

capital market, and the bidding prices create the interest rate when they interact with the supply prices of lenders.¹⁴

It is entirely possible that defects in the demand side of the consumer-credit market can affect the prices paid in the other parts of the capital market. Imperfections in both the demand side and the supply side of the consumer-credit market itself are of concern not merely to consumers, but to everyone interested in the proper functioning of interest rates in capital markets. If the imperfections of the consumer-credit market are such as to attract into consumer lending (through artificially high rates) an excessive amount of the total supply of loanable funds, this inevitably has a disruptive effect upon the productive side of the economy. Some entrepreneurs would be denied funds completely, while others would be made to pay a higher rate of interest than if consumer-credit rates were lower. Therefore, an understanding of the real demand from the consumer-credit side would contribute to a general improvement in the functioning of the whole economic system.

B. *Demand Side of the Consumer-Credit Market*

On the demand side of the consumer-credit market, the most important question is whether or not borrowers are in a position to understand the charges they are paying for consumer credit, because, without this understanding, a rational decision as to whether or not to borrow cannot be made. In most consumer-credit transactions, terms are stated as "add-on" or discount charges or as monthly dollar payments. Often borrowers, or purchasers, have no idea of the price they are paying for credit, as compared to the knowledge they have of the interest rates they receive on savings deposits or government bonds, for example.

One of the most important legal regulations suggested by consumer associations is the requirement that lenders state charges in terms of simple annual interest rates. The basic notion of a rate is nothing more than a measure of flow—of water, income, or what have you. Every rate is a ratio involving a time period, a base amount, and an increment related to that base over the time period. An annual interest rate is derived from the number of dollars which must be paid to borrow one hundred dollars for a year. It is what the market establishes as the price that borrowers pay for command over present purchasing power and that lenders receive for relinquishing command over

¹⁴ Here again, it is useful to put to rest once and for all the artificial attempt to inject a distinction between "pure" interest rate (the *actual* interest cost) and other service costs or charges associated with the demand for funds. As many others have pointed out, there is practically no interest rate anywhere in the economy that is not a mixture of elements of pure interest, service charges, and risk elements.