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CONSUMER INSTALMENT CREDIT

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"The greatest good of the greatest many" is the goal of an enlightened democratic society. The economic supports to the material achievement of this goal are production and consumption. The space between production and consumption is filled by markets which must first supply the units of production, whose output must then be transferred by market processes to the units of consumption. As consumption is the ultimate end of production, the market for consumer goods outranks in importance that for producers' goods, at least in a sociological sense. Put in another way, the consumer is king, but as a proportion of final consumers is also a factor in production, a harmonious relationship between all factors of production and consumption is essential to the smooth absorption at the consumer level of the national output. Economic research teaches all too well that a lasting imbalance in either production or consumption seriously interferes with the maximum satisfaction of consumer wants.

The purpose of the study of consumer instalment credit that the Board of Governors of the Federal Reserve System undertook at the direction of President Eisenhower is to provide an historical and factual basis for determining whether consumer instalment credit under some conditions becomes an unstabilizing economic influence which, if not contolled, exaggerates market movements in ways that can lead to cyclical disturbances inimical to "the greatest good of the greatest many." If the answer is yes, the next question raised is: To what form of control should consumer instalment credit be subjected?

Credit can be defined as the grant of the cash means for immediately acquiring and utilizing some desired goods or services whose acquisition would otherwise have to be deferred until the cost had been accumulated from saving. Consumer instalment credit fits this definition and, furthermore, is a built-in savings device through which the payment of the credit leaves the debtor in clear possession of whatever consumer goods had been added to his pleasure and convenience from the time of their acquisition. There are good grounds to state that consumer instalment credit adds to the material comfort and convenience of the American people and by doing so contributes to a rising standard of living. Also, as it can be said that a high standard of living bears a relationship to the economies of mass production and distribution, there is little doubt but that consumer instalment credit plays a major part in expanding the markets on which mass production depends.

An example of this theme is the role of instalment credit, both consumer and real estate mortgage credit, in facilitating the present vast migration to the suburbs of city dwellers who retain their urban employment but choose a suburban way of living. This mass movement to the suburbs is an evolution of immense and still somewhat incalculable sociological and economic significance. It is enough to say that instalment credit has been a major factor in meeting the housing and transportation needs connected with the present liking for suburban life. Moreover, to the extent that the physical burdens of family life have been lightened by the use of household appliances acquired on consumer instalment credit, new impetus has been given to our national productive forces by the time thus freed for fruitful application elsewhere and from the psychological benefits attributed to greater leisure.

If, indeed, there is so much to be said in favor of consumer instalment credit, what are the arguments calling for its control? Except for the period between September 20, 1948 and June 30, 1949, the imposition of consumer instalment credit controls has been associated with a national emergency.

The first of these emergencies goes back to the threat of war when on August 9, 1941, President Roosevelt issued an Executive Order controlling consumer instalment credit, which had as its chief objectives: (a) to facilitate the transfer of productive resources to defense industries; (b) to assist in curbing unwarranted price advances which tend to result when the supply of consumers' durable goods is curtailed without corresponding curtailment of demand; (c) to assist in restraining general inflationary tendencies; (d) to aid in creating a postwar backlog for consumers' durable goods; and (e) to restrain the development of a consumer debt structure that would repress effective demand for goods and services in the postdefense period.

In the light of World War II experience with controls over consumer instalment credit, similar reasoning properly led to their reimposition on the occasion of the Korean war emergency. On this occasion, controls were in effect by act of Congress from September 18, 1950 until May 7, 1952.

Experience with consumer credit controls during these two periods of wartime emergency generally justified the purposes for which they were specifically evoked. However, during the World War II period that the controls were in force, individual incomes rose and liquid assets in the hands of the public increased rapidly as consumers, in being deprived of a normal opportunity for acquiring consumers' durable goods, came into possession of large holdings of cash and readily convertible U. S. savings bonds through a species of forced savings. In effect, this added liquidity in the hands of the public denoted a repressed inflation which erupted into unusually heavy demands for consumers' durable goods as soon as the controls were lifted.

The Korean war period had somewhat similar effects in that public holdings of liquid assets increased again. On this occasion, not so much as the result of the actual curtailment of access to consumer goods as occurred in World War II, but because of the continuation of fiscal and monetary policies and practices that fostered a monetization of the national debt and thereby unleashed an inflationary inspired demand for consumer goods.

