THE USE OF RETAIL CREDIT IN TODAY'S ECONOMY

Address by

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According to a survey made late in the year 1955, retail merchandising accounted for 11.3 per cent in amount and 31.2 per cent in number of all Federal Reserve member bank loans. On both scores, retailing was the largest among all groups using commercial bank credit in the conduct of its affairs.

These statistics are important when considered along with the fact that in the chain of production and consumption, retailing is the final link to the ultimate consumer. Moreover, it is not too much to claim that retail credit is indispensable to the movement of goods from the producer on into the hands of the consumer. Without an extensive use of retail credit, the advantages of mass production and distribution would be hard to maintain.

Having paid deserved tribute to the economic usefulness and importance of retail credit, the door is now open for further investigation of the subject. Resourcefulness is a prime attribute of the American businessman and has been fundamental to the accomplishments of the American free enterprise system. Resourcefulness in its application to the use of retail credit has meant the constant adaptation of new uses of credit to the needs and wishes of American consumers. The process has been one of evolution from the retailer's acceptance of thirty-day charge accounts as a convenience for a select group of customers on to the use of various forms of credit for the purpose of sales promotion. The use of credit as a major aid to sales presents problems that are puzzling both to sociologists and economists.

For instance, on the side of sociology, we look on the quality of rugged individualism as a precious heritage from our forefathers for what it has done to form what might be called the American character. However, individualism also demands possession of another quality -- independence -- and as the beneficiaries of our forefathers, we are in duty bound to preserve in our generation the spirit of personal independence. In performing that duty, it is essential that credit shall always be the servant and never the master of those who depend on its use for improving their living standards. In keeping with that precept, introduction of new forms of credit should be analyzed as to their possible social implications; as, for example, whether encouraging the constant use of credit tends to weaken respect for the fulfillment of both pecuniary and moral obligations. To the best of my knowledge, there is no evidence of such a development, but we must do everything possible to be sure that it never will happen.

Control over the extension of credit is the most effective means for preventing its misuse; and because risk attaches to the extension of credit, avoidance of the risk of defaults is a natural form of control that is used by the credit man when setting credit terms that are calculated to minimize such risks. Thus it is that the self-interest of merchants exercises a wholesome degree of control over the use of credit. Multiplication of the self-interest factor in the control of credit over all of its dispensers indicates that what might be called an instinct for self-preservation complements the credit controls deliberately employed by governmental authorities to prevent the use of credit from becoming a disturbing influence in the national economy.

Then too, mention should also be made of another controlling influence that governs the extension of retail credit, which is the actual fiscal limitations on the ability of retailers to extend credit. Inasmuch as the act of extending credit simultaneously creates an account receivable on the retailer's books, it follows that the retailer's capacity to finance his receivables is limited by the extent of his cash resources, except as they can be augmented by the use of bank credit. And here, mention of bank credit returns the discussion to its introductory statement of the importance of retailer bank credit not only to retailers but also to the production and consumption cycle in the economy. And in that connection it will be shown that the very weight and volume of retail credit have an influence on the effects of the general credit controls that are administered by the Federal Reserve System.

Therefore, now is the time in our discussion to consider the Federal Reserve System's responsibility for regulating the total volume of credit and how its credit policies affect retail credit operations. Generally speaking, it is when retailers begin to expand their holdings of accounts receivable through the direct or indirect use of bank credit that Federal Reserve credit policies begin to influence the rate of expansion in the volume of retail credit. This is because Federal

Reserve operations, by regulating the total amount of bank credit that is available, can in a real sense set the limits to which banks can extend credit to their retailer clients and they, in turn, to their customers.

Then, by recalling to mind the fact that retail credit is the largest single element in the total of all bank credit, it soon becomes clear that the effects of Federal Reserve System credit policy reach beyond their primary influence in the field of retail credit. That is so because of the further fact, already referred to, that retail credit is indispensable to the movement of goods from producer into consumer hands. Such being the case, the effects of Federal Reserve credit policies, in either encouraging or discouraging the expansion of retail credit, have a far-reaching influence on the volume of goods that is being produced for the consumer market and hence on all economic activity.

A further step in our examination of credit control indicates that where personal self-interest plays a natural part in governing over the direct extension and use of retail credit, Federal Reserve System credit policy plays an impersonal and impartial part in governing the over-all use of credit by regulating its availability to the commercial banking system. Moreover, the fact that Federal Reserve System credit policy works itself out through the free market process of leaving the allocation of the available supply of bank credit to the discretion of the commercial banks accounts for the System's ability to set and reach economic objectives without fear or favor.

The goal of Federal Reserve System monetary and credit policy is, of course, to insure that credit will always be a constructive force in our dynamic and growing economy. To that end, in exercising the powers to control credit which it has been granted by Congress, the Federal Reserve System is guided by the principle that credit should always be available to the business community in whatever volume is consistent with the needs of a stable economy operating at a high level of activity.

Judgment as to what was an economically appropriate volume of credit, in 1953-1954 led the Federal Reserve System to encourage an expansion of credit as a means of stimulating business. Contrariwise, in 1955-1956 the Federal Reserve System modified its policies so as to restrain an expansion of credit which, if unchecked, held the threat of serious inflationary consequences. Between these two poles of Federal Reserve policy the economy has operated continuously at a high level of activity and has seen a redirection in the mass uses of credit from emphasis on consumer and real estate mortgage credit to emphasis on producer credit, with the possibility now emerging of a balance that will effect the kind of division in the use of consumer and producer credit that will be most conducive to a continued era of national prosperity.

In the light of current experience, there are good grounds for holding that the kind of general credit controls administered by the Federal Reserve System have proven their value as an essential instrument of national economic policy. There are also good grounds for claiming that the essence of their value derives from the fact that the impersonal and impartial characteristics of general credit controls are consistent with the American free enterprise system, in that the choice of to whom and in what amount the available supply of credit shall be granted is left to the unfettered discretion of those best qualified to make such decisions. Our consideration in this discussion of the vast importance of retail credit to a dynamic and healthy national economy serves to emphasize the responsibility that rests on retail credit men to administer wisely their powers for controlling the use of credit.