

AN ANALYSIS OF MAINE'S "36 MONTH LIMITATION" ON FINANCE COMPANY SMALL LOANS

by

George J. Benston

December 1972

. .

An Analysis of Maine's "36 Month Limitation" on Finance Company Small Loans

.

George J. Benston

,

Contents

Page	Section Heading
1	Background
4	Underlying assumptions about consumer behavior
9	Small loan companies' operations and the 36 month limitation
11	Revenue and costs from small loans
20	Profitability of finance companies
23	Effect of decline of finance company lending on aggregate consumer personal loans
32	Survey of lenders
33	Survey of borrowers - the data
35	Ability to borrow and source of funds of individuals surveyed
38	Borrowers' feelings about not having been granted a loan by the finance company
46	Characteristics of long and short term borrowers
53	Long term borrowing and bankruptcy
55	Summary and recapitulation
58	Policy conclusions

An Analysis of Maine's "36 Month Limitation" on Finance Company Small Loans

George J. Benston*

Background

Society does not think of "interest" and "credit" simply as "prices" that consumers pay for "goods." In the past, religious scriptures and economic beliefs held interest to be immoral and credit to be a valueless good that consumers should not need or want to purchase. While few people today believe that charging interest for the use of money is immoral, our laws and regulations reflect the still-held belief that people *ought* not pay more than a given rate of interest and *ought* not borrow without restrictions.¹ Thus state usury and small loan laws restrict the amount that can be charged and the maximum amount loaned to individuals and some state small loan laws and Federal Reserve regulations restrict (presently and potentially) the maturity of consumer installment loans.

Unlike supporters of minimum price laws (such as "fair trade" laws), whose position often is based on a crass desire to increase their income at the expense of consumers, supporters of interest rate ceilings and maturity limitations on consumer loans appear motivated by a desire to help consumers. Were it not for usury laws and limitations on maturities, they believe, some consumers might be charged "too much" for credit and be enticed or tricked into long-term "economic slavery." A good expression of this belief is given by Richard Poulos, Referee in Bankruptcy for the Southern District of Maine:

High interest has always plagued civilization. Most regulation has concentrated on controlling the *rate* of interest by setting maximum statutory limits. But this is not enough. Any problems about interest must be resolved by also considering (1) the *amount* of the loan and (2) the length of *time* for which it was granted. And the effectiveness of whatever restrictions may exist as far as these two factors are concerned must be tested against their possible evasion by the device of *renewals*.

Loans for short terms, even at high rates of interest, are not overly burdensome for most poor persons. The cost to meet some monetary emergency by a loan of one or two years is not exorbitant. But no one, let alone a low income person, can long endure (1) high rates of interest (2) on relatively large amounts of indebtedness (3) over long periods of time, from 3-8 years or more.

For example, it costs a borrower from a small loan company nearly \$440 for the use of \$2,000 for a year.² Often this represents between 10-15% of his take home pay. Defaults, a common occurrence, create serious problems because interest mounts rapidly. In a situation where the borrower is periodically in default of four months or more, the amount of the interest due (because of the high rate) may become greater than the amount of the installment payment. Unless their installments are greatly increased, something which rarely happens, nearly all subsequent payments are applied to interest and, therefore, the loan can never be repaid. As a result, indefinite extensions of the loan occur, year after year, through frequent renewals.

Renewals soon convert short term loans into long term obligations thereby subjecting the debtor to economic slavery. This has the effect of diverting large amounts of money from a debtor's limited income merely for the purpose of paying interest, thus hampering him from meeting the basic necessities of life for himself and his family. His financial strength is sapped to a point where any common hazard of life such as illness, loss of employment, divorce, etc., inevitably leads to a personal financial catastrophe compelling him to seek relief from welfare agencies or, ultimately, from the bankruptcy court.³

In large measure, due to the efforts of Referee Poulos and Gerald Cope, Mr. Poulos' Trustee in Bankruptcy,⁴ the 103rd legislature of the State of Maine adopted, in 1967, the "36 month limitation." This law reduced the maximum interest rate that licensed loan agencies could charge to 8 percent on any small loan remaining unpaid at the expiration of 36 months. This limitation has been applied very strictly; the maturity of a loan is dated from its inception, and extensions, rewritings and additional cash advances are not considered new loans. Nor can the effects of the "limitation" be avoided by splitting loans, since this practice was previously (and still is) prohibited. Much the same arguments as those quoted above were made in support of the legislation and in Governor Kenneth Curtis' veto in 1969 of a law that sought to relax somewhat the 36 month limitation.

Perhaps as a consequence of the 36 month limitation, the number of small loan offices in Maine decreased from 116 as of June 30, 1967 to 24 as of June 30, 1972. Tables 1 and 2 show and Figure I illustrates the number of companies and offices operated in Maine since 1965. Similarly, the dollar amount of loans outstanding went from \$31.0 million in December, 1967 to \$10.8 million in December, 1971. Opponents of the 36 month limitation point to these data as clear evidence of the disasterous effects of such legislation. Proponents of the law reply that other factors were more important. Among those cited are the relatively poor business conditions in Maine, the reduction of the maximum monthly rate of interest on the first \$150 of loans from 3 percent to $2 \frac{1}{2}$ percent, limitations on charges for health and accident insurance and a reduction of the maximum loan size from \$2500 to \$2000 that also were enacted in 1967 with the 36 month limitation. A decision by Referee Poulos in December 1965, reversed by the United States District Court but upheld on further appeal to the Court of Appeals for the First Circuit. In re Richards, 412 F. 2d 635 (1st. Cir. 1969), also reduced the revenue.⁵ It held that charges made by finance companies for creditors' insurance were "excessive" under Maine law and therefore not allowable in cases under the

Type and		Number as of June 30								
Asset Size	1965	1966	1967	1968	1969	1970	• 1971	1972		
Local										
\$0-\$300	7	7	7	6	3	2	2	1		
301-1000	2	2	2	2	1	1	1	1		
1001 +	_2	_2	2	2	2	2	_2	2		
Total	11	11	11	10	6	5	5	4		
National										
\$0-\$300	2	2	2	1	2	1	0	0		
301-1000	3	3	4	3	3	3	1	0		
1001 +	<u>11</u>	<u>11</u>	<u>11</u>	<u>11</u>	<u>10</u>	_8	<u> </u>	<u>5</u>		
Total	16	16	17	15	15	12	8	5		
All										
\$0-\$ 300	9	9	9	7	5	3	2	1		
301-1000	5	5	6	5	4	4	2	1		
1001 +	13	<u>13</u>	13	<u>14</u>	<u>12</u>	<u>10</u>	_9	<u>7</u>		
- Total	27	27	28	26	21	17	13	9		

Number of Local and National Companies Operating in Maine by Asset Size (in \$ Thousands) of Company^a

^aAs of December 31, 1965 or second year of operation, whichever is later.

Bankruptcy Act. In addition, limitations in the small loan companies' collection practices as a result of reform of Maine's antiquated "debtors' prisons" law and elimination of prejudgement garnishments of wages in 1971 and unfavorable rulings by the Federal Referees in Bankruptcy are believed to have increased their costs and/or reduced their ability to collect from over-extended borrowers.

In any event, some supporters of restrictive legislation maintain that consumers in Maine are better off without the small loan companies. As state Senator Levine put it in the debate on April 13, 1971, on a bill to revise the 1967 law: "Sure, we have all got to agree that the number of small loan companies in the State of Maine dropped and some of them went out of business. I think that is the best thing that ever happened to the people of the State of Maine. After all, we are here to legislate for the benefit of the majority of the people."

The hypotheses about consumer behavior and welfare and the operation of small loan companies held by supporters of the "36 month limitation" are outlined next, together with the counter-hypotheses of opponents of the legislation. This structuring of the argument serves as a basis for analyzing the effect of consumer loan legislation on consumer welfare.

Type and		Number as of June 30									
Asset Size	1965	1966	1967	1968	1969	1970	1971	1972			
T			-			-	-				
Local	7	7	7	6	2	2	2	1			
30-3300	1	2	2	0	3	2	2	1			
300-1000	5	2	2	2	1	1	1	1			
1000 +	4		4		<u> </u>		<u> </u>				
Total	14	13	13	12	7	6	6	5			
National											
\$0-\$300	3	3	3	1	7	1	0	0			
300-1000	7	9	12	10	9	5	2	0			
1000 +	87	88	88	88	74	42	28	<u>19</u>			
Total	97	100	103	99	90	48	30	19			
A11											
\$0-\$300	10	10	10	7	10	3	2	1			
300-1000	10	11	14	12	10	6	3	1			
1000 +	91	92	92	92	<u>77</u>	<u>45</u>	<u>31</u>	22			
Total	111	113	116	111	97	54	36	24			

Number of Offices Operated by Local and National Companies in Maine by Asset Size (in \$ Thousands) of Company^a

^aAs of December 31, 1965 or second year of operation, whichever is later.

Underlying Assumptions about Consumer Behavior

A number of assumptions about consumer behavior apparently are made by supporters of legislation to restrict the maturity and amount of loans that consumers can obtain (hereafter called "regulators.") The first assumptions considered concern the rationality and competency of consumers. Some regulators view consumers' decisions to borrow from small loan companies as "unnatural" and "not justifiable." The regulators consider that anyone who borrows money at a 36 percent annual interest rate (the highest legal rate on loans up to \$150 in Maine before the 1967 law change) or even 30 percent (the present maximum rate for loans up to \$300) is not making a rational decision. This hypothesis about consumer decision-making may take two forms. One is that some consumers cannot realize how much the funds they borrow really are costing them. Such borrowers are envisioned as unable to understand how much of their income will be required to meet the interest and principal payments despite the disclosures mandated by the "Truth in Lending" legislation. The second version of the irrationality assumption is that no (or very few) decisions made subject to such a high interest rate for funds can be rational, by definition. ("No one needs money that much.")

FIGURE I

Number and Total, National and Local Companies and Offices Operating in Maine, as of June 20, 1965 through 1972



Other regulators believe that borrowing at "high" rates is rational for periods of a year or two (or are willing to accept consumers' relatively short run irrational decisions), but believe that the consumer is not competent to plan his income and expenditures over a time horizon beyond three years. Hence, he borrows now to satisfy a present perceived need (perhaps extravagance) without considering or understanding that the amount borrowed plus interest will have to be repaid. Lenders, it is believed, take advantage of the borrower's lack of planning competence. They lend him the funds he wants even when they do not expect him to repay the principal plus interest within the contract period. Rather, lenders want him to extend the loan (perhaps with some additional funds added) over as long a period as possible in order to collect as much of the huge interest charged as possible.

Another version of the way regulators believe lenders take advantage of a borrower's incompetence or weakness is by offering him more money (perhaps by actually showing him cash) before a loan is fully repaid, to tempt him into continuing indebtedness. Thus, regulators claim, lenders get borrowers to mortgage their lives; the borrowers are, in effect, indentured servants to the loan companies.

A second set of assumptions held by some regulators is not based on consumer irrationality or incompetence. Rather, they believe that consumers are rational and hence would not borrow at such high rates ordinarily, but due to special situations, such as unexpected illness, auto repairs or replacement, loss of job, inability to cope with bills from many creditors, etc., are "driven" to borrow money from high interest rate lenders. Once in debt to these lenders, a consumer cannot fully pay off his loan because the high interest charges take too much of his income. Consequently, the loan company has him "on the hook."

Another sub-hypothesis within this set postulates that consumers are not aware of the lower rates at which they could borrow from commercial banks and credit unions. Rather, they are enticed into the small loan company offices by advertising or arrive by accident, and once in debt, cannot repay their loans because the high interest takes so much of their income.

Finally, in response to the finance companies' argument that they wouldn't lend if borrowers could not or would not want to repay the funds, regulators contend that the companies rely on harsh collection tactics to compel repayment. Threats of attachment of personal property, debtors' prison and garnishment of wages (allowed until 1971 in Maine), badgering and psychological persuasion are examples of the methods allegedly used to get unsophisticated borrowers to sacrifice a large part of their income to repay the loan companies. Alternatively, large interest charges make it profitable for the finance companies to provide funds beyond many borrowers' ability to repay so long as enough of them will (or can be persuaded to) repay their loans.

To summarize, regulators believe that consumers make irrational borrowing decisions, are incompetent to understand the future effect of present actions, are forced to borrow because of emergencies, and/or are ignorant of lower cost alternative sources of funds. For any or all of these reasons, borrowers become indebted to high rate small loan companies and cannot and/or are not allowed to get out of debt. Therefore, a law that limits the period over which lenders can charge more than eight percent interest on loans is necessary to protect borrowers from themselves and/or rapacious lenders. Otherwise lenders will be further encouraged to "push" money on people who should not borrow at rates they cannot afford.

Opponents of restrictive legislation (hereafter called "anti-regulators") argue that the regulators' hypotheses are either incorrect or irrelevant. That consumers borrow at what seems to be a "high" rate is not evidence of irrational behavior. Several rational explanations can explain this behavior. First, the anti-regulators argue, the interest rate charged is not "too high." Rather, the rate reflects the cost of lending relatively small amounts in a particular setting to a relatively high risk group of consumers. Small loan companies offer their customers "personalized" service. The loan company manager knows his customers individually, treats them with consideration, takes time with them to work out new payment schedules when some unexpected occurrence causes them to fall behind in payments, etc. The manager does not provide this service because he is a humanitarian but because this is part of the "good" that the borrower is buying for the "high" interest rate he pays.

Also, these borrowers present lenders with a greater risk of default than is faced by low interest rate lenders, such as commercial banks. To reduce losses through default, loan company managers endeavor to know their customers and work closely with them to work out loans. These services and the loan losses that do occur result in costs that are reflected in what appears to be high interest rates when compared to the rates charged for loans by other lenders.

Second, anti-regulators believe that consumers who borrow at "high" rates are not irrational. That these consumers are willing to make relatively high payments in the future need not be foolish. Who is to say that people should not have the right to meet present needs for medical care, education, auto or home repairs, clothing, reorganization of financial affairs, or even vacations or luxuries by contracting for payment from future income?

Nor do the anti-regulators believe that most consumers who borrow from loan companies are incompetent to understand future commitments. Andreasen points out that borrowing, even at high rates, is a rational strategy for persons with unstable income.⁶ For one thing, poor persons with relatives and others who are in need may find it difficult to maintain savings. For another, as Andreasen puts it, "...given high uncertainty of future incomes [borrowing is] a maximax strategy that takes the course of action that would yield the best outcome if the most favorable future circumstance prevailed."⁷

Third, anti-regulators question the assertion that small loan company customers can, or wish to, borrow from lower cost lenders. Commercial banks, they contend, would not lend to most of the people served by small loan companies because these people present the banks with excessive potential losses and/or too much trouble. Further, many of the loan company customers cannot get bank credit cards or charge accounts at the better retail stores. While many of these people do purchase merchandise on credit from other stores, they may pay as much or more for this credit in higher prices or poorer service on the merchandise purchased. Loans from credit unions are not available to people who do not have steady jobs, work for companies or belong to churches who run credit unions, or who cannot or do not want their employer, co-workers or church to know their financial condition.

The dilemma of necessitous borrowers is recognized by the anti-regulators but they say that denying them the services of small loan companies hardly solves their problems. If society believes that the cost of unforeseen medical or other disasters should not be borne by those afflicted, direct welfare transfers or loans can be made by a government agency. But those who wish to borrow should not be denied this alternative.

Finally, the anti-regulators admit that some borrowers are irrational, incompetent, and, generally, unable to forego gratification. But, they argue, finance companies provide some of these people with a discipline and management of their finances that allows them to function. More importantly, even though there may be some people who, by some standards, should not borrow, it is bad social policy to deny others the right to contract for the loans they wish. (Similarly, it is wrong to deny all people the right to buy liquor legally because some are alcoholics.) Not only does this policy wrongly limit the rights of others—it is doomed to failure. People who want to borrow will do so, illegally if necessary, at higher rates and with less consideration and protection from the courts than they would get from licensed small loan companies.