With respect to the interwar period, the inflationary reflex to the termination of World War II was an upward movement of prices that was closely related to the unsatisfied demand for automobiles and other consumers' durable goods. These demands were initially asserted through the application of the liquid assets accumulated during the control period, and were later augmented by the use of consumer instalment credit as consumer propensities to spend were contagiously excited following the suspension of consumer credit controls on November 1, 1947. In upshot, the inflationary impact of these unleashed demands caused official alarm and a special session of Congress was called which, as of September 20, 1948, reimposed consumer credit controls as a curb on their unsettling economic influence.

This period of control over consumer instalment credit lasted until June 30, 1949. This was the first and only time that consumer credit controls have been imposed as a purely peacetime measure to subdue inflationary pressures which, for that matter, might possibly have been overcome by means of general credit controls if their use had not been precluded by the ruling fiscal and monetary policies of that period. Even so, this experience may be a persuasive reason to some of those who favor legislation vesting standby authority in the hands of a Federal administrative body to impose such selective controls whenever the growth of consumer instalment credit is judged to be an unstabilizing economic influence.

To summarize, consumer credit controls are an essential weapon in the armory of emergency controls, as has been recognized from experience with their use during World War II and the Korean war. However, equally good reasons for their peacetime use are open to question in the light of historic analysis which reveals that the origin of every alarming increase in the outstanding volume of consumer instalment credit can be found in a previous period of high public liquidity induced by contemporary fiscal and monetary policies. It is, therefore, logical to conclude that economically undesirable fluctuations in the volume of consumer instalment credit can best be prevented, and the peacetime emergency use of selective credit controls avoided, by following fiscal and monetary policies that do not foster an undue degree of public liquidity.

The period of rapid growth in consumer instalment credit that paced the business revival that followed the recession of 1953-1954 deserves special comment. This was exclusively a peacetime phenomenon but, in common with its wartime precursors, had its roots in a high degree of economic liquidity. In this instance, the reappearance of substantial holdings of liquid assets in the hands of the public was the result of the conscious efforts of monetary policy makers to increase the liquidity of the commercial banking system as a means of stimulating a revival of economic activity. These efforts met with conspicuous success but, along with the effects of the 1954 reduction in Federal income taxes, are charged with having overstimulated the economy in that a psychological attitude of confidence was developed which spread beyond the application of presently available liquid assets to business and personal uses into an economically unstabilizing growth in the volume of consumer instalment credit. It is then argued that under such a condition general credit controls cannot work quickly enough and that, therefore, selective credit controls are the most appropriate means for correcting what are presumed to be the harmful consequences of so rapid a growth in the volume of consumer instalment credit.

The logic of this course of reasoning is impressive, but does not dispose of the fact that actions to forestall excessive economic liquidity probably afford the most effective means for avoiding any necessity for imposing selective controls over consumer instalment credit in peacetime.

Where such advance measures have not been, or cannot be, adequately taken, leaves for solution the problem of preventing a potentially excessive use of consumer credit from becoming an unstabilizing economic influence. The solution of this problem requires a judgment whether the peacetime imposition of consumer credit controls under a standby authority contains elements that are self-defeating in effect and, if so, whether the objectives sought after cannot better be attained through the use of general credit controls.

To understand better the problem, it is necessary to point out that consumer credit has its marginal influence on the markets that span the gap between production and consumption and which, as has been mentioned, are so essential to that "greatest good of the greatest many." Therefore, inasmuch as consumer instalment credit has so great an impact on consumer markets, a sudden major expansion in its volume generates a far-reaching and stimulating influence both on producer and consumer markets. It is this almost explosive market influence which consumer credit has exerted at times that has properly aroused the concern of economists and government officials. As has also been mentioned, a marked expansion of consumer credit is not necessarily connected with a shift from emergency to normal conditions, but is also related to "consumer attitudes," as is witnessed by the increase in consumer credit that accompanied more optimistic consumer sentiment following the 1953-1954 recession.

As regards the market influence of rapid expansion or contraction in the volume of consumer credit, it is argued that a market overstimulated by the use of consumer credit cannot only overreach itself by borrowing from the future, but may also engender the expansion of a productive capacity that may later prove to be redundant. In such an event, consumer credit becomes an unsettling economic influence whose adverse effects are aggravated by the obvious fact that the extension of consumer credit involves the assumption of a debt burden by its users, whose service may involve both individual and collective difficulties upon the advent of unfavorable economic conditions.

