

A Report to the Nation from the Commission on Thrift

For a New Thrift

Confronting the Debt Culture



**Institute for American Values
Institute for Advanced Studies in Culture
New America Foundation
Public Agenda**

**Demos
Consumer Federation of America
National Federation of Community
Development Credit Unions**

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Being listed as a member of the Commission on Thrift designates only the signatory's overall endorsement of the report, *For a New Thrift*.

For more information on this initiative, visit www.NewThrift.org.

On the cover (clockwise): Rent-A-Center Truck, (Merrillville, IN); Jack's Pawn Shop (Gary, IN); Quick Sam Tax Refund (Gary, IN); Payday Loan Store at Night (Merrillville, IN). Photos by Tamara Reichberg, 2007.

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Introduction

THE UNITED STATES IS EXPERIENCING a growing polarization in access to institutional opportunities to save and build wealth. For most of the twentieth century, nearly all Americans had access to grassroots institutions that helped them to save and to build a nest egg. These institutions included local retail banks, mutual savings banks, credit unions, savers' clubs, school savings bond programs, building and loan associations, savings and loans, and labor union-sponsored savings plans. Some institutions, such as credit unions, building and loans, and labor union plans, grew out of a cooperative, nonprofit banking tradition expressly created for the "small saver." But local retail banks also offered passbook savings accounts and children's savings programs for families of modest means. Together, these institutions constituted a broadly democratic "pro-thrift" sector of the financial service industry.



In addition to providing opportunities to save, pro-thrift institutions also limited the amount of debt that consumers could take on. Banks had strict rules for consumer lending. Americans who wanted to buy a house had to accumulate savings, apply to a local bank, document their credit-worthiness, undergo the scrutiny of the lending institution, and usually make a 20 percent down payment. Lending institutions were likewise constrained by government rules. Federal and state regulations set limits on the interest and fees lenders could impose. Finally, some forms of thriftlessness were outlawed entirely. Lotteries were illegal in all states; usury laws prohibited predatory interest rates; casino gambling was allowed in just a few venues, like Las Vegas and Atlantic City. To be sure, some Americans still borrowed from loan sharks, pawned their wedding rings, or gambled away the family farm. But these actions were widely viewed as disreputable, desperate, and beyond the pale of authoritative institutions.

Today, however, the institutional landscape looks much different. A pro-thrift sector still exists, but it is no longer broadly democratic in its reach. The institutions that encourage thrift have moved uptown. Major commercial banks and brokerages offer an ever-wider array of tax-advantaged opportunities to invest and build wealth. But in the wake of government deregulation and industry consolidation of the 1980s and 1990s, many leading financial institutions have abandoned the "small saver." Instead, they now focus on providing concierge services to Americans in the upper half of the income distribution. Changes in tax laws have also contributed to this upscale trend. Subsidies for savings now total more than \$300 billion a year and

go mainly to wealthier households that already have the means to take advantage of these tax incentives.

Meanwhile, new financial institutions have emerged to serve Americans whose wages or economic circumstances have locked them into the lower half of the income distribution. These institutions include a number of highly profitable businesses: subprime credit card issuers, payday lenders, rent-to-own merchants, auto title lenders, private student loan companies, some franchise tax preparers, check cashing outlets, and subprime mortgage brokers and lenders. Once a marginal presence on the financial landscape, these institutions now constitute a large and aggressively expanding sector. But this new sector is not pro-thrift. Quite the opposite. It is anti-thrift. And it is the growing influence of the anti-thrift sector that is dragging many American consumers into dissavings and overindebtedness.

Some anti-thrift institutions, such as the payday lenders, have become the new “people’s banks.” They provide face-to-face relationships, convenient service, and easy access that many small savers of modest means once found at the local bank and neighborhood savings and loan. Unlike the neighborhood pro-thrift institutions, however, the neighborhood anti-thrifts don’t offer opportunities to save through interest-bearing checking or savings accounts, CDs, or IRAs. Their business is limited to providing “fast cash” and “no hassle” loans at triple-digit interest rates.

Anti-thrifts exist in the public sector as well. State governments have created their own anti-thrift institution: the state owned and operated lottery. Like the private anti-thrifts, these public anti-thrifts have emerged in recent decades. For seven decades, from 1894 until 1964, not a single legal government-sponsored lottery existed in the United States. Today, forty-two states plus the District of Columbia run lotteries.

The state lottery does not make predatory loans, but it exerts a powerful anti-thrift effect on the low and moderate-income players who are its most loyal customers. Through state-financed advertising, promotions, and new product campaigns, lotteries work relentlessly to habituate players to spend their spare cash on gambling and to regard small dollar investments in the lottery as the way to instant wealth—or, as is more often the case, to a fantasy of instant wealth.

With the swift growth and spread of the anti-thrifts, a two-tier institutional system is emerging: The top tier consists of pro-thrift institutions that provide myriad ways and means for higher earning Americans to invest and build wealth. The bottom tier



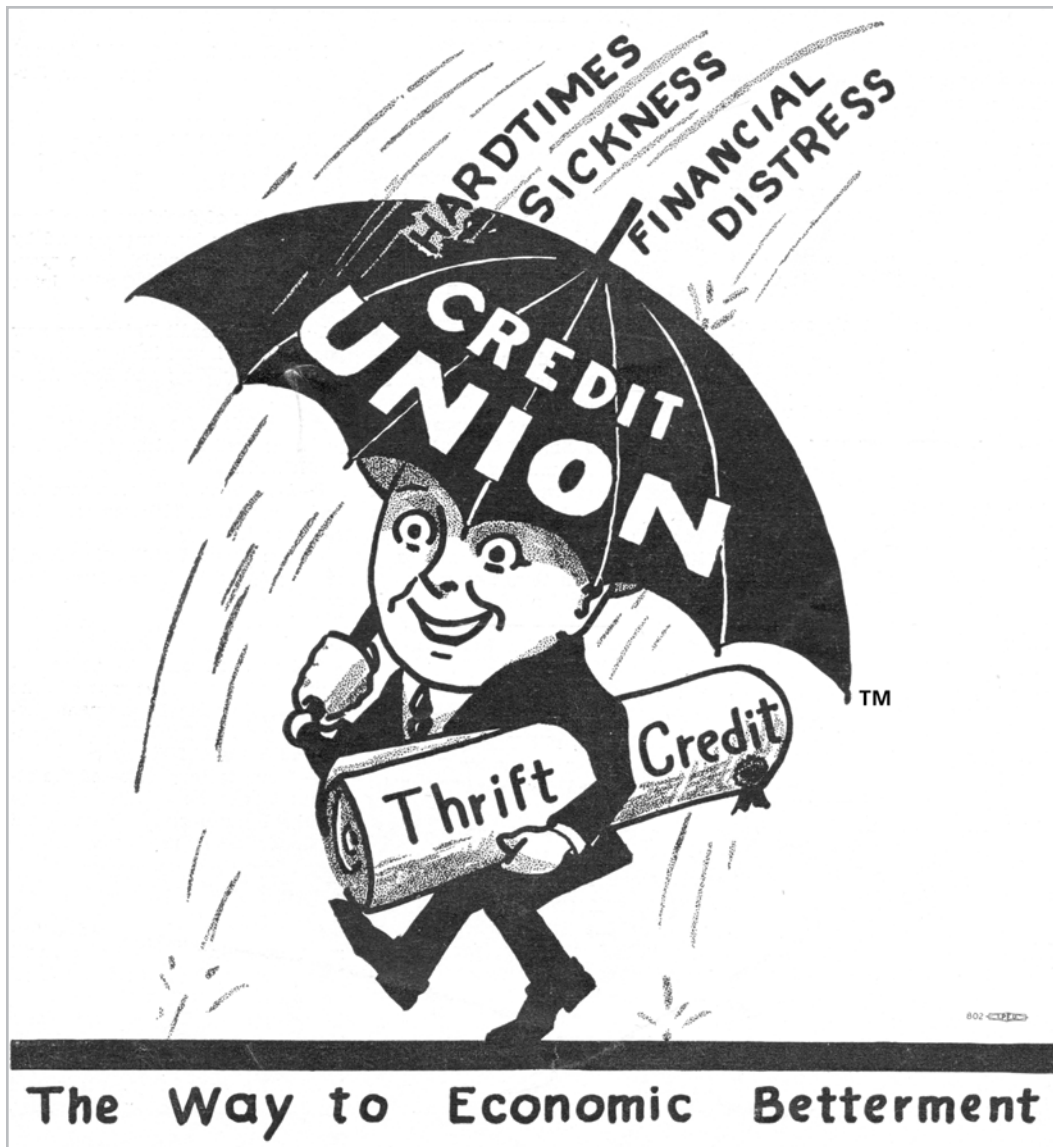
consists of anti-thrift institutions that provide multiple ways and means for lower earning Americans to forego savings, borrow at predatory interest rates, and fall into a debt trap.

THE TWO-TIER INSTITUTIONAL SYSTEM is contributing to a cleavage between an “investor class” and a “lottery class.” The higher earning members of the investor class are not necessarily smarter or more disciplined about building wealth. But they do have greater access to institutions and expertise that foster wealth-building discipline. They are beneficiaries of tax incentives and advantages linked to their savings and investment plans. They are courted and served by a bevy of insurance agents, tax lawyers, stockbrokers, tax accountants, deferred compensation experts and investment bankers who will help them with their financial planning. They are likely to work in organizations with 401(k)s, profit-sharing plans, Keogh plans, deferred income compensation plans, and retirement savings programs. With pro-thrift opportunities and disciplines so seamlessly integrated into their work culture, members of the investor class have an automatic pathway to building a nest egg. As one bank brags, its investors can “make money while they sleep.”

The lottery class, on the other hand, lacks such ready access to pro-thrift institutional disciplines. Many members of the lottery class are not working in jobs that offer benefits such as 401(k)s, profit sharing, or retirement plans. (In 2004, 70 million of America’s 153 million wage earners worked for employers without a retirement plan.¹) Nor are people in the lower half of the income distribution pursued by investment firms, tax accountants, or major banks. Instead, they are targets of payday lenders, sub-prime mortgage brokers, credit card issuers, tax refund lenders, and their friendly state lotteries. Their extra dollars do not find a convenient or automatic pathway into a savings account. Instead, they are drained off into high interest payments on predatory loans or used to support a daily lottery habit. Nor do they get tax-avoidance advice or tax advantages in return for their investments. More likely, they give up some of their tax refund dollars to franchise tax preparers in exchange for fast cash. And the leading public anti-thrift, the state lottery, imposes what amounts to an excise tax on them as well. In this way, millions of working Americans who might, under more favorable institutional circumstances, join the class of savers and investors, are now being recruited into a burgeoning population of debtors and bettors.

This is not the first time that anti-thrift institutions have stolen the dollars and dreams of so many working Americans. A century ago something similar was happening. Chattel lenders and salary lenders, more popularly known as loan sharks, were racking up huge profits by making usurious loans to a growing population of urban wage earners. In New York City alone, more than three out of ten workers owed money to the salary lenders.²

But back then, these predatory institutions did not go unchallenged. They faced fierce opposition from a small but determined band of Progressive reformers. These leaders spearheaded a campaign to drive the salary lenders out of business. They wrote social science reports and muckraking articles to expose the deceptive practices of the lenders, passed model legislation to encourage banks to compete against the loan sharks for the consumer loan market, and established a new pro-thrift institution—the credit union—to provide cooperative saving and low-cost lending as an alternative to the predatory lenders.³



At left: "Little Man Under the Umbrella," the main early symbol of the U.S. credit union movement.

Courtesy of the Credit Union National Association, Inc.

Debt and Its Discontents

THE ABILITY TO BORROW IS A GOOD THING. Or ought to be. Credit helps consumers to buy houses, get educations, start businesses, and acquire other valuable goods that may boost their job prospects and future income. As economists like to point out, consumer credit helps to smooth out spending over a lifetime—allowing people to borrow in their lower-earning years in order to build assets and investments for the future.

But easy access to consumer credit is always double-edged: It can open the door to greater opportunity and freedom, but, if promoted deceptively and used recklessly, it can close that door. As the subprime failure so painfully revealed, the binge in easy mortgage credit slammed shut a lot of doors. Foreclosures, which soared to over a million in 2007, are predicted to affect upwards of 2.5 million households in 2008. Consumer bankruptcy filings rose to 819,000 last year, and the stage is set for more than a million in 2008. In the wake of the mortgage meltdown, auto loan and credit card delinquencies are also sharply up.⁴

Even before the subprime debacle, however, many Americans were struggling with a growing debt burden. In 2004, according to the Federal Reserve's measure of burdensome debt, the typical family spent more than 18 percent of its income on debt payments, the largest share since the institution started collecting these data.⁵ Moreover, the proportion of families with debt-service payments exceeding 40 percent of their income rose to 12.2 percent in 2004.⁶ Consumer loan delinquencies also rose during this period.