Regrettably, many of the arguments presented cannot be resolved by reference to data or logic. Rather, they are in the realm of philosophy on the proper role of government and the desirability of allowing people to make their own decisions, even when they may harm themselves and their families. However, many important differing assertions by regulators and anti-regulators may be resolved with empirical analysis. In the next section, the effect of the 36 month limitation on small loan company operations is considered to determine whether or not it could be the cause of the companies' unwillingness to operate in Maine, and if so, why. Next, the profitability of small loan companies in Maine before and after the law is measured to gauge whether their operations were so profitable that they could have absorbed the additional costs imposed by the 36 month limitation, but did not. Then, the extent of the small loan companies' reduction in lending is measured to determine the effects of the legislation on the people of the state. Finally, the characteristics of long term borrowers and their propensity to declare bankruptcy are analyzed to test hypotheses about these people and their need for protective legislation.

Small Loan Companies' Operations and the 36 Month Limitation

Many supporters of legislation that reduces the rate of interest on small loans outstanding more than 36 months to 8 percent simply do not believe that a consequence will be the demise of the companies. In his veto message of an act passed by the 104th Maine legislature in 1969 that would have softened the provisions of the "36 month limitation," Governor Curtis recognized the small loan companies' "... important and legitimate role in the financial affairs of our communities." He continued, "They are often the only source of credit for people who are badly in need of financial help and who, because of marginal financial status, are cut off from other sources of credit." However, Governor Curtis evidently did not believe that the "36 month rule" would be severely damaging to the companies' economic condition, because he went on to say that "... in return for the risk of providing credit to those marginal borrowers, the state permits the small loan companies to charge a high rate of interest. Indeed, our small loan regulatory laws are, and they remain, favorable to small loan concerns."

In contrast, the small loan companies claim that they cannot operate successfully under the "36 month limitation." The law not only prohibits them from making loans with maturities longer than 36 months (which is an important limitation), but it also prohibits them from renewing loans past this limit. This prohibition, they claim, does not allow them to serve regular customers or extend the term of a loan on which a borrower is unable to make scheduled payments. As one company vice-president put it: "Each time the borrower refinances his loan with the lender, the term of the loan becomes shorter and the monthly payment is larger than the payment on the previous loan. Eventually, because of the 36 month limitation that dates from the initial loan, the term of the loan becomes so short and the payment so large that the lender can no longer serve the borrower's needs since he is unable to make the big payment each month." Consequently, the small loan company cannot renew or extend loans, but must limit its operations to making one-time loans. While data on the percentage of loans made to present customers are not reported to the Bank Commissioner in Maine, data from large companies and from other states indicate that about 62 percent of the number of loans made are renewals (with and without cash added), about 27 percent are made to new borrowers, and 11 percent to former borrowers.

As discussed above, regulators believe that renewals of loans by small loan companies is evidence of their exploitation of consumers' inability to withstand temptation. The regulators also believe that the companies profit additionally from frequent renewals because they can add 60 days of unpaid interest to the principal (thus compounding over 60 days unpaid interest in contravention of law).

In addition, regulators believe that other changes in the laws of Maine that restrict the ability of small loan companies to "force" low income borrowers to continue their payments (such as threats of debtors' prison, wage garnishments and attachment of personal property) and the unsympathetic attitude of the Referees in Bankruptcy (particularly Mr. Poulos) towards their claims against the property of bankrupt borrowers have reduced the (perhaps excessive) profits of the companies.⁸ Consequently, the regulators claim, factors other than restrictions on "normal" operations are the primary cause of the decline in the number of small loan licensees.

In operational terms, these factors reduce the loan companies' income. Most important, the regulators believe that the now reduced income came not from service to ordinary borrowers, but from "the hides" of those who can least defend themselves—weak, confused, unsophisticated, necessitous, easily tempted people whom government must protect.

Thus the regulators see the companies as having made exorbitant and immoral profits and view their departure as a suggestion that they are not satisfied with ordinary profits. Also some regulators believe that national companies have left to "teach the state a lesson," to show other states that restrictive legislation means losing the small loan companies. These regulators believe that the national companies find the cost of a normal profit a price well worth paying.

In contrast, the anti-regulators believe that the 36 month limitation operates primarily to increase the loan companies' operating expenses. Although they agree that the other factors listed above do reduce the companies' income somewhat, they believe that the emphasis presented above is misplaced. (Of course, they do not agree that most if not all income was improperly earned.) The primary reduction of income, they claim, is due to the reduction of interest earnings on funds in the possession of customers to a rate not much different from the rate that the companies pay to banks, eight percent. The companies' operating expenses continue-indeed are higher for customers in default-and the funds are not repaid to the banks or available for loans to other customers. In reply, regulators might argue that within 36 months most borrowers have paid back the principal and the "funds" that the companies claim are borrowed from banks actually represent the high interest charged by the companies. The anti-regulators can counter-argue by stating that this interest was earned by the companies as a consequence of the operating expenses they incurred and risk they took and, as such, are as much funds as are the amounts originally loaned.

The companies deny the regulators' belief that they ought to be able to make sufficiently profitable one-time loans with maturities of less than 36 months. Operating expenses will go up under such restrictions, they claim. Lending to a present borrower is much less expensive than lending to a new customer. The credit check required is much less extensive, the interview need not be as long and, most important, the risk is less since the present customer's payment record is known. Also, the cost of acquiring business is lower when additional loans can be made to present customers.

In large measure, then, the alternative positions are based on assumptions about the loan companies' income, expenses and return on capital. To put these viewpoints into perspective and render them testable, a descriptive model is presented next of the revenue and costs that a profit maximizing lender faces when deciding whether or not to grant a loan. With this model, the effect of the maturity and other restrictions on the lenders' decision-making function can be shown. With the important parameters of the model estimated, a test of the alternative hypotheses about loan company behavior can be made.

Revenue and Costs from Small Loans

In deciding the level of its loan portfolio in a particular location or state and whether or not to grant a loan to a specific individual, a consumer finance company must estimate the net cash flow that will be generated. With respect to the individual borrower, the company faces a certain outflow of the net cash loaned plus the operations cost of processing the required papers and an uncertain inflow of payments and the additional operations cost of processing the payments. Simply accepting payments and making bookkeeping entries is a small part of the expense of serving a customer. The type of customer who borrows from finance companies requires personal time and resource consuming attention because this is part of the product he purchases and because, were this attention not given, the probability of non-payment is expected to increase. As is the case for investments generally, there is an optimal amount of resources that should be spent on "servicing" a loan. At some point, the present value of greater expected amounts of payments are exceeded by the present value of additional expenditures or servicing. In general, if the expected net present value is not positive, the company will not make the loan. Because the state enforces a ceiling on the amount of interest and fees that can be charged, neither the company nor the borrower has the option to increase the gross amount of cash inflow.

Nevertheless, a loan may be made to a borrower for whom one loan appears unprofitable(negative expected net cash flow), if the company expects a profitable long term relationship with him. Several factors lead to this expectation. First, the operations cost of granting a second or additional loan may be less than the amount required for a new loan because the company already has established records for the borrower. Second, the company obtains information about the probability of repayment and the cost of servicing in the course of lending. This information is purchased at the cost of a negative expected present value cash flow from the first loan. However, this may be a profitable investment if the company is able to reduce its expected losses and the "excessive" operations cost of dealing with "unprofitable" customers by making a small first loan from which it can determine whom to grant larger second loans.

Finally, although a company might find loans under a given dollar size unprofitable (since gross income is determined by a ceiling rate per dollar while operating costs are not primarily a function of the dollar amount loaned but of servicing a customer, as such), it might be willing to make these loans as "loss leaders." If, in the company's experience, first time borrowers tend to make larger successive loans that are profitable, it would be willing to make individually unprofitable first loans. By making the customer a first loan, the company expects a high enough proportion of customers to borrow again from them: satisfaction with the service and/or inertia keep them from changing to another lender, even a lower cost lender such as a commercial bank or credit union.

Differences in the cost of lending to new and former compared to present borrowers were measured in a study of the branch operations of four major consumer finance companies. The methodology and data used and detailed findings derived are reported in another paper.⁹ In that study, data from approximately 2600 branches for each of three years were analyzed. Regressions of direct cash operating expenses (total direct branch expenses not including occupancy, advertising, losses and interest) were run for each year of each company on output (the average number of loans serviced), and cost homogeneity variables (percent of loans made to new borrowers, large-over \$1000-loans, percent of other than personal loans made, relative factor prices in the county, and whether or not the branch was in a suburb), and market structure and legal variables (concentration ratios, state laws on entry restrictions, and creditors' remedies). The elasticities estimated indicate that an increase in the percentage of loans made to new borrowers from, say, 25 to 30 percent, and an offsetting decrease in the percentage made to present borrowers might result in a 1.6 to 3.2 percent increase in total branch costs for one company, a 0.4 to 1.5 increase for the second, as much as a 4.9 percent increase for the third and no significant difference for the fourth. The data on former borrowers are not consistent. Two companies' data show operating costs to be lower the higher the percentage of former borrowers, while two reveal higher costs. However, the coefficients estimated are not significant.

It appears, then, that new borrowers are served at not much higher costs than present or former borrowers, such that even if a finance company made 54 rather than 27 percent of its loans to new customers, its operating costs might increase only by ten percent. Consequently it does not appear that a law that restricts lending to the present customers would increase operating costs sufficiently to "explain" the demise of the small loan companies in Maine.

To answer the question more directly, operating costs data as reported to the Maine Bank Commissioner were gathered for each year 1960 through 1971. After extensive checking (that proved both time consuming, frustrating and necessary), some of the data had to be rejected for obvious deficiencies in reporting. Data from the first full year of operation and the last year of operation were discarded as unrepresentative of normal operating conditions. Table 3 gives the number and type (local and national, assets under \$300,000, from \$300,000 to \$1,000,000 and over \$1,000,000) of the companies whose data were used.

The cost model estimated is based on an extensive consideration of the finance company operations presented in another paper.¹⁰ The primary output variable is the number of loans serviced, approximated by the average number outstanding during the year. Other variables are included to account for

TOOIC 2	T	ab	le	3
---------	---	----	----	---

	Type of C	ompanies	Size of Companies (\$ Thousands)			
Year	Local	National	Total	Under \$300	\$300-\$1000	Over \$1000
1960	10	12	22	5	5	12
1961	11	14	25	. 6	5	14
1962	12	14	26	7	5	14
1963	12	14	26	7	5	14
1964	12	11	23	7	3	13
1965	11	15	26	6	6	14
1966	9	15	24	4	6	14
1967	8	16	24	5	5	14
1968	4	13	17	2	3	12
1969	4	13	17	2	3	12
1970	4	12	16	2	3	11
1971	3	8	11	1	1	9

Number and Type of Observations Used for Analyses in Tables 4, 5, 6 and 7

differences among firms not related to the primary output of interest. A multiplicative cost function is assumed, as follows:

(1) $OE = b_0 NLO^{b_1} (NLM/O)^{b_2} (NLL/M)^{b_3} DEL60+^{b_4} (NLO/OF)^{b_5} LOCAL^{b_6}$,

where all variables are in common logarithms and

OE = operating expenses, total (excluding interest, income tax and losses)

NLO = average number of loans outstanding: (number year beginning + number year end/2)

- NLM/O = number of loans made /NLO
- NLL/M = number of large (over \$1000) loans made to the total number made, in percentages plus 1 (one is added because some companies did not make large loans and in this event log (NLL/M+1) = 0.)
- DEL60+ = dollars of loans delinquent 60 days or more per dollar of loans outstanding, in percentages

NLO/OF = NLO per office

LOCAL = 10 if the company is local, 1 if it is national

"Output" is measured by NLO; NLM/O measures the rate of growth of a company; NLL/M is an output homogeneity measure which extensive testing of a much larger amount and detail of branch data from three major companies showed to be the only meaningful distinction of loan size;¹¹ DEL60+ measures

the additional costs of handling delinquencies; NLO/OF measures the economies of scale related to office size rather than company size; and LOCAL measures differences in reported operating costs between local companies that tend to be owner-run and national companies that allocate central company overhead to their Maine operations. Unfortunately, data on loans to new, present and former borrowers are not reported to the state nor could these data be acquired from a sufficient number of companies.

The cost of servicing a small loan was estimated with multiple regression analysis, after all variables were transformed to common logarithms. Regressions were computed for each year individually, 1960 through 1971. Table 4 gives the regression coefficients (standard errors) and t values computed for each year. Notable in the table are the positive (though not large) coefficients for large loans (NLL/M), positive (though not consistently significant) coefficients for local vs. national companies (LOCAL), and generally insignificant coefficients for the size of office (NLO/OF). The coefficients of the last variable provide evidence contrary to the hypothesis of some regulators that the finance companies left the state because there was insufficient business to allow offices large enough for efficient operations.¹² In any event, the geometric mean number of loans per office for the sample was 367 in 1960, 246 in 1964, 278 in 1967, and 269 in 1970. Even if there were economies of scale related to the size of offices (as is indicated by the better data analyzed for the branch operations of three major companies and over-all operations of 124 companies)¹³ the reduction in the number of companies does not appear to have resulted in an increase in the size of the offices remaining.

Of greatest interest are the coefficients of the output variable, the average number of loans outstanding (NLO). These are consistently greater (though generally not significantly greater) than unity, indicating some diseconomies of scale.¹⁴ Again, the evidence is contrary to the regulators' hypothesis that larger companies could operate at lower costs.

The average costs of making a small loan, holding all variables constant at their geometric mean values and setting NLL/M after logarithms to zero, was calculated and is given in Table 5.¹⁵ Since not all of the coefficients shown in Table 4 were significant, the regressions were computed with a step-wise regression routine and average costs were calculated with the coefficients that were significant at the .05 level of significance (one tail). These also are given in Table 5, together with a listing of the significant variables. Except for 1971, where only 11 companies are included in the sample, the differences between the two calculations are slight.

The data show generally increasing average costs per loan over the period. From 1960 through 1963, costs averaged about \$56 a loan. From 1964 through 1967, when the 36 month limitation was enacted, they were about \$70 a loan. For 1968 through 1970 they were about \$82 a loan.¹⁶ In part, the increasing costs mirror the changes in the price level. However, the ceiling rates under which the companies operate were not changed to reflect changes in nominal costs. Rather, in 1967, the annual ceiling rate on loans under \$150 was reduced from 36 to 30 percent.

Determinants of Total Operating Expenses Regression Coefficients^a, (Standard Errors)^b, t Values^c (all variables in common logarithms)

Nexe		Independent Variables (see description below)									
Ical	NLO	NLM/O	NLL/M	DEL60+	NLO/OF	LOCAL	CONST				
1960	1.18 8	.65	.020	-11	.26	.22	.30				
1700	(14) b	(62)	(016)	(16)	(19)	(12)	(19)				
	8.59¢	1.04	1.24	.67	1.37	1.80	1.60				
1961	1.16	đ	.070	.12	.38	.17	.60				
	(.10)	-	(.090)	(11)	(12)	(.08)	(15)				
	11.46		.83	1.13	3.12	1.97	.65				
1962	1.22	1.03	.061	.60	02	.22	đ				
	(11)	(.43)	(.010)	(.13)	(15)	(.10)	-				
	12.71	2.39	6.35	4.53	.12	2.14					
1963	1.10	.74	.044	.38	.27	.22	đ				
	(.12)	(.36)	(.010)	(11)	(.16)	(11)	-				
	8.90	2.07	4.44	3.39	1.76	1.98					
1964	1.15	đ	.035	.16	.24	.30	.20				
	(.27)	-	(.018)	(.19)	(.34)	(.23)	(.30)				
	4.22		1.99	.85	.72	1.28	.66				
1965	1.30	1.30	.067	.23	- 20	.43	.38				
	(.14)	(.31)	(.012)	(.19)	(.21)	(.11)	(.18)				
	9.29	4.11	5.55	1.18	.99	3.69	2.15				
1966	1.29	.21	.037	.33	đ	.36	.23				
	(.10)	(.28)	(.017)	(.22)	•	(.15)	(.27)				
	13.14	.74	2.12	1.48		2.38	.82				
1967	1.28	.52	.077	.15	09	.39	.15				
	(.14)	(.26)	(.018)	(.15)	(.22)	(.15)	(.21)				
	8.88	1.96	4.35	1.00	.40	2.70	.70				
1968	1.10	.46	.041	05	.49	ð	.10				
	(.06)	(.35)	(.017)	(.09)	(.12)	-	(.32)				
	17.45	1.33	2.42	.60	4.07		.31				
1969	1.07	.20	.050	19	.42	.13	.16				
	(.14)	(.16)	(.031)	(.14)	(.25)	(.16)	(.17)				
	7.73	1.22	1.59	1.39	1.68	.82	.90				
1970	1.19	đ	.055	04	.09	.45	.50				
	(.26)		(.048)	(.25)	(.45)	(.34)	(.31)				
	4.55		1.14	.16	.19	1.35	1.60				

Dependent variable: total expenses before income taxes, interest and losses

See footnotes at end of table.

