Book Review

Shortchanged: Life and Debt in the Fringe Economy

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Author: Howard Karger
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Shortchanged: Life and Debt in the Fringe Economy, was written by Howard Karger, a Professor of Social Policy at the University of Houston and a two-time Senior Fulbright Scholar. In addition to five editions of his bestselling American Social Welfare Policy, Karger has authored or coauthored nine books and numerous articles that have appeared in The Washington Monthly, The Jerusalem Report, Tikkun, and other publications.

Part I: Overview of the Fringe Economy
Karger describes the fringe economy as “corporations and business practices that have a predatory relationship with the poor by charging excessive interest rates or fees, or exorbitant prices for goods or services” (p. x). He compares the term “fringe economy” to “alternative financial services,” a reference often used by consumer groups, saying that it “better addresses the marginality of this economy and many of its customers” (p. x). At first, you might assign the term fringe economy only to check cashers, payday lenders, and family-run pawnshops, but in reality, this industry is an all encompassing parallel economy that “is increasingly dominated by a handful of large, well-financed national and multi-national corporations with strong ties to mainstream financial institutions” (p. x).

The goals of this 252-page book are to uncover details about this “dark and shadowy sector of the American economy,” (p. xiii) expose the exploitation of poor and credit-impaired consumers, inform consumers of the dangers of doing business in the fringe economy, and demonstrate how the modern fringe economy reflects a break from the past. The author states, “What makes the modern fringe economy different is the level of organization, the corporate control, the presumed legitimacy of these enterprises, the growing appeal to large sectors of middle-income households, and the geographic reach of these companies. While older fringe businesses were local, the new fringe economy is national and even global in scope” (p. xiii).

Chapter 1: America’s Changing Fringe Economy
Chapter 1 offers several definitions of the fringe economy and overviews the scope and profitability of the fringe economy along with information regarding the involvement of mainstream financial institutions. The following comparison demonstrates the prevalence of the fringe economy in the U.S.

At the time of publishing (2005), these startling numbers compare the far reach of the fringe economy to mainstream retailers. “About 22,000 payday lenders extended more than $25 billion in short-term loans to millions of households in 2004. The 11,000 check-cashing stores alone processed 180 million checks in 2002, with a face value of $55 billion. The sheer number of fringe economy storefronts illustrates the scope of this sector. For example, McDonald’s has 13,500 U.S. restaurants, Burger King has 7624, Target has 1,250 stores, Sears has 1,970, J.C. Penney has about 1,000 locations, and the entire Wal-Mart retail chain includes about 3,600 U.S. outlets. These combined 29,000 locations are fewer than the nation’s 33,000 check-cashing and payday lenders, just two sectors of the fringe economy” (p. 6).
Chapter 2: Why the Fringe Economy is Growing
The author defines fringe economy customers and provides an explanation of the factors contributing to the fringe economy’s growth. The fringe economy is growing because an increasing number of consumers live well above their means. According to Karger, 43% of Americans are spending more than they earn. Other factors that contribute to the expansion of this sub-economy are welfare reform, rising poverty levels, more working poor, increased levels of immigration, and how the Internet is a significant contributor to the fringe economy as online payday lenders reach consumers anywhere, anytime without being regulated. “The Internet has allowed payday lenders, fringe mortgage lenders, and predatory credit card companies to operate not only outside of state laws, but sometimes even outside of U.S. borders. For example, payday lenders can use electronic transfers to send cash to borrowers through offshore banks” (p. 27).

“According to the Consumer Federation of America, about 53% of us live from paycheck to paycheck, at least some of the time” (p.18). When you think about the far-reaching effects this can have on households, it is staggering. For instance, one financial hiccup, such as a major car repair, could potentially land a person into a payday lending cycle, which might then lead to more serious situations like foreclosure or bankruptcy.

Chapter 3: Debt and the Functionally Poor Middle Class
The points addressed in this chapter include the relation of debt and the fringe economy, the overconsumption argument, and cultural change and the fringe economy. For the purposes of this chapter, the author defines the middle class as “households with a yearly pretax income of between $25,000 and $75,000—a group that occupies about the middle half of the Census income-distribution tables” (p. 30). These consumers are more likely to devote 40% or more of their income to debt repayment and family debt has increased a whopping 500% since 1957 (p. 32). The pursuit of more has contributed to debt overload, wasteful spending, and related stress and anxiety. In fact, debt is now cited as the number one problem facing newlyweds and is becoming a major cause of divorce (p. 33).