Some of this debt is to be expected. Many middle-income and young families—who now make up the largest share of households in the heavy debt-service category—are at the stage in life where they are rearing children and buying big-ticket items, like houses, cars, and computers. But families have also been hit hard by stagnating wages and the rising costs of health care, food, and energy. In a recent 2008 survey, fully 58 percent of the public say that their incomes are falling behind the rising cost of living.⁷ This has led many American families to rely on credit, not as a way of building assets, but as a way of simply making ends meet.

Some aren't making it. Late fees and missed payments on credit cards have risen, costing consumers \$17.1 billion in fees in 2006. About one in every seven families report that at some point in their lives they experienced debt problems serious enough to have caused them to file for bankruptcy or to use a credit consolidator. More than one out of three Americans say that they have felt their financial situation was out of control at some point in their lives.⁸ Even those who are able to

manage high household debt are increasingly operating at the razor's edge of solvency—with little cushion to cover an unexpected expense, such as a car repair or medical emergency. In 2006, about a third of adults said that they had experienced an unexpected expense in the past year that “seriously set them back financially.”⁹

DEBT IS BURDENING YOUNG AMERICANS AS WELL. Historically, young people are often poor, but they haven't always been buried in debt. Today, however, many are. Long before they finish school and become full-time earners, teenagers and young adults are amassing a staggering amount of debt. Most college students today enter school with credit cards and acquire more cards as they go along. Forty-four percent carry forward a balance each billing period, with an average outstanding balance of more than \$2,000. Almost a quarter of undergraduates in 2004 carried balances in excess of \$3,000.¹⁰

In addition, more students are borrowing to cover the costs of their education. In 2004, two-thirds (66.4 percent) of students at four-year colleges and universities had student loan debts, compared to less than half of four-year graduates in 1993.¹¹

Borrowing for college is generally considered a “good” debt, because college graduates earn substantially more than those with only a high school diploma. Research suggests that good debt for education, however, may be reaching a tipping point where it is turning into bad debt. Compared to the early 1990s, the level of student debt has become crushingly high. Graduating seniors in the Class of 2006 left college with an average debt estimated at \$21,000 in educational loan obligations, an 8 percent increase over average student loan debt in just the previous year.¹² In addition, some college students borrow to go to school but then fail to graduate, leaving them with few of the benefits and all of the debt obligations for the years they spent in college. Further, college graduates may find that their early earnings are not as high as they had hoped or that they can't find regular employment after graduation. Some students borrow heavily for college with the optimistic assumption that they will be able to repay college loans as soon as they find work. But life does not always obey optimistic assumptions. Recent college graduates who start out in low-wage jobs or face unexpected financial setbacks, such as job loss, health problems, or divorce, can struggle for years to pay off heavy student debt.¹³

In another troubling trend, more students are turning to private lenders who charge variable interest rates as high as 20 percent APR (annual percentage rate) compared to the fixed rate maximum interest of 6.8 percent on federal student loans.¹⁴ Private lenders typically prohibit student borrowers from paying off the loan ahead of time or paying more than the required amount on each installment—thus ensuring the lender maximum interest over the repayment period.¹⁵

Low-income students who enroll in a proprietary school are even more vulnerable to the risks of incurring debt but ending up with nothing to show for it—except perhaps a garnished paycheck. Proprietary schools enroll more than a million students, most of whom are poor, have experienced past educational failure, and must take out federal student loans in order to attend. The schools promise training for the local job market, but their placement services are often limited or nonexistent.¹⁶ And if low-income students graduate but fail to find work, they are less likely than more affluent students to have family resources to fall back on.

Many young adults remain strapped by debt well into their thirties. Indeed, the twenty-five to thirty-four-year-old age cohort devotes 24 percent of its income to paying off debt, most of which is for credit cards, student loans, and car loans.¹⁷ High debt can influence career paths. More than four out of ten college graduates cite student loan debt as the reason for not pursuing graduate school.¹⁸ Overindebtedness affects love as well as work. Young single adults and young unwed parents with high debt or bad credit ratings are less attractive as prospective marriage partners.¹⁹ Given these realities, it is fair to ask this question: How good is debt when it hangs on for a decade or more and creates obstacles to career development and family formation, the two main tasks of early adult life?

The Institutional Sources of the Debt Problem

Why is it that so many Americans are struggling with high levels of consumer debt? Some blame individual greed and recklessness. Clearly, human frailty is part of the story. Some people get over their heads in debt because of their own profligacy and irresponsible choices. Others point to a rampant culture of consumerism. To be sure, the ceaseless temptation to overspend is also part of the story. But soaring levels of household debt are also tied to another, often overlooked, source: recent changes in the institutional landscape.

In money matters, as in most things that matter, authoritative institutions play a role in guiding individual choices and in setting cultural norms. Individual choice is fallible; it is hard for an individual to take into account the full range of forces affecting the present and future and to assess personal outcomes as well as outcomes for others. Nor does every individual invest the time, effort, and practice in acquiring the knowledge and self-discipline that would make for highly informed decision making. That is where authoritative institutions come in. They establish the norms, conventions, and values that vest individual decision making with broader social knowledge. Additionally, institutions function as commitment keepers. They help individuals to form regular habits and steadiness of purpose in a cacophonous

world of competing messages and appeals. And finally, authoritative institutions command trust. They reduce the costly need for constant monitoring and surveillance. They are, as economists say, efficient.

But this is not to suggest that authoritative institutions are themselves infallible or that they consistently guide individuals into wise choices. Some authoritative institutions inculcate norms and values that foster unwise choices or contribute to unjust outcomes. Such is the case in today's debt culture. Newly powerful and aggressive institutions are promoting behaviors and attitudes that undermine the habits of thrift, the ability to save, and the opportunity to achieve important life goals.

America's Anti-Thrift Institutions

IN MID-TWENTIETH CENTURY AMERICA, a strapped wage earner who needed extra cash to pay an overdue utility bill, repair the family car, or make the rent had limited ways to get the necessary funds. Family and friends were often the first source of a short-term, possibly interest-free, loan. Failing that, pawn shops would take a wedding ring, musical instrument, fur coat, or some other piece of personal property as security for a small, high-interest loan. As a last resort, the local loan shark could provide the cash at predatory interest rates.



*At left:
Jack's Pawn Shop on
Broadway (Gary, IN),
2007.*

Today's pinched wage earner has more places to turn to get out of a financial jam. Credit card issuers will gladly provide blank checks to cardholders for any purpose and cheerfully increase the credit line on the card. Payday lenders will advance money until the next week's paycheck. Tax preparers will offer loans in advance of expected federal tax refunds. Auto title lenders will provide loans on the family car. Rent-to-own merchandisers will help replace the old refrigerator or buy a new computer for your child.

Thus, the good news for today's strapped wage earners is that they can get credit to tide them over until the next payday or to survive a financial emergency. The bad news is that this credit comes with a very high, and sometimes hidden, price tag: Anti-thrift institutions charge loan fees that are often equivalent to a 300–500 percent annual interest rate. Some, like the credit card issuers and payday lenders, tack on fees and other transaction charges over and above the interest. And virtually all anti-thrifts fail to provide consumers with clearly written and complete disclosure of all interest, fees, and penalties.

Today's anti-thrifts are not new. Some have been around for decades, and others, like the pawnshop, for centuries. But until recently, they existed as small operations located on the fringes of the financial world. Since the 1990s, they have aggressively moved into new markets and become national franchise operations, some with ties to the corporate banking industry.

*At right:
Rent-A-Center Store on
Broadway (Merrillville,
IN), 2007.*



For example, the rent-to-own business has expanded beyond its traditional base in poor, inner-city neighborhoods into a national franchising operation. Rent-A-Center, the largest rent-to-own franchise, boasts more than 3,500 company-owned stores in the United States, Canada, and Puerto Rico.²⁰ Blue Hippo, established in 2003, has grown into one of the largest rent-to-own merchandisers of computers. Check cashing outlets—businesses that make wire transfers, sell debit and phone cards, and cash payroll and government checks—have followed the same trajectory. Once small businesses located in urban—and largely minority—neighborhoods, the industry has more than doubled in size, from 6,000 check cashing stores in 2000 to an estimated 13,000 by 2005.²¹ During recent decades, commercial tax preparation firms have expanded their services to provide Refund Anticipation Loans—short-term, usurious interest loans secured by taxpayers’ expected tax refunds. In 2006, tax refund “loans” drained \$900 million in loan fees from the pockets of nearly 9 million American taxpayers.²²

Among the new anti-thrifts, payday lending is the fastest growing and most profitable. Nationally, there are 24,045 payday locations across the country. In addition, check cashing stores—including publicly traded ACE Cash Express and Dollar Financial Group—have expanded into payday lending.²³ The industry’s revenues have soared from \$810 million in 1998 to \$28 billion in 2006. Five of the leading payday lending chains trade on the major stock exchanges. South Carolina-based Advance America Cash Advance leads the list of publicly traded companies, with 2,900 stores in three dozen states and reported earnings of \$42.9 million in the first nine months of 2007.²⁴

But even payday lending is eclipsed by the size and sweep of the credit card industry—the nation’s most freewheeling anti-thrift business.

The Plastic Trap

Plastic has become an American way of life. More than one billion cards are in the hands of U.S. consumers.²⁵ More than three-quarters of American households have at least one credit card. The typical American adult has about four retail cards and three bank cards, plus a gasoline, travel and entertainment, or miscellaneous corporate credit card.²⁶ Even the young have joined the MasterCard mainstream. Many teenagers get their first card in high school. By the time students enter college, most will have one credit card and will acquire more as they go along. Fifty-six percent of final year college students carry four or more cards.²⁷ And little wonder. Credit cards are convenient, fast, and easy to use. They can be used to pay for almost anything, from milk to medical bills to music downloads. For online transactions,

credit cards are all but essential—especially for teenagers and college students who are prime shoppers in the explosively expanding e-tail market.

It is hard for today's teenagers to conceive of a time when plastic didn't exist. But, in fact, credit cards have only become a hugely profitable mass phenomenon in recent years. In the late 1950s, when the first general bank cards were introduced, they represented a miniscule share of the banking business.²⁸ They held little allure for the typical consumer and little benefit for a bank's bottom line. Few retailers accepted the cards, and conscientious cardholders typically paid off the entire balance every thirty days. In addition, usury laws in most states set a 12 to 14 percent cap on the rate of interest banks could charge on credit card balances. Some banks found the early credit cards so unprofitable that they got out of the business altogether.

Beginning in the 1980s, however, the credit card industry grew dramatically, thanks to several key developments. One was the deregulation of state usury caps on credit card interest. In 1978, the Supreme Court ruled that banks could charge interest rates allowed in their own (corporate) home state rather than in the consumer's home state. This decision allowed banks to move their credit card operations to those states that had eliminated usury caps, such as Delaware and South Dakota. Banks could then set whatever interest rate they wanted on balances, and eventually, on fees as well. Fearful of losing their banking industries to states with permissive usury laws, many states lifted their own caps to keep the industries at home. Today, banks in states with usury caps enjoy the same powers of nationally chartered banks and thrifts to move their credit card programs to states with no usury limit.

Another development was a shift in marketing strategy. In the early years of the industry, credit card issuers followed the model established by the personal loan business. They offered cards at fixed interest rates to their most credit-worthy users. (Anyone who got a credit card in the 1980s may remember filling out long application forms that asked for employment history, current income, monthly mortgage or rent payments, and credit references.) And true to form, these prime customers lived up to their reputation: They paid off their balances in full every thirty-day billing period, essentially getting an interest-free loan from the bank.

When the credit card industry realized that it could make little if any profit on short-term credit to financially solid customers, it shifted its marketing strategy by extending longer term credit to financially shaky customers. In the 1990s, the credit card industry launched an aggressive effort to reach lower-income users who needed credit but who would be likely to carry a monthly balance, thus generating higher revenues in interest and fees. This market included large numbers of single women, nonunion workers, and African Americans. To attract these users, the industry

lowered the minimum payment on monthly balances, shifted to more attractive variable rates, and unleashed a blizzard of mail offers to lower-income households. The strategy worked. Between 1989 and 2000, the rate of cardholding among the general population rose from 70 percent to 76 percent, while the rate of cardholding among households in the lowest income quintile rose from 29 percent to 43 percent.²⁹

Students represented another attractive consumer base. Few teenagers or college students could boast hefty incomes but many did have jobs, spending money, and a notoriously insatiable appetite for consumer goods. Young people also had a hidden asset: parents who would be likely to come to their financial rescue if they got over their heads in credit card debt.