For example, if it were possible to trace the onset of a business recession to a contraction in the volume of consumer credit, it might be revealed that the narrowing markets incident to a reduced use of consumer credit had in turn brought about lower industrial production schedules and reduced employment. At the same time, this contractive process would be further aggravated by a spirit of caution which would deter prospective users of consumer credit from incurring debt while others would apply their efforts to liquidating their outstanding obligations.

However, generally favorable experience with the use of consumer credit, plus a demonstrated capacity for general credit controls to influence movements in its volume, indicates that the economically depressing elements potentially inherent in wide fluctuations in the volume of consumer credit may not be a matter of serious concern. Therefore, searching thought and examination should be given to the objections sometimes raised to granting any Federal administrative body discretionary standby authority to impose selective credit controls.

As regards such objections, it is usually admitted that selective consumer credit controls represent an interference with individual spending habits and commercial sales practices that is not warranted except in exceptional circumstances. Also, it is known from experience that the enforcement of consumer credit controls poses difficult administrative problems except under emergency conditions when the populace is willing to accept the discipline of controls from patriotic reasons.

Furthermore, the economically successful operation of peacetime controls over consumer credit under a standby authority would demand infallible judgment on the part of those charged with the responsibility for appraising the need and choosing the time for their imposition. Although it is claimed that public awareness of the existence of authority to impose consumer credit controls would of itself serve as a moderating influence to prevent the overexpansion of consumer credit, either concern in that regard might unnecessarily deter constructive industrial and commercial programs or else, if consumer credit controls were summarily imposed after annual programming had been embarked upon, the disruptive effects on manufacturing schedules, inventories, and wholesale and retail sales might be serious.

The widespread opposition to consumer credit controls that has been voiced by industrial, commercial, and financial groups supports the position frequently taken that the imposition of consumer credit controls, except in time of crisis, could so upset the normal processes of production, distribution, and consumption as to take from rather than add to "the greatest good of the greatest many."

But to set out the problems and difficulties attendant to a peacetime imposition of consumer credit controls cannot hide the fact that major fluctuations in the volume of outstanding consumer credit contain unstabilizing economic influences that must be restrained. How appropriate restraint can be exercised suggests that it is not consumer credit alone, but the entire scheme of credit, that requires scrutiny.

Consumer credit as a constructive and dynamic factor in maintaining and raising our standard of living has already been adverted to, as has been the strength of its influence in broadening our markets and reaping the benefits of mass production. But what has been said of the good and bad qualities of consumer credit can also be said in more or less degree of other types of credit, which intimates that general credit controls may offer as appropriate a means for restraining any excess in the use of consumer credit as do selective controls.

Fundamentally, the total use of credit depends on the supply available in the hands of credit-granting institutions and how it will then be allocated among its claimants. Many considerations enter into the process of credit allocation, but all revolve around the principle that by and large a free market is a better vehicle for its allocation than a controlled market. However, the working of a free market is bound to be affected by the temper of the times, and thus it is that when consumer propensities to spend are attracted to any particular field of personal expenditure, it is a sequel that the use of consumer credit will also expand in that field and may, by a multiplier process, result in an overexpansion of some form of consumer credit.

Furthermore, as a previous period of rising public liquidity has been held to be the source of a subsequent sudden and rapid increase in the volume of consumer credit, it follows that if consumer credit controls were summarily imposed without a simultaneous reduction in the total supply of credit, the amount of credit forced out of the consumer credit sector might then rush into some other sector of credit. The consequences could conceivably become as economically disturbing as those that were believed to have justified imposing controls over consumer credit.

In the light, therefore, of these considerations, reliance on general credit controls for restraining any overexpansion of consumer credit under normal conditions looms as an alternative instrument of credit control and as one more consistent with the principles of a free market than are selective controls.

It is granted that general credit controls cannot act with the same promptness and dispatch in restraining the growth of consumer credit as can selective credit controls. On the other hand, there is presumptive evidence that over a period of time they are effective. A juncture in the state of the consumer mind when mass enthusiasm leads to a vast upsurge in the desire to apply consumer credit to the purchase of desired goods is the background against which general credit controls must exert their influence. Prior to that time, existing and new credit-granting units will have been drawn magnetically into the market for the satisfaction of such desires. Not only consumer credit, but all kinds of credit, expand in this type of economic setting and in the process the pressure of an increasing demand is exerted on the available supply of credit.

