The term “loan shark” has been commonly used to describe those who lend small sums at higher rates of charge than the law allows. It has been associated almost exclusively in recent years with loans to wage-earners. The qualities that give rise to loan-shark transactions—greed, on one hand, and compelling necessity, short-sightedness, or gullibility, on the other—are not new among human beings. Most civilizations for which historical records are available have been confronted with the problem of usury and have attempted to deal with it. Nevertheless, the loan-shark problem is substantially different from the historic problem of usury. To be sure, the loan shark of today has inherited the social stigma that attached to the business of his usurious predecessors, and he has made use of some of the devices which they developed to evade legal restrictions upon interest-taking. But here the relationship ends. The loan shark is essentially a product of modern industrial society. His field of lending and his techniques differ substantially from those of usurers of the past.

Earlier usurers made loans almost entirely on the security of tangible and readily negotiable collateral. The money-lenders of Augustan Rome, for instance, secured their contracts with mortgages upon real estate, ships’ cargoes, slaves, flocks of sheep, or herds of cattle, or by taking pledges of tools, merchandise, or precious stones. Shakespeare’s Shylock dealt with Venetian merchants whose stocks-in-trade presumably provided more effective, if less dramatic, means of enforcing payment than the flesh of borrowers. Similarly, the skin-flint village note-shaver, whose frustration delighted American theatre audiences of the latter part of the nineteenth century, had a mortgage on the heroine’s home or at least upon the family horse and buggy.

The fields of lending and to some extent the techniques and traditions of these early money-lenders have been taken over by banks, building and loan associations, pawnbrokers, and other specialized institutions that lend against tangible and measurable property values. The loan shark of today has created a new field and a new technique of lending at which even the boldest of his predecessors would probably have looked askance. While he may secure his loans with mortgages on

* A.B., 1923, Amherst College; D.S.S. (in Econ.), 1938, Graduate Faculty of Political and Social Sciences, Amherst College. Director, Department of Consumer Credit Studies, Russell Sage Foundation. Author, Consumer Credit and Economic Stability (1939); co-author (with L. N. Robinson), Regulation of the Small Loan Business (1935) and (with Holthausen and Merriam) Volume of Instalment Credit, 1929 to 1938 (1939). Author of numerous pamphlets and articles bearing upon the field of consumer credit.
household furniture or automobiles, he relies for payment not upon the resale value of such collateral but upon borrowers’ prospective incomes from wages or salaries.

So long as salaries and wages remained close to the subsistence level, the prospect of such incomes had no collateral value. When, however, wage-earners’ real incomes rose to the point where they covered the minimum necessities of life and at the same time provided a surplus for meeting payments of principal and interest on debts, prospective salaries and wages became assets, however inchoate, against which loans could be made. Thus the loan shark thrives upon high wages and rising standards of living and not upon abject poverty.

The possibility of using the capitalized value of the margin between wage-earners’ incomes and minimum subsistence costs as the basis for loans probably existed before the time of the earliest loan-shark transactions. But exploitation of this field of lending required substantial departures from money-lending tradition. The loan sharks’ predecessors carefully appraised the security behind each contract and assured themselves of the possibility of collection. The loan shark, on the other hand, deals with borrowers en masse, relying upon his high charges to cover the losses on individual contracts that he knows to be unavoidable. His safety lies in distributing risk over large numbers of small accounts. Hence, while his predecessors held themselves ready and willing to examine the credit worth of those who found it necessary to seek accommodation, the loan shark aggressively merchandises his wares, stressing the ease of borrowing and misrepresenting the cost in personal solicitations and in handbill, billboard, and newspaper advertisements.

In all probability usurious money-lenders of the past would have looked askance not only at the credit risks taken by the modern loan shark but also at his charges and practices. True, many of the former undoubtedly drove hard bargains. But certain characteristics of their business led to some degree of moderation. First, since tangible property values formed the basis for loans, the borrower had the alternative of selling his property. The availability of this choice put practical limits on the interest charges that could be demanded. Second, most borrowers were engaged in business enterprises. The lender in a sense became a partner in the enterprise, desirous of obtaining the largest possible share of the proceeds but not wishing to wreck it in the process. Finally, borrower and lender lived in the same community and dealt face to face in their negotiations, which probably contributed to fair dealing and discouraged fraud and abusive treatment.