Determinants of Total Operating Expenses Regression Coefficients⁸, (Standard Errors)^b, t Values^c (all variables in common logarithms)-Continued

Dependent variable: total expenses before income taxes, interest and losses

Year	Independent Variables (see description below)									
	NLO	NLM/O	NLL/M	DEL60+	NLO/OF	LOCAL	CONST			
1970	1.06 ^a (.13) ^b 8.47 ^c	20 (.16) 1.29	.016 (.023) .71	057 (.090) .63	.057 (.15) .32	.027 (.11) .26	1.47 (.36) 4.13			

 R^2 for any year's regression is no less than .96. See Table 3 for number of observations.

d - F value too small for inclusion.

Description of independent variables:

NLO = number of loans outstanding (year beginning + year end)/2
NLM/O = number of loans made/NLO
NLL/M = number of large (over \$1,000) loans made/total number made + 1
DEL60+ = dollars of loans delinquent 60 days or more per dollar of loans outstanding, in percentages
NLO/OF = NLO/number of offices
LOCAL = 10 if company is local, 1 if company is national (log₁₀ 10 = 1, log 1 = 0)
CONST = constant term

Table 5

Year	All Variables	Significant Variables Only Included ^a				
	Included	Amount	Variables			
1960	55.72	53.15	NLO, NLO/OF			
1961	54.73	53.44	NLO, NLO/OF, LOCAL			
1962	62.89	62.92	NLO, LOCAL, NLM/OF, NLL/M, DEL60+			
1963	62.81	62.08	NLO, LOCAL, NLM/OF, NLL/M, DEL60+			
1964	66.48	64.63	NLO, LOCAL, NLL/M			
1965	76.79	72.46	NLO, LOCAL, NLL/M, NLM/O			
1966	75.11	71.44	NLO, LOCAL, NLL/M			
1967	66.68	65.14	NLO, NLL/M, NLO/OF			
1968	96.25	96.55	NLO, NLL/M, NLO/OF			
1969	78.23	75.97	NLO, NLO/OF			
1970	82.08	73.54	NLO, NLO/OF			
1971	105.32	68.33	NLO, CONST			

Average Operating Cost Per Loan (Income taxes, interest and losses not included)

Source: All variables evaluated at geometric mean values against coefficients given in Table 4. See Table 3 for number of observations.

^a Variables included in regression that "explain" the variance of the dependent variable the most, whose t values are significant at the .05 level. While it appears that 36 percent (or even 30 percent) is a very high rate, the average cost *per hundred dollars* on small loans is even higher. Figure 2 shows the costs expressed as a percentage of dollars of loans, together with Maine's ceiling rates in effect before and after the 1967 law change. It seems clear that even under the higher rates allowed before 1967, loans under \$150 probably were not profitable (recall that losses and interest are not included in the average costs). With the lower allowable rates and average costs, the finance companies do not appear able to cover operating costs for loans under \$250 to \$300. Why, then, did and do finance companies make these loans?

From Figure 3, it appears that after the annual ceiling rate on loans under \$150 was reduced from 36 to 30 percent, the companies practically ceased making loans of less than \$100. Local companies, who made about 25 percent of their loans in this size range, reduced this type of loan particularly rapidly.¹⁷ By 1969 this percentage dropped to 3 percent. However, lending in the next size category (\$100 to \$300) does not appear to have been affected much by the rate ceiling change.

An explanation of why finance companies make what appear to be unprofitable loans (except when the negative contribution margin becomes too great) may be derived from the model of loan company operations presented above. Unprofitable small loans may be made when the company expects that a portion of these customers will renew them at larger amounts, primarily by borrowing additional amounts before the loan matures. Also, the loan company is able to assess the risk of lending larger amounts by first lending a smaller sum. Thus, an initially unprofitable loan may result in a later profitable relationship. As is indicated by the model, the present value of the expected net cash flow from the customer is expected to be positive.

This explanation is consistent with the data. Loans larger than \$300 to \$400 appear profitable. While the 1967 reduction in rate ceilings for loans under \$150 made these very unprofitable, the companies still found loans of between \$100 and \$300 worth making. However, the 36 month limitation deprived them of the opportunity of engaging a customer in a profitable long-term relationship. The effect on the average size of loans made by three major finance companies, shown in Figure 4, also is consistent with the implications of the model. Loans made to new and former borrowers were consistently smaller than those made to present borrowers. The average amount of all three types of loans increased over time as inflation reduced the real amount of funds borrowed and as increasing operating and money costs made smaller loans less profitable to the finance companies. In 1969, when the 36 month limitation became effective (and the particular companies whose data are reported realized that the law would not be repealed), the average size of new loans made increased sharply from \$482 in 1967 and \$528 in 1968 to \$712 in 1969. In comparison, the average size of loans made to present borrowers was \$758 in 1967, \$778 in 1968 and \$822 in 1969. As Figure 4 shows, by 1970 and 1971, the average size of loans made to new, present and former borrowers were about the same. For comparison, the average size of loans made by 35 fairly large companies from all parts of the United States



Source: Table 5



For number of observations in each year, see Table 3.

(some national, some regional and some limited to one or two states) in 1968, 1969 and 1970 was \$755 for new borrowers, \$578 for former borrowers and \$970 for present borrowers.¹⁸

Another factor that makes the 36 month limitation particularly unworkable for the finance companies is shown by the monthly payments schedule for a loan that provides the borrower with about \$600.¹⁹ At the present ceiling annual simple interest equivalent rate of 26 percent the monthly payment amount for a 12 month loan is \$58, for a 24 month loan \$32, and for a 30 month loan \$28. For about an \$800 loan the rate is a bit more than 24 percent and the monthly repayments are \$80 for a 12 month loan, \$44 for a 24 month loan and \$36 for a 30 month loan. The take-home family income of the average borrower in Maine who usually would be granted these loans is between \$475 and \$550 a month. While the borrower can make the required payments, a small disaster, such as illness or job layoff, might make it difficult for him to keep up to date. The loan companies recognize the possibility and usually "work with" the borrower by allowing him to extend his payments, often lending him additional funds to "tide him over." Possibly because of this practice, the loss rate actually experienced had been relatively low. Measured as charge-offs or increases to allowances for bad debts less recoveries divided by average dollars of loans outstanding, the net loss rate averaged 2.22 percent from 1960 through 1967. (The low was 1.87 in 1962 and the high 2.62 in 1967). In 1968 the net loss rate was 3.25 percent and in 1969, 4.10 percent.

The operating costs and loss rate data reported provide evidence contrary to the hypothesis that the finance companies make loans in the expectation that some borrowers will default their loans. The high operating costs measured and low loss rate make this "strategy" particularly foolish; consequently, it is doubtful if the companies would follow it.

With the 36 month limitation in effect, if the finance companies extend a borrower's payments, they must not only incur the additional expense of counseling and "working with" the borrower, but the funds they have loaned bear a rate of only 8 percent. As Table 5 and Figure 2 show, the operating costs alone are greater than 8 percent for most loans. Thus, it appears that the necessity of extending loans when the borrower is unable to pay on time, the reduction of revenue from which operating and other costs could be paid, together with the impossibility of maintaining a long-term customer relationship were important factors in the decision of finance companies to cease operations in Maine.

Profitability of Finance Companies

Those who urged passage of the 36 month limitation and the reduction in ceiling rates argue that the companies could easily withstand the lower revenue. As Governor Curtis said in 1969, "Indeed, our small loan regulating laws are, and they remain, favorable to small loan concerns." To provide a test of this contention, the annual yield on assets was computed for each finance company whose data are given above for the years 1960 through 1971. Because the data do not permit an unambiguous measure of yield, two rates were

FIGURE 4

Average Size of Loans Made to New, Present and Former Borrowers, 1960 - 71 Means of Averages at Three Major Finance Companies



computed. (1) Net small loan business operating income before income taxes and interest as a percent of average loans outstanding: income taxes are omitted because they need not reflect current operations and because they are often allocated arbitrarily by national companies. Interest also often is allocated arbitrarily by national companies and is largely a function of the type of financing (debt vs. equity, primarily) used. (2) Net total operating income from all sources before income taxes and interest expense as a percentage of average assets "used and useful," which includes working capital, furniture and fixtures, etc., and other assets in addition to loans receivable. While the returns on equity would have been preferable numbers, the data (particularly that of national companies and unincorporated local companies) do not allow meaningful measures.

Tables 6 and 7 present the percentages computed. The data were disaggregated because some critics of the finance companies believe that national companies shift profits from life, accident and disability insurance to an affiliated or owned insurance company and hence understate the income data reported to the Bank Commissioner. Mean percentage rates of return on assets are given for local and national companies, for the companies grouped according to asset size (under \$300,000; \$301,000 to \$1,000,000; and over \$1,000,000) and for the total. High and low percentages for each group also are given. Figure 5 presents some of these data graphically.

Without some standard of comparison, one can only draw definitive conclusions about the data that show a negative rate of return. Nevertheless, unless the reports are in error, it is clear that the net income before income taxes and interest expense of most finance companies in Maine after 1969 (when the 1967 law began to take effect) was inadequate to support continued operations. For all companies, small loan income as a percentage of average outstanding loans dropped from 10.8 in 1960 to 6.0 in 1967 to 4.6 in 1969 and 1.7 and .08 in 1970 and 1971. The reduction was similar for the total net operating income and for local and national, small, medium and large size operations.

Turning (with less certainty) to the period before the law, it appears that the finance companies' return on assets was reasonably good, considering that they are relatively highly levered. However, even before the 1967 law was enacted, their yields were trending down, as Figure 5 graphically shows. In part, the reduced percentages are explained by the increasing operating costs shown in Table 5. Average costs per loan increased from \$55.72 in 1960 to \$66.68 in 1967. Interest on the funds they borrowed also increased over the period.²⁰ but the maximum rates the companies could charge did not increase. It appears, then, that their rapid exodus from the state was due to decreasing returns primarily due to the 36 month limitation and, in some measure, to the reduction in the rate ceiling and maximum loan size, compounded by greater bad debt losses. Thus Mr. Cope's statement (quoted in footnote 11), that the finance companies were experiencing cost difficulties before 1967 appears correct (although his explanation "economies of scale" is not supported). But the data do not support Governor Curtis' belief that Maine's laws "... are, and they remain, favorable to small loan companies."

Small Loan Business Net Operating Income before Income Taxes and Interest Expense As Percentage of Average Loans Outstanding

_			• • •		•	
Year	Local	National	Total	Under \$300	\$300-1000	Over \$1000
1960	12.0	9.8	10.8	14.2	10.3	9.6
	(4 - 29)	(7 - 15)	(4 - 29)	(4 - 29)	(9 - 13)	(7 - 15)
1961	7.8	9.9	9.0	6.8	9.0	9.9
	(-11 - 18)	(4 - 14)	(-11 - 18)	(-10 - 18)	(5 - 13)	(6 - 14)
1962	8.6	10.6	9.7	7.2	10.5	10.7
	(-5 - 18)	(4 - 15)	(-5 - 18)	(-5 - 18)	(9 - 13)	(6 - 15)
1963	9.5	9.8	9.7	9.6	9.4	9.8
	(1 - 17)	(6 - 13)	(1 - 17)	(1 - 17)	(7 - 11)	(5 - 13)
1964	7.1	8.7	7.9	6.2	7.5	8.8
	(-8 - 18)	(3 - 14)	(-8- 18)	(-8 - 18)	(3 - 12)	(6 - 14)
1965	6.3	7.5	7.0	4.6	6.4	8.3
	(-10 - 20)	(-5 - 12)	(-10 - 20)	(-10 - 20)	(-5 - 12)	(3 - 12)
1966	11.0	6.4	8.1	11.8	5.5	8.2
	(6 - 19)	(-9 - 24)	(-9 - 24)	(6 - 19)	(-9 - 24)	(-4 - 16)
1967	7.6	5.2	6.0	7.8	6.7	5.2
	(-3 - 23)	(-9 - 12)	(-9 - 23)	(-3 - 23)	(-6 - 12)	(-9 - 11)
1968	6.3 (3 - 13)	4.5 (-7 - 11)	4.9 (-7 - 13)	(a)	4.9 (a)	4.3 (-7 - 11)
1969	5.6 (-3 - 15)	4.3 (-9 - 11)	4.6 (-9 - 15)	(a)	1.4 (a)	4.5 (-9 • 11)
1970	3.6 (-2 - 11)	1.0 (-21 - 8)	1.7 (-21 - 11)	(a)	-8.6 (a)	4.0 (-2 - 8)
1971	4.4 (a)	-0.5 (-8 - 5)	0.8 (-8 - 10)	(a)	(a)	0.4 (-8 - 5)

Arithmetic Mean (Range: low - high)

number of observations: see Table 3

a. Too few observations

Effect of Decline of Finance Companies Lending on Aggregate Consumer Personal Loans

In testimony before the Business Legislation Committee of the Maine Senate on March 3, 1971, Bank Commissioner Elmer W. Campbell stated:

Figure are available by the small loans companies (probably given at this hearing) indicating that the reduction of their loans is catastrophic. It is true that there is a large reduction in the total of their loans

Total Net Operating Income before Income Taxes and Interest Expense as Percentage or Average Total Assets Used and Useful

Year	Local	National	Total	Under \$300	\$300-\$1000	Over \$1000
1960	9.8	8.6	9.2	10.5	9.3	8.5
	(4 - 15)	(5 - 13)	(4 - 15)	(4 - 15)	(7 - 12)	(5 - 13)
1 96 1	7.4	8.7	8.1	6.7	8.0	8.8
	(-9 - 16)	(4 - 12)	(-9 - 16)	(-9 - 16)	(5 - 11)	(4 - 12)
1962	8.0	9.5	8.8	7.0	9.2	9.6
	(-4 - 16)	(5 - 15)	(-4 - 16)	(-4 - 16)	(6 - 11)	(5 - 15)
1963	9.1	8.9	9.0	9.7	8.3	8.9
	(1 - 18)	(6 - 12)	(1 - 18)	(1 - 18)	(6 - 11)	(5 - 12)
1964	6.8	7.8	7.3	6.6	5.8	8.0
	(-7 - 18)	(0 - 13)	(-7 - 18)	(-7 - 18)	(2 - 8)	(3 - 13)
1965	7.2	6.6	6.9	7.0	5.3	7.5
	(-1 - 20)	(-4 - 11)	(-4 - 20)	(-1 - 20)	(-4 - 8)	(3 - 11)
196 6	10.8	5.7	7.6	13.1	5.0	7.2
	(4 - 21)	(-8 - 22)	(-8 - 22)	(4 - 21)	(-8 - 22)	(-5 - 15)
1967	6.7	4.5	5.2	7.2	5.4	4.5
	(-5 - 18)	(-8 - 12)	(-8 - 18)	(-5 - 18)	(-6 - 10)	(-8 - 11)
1968	5.8 (3 - 12)	3.9 (-6 - 11)	4.4 (-6 - 12)	(a)	4.9 (a)	3.7 (-6 - 10)
1969	5.0 (-3 - 13)	3.6 (-12 - 9)	3.9 (-12 - 13)	(a)	1.4 (a)	3.5 (-12 - 9)
1970	2.1 (-3 - 8)	1.4 (-15 - 10)	1.6 (-15 - 10)	(a)	-7.2 (a)	3.8 (-2 - 10)
1971	3.2 (a)	1.0 (-8 - 4)	0.2 (-8 - 6)	(2)	(a)	-0.2 (-8 - 4)

Arithmetic Mean (Range: low - high)

number of observations: see Table 3

a. Too few observations

but that does not necessarily indicate that the public is suffering from their inability to obtain loans.

