CONSUMER INSTALMENT CREDIT
Chairman Martin's Testimony before the
Joint Committee on the Economic Report
February 7, 1956

The Economic Report recommends that "consideration should be given to restoring the Government's power to regulate the terms of consumer instalment credit" and suggests that "this is a good time for the Congress and the Executive Branch to study the problem."

The Board of Governors agrees that a special study of consumer instalment credit in relation to economic stability would be timely. The study might well be undertaken by or under the direction of Congress with the help of the interested Government agencies. Both the Twentieth Century Fund and the National Bureau of Economic Research made comprehensive studies of consumer instalment credit in the thirties. A current research project could build on the fundamental knowledge contributed by these pioneer studies. The Board would be glad to do what it could to facilitate the research.

There are important arguments both for and against enactment of an authority to regulate instalment credit terms. Among those in support of permanent Government regulatory authority, there are at least three that have merit.

The first concerns the tendency for instalment credit terms to be liberalized over the expansion phase of the business cycle. Such a tendency may result in increasing risk exposure to a point which at a time of economic reversal would intensify recession.

The second argument concerns the sharp variation in the outstanding volume of consumer instalment credit over the various stages of the business cycle and the resultant change in the contribution to, or diminution of, consumer purchasing power from the use of such credit. These swings in instalment credit volume also tend to accentuate ups and downs in general business activity.

A third argument, related to the others, is that consumer instalment credit extension is not as sensitively responsive to general credit controls--exercised through regulation of the supply of bank reserves and interest rates--as are many other types of credit. For example, in periods of general credit restraint consumer instalment credit may continue to expand and impinge on the availability of funds for competing uses, while in periods of decline such credit may contract because of the high level of previously incurred indebtedness, regardless of the ready availability of loan funds and low interest rates.

On the other hand, the most telling arguments against Government regulation of consumer instalment credit terms in other than recognized national emergencies need to be stated. First is the fact that this type of regulation would necessarily interfere with the allocation of credit resources by the interplay of market forces. To justify regulation, for example, it would need to be demonstrated that credit standards and credit volume over business swings vary to a greater extent for consumer credit than for other types of credit. It would also need to be demonstrated that longer-term economic growth would best be fostered by regulated terms. Over the long run, the argument goes, only competition, experience and the discipline of the market place can determine reasonable and sound maturities, down payments, and the volume of this type of credit.

Another argument against a regulatory authority is that the administrative problems involved in regulation are exceedingly complex. The instalment credit industry includes not only banks, finance companies, and large retailers but also many thousands of small retailers. There were nearly 200,000 lenders and retailers who registered as subject to Regulation W when last in effect. Moreover, enforcement requires public acceptance. Experience shows this is difficult to obtain in the absence of national emergency.

A third argument against the regulatory authority pertains to the problem of criteria for regulatory action. Determination of guides for deciding what terms were appropriate at different stages of the business swing is a complex undertaking in itself. Then, there is an allegation advanced by representatives of the consumer finance business that regulatory terms inevitably tend to become the standard credit terms. This tendency, if true, would make difficult orderly business adjustment to changes in regulatory terms, particularly when stricter terms became appropriate.

Thoughtful consideration of all of these arguments, as well as of other aspects of the economic role of consumer instalment financing, should be included in the broad study of the subject proposed in the President's Economic Report.

Concerning the specific question of an authority to regulate consumer credit terms, the Board's present thinking is much the same as I have expressed several times in recent years. The Board does not seek such authority, but if it were to be enacted, the Board would perfer that it be made a part of the basic Federal Reserve Act, to be used as and when economic circumstances require. With respect to the use of a selective control such as this one, as in the use of general credit controls, timing is of the essence. Finally, I want to emphasize that selective controls of this nature are at best supplements and not substitutes for the general over-all credit and monetary instruments.