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# Banking in the Consumer Protection Age:

## Part III

*Parts I and II of this series reviewed the development of consumer protection legislation in the United States, with particular reference to the Truth in Lending Act and the range of criminal and civil sanctions that may be imposed for failure to comply with it. Among the subjects discussed in this final part are the following: (1) elements of an internal Truth in Lending compliance program for banks; (2) principal features of the Fair Credit Reporting Act; (3) important recent and pending legislation involving bank credit cards; and (4) the work of the National Commission on Consumer Finance.*

An important protective clause of the Truth in Lending Act provides that a creditor may not be held liable for civil penalties "in any action" if it can clearly show that its violation was not intentional and resulted from a bona fide error even though it maintained procedures designed to avoid any such error.<sup>1</sup> Obviously, the same evidence would preclude any possibility of criminal prosecution. Banks can take advantage of this protective clause by following a number of comparatively inexpensive steps, thereby placing themselves in a favorable position when disputes with consumers or regulatory authorities arise because of errors in disclosure statements.

**Elements of a Truth in Lending Compliance Program** An effective program begins with designation of a particular officer to be responsible for establishing and maintaining compliance procedures on a regular basis within the organization. The first task of this officer is to equip himself with a file of essential published materials. At minimum, this should include a copy of the Truth in Lending Act and a copy of Regulation Z of the Board of Governors, including amendments and formal interpretations by the Board relating to it. Copies of these materials may be obtained free of charge from any Federal Reserve Bank or from the Publications Section, Board of Governors of the Federal Reserve System, Washington, D. C. 20551. Although the coverage of these materials is comprehensive, supplemental information applicable to particular lending or credit sales transactions will be useful in many situations. The most helpful supplemental source is the large number of informal opinions that have been

written by members of the Board of Governors and its staff. Well over 500 opinion letters had been written through December 1971, all in response to inquiries from creditors or the public presenting basic compliance issues in the context of stated factual situations.<sup>2</sup> These informal opinions do not have the same legal status as the formal interpretations of Regulation Z published by the Board of Governors; nevertheless, they do represent the considered judgment of the staff or of individual members of the Board on a subject committed to the Board for administrative decision by Congress. Presumably, therefore, the courts will give weight to these informal opinions in the event of litigation, even though they do not have the same legal status as the Board's official interpretations.

The practical problem a bank or any other creditor faces is how to prove in court that it does in fact maintain procedures designed to prevent unintentional violations from occurring. One important document to help accomplish this is a written compliance policy that has been distributed to all personnel in the organization responsible for the extension of consumer credit. By now, all banks should have forms that meet the disclosure requirements of Truth in Lending. The next logical step for a bank, therefore, is to be able to show that all personnel with responsibilities for completing the forms and transmitting them to customers have been trained to complete them properly. One way to accomplish this is to furnish credit personnel with sample forms properly filled out as they would be in actual or hypothetical transactions, accompanied by written explanations where needed.

As a supplement to direct written instructions to credit personnel, banks should also consider issuing a written directive to their Auditing Departments to make periodic spot checks of compliance. Auditing representatives should examine copies of completed disclosure forms that have been given to customers and make additional investigations as may seem necessary under the circumstances at any particular time. There is yet another advantage to this pro-

<sup>2</sup> One commercial publisher of these opinions is Commerce Clearing House, Inc., 4025 W. Peterson Avenue, Chicago, Illinois 60646, in 4 CCH *Consumer Credit Guide*. Another useful source for many of them, and for many other useful Truth in Lending materials as well, is the *Truth in Lending Manual* by Ralph C. Clontz, Jr., published by Warren, Gorham & Lamont, Inc., 89 Beach Street, Boston, Massachusetts 02111.

<sup>1</sup> 82 Stat. 157 (1968). Section 130(c) of the Act.

cedure. It increases the likelihood that the bank might be able to take advantage of the second creditor defense written into the Truth in Lending Act. Section 130(b) provides that a creditor has no liability for civil penalties if, within 15 days after discovering an error and prior to the institution of a legal action by the consumer or the receipt of written notice of the error from the consumer, the creditor notifies the consumer of the error and makes whatever adjustments are necessary to insure that the consumer will not be required to pay a finance charge in excess of the amount or percentage rate actually disclosed.<sup>3</sup> A program of regular surveillance increases the chances of detecting and correcting errors prior to notification from the consumer. If spot checks suggest that particular lending officers are prone to error in completing disclosure statements, more thorough review of their disclosure statements may be in order. For larger transactions, such as real estate loans, it might be feasible to have a single individual complete all disclosure statements, thus reducing further the chances of error.

The Truth in Lending compliance officer or department can also play a particularly useful role in monitoring the adequacy of disclosure by retail dealers for whom the bank discounts installment paper on a regular basis. Here again, as discussed in Part II, if Truth in Lending violations occur, banks may well be equally as liable for civil penalties as retail dealers themselves. Among the measures that can reasonably be taken by banks to reduce exposure to loss are (1) advance examination and approval of disclosure forms used by dealers; (2) spot checks of disclosure forms completed by dealers for accuracy; (3) insistence that dealers obtain written acknowledgments by consumers that they have received required disclosures; and (4) insistence that dealers forward copies of disclosure statements and acknowledgment of receipt of disclosures by consumers to the bank along with installment contracts that are assigned. While the last step will be of no help if the disclosures have not in fact been received *and* if the credit transactions involve security interests in real property, such acknowledgments are conclusive evidence of compliance by assignee banks in all other situations, *provided* the violations are not apparent on the face of the disclosure statements and the assignee did not know of the violation when the assignment was made.

For insured banks, good faith compliance with the Truth in Lending Act and Regulation Z is essential

not only because of the threat of legal proceedings for money damages by consumers but also because examiners are likely to become increasingly alert to the requirements of Truth in Lending and other new consumer protection laws. Already, examiners of the Federal supervisory agencies carry checklists of important Truth in Lending points to aid in their examinations of insured banks.

An excellent recent article by Mr. Griffith L. Garwood, Chief of the Truth in Lending staff of the Board of Governors of the Federal Reserve System, reviews developments with the Truth in Lending Act since 1968. It is published in *The Banking Law Journal*, 89, No. 1 (January 1972).

**The Fair Credit Reporting Act** With the growth of consumer credit, a necessary satellite industry dedicated to the accumulation and sale of information relating to individuals and their credit standing came into being. This industry is composed, for the most part, of credit bureaus, investigative reporting companies and other organizations whose business it is to gather and report information about consumers. Among the principal users of consumer reports are banks, retail merchants, lenders, insurance companies, and other companies who regularly decide whether individuals who are the subjects of these reports are to receive credit, be granted insurance, or be employed—and, if so, upon what terms.

Erroneous information in a person's file can cause serious injury if it leads or contributes to the denial of credit, insurance, or employment. Prior to enactment of the Fair Credit Reporting Act on October 26, 1970,<sup>4</sup> many people were apparently damaged by inaccurate information, yet there was little they could do about it.<sup>5</sup> Only one state had legislation designed to protect consumers against false and inaccurate reports affecting their financial standing, eligibility for insurance, or employment opportunities. Furthermore, common law rights of consumers have been almost completely ineffective.<sup>6</sup> The individuals themselves had no way of knowing what information was contained in credit files maintained on them. The typical credit investigation required only 30 minutes, and much of the information obtained was not verified. Frequently, victims of erroneous and harmful information were not even aware that a credit report had been used against

<sup>4</sup> Public Law 91-508, 84 Stat. 1127 (1970). The Fair Credit Reporting Act was added as Title VI of the Consumer Credit Protection Act of 1968.

<sup>5</sup> Hearings before the Subcommittee on Financial Institutions of the Committee on Banking and Currency, 91st Cong., 1st Sess., on S. 823 (1969), especially pp. 427-30.

<sup>6</sup> *Ibid.*, pp. 437-42; see also, "Credit Investigations and the Right to Privacy: Quest for a Remedy," *Georgetown Law Journal* (February 1969).

<sup>3</sup> 82 Stat. 157 (1968).

them. In addition, because many people have the same or similar names (John Smith, for example), adverse information about a particular Smith mistakenly found its way into the files of other, innocent Smiths. As data became automated, and as the files of different credit bureaus were interconnected by telecommunication techniques using direct access remote terminals, errors in the process of coding, key-punching, programming, or transmission became more likely, entirely apart from the problem of multiple John Smiths. Cases of abuse or misuse of consumer credit information also came to light in the course of Congressional hearings.<sup>7</sup>

The Fair Credit Reporting Act was designed to provide remedies for consumers adversely affected by false or inaccurate consumer reports and to limit the uses of such reports to legitimate business purposes. However, the statute is complex, and its effect in any particular factual situation depends upon three key definitions: (1) of "consumer report"; (2) of "investigative consumer report"; and (3) of "consumer reporting agency."<sup>8</sup>

A bank may well become a "consumer reporting agency" unless it is scrupulously careful in limiting the types of information about consumers it communicates to third parties. But even where this classification is avoided, every bank is a regular *user* of information about consumers obtained from third parties; and the statute imposes a number of duties upon users, regardless of whether the infor-

mation comes from a consumer reporting agency or from other third parties who do not fall within this classification.