Other sources are available and it is amazing to see the great increase in credit union loans in comparative periods.

From Dec. 31, 1966 to Dec. 31, 1969 loans of small loan companies decreased \$11,000,000.

During this same period credit unions in Maine increased their loans by \$29,540,000.

During 1970 it is estimated that credit unions increased their loans by an additional \$13,000,000.

FIGURE 5

Net Income before Income Taxes and Interest Expense All Local and Large (Assets over \$1 Million) Companies



A. Small Loan Net Income as Percentage of Average Loans Outstanding



25

These figures seem to prove that consumers are properly provided with credit even with the decrease in small loan companies and the consumer has the advantage of much lower interest rates.

The department of banks and banking has received no complaints from the public concerning the closing of small loan companies and it is the belief of the commissioner that the public is able to obtain proper loans.

Commissioner Campbell's figures are not adjusted for the increases in prices that occurred since the late 1960's. Figure 6 graphs for 1955 through 1971 year end total consumer cash loans (and total loans per capita) at commercial and mutual savings banks, state and federal credit unions, industrial banks and finance companies in 1971 dollars (deflated by the gross national product deflator, 1971 = 100). Loans at credit unions and finance companies, similarly deflated, also are graphed. It is clear that total loans have increased since 1967, although loans made by finance companies decreased. Credit unions show a steady increase over the 17 year period, with a slightly greater rate of increase after 1967. Loans outstanding at finance companies increased hardly at all through the early 1960's and then decreased sharply after 1967. As a proportion of total loans, credit union loans increased from 20.2 percent in 1954 to 49.6 percent in 1971 compared to the finance companies' proportions of 43.4 percent and 4.8 percent in 1971. (The market share of commercial and mutual savings banks increased from 32.6 to 40.5 percent and that of the industrial banks from 3.8 to 5.1 percent over this period). These data are consistent with Tables 6 and 7 and Figure 4, which also indicate that the finance companies were not in as good a position as the Maine legislature might have believed when they passed the restrictive legislation in 1967.

The increase in credit union loans after 1967 in absolute amount and as a percentage of the total, mentioned by Commissioner Campbell and shown in Figure 6, requires some explanation. Credit unions can obtain the funds they lend (with minor exceptions) only from their members.²¹ Unlike finance companies, they cannot borrow from banks or from the general public. How, then, did they obtain the increased funds? Mr. Ted Desveaux of the Maine Credit Union League believes the increase was due to an extensive advertising campaign by the credit unions.²² Their decision to expand predated the 1967 legislation, which they did not expect to be enacted. Thus the growth of the credit unions was coincident with but essentially independent of the decline of the finance companies.

While it is clear that credit unions' (and to a lesser extent, the other institutions') share of the market increased, it is not clear that the amount of loans supplied equaled the amount demanded. To determine whether total loans after 1967 were at the level they would have been had not the 36 month rule been enacted, a theoretically valid supply and demand model must be constructed, specified and tested for the period before 1968. The following model was developed for this purpose.

(2) LD = f(RL, G, P, UR, Y)





LOANS OF "GOOD" RISK LOANS OF "POOR" RISK

(3)
$$LS = g(RL, P, RB, C)$$

(4)
$$LD = LS$$
, where

- LD = total consumer installment cash loans demanded,
- LS = total consumer cash loans supplied,
- RL = rate charged on loans,
- G = goods purchased with consumer credit,
- P = population,
- UR = unemployment,
- Y = personal disposable income,
- RB = borrowing rate of lenders (gross opportunity cost of lending), and
- C = operating cost and risk of lending.

According to this model, consumers' demand for loans is a function of the rate they pay and their need for borrowing as determined by their purchases, unemployment and income. The amount of funds lenders supply is a function of the rate they earn and the cost of obtaining and lending funds. Population serves to account for the scale of demand and supply.

The demand equation may be written in the following linear form:

(5)
$$LD_{t} = a_{1}P_{t} + \sum_{h=t-n}^{t} a_{h}RL_{h} + \sum_{i=t-n}^{t} a_{i}G_{i}$$
$$+ \sum_{i=t-n}^{t} a_{j}UR_{j} + \sum_{k=t-n}^{t} a_{k}Y_{k} + U_{t}$$

where U_t is a random disturbance term and other variables are as defined above. Loans demanded at time t (LD_t), then, is a linear function of the population (P) and present and past rates charged (RL), purchases of goods, (G), unemployment (UR), and income (Y). Assuming that total loans with respect to population is homogeneous of degree one (as Figure 6 shows), $a_1 = 1$ and all variables can be stated in terms of loans, goods purchased, etc., per capita. Assuming further that the effects on loans of past goods purchases, unemployment and income are impounded in the beginning level of loans outstanding (for each period, loans supplied = loans demanded), equation (5) can be rewritten, either in total or per capita form, as:

(6)
$$LD_t = a_0 LO_{t-1} + a_1 \triangle RL_t + a_2 \triangle G_t + a_3 \triangle UR_t + a_4 \triangle Y_{t}$$

where

 LO_{t-1} = loans outstanding at the end of the previous period, and

 Δ = change.

The supply equation (3) also can be written in linear form (in total or per capita) as:

(7)
$$LS_{t} = \sum_{h=t-n}^{t} b_{h}RL_{h} + \sum_{i=t-n}^{t} b_{i}RB_{i}$$
$$+ \sum_{j=t-n}^{t} b_{j}C_{j} + V_{t}$$

where V_t is a random disturbance term and other variables are as defined above.

The amount of loans supplied, then, is a linear function of past and present lending rates, borrowing rates and lending costs. As is assumed for the demand equation, past rates and costs are impounded in past levels of lending, so that equation 7 can be rewritten as:

(8)
$$LS_t = b_0 LO_{t-1} + b_1 \triangle RL_t + b_2 \triangle RB_t + b_3 \triangle C_t + V_t.$$

Using two stage least squares, the equation can be solved for the common endogenous "price" variable, $\triangle RL_t$, and then for LD_t. Unfortunately, this planned procedure could not be effected because data on RL_t are not available for banks. Further, the data on gross loan income which are available for finance companies and credit unions do not adequately measure current period charges. Consequently, the simultaneous supply and demand model had to be abandoned. Considering that simultaneous equation models rarely provide much different estimates than are given by single equation models, this limitation may not be very serious.²³

As an alternative, the demand for consumer loans can be extended on the reasonable assumption that lenders supply the loans demanded to the class of borrowers whom they serve?⁴ The rates charged borrowers differ for banks, credit unions, industrial banks, and finance companies but, except when the legal ceiling changes, usually are at the ceiling. Lenders, then, provide funds to

borrowers at this rate in the amounts demanded, so long as the borrowers are within the risk class (or better) served by the lender. Thus, the volume of loans is demand determined and the rate charged, RL, being constant, is dropped from the equation. The following demand equation then was estimated:²⁵

(9)
$$LO_t = c_0 LO_{t-1} + c_1 \triangle RV_t + c_2 \triangle UR_t + c_3 \triangle Y_t, \text{ where}$$

RV = registered vehicles, used as a proxy for goods purchased for which cash loans are taken, since cars are the single most common good purchased with the proceeds of these loans.

Since the linear form need not be the best specification, equation (14) also was estimated in logarithmic form.²⁶

Equation (9) and its logarithmic counterpart were estimated with annual data for 1954 (the first year for which complete data on total consumer cash installment loans are available) through 1967. (Quarterly data are not available). The equations were specified with total and per capita amounts, but, as Figure 6 indicates, there was almost no difference in the coefficients. Hence only the total loan equations are reported.

The coefficients (standard errors) and t values estimated are as follows:

(9)
$$LO_t = 1.109 LO_{t-1} + .66 \triangle RV_t - 941 \triangle UR_t - 41.25 \triangle Y_t$$

(.003) (.21) (.10)
(.027) (.78) (1602) (41.09)
40.78 .84 .58 1.00

 $R^2 = .99$

Durbin-Watson statistic = 1.22

First order autocorrelation of residuals = .39

(10)
$$\ln LO_t = 1.013 \ln LO_{t-1} + .13 \Delta \ln RV_t - .11 \Delta \ln UR_t$$

380.8 .62 1.13
 $- 2.01 \Delta \ln Y_t$
(1.00)
2.02

 $R^2 = .98$

Durbin-Watson statistic = 1.25

First order autocorrelation of residuals = .27

Only the lagged loans outstanding are significant at the .05 level in either the original or logarithmic form. Considering a less rigorous definition of "significance," the equations with variables whose coefficients are at least as great as their standard errors are:

(9")	$LO_t = 1.089 \ LO_{t-1}; \ R^2 = .98$
	(.014)
	75.69
(10')	$\ln LO_t = 1.012 \ln LO_{t-1} - 1.15 \Delta \ln Y_t; R^2 = .98$
	(.002) (.68)

423.9

Omitting the "non-significant" variables affects the \mathbb{R}^2 and coefficients hardly at all. Thus, it appears that loans outstanding are best stated as a function of the previous balance outstanding and possibly, in the logarithmic form, of changes in personal income.

1.70

The coefficients thus estimated with data over the period 1954-1967 were used to "predict" loans outstanding in the post-1967 years. Table 8 shows the actual and the predicted amounts of total loans for each of the four equations whose coefficients are given above. With the exception of equation 9' for 1971, the predicted amounts are greater than actual for all models and years. However, the estimated amounts are not, in all cases, significantly greater than the actual loans outstanding. "Actual" is two standard deviations or more below "predicted" for the 1968 and 1970 original data models and the "good" 1971 original data model. The less stringent one standard deviation difference shows significantly less than predicted loans in all years for the original data models (except the 1971 all variables equation) and the "good" logarithmic equation. Thus, there is some evidence that the 36 month limitation may have resulted in a lesser amount of loans outstanding.

However, the aggregate data and the models specified really are not adequate or sufficient to determine the effect of the radical reduction in lending by finance companies on the availability of credit to consumers. People can borrow from many sources besides commercial and mutual savings banks, credit unions, and industrial banks--such as trade credit, auto finance companies, second mortgage lenders, friends, loan sharks and others whose data are not available on a statewide basis. Consequently, it is not possible to conclude, as did Commissioner Campbell, that "these figures seem to prove that consumers are properly provided with credit..." or the reverse, as the demand models indicate. Rather, at the least, one must go to the individuals affected to determine the effect of the 36 month limitation.

Actual vs. Predicted Total Loans, 1968 - 1971 Based on Coefficients Estimated with Data from 1954 - 1967

		1968	1969	1970	1971
Actual (A)		204	211	213	225
Predicted (P), Standard Error ³ (SE), and Predicted less Actual (P-A)					
Original Data:					
Equation 9' (all variables)	P SE P-A	222 8 18	220 8 9	230 8 17	223 8 -2
Equation 9" ("good" variables)	P SE P-A	222 7 18	226 7 15	234 7 21	236 7 11
Logarithmic Data					
Equation 10 (all variables)	P SE P-A	217 15 13	221 18 10	234 18 21	241 19 16
Equation 10'	P SE P-A	220 13 16	228 16 17	235 16 22	244 17 19

(millions of constant dollars, 1971=100)

^a Standard error(s) is corrected for extrapolation as follows:

 $s = (X_i[\hat{b}_i\hat{b}_j]X_j^{-1} + s_{y^*x}^2)^{-1/2}$ where X_j is a vector of independent variable values for 1968, 1969, 1970 and 1971, \hat{b}_j computed regression coefficients and $[\hat{b}_i\hat{b}_j]$ is the variance covariance matrix of the coefficients, and $s_{y^*x}^2$ is the variance of the regression equation.

Survey of Lenders

Commercial bankers and credit union officials were interviewed and a survey conducted to determine whether or not the reduction in lending by finance companies had affected them, and if so, how. While some of the bankers believed the restrictive legislation was good for consumers, most thought it unwise. Of greatest interest was their almost universal belief that they had "picked up" very little new business that they thought was formerly served by the finance companies. Bank charge cards, they said, generally would not be granted to these customers because charge cards, with which a holder can borrow on demand, present a bank with greater risk than installment loans. However, they thought that many people who borrow at finance companies could qualify for bank installment loans, if they would apply. Mr. Desveaux of the Maine Credit League believed that many former finance company customers were now served by credit unions, but he said that there were no data available to support or deny this belief. However, since credit unions can lend only to members, people who are not employed by companies with credit unions, attend a church that has a credit union or live in a neighborhood served by an area credit union, cannot be served.

Survey of Borrowers-The Data

To determine directly the effect of the reduction in finance company lending on their customers, a large sample of borrowers was interviewed. In November and December, 1971, four major consumer finance companies who were shrinking and/or discontinuing their operations in Maine were asked to supply the names, telephone numbers, addressees and other information on former or present customers who had wanted to take out or increase loans (roughly) during the past year, but whose requests were refused because the company was not extending or making loans. In all cases, these were people to whom the companies would have been pleased to lend had they not decided to reduce or eliminate their operations in Maine.

Table 9 gives the composition of the sample. Names, addresses and telephone numbers of 771 borrowers were received over a period of several months. All borrowers for whom valid telephone numbers could be found were contacted.²⁷ In all, 436 persons were contacted at this stage of the survey.

The telephone interviews proved very satisfactory, in part because the interviewers were very good at establishing rapport. The principal interviewer was a graduate student at the University of Maine who was familiar with much of the state. After some experimentation, he developed the technique of conducting an apparently unstructured conversation of from four to six minutes, during which he avoided leading the borrowers to answers, yet managed to get replies to most of the questions. When an interviewee wouldn't give information unless he or she were asked too specific questions (i.e., "Why did you want to borrow money?" No reply until the interviewer had to say-"To buy a car?") and then seemed to be answering to please or get rid of the interviewer, the interview was marked "refused to respond." Most in this group include people who simply wouldn't speak to the interviewer. Of the 436 people contacted, 58 (13.3 percent) refused to answer and 378 (86.6 percent) gave the requested information. The interviewers believe that they received valid answers to their questions, with one exception-"What percentage amount of loan was outstanding when you attempted to renew your loan?" Many interviewees gave vague replies which indicated that they either really did not know the amount or did not understand the question.

The 436 borrowers contacted represent 56.6 percent of the sample. It would be potentially misleading to assume that the persons not contacted are like those contacted; their not having locatable telephone numbers might be an

Porrowers contexted.		Number		Percentage
Successful contact with initial survey Follow-ups	-	378 82		49.0 10.6
Total complete information		460		59.6
Refused to answer		58		7.6
Total contacted		518		67.2
Borrowers who couldn't be contacted with initial survey:				
Total Follow-ups (included above)	335 -82		43.4 -10.6	
Total not contacted		253		32.8
Total sample:		771		100.0

Table 9 Composition of Sample of Borrowers

indication that inability to borrow additionally from the finance companies put them in a particularly difficult financial situation. Consequently, a sample of 82 (24.2 percent) of the 335 borrowers not contacted was selected. (The sub-sample comprised all borrowers in several towns). The last known home and work addresses of these borrowers was obtained, from which they were located (eventually) and interviewed. All of these borrowers were interviewed (although this proved quite time consuming). Thus a control against the 335 persons not contacted was established.