In addition to expanding their user market, the credit card industry set out to increase the market of retailers who accepted credit cards. By the end of the 1990s, businesses that took bank credit cards included every imaginable kind of sales or service. Even stubborn holdouts for hard cash, like New York City cabbies, finally capitulated. Internet and mail-order sales also boosted credit card use. Since 1999, e-commerce has increased the use of credit cards almost 15 percent per year.³⁰

Another key development was technological. With sophisticated computer modeling, credit card issuers were able to dispense with paper applications and tedious reviews of each customer's credit history. They could manage massive amounts of market research data to help them identify lucrative markets and peg the pricing of their credit to the level of financial risk. Finally, with computerized credit scoring, banks did not have to build depository relationships with cardholders. They could convert faces into figures, names into numbers, depositors into demographics. Thus, the credit card industry severed the traditional banking relationship between lender and borrower. Today, more than 80 percent of credit card accounts in the United States are with banks that do not have a depository relationship with the customer.³¹

In short, the credit card industry was the first anti-thrift to discover the huge but untapped profitability of the subprime market. In so doing, it upended the conservative philosophy that had guided consumer lending for a century. Instead of limiting the small loan market to prime customers who were likely to pay off the entire debt in thirty days, the industry went after a market of subprime customers who were likely to pay only the low minimum balance and to incur the additional costs of late fees, over-limit fees, and other penalties on a regular basis.

If the credit card industry was the first modern anti-thrift to target consumers who were once considered risky bets, it was also the first to develop new practices and products that ensured long-term consumer dependency on expensive credit. Low

teaser interest rates that converted to double-digit rates, extra transaction fees and penalties, securitization of debt, and abrogated relationships between the originating lender and borrower were not innovations of the subprime mortgage business. These practices were pioneered by the credit card industry.

During the 1990s, the credit card industry's expansion into subprime markets occurred under the banner of "democratization" of credit. The industry was reaching out to the unserved and underserved. The population of Americans who once had to make do with the cash in a weekly pay packet could now use plastic to make their everyday purchases—or to splurge on something special. Even the staid American Express shifted its marketing strategy from special-use to a "spend-centric" approach, rewarding customers for using the cards for everyday purchases.³² MasterCard made credit card transactions even easier by adopting "contactless payment technology," a device embedded in more than 20 million of its cards that allows consumers to tap their cards on a computerized reader rather than burning up precious minutes signing a receipt.³³ Moreover, credit cards conferred respectability. With a credit card, no one had to face the embarrassment of putting items back on the shelf or being turned away at the counter for not having enough cash on hand. Consumers could hold their heads high as members of the plastic-swiping public.

The worthy goal of democratizing credit, however, led to the widespread propagation of debt. Between 1989 and 2001, credit card debt almost tripled, from \$238 billion to \$692 billion. By fall of 2007, the amount of revolving consumer credit had reached \$937.5 billion, a 7 percent increase over the previous year.³⁴

In the good economic times of the 1990s, many families were able to manage higher credit card debt without undue distress. But even during the good times, the share of households carrying credit card balances gradually rose from 39.6 percent in 1989 to 46.2 in 2004.³⁵ In addition, the share of households with credit card debt service payments above 10 percent of income—a measure of burdensome debt—was over 19 percent in 2004.³⁶

In today's more troubled times, families who once kept on top of their credit card balances—even if it meant paying only the minimum on several cards—are now toppling into delinquencies and defaults. Nearly half of all credit card holders have missed payments in the last year.³⁷ With declining home values and tighter credit, fewer homeowners have the option of drawing down on the equity in their homes to maintain their standard of living or to consolidate credit card debt. And more households struggle simply to live from paycheck to paycheck—with no reserves of credit or cash to keep them from economic freefall. For those families on the financial edge, however, there is another place to turn to for "fast cash"—the local payday lender.

Payday Lenders Come to Applebee's America

A visitor driving from Indianapolis to Muncie (pop. 70,000) enters this iconic Indiana city on McGalliard Road, a featureless, four-lane thoroughfare with franchise fast food outlets and malls on each side. As recently as 1992, McGalliard Road was populated by the kind of small, family-owned businesses that once lined the streets of the old downtown. Muncie's shoppers could drop in at Hook's Drug Store, Miller Milk House Dairy, Betty's Boutique Flowers, Dave's Diesel, McGrory's Variety Store, and Fern's Needlepoint and Stitchery.

Today, however, McGalliard Road has become a slice of Applebee's America. Big box stores and national chains have replaced old family-owned stores. CVS has taken over Hook's Drug Store; Blockbuster Video has moved into the old Miller's Milk House Dairy; Chuck E. Cheese occupies the spot where McGrory's Variety Store once stood. Upscale Panera Bread, Starbucks, and Olive Garden have joined the fast food franchises along the road.

But the most striking transformation has occurred in the financial services on McGalliard Road. Fifteen years ago, branches of local banks and a few personal loan companies made up the financial institutions on the road. Today, the bank branches remain, but they have been engulfed by a tide of payday lenders. Along



*At left:
Cash Stop on McGalliard
Road (Muncie, IN), 2007.*

the three-mile stretch of McGalliard Road, consumers who need “fast cash” can choose among the following franchises: Cashland Financial Services, Check Into Cash, Ace Cash Express, Advance America, Check N’ Go, Cash Stop, Allied Cash Advance, Advance America Check Cashing, and United Cash Advance. There’s also an EZ Pawn shop that will offer cash for a rifle or ring and a Jackson-Hewitt franchise outlet that will offer advances on tax refunds.

What has happened on McGalliard Road in recent years is happening all over the nation. In the early 1990s, only a handful of payday lending outlets could be found in the entire United States. But in less than a decade, payday lenders have invaded the malls and main streets in thirty-seven states; indeed, between 2000 and 2004, the number of payday lenders more than doubled, from 10,000 to over 20,000.³⁸ Payday lenders outnumber McDonald’s franchises in four out of five of the nation’s most populous states: California, Texas, Florida, and Illinois. But the concentration of payday lenders is even greater in smaller states like Missouri, Mississippi, and Alabama where each state has at least 900 more payday lenders than McDonald’s franchises.³⁹ (With only 2.8 million people, Mississippi has 1,069 payday lenders, earning the dubious distinction of having the highest density of payday lenders in the nation.)⁴⁰

Payday lenders serve up “fast cash” and “free money” to 15 million people every month. The industry solicits wage earners with incomes generally ranging between \$18,000 and \$25,000. These borrowers live paycheck-to-paycheck and sometimes run out of money before their next payday. To qualify for a loan, most borrowers typically produce a recent pay stub, current bank statement, blank personal check, driver’s license or other government ID card, and proof of current address—more evidence than some credit-challenged borrowers had to produce to get a \$500,000 subprime mortgage.

According to a recent investigation by *The Wall Street Journal*, payday lenders are now intensively soliciting elderly and disabled recipients of government benefits. For years, Social Security recipients received their government checks in the mail and cashed them at a neighborhood store or local bank. By the late 1990s, however, the federal government began requiring electronic deposits of benefit checks into an established banking account, unless recipients chose to “opt out.” This rule was a cost-saving measure for the government, but it turned out to be an unexpected boon for the payday lenders. With direct deposit, many lenders could make predatory loans as an “advance” on the next month’s benefits check. Since Social Security, veteran, and disabled benefit checks arrive every month, for as long as the recipient is living and breathing, they represent a highly secure form of collateral. Making a loan on future Social Security checks bears about as much risk to the

lender as spotting Warren Buffett twenty bucks. Moreover, although the government prohibits direct deposits from going directly to a lender, many payday lenders get around this legal obstacle by establishing relationships with the banks that receive direct deposits of prospective borrowers' benefit checks. The banks, in turn, transfer the funds to the payday lenders, who deduct the amount of the loan, plus fees and penalties, from the benefit check. Thus, fixed-income borrowers end up applying to the neighborhood payday lender for what is left of their government checks.⁴¹

In Muncie, and thousands of similar locations, the payday stores are commonplace and, for many of their customers, essential financial institutions. They offer a reassuring image of normalcy. They fit comfortably into the franchise landscape; their clean, brightly lit outlets are nearly indistinguishable from McDonald's or Burger King. Payday lenders offer all the democratic amenities of fast food franchises. Service is friendly. Business hours are convenient. They hand out balloons and lollipops to the kids.

Like fast food, the payday loans can be ordered up and ready-to-go in a matter of minutes. At the local Check 'n Go, a sign on the door reads: "Getting a loan is as easy as 1-2-3: 1. Just Write Us a Personal Check. 2. Get the Cash You Need Instantly. 3. We Hold Your Check Until Your Next Payday . . . It's Quick, Easy and Confidential." Unlike fast food,



*At left:
Signs from various strip
malls located on
McGalliard Road
(Muncie, IN)*

however, “fast cash” isn’t cheap. It typically costs the borrower the equivalent of 300 to 400 APR.

And payday loans contain another financially unhealthy feature: They are structured so that it is hard for the borrower to repay in the requisite two weeks time. Instead, many consumers are likely to take the option of “rolling over” the original loan into the next payday, a practice that can lead to chronic dependency on expensive credit. And the profitability of the payday business depends heavily on getting borrowers into multiple rollovers. Over half (56 percent) of payday lending revenue is generated by customers who take out thirteen or more loans per year.⁴²

Here’s how payday lending works:

Let’s say that a Muncie single mother and nursing home aide faces an unexpected \$325 car repair bill. She needs the car to get to work; without it, she will lose her job. But she only has \$150 in her checking account, and her credit cards are maxed out. So she heads for one of the payday lenders on McGalliard Road to write a check for more money than she has in her account in order to get immediate cash.

The payday lender gives her \$325 in cash, ostensibly as an advance on the paycheck she will receive in two weeks. In return, she provides the lender with a personal check for \$377 (the \$325 principal plus the \$52 service fee). The payday lender promises to hold the uncashed check until the next payday, usually two or three weeks from the date of the transaction.

If this hypothetical borrower has been able to get the \$377 by the next payday, she can return to the lender and pay off her obligation—either in cash or by allowing the lender to cash the check. But what happens if, as is more likely, the borrower does not have enough money in her checking account to cover the amount of the loan by the next payday? Here, it is important to note a key provision of the payday loan: The borrower has to pay off the entire \$377. She cannot pay off \$376 by the next payday and the remaining \$1 a week or even a day later. She has to pay off every penny of the \$377 on the due date.⁴³ And if she is unable to do so, her check will bounce—incurring a steep penalty from her bank and also from her payday lender. (Payday lenders impose their own fees for a bounced check.)

To avoid paying these double whammy penalties, the borrower writes a new check, again for money she doesn’t have in her account, and pays the lender another \$52 to hold the check for another two weeks. And so it goes.



*At left:
(top) Access Cash
Advance on Broadway
(Gary, IN); (bottom)
Allied Cash Advance on
McGalliard Road
(Muncie, IN), 2007.*



The lenders' practice of holding uncashed checks for insufficient funds constitutes powerful leverage in getting consumers to "roll over" or extend their loan. Faced with the threat of bounced check fees, borrowers choose to pay the finance fee and hope that they can come up with the money—or get an unexpected windfall—to pay off the loan at the end of the two weeks. This rarely happens. According to a study of the payday lending industry, nine out of ten borrowers take out five or more such loans each year. Six out of ten take out at least twelve loans per year, each time paying a fee for their "cash advance." It is this cycle of repeat borrowing, plus the practice of check-holding and triple-digit interest rates, that trap so many payday customers in debt.⁴⁴

Payday lending has been able to thrive because of lax state usury laws. In 1965, every state in the union had a usury limit on consumer loans. Today, seven states have completely deregulated interest rates within their borders.⁴⁵ At least thirty-five states allow lenders to charge the equivalent of more than 300 APR on a typical payday loan.⁴⁶ There are significant regional differences in usury caps as well. The Northeastern states have been the most aggressive in limiting the pricing of consumer loans while the Mountain West has been the most permissive. In the Mountain West, the median APR of state usury limits has increased from 36 percent in 1965 to 521 percent in 2007.⁴⁷

So far, twelve states plus the District of Columbia have essentially banned payday lending by placing interest rate caps on small loans.⁴⁸ Likewise, Congress has acted to impose a 36 percent cap on payday loans to young, low-income military families—a popular target for the payday industry. And the FDIC has encouraged banks under its purview to market small loan products to the general population at 36 percent or less.⁴⁹ Other, more narrowly focused efforts to discourage payday lending, such as limiting the number of outstanding loans per consumer, restricting the number of rollovers, or introducing extended repayment plans, have been less effective in eliminating the payday debt trap.⁵⁰

The Return of a Public Anti-Thrift: The Modern Lottery

The payday lenders are not the only anti-thrifts to set up shop in Muncie. A public anti-thrift—the Hoosier lottery—has a prominent presence as well. There are 8 lottery outlets in the vicinity of the payday lenders on McGalliard Road, and an additional 63 sales outlets in other Muncie locations—almost 1 lottery retailer for every 1,000 citizens.⁵¹

Like the payday lenders, the Hoosier lottery arrived on the scene in the 1990s. After its approval by the Indiana legislature in 1989, the lottery grew rapidly. It established

4,100 sales outlets in the state, expanded its game portfolio to include Lotto and online betting, entered the multistate Powerball game, introduced the \$20 scratch ticket, and hauled in \$816 million in revenues in 2006, including over \$500 million in scratch ticket sales.⁵²

THE RISE AND RAPID GROWTH OF THE LOTTERY IS NOT LIMITED TO INDIANA. After being shuttered for seventy years in every state in the union, the lottery has become an all-American institution. Today, forty-two states plus the District of Columbia are in the lottery business.

