

CONSUMER CREDIT AND NATIONAL DEFENSE

Address By

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## CONSUMER CREDIT AND NATIONAL DEFENSE

This convention's discussion of consumer credit takes place against a background which even as late as one year ago I daresay would have been branded as fantastic and impossible by every man now in this room.

As a nation we are an important part of a world at war and it isn't the old kind of war which the world has always known, either. Modern war as dictators have shaped it is incredible in its speed, range, destructivity, malignancy, and totality. That last word is the one I want to fix in your minds. In this country we haven't yet even glimpsed what total organization for war means. But we will be compelled to understand it and to match it if democracies are to compete at war with dictatorships, and if we are to perform successfully the role of arsenal for democracies we are assuming.

Total war as dictators wage it subordinates or eliminates every other aim, interest, and consideration than the one goal of complete victory over present and potential enemies of their regime. There is much in that concept which democracy unconditionally rejects. But it grows increasingly apparent that we cannot now fashion to our heart's desire the world we live in. We face a grim challenge, not of our own choosing. Can we mobilize our vast potential industrial strength promptly and on sufficient scale, and at the same time preserve the essentials of a democratic way of life?

Obviously we cannot do it while preserving unimpaired all the privileges and immunities we as groups, classes, corporations and individuals have prized so highly. The best we can hope to do while joining forces in the task at hand is hold fast the democratic ideal of individual freedom, and in yielding from its form that which is necessary to single-minded action, do so in the determination to regain it all when the crisis passes.

Production for the purposes and on the scale to which we are committed can be had only from three sources: from the slack of unused capacity and unemployed men and materials which has existed in our economy; from new factories and expanded facilities and newly-trained labor recruits which have been or will be provided; and by diverting from peacetime production to the arms program a portion of the plants, materials and men that normally supply our consumer needs.

One simple statement will illustrate the enormity of the job we have undertaken. Scarcely one year ago the sum total of our government's appropriated commitments for armaments was two and one-half billion dollars. Today the total for our armed services and to supply the opponents of aggression abroad has reached the staggering figure of forty-four billions. And this expenditure is to be forced into the economy at the swiftest practicable rate and in the shortest possible time.

Only an incurable and unrealistic optimism can imagine that this will be done without profoundly changing our mode of life, our ways of business, and the inter-relationships between the government and both.

Two considerations arising in connection with the developments ahead of us lead me to approach today's discussion with the conviction that public policy will more and more direct and control the terms under which consumer or installment credit is to be extended in the months and the years to come.

The first and most immediate reason is that consumer spending on durable goods, such as automobiles, housing, mechanical refrigerators and other electrical household equipments, and, to a lesser extent, furniture, has been increasing rapidly in recent months, and it seems reasonable to expect that demands for materials and labor arising out of such consumer spending will compete in increasing degree with the national defense program, possibly to the extent of interfering materially with its rapid execution.

The second reason is that fluctuations in consumer spending on durable goods has regularly been one of the most important factors contributing to expansion and contraction of business activity generally. Quite aside from the effects on the national defense program, this long-run consideration is ample reason for considering some means of curtailing the expansion in such consumer spending at this time, so as to lessen the danger of a serious collapse when the war is over.

I have given you the setting as I see it for this convention's discussion of consumer credit. I am sure many bankers, no doubt some who are here this morning, do not agree with the conclusion that the two considerations I have mentioned will inevitably lead to public efforts to influence and direct installment credit. The other day in another city one of the leading bankers said to me: "I can't understand you fellows in Washington. A few years back and until recently you were encouraging banks to get into installment financing. Our institution has gone into it in rather a big way. Now I hear talk that the Federal Reserve ought to have power to fix minimum down payments required and the length of the period over which installment payments are to be made. Does that make sense?"

Well, the discussions that go forward at this conference and others like it ought to help throw light on the question he raised, as well as on many related matters. I predict that the work of your officers and committees will contribute much toward their solution. Not only problems relating directly to the methods of making and of servicing consumer loans, but also the broader problem of the role which consumer credit plays in the nation's economic life, should be threshed out here.

