Statement of Chairman Eccles
Before House Banking and Currency Committee on

REGULATION OF CONSUMER INSTALMENT CREDIT

June 10, 1947

The Board of Governors of the Federal Reserve System has recommended to the Chairmen of the Senate and House Banking and Currency Committees a bill which would authorize the Board to continue on a specific legislative basis the regulation of consumer instalment credit that is now based on Executive Order.

As the members of your Committee know, since the end of the war the question of whether some restraints upon overexpansion of this type of credit should be retained has been the subject of sharp controversy. The Board has hoped that Congress would hear the pros and cons before coming to a conclusion as to whether legislation should or should not be enacted. We feel that regulation of this character should have specific legislative sanction if it is to be indefinitely extended in peacetime. Accordingly, we have recommended to the President that the Executive Order be vacated in the event that the Banking and Currency Committees do not recommend favorably the enactment of appropriate authority for continuing regulation. The President has written a letter, which I will later read into the record, indicating that he will follow the Board's recommendation.

If legislation is to be passed, we believe from our experience that consumer credit regulation should be directed to the volatile sector of consumer credit, that is, instalment credit. This is the part which has been subject to the greatest fluctuations in the past, thus contributing to instability and unemployment. Regulation under the proposed legislation would be in about the form and scope effective at present under the Board's Regulation W. It would, with appropriate exceptions to provide administrative flexibility, prescribe maximum maturities for all types of instalment credit and in addition would prescribe minimum down payments for instalment credit to finance the purchase of important categories of consumers' durable goods. Thus, the regulation would cover not only instalment credit for consumers' durable goods but also instalment credit for other consumer purposes, both of which contribute to the accentuation of business upswings and downswings and neither of which can be sharply disassociated from the other.

Generally speaking, the instalment terms now prescribed by Regulation W call for maturities of not more than 15 months and down payments of at least one-third. Under the proposed legislation, terms would, of course, be varied from time to time depending upon changing economic conditions but with a view to restraining the development of unsound credit terms and with a view to preventing or reducing excessive expansion or contraction of consumer instalment credit which is that sector of consumer credit subject to the widest fluctuation. These would be the declared statutory objectives.

Under existing conditions when the articles commonly financed with instalment credit are for the most part in short supply relative to demand, it is apparent that the restraints help to dampen the demand and thus reduce the upward pressure on prices. Even when goods become available in larger quantities, however, reasonable restraints on consumer instalment credit would serve a useful public purpose, because they would tend to induce sellers to reach more customers by reducing prices instead of by resorting to a competitive relaxation of instalment credit terms while still maintaining high prices. Under prevailing conditions of maximum peacetime employment and national income, it would be economically unsound to encourage people to go deeper and deeper into debt on increasingly easy terms.

Notwithstanding continued shortages of goods, particularly durable goods, and notwithstanding regulation of consumer credit, instalment credit expanded during the past 12 months by more than 2 billion dollars. The economic effect of adding borrowed dollars to current income, together with the unprecedentedly large volume of savings in the hands of the public generally, can only be to prolong the period of inflated prices. The premature relaxation of restraints, or their complete removal, would make no more goods available. It would only help to hold prices high in the marketplace.

With existing shortages in consumers' durable goods and the restraint of Regulation W, the volume of consumer instalment credit has not reached a point where it could be considered excessive as viewed in relation to the level of national income and production. The restraint is now imposed because of other current factors such as the high individual incomes and the large cash resources which consumers widely possess as related to the supplies of consumers' durable goods available. Were goods available in larger volume and were many consumers able to finance their purchases on easier credit terms, there is little question but that the volume of consumer instalment credit would be much higher. As an indication of the potentialities, sales of consumers' durable goods in 1946 were nearly twice the dollar volume of such sales in 1940 but the volume of instalment sales credit extended in 1946 was less than three-fourths of the instalment sales credit extended in 1940. Thus with the elimination of restraint and the larger supplies of goods that are becoming available, consumer instalment credit could increase rapidly in absolute volume and in relation to national income.

The need for regulation is not merely a temporary one. Experience has shown that the excessive expansion and subsequent contraction of consumer instalment credit contributes substantially to the rise and fall of production and employment. Its role in instability is increasing with the growing importance of consumers' durable goods in the economy. It is recognized that the development of this type of credit has gone hand in hand with and facilitated the unparalleled industrial development of the nation. Yet, it is equally significant that when competition takes the form of relaxing credit terms and is carried to extremes, it is a symptom and cause of economic unsoundness. Millions of people are encouraged to overpledge future income. This inevitably entails instability, because the excessive credit extended during a business boom accentuates the boom and has to be liquidated out of current income on the downswing, which accentuates depression. The fact that current income has to be used to pay off excessive instalment debt created during the business boom necessarily diverts that income from the channels of consumer expenditures in the depression, especially in the important sector of consumers' durable goods.

Voluntary efforts made by foresighted retailers, sales finance companies, banks, and other lenders to prevent down payments from becoming excessively small and repayment periods from becoming over-extended in times of credit expansion are ineffective because of the aggressive competition of those who will not voluntarily cooperate in this objective.

The present trend of expansion in consumer instalment debt needs to be carefully watched and restrained so that the country shall not repeat the pattern of inducing American families to go heavily into debt on too easy terms, particularly for high-priced goods many of which are not only high-priced but of inferior quality. The decline that would be bound to follow would be felt not only in the durable goods industries but throughout the economy. Continued restraints as proposed in the legislation would help to prevent a repetition of such an unsound sequence of events.

The Board feels that this type of regulation, which is of a selective character, serves a useful purpose which cannot be reached by the exercise of any powers over bank credit in general. The regulation is needed, therefore, as a supplement to general credit control powers. As the Board pointed out in its 1945 Annual Report to Congress, however, overall restraints to the sources of bank credit have, under existing conditions, lost much of their effectiveness. For this reason it is all the more important for Congress to consider whether a selective control such as proposed would, as the Board believes, reduce economic instability and thus help to provide conditions more favorable to the maintenance of our private enterprise system.