More than half of the nation's adults have played the lottery in the past year. In 2006, the nation's lotteries raked in \$57 billion annually in revenues. Twenty percent of all Americans are frequent players.⁵³ Annual per capita spending on the lottery is nearly five times greater today than it was in 1973.⁵⁴ Five states report annual per capita spending of \$500 or more.⁵⁵

No other government agency makes itself such a regular presence in Americans' daily lives. Lottery tickets are sold at about 200,000 mini marts, bodegas, newsstands, bars, bus stations, check cashing outlets, mall kiosks, liquor stores, supermarkets, and self-serve gas stations nationwide. Lottery ads pop up on buses, subways, and billboards. Live drawings take place during the nightly news. (The New York lottery has televised drawings in ten major media markets in the state.) Lottery results can be delivered to cell phones. Inspirational stories of lottery winners are featured in the local media. Lottery promotions are tied to sports franchises, baseball game home openers, local traditions, state fairs, patriotic holidays, and family anniversaries—or almost any other event or theme a publicist could dream up. As Buddy Roogow, the director of the Maryland lottery puts it: “There is rarely a time when you could come to Maryland when you won't see a lottery promotion. Right now we have a poodles promotion. In November we will have a sprinkler promotion for Keno. It goes on and on and on.”⁵⁶

If the lottery has been woven into the fabric of daily life, it is also a growing part of the fabric of state government. Lottery agencies are big operations. Directors of state lotteries earn more than many governors. (In Tennessee, for example, the former Director of the Lottery earned up to \$750,000 in salary and bonuses in some years while the Governor's salary is pegged at \$85,000—an income the current governor chooses to forego.)⁵⁷

Not only is the lottery a growing part of the state's business, but also it is an expanding monopoly business within the state. The lottery exists for one and only one reason: to raise as much money as it can through the sale of gambling products.

Moreover, the lottery does not simply make its products available. It has a mission to “grow” the market for its products. Consequently, the lottery works hard to hold onto current players, entice new players into the game, and increase the frequency of lottery play. Its business plan sets the goal of making regular betting a part of individuals’ daily or weekly rituals. And its methods seek to habituate players to the game. As a game of pure chance, the pleasures of the lottery are not derived from skills, knowledge, or mastery of the game. They are derived from more immediate sensations: the suspense of scraping the latex square on the instant ticket to reveal the number underneath, the excitement of watching numbered balls drop down a chute in televised nightly drawings, the emotional rush over getting a small payout, and the addictive cycle of trying to beat the lottery “house” with just one more try. Thus, the lottery keeps its players engaged by providing the pseudo-experience of winning and only rarely delivering the Big Win.

In its aggressive pursuit of a “broad player base,” state lotteries rely heavily on advertising campaigns. Three-quarters of state advertising dollars go to the lottery. In 1997, states spent \$400 million on lottery advertising alone, and lottery commissions are constantly pressing legislatures to loosen restrictions on advertising spending.⁵⁸ In addition, the state lottery uses free media to publicize its winners, drawings, and prizes.

In addition to advertising, the lotteries are constantly doing market research to introduce new products and target consumers more effectively. They spend money on survey research, psychographic profiling, and customer satisfaction studies. States also promote the lottery with special events. The Texas lottery alone sponsors more than 1,500 retailer in-store promotions and more than 77 promotional events in a single year, including a bash at the Texas State Fair where “players from across the state play lottery games, enjoy a live game show that includes audience participation, and take a chance at winning additional lottery prizes.”⁵⁹

Not surprisingly, given their pervasive promotions and advertising campaigns, lotteries are hugely popular with the public. In the ten years between 1989 and 1999, public support for the lotteries has hovered around 75 percent, according to the Gallup organization. Legislators, too, are sold on the lottery. As one analyst ruefully noted, “[L]otteries may be the only tax that politicians actively and enthusiastically lobby for.”⁶⁰



At left: Hoosier Lottery Sign on Broadway (Gary, IN), 2007.

The Anti-Thrift Impact of the Lottery

As a source of public revenue, the lottery is highly regressive. As table 1 shows, players with lower incomes tend to spend *more* on the lottery per year.

More to the point, people with lower incomes spend a larger *share* of their incomes on the lottery. A household with an income under \$13,000 spends 9 percent of it on the lottery. But a household with an income of \$130,000 spends less than .3 percent on the lottery. The share spent by the low-income household is about thirty-two times larger than the share spent by the high-income household.

Further, as an influence on the spending-versus-saving decisions of people with lower incomes, the lottery promotes spending. That is, lottery players at the lower-income range suffer a larger anti-thrift effect; they give up the opportunity to save the proportionately larger share of dollars spent on the lottery—and to realize a return on that money. Presumably, if a low-income household can spend \$776 dollars a year on the lottery, it can save and invest the same \$776. If the low-income household were to invest these same dollars in stocks every year, estimates the Tax Foundation, its *return alone* after forty years would be slightly more than \$100,000.⁶¹

Lower-income Americans are more likely to be habituated to lottery play and to play more frequently than those at higher income levels. Blacks, high school dropouts, and the poor are overrepresented among those who play most heavily.⁶² In California, for example, a 1999 report found that people from households earning less than \$25,000 a year made up 41 percent of the lottery's heaviest gamblers, those spending an average of more than \$830 per year.⁶³ In Maryland, almost half—47 percent—of the state's heavy players come from households earning less than \$20,000 a year.⁶⁴ In Massachusetts, individuals in the poorer cities of Worcester and

| Table 1. Annual Household Spending on the Lottery | |
|---|-----------------|
| Household Income | Annual Spending |
| \$124,000 and up | \$419 |
| \$62,000 to \$123,999 | \$373 |
| \$31,000 to \$61,999 | \$575 |
| \$12,400 to \$30,999 | \$626 |
| Under \$12,400 | \$645 |

Chelsea spent an average of \$336 and \$445 respectively in the early 1990s, while people in the more affluent towns of Weston and Amherst spent an average of \$30 and \$42 per capita respectively.⁶⁵

Although the lottery extracts its revenues

disproportionately from the less privileged, it distributes funds to causes with broad public support. Revealingly, lotteries rarely dedicate revenues to chronically underfunded programs for halfway houses, prisoner release services, homeless shelters, services to the disabled, domestic violence prevention, and drug abuse treatment. In some states, lotteries have funded projects that favor the more privileged. Consider these examples:

- A 1991 study of the Florida lottery found that lottery-funded expenditures for K-12 disproportionately benefit those at higher incomes.⁶⁶
- According to a University of Georgia survey, black respondents were significantly less likely to have someone in the household who received a HOPE scholarship, the lottery funded program for college-bound students.⁶⁷
- In Massachusetts, where lottery revenues are distributed in local aid to the 321 cities and towns in the Commonwealth, communities with the strongest lottery sales do not receive commensurately high levels of local aid. For example, residents in the old industrial city of Lynn spend \$85 million a year on tickets and games but the city receives just \$15 million a year in lottery-financed local aid a net loss of \$70 million for the city.⁶⁸

Turning Potential Savers into Habitual Bettors

Millions of families today feel the American dream slipping away. They are losing hope of escaping from the cycle of overindebtedness, holding a good-paying job, or moving up the income ladder. But they are not yet ready to give up trying. Spending a few spare bucks on the lottery each week is a self-help step that they believe might improve their chances of getting ahead. Indeed, more than one in five respondents in a recent survey said that playing the lottery is the most practical strategy for accumulating the thousands of dollars needed for retirement.⁶⁹

In its democratic appeal and accessibility, the lottery resembles a “people’s savings bank.” It reaches out to the population of low- and moderate-income Americans who have a few extra dollars to invest each week. Its outlets are located in places where people are likely to stop off in their daily or weekly routines. It sets few barriers—other than age—to participation. It provides government guarantees of security and safety. It encourages its regular patrons to make small dollar deposits in an investment that promises to make them more economically secure.

But if the lottery resembles a savings bank in its outward features, it nevertheless subverts the classic incentives and messages to save (as we see in table 2). It is almost as if the state lottery has appropriated the hardware of the savings bank but rewritten the software to foster dissaving.

Further, lotteries claim to promote the economic welfare of their states. They do so, not by creating good jobs or by building broadly democratic savings and asset-building opportunities, but by teaming up with the gaming industry to produce a megamillion windfall for a very lucky few.

Through publicly funded advertising and marketing, the state lottery instills a psychology that is the antithesis of thrift. It emphasizes the hedonic over the productive uses of money and fosters a mindset that is the polar opposite of the cumulative, future-oriented, and purposive psychology of savings and thrift. Whereas savings institutions encourage the productive goal of putting small dollars into a fund that will grow over time through the miracle of compound interest, the lottery labels small dollars as cash that can be spent on fun and fantasy. As Florida LOTTO ads proclaim, “All it takes is a dollar and a dream.”

In another way, too, the state lottery influences people’s attitudes about the relationship of productive effort to getting ahead economically. People who have

Table 2. Small Bettors vs. Small Savers: A Comparison of Institutional Effects

| | <i>Lottery</i> | <i>Savings</i> |
|---------|---|--|
| Time | Short horizon Immediate gratification | Long horizon Deferred gratification |
| Money | Nonaccrual (each day, a new day) Small bets Cash prizes | Accrual (each day, interest comp'd) Small deposits Interest bearing accounts |
| Purpose | Fun Escape from debt | Fund Freedom from debt |
| Reward | Suspense/Excitement Windfall A few win | Security/Happiness Wealth Everybody wins |

access to institutions that help them build assets tend to believe that success comes from “working hard and playing by the rules.” People who lack those institutional opportunities are more likely to believe that success comes from the forces of accident, fate, and blind luck. The lottery institutionalizes the belief in luck. Its message is that success comes from “working hard and playing by the numbers.”

With pro-thrift institutional incentives, many low- and moderate-income Americans might be able to join the class of savers and investors. Instead, the lottery has managed to recruit them into a class of habitual bettors.

How Anti-Thrift Values Shape a Debt Culture

Anti-thrift institutions do more than simply hand out expensive credit. They also establish social norms and promote cultural values. For today’s anti-thrifts, the effort to influence values takes the form of highly organized and self-conscious marketing and lobbying campaigns. Modern anti-thrift institutions spend a lot of money studying the beliefs, habits, and preferences of their customer base; promoting their financial products through advertising, celebrity endorsements, and consumer testimonials; making the case for favorable industry legislation; and burnishing their image and reputation for probity.

These efforts are necessary to lower psychological and social inhibitions against overborrowing and overindebtedness. Few people enjoy being over their heads in debt. Indeed, overindebtedness is usually a stressful and unhappy experience. It can strain family and work relationships, leave a blot on one’s social reputation, and limit one’s freedom to achieve important life goals. Under ordinary circumstances, therefore, people try to avoid what earlier generations called “financial embarrassment.” Moreover, in past decades, the social geography of the financial world served to reinforce psychological inhibitions against too much debt. Reputable lenders were located in the commercial heart of town; disreputable lenders on the shadowy fringes. Bank architecture conveyed solidity; loan shark architecture reflected seediness. And a moral language that unabashedly labeled usurious lenders as “loan sharks” and “payroll leeches” set these businesses apart from the respectable mainstream. This combination of personal aversion to debt, the social stigma of overindebtedness, and the grubby image of predatory money lenders provided extralegal checks on the temptation to overborrow and to live beyond one’s means.

In winning favor with the public, the anti-thrifts have worked relentlessly to reduce the traditional inhibitions and stigma associated with overindebtedness. One strategy

has been to improve the image and reputation of their businesses. To achieve that goal, payday lenders have made their services more accessible and mainstream. They have become branded franchises, adopted the familiar franchise architecture of the suburban mall, and moved their outlets onto the strips where ordinary Americans shop. A realtor's testimonial on the Check 'n Go website touts the "first-rate appearance and store buildout" of the franchise lender and notes that the "Middle-America profile of its customers is consistent with the people who shop with the other retailers in our center."⁷⁰

Another approach is to treat overindebtedness as commonplace. Payday lenders cast themselves as friendly professionals who offer "finance solutions for all situations." Indeed, they've expunged the word "debt" or "loan" from their advertising. One payday lending website brazenly names its product as a "cash advance savings account." What's more, their marketing pitches proclaim, they have solutions for your problems. And as they also promise, they are there for you as often as you need them—or, more precisely, as often as you need to roll over your existing loan.