Every user must inform the consumer orally or in writing if information received in a consumer report from a consumer reporting agency causes the user to deny, or increase the cost of, credit or insurance or to deny employment. The user must also inform the consumer of the name and address of the consumer reporting agency issuing the report. The user is *not* required, however, to tell the consumer the nature of the information in the report.

In turn, every consumer reporting agency must, upon request and proper identification by any consumer, clearly and accurately disclose the nature and substance of all information (except medical information) in its files on the consumer at the time of its request. In addition, the agency must reveal the sources of any information unless it is to be used in an "investigative consumer report."<sup>9</sup> The agency must also disclose the names of recipients of any report on the consumer that it has furnished for employment purposes within the two-year period preceding the request, and for any other purposes within the six-month period preceding the request.

A different rule applies to information obtained by a creditor, insurance company, or employer from a source other than a consumer reporting agency. No disclosures of any kind need be made to the consumer in this situation unless credit is involved. If credit is denied, however, or if its cost is increased either wholly or partly because of information bearing upon the consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living, then the user of the information must disclose its nature to the consumer if, within 60 days after learning of the adverse action, the consumer asks in writing to know the reasons for it. The statute specifically requires the user clearly and accurately to disclose to the consumer his right to make a written request at the time the adverse action is communicated to him.

A bank or other financial institution may become a "consumer reporting agency" if it regularly passes on information in its files about consumers, other than information solely confined to its own transactions or experiences with the consumer.<sup>10</sup> The bank or financial institution may, however, relate information based solely upon its own transactions or experiences with the consumer without becoming a

<sup>7</sup> *Supra*, note 5, pp. 42-430.

<sup>8</sup> "(d) The term 'consumer report' means any written, oral, or other communication of any information by a consumer reporting agency bearing on a consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living which is used or expected to be used or collected in whole or in part for the purpose of serving as a factor in establishing the consumer's eligibility for (1) credit or insurance to be used primarily for personal, family, or household purposes, or (2) employment purposes, or (3) other purposes authorized under section 604. The term does not include (A) any report containing information solely as to transactions or experiences between the consumer and the person making the report; (B) any authorization or approval of a specific extension of credit directly or indirectly by the issuer of a credit card or similar device; or (C) any report in which a person who has been requested by a third party to make a specific extension of credit directly or indirectly to a consumer conveys his decision with respect to such request, if the third party advises the consumer of the name and address of the person to whom the request was made and such person makes the disclosures to the consumer required under section 615.

(e) The term 'investigative consumer report' means a consumer report or portion thereof in which information on a consumer's character, general reputation, personal characteristics, or mode of living is obtained through personal interviews with neighbors, friends, or associates of the consumer reported on or with others with whom he is acquainted or who may have knowledge concerning any such items of information. However, such information shall not include specific factual information on a consumer's credit record obtained directly from a creditor or from a consumer reporting agency when such information was obtained directly from a creditor of the consumer or from the consumer.

(f) The term 'consumer reporting agency' means any person which, for monetary fees, dues, or on a cooperative nonprofit basis, regularly engages in whole or in part in the practice of assembling or evaluating consumer credit information or other information on consumers for the purpose of furnishing consumer reports to third parties, and which uses any means or facility of interstate commerce for the purpose of preparing or furnishing consumer reports." Public Law 91-508, Section 603 (d), (e), and (f) (October 26, 1970); 84 Stat. 1128 (1970).

<sup>9</sup> The sources of information acquired solely for use in an "investigative consumer report" and used for no other purpose need not be disclosed except in the event of litigation.

<sup>10</sup> See note 8, *supra*, for definition of "consumer reporting agency."

consumer reporting agency, even if it regularly furnishes such information to a consumer reporting agency.

If a bank or other financial institution becomes a consumer reporting agency, it must comply with a number of duties to the consumer. First, information about consumers may not be disclosed to anyone except as authorized by Section 604 of the Act.<sup>11</sup> Second, certain types of obsolete information may not be furnished to anyone except in connection with a credit transaction expected to involve \$50,000 or more in principal, or the underwriting of insurance expected to involve a face amount of \$50,000 or more, or employment at an annual salary of \$20,000 or more. Third, reasonable procedures must be maintained to assure maximum possible accuracy of all information in every consumer report, and certification must be obtained from all users that the information disclosed will only be used for authorized purposes. Fourth, a consumer reporting agency may not furnish a consumer report to any person if it has reasonable grounds to believe that the report will not be used for an authorized purpose. Finally, the identity of all new users must be verified by the agency.

Banks and other financial institutions that wish to avoid becoming consumer reporting agencies must be particularly cautious in discounting installment paper for retail dealers. When a dealer calls the bank or other institution *before* credit is extended to inquire whether the contract will be purchased or credit will be extended to the consumer directly, and the bank or institution denies the credit or increases the cost even partially because of information obtained from outside sources, then the dealer and the bank or other financial institution must *each* make certain disclosures to the consumer if the bank or other institution is not to become a consumer reporting agency. First, the dealer must advise the

consumer of the name and address of the bank.<sup>12</sup> The bank must then follow the normal procedure a user of information follows. If the bank's decision is based on information in a consumer report, the bank must give the consumer the name and address of the agency. If the information comes from a third party, other than a consumer reporting agency, the bank must disclose to the consumer his right to make a written request within 60 days for the nature of the information. If, however, the bank's decision was based on its own prior experience with the consumer or its own internal credit policies, then it need not make any disclosures at all.

Special rules apply to a bank or other financial institution that uses or prepares an "investigative consumer report." As a user, if a bank requests such a report from a consumer reporting agency, the bank must mail or deliver written notice to the consumer within three days that an investigative consumer report may be made and that it may include information regarding the character, general reputation, personal characteristics, and mode of living of the consumer. The consumer must also be informed that he may make a written request for disclosure of the "nature and scope" of the investigation. If the consumer then requests this information within a reasonable time thereafter, the bank must within five days furnish the consumer with a complete and accurate written description of the "nature and scope" of the investigation.

If a bank or other financial institution denies or increases the cost of credit or insurance or denies employment based upon information in an investigative consumer report, it must make the same disclosures a user must make if it takes such action on the basis of an ordinary consumer report. No disclosures at all need be made, however, if an investigative consumer report is to be used for employment purposes and the consumer has *not* specifically applied for the position, or if the bank or other institution conducts the investigation for its own purposes, using its own employees.

These and many other important questions relating to the Fair Credit Reporting Act are discussed in two documents, both of which should be in the file of every bank or affiliated institution engaged in extending consumer credit. The first is a pamphlet containing the text of the Act and 61 specific questions and answers, entitled "Guidelines for Financial Institutions in Complying with the Fair Credit Reporting Act." The pamphlet was prepared jointly by

<sup>11</sup> Section 604 provides: "A consumer reporting agency may furnish a consumer report under the following circumstances and no other:

(1) In response to the order of a court having jurisdiction to issue such an order.

(2) In accordance with the written instructions of the consumer to whom it relates.

(3) To a person which it has reason to believe—

(A) intends to use the information in connection with a credit transaction involving the consumer on whom the information is to be furnished and involving the extension of credit to, or review or collection of an account of, the consumer; or

(B) intends to use the information for employment purposes; or

(C) intends to use the information in connection with the underwriting of insurance involving the consumer; or

(D) intends to use the information in connection with a determination of the consumer's eligibility for a license or other benefit granted by a governmental instrumentality required by law to consider an applicant's financial responsibility or status; or

(E) otherwise has a legitimate business need for the information in connection with a business transaction involving the consumer."

<sup>12</sup> 4 CCH *Consumer Credit Guide*, ¶99,486; Section 603(d)(3)(C) of the Fair Credit Reporting Act.

the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board. Copies may be obtained free of charge from any of the foregoing organizations or from any Federal Reserve Bank. The second useful document, entitled "Compliance with the Fair Credit Reporting Act," may be obtained free of charge from the Bureau of Consumer Protection, Federal Trade Commission, Washington, D. C. 20580. Both publications represent the informed views of the staffs of the agencies publishing them, but are *not* substantive rules having the force and effect of law. As a matter of fact, none of the agencies charged with enforcement of the Act has the authority to issue substantive rules, as does the Board of Governors with respect to Truth in Lending.<sup>12a</sup>

Consumers may bring legal actions for money damages against users of information and consumer reporting agencies who fail to comply with the Act, if they can prove that the agency or user was either *willful* or *negligent* in its noncompliance. This stands in sharp contrast to Truth in Lending where, as shown in Part II published last month, monetary penalties may be assessed for inadvertent violations. Moreover, no user or consumer reporting agency may be held liable for any violation of the provisions of the Fair Credit Reporting Act pertaining to investigative consumer reports if it can prove that at the time of the alleged violation it maintained "reasonable procedures" to assure compliance.<sup>13</sup>

Once again, then, the new consumer protection laws favor companies that take positive steps to comply. For users of consumer information who are not "consumer reporting agencies," this involves the following procedures, at minimum.