The principal question the borrowers were asked was whether or not they had obtained elsewhere the funds for which they had gone to the finance companies. To ascertain which characteristics were associated with ability or inability to get funds, data on the borrowers was obtained from the finance companies, as follows: occupation, weekly gross salary, age, marital status, number of dependents, number of years the borrower was continually in debt to the finance company, and number of previous loans the borrower had with the finance company.

The data first were used to determine whether or not the 67.2 percent of the sample contacted are representative of the entire sample. Tables 10 through 14 give the percentages of each sample in the subcategories for which information was gathered. The number of observations for which valid data were available also is given, as are the number and percentages of each sample for which data were not available. Table 15 gives the chi square statistics (which measure the probability that the differences are not due to chance) computed from two way comparisons of the samples. The chi square statistics show no significant²⁸ differences in any of the characteristics measured between the people who answered the initial telephone survey (A) and those who refused (R), between the A group and those who were contacted by field interviews (C), between the C group and those not contacted (N) and between the A and N groups. Only those who answered the initial survey (A) and those not contacted (N) showed significant differences in several respects. The most striking of the differences are as follows: those not contacted (N) include a slightly higher percentage of unskilled and much higher percentage of professional workers (see Table 10), they earn somewhat less (see Table 11), and have a higher percentage of single persons and fewer dependents (see Table 13) than the A group. Of greatest interest for this study, the groups do not differ much in number of years in debt or previous loans. Consequently, it is concluded that the 460 borrowers interviewed, on which the balance of this and the next two sections are based, represent the entire sample of 771 well.

Ability to Borrow and Source of Funds of Individuals Surveyed

Table 16 shows that almost exactly half the borrowers were able to obtain funds (O) from other sources and half did not obtain new funds (NO). This table and Table 18 report on differences between the two groups to ascertain why some borrowers get funds and others did not. Considering the reason for borrowing first, Table 16 shows that a greater percentage of those who obtained funds wanted the money to consolidate debts (54.5 vs. 48.9 percent) or buy a used car (19.5 vs. 12.7), while the percentage of those wanting to purchase furniture and household items was highest for the "did not obtain funds" group (10.0 vs. 5.6 percent). The percentages of what some might view "socially acceptable purposes,"-to pay medical bills, make home improvements, or pay school expenses-were about the same for each group. At the least, there seems no evidence that those who did not obtain funds wanted the money for obviously "less worthy" purposes.

Table 18 gives the chi-square statistics for each of the seven characteristics reviewed above as well as for the percent of loan unpaid at the time the borrower wanted additional funds (5 categories) and reason for borrowing. (Groups other than the obtained (O) vs. did not obtain (NO) funds groups are discussed below). Chi square statistics rather than the underlying data are reported since the only significant difference between the O and the NO groups is the "reason for borrowing," which is detailed in Table 16. Thus (contrary to expectations), the explanation of why some borrowers did and some did not obtain funds is not discernable from the data collected. The interviewers were unable to say whether the people who did not borrow tried to borrow but were refused, could not find another institution in their area from which to borrow

Occupation of Borrowers

.

	Not Cont First S	acted by urvey	Contacted by First Survey		
	Not	Included	in Study	Refused to	
	Contacted (N)	Contacted (C)	Answered (A)	Respond (R)	
Percentage of Valid Observations					
unskilled	28	34	24	17	
skilled and semi-skilled	31	42	39	38	
service workers (manual, janitor, etc.) white collar (sales, office, govern-	3	1	3	4	
ment, etc.) professional (teacher, executive.	9	9	13	17	
proprietor, doctor, etc.)	19	9	9	13	
other	<u> 10 </u>	5	<u>12</u>	_11	
total valid observations	100	100	100	100	
unknown	41	3	22	10	
Number of Observations					
total valid	180	80	310	53	
unknown	73		68		
Total	253	82	378	58	

Table 11

	Not Con First	tacted by Survey	Conta First	cted by Survey
	Not Included		Not Included in Study	
	Contacted (N)	Contacted (C)	Answered (A)	Respond (R)
Percentage of Valid Observations	· · · · · · · · · · · · · · · · · · ·	••••••	•	
\$0 - 80	14	21	10	11
81 - 120	50	43	44	32
121 - 160	27	21	28	32
161 - 200	5	10	12	17
200+	4	5	6	8
total known	100	100	100	100
unknown	45	3	22	10
Number of Observations				
total valid	175	80	310	53
unknown	78	2	68	5
Total	253	82	378	58

Weekly Gross Salary of Borrowers

Table	1
	-

	Not Con First	tacted by Survey	Contacted by First Survey	
	Not Included is		in Study	Refused to
	Contacted (N)	Contacted (C)	Answered (A)	Respond (R)
Percentage of Valid Observations 18 - 24 25 - 34 35 - 44	11 27 26	5 29 21	6 25 31	8 26 17
45 - 54 55 - 64 65 +	22 12 2	19 24 	22 14 2	37 15 0
Total valid	100	100	100	100
Unknown	73	3	51	26
Number of observations				
Total valid	146	80	250	46
Unknown	107	_2	128	
Total	253	82	378	58

Age of Borrowers

(such as a credit union), gave up trying after being told that the finance company would not advance them funds ("if they wouldn't lend to me, who would?"), or bought more goods on credit but did not consider this "borrowing."

Those who obtained funds were queried about the source of their borrowings. The greatest proportion (39.8 percent) shifted their debt to another finance company, which shows that the 36 month rule was not entirely effective. Banks provided loans to 32.9 percent, 20.8 percent borrowed from a credit union and the balance of 6.5 percent from other sources. None said they borrowed from a loan shark. Recalling that few of the bankers interviewed and surveyed thought that they had gotten much new business from former finance company borrowers, it may be that these people were considered by bankers to be sufficiently good risks to be not classified as "finance company clients."

Those who did not obtain funds took one of three actions. Most continued to pay regularly (77.3 percent) while almost all of the balance missed some payments but paid off the loan (22.3 percent). Only one person (.4 percent) declared bankruptcy.

	Not Contacted by First Survey		Conta First	cted by Survey
	Not	Included	in Study	Refused to
	(N)	Contacted (C)	Answered (A)	(R)
Percentage of Valid Observations				
Marital Status				
married	71	70	80	77
other		30	20	23
total valid	100	100	100	100
unknown	78	2	68	5
Number of Dependents				
none	36	32	21	26
one	14	15	19	10
two	17	14	20	13
three	16	13	1 6	17
four	9	16	15	15
five and over	8	10	_9	<u> </u>
total valid	10 0	100	100	100
unknown	45	3	22	10
Number of Observations				
total valid	175	80	310	53
unknown			68	
total	253	82	378	58

Marital Status and Dependents of Borrowers

Borrowers' Feelings about Not Having Been Granted a Loan by the Finance Company

The people interviewed also were asked how they felt about no longer being able to borrow from the finance company. Questions of this sort always must be treated with skepticism and interpreted with great care, since feelings are difficult to measure and people often answer according to how they think they should feel. This caveat is especially necessary when interpreting feelings about borrowing. Borrowers, no less than lawmakers, often regard being in debt (particularly from "lenders of last resort") as "bad." A good illustration of this is provided in an interview study of 101 people who were at that time borrowers from small loan companies.²⁹ The interviewers did not know this fact and, during the course of the interview, asked how many cash loans and installment purchases the interviewee had outstanding at the time of the interview (unfortunately, the two types of debt were grouped). Eleven percent

	Not Contacted by First Survey		Contac First S	cted by Survey
	Not	Included	in Study	Refused to
	Contacted (N)	Contacted (C)	Answered (A)	Respond (R)
Percentage of Valid Observations				
Number of Years in Debt to Finance Company:				
1	12	18	12	23
2-4	41	36	43	34
5 - 8	22	18	20	14
9 - 12	16	12	17	19
13+	_9	<u> 16 </u>	8	10
total valid	100	100	100	100
unknown	48	7	21	10
Number of Previous Loans:				
1	16	25	22	17
2-4	38	34	34	35
5 - 8	22	25	21	31
9+		16		
total valid	100	100	100	100
unknown	48	7	21	10
Number of Observations				
total valid	171	77	313	53
unknown	82	5	65	_5
total	253	82	378	58

 Table 14

 Number of Years Borrower was Continually in Debt and Number of Previous Loans before Refusal

of those interviewed said they had no loans, 23 percent said they had one, 28 percent said they had three, etc. Thus at least 11 percent reported no loans outstanding although they were then in debt to a finance company. To the extent that people had installment loans in addition to finance company debt, the percentage could be higher.

In the present study, the interviewers put the answers as to "feelings" into the categories reported in Table 17. Of those able to obtain funds, 74.1 percent felt better off, primarily because they established credit with a "better quality" financial institution (80.2 percent of the 74.1 percent). Most of the balance felt better off because they were "rid of the burden of the finance company." It is easily understandable that people who find that they can

Characteristics ^a	χ^2 at	Survey Groups: Chi Square Values				
	5% Level	A vs R	A vs C	A vs N	C vs N	
Occupation	11.10	2.48	6.76	15.14*	8.91	
Salary	9.49	2.83	7.99	10.23*	5.29	
Age	11.10	7.06	6.25	3.97	7.64	
Marital Status	3.84	.13	3.66	5.53	.00	
Number of Dependents	11.10	7.89	5.74	13.39*	3.69	
Years in Debt	9.49	5.85	6.75	.40	4.88	
Number of Previous Loans	7.81	3.28	2.49	2.50	4.38	

Differences between Samples of Interviewed and Not Interviewed Borrowers, Chi Square (χ^2) Tests

Notes

a. See Tables 10 through 14 for description of categories within characteristics.

b. Groups: A = answered initial survey

 \mathbf{R} = refused to respond to initial survey

C = contacted in follow up field interviews

N = not contacted in follow up interviews

Significant at least at the 5 percent level. See Tables listed in a for degrees of freedom.

Table 16

Primary Reason for Original Borrowing: Obtained (O) and Did Not Obtain (NO) New Funds

Percentages	0	NO
Consolidate debts	54.5	48.9
Used car	19.5	12.7
Medical bills	7.4	8.7
Furniture and household items	5.6	10.0
Home improvements	5.2	4.8
School related expenses	2.6	3.5
Miscellaneous	5.2	11.4
	100.0	100.0
Number of Borrowers Chi square (at 5% level, 6 degrees of freedom = 12.60)	231 12.78	229

borrow for a lower interest charge at an institution with more "class" feel better. It is interesting that most of the few who felt worse off even though they did find funds elsewhere (7.0 percent) said that they still found themselves under the burden of a financial institution—that it was too easy to get into debt. The remaining 19.1 percent who were able to obtain funds said they felt about the same, half because they still were in debt and a little less than half because they borrowed from another finance company. It also is interesting to find that 36.3 percent of those who did not obtain funds said they felt better, primarily because they were "rid of the burden of the finance company." The balance declared that finance companies are a "necessary evil," so having paid off their debt, they felt better. Most of those who felt worse blamed their condition on having borrowed from a finance company in the first place, which required them to pay off the loans. Only 11.4 percent of those who did not obtain funds (5.7 percent of the total) felt worse because there were no other alternatives available to them.

The characteristics (occupation, salary, age, marital status, number of dependents, years in debt, number of previous loans, percent of loan unpaid and reason for borrowing) of those who felt better (B), worse (W) or the same (S) were compared to ascertain if any of these were related to the feeling

	Obta Fu	ained Inds	Did Not Obtain funds		Total
	Sub	Total	Sub	Total	Jampa
Ealt Batton Off.					
Rid of "burden" of finance					
COMPARY	17.5		82.0		
Established credit with "better					
quality" financial institution	80.2				
Finance companies are a necessary					
evil	• •		16.9		
No reason given	2.4		<u> </u>		
Total felt better off	100.1	74.1	100.1	36.3	55.3
Felt Worse Off:					
Too easy to obtain money – still under "burden" of financial					
institution	87.5				
No other alternative available			31.4		
Burden of high interest rates lead			697		
No reason given	12.5		00.7		
Total felt worse off	100.0	7.0	100.1	36.3	21.6
Felt About the Same:					
Still borrowing from a finance	40.0				
Still borrowing from some	4 0.9				
financial institution	50.0				
Doesn't matter where one borrows			71 .4		
No reason given	<u>9.1</u>	<u>19.1</u>	28.6	27.6	23.3
	100.0	100.2	100.0	100.2	100.1
Percentage of Total		50.2		49.8	

Table 17

Borrowers Feelings About Not Being Able to Borrow from Finance Companies Percentages - 460 Observations

expressed. Table 18 gives the chi square statistics computed for these groups. Age for the B vs. W comparison is the only characteristic that is significantly different between the groups. The principal difference is that the B group is older; 3.3 percent are between 18 and 24 compared to 15.9 percent for the W group.

Chi square statistics that measure the significance of differences in the characteristics of those who obtained funds who felt better (B), worse (W) or the same (S) are given in Table 19. Only salary in the B vs. S comparison, occupation in the W vs. S comparison, and source of funds in the B vs. W and B vs. S comparisons are significantly different. The difference in salaries between the B and W groups is in the lowest category—\$0 - \$80 a week. The B group had 9.9 percent of its valid observations in this category compared to 30.8 percent for the W group. With respect to occupation, a greater percentage of those who felt workers (30.8 compared to 2.6) and a greater percentage of those who felt about the same (S) are unskilled (39.5

Table 18

Differences Between Borrowers, Chi Square Tests Those Who Obtained (O) and Did Not Obtain (NO) Funds and According to Feelings About Situation (Regardless of Obtaining Funds)

Characteristics ^a	x^2 at	Borrower Groups: Chi Square Values ^b				
	5% Level ^C	O vs NO	B vs W	B vs S	W vs S	
Occupation	11.10	1.35	8.11	5.18	9.04	
Salary	9.49	1.86	3.51	2.82	1.08	
Age	11.10	5.14	16.88*	2.30	7.50	
Marital Status	3.84	2.08	2.75	.25	.61	
Number of Dependents	11.10	8.47	5.60	7.58	4.00	
Years in Debt	9.49	5.71	3.62	.95	1.75	
Number of Previous Loans	7.81	4.35	1.32	2.23	1.71	
Percent of Loan Unpaid	9.49	5.58	4.22	4.34	7.30	
Reason for Borrowing	12.60	12.78*	3.70	6.85	3.14	

Notes

a. See Tables 10 through 14 and 16 for descriptions of categories within characteristics.

b. Groups: O = obtained funds

NO = did not obtain funds

B = felt better off, all borrowers

W = felt worse off, all borrowers

S = felt about the same, all borrowers

Chi squares based on number of valid observations, as follows:

occupation, salary, marital status, dependents, years in debt,

number of loans: O = 192, NO = 198, B = 214, W = 85, S = 91

age:
$$O = 162$$
, $NO = 168$, $B = 184$, $W = 69$, $S = 77$

percent unpaid, reason for borrowing, action taken: A = 229, NO = 231, B = 254, W = 99, S = 107

- c. See tables labeled in a for degrees of freedom.
- * Significant at least at the 5% level.

compared to 7.7). The other differences in occupation indicate that "higher status" workers were less content with the changed situation than were those with "lower status" jobs. Thus the people who feit worse off even though they were able to obtain funds otherwise appear to be lower paid white collar workers.

The source of the very large chi square differences with respect to source of funds are analyzed further in Table 20. Not surprisingly, the significant chi square statistic is due to the fact that 93.8 percent of the borrowers who feit worse off borrowed predominantly from another finance company while 67.8 percent of the borrowers who felt better off obtained funds from banks or credit unions.