Payday lenders promote the consumerist values of convenience and "no hassle" service. According to their advertising, their competitive advantage over commercial banks is the ease of getting a loan. One payday lender's online ad offers this pledge: "Applying for a savings account payday loan is a totally discreet and quite a different process than applying for a regular loan. You do not require [*sic*] to prepare a financial portfolio to take to the bank manager . . . This method is restrictive and for most people daunting. The savings account payday loans allow the customers to keep hold of their privacy and confidential documents."

Whatever the business of the anti-thrifts—whether payday loans or credit card purchases or lottery tickets—they all make the common claim of instant gratification. "Fast" is one of the most overused words in their advertising pitches: They promise fast cash, fast service, and fast solutions to money

*At right:
Cash Stop Sign on
McGalliard Road
(Muncie, IN), 2007.*



problems. To deliver on that promise, the anti-thrifts structure their services in such a way as to widely separate the time of the loan or purchase from the time of payment, thus making it easier for the consumer to get the money or goods immediately without thinking about the high cost of the credit—or, in the case of the lottery, the infinitesimal odds of a megamillion payoff.⁷¹

Further, to foster the trust of the borrowing public, some anti-thrift institutions link their business interests to those of highly credible and established institutions. The credit card industry, for example, makes deals with colleges and universities to use their campuses to market expensive credit cards to students. College students that accept cards from on-campus marketers are likely to be more indebted than those that obtain cards through other channels, yet they are also likely to believe that the card issuers are more reputable because they have been screened by the college.⁷²

Like other value-shaping institutions, the anti-thrifts take seriously the task of initiating the young into a debt culture. Lottery officials are eyeing eighteen to twenty-five year olds as the demographic group with the greatest future potential for increasing lottery play and revenues, especially with the expansion of online gambling.⁷³ The Texas Lottery, one of the few state lotteries required to provide detailed demographic breakdowns of its consumers, may be well on its way to cracking that youthful market. According to its 2006 report, eighteen- to twenty-four-year-old players spend a median \$50 per month on lottery play, the highest level among all age groups.⁷⁴ The credit card industry is intent on making the acquisition of a teenager's "first credit card" a rite of passage into a cashless consumer culture. Some card companies market their cards as money management tools, although most financial experts believe that kids are better off if they learn to save first and then use cash. Too often, experts say, teen credit card users fail to appreciate how much things cost, fail to grasp the concept of a sales tax, and fail to experience the *tristesse* of an empty wallet following a spending spree.⁷⁵

To appeal to college students, credit card issuers also hand out prizes and points:

- Chase +1SM Student MasterCard offers the limited edition Facebook T-shirt plus "Karma Points" for purchases of music, movies, and electronics.
- Citi® mtvUTM Platinum Select® Visa Card delivers extra "ThankYou Points" for "every dollar spent on restaurants, bookstores, record stores, movie theaters, MTV events, and airline tickets" as well as 250 to 2,000 "ThankYou Points" twice a year for maintaining a good grade point average.⁷⁶

*At right:
Check Cashers on
Broadway (Gary, IN),
2007.*





Progressives Take On the Loan Sharks: Two Models of Reform

THIS IS NOT THE FIRST TIME that the nation has faced a tide of anti-thrifts. A century ago, predatory lenders—otherwise known as loan sharks—began to make huge profits by making small loans at usurious interest rates. The most notorious practice was salary lending, a business that offered short-term, high-interest loans to wage earners as an “advance” on future wages. Salary lenders had been around since after the Civil War, but the business expanded rapidly in an urbanizing America. By the early twentieth century, nearly every major city in the nation could point to a cluster of salary lenders, some part of large, multistate chains. In each city over 30,000 in population, according to a 1911 estimate, one in five wage earners took out a salary loan in a year.⁷⁷

Two conditions spurred the phenomenal growth of predatory lending in the early twentieth century. The first was the growing market for consumer loans. As the population of the nation’s wage earners grew, so too did the need for cash to stretch their meager wages from payday to payday. Unlike farmers and small business owners, wage earners were entirely dependent on the dollars in their pay packet to meet their family’s needs. As one contemporary writer noted, “The wage has not the certainty of food produced on the farm . . . the workingman’s dollar has a way of depending on world finance to tell it how much food it will buy.”⁷⁸

Nor could strapped wage earners turn to local banks. Most commercial banks did not make small personal loans. As bankers pointed out, it took just as much paperwork and investigation to establish the credit-worthiness of an individual as it did for a business—so why not stick to the more lucrative business loans? Furthermore, existing state usury laws capped the amount of interest that could be charged on a personal loan at between 4 and 12 percent annually, with 6 percent being typical. Under such restrictive caps, bankers contended, they could not cover the additional costs of making consumer loans and still earn a decent profit.

Salary lenders, on the other hand, faced few such obstacles. They needed little capital to start their business. Once established, they earned healthy profits from high volume lending, frequent loan rollovers, and usurious interest rates, plus late fees, protest fees, application fees, collection fees, and other add-ons. Some of the big chains integrated the lending and collection businesses, thus generating another stream of revenue.

To be sure, there was an obstacle in the law. Salary lending was illegal under existing usury laws that restricted interest charged on small loans to 6 percent typically.

But the huge profits from loans pegged at usurious rates of 300 percent or higher outweighed the risks of penalties and prosecutions. Moreover, enforcement was difficult. Lenders disguised usurious rates in fees and service charges, required borrowers to sign blank or partially-completed contracts, and failed to give receipts for payments. These stratagems proved very effective ways to evade legal challenge. Even when the lender was convicted of usurious dealings, the penalties were generally civil and mild—ranging from forfeiting the amount of usurious interest charged to suffering the loss of the principal plus interest.

This was the Progressive Era, and a handful of progressive reformers set out to combat the “loan sharking evil.” They wanted to satisfy the growing need for consumer credit, but they were determined to shut down the loan sharking business as the source of usurious credit. To do so, they followed two very different strategies.

One strategy was to make the small loan business more profitable for banks and other legal lending institutions. The reformers essentially agreed with the bankers: Restrictive usury laws kept commercial lenders out of the consumer credit business and fed the growth of the illegal loan sharking businesses. By increasing the interest rates allowed under the law, however, the reformers hoped to create an incentive for banks to get into the consumer lending business. Once legal lenders got into the business of making personal loans, they believed, loan sharks would be driven out.



*At left:
EZ Pawn Shop on
McGalliard Road
(Muncie, IN), 2007.*

A second strategy was to create a pro-thrift institution for working people. This institution was the credit union. Like usury law reform, the credit union sought to solve the loan sharking problem by providing an alternative source of consumer credit to workers. Rather than trying to incentivize consumer lending for commercial banks, however, the credit union movement sought to institutionalize cooperative savings among wage earners themselves. The credit union did not try to set itself up as a competitor or imitator of the commercial lenders, or even as a charitable “remedial” lender. Instead, it offered something new: a local, nonprofit, democratically run “people’s bank” whose first purpose was to provide its members with the incentives and opportunities to save and then, when necessary, to borrow from each other.

Regulatory Reform: The Uniform Small Loan Act

In the early years of the twentieth century, a young Columbia graduate student named Clarence W. Wassam set out to investigate the salary loan business in New York City. Trained in the new empirical disciplines of the social sciences, Wassam believed in fact-finding as a way to expose social ills. Consequently, he behaved like a good investigative journalist. He hit the streets. He interviewed owners, managers, and debt collectors; he talked to workers who had taken loans; he collected the lenders’ newspaper ads; he put together case studies of trapped debtors and millionaire owners of chain lending operations; he gathered evidence of the deceptions and dodges that lenders, lawyers, and brokers used to ensnare borrowers. Wassam’s research, published in *The Salary Loan Business in New York City* (1908), was the first exhaustively detailed expose of the size, scope, and practices of the predatory lenders—and an equally vivid picture of a population of wage earners desperate for ready cash on any terms.

At the time Wassam began his research, New York City was the nation’s leading center of salary lending. In Manhattan alone, he counted more than thirty salary lenders, most clustered on Nassau Street and lower Broadway, with a few more in Brooklyn—a figure, he believed, that vastly underestimated the total number of salary lending outfits in the city. A more reliable measure of the illegal trade was the volume of business. Assuming that the average office had 1,000 active customers—another conservative estimate—Wassam calculated that there were 30,000 employees making payments to the lenders on every payday. Since the large majority of borrowers were married men with families, he concluded, at least 100,000 individuals were directly affected by the salary loan business.⁷⁹

Profits depended on high loan volume and frequent rollovers: The average loan was \$20, to be repaid in ten to fourteen weekly installments on each payday. Many

borrowers chose to roll the loan over. In one case, a factory worker took out a loan of \$24, for which he agreed to pay \$30 a month later. Unable to pay off the debt on the due date, he paid a \$6 fee to roll over the loan each month for two years, eventually paying \$144 in fees and still owing \$30 for the original loan. Some borrowers turned to multiple lenders in order to keep up with payments: “For \$150 in cash, one borrower paid about \$665 to ten different companies over the course of 19 months before he became destitute and sought charity. And the loan companies continued to dun him for the \$150.” These were not isolated cases. A New York City loan company, with 400 active accounts, had 163 borrowers “with the company” for over two years and an equal number on their books for one to one-and-one-half years.⁸⁰

The salary lenders didn’t operate in the shadows. On the contrary, they put on all the trappings of respectability. The loan officers wore white collars, sat behind desks, shuffled paperwork. Lenders advertised in all the New York newspapers, reassuring customers that everyone was borrowing. One ad proclaimed: “Money! Money! Money! There is no disgrace in being in need of money . . . We procure loans for EVERY ONE—railroad men, clerks, factory employes, street car men, office employes, and all salaried people.”

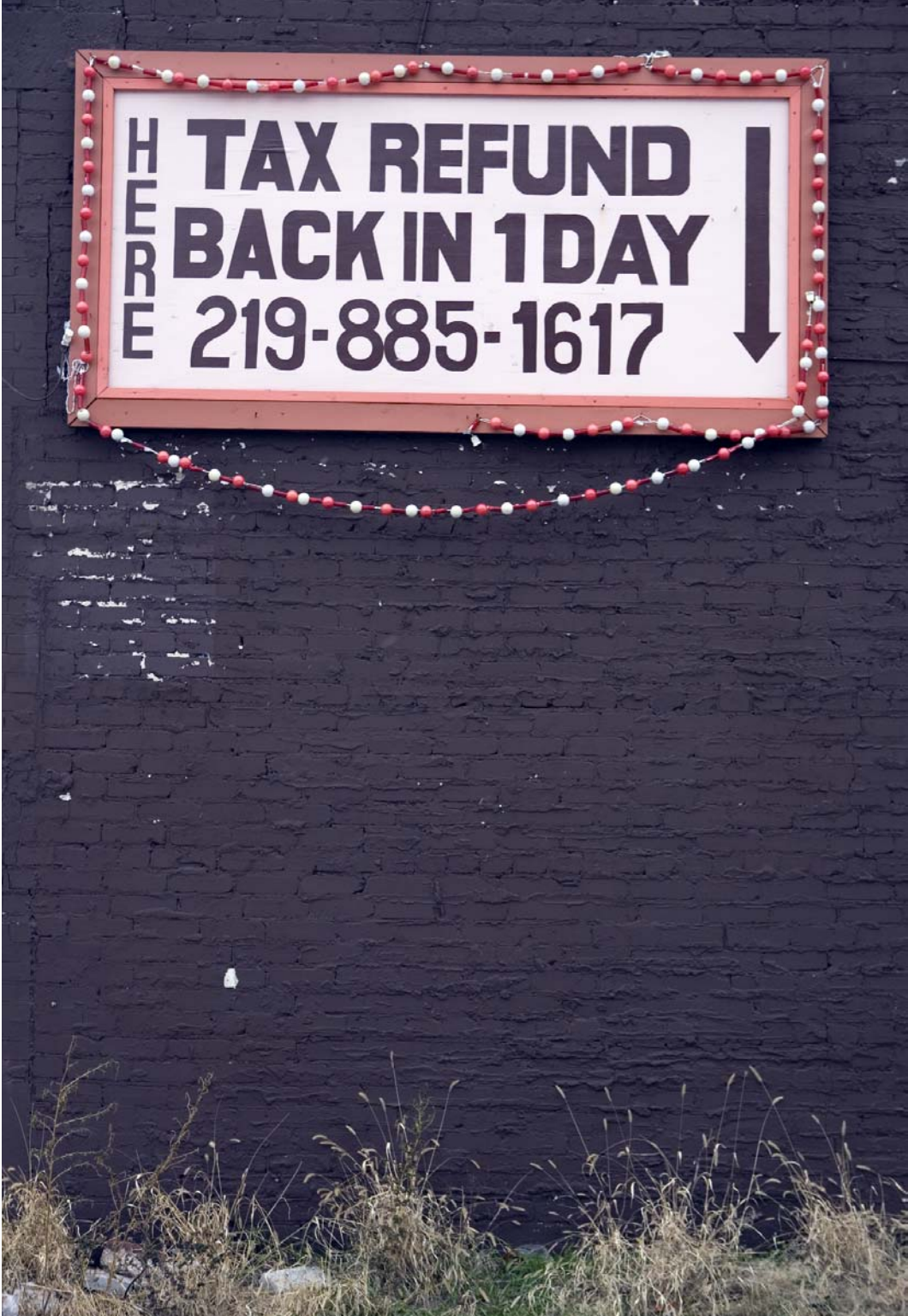
Finally, the salary lenders portrayed themselves as sympathetic friends with solutions to everyman’s money woes: “We have brought sunlight and happiness into many homes by loaning a man enough to pay up many scattered bills that were dragging him down.”⁸¹

