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Summary

THE field of this study, as of other volumes in the present series, is credit used for consumption and repayable within a relatively short or intermediate period of time in regular instalments, carrying a finance charge for the service rendered and attested by a negotiable instrument. Thus producer credit and two important types of consumer credit—retail charge accounts and real estate mortgage credit, even if extended to final consumers on an instalment basis—are excluded from consideration. Institutionally and statistically the boundary between the area of investigation and related fields is fairly distinct. But much of what will be said about the causes and consequences of consumer instalment credit fluctuations applies also to other types of credit.

Consumer credit, as contrasted with producer credit, is extended by special institutions (or by separate branches of general credit institutions, such as personal loan departments of commercial banks) to final consumers, and is used for the financing of consumption expenditure. But in regard to those groups of consumers for whom household and business are not sharply separated the line of demarcation between producer and consumer credit is somewhat blurred.

BASIC FACTS ABOUT CONSUMER INSTALMENT CREDIT AND ITS FLUCTUATIONS

Consumer instalment credit falls into two distinct types, commodity credit and cash loans. Commodity or sales credit results from instalment selling; a cash loan is the advance of money to be spent for any purpose. Commodity sales credit, which is extended by dealers or producers, and through them

by sales finance companies, industrial banking companies or commercial banks, has been quantitatively the more important, though in recent years cash loan credit has made much greater progress. Cash loans are extended by personal finance companies, industrial banking companies, credit unions and commercial banks, the latter mainly through specialized personal loan departments. The services of these different credit agencies differ mainly according to the typical or possible size of their loans and the security demanded. They are on the whole imperfect substitutes for one another, but many borrowers can qualify for the services of any or several of these institutions.

Practically all commodity credit and a large part of cash loans are used for the purchase of durable consumer goods, mainly automobiles, furniture and electric appliances; automobiles alone accounted for about three-fifths of the 3,700 million dollars of commodity credit extended in 1937. It is estimated that between 70 and 80 percent of all consumer instalment credit is used for durable goods.[1] If the figure is assumed to be 75 percent it can be calculated that in the period 1929-38 an average of about 45 percent of all durable consumer goods were sold on credit, the percentage rising (with fluctuations) from 40 percent in 1929 to 58 percent in 1938.[2] In the period 1925-40 roughly three-fifths of all new and used automobile sales, half of all sales of household appliance stores and two-fifths of the sales of furniture stores were made on credit.[3] These percentages fluctuate somewhat from year to year, but they show little correlation with business cycles.

A pronounced cyclical pattern is displayed, however, by the three basic series that are used as measures of credit expansion and contraction. These are the monthly series showing the volume of new credits granted, the amount of credit outstanding, and the "net credit change" (that is, the change

[1] P. 51.
[2] Footnote 57, p. 155.
[3] Chart XI, p. 137.

in outstanding credit from month to month). All three move in close correspondence with the ups and downs of general business cycles. It is true that there is no perfect conformity, but the deviations, though they are not negligible and not without interest, are not large enough to blur the basic parallelism of instalment credit cycles and general business cycles.

Retail sales credit[4] follows general business cycles more closely than cash loans do. New credits, outstandings and net credit change reach a peak in 1929, come to a low point in 1932 or 1933, reach another peak in about 1937 and another trough in 1938. There are short lags in the turning points of the three series, the sequence being net credit change, new credits, outstandings. This order is not a fortuitous phenomenon, but can be explained on theoretical grounds. Substantially the same cyclical patterns as in the aggregate series for sales credit are to be found in its five constituent series—automobile dealers, department stores, furniture, appliance and jewelry stores.[5]

The cyclical pattern of cash loan credit[6] is somewhat different: the violence of the cyclical fluctuations is much less than in the case of sales credit, and the correspondence with general business cycles is less pronounced. Cash loan credit has shown a sharp upward trend in recent years: its year-end outstandings, which were 557 million dollars in 1929, nearly doubled by 1937 (1000 million), and nearly doubled again by 1940 (1800 million), while commodity credit outstandings at the end of 1940 (2900 million dollars) and at the peak of 1937 (2500 million) were only slightly higher than at the peak of 1929 (2400 million). The cyclical pattern of consumer instalment credit as a whole is completely dominated by the quantitatively preponderant commodity credit, but

