CURRENT CREDIT DEVELOPMENTS

(Remarks of C. Canby Balderston, Vice Chairman, Board of Governors of the Federal Reserve System, before the Fourth Annual Consumer Credit Conference, Syracuse University, Syracuse, New York, on April 16, 1957.)

Fortunately the long future of our economy is one of rich promise. Thanks to technological advance and population increase, the long-term prospects are superb. The wide recognition of this fact leads to the speculative enthusiasm that inspires some of the current plant expansion. These prospects are so full of hope for high employment and an ever-rising scale of living that it would be a pity indeed if their realization were to be lost through failure to grapple with the immediate problems. These problems stem from the fact that aggregate demand is currently in excess of supply. Prices are being pushed upward, the economy endangered by cost squeezes, and values inflated by speculation. Too often binges have led to painful hangovers.

At a time when the general business climate is inflationary, it is obviously necessary to pursue policies designed to restrain excessive credit expansion. Also it is obviously not feasible for commercial banks to provide for the accommodation of all who wish to borrow. Some loans must necessarily be refused or deferred by commercial banks, even though the applicants may be technically credit-worthy.

The goal of economic progress is more jobs and more good combined with a dollar of stable buying power. The road toward this goal stretches ahead as an inviting path for us and our children provided the current economic traffic does not become snarled. Into the road there is now pouring more economic traffic than the present road capacity will permit to move forward at one time.

What is the nature of this traffic jam that threatens to impede economic progress? Too many people want too many things too fast. They want to build new plants, office buildings, ships and planes at an unheard-of rate and still retain record rates of production for residences and autos. The resultant pyramiding of demand not only creates scarcities for materials like steel and cement, but for certain labor skills as well.

What is so clearly evident in the case of scarce materials and labor applies also to money and credit. The so-called tightness of credit is often attributed to insufficient supply, whereas it has in fact resulted chiefly from a pyramiding of demand. Actually, the supply of money and credit is larger than a year ago, instead of being smaller as many imply when they use the phrase "tight money."

Moreover, money is being made to work harder. Demand deposits are being turned over about 8 per cent faster than a year ago. This increase in money activity is to be expected in a period of credit stringency, and has the effect of making the supply of money more active.

The aggregate and rival demands of corporations and individuals to borrow heavily in order to buy more goods than exist at the moment explain the concern over the cost and availability of credit. When the demand for credit exceeds its supply, the marketplace allocates the existing supply among the rival claimants for it. In the process, the cost of credit rises and many individuals and companies are disappointed that they cannot borrow all they wish in order to buy what they want right away. As a nation we are trying to spend faster than we save. If we should succeed, the higher prices that would result spell inflation with all its dread consequences to savings and to those dependent upon them. The well-being of wage earners who have pension rights is involved as well as that of widows, school teachers and all whose incomes are fixed.

The three inter-related instruments--reserve requirements, discount rates and open market operations--are tools for carrying out general, flexible monetary policies. They help to control the supply of money and credit in total, leaving its allocation to the competitive forces of the free market. Credit is allocated in the marketplace to those borrowers who are willing to pay the price of money. At a time when that price is high, the weaker demands for funds are set aside and with them some of the demands for goods.

In contrast to this relatively impersonal allocation of the money supply are so-called selective or direct controls. These represent efforts by government to intervene in the operation of the free market. Broadly speaking, they embrace rationing, price and wage controls, and regulation of specific uses of credit. Of course the government also intervenes when it uses subsidies, price supports and guarantees to shelter particular groups of citizens.

In wartime, spending has been curbed through price controls and rationing by many nations, including our own. Even though supported by wartime patriotism their success was limited. They did not prevent eventual loss in the purchasing power of the monetary unit. They did involve the policing of hundreds of thousands of enterprises and of private citizens. It is little wonder, therefore, that country after country shook off this harness of governmental controls when conditions permitted restoration of free markets. Even though many individual spending decisions be unwise, the free market gives people the satisfaction of relying on their own knowledge, judgment and initiative.

The proper role of government in these matters is to be responsible for fiscal policy, including the balancing of its own budget, and for general monetary policy. Responsible for the fiscal policy are the Treasury and the Congress. Responsibility for monetary policy has been assigned by the Congress to the Federal Reserve System with a mandate to serve as a trustee over the total supply of money, and to carry on its work without fear or favor, unaffected by partisan political pressure on the one hand, or private business pressure on the other. Its particular role is to regulate the reserves available to the commercial banks so that bank credit may expand and contract flexibly in accordance with the fluctuating needs of the economy.