The loan shark of today is subject to none of these natural restraints. The bargaining position of his customers is hopelessly weak. He deals with borrowers impersonally—his identity hidden by fictitious trade names and corporate entities and his sensitivities insulated from the seamy side of the business by salaried employees. His charges are limited not by the earning capacity of property given as security but by what wage-earners can earn beyond the minimum necessities of life.
THE LOAN-SHARK PROBLEM

Development of the Loan-Shark Business

The loan-shark business appears to have begun in cities of the Middle West shortly after the conclusion of the Civil War. The enormous profits of the earliest offices were reinvested in additional offices in neighboring cities. Employees of these chain companies left to establish their own offices as soon as they had accumulated or could raise the small initial capital that was needed. The obvious prosperity of the business attracted still other lenders. By these means, loan-shark offices soon spread to all principal cities throughout the United States. Arthur H. Ham, one of the pioneer students of the loan-shark business, estimated in 1911 that in cities of more than 30,000 population one loan shark could be found for every five to ten thousand people.

The business tended toward some degree of specialization with respect to security, charges, and size of loans. One group of lenders used wage assignments as security. These salary lenders made the smallest loans—ranging generally from $5 to $50—and charged the highest interest rates—ranging generally from 10 to 40% a month, depending usually upon the size of the loan. Another group of lenders took as security chattel mortgages on household furniture. Their loans generally ranged in size from $10 to $300, and their charges from 5 to 20% a month. A third group of lenders lent on unsecured notes. But these lenders generally relied upon their right to garnish wages in case of default and their loans and charges resembled those of the salary lenders. The great majority of loans of all three types of lenders, however, were for sums of $10 to $60.

Loans were customarily made for short periods of time. Very small loans were generally payable within a week, two weeks, or a month; and even the largest loans were usually payable within ten months. However high its rates of charge, the loan-shark business would not have created so much distress if borrowers had been able to pay off their loans when due. But lenders, seeking volume, encouraged renewals or made it difficult for borrowers to repay the principal. Many borrowers whose incomes were taxed to meet interest payments on a single loan gradually became indebted to a number of lenders. In such cases, interest charges became ruinous, standards of living were cut, and even adequate nourishment was sacrificed to keep the family ship afloat. Constant collection pressure upon borrowers, indebted to several lenders led frequently to family disruptions and physical and mental breakdowns, and occasionally to theft or even to suicide.

The loan-shark business was, of course, illegal under the usury laws that existed then as now in most states. But these laws provided little effective protection to borrowers. Penalties for usury were generally civil—ranging in severity from loss of the amount of usurious interest to loss of the entire principal and interest. In order to invoke these penalties, however, the borrower had to prove the usurious character of the transaction; and few borrowers were able to do so. The loan shark made proof of usury difficult by disguising his interest charges as fees for various

services, by requiring borrowers to sign notes in blank, by making advances in cash without witnesses, and by refusing to give receipts for payments. Even when aware of his legal rights, the borrower was rarely able to obtain legal representation, to have his wages withheld pending adjudication, or to establish proof of usury before courts in which the outward form of written contracts was given great weight.

Wherever necessary, the loan shark could create additional handicaps to legal defenses by borrowers. Confessions of judgment were frequently taken. Suits were sometimes brought in courts distant from the borrower’s home or work-place. In many instances where borrowers filed answers to complaints, actions were repeatedly postponed to compel loss of time from work. Moreover, the loan shark’s ample facilities for harassment could be concentrated upon the few borrowers who undertook to invoke legal defenses.

The Search for Remedies

By the turn of the twentieth century, many communities had become aware of the existence and anti-social characteristics of the loan-shark business, and remedies were sought by social agencies, public officials, and the press. Campaigns to enforce existing laws and to defend borrowers were instituted in many communities. Some cities established semi-philanthropic loan companies, known as remedial loan associations, to serve classes of borrowers upon whom loan sharks preyed. In some states, the penalties for usury were strengthened; in others, types of security used by loan sharks were outlawed. Massachusetts, in 1888, and New York, in 1895, enacted special regulatory laws applying to loans of small sums. But these efforts were spotty and sporadic, and the net results were extremely limited.