[4] Chart IV, p. 65.
[5] Chart I, p. 56.
[6] Chart V, p. 66. This chart shows only outstandings and net credit change, not new credits and repayments. The reason is that in cash lending the two latter series are swelled and made useless by the inclusion of refinanced balances, which are counted both as new loans and as repayments.

the upward trend during the period covered by the data is primarily due to the rise in cash loans.[7]

CAUSES OF INSTALMENT CREDIT FLUCTUATIONS

In considering why instalment credit fluctuates as it does we may distinguish between trend or growth factors and cyclical factors. Growth factors explain the long-run growth of instalment credit over several business cycles, from its first introduction as an important phenomenon, say in 1910, up to the present time. The cyclical factors are responsible for the shorter fluctuations, corresponding to business cycles, which stand out very clearly in the charts of monthly data.

The long-run growth in the volume of instalment credit[8] is due mainly to two factors: the rise in the production and use of durable consumer goods, notably automobiles, washing machines, refrigerators and the like; and the institutional growth of the lending and financing machinery, developing concurrently with a change in favor of instalment credit in the attitude of the consuming public, bankers and legislators. The long-run growth was most vigorous in the decade before 1929. Since that year the movements are to be explained mainly in terms of cyclical factors, though in the cash loan field institutional and other factors are still producing an upward trend.

Analysis of the causes of the short-run (cyclical) fluctuations in credit is facilitated by distinguishing between the forces influencing supply and those operating on demand. The quantity or amount of credit demanded and supplied is usually thought to refer to new credits extended, but it can also refer to outstandings, for a change in new credits is in ordinary circumstances reflected in a change of outstandings in the same direction.[9] It is not so easy to define what is meant by "price of credit."[10] In the first place, the

[7] Chart VI, p. 67.
[8] Pp. 82-84.
[9] Pp. 85-86.
[10] Pp. 86-89.

finance charges on different types of credit are not easily reducible to comparable terms; the charge may be stated as a lump sum per month, as a discount or as a straight interest rate on the average or current unpaid balance. Since the consumer does not always know the interest equivalent of alternative credit offers he is not always able to choose the most advantageous opportunity. A second difficulty in giving a precise meaning to "price of credit" is the fact that in addition to the finance charge there are other determinants of consumer demand for credit, especially down payment percentage and contract length (number of monthly instalments). Thus credit may be said to have become cheaper, or terms more liberal, if the finance charge is lower, if the down payment percentage has been reduced or if the contract period has been extended.

Fluctuations in the volume of credit appear to have been due more to cyclical shifts in demand than to cyclical shifts in the supply of credit. There is little statistical evidence that terms have been systematically and materially tightened during cyclical downswings, thus restricting credit, and liberalized during cyclical upswings, thus expanding credit, although to some extent lenders may have achieved this effect by raising and lowering the standards they follow in accepting risks—a course that would not be reflected in the statistical data on terms.[11] Moreover, supply seems to have been very elastic through most of the period covered by our statistical data (at least since 1933). That is to say, increases in demand could be easily accommodated without serious tightening of terms or severe rationing of credit. This holds of the supply of credit extended by the consumer credit institutions to the ultimate borrower and also of the supply of funds available to the consumer credit institutions themselves. The latter have acquired easy access to the general pool of the money market and can borrow from the banks without difficulties.[12]

[11] Pp. 90-95.
[12] Pp. 33-39, 95-97.