- (1) Instruct credit personnel in writing that consumer reports may only be obtained for permissible purposes, and list these purposes.

- (2) Establish procedures to insure that proper disclosures are made to consumers when credit is denied or the charge is increased based on information in a consumer report or received from third parties. Even though the Act does not require it, it is good practice to develop forms for making the required disclosures and

to retain copies showing that the disclosures were made.

- (3) Maintain records, even if only in the form of handwritten notations, of information received from others so that such information will be available in the event the consumer asks for it.

Banks and other financial institutions face much more formidable compliance problems if they become consumer reporting agencies. The document prepared by the FTC entitled "Compliance with the Fair Credit Reporting Act," mentioned above, is one essential source of information on this subject. Another useful one, entitled "How to Comply with the Fair Credit Reporting Act," has been prepared by Associated Credit Bureaus, Inc. Copies may be obtained free of charge by sending a stamped, self-address envelope to Associated Credit Bureaus, Inc., 6767 Southwest Freeway, Houston, Texas 77036.

**Credit Cards and the Proposed Fair Credit Billing Act** No survey of current consumer protection laws affecting banks would be complete without brief reference to recent and pending legislation relating to credit cards. Approximately 25 million bank cards are now in use, involving about 375 million purchases and over seven million loans annually. Outstanding charges based on bank credit cards at the end of 1971 approached \$4 billion, a dramatic increase from the level of \$633 million reported by the Federal Reserve System as recently as September 1967. Even though credit extended on the basis of bank cards accounts for something less than 10 percent of total consumer credit extended by banks at the present time, nearly 200 million statements were sent to consumers in connection with bank credit card programs in 1971.

Most credit card plans permit the cardholder to obtain a direct cash advance, up to a certain stated amount, from a participating bank, or to use the card as a substitute for currency or a check to pay for merchandise or services purchased from participating retailers. Where cash is advanced directly by a bank, an initial transaction charge of approximately 2 to 4 percent of the amount of the advance may be assessed, depending upon the particular credit card plan. In addition, finance charges may begin to accrue from the date the funds are initially made available to the cardholder, or at some later date. Where merchandise or services are purchased, the cardholder is ordinarily allowed a "free ride" period averaging about 45 days from the date of the purchase before finance charges begin to accrue. No charge is assessed if payment is received before the

<sup>12a</sup> Nevertheless, the courts are likely to give great weight to established administrative practices of the agencies responsible for enforcing compliance. *F.T.C. v. Mandel Brothers, Inc.*, 359 U.S. 385 (1959). Although, as discussed in Part I, FTC does not appear to have jurisdiction over banks themselves, it may have over bank holding companies and other affiliates of banks.

<sup>13</sup> Section 615 (c), 84 Stat. 1133 (1970).

end of the "free ride". Finance charges (exclusive of transaction and minimum charges) on both cash advances and retail purchases range from around 10 to about 18 percent per year, depending upon the particular plan.

Acceptance and use of a bank credit card is regulated by a complex network of contractual arrangements among banks and individual cardholders, on the one hand, and among banks and retail merchants, on the other. Under their agreements with merchants, banks take all of the credit risks associated with sales of merchandise or services by retailers honoring bank cards. Retailers accepting the cards for purchases discount the sales drafts with a participating bank, usually receiving immediate credit in their account for somewhere between 92 and 100 percent of the face amounts of the drafts depending upon the particular agreement between retailer and bank in individual cases. The average discount for credit card sales handled by merchants is said to be about 3 percent of the face amount of the sales drafts, or 54 cents on the average sale. Currently, income to banks from bank credit card programs, based upon finance and other charges paid by cardholders, is said to account for about 77 percent of total revenues of such banks from their credit card programs, while the remaining 23 percent results from merchant discounts in connection with sales transactions involving credit cards.<sup>14</sup>

A key feature of the cardholder's agreement with the issuing bank (a feature, by the way, that may be changed by pending legislation and by a proposed regulation of the Federal Trade Commission, as discussed below) is the cardholder's undertaking to look to the merchant from whom the goods or services were purchased for warranties of performance and not to the bank to whom payment is to be made.<sup>15</sup> Three states, Massachusetts, California, and New Jersey, have recently enacted legislation making such banks responsible for claims by consumers against merchants arising out of credit card sales.

In the neighborhood of 30 percent of the 382 million annual purchase and loan transactions by means of credit cards involve more than one bank,

<sup>14</sup> For a comprehensive review of current financial aspects of bank credit cards, see Andrew F. Brimmer, "Growth and Profitability of Credit Card Banking," paper presented at the 1971 National Credit Card Conference of the American Bankers Association (October 27, 1971).

<sup>15</sup> Interestingly, when the FTC issued its Trade Regulation Rule proscribing the issuance of unsolicited credit cards in March of 1970, it took the position that "the activity of issuing credit cards by banks appears to fall within the jurisdiction of the Commission." This seems exceedingly doubtful in view of the specific language of Section 5 of the FTC Act excluding banks from the Commission's jurisdiction. It is understood that most bank credit card plans are operated by banks directly, and not through nonbanking subsidiaries or affiliated corporations.

and many of these may be subject to the law of more than one state. Some 1,450 banks are now issuing bank credit cards, in cooperation with about 8,000 "agent" banks, approximately 4,200 of which are in the Master Charge system and about 3,600 of which are associated with the BankAmericard group. The functions and powers of agent banks vary according to the terms of their individual agreements with card-issuing banks, subject, however, to controlling interchange regulations governing the exchange of debits and credits among all the participating banks. These interchange rules are administered by the Interbank Card Association, in the case of Master Charge cards, and by National BankAmericard, Inc., in the case of BankAmericards. Interchange regulations are essential to bank credit operations for two reasons. First, a substantial (and increasing) use of the cards is in connection with interstate transactions, where the issuing or agent bank is in one state and the bank extending credit or the merchant selling to the cardholder is in a different state. Second, such regulations are needed for intrastate transactions if more than one bank is involved.

Prior to October 26, 1970, the legal status of individuals holding credit cards depended almost entirely upon their contractual agreements with participating banks under the laws of the 50 states, except for disclosure requirements imposed by the Truth in Lending Act. On that date, Title V of the Consumer Credit Protection Act became law.<sup>16</sup> This statute prohibits issuance of a credit card except in response to a request or application, although the prohibition does not apply to issuance of a card in renewal of, or in substitution for, an accepted card. It also limits the liability of a cardholder for unauthorized use of his card to a maximum of \$50. Even this liability does not exist unless the card issuer has given adequate notice to the cardholder of his potential liability for unauthorized use and unless two additional conditions are met. These are: (1) that the card issuer has provided the cardholder with a self-addressed, prestamped notification to be mailed by the cardholder in the event of loss or theft of the card; and (2) that the unauthorized use occurs before the cardholder has notified the issuer that an unauthorized use may occur as the result of loss or theft. Furthermore, after January 25, 1972, no liability for unauthorized use exists with respect to any credit card unless the card issuer has provided

<sup>16</sup> Public Law 91-508, 84 Stat. 1126 (1970).

a method whereby the user of the card can be identified as the person authorized to use it.<sup>17</sup>

As pointed out in a letter from the three Federal bank supervisory agencies to all insured banks in the autumn of 1971, many card issuers have continued to issue cards with statements imprinted on the reverse side such as the following:

In case the credit card is lost or stolen, the customer shall be responsible for any extensions of credit to anyone through use of the card until the card issuer receives written notice of its loss or theft.

The letter advised banks that continued issuance of cards with statements such as the above would not appear to be justified under present law.

Except for the above provisions of Federal law, and except for more general Federal authority under antitrust and trade regulation laws, state laws now control the legal relationships among cardholders, banks, and merchants. This situation is said to be unsatisfactory to both the credit card industry and to consumer groups, but for different reasons.

The principal objections of the credit card industry to the present state of the law center around the lack of uniformity of state laws and the high proportion of credit card transactions involving two or more states.<sup>18</sup> Serious conflict-of-law problems may arise when disputes occur in multi-state transactions, and this situation is aggravated by the tendency of states to enact different types of consumer protection laws or to enact similar types but with significantly different provisions. Vexing questions arise regarding which state laws should apply, and such controversies may well wind up in the courts. The credit card industry is said to believe that as credit cards evolve from the present concept of a currency substitute with a credit feature into an identity card by means of which the holder can gain access to a wide range of financial services on a nationwide scale, more uniform legal rules throughout the United States will become increasingly necessary.