At the same time, salary lenders promised complete confidentiality and privacy in the transactions. For example, the Piermont Finance Company targeted “ladies holding high class positions” with loans issued from its private office: “[Y]our business will be strictly confidential, no one will know you borrow, unless you wish to tell them. There will be no questions asked of any one in reference to your standing.”⁸²

When it came to their business practices, the salary lenders were similarly close-mouthed. As Wassam noted, “[T]he entire transaction with a salary loan company is surrounded with secrecy. It is impossible in most cases to know who owns the office, to secure a copy of the paper which the applicant signs, to secure the rates charged or to ascertain the amount of cash received on an individual loan.”⁸³

Another form of deception was the practice of requiring two “endorsers” for the loan, purportedly to attest to the good character of the applicant. The duped endorser, however, was actually cosigning the loan and therefore legally responsible for the entire loan, plus any fees, collection charges, and legal penalties for late payments or defaults.⁸⁴

*At right:
Tax-Refund Sign (Gary,
IN), 2007.*



To ensure repayment of the loan, salary lenders rarely resorted to violence. (They did, however, staff their offices with women in order to deter angry customers from attacking the help.) But their methods were as brutally effective as if they sent out goons to break kneecaps. If the borrower fell behind in payments, the salary lender would notify his or her employer and attach the worker's wages. Employers often fired the employee rather than going through the additional paperwork required to garnish wages.

A year after Wassam completed his study, one of his college classmates, twenty-six-year-old Arthur Ham, produced a companion study on chattel lending, another fast-growing predatory business that made usurious loans on the security of household goods. Together, the two studies led to a campaign to increase public awareness of the "loan sharking" evil among New York's social agencies, businesses, public officials, lawyers, and the press. The campaign succeeded in persuading the city's newspapers to stop running ads from predatory lenders.⁸⁵

The two young social scientists received funding support from the Russell Sage Foundation, a newly incorporated philanthropy that had earlier experimented with remedial lending—a charitable pooled income fund that made low-interest loans to needy families. The foundation found the approach too limited, however, to compete with the predatory lenders and soon hired Ham to pursue more thoroughgoing reforms.⁸⁶

Ham soon realized that the short-term successes of the loan-sharking campaign would not stamp out illegal lending over the long-term. The reasons were twofold: First, in an industrializing nation and a growing consumer economy, Ham argued, the need for mass consumer finance was an indisputable fact of modern economic life. If working men and women could not get money from legal lenders, they would seek it from illegal lenders.

Second, as long as legal lenders were constrained by restrictive usury laws, they would avoid getting into the business of making small personal loans. As Ham saw it, one solution was to create a legal personal finance business by raising the interest allowable on small consumer loans. He drafted and then lobbied for model legislation that eventually became The Uniform Small Loan Act. The Act capped interest at 42 percent per year, and prohibited fees or other add-on charges. It provided consumer protections for the borrower—the lender was required to disclose the terms, provide receipts for all transactions, and recovery in cases of overcharge—and required lender licensing and supervision by state agencies.

Despite tough opposition from salary lenders, Ham and his allies made headway. In a 1920 address to the American Industrial Lenders' Association, Ham was able to report: "[I]n the short space of five years, this bill is now a law, either in toto or in part, in nearly half of the states of the Union. . . the new law has vindicated the belief that neither a laissez-faire policy nor coercive measures will cure the evil of usury—that the remedy lies in the creating of something that will facilitate credit . . ."87 Twelve years later, twenty-five states had a small loan law, most incorporating the features of the model law.⁸⁸

Institutional Innovation: The Credit Union Movement

The campaign against loan sharking inspired a second progressive reform: the credit union movement. Like the uniform small loan laws, credit unionism was a Progressive Era response to workers' needs for low-cost consumer credit. Its first purpose, however, was to promote cooperative savings among its members. As its promoters endlessly explained, the credit union is, first and foremost, a "thrift agency, a plan to enable its members to acquire the habit of savings and to save appreciable sums by saving regularly in installments." Cooperative savings provided the capital for low cost credit. Members could borrow for emergencies as well as for such productive purposes as "shingling a house, paying taxes, paying for education, or starting a business."

Credit unions set themselves apart from commercial banks in several ways: First, they were nonprofit, membership organizations made up of people who had a preexisting bond with other members through work, church, neighborhood, or civic associations. Second, they sought to provide thrift disciplines to the entire cooperative, not just the individual saver; as one credit unionist put it, a credit union is a thrift plan to serve those who can save the least. Third, the credit union had a mission to reach out to the small saver. As its promoters explained, credit unions specialized in small units—which, in the early twentieth century, meant one \$5 share per person plus regular deposits of as little as a quarter a week, so small that "no one can possibly have an alibi which lets him out of utilizing the credit union." Individuals could save as much or as little as they desired; "the credit union is only hesitant about the member who has large sums of money and comes looking for high dividends."⁸⁹ Fourth, credit unions sought to eliminate practical obstacles to savings, including bankers' snooty attitudes toward working people: "We take the bank to the member; we make it simple; we do not wait in dignified silence behind a fretted grill in a mosaic paved, high vaulted banking room, condescending, willing to accept custody of what the timid depositor brings to us."⁹⁰

The inspirational leader and financial benefactor of the credit union movement was Edward Filene, the Boston department store baron and founder of the philanthropic Twentieth Century Fund. Filene was a self-styled “liberal business man” and enlightened employer who paid good wages; pioneered such employee benefits as paid holidays, free medical care, and worker savings plans; and dreamed of eventually turning his family’s department store into an employee-owned business. Even more ambitiously, he wanted to encourage financial solvency among the working class. Like Arthur Ham, Filene believed that wage earners should be able to buy the goods that they were producing and selling. Consumer credit for the masses, he thought, was the best way to avoid the economic immiseration that threatened to turn workers toward socialism.

Filene turned to the model of cooperative credit associations, small groups of members with preexisting ties to each other who pooled savings and provided one another with low-cost credit. Rooted in the principles of economic democracy and mutual aid, the cooperative credit movement originated in Germany in the nineteenth century and later spread through Europe and into the corners of the British Empire. During a trip to India in 1907, Filene encountered these “people’s banks” and came away impressed by the savings and microlending opportunities that they offered to the poorest villagers. Similarly impressed by the models of “*caisses populaires*” in Canada, Filene saw the credit union as the institutional means for realizing



*At left:
Sign from Quick Sam
Tax Refund on
Broadway (Gary, IN),
2007.*

a democratic consumer economy.⁹¹ He led a successful effort to pass the Massachusetts Credit Union Act, the first statute providing for the incorporation of credit unions, and to establish the Massachusetts Credit Union as “the mother union” of what he hoped would be a broader movement.

EARLY EFFORTS TO ESTABLISH CREDIT UNIONS PROVED DIFFICULT and fitful until Filene made one of the best decisions of his philanthropic career: In 1921, he hired a forty-year-old legal aid lawyer named Roy Bergengren to lead a nationwide campaign for credit unions. A graduate of Harvard Law School, Bergengren spent his early career as a legal advocate for shoe workers and sweatshop toilers in Lynn, Massachusetts where he saw loan sharking up close and personal—so much so that his clients usually had nothing left to pay his fees after they had paid their weekly tribute to the salary lenders.⁹² After returning from service in World War I and failing at a candy-making venture, Bergengren was in a hurry to find work. When he took on the task of carrying out Edward Filene’s bold vision, he knew nothing about credit unions.

Moving into a bare office with a secondhand desk and battered typewriter, Bergengren boned up on the philosophy of the credit union movement and then wrote a list of organizing goals, which he placed under the glass top on his desk: First, “get the laws”; second, establish multiple credit unions in every state; third, win passage of national legislation to support credit unions; and fourth, organize a national credit union association. For the rest of his career, he tirelessly pursued these goals, reaching out to legislators, business groups, factory workers, postal employees, newspaper reporters, packing house workers, utility companies, teachers, and anyone else who would come to a meeting to hear him speak. He traveled incessantly, “cold canvassing” legislatures in some states and dropping in on local employers in cities and towns across the country.⁹³

After fourteen years of organizing efforts, Bergengren could look at the list under his glass-topped desk and mentally check off “done” for each item on the list. When he began his work, only three states had effective credit union laws and there were only 199 credit unions in the entire nation. By 1935, amid the worst economic disaster in the nation’s history, Bergengren could point to the following benchmarks: thirty-eight states with credit union laws, Franklin D. Roosevelt’s signing of a federal credit union law in 1934, and 3,600 credit unions in the United States, with approximately 750,000 members. Further, by that year, the number of credit unions was increasing by about 100 per month, while the membership was growing at the rate of 6,000 weekly.⁹⁴

Bergengren was more than an indefatigable grassroots organizer; he turned out to be a brilliant publicist as well. Most Americans were not familiar with the concept

of the credit union. Therefore, the early success of the credit union movement depended heavily on winning popular acceptance of the credit union idea among legislators, workers, and employers. To further that goal, Bergengren wrote four textbooks, hundreds of articles, and produced an in-house publication, *The Bridge*, to explain the principles of credit unionism.⁹⁵ In all his writings, he professed his earnest faith in the goodness of common people. In Capraesque fashion, he evoked the struggles of ordinary hardworking citizens against the forces of power and greed: “One difficulty of our economic system,” he wrote, “is that it works so unevenly; so many folks have so much, so many have so little; so many work so hard for so little and so many acquire so much with no work at all.”⁹⁶ At the same time, however, Bergengren believed that economic democracy came about through the expansion of equality in the marketplace. His solution to economic inequality, therefore, was to establish the means by which ordinary people could participate in the consumer market.

As Bergengren explained it, the credit union had two linked goals: to encourage thrift among its members and to provide credit at reasonable interest rates for “provident and productive purposes.” (Provident loans were intended for financial emergencies, such as medical expenses, funerals, and temporary job loss.) Consequently, savings was the essential first principle and foundation for cooperative credit. But the habit of saving was not an end in itself; the members’ savings were put in the service of their access to credit. “A credit union,” Bergengren wrote, “is not composed of two groups—a group of thrifty savers and a group of thriftless borrowers; it is composed of one group, all of whom are members and systematic savers and some of whom borrow from time to time for legitimate purposes.”⁹⁷

Initially supportive of the credit union movement, the Russell Sage Foundation had cooled its enthusiasm by the 1920s. This cooling was due, in part, to competition and conflict with Filene’s Twentieth Century Fund, which had been the chief funder and leader of the credit union movement for fourteen years.⁹⁸ More fundamentally, however, the two Progressive Era strategies for providing low-cost consumer credit grew out of very different assumptions and approaches.

Usury law reform sought to provide profit incentives for commercial banks and other legitimate lenders to enter the personal finance business. The credit union movement set out to establish nonprofit institutions that would provide incentives for its members to practice thrift. Philosophically, the two approaches were different as well. The Uniform Small Loan Act grew out of the Progressive Era’s belief in research-based “scientific” legislation as a means to economic justice; credit unions grew out of a European movement for cooperative “people’s banks” as a means to economic justice. Both approaches helped to quell the spread of predatory lenders—at least for most

of the twentieth century. The reform of usury laws, however, had a longer-term, and unintended, consequence. As Christopher Peterson, a leading expert on usury law, explains: The higher interest allowed under the small loan laws diluted the long-standing moral strictures on usurious lending. Legal principle and practice shifted from imposing strict limits on interest rates to introducing flexible and variable caps. Once that happened, it became much more difficult to resist further deregulation. From the mid-twentieth century on, Peterson writes, each state began to chart its own course, creating all kinds of exceptions and loopholes for consumer lending. Especially during the 1980s, amid deregulation and inflation, political pressure to weaken or eliminate usury laws grew in the states. This climate in turn created a hospitable legal environment for the resurgence of a legal successor to the salary lending business—now called payday lending.⁹⁹

The irony is hard to miss. The progressive reform of usury laws, aimed at combating the first wave of predatory lenders in the twentieth century, helped to open the door to the second great wave of predatory lenders in the twenty-first century.