In 1907 the Russell Sage Foundation undertook an investigation of the loan-shark business which resulted in publication of two studies: The Salary Loan Business in New York City by Clarence W. Wassam (1908) and The Chattel Loan Business by Arthur H. Ham (1909). These volumes made available for the first time an accurate description of the scope and characteristics of loan-shark operations and an objective analysis of the problem. Both writers recognized that there was a tremendous and insistent demand for small loans to wage-earners; that the existing legal structure prohibited legitimate agencies from making such loans; that efforts to enforce repressive laws merely made the situation of the small borrower worse; and that the solution to the loan-shark problem lay in creating agencies to make small loans at the lowest possible rate and in regulating the existing small loan business.

These studies and their findings gave impetus and direction to efforts to improve the plight of the small borrower. Additional remedial loan associations were organized; legislation was enacted to enable operation of credit unions and industrial banking companies, such as the Morris Plan institutions; and the form of a law to regulate the small loan business in general was gradually evolved. After enactment of experimental regulatory statutes based on recommendations of the Russell Sage Foundation in Massachusetts (1911), New Jersey (1914), and New York (1915) over
the united opposition of money-lenders, a compromise between the Foundation and a group of progressive lenders was affected. Together they drafted a Uniform Small Loan Law, which both parties agreed to support pending further experience.\footnote{See Hubachek, \textit{The Development of Regulatory Small Loan Laws}, infra p. 108.}

The Uniform Small Loan Law has subsequently been amended five times and a further redraft is now in preparation. Since 1930, the Foundation alone has been responsible for its form, although associations of licensed lenders and state supervising officials have been consulted with respect to all proposed changes. Effective statutes based upon one or another of these various drafts have been enacted in 25 states and in the Territory of Hawaii. Eleven other states and the District of Columbia have enacted regulatory laws which depart from the model in whole or in part and which impose varying degrees of restraint upon loan-shark operations.

\textit{Present Scope and Characteristics of Loan-Shark Operations}

In spite of the substantial progress which has been made toward its solution, the loan-shark problem in many jurisdictions is more acute than ever. The gradual extension of effective regulatory legislation has driven loan sharks out of state after state. But it has also tended to concentrate and to increase his operations in the areas which are still ineffectively regulated. In fact, during the past eighteen years at least, the progressive curtailment of the area in which loan sharks can successfully operate has been accompanied by a substantial expansion of the total volume of loan-shark transactions.

When an effective small loan law is first enacted in any state, some of the existing lenders become licensees under the act; but others, fearful of their ability to operate profitably under regulation or unwilling to have their profits curtailed, move into unregulated territory. Consequently, following each successful campaign for the Uniform Small Loan Law, a prompt increase in the number of loan-shark offices in other areas can be noted. This shift of lenders and of capital has accentuated the normally high rate of growth that results from the high profits of the business. In addition, the demand for small loans has expanded rapidly in recent years, not only in regulated but in unregulated states.

In some states that lack adequate regulatory legislation, notably Alabama, North Carolina, Oklahoma, Texas, and Washington, there are important industrial centers that have long furnished an attractive field for loan-shark operations; and in these cities the number of loan-shark offices has increased with remarkable rapidity. A somewhat similar expansion has also occurred in smaller industrial cities. And in recent years, under pressure of narrowing territory and increasing competition, loan sharks have infiltrated rapidly into places that were formerly considered unattractive markets—small textile-mill towns of North and South Carolina; small agricultural trading centers of Kansas, North and South Dakota, and elsewhere; and the small mining towns of the Rocky Mountain states.

The increasing intensity of loan-shark operations is indicated by the following
figures, which show the diminishing size of the potential market and the increasing total loan balance in continental United States:

<table>
<thead>
<tr>
<th>Year</th>
<th>Urban population of inadequately regulated areas (millions)</th>
<th>Urban population of regulated areas (millions)</th>
<th>Estimated total loan balance of loan sharks (millions of dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1923</td>
<td>21.6</td>
<td>12.7</td>
<td>21.3</td>
</tr>
<tr>
<td>1929</td>
<td>15.2</td>
<td>16.2</td>
<td>49.5</td>
</tr>
<tr>
<td>1934</td>
<td>14.3</td>
<td>6.6</td>
<td>45.3</td>
</tr>
<tr>
<td>1939</td>
<td>7.8</td>
<td>5.5</td>
<td>71.7</td>
</tr>
</tbody>
</table>

