REMEDIAL LOANS—A CONSTRUCTIVE PROGRAM[1]

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DURING the last three years a bill designed to regulate the small loan business in the District of Columbia has been introduced in each session of Congress. This bill provides for the licensing and supervision of all money-lenders in the District and allows them to charge a monthly interest rate of 2%. In spite of the fact that the bill has had the unanimous support of the press of Washington, the approval of many philanthropic institutions and a large number of prominent individuals who have the welfare of the community at heart, it has not yet become a law.

There have been from the beginning intimations that a powerful lobby supported by combinations of money-lenders having their headquarters in Washington has been at work to prevent the passage of the bill and that political influence has been enlisted in most unusual and unexpected quarters. The real reason for the failure of the bill to pass is to be found in the attitude of several congressmen who have been members of the committees to which the bill has been referred. The chairman of one of these committees recently said, "The loan-shark bill as presented at the last session would have made it legal to charge 24% a year on money borrowed. This would have been detrimental to the needs of the District and I voted against it. There is not a place in the country where such a rate of interest is tolerated, much less made legal." Another prominent congressman in a letter recently received by me said, "I do not think the money-lenders who seek to get 2% a month ought to be protected. In my judgment they ought not be permitted to do business in the United States. I want strict regulations on this subject. I will never support any measure that proposes

[1] Read at the meeting of the Academy of Political Science, November 11, 1911.

2% a month or 1½% a month. More harm than good will come of it." Another senator insisted that a limit of 6% a year be fixed on all loans of this sort, that such a law strictly enforced would serve the purpose best of all.

These gentleman seem to believe that all Congress has to do is to enact a strict law forbidding a higher rate of interest than 6% and the loan-shark business ceases. They seem to be ignorant of the fact that in New York city, where until recently a higher rate of interest than 6% per annum has been prohibited under penalty of criminal prosecution, except to corporations organized under a special law, more than 300 loan sharks are charging from 120 to 500% per annum. Probably they do not know that in the state of Pennsylvania, where a higher rate of interest than 6% is forbidden, all cities and the larger towns are infested with loan sharks, one of whom was recently found to be charging more than 700% annual interest on his loans. They apparently have not noticed that during the last sessions of the state legislatures bills were introduced in twenty-two states allowing a higher rate of interest on small loans than the banking rate, and that in the state of Massachusetts the entire business of small loans has been placed under the control of a newly created state supervisor of loan agencies to whom power has been given to regulate the rates of interest, within a maximum of 3% a month.

Even a cursory examination of the conditions that have given rise to the loan-shark evil shows that banking rates of interest cannot be imposed on a business conducted on security not accepted by banks. The loan company, having no deposits to loan, must do its business on its capital alone, and in order to pay operating expenses plus a reasonable return on the investment and to meet the losses in a business notable for its risk a higher rate of interest than the banking rate must be charged. Shall the small loan business, then, be recognized as a national institution, to be made legitimate, regulated and controlled and subjected to reasonable conditions, or shall it by the passage of drastic laws be rendered more clearly illegal? The answer must be in favor of legalizing the small loan business, for drastic laws result, not in the discontinuance of the usurious

loan business, but in driving it further into the dark. Any attempt to work unnecessary hardships on the lender, to compass him about with unreasonable restriction, has the inevitable result of forcing the borrower to pay a still higher charge for his loan.

The average annual wage of the American workingman is not more than $500. This falls far short of the minimum expenditure upon which it is estimated that a normal standard of living can be maintained. Enforced idleness, unexpected illness and similar emergencies necessitate the borrowing of money. This condition cannot be eliminated without the entire remodeling of our whole social and economic system. The small loan evil has reached far greater proportions in the United States than in foreign countries, not because of the prevalent American unthrift about which we hear so much, nor because the American workingman is worse off in the matter of wages than the workingman in other countries, but because our country has been backward in enacting social legislation and in recognizing the duty of the community toward its marginal laborer, and because the workingman himself has still to grasp the full possibilities of voluntary protective effort.

Many foreign countries, realizing the evils resulting from exploitation in the field of small loans by private enterprise, have with varying degrees of success attempted to regulate the business by making it a governmental monopoly. In several European countries the need for loans among workingmen is met by the operation of municipal or semi-public loan associations that advance money on household goods, clothing, jewelry and other property at low rates of interest. Out of 10,000,000 discounts made by the Bank of France last year, over 2,000,000 were for loans of 50 francs or less. It was the boast in Scotland more than a century and a half ago that any young Scot known to his neighbors as industrious and honest could get a loan at a local bank at banking rates. The Scotch local-bank idea has been developed in many other countries into a system of co-operative credit associations. It is estimated that there are some 40,000 of these associations now in operation in Europe with over 3,000,000 members and $1,000,000,000 resources.

52 of these credit unions are operating successfully in the Dominion of Canada.

