $15 billion, is at an all-time high, and the end is nowhere in sight. Literally millions of automobiles, homes, refrigerators and washing machines are still needed and/or wanted — and will be borrowed against. The all-cash automobile and home buyer of the easy-money war days has disappeared. Millions are being forced to borrow to keep abreast of the cost of living.

The chances are nine out of ten that a borrower will not be getting his money's worth. The interest he pays will be high. Rates of 30 to 40 per cent a year and up are commonplace — and for those who borrow from loan sharks the rate can go well above 500 per cent a year. It often does, in fact, pass the 1000 per cent represented by the $5 weekly loan for which you repay the shop's moneylender $6 the following pay day — the famous "6-for-5" accommodation loan popular among the very poor. Then there are the hidden charges, recapture clauses involving possessions which played no part in the loan, garnishees, and assignments of wages, all of which can rise to torment the borrower who fails to repay on time. To say nothing of the brass-knuckle goon squads employed by some loan sharks.

Consumer credit is almost always a "blind" purchase and an expensive service — usually blindest and most expensive for the people who need it most. A recent survey of the small-loan and instalment-credit field yielded the startling fact that two thirds of all people who need between $50 and $300 in a hurry borrow blindly. They neither know nor take time to learn the rates of interest they must pay, what the total cost of their loans will be, what other sources are open to them, what protection they have in case of default. The reason for this blindness is obvious. The average

SAM SHULSKY, *assistant financial editor of the International News Service, is a regular contributor to the* MERCURY. *His "Case Study of Government in Business" appeared in last month's issue.* **DON HASSELL** *is a veteran of some twenty years in the newspaper business, who is now a member of the financial staff of the New York* Journal-American.

small-loan borrower is at a tremendous disadvantage. His need for money is urgent. He is in no position to bargain, and the seemingly small payments he must make over a dozen months hardly bulk as large in his thinking as the lump sum that is put in his hand by the lender. Even if he were not harried, the task of finding out what he is paying for help in satisfying his creditors (or for enjoying a television set a year before he has the money to pay for it) is probably far beyond his business ken. Credit costs are more often than not expressed in a jumble of percentages added or deducted in advance; percentages applied to original loans, or to declining unpaid balances; or to special charges for investigation, insurance and registration.

Before the first mild laws for the protection of borrowers came on the books a generation ago, money-lenders were such barefaced robbers that in some cities men of substance banded together to form "remedial" loan societies. They organized pawn shops whose capital was furnished on a near-charity basis and whose profits were limited. Some of these societies still exist. In New York City the Provident Loan Society, established in 1894, charges borrowers an over-all rate of only 1 per cent per month on unpaid balances. But only a few dozen cities have such organizations.

II

Neither protective laws nor kind-hearted societies can help those who refuse to help themselves by shopping around for their loans, by checking all the possible sources of credit before borrowing.

There are many such sources for the small-wage earner, and they range from the neighborhood racketeer who lends money directly from his wallet, and whose office is the corner saloon, to the ultra-respectable bank with assets anywhere up to $6 billion. Yet a single rule governs all lending, and the rule offers small comfort to the average borrower: The man who needs the money less can get it easier and cheaper. There seems to be nothing that can be done about the rule. It is sanctioned by the Bible ("To him who hath shall be given and from him who hath not shall be taken away even that which he hath"), accepted as natural on Broadway ("A banker is a guy who is always ready to lend to anybody who doesn't need it"), and considered axiomatic by the lenders themselves. Thus the desperation and ignorance of the small borrower are in direct proportion to the rate of interest he is charged. The closer he is to the end of his fiscal rope the more he will be charged, and the more he will have to pledge as collateral. If a man pays 5 per cent interest he may be presumed to be well-informed and not too hard up. If he pays 1200 per cent he is probably poor and uneducated, and without much credit standing. (Credit standing is an all-embracing term which includes character, regularity of income, ability to live within that income, past record in meeting debts, and resources —

stocks, bonds, possibly a reserve fund built up in life insurance.)

In borrowing money from legitimate sources, there are several criteria by which one can judge the relative advantages of the terms. The wise borrower will apply all of them and check them against as many lending agencies as his standing allows him to approach.