Probably some have looked forward to this convention as a welcome breathing spell from the steadily increasing pressure of defense problems.

After all, consumer credit might be one element in the economic scene we could expect to escape the impact of the defense program. Quantitatively, the volume of consumer credit, despite its growth in recent years, is still relatively insignificant in the total of the people's purchasing power. I am afraid, however, that my main purpose here today is to shatter illusions as to the ability of consumer credit to remain isolated from the effects of the arms program.

Before I explore that thought further, however, let me devote a few sentences to the part of the commercial bank in installment financing as a long-range thing quite independent of considerations of national defense. Consumer credit has assumed a position of increasing importance in our credit system in recent years and I believe the signs point toward the continued strengthening of its relative position. Institutions, to survive, must adapt themselves to meet the needs of our ever-changing society. This is no less true of banks than of any other. If banks are to serve the credit requirements of their communities, they must anticipate the inevitable changes in the demands for credit by the public and be prepared to provide facilities to meet the new demands when they appear.

Now let me turn again to my main theme - consumer credit and national defense. It is especially fortunate that the organization of your section of the American Bankers' Association should be set up and functioning at this time when our country has undertaken the greatest program of armament in its history. We are in the midst of a national emergency whose broad implications few of us from our own past experiences are able to see concretely. The familiar American democratic form of government which we have long taken for granted now demands new strength and vision from us. We must mobilize

our vast store of manpower, machines, physical resources, money and brains toward one huge job which may eventually encompass every element of our normal existence.

The defense program to date is mainly a program of buying and building. But it involves the buying and building of entirely different types of goods and of facilities for the production of those goods than occurs in the ordinary peacetime economic expansion. Although every sector of the economy is feeling the effects of defense expenditures, we must not forget that the production of the arms necessary to our own defense and to the aid we have pledged the nations now fighting aggression comes first. To achieve success in this effort, it is essential that all economic activity be continually maintained at the highest possible level, but no private demand which might interfere with the prompt delivery of military goods can be sanctioned.

The imposition of this ruthless but under the circumstances necessary rule upon all economic activity raises innumerable and complex problems. Buying and building for defense means increased industrial activity, more employment, greater volume of retail sales, and larger profits. It means a rising national income and a substantial rise in the stream of consumers' income directed toward the stocks of consumers' goods, durable and nondurable, found in the market places. But the generalized rise in the volume of purchasing power in the hands of the people resulting from the defense program, might act as an obstruction to the realization of the very defense program itself. This is the paradox we face today.

Our armament program is characterized by unusual demands on plants producing durable goods. Guns and shells, tanks, planes, and trucks, all are rapidly absorbing the output capacity of our durable goods industries. New plants are being erected as rapidly as possible, and existing smaller plant facilities are steadily being reached through the sub-contracting of defense orders. The commercial banks, I believe, will feel the impact

of the defense program with ever-increasing force as the smaller firms become more actively engaged on Government orders. Loans for plant expansion as well as working capital loans will grow as defense production is decentralized and reaches smaller companies which have scantier cash resources.

But the crucial point for this conference to think about, lies in the fact that the defense demand is concentrated in those areas of the economy producing durable goods. And much of the purchasing power derived from consumer credit is likewise spent on durable consumer goods. Roughly, about half of consumer credit is used to buy new and used automobiles, nearly one-fifth for furniture, about 15 per cent for electric refrigeration, and over 10 per cent for other electric equipment. These are the percentages if housing is excluded. But not only is consumer credit largely concentrated in a few products; it also finances a heavy percentage of the total sales in certain industries. For example, in the period 1929-1939 installment sales accounted for three-fifths of the total sale of new and used cars, one-half of the total sales of household appliances, and two-thirds of the total sales of furniture stores.

The recent announcement that next year's automobile production will be cut to 20 per cent to release facilities, skilled labor, and materials for armament, high lights the obvious conclusion; Expansion of the volume of consumer credit creates buying power that would in large part compete with imperative government needs. One or the other will give way.