It is a regrettable fact that until very recently the small loan business in this country has been almost entirely and even now is very largely in the hands of discredited and disreputable people. Governmental monopoly of the small loan business has never been attempted in the United States and only very recently has it been discussed. The rapidly rising storm of protest against the evils of usury in this country during the last few years has given an impetus to the remedial loan movement that has taken the form in many cities of competing loan institutions of a semi-philanthropic nature. There are at present twenty-one of these remedial loan societies in nearly as many cities, employing $10,000,000 of capital. All are paying a reasonable return on the investment and by their competition are forcing the usurers to reduce their rates or vacate the field. A notable example is the Provident Loan Society of New York city, which loans money upon pledge of personal property at 1 % per month. During its seventeen years of existence it has grown from a small society with a capital of $100,000 to a great financial institution now employing $7,500,000. The result of the work of this society is shown by the fact that most of the larger pawnbrokers in New York city are now loaning money at 1 % per month, and the proportion of pawnbrokers to population has decreased nearly one-third. An effort is being made to supplement the work of the Provident Loan Society in this city by the organization of a similar institution to make small loans upon security of mortgages on household furniture.

This endeavor has not been extended to the field of salary loans, nor is it necessary that it should be. The salary loan evil is a problem that can be and is being solved by protective effort on the part of employes with the coöperation of employers.

Borrowing on assignments of wages is not peculiar to any one class of employes. It is prevalent among clerks employed by public service corporations, banks and mercantile houses and federal and municipal employes. A recent investigation in this city by the commissioner of accounts showed that many loan sharks operating exclusively among city employes are charging

from 60 to 400 % per annum on their loans. Not only was a large percentage of firemen and policemen found to be involved, but aldermen, city magistrates, and even supreme court judges were among the loan sharks' clients. It is estimated that in New York city more than 200,000 persons are involved with the loan companies, many of whom are every year paying back in interest alone two or three times as much as they ever borrowed. The statement could probably be proved that one city dweller in every twenty, one voter in every five, finds it necessary at some time during the year to discount two days' labor for the immediate price of one.

A business of this character and extent, carried on among employes, has naturally become a source of great annoyance and worry to employers. Many of them, casting about for a solution, have attempted to discourage the habit of assigning wages among their employes by threatening with immediate discharge upon discovery any employe found so involved. This rather common attitude among employers is illustrated by the following excerpt from a letter which I recently received from the president of a large manufacturing concern in this city: "We now have a rule that whenever an employe's salary is attached by one of these firms and such notice is served upon us, the employe is subject to discharge. This, we think, is a good rule, as knowing that such is the case, it prevents our employes from going to these agents, whether to purchase goods or to get a loan on their wages." The effect of such action on the part of the employer is shown by the following typical case.

A young man holding a responsible position endorsed the note of a friend who had been compelled to borrow $50 from a salary loan shark. Under the loan shark system the endorser as well as the borrower is required to give an assignment of his wages. Subsequently the borrower, before he had paid his loan, lost his position and left the city. The loan company called upon the endorser to make good the loan. He was unable to do this, but knowing that his employer would discharge him if it became known that he had dealings with the loan company, as the loan shark was already threatening to notify his employer he went to a second loan company to

borrow the amount claimed by the first. This began a chain of transactions that lasted for about eighteen months. During that time he paid the money-lenders $250 in excess of the amount received from them and was then indebted to the extent of $300. The loan shark one day informed him that unless the total amount due was paid on the following day a file would be placed against his wages. Knowing that such a development would cause his discharge he determined to raise the money by whatever means he could, and in desperation he unwisely took what seemed to be the easiest course under the circumstances and appropriated $200 of his employer's funds at that time under his care. This was sufficient to meet immediate demands, but the loan shark still claimed a balance of $100 and after a time again became insistent in his demands for payment. Unable to get more money from the man, the loan company filed on his wages and he was discharged. When his theft had been discovered, it was found that he had disappeared and it is believed by his wife and his employer that he has committed suicide.

The greatest evil in the salary loan shark's business lies in his power over men upon whose wages he has loaned money and who dare not let their employers know of their assignment through fear of loss of employment. The salary loan business has been termed "the loaning of money without security." On its face it is almost this, but in reality the salary loan shark has at his command a very effective agency for collection—the borrower's fear of discharge. All employers can profit by the simple device adopted by a Philadelphia firm which reversed its former policy and took up the cudgels for its men, declaring that it would discharge no man for assigning his wages and giving notice that it would defend its men against the loan sharks' extortion. The terrorism of discharge was taken out of the transaction and one feature of the evil minimized.

The recent decision of the appellate division of the New York supreme court in the case defended by a large department store of this city upholds this attitude. The court held that no assignment of wages is valid unless filed with the employer within three days from the date the loan was actually made.