First, there is the tricky problem of calculating how much the loan will cost. There are two approaches to measuring a charge for the rental of money — it can be figured in dollars and cents and in percentage rates. Both approaches can be deceptive.

If you borrow $100 for one year, at the end of which you pay back $106, you have paid a simple interest charge of 6 per cent. If the loan is due in six months, your interest charge — even though you make the same repayment — is 12 per cent.

The problem becomes more involved if (and this is a common transaction) you borrow the same $100 under an agreement to repay $106 in twelve equal instalments over the course of a year. In this case, your interest cost is not 6 per cent, but nearly 12, since the *average* debt on which you are paying interest is only slightly more than half the amount originally borrowed.

In many cases — including those where the commercial banks are the lenders — the interest is discounted, *i.e.*, it is deducted at the very start of the transaction. So that if you borrow $100 at 6 per cent, you receive only $94, and if you repay your loan of $100 in a lump sum at the end of twelve months your interest charge is not 6, but nearly 6.4, per cent. If you are expected to pay back the $100 in twelve equal monthly instalments, you are actually paying nearly twice as much interest for the money.

Interest cost, then, is a matter not only of rate, but of time. The man who borrows should be certain in his own mind as to (1) how much money he is actually receiving, (2) how long he will have the use of it, and (3) how much he will have to repay. The suckers who borrow at what they conceive to be low rates, but who fail to get these vital details clear in their minds, are themselves responsible for most of the dishonest practices in the money-lending business.

III

The chief sources of legitimate consumer credit are: life insurance companies, commercial banks, pawn shops, small-loan companies, and stores which allow instalment purchasing.

The borrower who can put up something of value as bond for his loan is obviously in a favored position, and the more salable the collateral, the easier the terms of his loan will be. If, for example, he turns over 100 shares of U. S. Steel, worth around $7000, to secure a loan of $2000 to modernize his home, the lender, who is fully protected, can afford to cut his interest demands to a bare minimum. He will have to set aside little or no reserve for possible loss. But if the borrower puts up a racing sloop and a summer home in the woods as collateral, the lender would have to consider the possible difficulty of disposing of them should the payments be defaulted on.

For this reason, those who can borrow money against insurance policies having a cash reserve value can obtain just about the lowest rates available for individual consumer credit. If you have a policy with a cash value standing at, say, $2500, you can borrow up to that amount on it from your insurance company at a rate of 5 or 6 per cent. Most companies charge the higher rate for older policies, since the premiums on these policies were usually based on that scale of interest. In recent years most companies have included clauses in policies giving the insured the privilege of borrowing at 5 per cent; and a few insurance companies have reduced the rates on all policies to the lesser charge.

In any case, when you borrow against an insurance policy, you are, in effect, borrowing your own money, and you can count on good terms. If, for example, you borrow $2000 to remodel your house, you pay only $100 a year for as long as you keep the money, and a proportionately lower amount if you repay any. This is a straight charge of $5 per $100 per year, which is pretty cheap borrowing.

In recent years commercial banks have been so zealous in cultivating small-loan business that they now undersell even the insurance companies. It is possible to pledge your insurance policy with a commercial bank and obtain a loan for as little as 3 per cent a year. However, a few commercial banks offer different and less attractive terms — including deduction of the interest at the beginning of the loan, monthly repayments, etc. In these instances it takes a lot of close figuring to decide whether, in the final analysis, you are actually getting a better deal. It should also be realized in borrowing against a life insurance policy, either at an insurance company or a bank, that if anything happens to the insured person during the period of the loan, the amount of the loan will be deducted from the policy before anything is turned over to the beneficiaries.

If you have no insurance policy against which you can borrow — of if you do not want to jeopardize your family's protection by having your insurance signed away for long periods of time — your best bet is the commercial bank. There are now 11,000 of these banks in the small-loan field.

Anyone who feels that it would be faintly ridiculous for him to walk into a marble-pillared, high-ceilinged institution with assets of anywhere from $10 million to $6 billion, and ask for a $200 loan, can speedily rid himself of that feeling. The world's biggest banks today are actively seeking small business, and they are prepared to advance you as little as $60 for any legitimate purpose. Nor does the fact that the bank stands prominently in the center of town mean that your affairs will be any less private than if you walked up two flights to a small-loan office. Both lending institutions check exactly the same credit sources and go through the same procedures. The only difference is that the commercial bank, in return for charging a lower rate of interest, restricts its clientele to those it considers select risks. At New York City's Chase National Bank, for example, a small borrower would have to have a steady job with a reputable concern and a good credit record as an individual, *i.e.*, no unsettled judgments or garnishees. And his loan should not exceed 15 per cent of his annual income.