Consumer groups advocate greater Federal regulation of credit card practices on the ground that many historic provisions of state law are unfair to consumers. Under particularly heavy attack are the so-called "holder-in-due-course" doctrine and the "waiver of defense" clause, both of which have the

<sup>17</sup> The statute places the burden of proof upon the card issuer to show that the use was authorized or, if the use was unauthorized, to show that the conditions of liability set forth above have been met. In a separate provision, the statute declares that any person who, in a transaction affecting interstate or foreign commerce, uses any counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained credit card to obtain goods or services, or both, having a retail value aggregating \$5,000 or more, shall be fined not more than \$1,000 or imprisoned not more than five years, or both.

<sup>18</sup> *The American Banker* (October 27, 1971).

legal effect of preventing cardholders from refusing to pay issuing or agent banks when merchandise or services, purchased by means of the cards, turn out to be defective. Pending in Congress is S. 652, the "Fair Credit Billing Act," sponsored by Senators Proxmire and Brooke, which, among other things, contains the following provision:

#### §169 Rights of Credit Customers

A card issuer who has issued a credit card to a cardholder shall be subject to all claims and defenses arising out of any transaction in which the credit card is used as a method of payment or extension of credit.

Presumably, this section is designed to increase the consumer's leverage by permitting him to withhold payment from the bank in the event of disputes with merchants regarding products or services purchased. Conceivably, however, the broad language might be construed to render card issuers subject to liability for tort claims arising out of use of the merchandise. Moreover, in many situations, particularly involving interstate transactions or small purchases, a credit card is not used to obtain credit in the traditional sense, but instead is merely a convenient substitute for cash or a check. Probably no finance charges are imposed in the vast majority of interstate sales or sales involving small purchases because the cardholders pay before expiration of the "free ride" period. It seems questionable, therefore, whether there is any rational basis for using a statute purportedly dealing with the regulation of consumer credit as a means of eliminating state-created legal rights where the transactions have only a distant relationship, at best, to the extension of consumer credit. This section of the proposed Act is under heavy fire from creditors, many of whom argue that it would force them out of business.<sup>19</sup>

Other significant provisions of the proposed "Fair Credit Billing Act" are summarized in the footnote below.<sup>20</sup> An informative and extensive review of

<sup>19</sup> *The American Banker* (October 28, 1971). Apart from S. 652, and the new state statutes in Massachusetts, California, and New Jersey referred to earlier, the Federal Trade Commission has proposed a "Trade Regulation Rule," which would require a merchant's "promissory note or other instrument of indebtedness" in a credit sale to provide that any holder in due course who takes the instrument takes it subject to all claims and defenses of the merchant's customer arising out of the sale. 16 C.F.R. §433, 36 Fed. Reg. 1211 (1971).

<sup>20</sup> The proposed bill would also: (1) amend §127(b) (2) of the Truth in Lending Act by adding a requirement that the card issuer identify on the periodic statement the "vendors and/or creditors involved"; (2) amend §127(b) to require that periodic statements contain an address or telephone number for use by the cardholder in making inquiries about his billing statement; (3) require the card issuer to acknowledge complaints about billing statement errors within 10 days and correct the account within 30 days, or send the cardholder an explanation with documentary evidence of the accuracy of the account; (4) prohibit open-end creditors offering a "free ride" period from imposing a finance charge unless the billing statement was mailed at least 21 days prior to the date payment must be made; (5) require the creditor, in determining the balance upon which the finance charge is computed, to reduce the opening balance in the account at the beginning of the billing cycle by deducting all payments and credits made during the cycle; (6) prohibit open-end creditors from imposing minimum finance charges; (7) prohibit credit card issuers from offsetting a cardholder's indebtedness against funds of the cardholder held on deposit with the card issuer; and (8) assure the consumer of his right to refund of any credit balance in his account.

pending Federal and state regulatory developments affecting the credit card industry may be found in *The Business Lawyer*, 27, No. 1 (November 1971), 93-138.

### **The National Commission on Consumer Finance**

Basic research of great potential significance for the future of the consumer credit industry in the United States is now in progress by the staff of the National Commission on Consumer Finance. Created in 1968 by Title IV of the Consumer Credit Protection Act,<sup>21</sup> the Commission is composed of Senators John J. Sparkman (D.-Ala.), William Proxmire (D.-Wisc.), and William E. Brock (R.-Tenn.); Representatives Henry B. Gonzales (D.-Tex.), Leonor K. Sullivan (D.-Mo.), and Lawrence G. Williams (R.-Pa.); and Dr. Robert W. Johnson, Professor of Industrial Administration, Purdue University, Douglas M. Head, Minneapolis attorney and former Attorney General of Minnesota, and Ira M. Millstein, New York City attorney, who is Chairman. The Commission's principal duty is to ". . . study and appraise the functioning and structure of the consumer finance industry, as well as consumer credit transactions generally." The law requires it to report to Congress on or before July 1, 1972, on ". . . the adequacy of existing arrangements to provide consumer credit at reasonable rates."

In an interview with this writer in Washington, D. C., Mr. Milton W. Schober, General Attorney for the Commission, and Professor Robert P. Shay, Professor of Banking and Finance, Columbia University, and consulting economist to the Commission, described two major data-gathering projects now in progress by the Commission's staff. The first is a massive survey of consumer creditors, entitled "Survey of Consumer Credit Volume, Outstandings, and Rates." Designed by Dr. Shay, the objective of the survey is to determine the amounts of all of the various types of consumer installment credit outstanding in each state and the corresponding finance charges. The initial purpose is to assess the influence of state laws and regulations on the price and availability of consumer installment credit. The survey is based upon questionnaires approved by the Office of Management and Budget, which were sent to 2,325 commercial banks; 490 mutual savings banks; 1,375 finance companies, including the large nationwide sales finance companies as well as approximately 30 large, diversified finance companies

operating on a national or regional basis; about 2,000 credit unions; and approximately 1,500 retailers. All 50 states and the District of Columbia were represented in the sample.

Among other things, the questionnaires call for information on the volume of consumer credit extended during the second quarter of 1971 and the amount of such credit outstanding on June 30, 1971. It is understood that the response rate has been well over 90 percent for every class of creditor except credit unions, whose response rate has been somewhat lower. Most of the data was collected by the Bureau of the Census, and all of it was processed and tabulated by that Bureau's data processing facilities and personnel. It is now being analyzed by the Commission's staff.

The second important project is an evaluation of the effectiveness, under the laws of the 50 states, of creditors' legal remedies to enforce payment of consumer debt. One objective of this survey, entitled "Survey of Consumer Collection Practices and Creditors' Remedies," is to find out which legal remedies of creditors are actually used and which ones are not. A questionnaire running to 30 legal-size pages, also approved by the Office of Management and Budget, has been distributed to 1,250 commercial banks, 600 credit unions, 650 finance companies, 380 retail creditors, and 300 collection agencies. Here again, it is understood that the response rate has been high. The data is currently being analyzed by the Commission's staff.

In conjunction with the gathering of data, the Commission held public hearings in Washington, D. C., in June of 1970, on methods used to collect consumer debts. In announcing the hearings, Mr. Robert Braucher, Professor of Law at Harvard and Chairman of the Commission at the time, stated: "We believe there are widespread abuses of creditor remedies which place a particularly harsh burden on unsophisticated or uneducated low-income families. Indications are that these abuses have had severe economic and social consequences on thousands of American families." Subjects explored at the hearings included (1) legal tactics or devices that may be used to circumvent the consumer's ability to contest claims against him, including the holder-in-due-course doctrine, (2) confessions of judgment, (3) wage assignments, (4) postbankruptcy suits, (5) debtors' prisons, and (6) misuse of the small claims court. Additional public hearings were held in June of 1971 to determine the extent

<sup>21</sup> 82 Stat. 164 (1968) as amended 84 Stat. 440 (1970).

of Federal and state enforcement of existing consumer credit protection laws.<sup>22</sup>

The next step planned by the staff is the preparation of an econometric model that will include demographic data of the consumer credit market in each state. The Commission's staff will then attempt to tie together the results of its two surveys. In particular, the staff plans to look closely at "convenience and advantage" laws in many of the states, which have the effect of limiting freedom of entry into the consumer finance industry. The staff plans to evaluate the possible effects of these laws on availability of consumer credit, as well as rates of finance charges for consumer credit.

