STATEMENT ON REGULATION OF CONSUMER CREDIT*

The Board of Governors of the Federal Reserve System welcomes this opportunity to report to your Committee on its regulation of consumer credit and particularly automobile instalment credit, as authorized by Title VI of the Defense Production Act of 1950.

At the outset, I should like to emphasize that the Board has viewed its stewardship under the Defense Production Act in the light of its responsibilities for monetary and credit policies that will help maintain a stable value for the dollar and preserve a strong economy. In carrying out its responsibilities under the Act, the Board, of course, has also been guided by the observations of the House and Senate Banking and Currency Committees concerning the inflationary role of consumer and mortgage credit under current conditions, made in their respective reports on the Defense Production Act.

The Federal Reserve has acted to carry out its assignment in the light of its understanding of the objectives that Congress had in mind. As long as you leave the responsibility with the Federal Reserve we believe you will expect us to do our duty in accordance with the objectives of the Congress.

During the period the Congress was deliberating and acting on the Defense Production Act of 1950 —from July 19 to September 1—business and consumer markets were being swept by hysterical buying, prices in practically all sectors of the economy were advancing sharply, and inflationary pressures were generally rampant. The Congress, the Administration, and the public were very apprehensive about these developments both because they threatened the very foundations of our free enterprise society and because of their adverse effects upon our preparedness efforts. I can assure you that we at the Federal Reserve System were very deeply concerned. In the light of this background, the intent of Congress with respect to Title VI of the Defense Production Act seems to me clear. Let me here state briefly my beliefs in this respect:

1. I believe the Congress at that time was deeply conscious of the concern felt by the American public over the value of their dollars, and wished to take every practical step to preserve the integrity of our money.

2. I believe also the Congress intended that adequate taxes and general and specific credit controls should be the first reliance in maintaining the value of the dollar.

3. I believe the Congress intended that the powers to regulate consumer and real estate credit should be used to the fullest extent practicable, as a means of limiting demand to the available supply in the affected fields, thus restraining further price increases.

4. I believe also that the Congress had in mind that the use of these powers, in limiting demand, would help in the transfer of resources from the production of civilian goods to the production of military goods without unnecessary price inflation.

During the period when the Defense Production Act of 1950 was under study by the Congress, the Board and its staff, in collaboration with officials of the twelve Federal Reserve Banks and their twenty-four branches, carried on intensive studies of the consumer credit business, including numerous consultations with the major segments of the trade. In all, some 750 trade consultations were involved in this pre-regulation exploration. Officers of the twelve Reserve Banks conducted a total of 725 of these regional conferences with trade groups and businessmen prospectively subject to consumer credit regulation. The Board and its staff consulted on 25 different occasions with such groups, including the major national trade associations affected.

As evidence of the way in which the Board has consulted with the interested public while making decisions regarding Regulation W, I should like to quote from the October issue of the official magazine of the National Automobile Dealers Association. The auto dealers said:

"N.A.D.A. officials did a great deal of work and cooperated closely with the Federal Reserve Board during the period that the new Regula-

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tion W was being drafted. They compiled and presented data showing that the terms should not be so strict that they would work a needless hardship on persons who have the greatest need for reliable transportation.

"N.A.D.A. is continuing its frequent contacts with the Board, which has been working on interpretations necessitated by special problems that have arisen."

Against this broad background of study and consultation, a draft of the regulation was prepared and considered by the Board after submission to all of the Federal Reserve Banks. Thus, the Board was ready for formal action once authority to regulate consumer credit was enacted into law.

The Board issued Regulation W on September 8 within the hour after the President signed the Defense Production Act of 1950. The regulation was made effective ten days later on September 18. This interval was considered the minimum period for placing the regulation in the hands of registrants and enabling them to adjust their operations to it. The Board's decision as to the terms of the consumer credit regulation was based on the practical consideration that the regulation should restrain consumer demand and credit growth in the most volatile segment of the field, namely, the instalment financing segment.

Taking the field of instalment credit as a whole, however, the initial minimum down payment and maximum maturity requirements under Regulation W were only moderately restrictive in relation to practices generally prevailing in the instalment financing trade. In the used car field, particularly for older models, and also in some appliance lines, the regulatory terms were more liberal than those practiced by the conservative trade. Data supplied by the trade indicated that the bulk of the transactions being written on new and late model automobiles and on other items of relatively high unit price in the months just prior to the regulation were somewhat more liberal as to down payment, maturity, or both, than the introductory terms of the regulation. Information subsequently obtained by the System's own field investigators has confirmed this basic finding.

In announcing the new Regulation W to the press, the Board expressly stated that, if the terms established did not provide an adequate restraint on consumer demand, as well as on further rapid inflationary expansion of instalment credit, the Board was prepared to reexamine its regulation and establish more stringent terms. On October 13, five weeks after the issuance of the original regulation, the Board announced Amendment No. 1 to Regulation W establishing, effective October 16, minimum down payments and maximum maturities substantially stricter than those which became effective on September 18. This action was taken three days after the Board had issued Regulation X, to be effective October 12, establishing down payment and maturity terms on mortgage credit to finance newly constructed houses. The following table compares the new terms of Regulation W with those provided in the initial regulation.