A cultural change among middle class consumers includes a shift from saving up to purchase new cars or fund vacations and instead using home equity loans to consolidate these purchases as well as adding credit card payoffs, linking unsecured debt to secured debt. Karger says it well by stating, “Overconsumption, conspicuous consumption, status consumption, inability to defer gratification, and impulse buying are socially transmitted diseases” (p. 37) that plague middle class consumers. He also notes, “Credit card companies and other financial institutions have helped redefine the concept of acceptable debt,” (p. 37) making consumers more comfortable with living beyond their means.

Part II: The Fringe Sectors
Chapter 4: The Credit Card Industry
In this chapter the author overviews the credit card industry, discusses how creditworthiness is determined, introduces key industry players and explains how they work, reviews the types of credit cards available to consumers, and discusses credit card industry reform. Karger states that credit is the cornerstone of the modern U.S. economy and that consumers use credit as a cushion by turning to their credit cards when financial needs arise. He describes credit as a bridge for consumers who earn less, but want to live as if they earn more. To illustrate this point, the following statistic is shocking! Most (90%) of Americans claim that credit card debt is not a source of worry. Curiously, 47% would refuse to tell a friend how much they owe” (p. 45).

For students, high debt loads have proven to be extremely detrimental as more students drop out of college due to credit card debt than to academic failure. Older Americans are also among consumers who have succumbed to overuse of credit and as a result, an increase in bankruptcies among this demographic has significantly increased, making them the “fastest-growing age group in the bankruptcy courts” (p. 45).

Chapter 5: Storefront Loans: Pawnshops, Payday Loans, and Tax Refund Lenders
This chapter details the history of pawnshops and discusses payday lending in detail with information on the growth and profitability of payday lending and how it works. It also offers an overview of tax preparation and refund loans, provides a comparison between payday loan costs versus bounced check fees at mainstream financial institutions, and gives insight on efforts to reform the storefront loan industry.

The author shares heart-wrenching experiences of consumers who are targeted by the payday lending industry. Among regular customers are low-income workers, single mothers, women on welfare, senior citizens (many on Social Security), and military personnel. However,
higher-income consumers are not immune from the fringe economy, according to Karger. It would seem that only the poorest of poor would be utilizing the services of payday lenders, yet, a study conducted by Georgetown University found that “more than half of payday loan customers came from households with yearly incomes of between $25,000 and $50,000” (p. 73).

Chapter 6: Alternative Services: Check-Cashers, the Rent-to-Own Industry, and Telecommunications
Check cashing is a large and profitable business. Karger mentions it has had spectacular growth and has attracted non-finance related corporations to the mix of available outlets. These include convenience stores such as Toot’n Totum, Allsup’s, Cracker Barrel, and EZ Mart, all of which have check cashing kiosks. This situation only blurs the boundary between mainstream retailers and fringe-market check cashing outlets (CCOs). This is a win-win for the convenience stores as customers will have cash in hand ready to purchase overpriced merchandise.

He talks about the rent-to-own industry and how credit limited and cash strapped consumers turn there as an alternative to purchasing furniture outright. Suggestions for reform include “credit unions and banks being prohibited from charging fees for checks drawn on their bank and rent-to-own transactions being classified as credit sales rather than leases making them subject to state and federal consumer credit laws” (p. 105).

Comparisons are made between prepaid and postpaid telecommunications to demonstrate the high costs and fine print involved with selecting prepaid plans. An example is shared where monthly charges actually doubled for one woman who had to rely on prepaid telecommunications due to her neighbors using her phone and causing her to default on her postpaid plan.