Another responsibility of the Commission is to study the adequacy of existing Federal and state enforcement mechanisms to prevent violations of consumer credit protection laws. The Commission is itself reviewing enforcement practices of Federal regulatory agencies. In cooperation with the Commission, the National Conference of State Bank Supervisors is undertaking to study the capability of state banking departments to enforce state laws. The Commission's report to Congress may be expected to comment on both Federal and state enforcement laws and practices, and their effectiveness.

**Concluding Comments** Until 1968, banks and bank holding companies had little reason to be concerned about Federal consumer protection laws. The Federal Trade Commission Act was the principal Federal statute dealing with prevention of unfair and deceptive business practices, but it did not apply to commercial banks (and still does not). Multi-bank holding companies were severely restricted in the performance of consumer credit functions, and the activities of unregulated one-bank holding companies were only beginning to be of importance.

A combination of events commencing in 1968 drastically changed the entire situation. The Truth

in Lending Act was enacted that year, applying equally to commercial banks and their affiliates engaged in extensions of consumer credit and to other, nonbanking enterprises. The rapid expansion of unregulated one-bank holding companies, beginning in the spring of 1968, led to extensive changes in bank holding company regulation in 1970, greatly enlarging the permissible range of activities for all types of bank holding companies both functionally and geographically. Although banks themselves continue to be specifically exempt by statute from the enforcement jurisdiction of the Federal Trade Commission, bank holding companies and their affiliates may not be.

In 1970, the Fair Credit Reporting Act was enacted. Like Truth in Lending, it covered banks, bank holding companies and other bank affiliates, as well as nonbanking organizations, and imposed affirmative disclosure requirements. Credit card usages were also brought under certain Federal restrictions, and more extensive legislation may be enacted. The work of the National Commission on Consumer Finance may lead to greatly expanded Federal legislation in the area of consumer finance.

Banks and bank holding companies that fail to establish and maintain effective internal compliance programs to deal with the broadening requirements of Federal and state consumer protection laws may find that the risks they have assumed far outweigh the effort and expense they have avoided. This will be even more probable if Congress accepts the recommendation of the Board of Governors in its *Annual Report to Congress for the Year 1971* that the Truth in Lending Act be amended to provide for a "good faith" defense such as is contained in the Securities and Exchange Act of 1934—one which would apply not only to the Board's Regulation Z, but also to all interpretations of it by the Board.<sup>23</sup>

*William F. Upshaw*

<sup>22</sup> At this hearing commercial banks and savings and loan associations were criticized by the Chairman of the Federal Trade Commission, Miles W. Kirkpatrick, for their alleged failure to refuse to discount retail installment paper not in full compliance with the Truth in Lending Act. As discussed in Part II, the Federal supervisory agencies have taken positive action to call to the attention of regulated financial institutions their responsibilities in connection with dealer paper.

<sup>23</sup> The relevant section of the Securities and Exchange Act states: "No provision of this subchapter imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule or regulation of the Commission, notwithstanding that such rule or regulation may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason." 12 U.S.C. §77s(a).

*The MONTHLY REVIEW wishes to express its appreciation to Mr. Griffith L. Garwood, Chief, Truth in Lending Section, Division of Supervision and Regulation, Board of Governors of the Federal Reserve System, for his many useful suggestions and comments and for making available materials that were most helpful in the preparation of "Banking in the Consumer Protection Age."*

# FORECASTS 1972

## *Success for the New Economic Program?*

Like the economy itself, economic forecasting has its peaks and troughs. Based solely on last year's forecasts for current dollar GNP, one would conclude that some recovery is under way in the forecasting accuracy cycle. A more comprehensive evaluation of last year's forecasts, however, calls this conclusion into question.

In general, last year's forecasts were close to predicting current dollar GNP accurately, but overly optimistic with regard to the rate of inflation. The forecasters did not expect cost-push inflation to continue in 1971 to the extent that it did. Thus, they overestimated the increase in both real GNP and the index of industrial production but underestimated the rise in the unemployment rate.

In retrospect, cost-push forces could have been expected for 1970 and 1971, since an extraordinarily large number of workers were due for contract renegotiation in those years. But the forecasters apparently did not think that cost-push forces would be sufficient to outweigh the excess capacity and easing employment markets that resulted from the 1970 recession.

This year the forecasters are relying upon President Nixon's New Economic Program to restore the economy to a healthier rate of real growth and a lower rate of price increase and to engender a decline in the unemployment rate. The large increase in residential construction spending in 1971 is expected to lead to rather substantial increases in consumption spending for major household goods and appliances in 1972. This rise in the demand for consumer home durables, coupled with an expected high level of domestic automobile sales due to the excise tax cut and the lessening of import competition, is expected to generate a 9.1% growth rate for total durable goods expenditures. Most of the forecasters are also predicting a good year for the steel industry because of strong durable goods demand, rebuilding of inventories, and lessened import competition.

The consensus of forecasts examined in this article indicates a 1972 GNP of around \$1,141.0 billion. Based upon current Department of Commerce estimates for 1971 GNP, this figure would represent a gain of approximately 9.0%, which is somewhat larger than the 7.5% rate in 1971. Economists are predicting a rather steady rate of

growth of GNP throughout the year with no major strikes expected. Inventory replenishment will be a notable source of strength if the recovery proceeds as expected.

The 1972 forecasts summarized here represent the best efforts of business and academic economists during the autumn and winter of 1971 to predict the performance of the U. S. economy in 1972. This article attempts to convey the general tone and pattern of some 60 forecasts reviewed by the Research Department of this Bank. Not all of them are comprehensive forecasts, and some incorporate estimates of the future behavior of only a few key economic indicators. Several represent group rather than individual efforts.

*The views and opinions set forth in this article are those of the various forecasters. No agreement or endorsement by this Bank is implied.*

### 1971 FORECASTS IN PERSPECTIVE

The consensus forecast for 1971 GNP, published in last February's *Monthly Review*, was \$1,049.6 billion, an increase of 7.8% over 1970. The collection of forecasts ranged from a low of \$1,031.0 billion to a high of \$1,059.0 billion. After allowing for expected price increases, the growth of real GNP was predicted to account for more than half of the 7.8% rise. On the government side of the forecasting spectrum, the controversial forecast made by the Council of Economic Advisers from the now well-known Laffer model projected a GNP of \$1,065.0 billion for 1971. Latest estimates by the Department of Commerce indicate a 1971 GNP total of \$1,046.8 billion, which is reasonably close to the consensus forecast of the business and academic economists. Compared to 1970, when the seers overestimated the GNP by \$10.0 billion, and to 1969, when they underestimated it by \$18.0 billion, 1971 was a better year. At least so far as current dollar GNP is concerned.

In late 1970 and early 1971 forecasters were anticipating an increase in the implicit price deflator for GNP of around 3.6%, which would indicate a real growth rate for GNP of almost 4.2%. In fact, the implicit price deflator for GNP rose 4.6%, and

RESULTS FOR 1971 AND TYPICAL FORECAST FOR 1972

	Unit or Base	Preliminary 1971	Forecast 1972*	Percentage Change	
				1970/1971	1971/1972
Gross national product .....	\$ billions	1,046.8	1,141.0	7.5	9.0
Personal consumption expenditures .....	\$ billions	662.2	717.8	7.5	8.4
Durables .....	\$ billions	100.4	109.5	13.3	9.1
Nondurables .....	\$ billions	278.8	300.3	5.3	7.7
Services .....	\$ billions	283.0	307.9	7.8	8.8
Gross private domestic investment .....	\$ billions	150.9	167.5	11.5	11.0
Business fixed investment .....	\$ billions	108.2	116.3	6.0	7.5
Residential construction .....	\$ billions	40.6	44.3	33.6	9.1
Change in business inventories .....	\$ billions	2.1	6.9	---	---
Government purchases of goods and services .....	\$ billions	233.1	252.7	6.2	8.4
Net exports of goods and services .....	\$ billions	0.7	3.0	---	---
Plant and equipment expenditures .....	\$ billions	81.43	87.25	2.1	7.1
Corporate profits before taxes .....	\$ billions	84.9	97.6	12.6	15.0
Private housing starts .....	millions	2.03	2.07	42.0	2.0
Automobile sales .....	millions	10.1	10.5	20.2	3.9
Rate of unemployment .....	percent	6.0	5.4	---	---
Industrial production index .....	1967	106.3	113.2	-0.4	6.5
Wholesale price index .....	1967	113.7	116.1	3.0	2.1
Consumer price index .....	1967	121.3	125.1	4.3	3.1
Implicit price deflator .....	1958	141.5	146.0	4.6	3.2

\* Figures are constructed from the typical percentage change forecast for 1972.

real GNP increased only 2.8%. Thus, although the forecasters predicted current dollar GNP relatively accurately, they underestimated the rate of inflation and overestimated the rate of real growth. This type of forecasting error is hardly a new phenomenon. The consensus predictions have substantially underestimated the rate of inflation for each of the last four years. The 1971 inflation forecast, in particular, would have been even less accurate if the wage-price freeze had not been ordered.