Compared to usury law reform, the credit union has turned out to be a far more durable solution. For nearly a century, the credit union has carried out its mission of serving the small saver and investor; today, more than 8,100 credit unions provide savings accounts, low-cost credit, financial education, and investments for more than 86 million Americans.¹⁰⁰

The credit union was successful for at least four reasons. First, it began as a social movement and was fueled by the energy, commitment, and sense of mission that is common to social movements. Second, the credit union movement united two ideals: democratic economic cooperation and thrift, broadly understood as the wise use of resources for productive purposes. Third, the credit union movement adopted an organizational model that applied a pro-thrift solution (cooperative savings) to a contemporary problem (predatory interest rates on consumer loans). Fourth, the credit union was organized to fit the habits and routines of its members' daily lives. People did not come to the credit union. It came to the people. As Roy Bergengren put it, the credit union should operate so that the member is constantly falling over it.¹⁰¹

REAL THRIFT

is the saving' and
intelligent use
of



HEALTH



TIME

and



PROPERTY

of all kinds, including'



MONEY

THRIFT (19)

THE HOPE OF A NATION POSTER SERIES
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JANUARY

For a New Thrift

A CENTURY AGO, THE UNITED STATES FACED a serious debt and credit crisis, as large and growing numbers of ordinary Americans both failed to save adequately and, lacking access to affordable credit, turned in desperation to salary loan outfits (“loan sharks”) and other anti-thrift institutions. As we have seen, that crisis prompted fresh thinking and bold action, including regulatory reform and the creation of the modern credit union movement.

Today in the United States, we face an almost identical crisis—low savings, large and growing numbers of Americans over their heads in debt, and the return with a vengeance of payday lending and other anti-thrift institutions. Will this current crisis also prompt fresh thinking and bold action? Will it produce a new generation of Edward Filenes and Roy Bergengrens?

It is to that aspiration that this report is dedicated, and to that purpose that we the undersigned hereby dedicate ourselves.

Two Goals

Our first goal is to renew thrift as an American value.

Our second goal is to create broadly democratic pro-thrift institutions as alternatives to the current crop of anti-thrift institutions.

Five Objectives

1 **CREATE A NATIONAL THRIFT INITIATIVE.** Ultimately, the changes we seek must, and can only, result from a broad shift in the opinions of leaders and the public and an effective, broadly based social movement aimed at creating those changes. To help change public opinion and help spark that movement, we will in the coming months explore the possibility of working together in an ongoing way as a (tentatively entitled) National Thrift Initiative.

The purpose of such an initiative would be to bring together a diverse coalition of leaders and organizations to share ideas, incubate strategies, and identify creative ways to promote thrift. What would be the initiative’s specific activities? Many excellent ideas are available. To start the conversation, here are several possibilities:

Reestablish a Public Education Campaign

During World War II, Americans saved at extraordinarily high rates—about 25 percent on average.¹⁰² This impressive display of thrift and sacrifice was driven primarily by the war, but it also had a more proximal source: The U.S. government, partnering with the leaders of civil society, actively stressed the importance of saving for the war effort while also providing a specific new savings tool, in the form of war bonds.

Perhaps the time is right to reestablish, on a broad basis, a public education campaign for thrift. Similar public education campaigns to decrease drunk driving, reduce smoking, and encourage seatbelt wearing all in recent years appear to have had demonstrable impact on people's behavior.

If we as a nation can spend millions of dollars annually on public advertising aimed at convincing ourselves to gamble away our money and purchase virtually worthless lottery tickets, then there should be no reason why we should not consider a serious public education effort to increase savings, facilitate non-predatory lending and the responsible use of credit, and promote thrift as a value and practice.

Revive National Thrift Week

National Thrift Week began in 1917, under the sponsorship of a coalition led by the YMCA, and ended in 1966, when it was sponsored by a coalition led by the U.S. Savings and Loan League. It had a very good run! It did much valuable public education. Is the time right to revive it? Perhaps in conjunction with World Thrift Day, sponsored by the Brussels-based World Savings Bank Institute and observed every October 31?

Help to Carry Out the Objectives Outlined in This Report

The obligatory “recommendations” that accompany nearly every report on any subject often fail to move off the printed page because no one is committed to carrying them out. In this report, we use the word “objectives” instead of “recommendations” to signify that, instead of calling others to take action, we intend to take action ourselves. We intend, in short, to carry out our own recommendations. A National Thrift Initiative could be one instrument for achieving this goal.

2 CREATE A THRIFT SAVINGS PLAN AVAILABLE TO ALL AMERICANS. The U.S. stock market is historically a powerful tool for building wealth. If Sally from San Antonio in January of 1997 invested \$10,000 in the S & P 500, Sally's nest egg as of January 2008 would have more than doubled in size, to about \$23,000—and that figure does not account for any dividends that Sally would have collected along the way. If she had invested that \$10,000 in 1980, her nest egg today would be about \$110,000. That's a pretty good deal for Sally! In the United States, the average rate of return on stocks far exceeds that of most other assets.

Yet most moderate and lower-income Americans have little or no connection to the stock market.¹⁰³ Why? Fees and financial guidance can be expensive for small investors. Many people simply have never been exposed to investing. And most investment institutions, for obvious reasons, tend to court primarily those Americans with relatively high net wealth.

So if Sally in San Antonio is a doctor or a college professor, she is probably already using the stock market to save and build wealth. But if she is a dental assistant or an administrative assistant or a cleaning person or a clerk at a convenience store, she probably is not.

Ironically, as a merely technical matter, it is easier and cheaper than ever in the United States for persons of modest means to gain diversified access to the stock market. Today there are hundreds of low-cost index funds that are divided up and sold as stocks, which can be acquired for a one-time trading fee. For Sally the dental assistant, what is missing is not the technical feasibility. What is missing is the institutional support and facilitation.

That support and facilitation is exactly what our federal government currently provides for all federal workers and for those serving in the military. Since 1986, the government's Thrift Savings Plan has permitted federal employees to build wealth and save for retirement by systematically placing a small portion of their earnings into diversified stock-and-bond index funds. These funds are managed by an independent board, with oversight from the public and private sectors. The expense ratios on Thrift Savings Plan funds are a low .06 percent—a ratio which makes these funds cheaper than commercially-run funds. Currently, the U.S. Thrift Savings Plan has 3.7 million participants, manages assets of approximately \$225 billion,¹⁰⁴ and is widely viewed across the political spectrum as a major success.

We propose that federal policymakers and others consider offering this same wealth-building opportunity to *all* working Americans.

Like the current Thrift Savings Plan, the expanded program would strive to be simple and user-friendly. The worker would participate in the plan through his or her place of employment. Current evidence suggests that the administrative costs borne by employers would be quite low. The investment vehicle would probably consist of money market and stock-and-bond index funds. Participants would be able to invest designated portions of their salaries in specific funds (such as small cap, large cap, or international) if they so desired, but they could also choose a fund that automatically selects an investment mix suited to the individual's risk tolerance and time horizon.

The plan could offer Individual Retirement Accounts, but the plan's directors might consider requiring that all other contributions be made after taxes, which means that the individual could withdraw his or her money for any purpose. This innovation could make the expanded program a more flexible savings instrument, as opposed to an instrument strictly dedicated to saving for retirement. At the same time, there are many ways that such a plan could be structured to encourage and reward those who leave their money in their accounts to grow over time.

3 BUILD NEW THRIFT INSTITUTIONS. To achieve the social changes we seek, our objective is to build new, community-based thrift institutions that can stand as attractive alternatives to the payday lenders and the other anti-thrifts. If we are serious about confronting the debt culture, building these new thrift institutions is almost certainly our most urgent task. These institutions must possess three core traits:

- Functionally, they must offer people opportunities and incentives to save and build wealth and must offer those same people access to credit at affordable costs and for prudential purposes.
- Structurally, they must be broadly democratic, organized as not-for-profit cooperative or mutual organizations.
- Physically, they must be conveniently located and easily accessible to persons of moderate and modest means.

Across the nation, these new institutions are already busy being born. For example, in Appleton, Wisconsin, the Prospera Credit Union recently teamed up with Goodwill Industries of North Central Wisconsin to create GoodMoney, where consumers can get short-term loans at about half the cost of the commercial payday lenders that have invaded the town in recent years. The program to date has been successful, and these leaders believe that the GoodMoney model is replicable throughout the country.

Both the North Side Community Federal Credit Union of Chicago and the New Orleans-based ASI Federal Credit Union have developed alternative payday loans that allow people to borrow for immediate needs on much better terms. The Faith Community United Credit Union in Cleveland, Ohio, which used to provide low-interest Grace Loans from borrowed space in a church, now occupies a former bank branch. The North Carolina State Employees Credit Union makes payday advances at 12 percent APR with no extra fees, and they also, crucially, include a savings feature: Borrowers put 5 percent of the loan amount into a savings account for short-term financial shortfalls and emergencies.

Numerous other examples could be cited. No one has to reinvent the wheel. Rather, the challenge is to recognize and support these emerging institutions, determine through careful analysis what is working best, and then help these institutions in the coming years to dramatically extend their reach and capacity.

How can we best achieve this objective? Here are three opening ideas:

Support Credit Union Expansion and Innovation

When the United States faced this same crisis a century ago, probably the single most important response from progressive reformers was the creation of the credit union movement. Today, there is every reason to hope and believe that a newly resurgent credit union movement, dedicated to expansion and innovation, can again play a pivotal role in providing serious, community-based, democratically organized alternatives to the payday lenders and other anti-thrifts.

Recall the fundamentals: Credit unions are small-scale economic cooperatives through which members build and pool their savings and offer one another access to affordable credit. Today, those are the precise foundations on which a social movement to build wealth among people of modest means and to reduce the need for payday lenders can best be built.

Innovative credit union leaders today face many challenges—lack of public understanding about credit unions as thrift institutions, regulatory restraints, membership restrictions, and others. We want them to be important leaders in what we do, and we want to do our best to help them build a new movement for social change.

Expand Community Development Finance Institutions

Community Development Finance Institutions can take the form of banks, credit unions, or investment funds. Their mission is to provide lower-income communities

with capital and constructive financial services. Most operate as not-for-profits. As of 2005, there were approximately 1,000 such organizations across the nation, with asset sizes ranging from \$5,000 to over \$1 billion.¹⁰⁵ According to the CDFI Data Project, these institutions have been quite successful in managing risk, with net loan charge-off rates similar to those for all financial institutions generally.¹⁰⁶ Meanwhile, the capital injected into communities by these organizations has helped to increase high-quality jobs, affordable housing, community facilities, and financial services for lower-income Americans. Community Development Finance Institutions are supported by the CDFI Fund, established by the U.S. Congress in 1994. To date, this fund has awarded \$820 million to local financial institutions.¹⁰⁷ Results to date appear to be promising. The need is great. Is it time to increase the capacity and reach of this fund?

Test New Models through Pilot Projects

- Should state governments consider improving financial support for full-time organizers of new pro-thrift institutions, as occurred in Wisconsin nearly a century ago when the state legislature appropriated funds to support a credit union organizer?
- When a low-income adult or child joins a local thrift organization and opens a savings account, should that organization, thanks to government or private-sector funding, be able to encourage and support that person's pro-thrift decision by adding extra funds to his or her savings account? (In the 1940s, the J.C. Penney Company set up exactly such accounts, called "Thrift Fund Accounts," for their employees.)

We, as a group, do not know the answers to these and similar questions, but we do agree that such questions should be asked—and tested. Seriously confronting the debt culture requires thinking anew about old problems, persistent experimentation, and creative innovations to time-tested models.

For this reason, the U.S. Congress might wish to consider, perhaps as an expansion of the CDFI Fund, inviting proposals for, and supporting financially, up to 100 pilot projects across the country aimed at innovation and effectiveness in meeting the currently unmet savings and credit needs of millions of Americans. After five years, the programs could be evaluated to determine which, if any, might be worth replicating on a wider scale.

4 REPURPOSE THE LOTTERY. State lotteries, currently operating in forty-two states and the District of Columbia, are today's most egregiously anti-thrift state-run institutions. Because the lotteries typically enjoy broad political support and are also popular with much of the public, we recognize that it is not politically feasible, at least currently, to outlaw these operations. But in keeping with the thrift ethic, which historically has emphasized reusing and repurposing rather than discarding, we propose to repurpose the lottery to promote savings and thrift.