IV

Let us assume he qualifies, and arranges to borrow $600 at Chase to modernize his kitchen. The cost of the loan would be worked out this way:

If he has stocks or bonds, or other negotiable investments to put up as security, the interest rate will be 4.5 per cent. This *does not* mean that he pays only $4.50 for every $100. In the first place, the interest is deducted from the amount he actually receives; so that after signing a note for $600, payable, say, in twelve monthly instalments of $50, he is given $573. Furthermore, the repayment procedure means that the average amount of the money available to him during the year is only a little more than half the original loan. His interest cost is really just under 8.7 per cent.

If he had no collateral to offer, the amount deducted would have been $30 ($5 per $100), and the interest cost would have been 9.7 per cent on an annual basis. In either case, however, this would still be cheap borrowing for the average man.

Anyone who cannot qualify for an insurance or commercial bank loan will find the personal-loan companies far more lenient in their credit demands, but rather more expensive in their interest charges. Licensed small-loan companies charge rates between 2.5 and 3.5 per cent a month on the unpaid balance. They do not, however, deduct the interest at the start of the transaction, so that you at least get all the money you sign up for.

A man who borrowed $100 from one of the biggest of these companies, and repaid in monthly instalments over a year, would end up paying an interest rate of about 30 per cent. In an average transaction he would repay $9.75 at the ends of twelve successive months, for a total of $117. The $17 represents to him the cost of a loan which started out at $100 and, in the last month, was down to $9.75. This comes to an average loan of a few cents under $55 for the entire year. Dividing $55 into $17, we find he paid an interest rate of about 31 per cent for his money. If he had decided to borrow the $100 for only six months, he would have repaid $18.15 a month, or a total of $108.90. In other words, he would have paid $8.90 for the rental of approximately $59 for a half year — which figures out to around

30 per cent interest. A larger amount, say $300 (the maximum these companies may lend in many states), would have cost about $45.84 in actual rental, which adds up to an interest rate slightly under 30 per cent.

The pawn shop, where you customarily pledge an article worth two to three times the amount of your loan, generally charges stiff rates. Anyone who wants to get hold of $50 to repay a personal debt that can't wait, can, of course, wrap up that fine camera Uncle George brought back from overseas and take it to Willie-the-Lender. But he would be wise to check on the rates before turning it over. In many states the maximum allowed by law is 3 per cent a month for the first six months and 2 per cent on the next six for loans under $100; and 2 and 1 per cent, respectively, for loans above that amount. The first charge figures out to 30 per cent interest, the second — which is harder to get — to only 18.

For those unfortunate would-be borrowers whose credit standing and lack of resources rule out any legal loans, there are the loan sharks. To borrow from them a man need have nothing to do with chattel mortgages or signed contracts, and he can have a prison record a yard long. The shark operates only with a "runner," who steers business to the boss, and a well-organized brass-knuckle squad. While the latter effectively enforces contracts and discourages those who would run to the district attorney crying usury, the boss exacts interest costs running above 1000 per cent a year. Moreover, the loan shark's customers tend to keep paying for years, since the usual aim of these lenders is to get the borrower into debt and keep him there. If the sucker tries to repay part of his debt every week, and thus work himself out of this quicksand, he is told that he must repay the entire loan or none. If he falls behind in a payment he is "refinanced," *i.e.*, passed on to another company owned by the same gang, and charged a substantial refinancing fee. One unfortunate victim of these usurers finally called in the police last year, after he had been kept in slavery for ten years. In January 1939 he had borrowed $20 to pay a medical bill. Every month thereafter until January 1948 he had renewed his loan. By that time he had paid $1053 in interest for the use of the $20, and he still owed the usurer more than he had borrowed.

V

Fully half the personal credit contracted for in this country is in the form of instalment buying. For thousands of families, the prices of automobiles, refrigerators, radios, furniture and other items bulk so large beside the weekly income that they can be had only on the instalment plan — at once the most popular and the least understood form of purchasing practiced in this country.