The consensus of the quarter-by-quarter forecasts for 1971 was that current dollar GNP was expected to rise by approximately \$30.0 billion during the first quarter, \$20.0 billion in the second, \$17.0 billion in the third, and \$18.2 billion in the fourth. GNP actually increased \$32.4 billion, \$19.2 billion, \$13.4 billion, and \$19.6 billion for the four quarters, respectively. Again, the estimates were remarkably close to the actual quarter-by-quarter figures.

The quarterly inflation predictions of 3.9%, 3.5%, 3.4%, and 3.1% made by the forecasters were too low for the first half of the year and too high for the price-controlled second half. During 1971 the

annual rate of price increase was 5.3% in the first quarter, 4.2% in the second, 2.5% in the third, and 1.5% in the fourth.

On the consumer side, 1971 personal consumption expenditures were expected to total \$663.4 billion, but they now appear to be \$662.2 billion. Gross private domestic investment was underestimated; that account was predicted to reach \$145.0 billion, but it actually totaled \$150.9 billion. Much of this underestimate is attributable to the greater-than-expected upsurge in residential construction. Forecasters had predicted that private housing starts would total only 1.7 million units in 1971, but they actually totaled over 2.0 million.

With respect to the public sector of the economy, government purchases of goods and services were predicted accurately. The consensus of forecasters expected these outlays to total \$233.9 billion. Actual spending was \$233.1 billion, according to the preliminary estimates.

Because it overestimated the rate of real growth of the U. S. economy, the consensus forecast for the average unemployment rate was overly optimistic.

The rate, predicted to average 5.5% for the year, was actually 6.0%.

The tendency to expect a more rapid recovery was also evident in the forecast for the index of industrial production. The predictors expected a 3.6% increase, but the index actually fell 0.4%.

Strangely enough, the seers, having *overestimated* the fall in the unemployment rate, the rate of real growth, and the index of industrial production, *underestimated* corporate profits. Pretax corporate profits, estimated to increase 8.0%, actually rose 12.6%. If their expectations for a stronger recovery had been correct, their corporate profits estimate would have been even farther from the mark.

The consumer price index rose 4.3% from its 1970 average, a figure close to the consensus forecast of a 4.0% rise. The wholesale price index, however, predicted to rise 2.0%, rose approximately 3.0%.

Many of last year's forecasters apparently thought that the U. S. economy in 1971 would recover from its recessionary and inflationary woes more vigorously than it did. On the other hand, the consensus of forecasters for the year before that, 1970, underestimated the extent of the downturn. Although this tendency to underestimate a downturn and to overestimate an upturn might tempt the analyst to accuse the business and economic forecasters of a maidenly optimism, the more likely explanation is that years of recession and recovery are much more difficult to project than those of more normal growth.

### 1972 FORECASTS IN BRIEF

**Gross National Product** Forecasts for 1972 current dollar GNP are concentrated around \$1,141.0 billion. This estimate represents an approximate 9.0% yearly gain, which is somewhat more than the 7.5% advance registered in 1971. However, price rises are expected to account for only about one-third of the anticipated increase, whereas they accounted for nearly two-thirds of the 1971 increase in current dollar GNP. The forecasts range from a low of \$1,135.0 billion to a high of \$1,155.0 billion. Most of those who made quarterly forecasts expect GNP, measured at seasonally adjusted annual rates, to increase by almost \$26.5 billion during the first quarter and by about \$25.5 billion in each of the three succeeding quarters.

Personal consumption expenditures are estimated to total \$717.8 billion in 1972, an 8.4% increase compared with the 7.5% rise registered during 1971. The forecasters expect relatively more of the 1972 increase to stem from expenditures for durable goods

### TYPICAL\* QUARTERLY FORECAST FOR 1972

	Quarter-by-Quarter Changes in Billions of Dollars Unless Otherwise Noted			
	I	II	III	IV
Gross National Product	26.5	25.4	25.8	25.6
Personal Consumption Expenditures	15.1	14.0	15.0	15.0
Gross Private Domestic Investment	5.0	4.5	5.5	4.9
Net Exports	1.0	0.5	0.2	0.6
Government Purchases	5.6	5.0	6.1	5.1
Implicit Price Deflator†	3.4	3.0	3.3	3.3
Rate of Unemployment (%)	5.7	5.5	5.3	5.1

\* Median.

† Percentage changes at annual rates.

than from nondurable goods spending. The forecasts call for a 9.1% increase in durables spending and a 7.7% rise in outlays for nondurables.

Government purchases of goods and services are expected to total \$252.7 billion in 1972. This projected increase of 8.4%, larger than the 1971 gain of 6.2%, reflects the probability that defense spending will again begin to rise.

Gross private domestic investment is expected to rise by about 11.0% to \$167.5 billion, which is only slightly smaller than the 11.5% increase during 1971. However, compared to the 3.1% decline in 1970, the projected gain for 1972 represents a continuation of the substantial recovery achieved in 1971. The forecasters' estimates for gross private domestic investment ranged from \$163.0 billion to \$178.0 billion. No clear-cut consensus emerged, so a median figure was chosen for use in the accompanying table. Fully half of the forecasters' estimates, it should be noted, were between \$166.0 billion and \$169.5 billion.

The leading growth component of gross private domestic investment during 1971 was residential construction, which increased 33.6% from its depressed 1970 level. Residential construction is expected to rise approximately 9.1% in 1972, a reduced but still healthy rate. Business fixed investment expenditures are projected to rise 7.5%, an improvement over the 6.0% growth registered for 1971. Finally, businessmen are expected to rebuild their inventories in 1972. Of the expected \$16.6 billion increase in gross private domestic investment, \$4.8 billion stems from inventory buildup. The estimates for inventory investment ranged from \$5.1 billion to \$10.1 billion.

**Industrial Production** Most predictions call for the Federal Reserve index of industrial production (1967=100) to average 113.2 during 1972, an increase of 6.5% over the previous year. This compares with a 0.4% actual decline for 1971 and a 3.0% drop for 1970. The forecasters are expecting increases in automobile production, steel production, and an expansion in the production of consumer household durables.

**Construction** The value of new construction put in place is expected to total around \$117.0 billion or \$118.0 billion in 1972, an increase of around 9.0% or 10.0% over 1971. Both private residential construction and private nonresidential construction are expected to do well in 1972. Private residential construction is predicted to increase 9.1% for the year. This forecast is considerably below the 33.6% increase actually registered during 1971, because much of the pent-up demand for housing appears to have been satisfied. Private nonresidential construction is expected to increase 5.0% to 6.0% over its 1971 total. Private housing starts are commonly expected to increase only a slight 2.0% over the very large 1971 total of 2.03 million units. The prediction that they will remain as high as the 1971 level, however, implies that the housing industry will have another good year.

**Business Fixed Investment** Most forecasts indicate that firms will put \$116.3 billion in fixed investment spending in 1972. This figure represents an increase of 7.5% over 1971. This projected increase over the 6.0% rate realized in 1971 stems from an expected moderate resurgence of investment spending during the second half of the year. Most of the forecasters based their predictions on the assumed passage of President Nixon's investment tax credit.

**Corporate Profits** Forecasters are far from unanimous about the future for corporate profits, and predictions for the growth of corporate profits before taxes range from around 8.0% to 20.0%. Most of the estimates, however, center around a 15.0% growth, which would raise the total to \$97.6 billion for the year. Such a growth of corporate profits suggests a more profitable year for businesses than either 1970 or 1971. In 1971, pretax profits grew approximately 12.6%; in 1970 they fell 9.4%.

**Unemployment** The unemployment rate is projected to average 5.4% by most of the observers of the 1972 scene. Individual forecasts range between 5.0% and 5.7%. The unemployment rate reached 6.1% in December 1971 and averaged 6.0% for all of 1971. Hence, forecasters are predicting a moderate fall in the rate.

**Prices** This year all forecasters are predicting a more moderate rate of price increase. The most common prediction is that the implicit deflator for GNP will increase by only 3.2%—well below the 4.6% increase of last year. The most pessimistic of the forecasters predicts an increase of 4.0%. The consumer price index is expected to rise 3.1% during the year. Predictions of the increase in this index ranged from 2.0% to 3.5%. Wholesale prices are expected to increase by a smaller amount, approximately 2.0%, during the year.

**Quarter-by-Quarter Forecasts** Fourteen forecasters made quarter-by-quarter predictions for 1971. As indicated by the quarterly table, these forecasters call for a fairly steady rate of increase of around \$25.0 billion per quarter in GNP measured at annual rates and adjusted for seasonality. Prices are expected to rise at an annual rate of about 3.4% in the first quarter, 3.0% in the second, 3.3% in the third, and 3.3% in the last. The rate of unemployment is expected to fall steadily from an average of 5.7% in the first quarter to an average of 5.1% in the fourth.

