

against being caught with too much poor consumer paper. That hedge is known as a dealer reserve. It works this way. A car dealer, for example, sells his installment contracts to a bank or a sales finance company. (This is, by the way, what happens to all but a tiny fraction of the contracts consumers sign at a dealer's lot or for that matter at most retail outlets where consumer durables are sold.) The lender makes a deal with the car dealer about how much he (the lender) wants to charge for the car loan. This is not the amount, however, that the car buyer pays. He pays more. If the lender's agreed-upon take from the loan is, say, 12% true annual interest, the dealer may write up a contract calling for 18%, 24%, or even 35½. (It is not written in, of course, as an interest charge; but as a sum called a time-price differential.) The difference between the lender's interest rate and the dealer's is known as the dealer's kick-back, or, in more polite terms, the dealer's reserve. It is his share of the finance charges. And whatever that amount may be, it is credited at the bank to the dealer's account. But, although the money is the dealer's—he pays income tax on it—the lender controls it. These funds are held by the lender until an agreed-upon total has been accumulated in the reserve. The total that must be maintained is a matter of negotiation between an individual dealer and a lender.

This reserve is supposed to insure the lender against poor consumer loans. Thus, when a car buyer fails to make his payment, the lender takes the balance due him on the contract out of the dealer's reserve and hands the contract back to the dealer. What happens when a bank or sales finance company dips into a dealer reserve to pay up a consumer loan is quite important to those of us who are concerned about the role of consumer credit in our lives today. On the lender's books that car contract, which went sour, appears as a fully paid-up loan. No wonder we hear such glowing reports from lenders about the quality of consumer credit, about how only 1% or 2% of installment contracts are losses. Under such a fool-proof scheme you wonder how there can be even a 1% or 2% loss. In many cases a bank's agreements with dealers will call for the bank returning the car as well as the contract to the dealer, hence there are repossession costs involved. These account for some of the losses. Then there is the skip—the fellow who signs a contract and takes off with a car to parts unknown where neither lender nor dealer nor their nationwide trading set-up can find him or it. And finally there are dealer failures and sometimes a lender has not had the foresight to fatten the reserve sufficiently to cushion him against all the loss from a bankrupt dealer's bad paper.

What about overcommitment? What about the risk to the whole community against which lenders would shield us? How does this dealer-reserve insurance system that protects lending affect borrowing?

The effect has been to turn retailing of durable goods into a game of chance in which chicanery can produce better returns from poor credit risks than price competition would allow on a cash sale. Car dealers, for example, would rather sell cars on credit to poor risks than to sell cars for cash. This doesn't mean that dealers would rather sell poor risks than good risks; but it does mean that the gamble of credit-selling holds out such rewards that cash sales tend to be less profitable than credit sales. Part of the profit on credit sales, of course, a goodly part, builds up in dealer reserves, but the lure of those funds that a dealer owns only after a fashion is more hypnotic than was the Piper of Hamelin. Then there are the insurance commissions to be earned on auto contracts. These are handsome. And insurance charges build up the interest earnings in a contract. Finally, a repossessed car also offers a promise of another sale, and another contract. Credit selling allows dealers to charge what the traffic will bear and under such circumstances the buyer often doesn't know what he has been charged. He'll know his trade-in and his monthly payments, and that's all. And that leaves all kinds of room for profitable maneuvers when an enterprising dealer has an unsophisticated customer at hand and there are, when it comes to credit contracts, millions upon millions who are unsophisticated.

The car story is duplicated in nearly all consumer durables, including television sets, furniture and rugs. For these goods, too, a dealer reserve protects lending and has much the same effect on borrowing. All these sellers say, and they mean it, that they make more on the credit than on the goods. Another group of lenders that has no dealer reserves to count on. It is a large group made up of various kinds of lenders: personal loan companies, department stores lending on revolving credit accounts, credit-card issuers, and banks, too, for that smaller part of their consumer lending where they deal directly with a borrower rather than through a dealer. Although this group of lenders is numerous,