If the supply of credit becomes excessive in relation to the goods and services available, prices tend to rise; if the converse is true, prices tend to fall. Therefore, if the value of money is to be stable and to assist the economy to move steadily upward, its supply (at the current rate of deposit turnover) must be harmonized with the flow of goods. Hence, the supervision of government is needed over the total supply of money and credit. The apportionment among individual borrowers, however, is best left to competition between private borrowers and private lenders. It is the responsibility of the central bank to influence the total supply of credit, but the selection of the particular customers to whom loans are to be made should be left to the discretion of commercial bankers and other private lenders.

Of the selective controls over the use of credit, the Federal Reserve has had experience with three forms. The first of these is the control over stock market credit, which was delegated to it by the Congress in 1934 and still remains its responsibility. The second is the control over mortgage credit which took the form of Regulation X. The third is the control over consumer instalment credit which took the form of Regulation W.

The control of stock market credit is exercised through the

System's authority to prescribe margin requirements applicable to registered securities. This particular form of selective control has been effective. The customer credit flowing into the stock market through both banks and brokers is 5 per cent less than a year ago. Throughout the current boom, it has never risen much above $4 billion in contrast to the $145 billion in mortgages and $42 billion in consumer credit. This direct control has worked chiefly because it has been easy to administer.

This brings me to the control of consumer instalment credit, which the Board was asked by the President to study. Probably the concern of the President and of Dr. Arthur Burns stemmed from the liberalization of the terms of automobile instalment credit in 1955 and the stimulation that its use gave to the sale of an abnormal number of autos in that year (at least a million more than would have been sold otherwise.) The study has flowered into a massive 6 volume report.

Volume 1 deals with the changing role of consumption, the types of instalment credit and credit institutions, their operating experience, the effects of changes in instalment credit terms and their impact upon aggregate demand and economic stability.

Volume 2 deals with the financial characteristics of principal consumer lenders and their responsiveness to changing credit conditions. It also contains the results of the national survey of households as to their debt status, car purchase and home ownership.

Volume 3 presents the proceedings of a conference of the National Bureau of Economic Research, dealing with the position of consumer credit in the economy and its bearing on the problem of regulation.

Volume 4 is likewise the outgrowth of the National Bureau conference and deals with the pros and cons of consumer credit regulation.

Volume 5 sets forth the views of the consumer credit industry.

Volume 6 is a pioneering analysis of new car financing in 1954-55, that, when available shortly, will prove of tremendous interest.

Advocates of selective control think of it as a useful supplement when consumer credit spending threatens instability. For example, an officer of the Bank of England has observed that Britain's monetary restraint would have had to have been even more severe than that reflected by last year's 5-1/2 per cent "bank rate," with the 3-1/2 per cent War Loan bond selling at 68 to yield over 5.1 per cent, had Britain not used selective control over what it calls hire-purchase credit. The principal argument favoring standby authority to regulate instalment credit is based on the view that booms and depressions are serious wastes and that governmental regulation can moderate unstabilizing fluctuations in selected credit areas. According to this reasoning, the national cost of economic stability is the waste of resources that are overcommitted in periods of inflationary upsurge and boom. Such waste leads later on to the unemployment of labor and other resources, and to capital losses.

The arguments opposed to regulation center in its alleged distortion of the allocation of resources by the market, in its interference with economic growth, and in the administrative difficulties of enforcement. It is argued that additional selective regulation would divert the attention of credit and monetary policymakers from the important problem of promoting stable economic growth without inflation or deflation. Monetary management is seen by these opponents of standby control as difficult enough, without adding the complex task of deciding whether particular sectors are using too much credit, or too little.

From the point of view of the control of money and credit, the central question concerning consumer instalment credit is its responsiveness to general controls. Those who believe that the traditional tools of credit and monetary action are adequate point to the fact that lenders of instalment credit also have to pay higher interest costs when interest rates rise.

It may be observed that the sudden liberalization of terms that took place in 1955 with some disturbance to the economy may not be repeated soon. At least the incentive to stretch terms further is not strong.

The regulation of consumer credit for which the Federal Reserve has had the responsibility on three occasions, imposed tremendous administrative burdens. It was onerous to both the regulators and to the regulated. Developments in consumer credit since 1955 have not been of as great concern as those during that year, but the Board is continuing to study the problem.

To summarize:

The expansion of credit which has characterized the current boom has been world wide. Other countries, like our own, have faced the evidences of incipient inflation: efforts to invest more than is saved and to spend more than is produced. As a result, debt has mounted but the demand for credit has mounted still faster. Future students of financial history will doubtless study this era with especial interest because nations have been relying more heavily upon general monetary and fiscal controls than upon selective ones. If sound fiscal policy, which includes budgeting and taxing, together with sound monetary policy should provide reasonable protection for the dollar's buying power, they will take their places as among our country's greatest boons. For they will have demonstrated that in peacetime they, with public understanding and support, can help to foster sound economic growth without inflation.