There can be little question as to the present trend in volume of consumer credit. The installment loans of all insured commercial banks amounted to nearly eight hundred million dollars on December 31, 1940, an expansion of over 40 per cent above the twelve months preceding. I believe that with the increased national income and greater employment of

our manpower, we can expect the demand for such credit to continue growing at an ever greater rate. That demand is motivated by the very human desire to obtain the present use of desirable goods and services. Fluctuations reflect primarily the influence of changes or prospective changes in incomes. When incomes fall the purchase of durable goods is usually postponed; when incomes increase there is a tendency to borrow and buy more goods.

Almost invariably in the past the movements of consumer credit correspond roughly with changes in the national income. The period of the World War is the one exception. During 1917 and 1918 consumer credit failed to expand as rapidly as national income because of the diversion of productive resources and incomes to military purposes under the regulations issued by the War Industries Board.

One way to visualize the problems implicit in the present expansion of consumer credit is as an aspect of the relationship between monetary purchasing power and production. The absence of installment credit, in a period of general expansion, would limit the increase in the expenditures of people who have no salable assets or lines of credit to no more than the current additions to their incomes. This means that consumer purchases would flow in a fairly steady stream. Consumer credit, however, permits the stream of current purchases to swell, possibly into a flood which could set into motion forces that might interfere seriously with the defense effort.

The stimulating effect of consumer credit, added to the already substantial expansion of current purchasing power, can be accompanied by (1) a rise in aggregate output, (2) a rise in prices, or (3) both in some proportion. Whichever of these three conditions finally results depends upon such factors as the existence of excess plant capacity and unused



productive resources; upon their distribution over various industries, and upon the flexibility of prices and costs, including labor costs.

Generally we cannot predict whether higher prices or higher output will be the result of increased consumer purchasing power. But in the case of purchasing power based on increased consumer credit the results are fairly predictable right now. That part of monetary purchasing power that is based on consumer credit is concentrated on durable goods, now being rapidly absorbed for defense uses. In that important sector of the economy the result will most probably be a combination of price and output rise at the outset, gradually developing into bottleneck price increases alone, as capacity rapidly becomes absorbed into military production.

There is no clear-cut line at which an increasing number of bottleneck advances in prices passes over into general inflation. The development of widespread bottlenecks in such a strategic area of the economy as that producing durable goods, however, would require most urgent attention to prevent the outbreak of more general inflationary movements.

I have outlined in very general terms some aspects of the relation of consumer credit to the immediate and fundamental job of expanding production for defense purposes. The recent action of the automobile manufacturers in agreeing to a 20 per cent cut in next year's output of cars and trucks poses a most concrete question: is there any use of restricting the use of consumer credit for the specific purpose of buying automobiles in view of the production cut already announced?

The automobile industry is one that is extremely important to our economy. At an annual production rate of five million cars and trucks, the industry would employ directly about five hundred thousand men who are

well trained in mass production techniques. It would buy finished steel equivalent to about 12,000,000 tons of raw steel, or about 15 per cent of total steel capacity, as well as large amounts of rubber and other strategic materials. In addition, the industry has a large amount of modern machines and machine-making facilities which are vital to "all out" industrial mobilization.

Should defense authorities decide that it is necessary to restrict further the production of automobiles in order to release the industry's men, machines, and materials for the production of essential national defense items, the impact of increasing consumer purchasing power upon the curtailed supplies would mean sharp price increases. In such circumstances, it may be desirable to take positive action to slow down demand in order to prevent disorganized price advances in automobiles and to forestall the possible repercussions that such advances might have on the prices of other types of durable goods.

Several possible courses of action come to mind. The government might impose heavy excise taxes on automobile sales. A start might be made toward rationing the available supplies to consumers. Some type of general sales tax or forced saving scheme might be introduced which would produce an over-all reduction, or at least a curtailment of the increase, in consumer buying power.

Whatever might be done along these lines, however, an important supplement in order to make them effective would, in my opinion, be some action on consumer credit which is used to finance automobile purchases. To the extent that it is successful in slowing down consumer demand, we could avoid the imposition of less selective methods of control which might have undesirable consequences upon agriculture and certain other industries. As I mentioned before, installment sales account for a high percentage of the total sales

of new and used automobiles. This fact gives reason for some optimism about the efficacy of credit control in reducing the demand for automobiles.