For an analysis of demand for credit it is best to deal separately with that part of credit—about three-fourths of the total—which is used for buying durable goods, and that part which is used for other purposes, the latter including the credit that is needed for tiding the borrower over unforeseen emergencies. With regard to the responsiveness (elasticity) of demand to alterations in the "price" or terms of credit, it appears that changes of a few percent in the finance charge, or in its interest equivalent, make too little difference in the amount of monthly instalment payments to be of much significance in influencing the quantity of credit demanded. But to changes in down payment percentage and contract length demand may react strongly, especially if such changes attract income groups for which the commodity was hitherto out of reach.[13] Cyclical shifts in demand for credit used for the purchase of durable goods correspond with general business cycles, and are due mainly to changes in income. When incomes fall in depressions purchases of durable goods are postponed, and when incomes rise in prosperities purchases of such goods are hastened.[14]

This behavior is not so pronounced in the credit purchases of non-durable goods. It has occasionally been suggested that consumers try to maintain their consumption standards on a more even level by borrowing in depressions and repaying their debts in good times. But it is doubtful whether many people are sufficiently cycle-conscious for such a behavior, and even if they were, the uncertainty about the length of the depression, the high finance charge and the reluctance of lenders would prevent most of them from following such a course.[15] Cash loans, however, do show traces of such an anticyclical behavior, probably because people borrow after the onset of a depression in order to refinance debts contracted during the preceding boom, and because it takes some time to reduce one's living standards when

[13] Pp. 100-05.
[14] Pp. 105-06.
[15] Pp. 106-09.

income has fallen.[16] Cash loans thus contain a fair measure of what has been called emergency borrowing. For the same reason a negative correlation with business cycles appears also in another type of credit, life insurance policy loans,[17] but credit of this type is of a special character and is not extensively treated in the present study. As we have seen, however, the cyclical pattern of instalment credit as a whole is dominated by sales credit.

INFLUENCE OF INSTALMENT CREDIT ON AGGREGATE EXPENDITURE AND CONSUMER SAVING

Fluctuations in aggregate expenditure, producer as well as consumer, constitute one of the most striking and important manifestations of business cycles. Therefore instalment credit's effect on aggregate expenditure is one of the most important determinants of its effect on economic activity and stability.[18]

Consumer expenditure appears to be increased by new credits and reduced by repayments.[19] Hence the difference between the two, that is, net credit change (the monthly change in outstanding credit), measures the net direct effect of credit on consumer expenditure.

This result is by no means self-evident and, in fact, it needs certain qualifications. It is conceivable that if credit were not available consumers would make their intended purchases just the same, and finance them by drawing on accumulated savings, either replenishing the depleted savings, or not; or they might first accumulate (save) the necessary sums and buy a little later for cash. And even if they did not make the intended purchases they might save the whole or part of the sums otherwise needed for instalment payments, instead of spending them on consumption. If these respective behaviors were typical we would have to

[16] Pp. 109-10.
[17] Pp. 110-14.
[18] Chapter 2 is largely devoted to an analysis of this problem.
[19] Pp. 39-46.

say that instalment credit has no effect on consumer spending, or that new credits do not affect it though repayments diminish it, or that new credits increase it though repayments do not affect it.[20] On the basis of certain facts and a priori reasoning it appears most probable, however, that the majority of consumers would not make the intended purchases but would spend on daily consumption items the amounts otherwise needed for instalment payments—in other words, that on the whole new credits increase and repayments decrease consumer expenditure. But the possibility that some people would find other ways of financing their purchases, or would save *ad hoc* and buy a little later for cash, cannot be wholly excluded. It follows that net credit change probably overstates somewhat the net direct contribution of instalment credit to consumer expenditure.

Consideration of the effect of instalment credit on producer expenditure raises somewhat different questions. It might be that an expansion or contraction of consumer credit would restrict or expand the supply of funds for producer credit, and thus restrict or expand producer expenditure. This would happen if the banks had no further funds available for lending, with the result that an unsatisfied demand for funds pressed against an insufficient supply. In this case an expansion of consumer credit would curtail the flow of funds into producer credit channels, and a contraction of consumer credit would liberate funds for production uses. It would follow that consumer credit, although affecting consumer expenditure, would not affect aggregate expenditure, for it would only bring about a transfer of purchasing power from the field of producer to that of consumer goods.

This possibility that consumer instalment credit is to some extent of the transfer type cannot be wholly excluded, but a consideration of the monetary and banking situation in the last ten years or so reveals that in the period under review consumer credit institutions could easily borrow from

[20] The various possibilities are discussed in detail in Appendix A.

the money market and the banking system; these have been very liquid since at least 1933. Therefore expansions of consumer credit cannot have encroached seriously upon the supply of funds for producer credit, and contractions of consumer credit cannot have led to any significant expansion elsewhere.[21] Before 1929 the situation may sometimes have been different.