These figures are exceedingly crude. Classification of regulatory statutes with respect to their effectiveness necessarily involves arbitrary decisions because lines of demarcation are elusive. Population figures from the 1930 Census have been used for each of the years. There are, of course, no official reports of loan-shark operations, and the business is naturally secretive. Estimates of loan balances were based upon periodic enumerations of loan-shark offices through examinations of directory listings and newspaper advertisements in all unregulated and partially regulated states and upon intensive local studies in certain areas. Regardless of the shortcomings of these figures, the errors are not so great that the general tendencies and magnitudes indicated by the table may not be taken at their face value.

Of the total loan balance of loan sharks in the United States, the largest part is to be found in twelve states that lack special regulatory small loan laws. The writer's estimates of the total and per capita loan balance of loan sharks in each of these states is as follows:

<table>
<thead>
<tr>
<th>State</th>
<th>Estimated total loan balance (millions of dollars)</th>
<th>Per capita loan balance—1930 urban population (dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Idaho</td>
<td>0.7</td>
<td>5.41</td>
</tr>
<tr>
<td>Kansas</td>
<td>3.0</td>
<td>4.11</td>
</tr>
<tr>
<td>Montana</td>
<td>1.2</td>
<td>6.63</td>
</tr>
<tr>
<td>Nevada</td>
<td>0.3</td>
<td>8.71</td>
</tr>
<tr>
<td>North Carolina</td>
<td>3.4</td>
<td>4.20</td>
</tr>
<tr>
<td>North Dakota</td>
<td>0.5</td>
<td>4.41</td>
</tr>
<tr>
<td>Oklahoma</td>
<td>7.2</td>
<td>8.76</td>
</tr>
<tr>
<td>South Carolina</td>
<td>1.8</td>
<td>4.85</td>
</tr>
<tr>
<td>South Dakota</td>
<td>0.7</td>
<td>5.35</td>
</tr>
<tr>
<td>Texas</td>
<td>23.0</td>
<td>9.63</td>
</tr>
<tr>
<td>Washington</td>
<td>4.2</td>
<td>4.75</td>
</tr>
<tr>
<td>Wyoming</td>
<td>0.5</td>
<td>7.13</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>46.5</strong></td>
<td><strong>6.98</strong></td>
</tr>
</tbody>
</table>

*For year-end estimates of the outstanding loans of “unregulated lenders” for the period from 1933 to 1937, see Nugent, Consumer Credit and Economic Stability (Russell Sage Foundation, 1939). The estimates for unregulated lenders after 1934 include figures for personal property brokers in California and for licensed money-lenders in Colorado. Although the operations of these agencies were within the law, the rates charged by many of them were similar to the charges of loan sharks in other areas.*
THE LOAN-SHARK PROBLEM

A considerable part of the remainder of the loan-shark business is situated in ten jurisdictions that have small loan laws which for various reasons are not fully effective. In Florida and Kentucky, loan sharks operate by virtue of specific loopholes in what are otherwise sound regulatory statutes. In the other states, they operate by means of evasive devices, by virtue of legal loopholes, or in sheer defiance of the law and prosecuting authorities. The writer's estimates of loan balances in these states are as follows:

<table>
<thead>
<tr>
<th>State</th>
<th>Loan balance (millions of dollars)</th>
<th>Per capita loan balance—1930 urban population (dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama</td>
<td>3.0</td>
<td>4.03</td>
</tr>
<tr>
<td>Arkansas</td>
<td>0.5</td>
<td>1.31</td>
</tr>
<tr>
<td>Delaware</td>
<td>0.3</td>
<td>2.44</td>
</tr>
<tr>
<td>District of Columbia</td>
<td>1.2</td>
<td>2.47</td>
</tr>
<tr>
<td>Florida</td>
<td>2.0</td>
<td>2.63</td>
</tr>
<tr>
<td>Georgia</td>
<td>4.0</td>
<td>4.47</td>
</tr>
<tr>
<td>Kentucky</td>
<td>0.8</td>
<td>1.00</td>
</tr>
<tr>
<td>Mississippi</td>
<td>0.5</td>
<td>1.48</td>
</tr>
<tr>
<td>Nebraska</td>
<td>0.4</td>
<td>0.82</td>
</tr>
<tr>
<td>Tennessee</td>
<td>2.5</td>
<td>2.79</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>15.2</strong></td>
<td><strong>2.57</strong></td>
</tr>
</tbody>
</table>