The use of selective types of credit control is not new. The Banking Act of 1933 and the Securities Exchange Act of 1934 gave the Board of Governors of the Federal Reserve System broad powers to prevent the excessive use of credit for the purchase or carrying of securities listed on a national securities exchange. There has been no wave of speculative activity in stocks since the defense effort began. Nevertheless, I believe it is a comforting thought to know that we have these powers in reserve to prevent, or at least to lessen, speculative developments in the stock market that might generate inflationary tendencies elsewhere and thereby interfere with the progress of national defense.

I do not profess to know whether the use of selective consumer credit controls for durable goods is necessary today or when it may become necessary. Nor do I feel sufficiently at home in this field to know exactly what machinery is required to do the job should it have to be done.

The general plan would probably be to require larger down payments and to increase the installment payments by shortening the period over which the payments were to extend. In periods such as the present, when incomes are rising rapidly, and when there is a tendency for consumers to increase their expenditures on durable goods more rapidly than their general expenditures, such control, to be effective, would probably have to be applied rather generally.

Otherwise if, for example, it were applied only to automobile installment sales, it is likely that there would be a shift of consumer spending to such things as houses, mechanical refrigerators, and other household equipment. While the consumption of certain materials, especially metals, might not be as great in such lines as in automobiles, it would nevertheless be substantial, and would involve the use of labor which might otherwise be utilized in the defense industries.

Control of installment financing terms could have some of the advantages of the forced savings plan. Larger down payments and larger installment payments would probably cause the postponement of expenditures for durable goods in many cases, and in any event would absorb more of current incomes, and thus would reduce the over-all amount of such spending. On the other hand, more liberal terms at the appropriate later time would tend to encourage spending to some extent, although it would probably be found more difficult to stimulate spending by more liberal terms than to restrain spending by more restrictive terms.

The great difficulty of applying such control over installment financing lies in the large number of institutions that are engaged in extending credit to consumers. Not only the finance companies and banks but also retail establishments and personal finance companies are engaged in this business. To be most effective the control should be applied broadly to all such institutions at the point of extension of credit to consumers. Legal difficulties may be encountered in extending controls by Federal legislation to institutions that are not engaged in interstate business. These would have to be met; to be successful the restrictions would have

to apply with reasonable uniformity throughout the field.

I suggest that these are details which this section of the American Bankers' Association must place first on its agenda in the period ahead. The advice which you are equipped to give in formulating a workable program of consumer credit control, should such control become necessary, will be invaluable to the Government. It provides you also with an opportunity to perform a vital public service in this crucial period of our history.

I do not wish you to infer from my remarks that the restriction of consumer credit, should it become necessary, would mean an absolute loss of income to the banks of the country. The brighter side of the picture is reflected in the sustained current growth of commercial loans throughout the banking system. Commercial, industrial, and agricultural loans at reporting member banks have been expanding steadily since last August. This has been due to the continued high level of business activity which has accompanied the present defense program. Therefore, subsequent necessary restrictions of new loans for consumer installment purchases would take place in a period when the general demand for bank credit is expanding. The banks would not face an over-all reduction in earning assets if they were asked to help slow down the demand for consumer credit; rather they can reasonably expect a steady growth in the demand for commercial loans, which should result in a net increase in their earnings.

Before closing I would like to point out that the question of consumer credit is not only important in connection with national defense. It goes beyond that to the period of post-defense adjustment. A proper understanding of the present status of consumer

credit requires an appreciation of the extremely important role it will play during the period of post-defense adjustment.

In conclusion: Recent and prospective developments make it clear that this country will soon be seriously considering plans to influence the terms and use of installment credit in the interests of national defense. I can think of nothing more helpful than to forge these plans on the anvil of public and general discussion. I am delighted to have had a part in this first meeting of the Consumers Credit section of the American Bankers' Association. You can contribute much to the open discussion this subject should receive.

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