Therefore net credit change measures the direct contribution of instalment credit not only to consumer expenditure, but also to aggregate expenditure ("effective demand"). So long as net credit change is positive, that is, so long as outstandings grow, credit is a stimulating factor. So long as net credit change is negative, that is, so long as outstandings decline, credit exerts a depressing (deflationary) influence. The measure of the intensity of the stimulating and depressing force during any month or year is, of course, net credit change, and not outstanding credit.[22]

ECONOMIC CONSEQUENCES OF INSTALMENT CREDIT FLUCTUATIONS

In the light of these conclusions it is possible to form an opinion as to how the long-run growth and cyclical fluctuations of instalment credit influence the level and stability of output and employment.[23] There can be no doubt that the introduction and subsequent institutional expansion of consumer instalment credit, which occurred during the 1920's, had a stimulating effect on the economy in the short run. It led to an increase in consumer demand, especially for durable goods, and was an important factor in the rapid rise of the durable goods industries and all the other industries that were directly and indirectly benefited thereby. But whether this development is to be regarded as favorable or unfavorable for economic stability over the long run de-

[21] Pp. 33-39.
[22] Pp. 73-80.
[23] Chapter 5 is devoted to this question.

pends upon questions of business cycle theory on which expert opinion is still divided. Most economists agree that during a depression the autonomous growth of a factor that stimulates consumer demand is highly desirable. There is sharp divergence of opinion, however, as to the value of such a factor during an upswing and a state of greater prosperity.

Those writers (such as J. M. Keynes, Alvin Hansen and their schools) who believe that there is such a phenomenon as "oversaving," and hold that in the present stage of economic development there are no longer sufficient investment opportunities for the increased savings resulting from higher incomes, conclude that there is the greatest need, during cyclical expansions as well as contractions, for anything that will increase consumption (decrease saving) or stimulate investment. Thus an expansion of consumer credit—which increases consumption and decreases saving—is regarded as desirable during an upswing as well as during a downswing of economic activity, and various writers have attributed the prosperity of the 1920's in considerable degree to the growth of instalment credit. On the other hand, there are economists who hold that prosperity periods are interrupted by excessive consumption rather than by oversaving, and in their opinion any credit expansion, but especially one for consumption purposes, is necessarily dangerous. Between the two extremes are those who believe that the effects exerted during an upswing by a stimulative factor, such as the introduction and development of consumer instalment credit, are dependent on various surrounding conditions, and that no sweeping generalizations can be made.

Just as there can be no doubt about instalment credit being a stimulating factor when it is first introduced and promoted on a large scale, it is clear that its abolition or rigorous restriction would be highly depressive or anti-inflationary. This is an important fact in the present emergency. But even a cessation or rapid curtailment of the rate

of growth, without an actual decline, may become a disturbing factor.

After the system of instalment credit has reached maturity, after its legal and institutional setting has been fully developed and its long-run growth has, temporarily or permanently, come to an end, credit is still subject to cyclical fluctuations. These fluctuations are then the result rather than the cause of cycles in general business activity: the dog wags the tail and not the tail the dog. This does not mean, of course, that the fluctuations in credit do not react back on the economic system as a whole. We have seen that when incomes rise in the upswing of the cycle, demand for credit increases, implying that people increase their expenditures by more than the increase in their income. When incomes shrink in the downswing of the cycle, credit contracts and people are forced to decrease expenditure more than they would if they had not contracted debts in the preceding upswing. It follows that credit intensifies the cyclical swings in consumer expenditure and hence in economic activity, functioning like an amplifier or resonator. This behavior is in no way different, however, from that of credit in general, producer credit included.

