

CREDIT FOR CONSUMERS

**Address
by
Delos C. Johns
President, Federal Reserve Bank of St. Louis**

**Before the
National Instalment Credit Conference
Sponsored by the American Bankers Association
Jefferson Hotel, St. Louis, Missouri
Monday morning, March 21, 1955.**

CREDIT FOR CONSUMERS

Many of us gathered here today find it difficult to reflect on the early 1920's without a momentary pang of nostalgia. Yet I think we would not wish to turn the calendar back if we could, for an undeniable fact of life in the early twenties was this: the members of the family worked much harder at entertaining themselves and at keeping the household going than they do in 1955. Though people of some means then commonly passed housework on to full-time domestic servants, much drudgery remained nevertheless, and escape from the boredom of repetitive chores was a challenge to the ingenuity of many.

But new, durable goods were already beginning to change living patterns. By 1921 the first two great labor-saving household appliances, washing machines and electric refrigerators, were gaining rapid acceptance. A 1921 washing machine was an ugly contraption, requiring almost as great expenditure of human energy as the tub and washboard. An electric refrigerator of the early twenties, with its compressor installed in the basement, made a great noise, setting up sympathetic vibrations in various parts of the house as it grumbled on and off. On balance, however, both appliances reduced household toil, as did the electric and gas ranges which by 1925 were quickly replacing kerosene cook stoves and wood-and-coal-burning kitchen ranges. Though pianos had long been installed to further the family's cultural progress, they unfortunately required individual playing skill. Thus the player-piano and phonograph, when they were introduced, vied for popular favor as providers of ready-made music. The phonograph was winning out until the realization at last came that radio had become commercially feasible. Radios, most of them still tuned with three dials, were by 1925 fast becoming the center of the family's evening interest, but were not

yet always dependable sources of entertainment.

Households had always used durable goods, of course; the 1920's simply witnessed a change in their kind. As the automobile revolutionized American life and mechanization spread to the home, the share of furniture and furnishings in consumer durables production fell off rapidly. Automobiles and electrical appliances not only replaced older durable goods, such as horse-drawn carriages and iceboxes, but also brought about an increase in the share of consumers' expenditures going to durables. By 1929 almost 12 per cent of personal consumption expenditures were for durables. Moreover, by that year the composition of expenditures for different categories of durables was pretty well set. For example, in 1929 about one-fifth of outlays for durables went for the purchase of appliances, a proportion which has remained quite stable into the present. In spite of the continual introduction of new and acceptable electrical devices, the share of these goods in the total dollar expenditures of consumers has remained almost constant. Typically, if an appliance gains consumer acceptance, sales will increase at a rapid rate for several years and then level off or actually decline. Thus the fabulous successes of mechanical refrigerators in the 1930's and home freezers, automatic washers, television sets, and room air-conditioners in the post-World War II period just about offset the leveling off or decline in demand for previously established items such as radios and wringer-type washing machines.

How shall we evaluate the importance of durables in shaping the pattern of consumer expenditures since 1929? Inspection of available data leads to two

observations. First, consumer durables sales are extremely sensitive to both war and depression. The purchase of durables is postponable, and during periods of falling incomes the percentage drop in demand for consumer durables has been about the same as the drop in demand for producer durables. Wars, of course, demand the same raw materials that go into consumer durables and thus cut into their output. Second, in every year beginning with 1947 consumer purchases of durables have exceeded the 12 per cent level of total consumption expenditures reached previously only in 1929. During the 1940's, despite wartime restrictions and rapid growth in the population, per capita ownership of durables increased at an annual rate greater than that of the twenties. Today the average per capita value of consumer durables in use (in 1929 dollars) is at least half again as great as it was in 1929.

We may conclude then that the trend since 1920 has been for households to consume a higher proportion of their income in the form of durables, and it is quite possible that this tendency has increased since the end of World War II. (That trend, of course, has been obscured at times by depression and war.) How shall we account for this apparent shift in attitudes? A number of studies have demonstrated what we have long known intuitively - that expenditures on durables are closely correlated with income change. As people become richer, they spend a greater portion of their incomes on goods yielding services that will relieve work or monotony and increase personal and family prestige.

But we must look a little further. The purchase of a durable good requires a relatively large outlay at one time for a flow of services over a period of future

time. There is nothing to prevent families with sufficient incomes from saving up to make the outlay, and some do. But experience has shown that many, perhaps a majority, of American consumers find it irksome to save the full purchase price of major durables before buying. Consumer credit is a device, though not necessarily the only one which could be used, that puts the desire of households for capital equipment on a competitive basis with the desire for nondurables and services. As distinguished from convenience (charge account) credit, consumer credit enables the consumer, at any moment of time, to increase his purchases over and above what they would be if he depended upon his existing cash resources. Human character being what it is, families must enforce saving on themselves after committing themselves to a purchase contract.