Chapter 7: Fringe Housing
An overview of the subprime and predatory housing market is given in this chapter focusing on the line between subprime and predatory loans, the growth of this particular market and how it affects minorities. The author shares, “In 2002, 27% of subprime loans went to African Americans, almost 20% to Hispanics, and 16% to Native Americans; by comparison, only 7.4% of subprime loans went to Whites” (p. 114). He also discusses various home mortgage loan products and makes comparisons between fixed rate mortgages to adjustable rate mortgages (ARMs), balloon, reverse mortgages, and share appreciated mortgages (SAMs), which he describes as “a new version of share-cropping and instead of the landowner taking a portion of the farmer’s crops, we have lenders now taking a portion of a homeowner’s equity” (p. 118). Hidden mortgage costs and other predatory tactics are also brought out in this chapter involving refinancing and home equity traps.

Chapter 8: Real Estate Speculation and Foreclosure
This chapter covers rent-to-own housing schemes, housing speculation and foreclosure scams, and suggests ways to reform the fringe housing economy. Karger outlines several ideas for reform including prohibiting nonessential insurance, such as credit life insurance; regulating fees charged by mortgage brokers; origination fees, service release fees, processing fees, and discount points; and finally, abolishing prepayment-penalty-fee clauses. These predatory products and practices only contribute to higher loan costs for consumers keeping them from building wealth. The author makes a significant point relating to the intergenerational transfer of debt which occurs as a result of the fringe housing economy and how this erodes the possibility of heirs receiving money for education, a down payment on a home, or capital to start a small business once the homeowner dies.

Chapter 9: The Fringe Auto Industry
Karger shares experiences from his research while visiting mainstream and fringe car lots and actually found that mainstream dealerships employed more aggressive sales staff. He discusses the dangers faced by the poor who often turn to fringe dealerships including available inventory being old high mileage cars, high down payments, extortionate interest rates and overpriced insurance. The connection is made between fringe dealerships and fringe auto insurers, “Insurance scoring is a form of redlining that punishes those with poor credit, minorities, and the young” (p. 162). Insurance companies using credit scoring as part of risk assessment of policyholders punish consumers by charging higher premiums to those with poor credit, limited credit, and minorities.

Chapter 10: The Getting-Out-of-Debt Industry
The evolution of the credit counseling agency (CCA) and its involvement with the fringe economy is presented in this chapter with a close look at debt-management plans, “not-for-profit” CCAs, debt dispute and file segregation, the challenge of holding CCAs accountable for the services they offer, and finally, the impact that bankruptcy laws have on this industry.

Industry abuses are also addressed including CCAs failing to remit payments on time causing late fees, sometimes
non-payment of clients’ debts, and some credit counselors working on commission. The author also takes a close look at some of the catches with debt settlement. For example, a consumer who is trying to negotiate with a creditor may not be given a realistic repayment option, they may also be subject to income taxes on the amount settled, and may incur attorney fees.

**Part III: Looking Forward**

**Chapter 11: What Can Be Done to Control the Fringe Economy?**

The final chapter explores strategies for reforming the fringe economy and recognizes the difficulty of this enormous task. The author gives a four-pronged approach which includes:

- Instituting more robust federal and state regulation of the fringe economy
- Empowering consumers through advocacy and helping them achieve financial literacy
- Encouraging traditional banks and other mainstream financial institutions to serve low-income populations in a nonpredatory fashion
- Developing more and better-funded community-based financial institutions.

Karger suggests the need for mainstream financial institutions to serve the poor by offering products and services to help underbanked, unbanked and credit-challenged consumers avoid carrying large amounts of cash and allow them to make a transition into mainstream financial services. Several examples are given of how some credit unions and banks are helping consumers transition into mainstream financial products and services. By developing relationships with underbanked and unbanked households and providing transitional products and services, mainstream financial institutions may foster new full-service members and also facilitate better community relations and improve the banks’ ratings under the Community Reinvestment Act (CRA).

**Summary and Recommendations to Readers**

This book provides an in-depth overview of the fringe economy and examines this complex sector of the financial industry. As financial practitioners, we work with people every day who are enveloped in the fringe economy and are struggling to make their way out. Having insight into how the different parts of the fringe economy combine to work together against consumers is especially helpful to practitioners as they assist clients and make recommendations for improving their client’s financial situation. Also, being informed of the dangers these practices hold for individual consumers as well as the American economy as a whole can motivate counselors to take action and advocate for better regulation and reform. This book can be used as a reference for presentations on predatory lending and also provide counselors with background knowledge of the fringe economy when meeting individually with clients.