The basic idea is quite simple. State lotteries are vast operations. They have outlets everywhere. These outlets are conveniently located, especially with respect to their main customer base of moderate and lower-income people. No one has to struggle or figure out some new technology or go very far to buy a lottery ticket. It is as easy as walking into a bar or a convenience store or a coffee shop. You walk up to the person behind the counter, you pay your money, and you take home your tickets.

Our proposal is that, in every state lottery outlet, you would not only be able to buy lottery tickets. You would also be able to walk up to the same person behind the counter, pay your money, and take home your *savings* tickets.

In this way, a comprehensive public apparatus devoted to encouraging everyone to become a bettor would, as a result of this one addition to its inventory, become simultaneously a comprehensive public apparatus devoted to encouraging everyone to become a saver.

State lotteries constantly invent new games. They also constantly bombard us with attractive ads. In short, they spend millions of public dollars each year figuring out how to get more and more of us to gamble. Under our proposal, this same group of publicly funded wizards who develop games and ads to sell lottery tickets would also be charged with developing innovative sales techniques and jazzy new promotions for savings tickets.

It ought to be an easy sell. Indeed, one ad slogan for these savings tickets might be, "Every ticket wins!" because, quite unlike the regular lottery tickets, *every single* savings ticket *would* improve the financial well-being of the purchaser.

The core idea is to utilize a huge anti-thrift institution for a pro-thrift purpose. Currently, the lotteries go to great pains every day to give millions of Americans the chance to bet. Once our proposed repurposing was instituted, these same lotteries, using their same methods of customer solicitation and product delivery, would also go to at least some pains every day to give those same millions of Americans the chance to save. Is this an idea worth exploring further?¹⁰⁸

5 CONSIDER ADDITIONAL IDEAS FOR OUR INITIATIVE. In addition to the four objectives listed above, there are other ideas that we may want to pursue as worthy goals in promoting savings and thrift. These ideas come from diverse sectors of society and from across the political spectrum.

Reform Usury Laws

A return to usury rate caps accomplishes two goals: First, and most obviously, it restricts predatory lending practices by anti-thrift institutions. Some steps toward reinstating small loan caps have already occurred. For example, Congress recently enacted a 36 percent annual interest rate cap to protect active duty Service members from high cost lending. States such as New Hampshire, North Carolina, and Oregon have recently reapplied rate caps to payday lending. The District of Columbia has repealed the payday loan exemption from its 24 percent usury cap, and the Arkansas Attorney General is currently taking steps to enforce the 17 percent usury laws.

Second, and importantly, a return to small loan rate caps helps to reestablish a pro-thrift norm. University of Utah law professor and usury reform advocate Christopher Peterson explains: “Usury caps have a normative, as well as regulatory, function. In addition to deterring predatory lending through the force of law—surely a valuable government objective—usury laws help to socialize thrift and constitute a statement of our collective aspirations for fair, productive, and prudential lending practices.”

Keep Credit Card Companies off Campus

We as a society should consider banning the credit card industry’s college campus marketing at freshman orientation, student unions, sports events, and other campus activities. As an alternative, as part of freshman orientation, colleges and universities might offer workshops on how to avoid credit card debt, manage finances responsibly, and find low-cost financial advice and services through organizations such as credit unions and student investment clubs.

Establish National Opt-Out Savings Regulations

When an employer offers a savings program to employees, many employees never get around to taking the affirmative steps—filling out the paperwork, making the specific choices—required to open the account. But some companies help

employees circumvent this inertia. The method is simple: They *automatically* enroll employees in the program, while giving them the option to opt out. No one is forced to participate, but no one has to do any work to enroll, either. These so-called opt-out savings programs have been quite successful. One study finds that when companies start automatically enrolling workers in retirement plans, rates of participation among poorer workers skyrocket from about 10 percent to about 80 percent.¹⁰⁹ For these reasons, Congress might consider requiring all U.S. employers offering these plans to provide them on an automatic enrollment (that is, on an opt-out, rather than an opt-in) basis.

Establish Matched Savings Accounts for Low-Income Adults

Each year, the federal government spends (through forgone tax revenue) about \$110 billion on tax incentives to encourage people to put money in IRAs, 401(k) plans, and other retirement savings accounts.¹¹⁰ Yet because these incentives come in the form of forgiven taxes, they disproportionately benefit wealthier Americans with higher tax rates. One idea for partially correcting this imbalance, and thereby encouraging savings across the society, is to create nationwide a program of savings accounts in which deposits from low-income Americans, which would grow tax-free and which could only be withdrawn for specified pro-thrift purposes, would be partially matched, or subsidized.

Establish Matched Savings Accounts for Children

A national children's savings account program could allow parents, beginning during the year of the child's birth, to deposit up to a specific amount—say, \$2,000 per year—into a savings account, which would grow tax-free and which could be used for the child's post-secondary education or perhaps also for other specified pro-thrift purposes to aid the child. For children of low-income parents, contributions from the parents would be partially matched, or subsidized. Bills proposing accounts similar to these have already been submitted to the U.S. Congress with bipartisan support.¹¹¹

Establish More and Better School Savings Programs

Studies find that financial knowledge and experience are some of the most important predictors of wise financial behavior.¹¹² Studies also find that the ability to delay gratification—a skill essential to saving—can be learned most easily in

childhood and adolescence.¹¹³ These facts suggest that more and better school savings programs might be a wise pro-thrift investment. The history of these programs further suggests that the most effective programs teach children that “wise saving is good for you and good for your community” rather than simply promoting the idea that “saving will help you buy something nice that you want.” Some of the most promising programs also teach students how to earn money by becoming small entrepreneurs. The best programs help students *actually save money*, rather than simply instruct them in financial literacy. Policymakers and others can also look to recent successful campaigns—such as “Save for America”—for guidance and for models.¹¹⁴

Create Private-Sector Initiatives to Teach Thrift to Children

One idea is a campaign that could be called “Save for Change.” The campaign would distribute thrift-boxes (“piggy banks”), in which children and others could put coins for saving, which in turn would be linked to an educational website to teach children thrift and helping others. Over time, the campaign could be co-sponsored and carried out by any organization in the U.S. or around the world that works with children and families on issues of economic development, savings and asset building, sustainability, and thrift and generosity.

Create State Commissions on Anti-Thrift Institutions

Policymakers and legislators might consider establishing state-level blue-ribbon commissions to examine the current scope and practices of anti-thrift institutions, including payday lenders, rent-to-own stores, and check cashing businesses. In particular, state commissions might scrutinize such anti-thrift practices as loans based on unfunded personal checks held for future deposit or on electronic access to borrowers’ bank accounts, unrealistic repayment terms on small loans, rent-to-own stores’ exemptions from state retail installment loans, and loans made without regard to a borrower’s ability to repay.

Particularly pressing is the need for state-level blue ribbon commissions to assess the anti-thrift impact of the lottery especially on the young and the poor. Blue ribbon commissions might investigate the social, financial, and ethical consequences of states’ growing dependency on gambling revenues; review practices and standards in lottery advertising, annual reports, and promotions; and assess the effects of the lottery on players’ attitudes about saving and spending.

Create a U.S. Financial Products Safety Commission

Professor Elizabeth Warren of Harvard Law School has suggested the creation of a U.S. Financial Product Safety Commission, roughly on the model of the U.S. Consumer Product Safety Commission. She argues that consumers today cannot independently rate the safety of financial products—just as they cannot with consumer products—and that therefore this new agency should set minimum safety standards, establish customer disclosure rules, and require modifications of excessively dangerous products.



Is there a need? Consider two facts from the subprime mortgage crisis. First, Fanny Mae estimates that about half of those who have been sold subprime mortgages would in fact have qualified for prime-rate loans.¹¹⁵ Second, in recent years many mortgage lenders have been content to issue so-called “liar loans,” which allowed customers to declare their own income without providing verification. Such loans are an invitation to mutual fraud.

Additionally, student borrowers would benefit from full disclosure and financial comparisons on student loan products. According to a study by the American Council on Education, one out of five students who take out high-cost private educational loans is eligible for a lower cost federal Stafford loan but does not take advantage of this option, perhaps because the student borrower may not be fully aware of the cost differences between government programs and private loans.¹¹⁶

Help Banks Reach the Unbanked

Some argue that commercial banks can and should do a better job of reaching out to unbanked and under-banked Americans. For example, Professor John Caskey of Swarthmore College has proposed that banks create special branches called “outlets” that would cater to the needs of lower-income communities.¹¹⁷ These outlets would mimic the format of cash cashing centers: They would be small; conveniently-located; and would cash checks, provide money-orders, and offer small loans. However, they would also offer deposit accounts, contractual savings accounts, and, for those who wanted them, traditional bank products. Such an outlet would essentially be a hybrid of a check casher and a regular bank branch. Another idea for reaching the under-banked centers on the use of stored-value cards, which work like debit cards but are not associated with an independent account.

Speak Out for More Federal Fiscal Responsibility

Individual and private thrift is closely connected to, and at least partially dependent on, collective and social thrift. It seems unlikely that historically high, steadily rising, and perhaps by now structural federal budget deficits are consistent with thrift as a value and practice.

Question “More Consumer Spending” as a Main Solution to Economic Problems

Whether it is a national security crisis, such as 9/11, or worrisome economic news, such as a downtick in employment, our leaders in recent years seem increasingly determined to insist, as a response to such challenges, on the importance of high and continued consumer spending. But as Professor Dalton Conley of New York University and others have suggested, in a society marked by dangerously high levels of debt and dangerously low levels of saving, this advice is, at best, partial and misleading.¹¹⁸ Perhaps it is time to balance the message of more spending with the message of more saving and more wealth building.

Conclusion

WE COME TOGETHER BECAUSE THE TIMES DEMAND IT. We come together because a society in which more and more of us are over our heads in debt is unlikely to remain a thriving society.

We come together recognizing that, a century ago, facing the same challenge, our predecessors came together to create progressive, effective social change. We believe we can do the same.

We come together to seek a new thrift.

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107. The CDFI Fund also awards tax credits to people and institutions who invest in community development institutions. So far, these credits have attracted \$12.1 billion in private-sector investments. For more on the CDFI Fund, see: <http://www.cdfifund.gov/index.asp>; Lehn Benjamin, Julia S. Rubin, and Sean Zielenbach, “Community Development Financial Institutions: Current Issues and Future Prospects,” *Journal of Urban Affairs* 26, no. 2 (2004): 177–195.

108. One possible way of structuring savings tickets to be sold at lottery outlets is to make these tickets essentially interest-bearing government bonds that also, in addition, make the owner eligible to receive a cash prize, to be determined (as is the case currently with lottery tickets) through regular public drawings. These numbered bonds could be redeemed at any time, but the longer that the owner (the “player”) holds onto the bond, the greater the bond’s value and, in addition, the greater the chance of winning a cash prize at one of the regular drawings. Similar programs, which seek to combine the essence of a savings bond with an element of lottery-style cash prizes as an added incentive to save, currently operate in Britain and Pakistan.

109. B. Madrian and D. Shea, “The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior,” *Quarterly Journal of Economics* 116, no. 4 (2001): 1149–1187.

110. Office of Management and Budget, *Analytical Perspectives. Budget of the United States Government, Fiscal Year 2009* (Washington, DC: U.S. Government Printing Office, 2008), Table 19-1.

111. For a concise summary of some of these proposals, see “Savings Accounts at Birth and Other Children’s Savings Accounts Proposals,” New America Foundation, available at <http://www.newamerica.net/files/CSA%20two%20pager.pdf>.

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118. Dalton Conley, "Go on a Savings Spree," *New York Times*, February 22, 2008, A23.

About the Sponsoring Organizations

Consumer Federation of America

Consumer Federation of America (CFA) is a 501(c)(3) organization founded in 1968. It is an association of some 300 nonprofit organizations from throughout the country with a combined membership exceeding 50 million people. CFA provides consumers with a well-reasoned and articulate voice in decisions that affect their lives through research, education, information and advocacy. In particular, CFA looks out for those who have the greatest needs, especially the least affluent. For more information, visit: www.consumerfed.org or call (202) 387-6121

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National Federation of Community Development Credit Unions

Established in 1974 by a coalition of credit union leaders dedicated to revitalizing low-income communities, the Federation's mission is to strengthen the credit unions that serve low-income, urban and rural communities — known as “community development credit unions,” or CDCUs. The National Federation advocates for and provides financial, technical, and human resources to CDCUs. For more information, visit: www.cdcu.coop or 800-437-8711.

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About the Photographs

The photographs seen throughout *For a New Thrift* were taken in late 2007 by Tamara Reichberg in and around Gary, Indiana (particularly along Broadway), and in and around Muncie, Indiana (particularly along McGalliard Road). Tamara’s company is Tamara Reichberg Photography.



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