Instalment credit is not new; a century ago sewing machines, pianos, some furniture, and books were sold "on time". During the first two decades of the twentieth century, instalment credit gradually became more respectable, and by 1920 even the most conservative merchants were offering easy payment plans. It is estimated that by 1926 nearly two-thirds of the new cars and three-fourths of the furniture were sold on a time-payment basis. By 1929 instalment credit was an accepted American institution.

During the 1930's the proportion of instalment sales to total sales ranged between 50 and 60 per cent at furniture and household appliance stores. About 60 per cent of all automobile sales were made on time during most of that decade, and this ratio came to be accepted as normal. Post-World War II experience seems to bear out this estimate of normalcy. After household units spent the cash

saved during the war for the specific purpose of buying durable goods when they should become available, the percentages which obtained in the 1930's were approximately equaled.

Consumer credit is obviously important to sellers of durables. Indeed, it is important to us all. At the end of 1954 total consumer credit outstanding stood at more than \$30 billion and instalment credit at more than \$22 1/2 billion, both just under the all-time highs of a year previous. Instalment debt amounted to about 8 1/2 per cent of disposable income, again not far from a peak reached in 1953. By themselves these figures are no cause for concern. The income left to most household units today after meeting the basic expenses of food, clothing, and shelter is much larger than before World War 11, and from this "discretionary" income people may safely commit a larger portion for consumer durables. Moreover, the bulk of consumer debt is owed by people with generally good economic prospects, - about two-thirds of it by middle-income families and by young married couples with children.

Bankers and economists have nonetheless frequently expressed alarm over swings in instalment credit, which is so closely related to the purchase of consumer durables. For the past twenty-five years expenditures on consumer durables have been of the same order of magnitude as gross business expenditures for durables, and the latter are notorious for their unstabilizing effects on the economy. This leads to the frequent asking of these questions: does not the institution of instalment credit make possible greater expenditures on consumer durables in the expansion phase of the cycle, and do not net repayments on instalment accounts have a deflationary impact when incomes are falling?

There is no denying the fact that instalment credit tends to concentrate effective demand for durables in times of expanding business activity. Nor can it be denied that instalment credit introduces additional rigidity into consumer budgets. If on the upward phase of a cycle there is unemployment of resources, injections of purchasing power via the instalment credit route stimulate activity in the durable goods industry at a propitious time. If on the other hand full employment conditions prevail and consumers already have incomes sufficient to enable them to take from the market what is produced, further injections of purchasing power generate inflationary pressures. During times of falling business activity and declining incomes rigidities introduced by instalment credit into consumer budgets have a pronounced deflationary impact. Like mortgage payments, property-tax payments, and insurance payments, payments on a car or furniture constitute for a time at least an unavoidable charge on income. Insofar as repayments on instalment accounts exceed new credit extensions the effect on the economy is depressing.

But such considerations need to be put in better perspective. Relative to total consumer outlays, expenditures on consumer durables are not large. Wide swings in consumer durables purchases may accent the business cycle but are relatively unimportant when viewed against the stability of expenditures for nondurables and services, which presently constitute about 88 per cent of total consumption expenditure. Indeed, as one durable good after another becomes generally accepted by consumers, resources are more and more drawn into the service trades. We have garages and filling stations because there are automobiles and television service establishments because there are television sets. The

experience of the great depression teaches us that the demand for such services holds up very well during a deflationary period, especially as people make their durables do for longer-than-normal periods. In this we find some contracyclical effect.

Nor does a comparison of consumer credit with other credit put the former in a bad light so far as stability is concerned. During the deflation years of 1930-1933, consumer credit moved downward at about the same rate as did loans of all commercial banks and non-real estate farm credit, but at a faster rate than did urban real-estate credit. On the other hand, beginning in mid-1933, consumer credit began a sharp upturn, well ahead of the other series. During the relatively depressed 1930's consumer credit on balance appears to have exercised a buoyant influence. An exception was the relatively sharp but brief fall in consumer credit in 1938. In the postwar years the upward thrusts of the consumer credit and instalment credit curves are not out of line with other series. It is not unreasonable to argue that in 1949 the upward change in both instalment and urban mortgage credit, so far from being a source of instability, actually helped to carry the economy over the threat of more severe depression. Again, in the recession of 1953-1954, although instalment repayments slightly exceeded extensions in some months, instalment credit seems to have operated as a sustaining force in the economy.