Then, because the effect of general credit controls is to restrict the expansion of credit, their restraining influence becomes progressively greater as the total volume of credit expands and bears with especial weight on the commercial banks who are the most dynamic force in the area of credit-granting institutions. What is more, commercial banks are the most important single factor in the extension of consumer credit, accounting directly and indirectly for more than one-half of the total volume of funds that eventually are lodged in consumer credit paper. Considering the dominant role played by commercial banks in the field of consumer credit and their companion responsibility to serve simultaneously a myriad of other needs for credit, it becomes apparent that the impact of general credit controls on the credit-granting activities of commercial banks is far-reaching and especially so at a time when they are being employed vigorously. This is because the effectiveness of general credit controls increases with the expansion in the volume of credit it is sought to restrain, but with a pervasiveness throughout the general structure of credit that does not forcibly interrupt whatever expansion of credit is appropriate to the healthy growth of a dynamic economy.

Besides their leading role in the field of consumer credit, commercial banks, as has been mentioned, have diverse responsibilities for the extension of credit that also run parallel to an even superior responsibility to be prepared to meet the withdrawal requirements of their depositors. These responsibilities, in combination, demand that bank managements arrange the distribution of the resources at their disposal so as best to meet the claims for credit pressed upon them and at the same time to maintain the degree of liquidity essential to the fulfillment of their deposit obligations. This is an art whose peak of perfection is expressed most capably when the expansion of credit is being vigorously subjected to the influence of general credit controls. And it is in the consciously determined distribution of banking resources that general credit controls reach their maximum of efficiency.

In illustration of the manner in which commercial banks distribute their loanable resources, their holdings of consumer instalment paper increased by $1,081,000,000 for the year ended December 31, 1956, as compared to an increase of $1,805,000,000 for the year ended December 31, 1955. Taking full account of a major slowdown in the rate of increase in holdings of automobile paper, the slower overall growth in holdings of consumer instalment paper during 1956, which was another year of intense demand for commercial bank credit, reflects both the pressure exerted by general credit controls on the commercial banks to allocate their available supplies of credit among their most deserving claimants, and the necessity at a time of falling liquidity to accomplish whatever arrangement of resources was most consistent with the character of their deposit liabilities.

Broadly speaking, the effects of general credit controls in 1956 were compatible with the objectives sought after, as seen through the credit activities of the commercial banks, which witnessed a slowing down in the growth of their holdings of consumer instalment paper at the same time that credit extended in other directions contributed to enlargement of the nation's productive capacity and thereby to the potential relief of the heavy demands made on the supply of essential commodities and materials.

In short, the unfettered allocation of banking resources played a vital part in achieving the sort of rolling adjustment in our national economic activity that is looked upon more and more as the prerequisite of a stable economy operating at a high level of activity, and which in 1955 and 1956 shifted concentration on the production of consumers' durable goods into concentration on the production of producers' goods.

Lest it be thought that the place of commercial banks in the scheme of consumer credit expansion and control has been raised too high, the reminder is necessary that as the supplier of over half of the volume of funds that finds its way into consumer credit, commercial banks have a decisive voice in the allocation of consumer credit. Thus, it is also true that as general credit controls operate directly through the mechanism of the commercial banks, their effects reach through the banks to their customers, and especially to those customers who in turn look to bank credit as their source for making consumer credit advances. The secondary influence of general credit controls on the sales finance companies who operate extensively with commercial bank credit is a case in point. But of still more importance is the influence of general credit controls on the marginal type of bank borrower that is the last to be drawn into the extensive use of bank credit at a time of high economic activity and the first to be forced out as the effectiveness of the controls strengthens. The pressure exerted by general credit controls on these marginal operators to a considerable degree measures their restraining influence on the total expansion of consumer instalment credit.

In brief, although experience indicates that general credit controls eventually exert timely restraint over the growth of consumer credit, it is acknowledged that in doing so the free market process of allocating the available supply of credit at a time of an active demand for credit may not serve the credit needs of all claimants. Judging, however, from the continued growth in the total amount of all types of member bank loans during this past year, which came to $7,310,000,000, and analysis of its uses, most needs, both small and large, have been met, even though delays have occurred, and where difficulties were encountered existing specialized credit-granting institutions have given assistance. Whether the use in 1955 and 1956 of the cruder instrument of selective credit controls to restrain the growth of consumer credit would have been more beneficial to an economy operating under forced draft than the use of general credit controls cannot be answered.

Lastly, in our thesis of "the greatest good of the greatest many" comes the question: Is consumer credit really good for the greatest many? Collectively, the answer "yes" has already been given, in the contention that the use of consumer credit has been beneficial to our high standard of living.