At its best — in the form of a department store charge account — instalment selling involves small articles

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Cost, in Dollars, of One-Year Straight Loan

Size of Loan	$100.00	$200.00	$300.00
Insurance 5%	5.00	10.00	15.00
Insurance 6%	6.00	12.00	18.00
Pawn Shop	30.00	36.00	54.00

Cost of One-Year Loan to Be Repaid in Monthly Instalments

Size of Loan	$100.00	$200.00	$300.00
Commercial Bank with Collateral	4.50	9.00	13.50
Commercial Bank without Collateral	5.00	10.00	15.00
Small Loan Company	17.00	31.96	45.84
Department Store Credit Accounts	12.00	24.00	36.00

carried for 30 to 60 days, with no increase in price. At its worst it adds up to shoddy merchandising at high prices, with trick recapture clauses and excessive interest. The old rule, *caveat emptor* — let the buyer beware — applies nowhere with more force than it does here. For not only must the buyer determine what he is being charged for the privilege of deferred payment on a $300 radio, but he must also make certain that it really *is* a $300 radio. While there is no good evidence that credit stores sell merchandise of less value than cash stores, differences in credit terms do make any quality comparison more difficult.

A man who knowingly pays $300 ("in twelve easy payments") for a radio which sells elsewhere for $250 cash, and charges the extra $50 off with a "so what — I didn't have the $250 anyway," might do well to pause for a few computations. He is paying $50 for the privilege of paying $250 in twelve monthly instalments. Looked at another way, he is receiving a series of monthly loans whose average, for the year, is about $135. When he pays $50 interest for the year's loan of $135, he is paying more than 37 per cent for his money.

He could probably do better by borrowing the money outright from a small-loan agency and paying cash.

Still better, he might have sought out those stores which do business on a one-price basis and make no charge for credit. Department-store and men's-clothing-store charge accounts are, of course, outstanding examples of month-to-month credit at little or no cost. It is worth making special efforts to keep these charge accounts in good shape. For not only do they provide an easy way to carry a credit charge from month to month, but they are excellent references which every credit agency will accept as a measure of financial character.

For anyone who still feels impelled to pay instalment fees on a large purchase, there are advantages to shopping around, to getting the lowest rates and the clearest contract. Suppose, for example, that a man buys a $300 radio on which he can pay $100 down. A fairly good charge would be 6 per cent for the $200 balance, or $12, which is paid when he hands over the $100 down payment. He pays the balance in ten or twelve equal instalments. Dollarwise this amounts to a charge of only $12; percentagewise it means not 6, but 12 per cent, since the interest cost is $12 on a loan whose average amount outstanding is only slightly more than $100. This 12 per cent loan, costing $12, is actually not a bad arrangement as instalment plans go. It is, for example, better than borrowing from those stores which adhere to the old custom of adding 10 per cent to the cash price of an article bought on credit, and then making easy payment terms "at no further charge to you." That would mean $30 added to the cost of the $300 refrigerator, which makes the instalment contract cost $30, instead of $12. In general, it's a good idea to stay away from these old-fashioned credit terms.

Even in states with the most comprehensive instalment-buying safeguards there is no safety for the borrower who signs a deferred-payment contract first and reads it later. A New York state legislative investigation into sharp bargains driven by automobile dealers turned up interest rates running to 291 per cent a year. (These were hidden in contracts which appeared to be charging 37.4 per cent.) In some cases, it was revealed, these terms were set up and pressed on buyers who had been ready to pay cash for their cars; who, in fact, ran into trouble later when they tried to prepay their loans.

The instalment situation, in fine, has begun to smell so bad that many bankers have felt themselves obliged to point out that figures can lie; and that whereas the "retail instalment seller was once in dire need of protection, today he is quite adequately protected by law and it is rather the buyer who often needs protection." The American Bankers Association organ, the sober and conservative monthly, *Banking*, gives this example of a man in "low finance."

"He wants a car," the magazine article begins, "but lacks cash. A helpful dealer tells him, 'It's O.K. to owe Shea. You can pay Shea on pay day,' and gives him a car in return for a small down payment and the balance 'in convenient instalments.'"