**Summary** The forecasters for 1971 were relatively close to the target in predicting current dollar GNP for the year. However, they rather substantially underestimated the rate of inflation, thereby overestimating the rate of real growth. The unemployment rate, expected to average 5.5%, actually averaged 6.0%.

The 1972 consensus forecast indicates a healthy rate of real growth, an abatement of inflation, and a decline in the unemployment rate. These forecasts seem to be based on the presumption that President Nixon's program will continue to show results on the inflation front. They can be termed "generally optimistic." If these expectations are realized, the economy should show more health and vigor in 1972.

*William E. Cullison*

## *A Fifth District Review of . . .*

# 1971 FARM FINANCIAL AND CREDIT CONDITIONS

*This analysis, prepared in December 1971 at the request of USDA's Agricultural Finance Branch, is based on a sample survey of Fifth District bank agricultural specialists and on data from the U. S. Department of Agriculture, the Farm Credit Administration, and the Federal Deposit Insurance Corporation.*

Weather's capricious nature, continued tightening of the cost-price squeeze, effects of present Government farm programs, less expensive credit, and an increase in the availability of funds for farm loans were prime factors influencing the financial and credit conditions of Fifth District farmers in 1971. A full review of the situation turned up the following major findings. Farmers' cash income from farming may well have been slightly below the improved level of 1970, but their off-farm income continued to climb. Farm and family living costs also rose further. Expenditures for capital items showed a slight advance, as did spending for family living items. Prices of farmland continued to rise and at a much faster pace than in the past several years. Farm real estate market activity remained slow but apparently not as slow as in 1970. Farmers' demand for farm credit was strong, and the availability of bank loan funds improved. Bankers' loan policies were generally about the same as those a year earlier.

**Farm Income and Costs** Location and type of farming determined the level of farm income more than ever in 1971. Many livestock farmers, especially poultry and hog producers, experienced a poor year. Crop farmers had widely different experiences. Viewed as a whole, it seems quite likely that total District farm income was moderately below that in 1970. Bankers' views concerning farm income in 1971 relative to farm income in 1970 varied considerably but indicated a slightly improved level overall. Even if gross cash income from farming records a modest increase, the gain will probably not be high enough to offset the persistent rise in farm production expenses.

Lower livestock prices, particularly for poultry and hogs, were the major reason for the reduced level of income from livestock and livestock products in 1971. Livestock prices were below year-earlier levels in all District states, in fact, with average de-

creases ranging from 2% in Maryland to 8% in the Carolinas. Market supplies of milk and cattle and calves were about the same as in 1970. Broiler supplies were about 5% smaller, and supplies of eggs were down around 2%. Hog marketings, on the other hand, were 13% larger, and the number of turkeys marketed was up some 4%.

Farmers' January-October cash receipts from sales of livestock and livestock products were 5% below those in the comparable period of 1970. Losses were recorded in all District states and ranged from 1% in Virginia to 8% in North Carolina. The production and price indications since October, coupled with the fact that more than four-fifths of all livestock income is normally received during the first ten months of the year, suggest that the reduction in livestock receipts for the entire year may approximate that of the January-October period.

The 1971 growing season was generally good, and farmers had prospects for excellent harvests. Yields per acre were up, and, except for tobacco, acreages for harvest were mostly larger because of the changes in Government farm programs. During the height of the harvesting season, however, Hurricane Ginger struck, followed by four weeks of heavy rains. Damage to the cotton, corn, and soybean crops was high, and losses suffered by the Virginia-North Carolina peanut crop were of drastic proportions. Seven per cent of the peanut acreage had to be abandoned, yields dropped 25% below 1970 yields, and total production was down 31%.

Despite the cotton, corn, and soybean losses resulting from the poor harvesting conditions, production of these crops was well above that in 1970—cotton by 8%, corn by 23%, and soybeans by 15%. Output of each of the small grains showed impressive gains, and the pecan crop was five times the small 1970 crop. Other production increases were: Irish potatoes, 7%; hay, 6%; and apples, 3%. The

tobacco, peach, and sweet potato crops were smaller, however—tobacco by 7% ; sweet potatoes, 8% ; and peaches, 11%.

With the price of corn the chief exception, crop prices generally proved to be a major source of strength in 1971. Except in West Virginia, where prices were lower, crop prices averaged moderately higher in Maryland, Virginia, and North Carolina and were up some 4% in South Carolina. Flue-cured tobacco prices were the highest in history, averaging some 8% above those a year earlier. Prices of peanuts, soybeans, and cotton were also higher.

District farmers' cash receipts from crop marketings for the first ten months of 1971 were some 2% larger than at the same time the previous year. In view of overall crop production prospects and the generally favorable price situation which has prevailed, it would seem that total crop receipts for the year as a whole might well be on the plus side. The increase will help to offset a good part of the reduction in livestock income.

Farm production expenses appear to have kept up their record-setting pace in 1971. Prices paid by farmers for commodities and services, including interest, taxes, and farm wage rates, advanced almost 5%—about the same as in 1970. Many farmers' costs were further increased because they had to buy additional inputs. Nearly two-fifths of the replying bankers, in fact, held the view that the volume of purchased inputs had risen. The increase appears to have been somewhat larger than in 1970.

Income from off-farm employment—an important source of buying power for farm families—continued to increase. This belief, expressed by three-tenths of the replying bankers, applied to both farm operators and to other members of farm families. The pace of this upward trend in nonfarm earnings appeared to have tapered off in some localities, however, since some bankers reported slight declines in this source of income. The declines, which applied chiefly to the off-farm income of farm family members other than the operator, resulted in several instances from the closing down of industrial plants in rural communities.

**Farmers' Savings and Spending** The financial savings and reserves of Fifth District farmers at year's end appeared, on balance, to be slightly larger than a year earlier. This situation no doubt resulted from several factors. With the lowering of interest rates, for example, farmers generally were not as reluctant to borrow as they were in 1970 and hence did not draw down their savings to meet current

operating and capital needs. Still others reduced their expenditures for machinery and equipment, facilities, and other capital goods.

Farmers' spending for family living purposes continued to advance. Like their urban counterparts, farmers were again confronted with a general increase in the cost of living. The farm family living index—a measure of the prices farm families pay for food and tobacco, clothing, household operation items and furnishings, house building materials, and so on—rose some 4% during 1971, the same as in 1970. With this increase and farmers' spending patterns generally, it is not surprising that 65% of our survey responses indicated that farmers' expenditures for family living items were slightly higher than a year earlier. Most of the remaining respondents felt that farmers had held this type spending to about the same level as in 1970.

Farmers also stepped up their investment in capital goods in 1971. Capital outlays for machinery and equipment appear to have been larger than those for facilities and other capital goods, however. Farmers' purchases of machinery and equipment were reported to be larger—though just slightly so—than in 1970 by 45% of the replying bankers. A like proportion were of the opinion that there had been little change in this kind of spending, while 10% expressed the belief that machinery and equipment purchases had declined. Spending for facilities and other capital goods was believed to have been slightly larger by 35% of the respondents, one-half felt that purchases of this nature had changed little, and the remaining 15% thought that there had been a slight decline. Much of the increase in capital expenditures in 1971, which is in sharp contrast to the situation in 1969 and 1970, can doubtless be attributed to the lower cost and increased availability of credit.

Farm real estate prices in the District as a whole picked up momentum during the year ended March 1, 1971, rising slightly more than 8%. The rate of increase marked the fastest year-to-year advance since 1967 and compared with only a 3% gain nationally. Market values moved upward in all District states, with increases of 8% or better occurring in all states except West Virginia. There the advance was about 4%. Though no official state estimates of farmland prices have been released since March 1, our banker respondents, when asked how prices of farmland for calendar year 1971 compared with those a year earlier, indicated for the most part that the uptrend in prices had continued.

On balance, activity in the farm real estate market in 1971 appears to have remained rather slow, although slightly renewed activity occurred in some

areas. In certain instances, very little farmland was reported to be for sale. Purchases of farmland for farm enlargement were apparently not quite as slow as in 1970. Slight declines in the number of enlargement purchases were indicated by only one-fifth of the bankers surveyed in 1971, compared with 65% a year earlier. On the other hand, one-fourth of the survey responses noted an increase, mostly slight, in the purchase of land for farm expansion, while only 5% reported such gains in 1970. The remaining 55% believed there had been little change in purchases of this type.