A less positive answer can be given to the case of the individual user of consumer credit. It is estimated that about 30 million households, or three-fifths of all households in the United States, owe some form of consumer debt. An estimated 13 million households owe debt for more than one purpose. Mortgage debt is the most common obligation but nearly one-half of all households are in debt for autos, household equipment, or other nonmortgage purposes. Acquisition and possession of the physical assets for which these obligations were assumed have, as has been stated previously, added to the convenience, comfort and efficiency of the American people. In so doing, however, consumer instalment credit is recognized to be a leading and amplifying force in economic fluctuations and to have contributed to and intensified inflationary pressures in boom periods.

In that connection, the growth of consumer instalment credit from a total outstanding of $2,462,000,000 in 1945 to $31,552,000,000 at the end of 1956 gives cause to ponder what might be the reverse effects on the economy if an unfavorable change in business conditions should curtail the expansive economic influence of consumer instalment credit proportionately to a reduction in personal incomes and a consequent lowered ability for users of consumer instalment credit to take on similar new obligations because the burden of servicing their existing obligations was growing heavier. Lacking previous experience with any serious development of this kind, it is impossible to answer this question categorically. However, as in the opinion of competent observers, consumer instalment credit has been a less aggravating factor during recessions than an inflationary factor during boom periods, there are grounds to believe that the effects of such a situation might not be as direful as sometimes supposed. In support of this view, it is cited that the use of consumer instalment credit does not represent expenditures separate and apart from the run-of-the-mill type of household expenditures, but in reality substitutes for many such expenditures. For example, mortgage and related payments on homes may be regarded as an alternative to rent; outlays for a washing machine and dryer take the place, to some extent, of payments to a laundry establishment; while the ownership of television sets replaces, in some degree, admissions to theatres and sports arenas. On the premise, therefore, that the end use of many essential consumer expenditures has been provided for previously through the application of consumer instalment credit, a reduction in personal incomes should not be expected to have as abrupt and harsh an impact on the general level of essential consumer household expenditures as might have been the case in years gone by when consumer credit was not used as extensively.

Granted that it is reassuring to feel that consumer instalment credit contains qualities that tend to offset some of the potentially depressing economic effects of a reduction in the level of personal incomes, economic vulnerability from that direction cannot be dismissed out of hand for the hard fact remains that in 1956 payments on instalment debt took 12.9 per cent of consumers' disposable incomes. The claims for debt service over other uses of personal incomes are, therefore, always to be reckoned with when discussing the possible results of a downward movement of personal incomes.

Even so, recent experience gives hope that future shifts in the nation's economic activities will also be of the rolling adjustment type that redirects many primary factors of production and consumption without materially altering the total level of economic activity. In that event, the high rate of turnover in consumer instalment credit should serve to counteract the possibility that the weight of instalment payments against reduced personal incomes will exert cumulatively depressing effects on consumer purchasing power. Encouraging to that view is the fact that the existence of consumer instalment credit is concentrated in the younger elements of society whose job and income security, and consequently their debt-paying ability, is better assured than may be that of the older elements who, on the other hand, have tended to free themselves from the burden of debt along with the passage of years.

To say that the constant employment of consumer credit by the younger generation is more harmful, in making it callous to a respect for debt obligations, than it is helpful in easing the path of its living habits, seems to be denied by payment records, which have been good. To criticize the use of consumer instalment credit from the vantage point of those whose youthful debts are behind them, ignores the imponderable fact that as time marches on, evolution in the use of credit marches with it from a present into a future that it is folly to attempt to predict will or will not serve "the greatest good of the greatest many."

But it is not enough to look at what might be termed these global aspects of consumer instalment credit. The quality of the individual obligations must also be viewed. Where instances in the rapid growth in the outstanding volume of consumer instalment credit have been associated with periods of economic boom, investigation has identified these same periods with a deterioration in the quality of consumer obligations, as competition and the hectic excitement of the boom have led to a lowering of down payments and an extension of maturities. However, if it is a demonstrable fact that booms have their origins in earlier periods notable for a high degree of economic liquidity, and if it can be conceded that the problems incident to excessive public liquidity can be prevented through properly conceived fiscal and monetary policies, quality problems with respect to consumer instalment credit obligations are less likely to arise. Moreover, even should history be repeated and consumer instalment credit again become suspect as being a potentially unstabilizing economic force, I am sure everyone will agree that in our search for "the greatest good of the greatest many" consumer instalment credit has its fitting place of honor.