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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Statement of Governor R. M. Evans
Before Senate Banking and Currency Committee on

REGULATION OF CONSUMER INSTALMENT CREDIT

For immediate release

November 24, 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 regulate consumer instalment credit.

If legislation is to be passed, we believe 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. It is also the part that is now increasing most rapidly and doing most to keep prices on the upgrade.

Regulation under the proposed legislation would be in much the same form as it was under the Board's Regulation W when that regulation was still in force. Allowing for appropriate exceptions to provide administrative flexibility, the regulation would 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. The regulation would accordingly 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. At the consumer level, both instalment selling and instalment lending are among the inflationary forces that are at the present time causing so much apprehension to the public and to the Congress.

Generally speaking, the instalment terms finally prescribed by Regulation W called for maturities of not more than 15 months and called for down payments of at least one-third in most cases and for 20 per cent in some cases. 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. 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 which could be imposed would 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 and improving quality 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 the regulation of consumer credit that has been applied, instalment credit has 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. At the present time this is the really crucial point. Easy credit terms would make no more goods available. They would only help to hold prices high in the marketplace. 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 increase even more rapidly than it has increased during the past year.

The need for regulation is acute at the present time but the need is not merely a temporary one. Experience has shown that the excessive expansion and subsequent contraction of consumer instalment credit contributes substantially to economic instability. Its role in instability is increasing as the years go by, 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 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 then 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 have been made from time to time 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. These efforts, however, have always been ineffective because of the aggressive competition of those who will not voluntarily cooperate in this objective. Since the end of Regulation W, only three weeks ago, for example, and notwithstanding efforts by many to "hold the line," instalment credit terms have been growing more and more liberal in many fields. Credit terms, in fact, have already become too easy for these boom times.

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. The proposed restraint 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, and not a substitute for, general credit control powers. Each instrument has its proper place in a well-rounded anti-inflation program.

In connection with any Congressional action on the subject, there are some legislative alternatives that seem to us to deserve the careful consideration of the Congress. Executive Order No. 8843, under which Regulation W was issued, served its purpose reasonably well. Six years of experience, however, have shown that it would be preferable for legislation on the subject to convey independent authority for the necessary regulation rather than merely to revive the Executive Order.

For one thing a statute enacted at this time could provide clearer and more appropriate standards or guides to be followed in prescribing regulations. In addition, it could place clearer and more precise limits on the Board's authority as, for example, by limiting it to only that portion of consumer credit that takes the form of instalment credit. A bill conferring such independent authority could still be relatively short, and it would be distinctly more satisfactory than a mere continuation of the Executive Order. This would be true not only from the standpoint of sound administration but also from that of greater convenience for those subject to the legislation.

The matter of appropriate enforcement provisions also deserves the consideration of the Congress. Such provisions could be incorporated more conveniently in an independent bill such as we have suggested, but in any event the problem is one which the Congress would not wish to overlook. It has been our experience that the penalties applicable under the Executive Order and the underlying authority in the Trading with the Enemy Act are so drastic that it is difficult to apply them in actual practice. To provide enforcement that is both equitable and effective, it is essential that there be specific provision for courts of equity to aid enforcement through their power to enforce subpoenas and enjoin violations. That is a sound type of enforcement machinery that the Congress has adopted in connection with other similar matters. If necessary, this authority could be given in a single-sentence provision through the incorporation by cross reference of provisions on this subject in statutes already applicable to other agencies.

The case for permanent legislation seems to the Board to be very strong. It is important in any event that any legislation on the subject should have a long enough life really to achieve the objectives of the Congress. We believe the Congress would largely defeat its purposes if it attempted to confine the operation of the legislation to an unduly short period. It would be rash to assume that inflationary pressures will substantially subside in the near future. Furthermore, any temporary statute tends to lose much of its effectiveness as it approaches its termination date, and this can become serious long before that date is reached. Accordingly, if the Congress is not disposed at this time to enact permanent legislation, the Board would recommend that the measure authorize application of the necessary restraint for a period as long as three years. At any time within this period the Board would be in position to modify whatever restrictions may be prescribed, or even to remove them altogether, in the event that such action should be warranted by a change in economic conditions at any time during the period. It should be taken for granted that the administration of consumer credit regulation must be, and would be, altogether flexible.