Table 21 gives the chi square statistics for differences in the characteristics (occupation, salary, age, etc.) of those who did not obtain funds according to their feelings about the situation. The only significant differences are in comparisons of years in debt of those who felt better (B) vs. worse (W)

Table 19

Borrowers Who Obtained Funds						
Chara stariatise	χ^2 at	Feelings	Feelings: Chi Square Valuesb			
	5% Level ^C	B vs W	B vs S	W vs S		
Occupation	11.10	9.94	7.24	14.65*		
Salary	9.49	5.67	10.94*	4.35		
Age	11.10	8.90	1.80	2.81		
Marital Status	3.84	.03	.11	.06		
Number of Dependents	11.10	2.44	4.07	4.00		
Years in Debt	9.49	.58	3.42	2.27		

7.81

9.49

12.60

11.10

3.87

1.96

6.36

33.24*

2.69

4.10

7.37

47.90*

2.20

1.72

1.29

2.22

Differences According to Feelings, Chi Square Tests

Notes

Number of Loans

Source of Funds

b. Feelings:

Percent of Loan Unpaid

Reason for Borrowing

<u></u>

a. See Tables 10 through 14 and 16 for description of categories within characteristics.

- W = felt worse off
- S = felt about the same

Chi squares based on number of valid observations, as follows: occupation, salary, marital status, dependents, years in debt, number of loans: B = 141, W = 13, S = 38

age: B = 121, W = 12, S = 35

Percent unpaid, reason for borrowing, source of funds: B = 171, W = 16, S = 44

- c. See tables listed in a. for degrees of freedom.
- Significant at least at the 5% level.

Source of Funds		Feelings ^a						
	Total	B	W	S				
Another finance company Bank Credit union Relative Friends Own funds or sale of property	39.8% 32.9 20.8 4.3 1.3 .9	24.6% 42.7 25.1 5.3 1.2 1.2	93.8% 0 6.3 0 0	79.5% 6.8 9.1 2.3 2.3 0				
	100.1%	100.1%	100.1%	100.0%				

Source of Funds, in Percentages, of Those Who Obtained Funds, By Feelings About Inability to Borrow at Original Finance Company

a. B = felt better off

W = felt worse off

S = felt about the same

Chi-square statistics (significantly different from 0 if > 11.10, 5 degrees of freedom):

33.24
47.90
2.22

and action taken of B vs. W and W vs S (felt the same). The major differences with respect to years in debt are in the proportions who were in debt three or fewer years. However, the pattern of difference is erratic. The percentages for 1, 2 and 3 years in debt for the B vs. W groups are: 2.8 vs. 17.6, 50.7 vs. 37.8 and 24.9 vs. 16.2. Considering that 78.4 vs. 71.6 are the B vs. W percentages for 3 years and under, it is doubtful if the differences are meaningful.

The feelings of those who did not obtain funds is analyzed with respect to their actions in Table 22. Most of those who felt better (81.9 percent) continued to pay on their loan, compared to 62.7 percent of those who felt worse and 90.5 percent of those who felt the same. That 37.3 percent of those who felt worse missed payments but paid off the loan probably indicates the difficulty they experienced in repaying their debt-hence their negative feelings.

How should the data on "feelings" be interpreted? First it should be recalled that the borrowers were interviewed at about the time when they had managed to repay their loans to the finance companies. After perhaps much struggle and privation, some were out of debt for the first time in years. At this point, they were likely to be pleased that they had been unable to borrow a year or two earlier. Second, many borrowers, particularly those from the New England state of Maine, may be somewhat ashamed of being in debt, particularly from lenders whom they and others regard as higher cost lenders of last resort. Third, it should be recalled that the borrowers interviewed were finance company customers in good standing. People who had not previously been customers of the companies but who wanted to take out loans were not interviewed because records on them are not available. Consequently, nothing

O to	X ² At 5%	Feelings: Chi Square Values ^b				
	Signif. ^C	B vs W	B vs S	W vs S		
Occupation	11.10	9.44	1.17	4.38		
Salary	9.49	3.96	7.53	4.19		
Age	11.10	10.25	3.88	8.58		
Marital Status	3.84	.66	.01	.38		
Number of Dependents	11.10	3.96	4.19	8.63		
Years in Debt	9.49	10.55*	3.23	2.44		
Number of Loans	7.81	2.52	1.15	.89		
Percent of Loan Unpaid	9.49	1.13	5.66	9.40		
Reason for Borrowing	12.60	6.29	3.90	3.45		
Action Taken	5.99	9.56*	2.47	13.22*		

Differences According to Feelings, Chi Square Tests Borrowers Who Did Not Obtain Funds

Notes

^a See Tables 10 through 14 and 16 for description of categories within characteristics.

^b Feelings: B = felt better off W = felt worse off S = felt about the same

Chi squares based on number of valid observations, as follows:

occupation, salary, marital status, dependents, years in debt, number of loans: B = 73, W = 72, S = 53 age: B = 63, W = 57, S = 42 percent unpaid, reason for borrowing, action taken: B = 83, W = 83, S = 63

^c See tables listed in a. for degrees of freedom.

* Significant at least at the 5% level.

Table 22

Action Taken, in Percentages, by Those Who Did Not Obtain Funds, By Feelings About Inability to Borrow at Finance Company

Percentages	All	Better	Worse	Same	
Continued to pay	77.3%	81.9%	62.7%	90.5%	
Missed payments but paid off loan	22.3	16.9	37.3	9.5	
Declared bankruptcy	.4	1.2			
	100.0%	100.0%	100.0%	100.0%	

is known about their feelings about not having the alternative of borrowing from a finance company. For these reasons (and others given below), I interpret the predominant belief of borrowers that they "felt better" (Table 17), not as support for closing down small loan companies, but as an indication of the relief that many borrowers feel as a result of being out of debt or borrowing at lower than previous rates. The implications of this and alternative interpretations are considered further below.

The "hard data" revealed by the survey allow firmer conclusions to be drawn. Half of the former finance company borrowers did not obtain funds elsewhere and 20.0 percent simply borrowed from another finance company. Only 27.0 percent of the former borrowers were able to obtain funds at lower rates than they otherwise would have paid (30.0 percent if loans from relatives and friends are included). Thus, it appears that not all those unable to borrow from finance companies were otherwise accommodated.

Characteristics of Long and Short Term Borrowers

The 36 month limitation was enacted in the belief that long term borrowers need protection from the finance companies and from themselves. In-depth psychological, economic, and sociological studies of long term borrowers would be desirable to determine whether the legislation is, in fact, wanted by and helpful to them. Unfortunately, such studies not only are very expensive to make, but difficult to interpret. However, the economic and other measurable characteristics of long term borrowers can be compared to those of shorter term borrowers to determine what characterizes people presumed to be in need of protection. Data on the sample of borrowers surveyed, described above, are used for this analysis.

Table 23 shows the occupations of borrowers who were in debt to a finance company continuously for 1, 2-4, 5-8, 9-12 or 13+ years or who had 1, 2-4, 5-8 or 9+ previous loans. The data are presented as percentages of the total number of each grouping of years in debt or previous loans (1, 24, etc.). However, since there are an uneven number of borrowers in the different occupation categories (a greater proportion of finance company customers are skilled and semi-skilled or unskilled workers than are white collar workers, etc.), the percentages should be compared to the percentage distribution of the sample (given in the first column).³⁰ Table 23 shows that unskilled workers comprise a greater percentage of short term (one year in debt or one previous loan) borrowers than would be expected by their number in the sample. Relatively more skilled and semi-skilled workers are longer term borrowers. Borrowers in the other occupation groups do not exhibit any particularly marked relationship to term of indebtedness. Taken as a whole, the chi square statistics computed indicate that the relationships between occupation and number of years of continuous indebtedness and number of previous loans are not significantly different (at the 5 percent level) than would be expected by chance.

Occupation	Distribution	Number of Years Continuously in Debt					
	of Sample	1	2-4	5-8	9-12	13+	
Unskilled	26	46	28	14	18	19	
Skilled and Semi-Skilled	40	26	38	42	52	46	
Service Workers	2	4	2	3	2	3	
White Collar	13	8	11	16	13	14	
Professional	9	6	11	12	5	5	
Other	<u>10</u>		9	13	10	14	
Totals	100	100	99	100	100	101	
Total Number of Years	100	13	42	20	16	10	

Occupation of Borrowers According to Previous Indebtedness to Finance Company In Percentages, 383 Observations^a

Chi square statistic = 27.31 (31.40 at 5 percent level of significance.)

Occupation	Distribution	Number of Previous Loans				
	of Sample	1	2-4	5-8	9+	
Unskilled Skilled and Semi-Skilled Service Workers White Collar Professional Other	26 40 2 13 9 10	35 33 2 9 8 13	28 40 3 13 11 6	25 40 1 15 9 11	13 50 2 12 9 15	
Totals	101	100	101	101	101	
Total Number of Loans	100	23	35	21	28	
Chi square statistic = 18.33 ((25.00 at 5 percent	level of si	gnificance	.)		

^a All those of the sample of 460 for whom data on salary and previous indebtedness are available.

Table 24 presents a similar analysis for five categories of weekly gross salary. With respect to number of years continuously in debt, the percentages show a slight tendency for the borrowers with incomes of \$81 to \$120 a week to be longer term borrowers, while those making \$161 to \$200 a week appear to be shorter term borrowers. However, the overall relationship between salary and years in debt is not strong, as indicated by the non-significant, rather low value of the chi square statistic. With respect to the number of previous loans, poorer borrowers (those making less than \$80 a week) had a much higher than proportionate percentage of only one previous loan. In contrast, the highest paid group (those making \$200 a week or more) had a somewhat greater proportion of previous loans.³¹ The middle salaried groups show no special relationship to number of previous loans. Consequently, the chi square statistic

Wcekly Gross Salary	Distribution of	Number of Years Continuously in Debt					
	Sample	1	2-4	5-8	9-12	13+	
\$0-\$80	12	14	13	9	10	14	
81-120	44	44	42	41	49	49	
121-160	26	22	28	30	23	24	
161-200	12	18	12	11	12	5	
200+	6	_2	5		<u> </u>	8	
Totals	100	100	100	100	101	101	
Number of Years	101	13	42	20	16	10	

Salary of Borrowers According to Previous Indebtedness to Finance Company In Percentages, 383 Observations^a

Number of Years	101	13	42	20	16
Chi sou are statistic = 9 57 (36 20	at 5 nement	t level of sid	mificanc	~)	

Weekly Gross Salary	Distribution of	Number of Previous Loan			
	Sample	1	2-4	5-8	9+
082-02	12	20	10	11	9
81-120	44	44	38	51	46
121-160	26	26	29	24	2 6
161-200	16	7	17	10	10
200+	6	3	6	5	
Totals	100	100	100	101	101
Number of Loans	100	23	35	21	21

^aAll those of the sample of 460 for whom data on salary and previous indebtedness

are available.

indicates that, on the whole, salary is not significantly related to number of previous loans.

In contrast, age and previous indebtedness to the finance company are highly significantly related, as indicated by the large chi square statistics reported in Table 25. The relationship is not surprising, since young borrowers cannot have been in debt for very long. As Table 25 shows, relatively few borrowers in the 18 to 24 age bracket had been in debt more than four years or had more than one previous loan. Borrowers in the next age bracket (25-34), who represent about a quarter of the sample, also were in debt relatively fewer years than the older borrowers. The long term borrowers are those between 45 and 64 years of age. These data indicate that long term borrowers started with the loan company in their thirties, perhaps after they found it difficult to manage their finances otherwise.

It would seem that married people would tend to be longer term borrowers than those who are single, divorced or widowed, since their need for

	Distribution of Num		Number of Years Continuously in Debt					
	Sample	1	2-4	5-8	9-12	13+		
18-24	6	12	9	3	0	0		
25-34	26	44	27	27	13	7		
35-44	28	22	30	40	24	11		
45-54	21	6	16	22	38	41		
55-64	17	12	16	7	22	41		
65+	_2	_4	_2	_0	_2	_0		
Totals	100	100	100	99	99	100		
Total Number of Years	99	15	44	18	14	8		

Age of Borrowers According to Previous Indebtedness to Finance Company In Percentages, 323 Observations^a

Chi square statistic =	• 64.28 (31.40 at 5	percent level	of significance.)
------------------------	---------------------	---------------	-------------------

Age	Distribution of	Number of Previous Loans				
	Sample	1	2-4	5-8	9+	
18-24	6	19	3	2	0	
25-34	26	29	30	28	10	
35-44	28	26	34	28	22	
45-54	21	12	17	25	36	
55-64	17	13	13	15	32	
65+	2	1	4	2	0	
Totals	100	100	101	100	100	
Total Number of Previous Loans	100	26	35	21	18	
Chi square statistic = 64.11 ((25.00 at 5 percent	level of	significa	nce.)		

^aAll those of the sample of 460 for whom data on salary and previous indebtedness are available.

funds is greater. However, as Table 26 shows, such is not the case. While the relationship between marital status and previous indebtedness is not significant, it appears that married people have a proportionately greater share of one year debt and one previous loan than do the others.

The relationship between the number of dependents and previous borrowings shown in Table 27 is consistent with that of marital status. Borrowers with no dependents comprise a far greater proportion of long term debtors (13+ years previously in debt of 9+ loans) and those with three or more dependents a lesser proportion than do the others. The overall relationship, however, is not significant. Thus, it appears that short term debtors are more likely to be either single or married people with three or more dependents.

Table 28 shows the relationship between the borrower's primary reason for borrowing and his/her previous indebtedness. Borrowers who wanted funds to consolidate debts were proportionately more heavily represented in the 13+ previous years group, but did not have a much different than expected number of previous loans. Those who wanted money for a used car or school related expense do not show any special pattern of previous indebtedness. Both groups of borrowers tend to have much lower than expected percentages of more than nine previous loans or years in debt. In addition, borrowers who wanted money for medical bills show higher than the expected proportion of one year in debt and one previous loan. These data are consistent with the common sense belief that borrowers who want money for immediate needs are shorter term debtors than those who want money for longer term purposes.

Finally, previous indebtedness is related to the borrowers' feelings about not having been able to borrow from the finance company. As Table 29 shows, less than a proportionate number of very short term (one year in debt, one previous loan) borrowers tended to feel better off, perhaps indicating that they were pleased with their new relationship with the finance company. However, as the chi square statistics indicate, the overall relationship is not significant.

In summary, long term borrowers (those continuously in debt for 9 or more years = CD, or those who had 9 or more previous loans = PL) tend to be skilled workers (CD and PL), people who make \$200 or more per week (PL), between 45 and 64 years of age (CD and PL), people with no dependents (CD and PL), and borrowers who wanted the money to consolidate debts (PL). The

Marital Status	Distribution of	Number of Years Continuously in Debt					
	Sample	1	2-4	5-8	9-12	13+	
Married	79	86	75	82	80	73	
Other	21	14	25	18	20	27	
Totals	100	100	100	100	100	100	
Total Number of Years	101	13	41	20	16	10	

Table 26

Marital Status of Borrowers According to Previous Indebtedness to Finance Company In Percentages, 383 Observations^a

Marital Status	Distribution of	Number of Previous Loans				
	Sample	1 -	2-4	5-8	9+	
Married Other	79 21	87 13	72 28	78 22	80 20	
Totals	100	100	100	100	100	
Total Number of Previous Loans	100	23	35	21	21	
Chi square statistic = 7.43 (7	.81 at 5 percent les	vel of sig	znificanc	c.)		_

Chi square statistic = 3.76 (9.49 at 5 percent level of significance.)

⁸All those of the sample of 450 for whom data on salary and previous indebtedness are available.

Number of Dependents	Distribution of Sample	Number of Years Continuously in Debt					
		1	2-4	5-8	9-12	13+	
None	23	14	22	29	16	38	
One	18	14	18	18	18	24	
Two	19	20	21	9	21	19	
Three	15	16	18	14	16	5	
Four	16	22	11	23	18	8	
Five and over	9	14	10	_6	<u>10</u>	5	
Totals	100	100	100	99	99	99	
Total Number of Years	101	13	42	20	10	10	

Number of Dependents of Borrowers According to Previous Indebtedness to Finance Company In Percentages, 383 Observations⁸

Chi square statistic = 25.99 (31.40 at 5 percent level of significance.)