As already noted, 26 jurisdictions have enacted effective regulatory small loan laws under which the small loan business has been subjected to rigid public supervision. These jurisdictions—Arizona, California, Connecticut, Territory of Hawaii, Illinois, Indiana, Iowa, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, New Hampshire, New Jersey, New York, Ohio, Oregon, Pennsylvania, Rhode Island, Utah, Vermont, Virginia, West Virginia, and Wisconsin—include all of the predominantly industrial states in which loan-shark operations were formerly most extensive.

The protections available to small borrowers in these jurisdictions are vastly superior to those available elsewhere. However, even these jurisdictions are not entirely free from loan-shark operations. In a few states, carelessness or lack of interest on the part of law-enforcement authorities has permitted illegal lenders to get a foothold. In others, narrow legalistic interpretations of evasive devices by the courts have prevented eradication of certain types of high-rate lenders. In large metropolitan areas, the job of protecting small borrowers is a trying one even under the most favorable circumstances. Delays in obtaining information concerning illegal lending

4 The Kentucky small loan law exempts loans on the sole security of automobiles; the Florida act exempts purchases of choses in action, whereby large numbers of salary-buying loan sharks escape the regulations of the act.

5 The classification of small loan statutes used here differs somewhat from those of Hubachek, infra pp. 122-125, and of W. T. Foster, infra pp. 155-159, as well as that of LeBaron R. Foster in Small Loan Laws of the United States (Pollak Foundation, 1940). These differences in classification result from differences in the criteria by which effectiveness of individual statutes was judged and not from differences of opinion among those responsible for these classifications.
activities, difficulties of obtaining adequate evidence or testimony to support prosecu-
tions, devices that give the color of legality to usurious contracts, and defense counsel
skilled in obstructive tactics frequently handicap the most vigorous and persistent
prosecutors. Consequently, a fringe of illegal lending which can be minimized but
not completely eradicated persists in most industrial metropolises.

This fringe of loan sharkery in states with effective regulatory laws has been
progressively reduced by a growing awareness among prosecutors of the social im-
portance of eliminating illegal lending, by development of new skills and techniques
of law enforcement, by increasing cooperation of licensed lenders in furnishing
evidence of illegal lending activities, and by the gradual establishment of helpful legal
precedents with respect to evasive devices. The writer's crude estimate of the 1939
loan balance of illegal lenders in states which have adequate regulation is 10 million
dollars, or 19 cents per capita of urban population—an extremely low figure as com-
pared with the per capita loan balance in other areas.

Two states—Colorado and New Mexico—remain to be accounted for. In these
states, the amount of illegal lending appears to be negligible. But this has been
accomplished by authorizing charges for certain classes of loans that are almost if not
fully as high as those charged by loan sharks in other jurisdictions. Under the Col-
orado Money-Lenders Act of 1935, an interest rate of 189% a year may be charged on
loans of $50 payable in ten monthly instalments, and equally high rates may be
charged on many other classes of loans. Extremely high charges are also made by
certain enterprises operating under the Colorado Industrial Bank Act. The New
Mexico Small Loan Act of 1939 permits rates of charge similar to those allowed by
the Colorado Money-Lenders Act of 1935.

The situation in Colorado and New Mexico differs, however, only in degree from
that in a number of states where poorly drawn enabling acts for specific types of
lending agencies make it possible to obtain very high rates of charge with full legal
sanction. Under the Missouri Loan and Investment Act and under the Oregon Motor
Vehicle Finance Act, lenders may charge fees, ostensibly for insurance, which result
in exorbitant rates of charge. In California, the fees permitted by the act under
which industrial banking companies operate have been manipulated by some lenders
to produce a yield in excess of 70% a year; and somewhat similar abuses occur under
industrial banking company laws in other states. In Georgia, the building and loan
act has been perverted to the use of high-rate lenders.