We may, I think, evaluate the significance of instalment credit to economic stability as follows. The rate of capital formation plays a large part in total cyclical fluctuations in output, employment, and prices. The share of consumer

durables in the rate of capital formation is comparable in character and size to that of producer durables. Insofar as the institution of consumer credit increases fluctuations in the rate of consumer capital formation, it adds to the factors making for instability. But these factors, including the very fact that there are such things as durable goods, outweigh the unstabilizing effect of the institution of consumer credit itself.

The old notion that changes in consumer credit are important enough to induce either an upswing or downswing in economic activity no longer has widespread acceptance. Nearly everyone would agree that changes in outstandings reinforce economic fluctuations; but there would likewise be agreement that consumer credit is only one of several variables which help to determine the national income, whereas fluctuations in the national income appear to be the dominant factor affecting the volume of consumer credit outstanding. In sum, many economists are taking a progressively more moderate view of the proposition that consumer credit is a major factor in causing instability.

I do not want to leave you this morning without reflecting on the implications of these conclusions for credit policy. It has been argued that the general credit instruments cannot be depended upon when it appears that instalment credit outstandings are increasing too rapidly. This proposition rested largely on the assumption that lenders to consumers do not respond very rapidly or very strongly either to credit stringency or to changes in the interest rate. For this reason it was assumed that consumer credit outstandings are not responsive to the general instruments. It was then but a step to the conclusion that selective control

of credit is a legitimate complement to the general instruments, that it can be used to reinforce, to compensate, or at certain times to serve as a partial substitute for the general instruments.

Several recent studies raise some doubt as to the validity of the argument that there is only a tenuous relationship between consumer credit outstanding and the supply of credit in general. Consumer credit may be more responsive to the general instruments than we had thought. Thus it seems now that the following propositions hold true:

- (1) Interest costs definitely enter into the considerations of both bank and nonbank lenders to consumers.
- (2) Lenders to consumers do react to the rising costs and reduced availability of credit in general.
- (3) Nonbank lenders pass along the effects of rising costs and reduced availability of credit by applying stricter credit standards, by cutting lines to dealers, and by raising rates.
- (4) Banks do appear to "ration" their resources with respect to consumer credit departments.
- (5) Even though consumer borrowers may not be especially affected by changes in interest costs, they are responsive to changes in credit standards, including terms.

In making a judgment regarding the sensitivity of consumer credit to general controls, one further point should be borne in mind. The best estimate of the percentage of consumer credit outstanding financed by banks both directly and

indirectly indicates a proportion of roughly three-fifths. This suggests that pressure on banks via general credit controls can scarcely avoid the effect of restricting consumer credit. Credit lines to dealers and lenders are not only likely to be tightened, but a tighter money policy also changes the economic climate in which consumers make their decisions. If it is successful, a tight money policy inhibits economic activity. As this happens, the rate at which the national income increases will slacken, or the national income may actually begin to decrease. We have already remarked the correlation between changes in the level of the national income and the level of consumer credit outstanding; it follows that actions which reduce the rate of increase of the national income are likely to reduce the rate of increase of instalment credit outstanding. Events of the past two years seem to substantiate this proposition.

The foregoing analysis suggests that when general credit policy can be free and its implementation flexible there is little, if any, need for selective regulation of consumer credit. But note that the conclusion is qualified by the statement that general credit policy be free and flexible, free to be easy or to be restrictive, flexible as to application within that range. And one further point needs mention here. A theoretical case can be made for the usefulness of a selective consumer credit control in special circumstances, say in a period of rapid defense build-up unaccompanied by materials allocation and price controls. Such circumstances, in my opinion, should not really be permitted to occur and hence the need for the selective control should not occur. However, none of us is always wise and sometimes all of us are unwise, and so it is possible to be faced with such a set of circumstances.

We have come a long way in a short while. Let me bring this discussion to a close.

There seems little question that the institution of instalment credit has done much to make possible large-scale output of consumer durables. By increasing the rate of consumer capital formation, instalment credit has contributed to a rise in the American level of living and has stimulated the growth of the national income. But consumer credit is a two-edged sword. It can cut both for you and against you. In times when inflationary pressures are great or when deflation is sharp and protracted, instalment credit may be just one more force making for instability in the economy. But we should not be surprised to find that this is so, for the very nature of capitalism implies certain inherent sources of instability. In other words, instability is a part of the price we pay for the enjoyment of goods which yield their services over time.

The case for and the case against selective regulation of consumer credit is becoming better understood. The arguments for it no longer rest on an assumption that without selective controls the monetary authority is substantially unable to influence the rate of expansion of consumer credit. It is now recognized that other considerations are also involved, including profound concepts of non-discriminatory monetary management in a free capitalistic economy. There is much to be said for the view that instead of intervening in particular markets it is the primary business of the monetary authority to do what it can to create a salubrious monetary and financial climate in which business decision makers like yourselves can compete freely and vigorously.