Number of Dependents	Distribution	Number of Previous Loans				
	of Sample	1	2-4	5-8	9+	
None	23	19	23	18	32	
One	18	12	20	20	20	
Two	19	22	15	21	18	
Three	15	17	18	12	12	
Four	16	15	15	21	12	
Five and over	9	15	9		6	
Totals	100	100	100	99	100	
Total Number of Previous	100			- 1		
Loans	100	23	35	21	21	
Chi square statistic = 16.36 (25.00 at 5 percent	t level of s	ignificance)		

^a All those of the sample of 460 for whom data on salary and previous indebtedness are available.

long term borrowers appear not to be professional workers (CD), people making less than \$80 a week (PL), and those under 34 years of age (CD and PL). Very long term debtors (those in debt continuously for 13 or more years) particularly include *fewer* than expected borrowers with three or more dependents and those who wanted money for medical bills, furniture and home improvements. Short term debtors (those continuously in debt for less than four years = CD, or with one previous loan =PL) tend to be unskilled workers (CD and PL), people earning less than \$80 a week (PL), those under 24 (CD) or 34(PL), married (CD and PL), people with five or more dependents (CD and PL), and those whose primary reason for borrowing was to pay medical bills (CD and PL). Short term borrowers appear *not* to be skilled and semi-skilled workers and white collar workers (CD and PL), people making over \$161 a week (PL), those between 45 and 64 years of age (CD and PL), unmarried people, or those with one or no dependents (CD and PL). The portrait of the long term borrower that emerges from the data reviewed is not consistent with the view that they are a homogeneous group who are ill equipped to handle their financial affairs. Rather their occupations, salaries, marital status, number of dependents, and stated reasons for borrowing show that they are diverse. Only age is significantly (and obviously) related to previous indebtedness. Further, the relationship between the borrowers' characteristics and whether they are short or long term debtors shown by the data are consistent with (though of course do not prove) the view of borrowers as rational consumers whose debts reflect their economic and family positions and need for credit. As a further test of whether long term

Table 28

Primary Reason for Original Borrowing According to Previous Indebtedness of Borrowers to Finance Company

Primary Reason for Borrowing	Distribution	Number of Years Continuously in Debt					
	of Sample	1	2-4	5-8	9-12	13+	
Consolidate debts Used car	51 16	52 15	49 19	4 7 13	49 15	66 16	
Medical bills Eurniture and household	8	13	9	9 13	5	3	
Home improvements	8	6	9	9	10	5	
Miscellaneous	5	4	4	5	10	5	
Totals	99	100	100	99	100	101	
Total Number of Years	101	13	42	20	16	10	

In Percentages, 389 Observations^a

Chi	square statistic •	= 6.30 (36.41 at	t five percent lev	el of significance)
-----	--------------------	------------------	--------------------	---------------------

Primary Reason for	Distribution	Number of Previous Loans					
Borrowing	of Sample	1	2-4	5-8	9+		
Consolidate debts	51	54	51	45	54		
Used car	16	17	14	19	16		
Medical bills	8	11	9	8	5		
Furniture and household	8	3	11	8	6		
Home improvements	8	6	7	12	8		
School related expense	3	3	3	2	4		
Miscellaneous	5	6	_4	5			
Totals	99	100	99	99	100		
Total Previous Loans	100	23	35	21	21		

Chi square statistic = 11.96 (28.86 at five percent level of significance)

² All those of the sample of 460 for whom data on salary and previous indebtedness are available.

Borrowers' Feelings About Not Being Able to Borrow from Finance Company According to Previous Indebtedness to Company

Borrowers' Feelings	Distribution of Sample	Number of Years Continuously in Debt					
		1	2-4	5-8	9-12	13+	
Felt better off	54	48	56	59	51	50	
Felt worse off	22	31	20	20	23	26	
Felt about the same					26		
Totals	99	100	100	100	100	100	
Total number of years	101	13	42	20	16	10	

In Percentages, 389 Observations^a

Chi square statistic = 4.26 (15.50 at five percent level of significance)

	Number of Previous Loans				
of Sample	1	2-4	5-8	9+	
54	48	55	57	57	
22	25	21	25	19	
23	_27		<u>_18</u>		
99	100	100	100	100	
99	23	34	21	21	
	^o of Sample 54 22 23 99 99	'of Sample 1 54 48 22 25 23 27 99 100 99 23	of Sample 1 2-4 54 48 55 22 25 21 23 27 24 99 100 100 99 23 34	of Sample 1 2-4 5-8 54 48 55 57 22 25 21 25 23 27 24 18 99 100 100 100 99 23 34 21	

Chi square statistic = 3.32 (12.60 at five percent level of significance)

^a All those of the sample of 460 for whom data on salary and previous indebtedness are available.

indebtedness is "bad" for consumers and/or society, the relationship between such borrowing and bankruptcies is considered next.

Long Term Borrowing and Bankruptcy

Concern over the number of personal bankruptcies filed in Maine was an important reason for the enactment of the 36 month rule. In a speech supporting the legislation on April 5, 1967, Senator Peter Mills said:

The real question, however, is why do people become so indebted that they cannot meet their monthly payments and, therefore, are compelled to file bankruptcy. The main reason for this is the:

- (a) high cost of credit
- (b) on unreasonable large indebtedness
- (c) for long periods of time [capitals in original a, b and c]

Referee in Bankruptcy Poulos also considers long term indebtedness an important cause of bankruptcies,³² perhaps because he comes in direct and frequent contact with those who declare bankruptcy and their creditors.

Table	30
-------	----

Number of Descrites	Cases in	Bankruptcy	Good Customers		
	Number	Percentage	Number	Percentage	
0 1 2	2 59 13	2.2 65.6 14.4	0 17 18	0.0 14.0 14.9	
3 4 5	2 1 3	2.2 1.1 3.3	11 4 9	9.1 3.3 7.4	
6 7 8 9	1 1 1	1.1 1.1 1.1 1.1	6 4 6 3	5.0 3.3 5.0 2.5	
10 11 12+	1 2 3	1.1 2.2 3.3	7 1 35	5.8 .8 28.9	
	90	99.8	121	100.0	
No information	<u>261</u>	290.0	<u>116</u>	95 .9	
	351		237		

Number of Times Loan was Previously Rewritten at a Large Finance Company

Aside from the important philosophical (and empirical) question of whether bankruptcy is detrimental to consumer welfare, the preliminary question to be answered is whether long term indebtedness is associated with (or a causal factor of) bankruptcies. Some data on this question were gathered by Referee Poulos from 351 bankruptcy cases on file as of June 13, 1972, in which a particular finance company was the principal creditor. Referee Poulos' staff analyzed the files available to them and determined the number of times the loan in question had previously been rewritten (with or without an additional cash advance). This determination could be made for 90 of these loans. Table 30 gives the number and percentage of the number of rewrites of this total compared to similar data, from the same company, of borrowers who were included in the sample described above. It is clear from Table 30 that the people who declared bankruptcy had renewed their loans far fewer times than those who were considered good customers by the finance company and who, when credit was cut off, did not declare bankruptcy. Thus the available data are contrary to the belief that long term indebtedness is associated with bankruptcy and hence is unlikely to be a causal factor of bankruptcy. Rather, as several studies have shown, bankruptcy appears related to harsh wage garnishments and unexpected costly medical problems, job losses and marriage failures³³

Summary and Recapitulation

This study analyzes the arguments for and against allowing finance companies to lend originally or extend a loan for more than 36 months without incurring the severe penalty of having the balance unpaid after 36 months carry a maximum rate of 8 percent simple. Maine passed such a law in 1967, in large measure because the legislators and others ("regulators") believed that long term indebtedness to high interest rate lenders resulted in a form of "economic slavery." The regulators' arguments are based on a belief that borrowers either are not good judges of the future effect of their present action of borrowing and/or are enticed into long term, high rate borrowing by finance companies, from which they cannot extricate themselves. Those opposed to the legislation ("anti-regulators") believe that consumers can and do make rational borrowing decisions and that, in any event, the finance companies simply respond to rather than create demands for credit. Aside from this basic perceptual disagreement, the regulators and anti-regulators disagree about the effect of the legislation on the availability of credit in the state.

There is no doubt that the number of finance companies and offices operating in Maine has declined drastically since the 36 month rule was passed in 1967, as shown by Figure 1 and Tables 1 and 2. This figure also provides a test of the regulators' hypothesis that national companies left the state deliberately to show other states what would happen should they pass a law such as that enacted in Maine. The equivalent decline in the number of local companies and offices (who could not benefit from such an action) and national companies and offices is contrary to the hypothesis.

The virtual elimination of finance companies as lenders in Maine is explained best with an analysis of their operations and costs. In deciding whether to lend to a potential customer, the companies consider the profitability of the entire relationship. The net cash flow from subsequent, as well as the first, loans is discounted. To an extent (smaller than expected), lending to new borrowers is more costly than lending to present or former borrowers. The major advantages in a long term relationship seem to rest on a reduction in losses by permitting a customer to extend payments and in the fact that longer term borrowers generally have larger outstanding balances than new borrowers. The finance companies provide customers with "personalized" service; the loan office managers know their clients individually and learn to judge how much debt the clients can carry. When a borrower gets behind in payments, perhaps because he has lost his job or had an unexpected expense, the manager can reduce the required payment by extending the debt. He also may lend the borrower an additional amount, to "tide him over." With the 36 month limitation in effect, such extensions become prohibitively unprofitable and losses mount.

The other aspect of finance company operations is that loans to new and one time borrowers often are not profitable. The companies' operating costs are a function primarily of the number rather than the amount of loans they service; thus making and processing a \$400 loan costs about as much per year as a \$700 loan. Consequently, the rate ceilings allowable in Maine (particularly since the ceiling on loans under \$150 was lowered in 1967) do not provide enough revenue to make loans of less than \$300 to \$400 profitable. But new customers generally borrow less than present customers who increase and/or extend their loans. In 1966, new loans in Maine averaged \$447 compared to \$718 for loans to present borrowers. Hence, a customer relationship often if profitable only if the companies can expect that a fairly large percentage of new customers will borrow additional amounts in the future. With the 36 month limitation in effect, this expectation is removed.

The data analyzed are consistent with these explanations. The loss rate in Maine averaged 2.2 percent before the 36 month limitation was enacted in 1967; in 1968 it was 3.25 percent and in 1969 (the latest year for which these data are available), 4.10 percent. The average cost per loan computed was \$56 in the early 1960's, \$70 in the middle 1960's and \$82 in the later 1960's (Table 5). As Figure 2 shows, these costs make loans under \$240 unprofitable without consideration of interest, losses, income taxes, and return on capital. Further evidence is derived from the fact that when the ceiling rate on loans under \$150 was dropped from 36 to 30 percent in 1967, the companies virtually ceased making loans under \$100 in size (Figure 3). Also, the average size of a new loan made in Maine after 1967 was about equal to the size of a loan made to a present customer (Figure 4).

It has been claimed, on the one hand, that the companies were sufficiently profitable to absorb the increased costs of the ceiling rate reduction and the 36 month limitation and, on the other, that they would have left Maine anyway since the size of office they could operate was not economical (economies of scale are assumed). Calculation of the companies' rate of return on assets (Figure 5 and Tables 6 and 7) show that they hardly could be described as "very profitable." Nor do the data give any evidence of economies of scale (Table 4). However, the data do show that the companies' share of the market and amount of loans was declining before 1967 (Figure 6). A major reason for this decline was the increase in their operating costs and in the cost of money and the rigid ceiling on interest rates they could charge, which resulted in a decline in their rate of return. Thus, the effect of the 36 month limitation together with the ceiling rate reduction (and perhaps the actions of the Referee in Bankruptcy, Mr. Poulos, in reducing their income from insurance and recoveries of bad debts) resulted in a decline in profitability that forced the companies to reduce and eventually cease operations in Maine.

The effect of the reduction in finance company lending, in the aggregate, appears to be reflected in a lower amount of loan dollars supplied relative to the amount demanded, particularly in 1968, 1969 and 1970 (Table 8). Much of the apparent increase in the amount of loans supplied is due to changes in the price level since 1967 that inflate the figures. Nevertheless, the increases in loans made by credit unions (and, to a much lesser extent, by banks) do offset loans not made by finance companies, in the aggregate. However, the aggregate data are not adequate to determine whether those who otherwise would have borrowed at finance companies were served by other lenders. Therefore, a survey of these people was undertaken.

Four hundred sixty people, good customers of finance companies who wanted to borrow but to whom the companies would not lend because of reduced operations in Maine, were surveyed. Half did not obtain funds elsewhere. Of the other half, 40 percent borrowed from other finance companies, 33 percent from banks, 21 percent from credit unions, and 6 percent from other sources. (None said they borrowed from loan sharks.) Those who did and did not otherwise obtain funds do not differ significantly in such characteristics as occupation, salary, age, marital status, number of dependents, percent of loan unpaid at the time, and years in debt and previous loans to the finance company (Table 18). The only statistically significant difference was in the reason for borrowing: a higher percentage of those who obtained funds wanted them to consolidate debts or buy a used car while relatively more of those who did not obtain funds wanted money to buy furniture and household items (Table 16). Thus, there do not appear to be any obvious (or at least, tested for) reasons for half of those surveyed having been able to borrow compared to the half who didn't. Most (77 percent) of the half who didn't obtain funds paid off their loans regularly, while the balance (except for one person who declared bankruptcy), missed some payments in paying off their loans.

When asked their feelings about the situation (Table 17), 55 percent of the people surveyed said they "felt better," primarily because they were "rid of the burden of the finance company" or were borrowing from a "better institution." Twenty-two percent said they felt worse and 23 percent said they felt about the same. Of the total only 6 percent said they felt worse because "there was no other alternative available." Tests of differences among the interviewees according to their feelings about not being able to borrow from the finance company revealed no significant differences (Table 18). In interpreting these findings, one should recognize that people who borrow from what they know to be high cost "lenders of last resort" often are not proud of their situation. They were surveyed at about the time that they had managed to pay off their loans or made other, often preferable, arrangements. The pain of repayment was past and the pleasure of freedom from debt prevailed.

The occupations, salaries, age, martial status, number of dependents, and reason for borrowing of long and short term debtors were compared to determine whether long term borrowers are a group that appears in need of state protection. No statistically significant differences were found in these comparisons (Tables 23-29). The differences that did emerge show long term borrowers to be a diverse group whose period of indebtedness seems to reflect rationally their economic and family positions and need for credit.

Finally, the belief of regulators that long term indebtedness results in bankruptcy was tested. The number of loans previously made to people who subsequently declared bankruptcy was compared to the number made to customers of the same company whom they considered to be good risks (none of whom, in fact, went bankrupt when the company did not extend further instant gratification, or who cannot withstand temptation can be taken credit to them) (Table 30). The percentage of long term borrowers was far greater among those who did not declare bankruptcy compared to those who did. In fact, the majority of bankrupts were relatively new customers of the company.

Policy Conclusions

It seems clear that, regardless of its intended purpose, the 36 month limitation was a prime causal factor of most finance companies leaving the state of Maine. Their leaving appears to be the result of the rate ceiling imposed by the state, which makes the revenue derivable from small loans less than the associated operating costs, and on the 36 month limitation, which makes a compensating long term relationship impossible. As a consequence, many people who want to borrow small amounts are not served and loans under \$100 are rarely made. Half of the borrowers surveyed who previously were considered good customers of the finance companies did not obtain funds when they wanted them. Nor are persons served who would be one time borrowers.

"But," regulators might argue, "on balance this is a good situation. Even most of those who could not obtain funds felt better off." In part this objection is valid and in part it is not. First, people who had not been good borrowers from finance companies were not surveyed. The companies often serve people who, because of their occupation, salary, age, and lack of previous credit record, may not be considered good risks by commercial banks or be able to join a credit union. What of those to whom banks will not lend and those for whom credit union membership is not available?