The rapid growth of loan-shark operations in inadequately regulated areas has
made it impossible for this business to escape widespread public attention and indig-
nation. Anti-loan-shark campaigns conducted by public officials, bar associations,
busine"s men's organizations, social agencies, and the press have increased in fre-
cuency and in intensity. Consequently, loan sharks have come to rely more and
more heavily upon devices which give the color of legality to their transactions.6 As
early as 1920 certain loan sharks developed the scheme of giving their loans the form

of a pretended purchase of wages. Through the ingenuity of the loan shark and his
counsel, the legal principle of bottomry collateral purchase agreements, merchandise
coupon schemes, surety bond premiums, and many other devices have been used for
the purpose of disguising interest charges in small loan contracts.

Apart from an increasing reliance upon evasive devices in certain areas, the loan-
shark business has changed but little since the days of the first studies by the Russell
Sage Foundation. If we may judge by the recent crop of local studies, the size
distribution of loans has remained almost the same; the same types of securities are
being taken, although as might have been expected the automobile has been added;
rates of charge have certainly not declined; the use of advertising to attract customers
has perhaps increased; fraud continues to be common; and collection practices are as
abusive as ever.

The Loan-Shark Problem in Theory and Practice

The history of the attack upon the loan-shark problem now covers a period of
half a century during which a wide variety of remedies has been tried. Gradually,
however, the antidote has become more specific. Since 1915, there has been increas-
ingly general acceptance of the thesis that stringent regulatory legislation must con-
stitute the keystone of any constructive program. In addition, a considerable measure
of agreement has been reached concerning the cardinal principles of such legislation.

When we look back on the experience of fifty years, progress in the small loan
field has been largely a matter of trial and error experimentation with remedies for
observable abuses rather than of incisive theoretical analysis of their underlying
causes. True, those who formulated the Russell Sage Foundation’s first legislative
recommendations were thoughtful students whose background led them to examine
the economic and sociological roots of the problem with which they were dealing.
But their proposals were shaped primarily by pragmatic considerations. They exam-
ined the results of earlier regulatory statutes; they studied the operating experience
of remedial loan associations; and they discussed practical remedies for specific evils
with money-lenders, social workers, lawyers, and legislators.

The remedial program had to be fitted into the existing legal and institutional struc-
ture. It had to move step by step toward objectives that were readily comprehensible
to the general public, by means of legislative proposals that could be justified before
legislatures and the courts and that were tolerable at least to some lending enterprises.
The test of each new proposal was not whether it would contribute to the removal
of underlying causes of the loan-shark problem, but whether it would remedy ob-

7 See Weaver, Oklahoma’s Small Loan Problem (1938); Gisler and Birkhead, Salary Buying in
Kansas City, Missouri (Conference on Personal Finance Law, 1938); Simpson, The Small Loan Problem
in South Carolina (1940); Root, Special Report on Investigation of High Rate Loan Companies in
Minneapolis (Minneapolis Better Bus. Bur., 1939). The conditions described by Messrs. Gisler and Birkhead
and by Mr. Root have since been remedied by legislative enactments.

8 See Simpson, Cost of Loans to Borrowers under Unregulated Lending, infra p. 73.

9 See Birkhead, Collection Tactics of Illegal Lenders, infra p. 78.
served abuses, would contribute further protections to borrowers without restricting the availability or increasing the cost of credit, and would be sustained by the courts.

With all of its shortcomings, this was probably the soundest and perhaps the only practicable formula for progress. We know now that the underlying causes of the loan-shark problem are exceedingly complex. The long period and wide range of trial and error experimentation with remedies was probably necessary to an adequate understanding of causes. Without this elaborate experimentation, theoretical analysis might readily have led to misconceptions of the problem.

For instance, it has been argued by eminent theorists that the problem of usury arises essentially from an artificial maladjustment of demand and supply induced by legal restrictions upon interest charges. They have contended that repeal of restrictive legislation would distribute the supply of funds equitably among all types of loans for which there was a demand and that the resulting competitive market would fix going interest rates in accordance with risks and costs.