COMPARATIVE IMPORTANCE OF INSTALMENT CREDIT

We have seen that net credit change measures (but probably somewhat overstates) the net direct contribution of instalment credit to consumer expenditure. Hence by comparing this magnitude with national income and consumer expenditure, and with other factors that affect expenditure and national income in much the same way as instalment credit does, we can form an opinion about the relative quantitative importance of instalment credit.[24] Such a comparison suggests that in the period 1929-40 consumer instalment credit,

[24] Pp. 145-53.

while not negligible, was not a very important factor. Annual net credit change never amounted to more than 1.5 percent of total consumer outlay, and in most years was well under 1 percent. A comparison with national income naturally yields somewhat smaller percentages. After 1930 the financial operations of the federal government exerted a much more powerful influence on economic activity than instalment credit, as can be seen from a comparison of net credit change and "income-creating expenditure" of the federal government, the magnitude that corresponds in the field of government finance to net credit change. Net change in instalment credit was, in magnitude, more comparable to the net change in farm mortgage outstandings and in urban home mortgage outstandings, though the cyclical pattern in these magnitudes was different from the pattern in instalment credit.

It would be a mistake, however, to conclude that a drastic contraction of instalment credit would be a matter of little consequence. It must be borne in mind that net credit change measures only the actual direct influence of credit on consumer expenditure. The potential importance of instalment credit is much greater. If, for example, instalment credit were drastically restricted or altogether abolished, and outstanding credit liquidated through repayments, say within a year, the immediate (negative) contribution of credit to consumer expenditure would be far greater than is indicated by the actual figures on net credit change. In the extreme case, with credit being completely liquidated, net credit change would equal the amount of outstanding credit at the beginning of the year, and would be a very important factor in the short run.[25]

There is still another aspect of the matter to be considered. We have so far discussed the influence of credit on consumer expenditure, and through it on economic activity. The influence of instalment credit on particular industries

[25] Pp. 153-54.

has been touched upon, explicitly and by way of implication, but requires more consideration.[26]

There are reasons for believing that most instalment buyers would not buy if credit were not available. If this were 100 percent true, demand for durable goods would fall off tremendously in the event of the abolition of instalment credit, because a large proportion of automobiles and other durable consumer goods are bought on credit. It is easy to see that far-reaching repercussions would follow. If the automobile industry, for example, would not have developed to its present level without the rise of instalment credit, we should have to attribute to such credit a much greater role in the American economy than is suggested by the comparison of net credit change and national income or consumer expenditure. It is necessary, however, to qualify the assumption that most instalment buyers would not buy if credit were not available, or if it were regarded as too expensive. Especially the possibility must be borne in mind that some people would save *ad hoc* and buy a little later for cash.

Since it is impossible to know exactly what consumers' behavior would be if credit were not available, it is impossible to know exactly how the industries mainly affected by instalment financing would be influenced by a drastic curtailment of credit. But it seems reasonable to assume that the rise in the production of the durable goods that are largely bought with the aid of instalment credit would have been less rapid if credit had not existed, and that a sudden restriction of credit would, at least in the short run, lead to a slump in sales and a rise in costs.

CONTROL OF INSTALMENT CREDIT

It has been shown that in the past consumer instalment credit, like credit in general, has operated to accentuate fluctuations in economic activity. This behavior is by no

[26] Pp. 154-57.

means to be taken as a sufficient basis for a condemnation of the institution of instalment credit; but there can be no doubt that economic stability would be promoted if it were possible, without changing the long-run volume and trend of credit, to mitigate its cyclical fluctuations or, still better, to bring about an anticyclical pattern in credit—that is, if credit could be expanded in depressions and contracted in prosperity periods—so as to counteract the cyclical fluctuations in consumer expenditure and economic activity in general.[27]

It is not difficult to think of measures that would control the long-run volume of credit. In various fields of instalment financing such measures have been in operation for a long time, differing in the different states of the Union. These measures are mainly in the form of regulations concerning licensing and lending practices, especially maximum charges and maximum loan amounts; but their purpose has been the protection of the borrower from exploitation, rather than the promotion of economic stability.