Collaterally, would even the 27 percent of the former finance company customers surveyed who borrowed the funds they wanted from banks and credit unions have been accepted by these institutions had they not established good credit records by previous borrowing from a finance company? The law that "forced" these borrowers to go to lower cost lenders probably benefited most of them, since otherwise they might have continued to borrow at much higher rates at the finance companies in the belief that banks and credit unions wouldn't give them credit, even though some of these people may have found these alternative institutions to be less flexible or personal in meeting their needs. However, the banks and credit unions are unlikely to offer credit to new borrowers who appear to lack the discipline or ability to handle credit. How will these people be able to establish a favorable credit rating? How can they "graduate" from finance companies to lower cost lenders if the finance companies don't exist?

Second, is the 36 month rule really effective? The data show that most companies in Maine did cease or reduce and change their operations as a result, although some others may have evaded the law. Of those former finance company customers surveyed who obtained funds, 40 percent borrowed from other finance companies. Many interviewees said they were told to give their present company a check to repay their loan on one day and borrow the next day from company X. They needn't worry about the check "bouncing," since the first company wouldn't "get around" to depositing it for several days. This trading of customers between companies effectively nullifies the 36 month limitation, though at some cost and risk to the companies and, therefore, to their clients.³⁴

It should be emphasized, however, that the decline in the number of finance company dollars of loans outstanding indicates that the evasion was quite limited in scope. Two factors may explain the general inability or unwillingness of finance companies to evade the law. One is the fear of being caught; Mr. Poulos, the Referee in Bankruptcy, is an able and tenacious supporter of the law whom the finance companies have reason to fear. The Bank Commissioner also attempts to catch and punish violators of the law and regulations. The other is the past competitive nature of the industry which makes it difficult for rival companies to "cooperate" in sending each other their good customers. However, if the situation in Maine in the future follows the pattern of regulations in most states, the zealous supporters of legislation will shift their attention to other concerns and companies will overcome their past rivalry in favor of collusion.

Third, will people who have paid off loans or not made them remain out of debt if finance companies do not exist to serve them? One should recall that small loan legislation was passed in 1916 to allow lenders to provide money at higher than the usual usury rates when it finally became obvious that people were borrowing from loan sharks who exacted a far higher toll than would have been charged by legal lenders. While no evidence of loan sharking was found in the survey done for this study, the experience of other states and times speaks otherwise. But even if illegal lenders do not take the place of the finance companies, people still will have to pay for the credit they demand. Studies of the effect of severe usury laws on prices and credit provide evidence of what happens when laws make normal lending impossible. Arkansas has a rigidly enforced 10 percent simple usury law, with no provision for small loans (the Small Loan Act was repealed in 1954). A very careful study of the effect of this law by George C. Lynch³⁵ shows clearly and conclusively that, as a result, non-locally produced goods cost more in Arkansas than in comparable out-of-state areas since retailers raise their prices to compensate for excess credit costs. Consequently, people who pay cash for goods are penalized, as are retailers located in towns near other states where other retailers can offer lower prices to cash customers. If people who borrow do so because they wish to buy goods or services or meet what they consider to be necessary obligations, the absence of finance companies cannot prevent merchants from raising their prices. Cash customers must pay for credit they don't want and people who want credit must purchase goods from a specific merchant; both groups pay more.

Finally, what of the argument that finance companies keep people in debt by "forcing money on them"? No doubt this claim is true for some people and some lenders. People who are impulse buyers, who must achieve advantage of. Unfortunately, perhaps, prohibition never before has been a successful remedy for similar maladies. Drunks rarely are reformed for long by closing the bars and liquor stores. Nor does it seem fair to penalize those who can handle credit for the shortcomings of those who can't.

Several salutary changes can be made, however. First, the 36 month limitation should be repealed. Second, the ceiling rate on small loans should be restated to allow lenders a return that makes providing small loans worthwhile. The ceiling should be stated as an amount per loan to cover operations costs plus a rate per dollar to cover interest, risk and capital costs. The data presented in this study suggest about \$80 per loan and, perhaps, 12 to 15 percent per dollar. Since renewals are somewhat less expensive for lenders and if emphasis on loan renewals by finance companies is not to be encouraged, the allowable amount for a renewal might be \$70 or so. These amounts should be tied to and automatically adjusted by a price level index (such as the GNP deflator) and an interest rate index (such as the rate on finance company loans reported in the Federal Reserve Bulletin). Third, some possible abuses should be corrected. One is that the creditors' defense of fraud in bankruptcy proceedings might be disallowed, as suggested in a comprehensive study by Philip Shuchman.³⁶ Another is removal of the limitation that a consumer can declare bankruptcy only once in six years. The present limitation makes it desirable for lenders to extend possibly improvident loans to people who have just completed bankruptcy.³⁷ These changes (and the others recently enacted that eliminated debtors' prison and holder in due course defenses) should make it easier for borrowers to be relieved of debts that they cannot carry and put creditors on notice that overburdening debtors is not profitable. But, creditors also should be allowed to have the debtor voluntarily agree to automatic loan repayments by means of payroll deductions, such as are available to credit unions. At the same time, credit unions should be allowed to offer loans to much wider groups. This competition among lenders can serve to provide borrowers with better and less expensive service.

Finally, those people who are unable to manage their affairs need help, much as do alcoholics. Organizations such as the Credit Counseling Centers should be encouraged and supported. Other direct aid to the poor and ignorant, such as education about the costs of borrowing and the value of saving, might be offered by government. But, in a free society, this type of help and the fair enforcement of laws should be the extent and limit of governmental "concern."

FOOTNOTES

*Professor, Graduate School of Management and Center for Research in Government Policy and Business, University of Rochester. This paper was supported by and prepared for the National Commission on Consumer Finance (as of December 1972), who do not necessarily support the views expressed herein. Thanks are due to Neil Murphy, James Kershner and Dan Sullivan of the University of Maine, who supervised and conducted the survey of borrowers; Richard Poulos and Gerald Cope, who provided background documents; the finance companies and the State of Maine Banking Department, who generously provided

data without knowing whether these would be used for or against them (or used competently and honestly, as I hope has been the case); and Kim Benston, Joe Safier and Marie Robare, who aided in research and typing. Of course, they are not responsible for and may not agree with the paper.

¹Doubt about the morality and value to society of money lending, particularly by high rate lenders, still underlies much legislation, as illustrated in speeches of Maine State Senator Peter Mills, the leading proponent of the restrictive finance company legislation analyzed below: "As I said a while ago, you would think that [the finance companies] were manufacturing shoes or producing something good for the economy if you read the official reports in regard to [t] heir expansion over the State. I don't think it is a good thing for the Sta[t] e to have eight or ten of them in Augusta, or five or six in Skowhegan. and I will explain why. They are not like banks. They are not doing a banking business. They are not in there providing a service to people who need money in trouble. They are pandering these loans. They are pushing these loans onto people who shouldn't have them." Journal, Maine State Senate, June 8, 1967, debate on Senate Amendment "A" to bill "An Act Revising Laws Relating to Licensed Small Loan Agencies" (H.P. 468) (L.D. 681). (Note: At the time of this statement, there were six loan company offices in Augusta and three in Skowhegan.)

²Under present law, the interest charges on such a loan, if repaid in twelve installments of \$186.26, would be \$235. If no payments were made until the end of one year, the interest would be \$396.

³Richard E. Poulos, "Proposed Revisions for the Treatment of Uncontrovertable Claims in Chapter XIII Proceedings," unpublished, undated paper, pp. 24-25.

⁴The referee in bankruptcy is appointed for a renewable six-year term by the Federal District Court for the district in which he sits. The referee must be a lawyer. He occupies a judicial position in that almost all cases filed under the Federal Bankruptcy Act are automatically referred to him. His decisions may be appealed to the district court and thence to the federal court of appeals and the Supreme Court of the United States. In wage earner cases under Chapter XIII of the Bankruptcy Act the referee appoints a trustee to administer debtors' repayment plans. In ordinary bankruptcy cases, in which the debtor's assets are liquidated for distribution to his creditors and the debtor obtains a discharge, the referee appoints a trustee if the creditors fail to elect one.

⁵In re Richards, CCH Installment Credit Guide, 98.556, January 4, 1966. Also see In re Perry, 272 F Supp 73 (D Me. 1967), affirming Referee Poulos' decision that under Section 656(b) of the Federal Bankruptcy Act, a claim for repayment would be totally disallowed unless the lender could prove that the loan was free from usury. Because the finance companies were charging the maximum rates allowed for interest, creditors' insurance charges that they could not prove to be "not excessive" were held additional interest that was usurious. All except one company chose to settle their claims at about 50 percent of the amount due rather than attempt the required proof.

⁶Alan R. Andreasen, "Consumerism in the Inner City," unpublished paper, May 1972, presented at the Consumer Affairs Conference at the University of Rochester. ⁷Ibid., p. 14.

⁸A serious flaw in the logic of this argument must be pointed out. If loan companies find renewals profitable because they can use legal and quasi-legal methods to force borrowers to pay off loans that otherwise would be defaulted, severe limitations on creditors' collection remedies would cause loan companies to abandon renewals and concentrate on short term loans. In this event, a legal penalty for extended maturities would not be necessary. However, regulators might retort that the loan companies can avoid restrictions on their collection practices because they deal with unsophisticated customers who are unaware of the creditors' actual legal powers and thus can be bullied or tricked into signing away their rights. The 36 month limitation, on the other hand, is a relatively unambiguous, easily enforced control.

⁹George J. Benston, "The Costs to Consumer Finance Companies of Extending Consumer Credit", prepared for the National Commission on Consumer Finance.

¹⁰Ibid.

¹¹Ibid.

¹²For example, Gerald Cope (Trustee to Richard Poulos, Referee in Bankruptcy) wrote to Rodney Scribner, State Controller, on January 20, 1971: "The reduction in the number of offices of small loan companies is explained from other circumstances to the exclusion of the 36 month rule. The cost factor of maintaining offices with small loan volumes became evident to the industry in the middle sixties and most companies had undertaken a concentration of their business in fewer offices prior to the enactment of the 36 month rule legislation."

¹³Benston, Op. Cit.

¹⁴Since all the data are in logarithms, the coefficients measure elasticities directly. For example, the 1960 coefficient of 1.18 indicates that a 10 percent increase in the number of loans outstanding might result in an 11.8 percent increase in operating expenses.

¹⁵Since total expense = $TE = b_1 NLO^{b_2} (NLM/O)^{b_3} (NLL/M)^{b_4}$ etc., setting NLL/M to 1, average cost = $TE/NLO = b_1 NLO^{b_2-1} (NLM/O)^{b_3}$ etc., where bars denote geometric means. Marginal costs can be calculated by multiplying average cost by b₂. Since b_2 is not significantly different from 1, these calculations are not presented.

¹⁶It is interesting to note that the operating costs per loan in 1968, 1969 and 1970 estimated from data from 124 national companies averaged \$72. (Benston, Op. Cit.)

¹⁷Table 4 shows that local companies reported costs are higher than those of national companies, cet. par. From interviews, I believe that the local companies, who need not rely on pre-established policies as much as do the national companies, can discriminate among customers better and hence can accept more smaller loans.

¹⁸Unpublished National Consumer Finance Association data.

¹⁹The actual proceeds are adjusted up or down to make the monthly payments

equal, even dollar amounts. ²⁰The annual average rate of finance company paper placed directly, 3 to 6 months, was (from 1954) 1.42, 1.97, 3.06, 3.55, 2.12, 3.82, (1959), 3.54, 2.68, 3.07, 3.40, 3.83, 4.27 (1965), 5.42, 4.89, 5.69, 7.16, 7.23 (1970), 4.91. [Federal Reserve Bulletin, various issues.]

²¹ In 1969, federal credit unions in Maine had "notes payable" of \$3.2 million and total assets of \$82.3 million while state credit unions had borrowings of \$.4 million and total assets of \$22.1 million.

²²This belief is supported by evidence presented by Ryland A. Taylor, "The Demand for Credit Union Shares: A Cross-Sectional Analysis," Journal of Financial and Quantitative Analysis, VII (June 1972), 1749-56.

²³For an example related to consumer loans, see Walter Nicholson, "A Simultaneous Model of the Demand for Consumers' Durable Goods and Consumer Credit," unpublished paper presented at the Winter Meetings of the Econometric Society, New York, December 23, 1969.

²⁴See Maw Lin Yee, "An Analysis of Installment Borrowing by Durable Goods Buyers," Econometrica, 30 (October 1962), 770-87; Helen M. Hunter, "A Behavioral Model of the Long Run Growth of Aggregate Consumer Credit in the United States." Review of Economics and Statistics, May 1966, 124-140; Horace J. DePodwin and Howard N. Ross, The Supply and Demand for Personal Credit in New York State, 1950-1970, Savings Bank Association of New York State (New York, 1965); and James F. Smith, The Demand for Consumer Credit Since 1948: A Dynamic Stock-Adjustment Approach, unpublished dissertation, Southern Methodist University, May, 1971.

²⁵A forecasting model, in which both supply and demand factors were included, could not be specified, since annual data on consumer loan costs at commercial banks in Maine are not available.

²⁶Equation (9) also was stated in terms of changes, in an attempt to reduce the problem of autocorrelation of the residuals. However, this form proved to have a lower Durbin-Watson statistic and higher first order autocorrelation of residuals, as well as a worse fit to the data.

²⁷Initially, borrowers were sent a letter that informed them of the study and that they would be contacted by telephone, assured them that they would not be "sold anything," that the information gathered would be kept confidential and that the study might benefit them. The letters appeared to be ignored completely. Consequently this procedure was abandoned.

²⁸A measured chi square statistic as large or larger than that at the five percent level of significance indicates that the relationship measured could have occured by chance no more than five times in a hundred. Thus, in Table 15, the measured chi square for occupation between the A vs. R. samples of 2.48 compared to the chi square at the 5 percent level of 11.10 is considered evidence of an "insignificant" difference in the occupations of borrowers in the two groups.

²⁹ John B. Lansing, Gerald P. Ginsburg, and Kaisa Braaten, "A Pilot Study of Characteristics of People who Borrow Cash from Small Loan Companies," Survey Research Center, Institute for Social Research, University of Michigan, December 1957, mimeographed. ³⁰The percentage distributions of the sample are weighted averages of the

³⁰The percentage distributions of the sample are weighted averages of the percentages in the number of years or loans rows, the weights being the percentage of each number of years or loans grouping to the total. These percentages are given at the foot of the columns.

³¹It is interesting to note that this group is not characterized by a much greater number of years in debt than expected, which indicated that they may have rewritten their loans more often.

³²See last sentence of quote on page 2 above.

³³See David T. Stanley and Marjorie Girth, *Bankruptcy: Problem, Process, Reform.* The Brookings Institution (Washington, D.C., 1971); and Philip Shuchman and Gerald R. Jantscher, "Effects of the Federal Minimum Exemption from Wage Garnishments on Nonbusiness Bankruptcy Rates," *Commercial Law Journal*, November 1972, pp. 360-3.

³⁴The practice is illegal where a NSF check is issued to a company who afterwards makes a loan. After a hearing before the Bank Commissioner, one licensee was required to refund more than \$20,000 because of violations involving this practice.

³⁵Gene C. Lynch, "Consumer Credit at Ten Percent Simple: The Arkansas Case," Law Forum University of Illinois, 1968, pp. 592-618.

³⁶Philip Shuchman, "The Fraud Exception in Consumer Bankruptcy," Stanford Law Review, 23 (April 1971), pp. 735-73.
 ³⁷Sce analysis and proposals by Conrad K. Cyr, Referee in Bankruptcy, Bangor,

³ 'See analysis and proposals by Conrad K. Cyr, Referee in Bankruptcy, Bangor, Maine, "Single Claim Jurisdiction for the United States Court of Consumer Affairs: An Interim Proposal for Relevant Regulation of Consumer Credit," unpublished, undated paper.