There can be little doubt that repressive legislation is an important factor in the loan-shark problem. Small, inadequately-secured loans can not be profitably made at the rates allowed by the usury laws. Wherever these laws apply, the small loan business is limited to those willing to risk the penalties and bear the opprobrium of usury for a large profit. Not only was a seller's market created, but natural selection tended to limit those who entered the business to the thick-skinned, to the grasping, and to those skilled in trickery, fraud, and corrupt political maneuvers.

Nevertheless, trial and error experimentation has made it perfectly clear that this is an inadequate analysis of the cause of the loan-shark problem. In Great Britain, Maine, Massachusetts, and New Hampshire statutes restricting interest rates were repealed. But extortionate interest charges continued in the small loan field and in each of these jurisdictions it was later found necessary to enact special regulatory laws. Only recently California discarded as a costly failure a similar experiment in freedom of contract for small loans.¹⁰

Under conditions of complete freedom of contract, the small loan field provides an excellent example of imperfect competition. First, the bargaining strengths of borrower and lender are far from equal. The borrower is usually pressed by an immediate need for cash and must meet the lender's terms. Unlike the merchant who offers his wares for cash, the lender has the right to select his customers. Consequently, no matter how casual the need or how much the lender's advertising has contributed to its development, the borrower approaches the lender in the psychological position of a petitioner for favorable consideration of his application. Second, it is easy to mislead borrowers concerning rates of charge. Extensive advertising may be used to offset rate competition. In fact, lenders who advertise their true rates in the hope that their lower charges will attract business frequently succeed only in

¹⁰ From 1935 to 1939, the interest charges of personal property brokers in California were not restricted. An analysis of all loans made by personal property brokers during Dec., 1938, which is not yet complete as this is being written, suggests that roughly three fourths of the loans bore interest rates in excess of 50% per annum, roughly one half bore interest rates in excess of 100% per annum, and roughly one fourth bore interest rates in excess of 200% per annum.
diverting business to others who dissemble their rates of charge. Third, competition in price can usually be subordinated to competition in speed of credit granting, in the simplicity of obtaining loans, in promises of privacy and in liberality of terms of repayment. If price competition in the small loan field is to be effective, it must be positively promoted by regulations designed to prevent misleading advertising to facilitate comparison of charges and to permit borrowers to shift without sacrifice from higher to lower-cost contracts for which they may be eligible.

The fixing of any maximum rate in small loan legislation tends, of course, to exclude certain classes of borrowers from the legitimate market for small loans. There are some who say that this is uneconomical—that so long as there are borrowers ready and willing to pay still higher charges the legislative maximum can be enforced only by constant and vigilant repression of the illegal business that will spring into existence to meet this demand.

It is certainly true that, other things remaining equal, the lower the maximum rate in regulatory statutes, the more difficult the job of enforcement. But we know also that there are many people who will make the most burdensome promises for the future in exchange for present purchasing power and that the higher the interest rate the more likely it is that the loan will merely aggravate the borrower’s financial difficulties.

If the borrower alone suffered the consequences of his folly, exorbitant interest rates might be condoned where he was put on notice as to the true nature of his contract. However, not only the borrower but his family, his employer, and those who supply him with housing, food, medical care, and other services share in varying degrees in the consequences of his shortsightedness. Moreover, the burden of extortionate interest charges may in the end be shifted to the community at large. A society which is highly integrated, which assumed responsibility for providing decent standards of living and adequate nourishment for children, and which recognizes the relationship between economic pressures and crime, cannot tolerate loan contracts that are liable to result in economic peonage. Alternative means of relief must be furnished and those pressed by necessity compelled to use them.

It has been suggested by some students that the roots of the loan-shark problem lie in the maldistribution of incomes and in the irregularities of family incomes and expenses. “Solve the problem of inadequate incomes, provide steady employment and insurance against family emergencies,” they would say, “and the loan-shark problem will disappear.” Worthy as these objectives are, our empirical evidence clearly demonstrates that the loan-shark problem would outlast their attainment. Wage-earning classes that have the highest incomes and the most regular employment have frequently been the most seriously victimized by loan sharks.

It will be seen that the loan-shark problem is compounded from many interrelated economic and sociological forces. Our present knowledge of these forces is far from complete. But, as will be amply demonstrated by other contributions to this symposium, understanding is being continuously furthered by experimentation and observation on a broad front.