Buying farmland for nonfarm purposes seems to have generated a little more market activity than purchases for farm enlargement; however, market demand overall was apparently somewhat below that of the previous year. One-third of the responding bankers reported slight increases in buying for nonfarm reasons as against one-fourth who noted gains in purchases for farm enlargement. The 33% who felt increases in nonfarm purchases had occurred in 1971 compared with 40% who believed likewise in 1970. In contrast, 27% of the 1971 respondents, about the same proportion as a year earlier, indicated slight declines in the purchase of farmland by nonfarm buyers. Generally, quite a few who bought farmland for reasons other than farm enlargement were said to have done so for speculative purposes.

**Farm Credit Situation** Farmers' demand for credit showed renewed strength in 1971. With the softening in interest rates and an increase in the

availability of loan funds, the District's farmers accelerated their use of both long-term and short-term credit as they sought to catch up on capital improvements and meet the seemingly ever-increasing costs of production inputs. As a result, short-term farm debt grew at a faster pace than a year earlier, both at commercial banks and at production credit associations. There was some slackening in the growth of long-term debt held by the Federal land banks. Commercial banks, however, resumed more vigorous activity in the farm-mortgage lending field after having cut back in 1970. The resulting increase in the dollar volume of long-term loans held by banks was more than double the amount by which the growth in Federal land bank loans was reduced. (The gain in the volume of bank held farm real estate loans would have been even larger had the method of reporting Farmers Home Administration insured notes on the Call Report not been changed as of mid-1971. Because of this change, FHA insured notes are no longer reported as farm real estate loans.)

Our survey findings showed that the overall demand for farm credit strengthened in 1971. Statistical evidence supports these findings. Farm-mortgage loans held by all the District's insured commercial banks in mid-1971, for example, totaled \$304.7 million, around 5% or \$13.9 million above a year earlier. This increase contrasts with a reduction of roughly 1% or \$1.7 million in bank held long-term farm debt during the year ending at mid-year 1970. In comparison, outstanding loans held by the Federal land banks on June 30, 1971 amounted

**FARM DEBT: AMOUNT OUTSTANDING HELD BY SPECIFIED LENDERS, BY TYPE**  
United States and Fifth District by States, June 30, 1971 compared with June 30, 1970

State or Area	Farm-Mortgage Debt				Non-Real-Estate Farm Debt			
	All Insured Commercial Banks		Federal Land Banks		All Insured Commercial Banks		Production Credit Associations	
	Amount Outstanding	Change from 1970	Amount Outstanding	Change from 1970	Amount Outstanding	Change from 1970	Amount Outstanding	Change from 1970
	\$ Million	Per Cent	\$ Million	Per Cent	\$ Million	Per Cent	\$ Million	Per Cent
Maryland*	74.6	+8.6	66.8	+10.2	38.4	+1.4	40.5	+6.4
Virginia	89.5	+7.1	120.1	+6.7	114.2	+5.3	61.5	+10.4
West Virginia	35.1	+6.6	12.3	-0.7	19.2	-0.7	9.0	+7.6
North Carolina	76.5	-1.1	206.6	+11.3	137.7	+7.2	225.0	+20.7
South Carolina	28.9	+2.8	118.3	+8.6	43.3	-3.6	110.7	+17.2
Fifth District	304.7	+4.8	524.0	+9.1	352.9	+4.1	446.8	+16.6
United States**	3,970.2	-1.5	7,578.7	+8.4	12,232.2	+8.8	6,273.2	+17.1

\* Includes District of Columbia. \*\* States and other areas.

Note: Data may not add to totals because of rounding.

Source: Federal Deposit Insurance Corporation and Farm Credit Administration.

to \$524.0 million for a gain of 9% or \$43.8 million during the same 12-month period. The increase, however, was lower than the 12% or \$49.6 million gain recorded by the Federal land banks during the preceding 12 months.

Non-real-estate farm debt outstanding at District banks at midyear 1971 totaled \$352.9 million. The loans outstanding were up 4.1% or \$13.8 million, compared with a gain of 3.8% or \$12.5 million during the year ended in mid-1970. The volume of non-real-estate debt held by the PCA's, on the other hand, amounted to \$446.8 million for an increase of 17% or \$63.7 million during the same 12 months. The gain in PCA loans compares with the 15% or \$48.8 million upturn recorded by the PCA's during the 12-month period ended in mid-1970.

The number of farmers borrowing from commercial banks dropped slightly, primarily because of fewer farmers. But the average size farm loan increased again, and in a good many cases by a considerable amount. Bankers' farm loan repayments, on balance, were better than in 1970, and the number of delinquencies was generally lower. Farm loan renewals were down, but only moderately so.

Bankers' loan policies or practices, for the most part, were about the same as a year earlier, or generally tight. One-fifth of the respondents indicated, however, that they adopted more lenient policies during 1971. Bankers in general continued to weigh heavily good management ability and repayment capacity when evaluating loan requests.

Bank funds available for lending to farmers in 1971 were reported to have been larger than in 1970 by 55% of the bankers surveyed. The remainder indicated that their available funds had been about the same as in the previous year. Without exception, all bankers said they had not found it necessary to turn down farm loan applications because of lack of funds.

Fifty-five per cent of the sampled banks indicated that they had had requests for farm loans from corporations during 1971. Of those replying in the affirmative, 18% said their requests came from family farm corporations, 27% indicated they came from other types of corporations, and 55% pointed out that the requests had come from both kinds. Overall, there seemed to have been little change from 1970, either in number or amount, in the requests of corporations for farm loans. Where changes were indicated, they were in an upward direction. On the whole, a higher proportion of family farm corporations increased their requests for farm loans than did other types.

**Farm Financial and Credit Outlook for 1972** On balance, some improvement in farm income is anticipated in 1972. Assuming that the weather will be average or better during both the growing and harvesting seasons, one-half of the replying bankers looked for an increase—primarily slight—in income from farming, two-fifths expected little change, while the remainder foresaw a decline.

Farm operating costs appear likely to increase further. This view was held by four-fifths of the survey respondents. The remainder believed there would be little change. Of those anticipating a further rise in farm costs, the majority felt that the increase over 1971 would be slight.

Farmers' demand for credit in 1972 is expected to be about the same as, or slightly larger than, that in 1971. Half of the participating bankers, in fact, looked for farm loan demand to continue at roughly the same level as in the current year. The other half anticipated some slight step-up in demand. The expected increase in the costs of farm production items will no doubt add to the credit demand.

The level of farmers' spending and investment in 1972 may well be moderately higher than a year earlier. This was the opinion of two-fifths of the survey participants. The remaining three-fifths believed farmers will hold their spending and investment to about the same level as in 1971.

The outlook indicates that bank funds for farm loans will be more readily available to farm borrowers in 1972 than in 1971. This indication applies more to funds for short- and intermediate-term loans than to those for long-term loans. Some increase in the availability of funds for long-term farm loans was anticipated by 16% of the banker respondents, however. Despite the expected increase in available loan funds, bankers emphasized that the more credit-worthy farmers with sound farming operations would have the best chance of obtaining needed loans. Basically, little change in bankers' current policies on farm loans, already said to be fairly restrictive, is expected for 1972. A tally of survey responses revealed that although 85% of the bankers indicated they would adhere to about the same policies as in 1971, the remaining 15% said their loan policies would be more lenient.

The somewhat softer interest rates that banks charged on farm loans in 1971 can be expected to prevail in 1972. The most prevalent rates quoted, according to survey results, were 8% for long-term loans and a range of 7½% to 8% for both short- and intermediate-term loans. But interest rates cited for 1972 showed considerable variation. Rates

ranging from 7% to 9% were quoted for long-term loans, from 7% to 8% for short-term loans, and from 7% to 10% for intermediate-term loans. To the question "What trends in interest rates do you foresee?" seven-tenths of the responses indicated little change, one-fifth looked for some further softening, and the remaining one-tenth expected an upward trend.

The general debt and financial position of District farmers overall apparently will not be substantially different in 1972 from that in 1971. With the advance in the market values of farmland in

1971, most farm owners are in an improved equity position as they enter the new year. The cash income position of farmers varies considerably, however. Better incomes in 1971 enabled a good many farmers to improve their debt position by paying off old debts. But unfavorable 1971 returns reduced the financial position of farmers in some locations—especially in the Coastal Plains of North Carolina and Virginia. Many of these farmers were unable to meet their loan obligations in 1971 and will need to borrow heavily if they are to continue in farming.

*Sada L. Clarke*

*The Federal Reserve Bank of Richmond is pleased to announce the publication of FIFTH DISTRICT FIGURES—1971 Edition and BUSINESS FORECASTS FOR 1972. FIFTH DISTRICT FIGURES is a compilation of economic statistics on Fifth District States and Standard Metropolitan Statistical Areas, as well as on the United States. BUSINESS FORECASTS is a compilation of representative business forecasts, with names and details of estimates, for the coming year. Both publications are available free of charge from this Bank. Please address requests to Bank and Public Relations, Federal Reserve Bank of Richmond, P. O.Box 27622, Richmond, Virginia 23261.*