This decision has been reiterated in a recently enacted law known as the Brooks law. It cannot be denied that such a court decision coupled with legislation like the Brooks law relieves the employer of much annoyance caused by the filing of assignments, but it must be remembered that the problem involves the interest not only of the employer but of the borrower and lender. While the Brooks law benefits the employer it renders the plight of the borrower worse than ever. Making it more difficult for the loan shark to collect his money always results in a higher charge to the borrower. The employe will borrow from loan sharks in time of need if he is unable to obtain money elsewhere, and the Brooks law, while it may remove the fear of discharge in many instances, does not remove the fear of displeasure of the employer. This fear, in the hands of the loan shark, is almost as effective a weapon for collection as the fear of discharge. Obviously the remedy for the salary loan evil is not to be found in legislation alone. The very fact that the salary loan business has increased so rapidly shows that it has arisen in response to a need, and that no remedial plan, legislative or otherwise, can be successful unless it gives the borrower an opportunity to obtain loans at fair rates and under reasonable conditions.

The progress that has been made by the remedial loan movement so far as it affects borrowers who have no security to pledge except their earning capacity has taken the form of industrial organizations, capitalized sometimes by the employer alone, sometimes by him in coöperation with his employes, while several corporations have loan funds capitalized and administered wholly by their employes. Under the first-mentioned arrangement, the employer's loan fund, employes in good standing may, upon the approval of an official, borrow from the company sums not exceeding the monthly wage, to be repaid in regular instalments, which are taken out of the pay envelope by the paymaster or treasurer of the company. It is not surprising that this arrangement has not become popular among employes. Other employers, recognizing the defects of the paternalistic system just described, have encouraged the organization of coöperative associations among their employes, which stimulate

thrift among members by encouraging savings accounts, and which afford facilities for borrowing at reasonable rates without the knowledge of the employer, loans being voluntarily repaid in partial payments at stated periods. The organization of these coöperative associations has not been uniform. In some of them the majority of the stock is held by members who never borrow, in this way making for themselves a substantial profit out of the returns upon loans made to other members. This is often the case with coöperative associations existing in newspaper offices in large cities. The best type of coöperative associations for savings and loans is that which places a limit upon the interest that any one member can hold in the association and fixes the interest charge on loans at a rate that will pay expenses of operation and return to savings depositors an interest slightly in excess of that paid by regular savings institutions. Associations operating along this line afford an effective solution to the salary loan problem in an industrial establishment. There are many of them that have been operating successfully for years, but none has been more successful than the savings and loan association of the Celluloid Company of Newark. In that company the salary loan evil is now practically unknown.

At a recent conference held in this city many large employers unanimously agreed that the following course of procedure should be adopted: (1) that employers rescind rules of discharge, in order to assist employes in resisting unreasonable interest charges; (2) that all employers disregard claims by money-lenders against the wages of employes, not in direct compliance with law; (3) that in self-interest as well as for the benefit of their employes, the creation of coöperative savings and loan associations be encouraged; (4) that laws be enacted which will allow a reasonable rate of interest on all small loans and provide for the licensing of money lenders under the efficient supervision and control of a state department.

Following this conference an unusual amount of interest in the coöperative savings and loan idea has been shown by many large employers, and it is hoped that it will not be long before these associations will be in operation in most of our industrial establishments, railroad and telegraph offices and city departments.

For workingmen the condition of whose employment will not permit of the establishment of coöperative savings and loan associations, the remedy appears to lie in attracting honest capital into the salary loan business on a reasonable money-making basis. The Brooks law, to which I have referred, allows an interest rate of 18% per annum. This, in my opinion, is not sufficient. It provides that lenders on salaries must register their names and places of business with the county clerk. This is not the supervision and control needed.

A satisfactory law should allow a sufficiently high interest charge to enable the business to compete with other enterprises for the capital needed. The interests of the borrower should be safeguarded by provisions requiring license or incorporation under the supervision of a state department or bureau whose duty it should be to make frequent examinations of the business of the licensees with the idea of detecting illegal practises and unjust methods. To this department should be given certain discretionary powers in the matter of regulations for the conduct of the business. Violations of the law by overcharge or other unfair practises should be severely punished. Such a law would soon remove the odium and disrepute by which the salary loan business is now surrounded; it would ensure a fair profit to lenders and would relieve borrowers from the necessity of paying interest for years after the cancellation of the actual debt.

To summarize, a successful program for minimizing the evils of small loans must include competition and constructive legislation. The competition must take the form of semi-philanthropic loan agencies in the pawnbroking and chattel-loan fields and coöperative associations for savings and loans among employes, supplemented by the investment of honest capital on a reasonable money-making basis. No legislation should be permitted except that which, dealing fairly with all interested parties, recognizes the business as a necessary element of our financial system, to be legalized, regulated and controlled. Let us not forget that the operation of loan agencies under conditions approaching justice will do more to remedy the small loan evil than any number of laws based on suppression.