The buyer signs the contract:

> The payments arranged are much higher than Jones [the buyer] expected, and almost beyond his means. . . . The charge is high because the dealer has packed it beyond reason for his benefits, and because it also reflects the cost of bonuses and rebates of the financing charges which a financing company will pay him for assigning the contract. (In other words, for getting his loan business.)
>
> There are other charges, for recording the contract, insuring the car, and so on. The fees are higher than actual cost.
>
> Jones is strapped but meets his payments until he receives, at a shorter interval than usual, a bill higher than usual. This causes him to default. When he does pay he finds that he contracted stiff delinquency and collection charges and an "attorney's fee," although no attorney ever entered into the picture. Then, after most of the price of the car is paid, he is told that he is a poor credit risk, and that the remaining balance is therefore declared due. He defaults again. The car is repossessed (at expense to Jones) and sold at a bargain price which still leaves an unpaid balance.

This, however, will be taken care of with no further trouble to Jones since it will be paid out of an assignment of wages which he agreed to, unknowingly, in the first place.

This is an old, old story. Not until 1935 did anybody try to do anything about it. Indiana, Wisconsin and Utah finally passed legislation protecting the instalment buyer. During the war, the Soldiers and Sailors Civil Relief Act gave protection to the bulk of those who were forced to buy on a time-payment basis, and since then more states have put laws on their books. Today about half of the 48 make some pretense of safeguarding buyers.

But until this protection is more thorough and widespread than it is today the instalment buyer would do well to look out for himself. Except in rare instances, the buyer can save a substantial part of these instalment credit costs by doing his own financing, *i.e.*, by borrowing money at a bank and paying cash for his purchase. This is especially true in the purchase of automobiles and other expensive items where the deferred payment plan often includes increases in rates of as much as 40 per cent, theoretically as a "reserve" for cars or other high-priced equipment which may have to be reclaimed, but actually as a kickback by the finance company to the dealer. In the dear, departed pre-World War II days, when cars had to be sold and buyers had to be "sweetened up" with too-optimistic trade-in values for their old cars, this kickback added to the instalment bill was often the dealer's principal source of profit.

People have borrowed since before Biblical times, and they will undoubtedly continue to do so. Borrowing does not have to be the social evil that it often is. But until the small borrower learns to check on his rights, and to "shop around" before making a loan, it will continue to be a major source of injustice.

THE DAMAGED ONES

A STORY

BY *HARRIET RENAUD*

All evening Saxe had been waiting for this particular point in the party. It was the point that was reached just before a party broke. If you saw a party as a large bubble, then you got so you could recognize the exact moment when it stopped floating and all the people in it were, for an instant, perfectly suspended. Then the bubble broke, and even if you stayed on, you knew the party was really over, and the people were divided into three groups — those who sat because they couldn't move, those who got home (their own or someone else's), and those who got as far as the bedroom and fell asleep on your coat on the bed.

It was really because of this last group that Saxe had stayed drunk enough to see the bubble, and sober enough to be conscious of it at the crucial moment. He had decided, in the middle of what had been a particularly bad week, that it would be a very important omen of some kind if he and Kitty went home together from the next party they went to. And now he had it figured, craftily, that if he knew just when to make a dash for the bedroom, he could get his and Kitty's coats without any trouble whatsoever, and be that much ahead.

He had the small worried hope too that once the party started breaking, Kitty would be able to hear him again when he spoke to her. It had been several hours now since he had been able to make any sound that she would respond to. He hadn't had that trouble with anyone else; in fact, several people had told him with great affection to shut up. But although he had definitely seen Kitty's eyes focus on him at least twice, he had not been able to get her to make a sign that she heard anything at all of what he was saying to her.

He took a quick look at the bubble, just beginning to round into its final moment, tipped his glass back until it was empty, and made for the bedroom. There was no one there yet, and he got his and Kitty's coats, just as he'd planned, and went directly back to the spot where he had a feeling Kitty had been the last time he'd seen her. But she wasn't there.

HARRIET RENAUD *has worked in recent years as a writer on movies and the theatre for* Newsweek, *and as a graduate teaching fellow in English at the University of California in Berkeley. A previous short story of hers appeared in* THE AMERICAN MERCURY *of April* 1944.