Regulation of the supply of instalment credit in the interest of economic stability can be effected at two points: the flow of funds to the credit institutions themselves; and these institutions' supply of credit to the final consumer. Since the instalment credit agencies receive a large part of their funds from the banks and the money market, they are influenced by any general policy of credit expansion or restriction followed by the monetary authorities. But changes in interest—the classical method of credit control—are not likely to have any influence in determining the volume of instalment credit, since the interest cost on borrowed money is a negligible factor in the total operating costs of instalment lenders. More drastic measures, such as a rationing of the supply of funds, would be required, but such measures would be difficult to carry out effectively and equitably.

The flow of credit can be more easily regulated at the point where the funds leave the credit agency for the final

[27] This problem is discussed in Chapter 6.

consumer. This is the method followed in the program of enforced contraction of instalment credit inaugurated by the federal government in August 1941 and administered by the Federal Reserve Board. The means employed is the stipulation of minimum down payment percentages and maximum contract lengths for credits extended in connection with the purchase of certain specified commodities.

The first regulation issued by the Board, amended as of April 1, 1942, prescribes a minimum down payment of 33⅓ percent of cash purchase price in the sales of automobiles and motorcycles, and 33⅓ percent of cash purchase price minus trade-in allowance in sales of outboard motors, aircraft, motor boats, bicycles, radios, metallic musical instruments, cameras and various household appliances. For stoves and heating units, clocks, pumps, plumbing fixtures, furniture and floor coverings the minimum down payment required is either 10 or 20 percent of cash purchase price minus trade-in allowance. These requirements apply also to cash loans of $1500 or less that are used for the purchase of any listed commodity, whether or not the loan is secured by the article bought. For most listed commodities 15 months is the maximum maturity allowed, and this maximum applies also to cash loans not in excess of $1500, including those used for miscellaneous purposes; "modernization loans" are allowed a maximum maturity of 18 months if they amount to $1000 or less. Compliance with these regulations is enforced by subjecting contraventions to severe penalties.

The objective of this policy in the present emergency is threefold: first, to conserve material, labor and equipment that are needed for defense by diverting civilian demand away from durable goods; second, to combat inflationary tendencies by forcing consumers to repay their debts more quickly and thus reducing their purchasing power; and third, to create a backlog in consumer demand which will be helpful in overcoming a postwar slump.

In view of the rapid rise in income that is occurring at the present time, and the general apprehension among the

public about rising prices and growing scarcities, it is unlikely, however, that the tightening of credit terms decreed so far will choke off a substantial part of demand for credit; new credits will be somewhat reduced because of the greater down payment percentage, but it is not likely that credit sales will be much reduced below the level that would otherwise obtain. It follows that the first and third objectives listed above will have to be achieved by scarcities in materials, price rises and direct restrictions imposed on, and rationing of, durable goods production, rather than by instalment credit contraction. But outstandings will be reduced somewhat by the larger down payment requirements and the shorter maturities, which force consumers to repay their debts more quickly. This will contribute to the second objective mentioned above: consumer purchasing power will be somewhat curtailed, a development that will have a welcome anti-inflationary effect.

The machinery of credit control built up in connection with the present emergency, and the experience gained in its application, will be of use even after the war boom is over and the danger of war inflation passed. It will then be possible to utilize the new weapons of credit control for promoting economic stability by mitigating the ups and downs of ordinary peacetime business cycles. Under these conditions, however, the chances to achieve a satisfactory result are not so promising as under a war boom. It is true that an intense cyclical boom that entailed full employment and threatened price inflation would be similar to the present war boom. But during the period since the last war, that is, during the period in which consumer instalment credit has become an important factor, business cycles have not been of that type. At least during the decade after 1929 full employment was never reached. Even with respect to the boom that culminated in 1929 expert opinion is divided as to whether restrictions on credit would have served to mitigate the subsequent slump. Hence in the period under consideration there has been no strong case for credit contrac-

tion in upswings. The fluctuations in credit that did occur must be attributed mainly to changes in demand rather than in supply. But if the terms of credit have not been much tightened in the upswing there is not much scope for a liberalization and expansion in the following downswing.

A policy of cyclical variation of credit terms could be tried, however, tightening terms in the upswing and liberalizing them in the downswing. Such a policy would contribute something to economic stability by counteracting the cyclical fluctuations in the volume of instalment credit.