MINIMUM DOWN PAYMENTS AND MAXIMUM MATURITIES UNDER REGULATION W

Listed articles and loans	Minimum down payment [1] [Per cent]		Maximum maturity [Months]	
	Sept. 18–Oct. 15	Oct. 16–	Sept. 18–Oct. 15	Oct. 16–
Listed articles:				
Passenger automobiles	33 1/3	33 1/3	21	15
Major appliances [2]	15	25	18	15
Furniture and floor coverings	10	15	18	15
Home improvement materials, articles, and services [3]	10	10	30	30
Loans:				
To purchase listed articles	(4)	(4)	(4)	(4)
Unclassified			18	15

[1] Exemptions: Sept. 18–Oct. 15, listed articles costing less than $100; beginning Oct. 16, those costing less than $50.
[2] Includes radios, television, refrigerators, food freezers, phonographs, cooking stoves, ranges, dishwashers, ironers, washing machines, clothes driers, sewing machines, suction cleaners, room-unit air conditioners, and dehumidifiers.
[3] Includes heating, plumbing, and other household fixtures.
[4] Requirements same as on instalment sales of the respective articles.

I should like to make entirely clear three aspects of the Board's Amendment No. 1 to Regulation W. First, the Board's amendment action was taken in the light of the total economic and credit situation. It was taken not primarily because of developments in the specific fields during this period but because the magnitude of the general inflationary problem became more clear. It reflected the Board's apprehension over the continuing strong inflationary trends in the economy generally as well as over the continuing strong consumer demands for durable goods and accompanying expansionary trends in instalment credit. Figures now available show that loans of commercial banks expanded 5.7 billion dollars from the end of June

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to October 25 of this year—the largest loan expansion in such a short period of time in the country's history. More than 25 per cent of the loan expansion was the direct or indirect result of growth in consumer credit and another fifth was due to a rise in bank holdings of real estate mortgages. This loan expansion was accompanied by a further increase in bank holdings of corporate and municipal securities. The total expansion of bank holdings of loans and non-Government securities was the immediate cause of a 3 billion dollar increase in the economy's already large supply of money.

Second, the Board was seriously concerned, as were other agencies of Government, over the undesirable and hindering effects of inflationary pressures generally on the rearmament, stockpiling, and industrial expansion programs. Appropriations for national defense were able to buy far less this fall than contemplated when Congress passed them.

Third, the Board took its action only after consultation with other interested agencies of Government.

I should now like to report on what I think the effects of Regulation W have been. To report first in general terms, the regulation has limited the rise in prices in the durable goods field; it has limited somewhat the further expansion of the money supply; because of these two effects, it has limited the advance of prices generally; and, lastly, it has removed some of the pressure which would have hampered diversion of materials and manpower to the military effort. These results have been of great benefit to the American people.

Let us now examine the effects of the regulation in the automobile field, with which your hearings are particularly concerned. At the time the Congress was deliberating the Defense Production Act, new cars were not generally available at list prices, i.e., unloaded of extra equipment or special premiums, to the great bulk of the people who wanted to buy them. With respect to used cars, average retail prices of a representative popular priced 1949 model car rose from approximately $1,430 in June to $1,635 in August. On the average, monthly payments to buy the 1949 model used car had risen from $56 to $63. It is clear that inflation in the retail automobile markets was impinging adversely on both those who bought higher priced cars and those who bought lower priced cars.

Let us look at the retail automobile market today compared with August. New cars are available to the buying public at list prices, without required extras or premiums. On the basis of advertised prices, a popular priced 1949 model used car could be purchased in leading cities in November for $1,280, compared with $1,635 in August. The buyer of such a model had to pay one-third down or $427 in November compared with one-third down or $545 in August. The unpaid balance in August was on the average paid off in 21 months at the rate of $63 per month. In November the balance was required to be paid off in 15 months or at the rate of $67 per month.

A great proportion of the cars bought by consumers in the United States are used cars. In 1949 it is estimated that 6.9 million used cars were bought by consumers as compared with 4.5 million new cars. Old cars predominate in the holdings of the population. It is estimated that 69 per cent of the passenger cars in operation are more than three years old. The man of average income typically buys a used car. In helping to keep used cars at a reasonable price and to make new cars readily available at effective prices at or below the list, Regulation W has been of great service to the American consumer. It has done a great deal to combat the price inflation which seemed last summer to be getting completely out of hand.

At the present time about 20 million out of our 38 million privately owned cars are prewar cars and when sold as used cars have a price of around $500 or less. Before imposition of Regulation W, if a purchaser bought a $450 car on a basis of one-third down, he paid $150 cash and paid off the balance at a rate of $24 to $28 per month, depending on whether the maturity was 15 or 12 months. Regulation W has not affected the typical terms of payment for these cheaper cars. One-third down and 12 or 15 months to pay, if dealers will finance on these terms, are still permitted. Good usable cars for performing a great portion of the daily travel of the public continue to be available under Regulation W on purchase terms of about $25 a month or less. These are the cars which are customarily bought and used by large numbers of our working population who are looking for transportation and not for the latest style and gadget.

Supply developments in the retail automobile market following the introduction of Regulation W

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and its subsequent tightening are of course not all attributable to the regulation. Some buying that would otherwise have been done this fall was accelerated and done in the summer months. The fall is typically a season of declining automobile travel and softened demand for cars. The industry has been preparing new models and this fact has no doubt induced some deferment of new car buying by purchasers who would otherwise be in the market. But the important fact for these hearings is that the market with Regulation W is less inflationary and more competitive than it was. It is more of a buyers' market and less of a sellers' market. It is in every respect a more normal market situation. Despite the role of other influences, I believe that Regulation W has contributed significantly to this more healthy market condition.

Inventory of new cars was at an abnormally low level when consumer credit regulation was inaugurated. This enabled manufacturers to go ahead full tilt at high levels of output despite the regulation. In recent weeks production has been down from earlier peak rates, the lower level reflecting primarily model changes, but the current rate of output of about 120,000 cars a week is still, historically speaking, a very high rate. Some inventory accumulation by dealers has recently taken place, but new car inventory for the new car dealer trade as a whole is still not above traditional relationships with sales. The latest retail sales reports with respect to new cars indicate that November sales were probably one-tenth above a year ago. Sales a year ago were in large volume. The rise in retail inventory of new cars probably tapered off considerably in November.

The foregoing observations relate to the automobile market as a whole. The situation will vary for different makes of cars, and among individual dealers. Such differences are matters for competition and not regulation to iron out. Regulation W affects the general terms of sale on credit.

With respect to the size of the current automobile inventory: trade sources estimate inventory of new cars at about 500,000 on November 1. With output at an annual rate of over 6 million cars now, with dealers generally in the best financial condition of the automobile industry's history, and with the use of materials already ordered curtailed, it would seem that inventories are not excessive.

It has been argued that Regulation W will throw men out of work. But to date unemployment has been at a low level and employment has reached a new high level. If some unemployment does develop, the principal cause will be the dislocations that are inevitable in the transition to military production, and not Regulation W.

It is sometimes claimed that Regulation W has prevented the American working man from buying the automobile that he needs to provide his transportation. It is said that Regulation W favors the rich as against the poor, that it bars from the market the low income man with his credit and leaves the high income man free to buy with his cash. The truth is that Regulation W has helped rather than penalized the person of moderate or low income. It helps him where he is most in need of help—in his pocketbook. Cars, new or used, are available at various prices to meet the budgets of practically all workers who want or need cars. And these cars cost less than they would have cost in the absence of Regulation W. Furthermore, prices are lower for other articles listed in the regulation, and also for articles not listed, than they would have been without the regulation. The American consumer is better off as a result of Regulation W.

We must of course bear in mind that the borrower is getting credit, not a gift. This credit must be paid back—and with finance charges added, too. In other words, when the consumer increases his expendable income of today by borrowing, he is, at the same time, reducing his expendable income of tomorrow. The thing that limits the man of low income is his income. He doesn't get something for nothing by borrowing to go into the market to bid against others for a limited supply of goods. He merely helps to push up the price of that limited supply of goods and increases the burden that he must meet out of his same income.

To encourage the man of low income to do that under present conditions is to encourage him to engage in a contest where he is at the greatest possible disadvantage. The wealthy can always meet high prices more easily than can those of lower incomes. Price is exactly the field where the man of low income is at greatest disadvantage. Under current conditions, the low-income man will find that the bait of easier credit is carried on a hook of higher prices.

It is of the very essence of regulation of con-

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sumer credit that the business of those financing consumers will be affected. If their business were as great under Regulation W as it would be in the absence of the regulation, then there would be no point to having the regulation. Any contraction of the business of these financing agencies is not an end to be desired as such. But it is a necessary consequence of limiting demand by these means. The sacrifices of those called into the armed services are not in themselves desirable but they are necessary.

By and large the consumer finance agencies have proved themselves extremely adaptable. In time of peace they have facilitated demand which has contributed to our great production and to our high standard of living. In war they have proved their capacity to adapt themselves to new conditions and stand by till a day when they can again serve their basic function.

We must continually remind ourselves, and others, that we cannot get something for nothing. We can't buy more goods than can be produced. To weaken or abolish Regulation W will not produce more goods. If we are to succeed in maintaining stable prices and preserving confidence in the value of the dollar, we must make a determined effort to mop up all sources of excess buying power which tend to make the demand for goods greater than available supplies. Otherwise, we know from past experience what to expect.

In conclusion, I would like to make this point clear: that selective credit controls including Regulation W will not of themselves check all of the inflationary forces. More fundamental than selective credit controls is an adequate program of fiscal and general controls that restrains all types of bank credit and thereby curtails the total dollar volume of private expenditures.

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