To the Graduate Council:

I am submitting herewith a dissertation written by Paul Joseph Kubik entitled "The Views of Federal Reserve System Officials Toward Consumer Credit in the Interwar Period." I have examined the final copy of this dissertation for form and content and recommend that it be accepted in partial fulfillment of the requirements for the degree of Doctor of Philosophy, with a major in Economics.

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THE VIEWS OF FEDERAL RESERVE SYSTEM OFFICIALS TOWARD CONSUMER CREDIT IN THE INTERWAR PERIOD

A Dissertation

Presented for the

Doctor of Philosophy

Degree

The University of Tennessee, Knoxville

Paul J. Kubik

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DEDICATION

This work is dedicated, with love, to Margaret Ray and Andrea Brigagliano. It is my fervent wish that these two will get along in the future as well as they have in the past.

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The difficulty I face in choosing the proper words to express my gratitude to the individuals listed here has revealed to me the magnitude of the debts I have collected. My debt to these individuals cannot be repaid.

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ABSTRACT

The purpose of this dissertation is to examine the ways in which officials of the Federal Reserve System responded to the development of consumer credit and the institutions extending it during the interwar period and to determine the influence these views had on the formation of monetary policy, particularly in the course of the Great Depression. Direct evidence from the minutes of the interwar Federal Reserve Board meetings, the minutes of the open market policy committee meetings, and various Federal Reserve publications are utilized in addressing this issue.

The volume of consumer credit was insignificant at the time of the writing of the Federal Reserve Act. The 1920's, however, witnessed a rapid increase in the amount of credit extended to the household for consumption. Outstanding consumer debt per household (constant $1972) increased from $237.15 to $540.28 between 1919 and 1929. The rapid development of consumer credit in the 1920's generated a significant amount of social debate. Individuals from the banking, business, labor and intellectual communities, as well as Federal Reserve System officials, participated in this debate. Analysis reveals that the attitudes of Federal Reserve officials paralleled others. Despite this initial show of concern the interwar development of consumer credit did not directly influence

the policies pursued by the System during this period. Federal Reserve System officials did not appreciate the importance of consumption and consumer credit in the 1920's and early 1930's. Consequently, they did not act so as to limit the drastic reduction in consumption spending during 1929-33.

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CHAPTER I

INTRODUCTION

This dissertation has two objectives. The first is to examine the ways in which officials of the Federal Reserve System responded to the development of consumer credit and the institutions extending it during the interwar period. The second is to use this information on their response to shed additional light on the ongoing debate over the role of the Federal Reserve System in the Great Depression.

The volume of consumer credit was insignificant when the Federal Reserve Act was written. As a consequence, it is not surprising that the provision of consumer credit was not mentioned in the original Act. The 1920's, however, witnessed a rapid increase in the amount of credit extended to the household. As shown in Table 1 consumer debt per household in real terms more than doubled over the course of the twenties. By 1924 outstanding consumer debt per capita was higher than in any prewar year and it continued to increase rapidly. By 1929 household debt was 170 per cent of the highest prewar level and more than double the levels attained in 1919, 1920, and 1921.

The increased volume of credit extended to consumers was one development in a group of new developments in the 1920's. As Minsky put it,

TABLE 1

Outstanding Consumer Debt (Constant $1972)/Total Number of U.S. Households (1900-1939)

Year	Amount	Year	Amount
1900	260.00	1920	244.37
1901	268.41	1921	249.81
1902	278.38	1922	274.86
1903	288.45	1923	305.25
1904	302.34	1924	331.87
1905	309.60	1925	372.83
1906	315.22	1926	425.42
1907	286.96	1927	432.19
1908	268.27	1928	478.14
1909	316.52	1929	540.28
1910	303.61	1930	491.39
1911	279.00	1931	440.48
1912	264.88	1932	362.84
1913	247.04	1933	349.95
1914	263.57	1934	373.11
1915	272.02	1935	471.35
1916	292.49	1936	575.30
1917	273.84	1937	598.04
1918	258.69	1938	544.39
1919	237.15	1939	620.95

Source: Martha L. Olney. "Advertising, Consumer Credit, and the 'Consumer Durables Revolution' of the 1920's," Ph.D. dissertation, University of California, Berkeley, 1985, Table V-1, p.150. Consumer debt includes the following: instalment loans extended to households by: commercial banks, small loan companies, industrial banking companies, and credit unions; single-payment loans from commercial banks and pawnbrokers; instalment sales credit; retail charge accounts; and service credit repayable in instalments, e.g. for funeral and medical expenses.

> [o]ne theme that helps explain the evolution of the relations among banking and industry in the 1920's and 1930's is that the British tradition, in which banks were not vehicles for equity financing of business and other long-term financing of business, households and industry, was inconsistent with the financing needs of the rapidly expanding utilities, capital intensive manufacturing and the emerging patterns of household ownership of durable and expensive consumption assets. Thus there were opportunities for profits in the development of new institutions and the new use of old institutions that centered around the financing of capital assets of households and business.[1]

The development of new credit institutions and of new uses of credit, including consumer credit, generated significant social debate in the twenties. As a debating handbook of the late twenties points out, the extension of credit to the household for consumption purposes was not a significant issue for popular consideration at the time of the writing of the Federal Reserve Act.[2] It certainly was by the Great Depression. Because the behavior of the Federal Reserve System (hereafter FRS) has been given a pivotal role in many explanations of that collapse and because a sharp fall in consumer spending was part of that collapse, the response by the FRS to the growth of consumer credit is of more than antiquarian interest. It

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[1]Hyman Minsky, "Banking and Industry between the Two Wars: The United States," Journal of European Economic History 13 (Fall 1984): 244.

[2]E.C. Buehler, Debate Handbook: Instalment Buying of Personal Property. Bulletin of the University of Kansas, V. 30 (Manhattan, Kansas: University of Kansas, 1929), p. 30.

is possible that the inaction of the System during the Great Depression was partly a response to the rapid build-up in consumer credit prior to the downturn. A full assessment of the role of the FRS in the macroeconomic events of the late 1920's and early 1930's requires an understanding of how the individuals within the FRS responded to the development of consumer credit.

Review of the Literature

This section reviews the academic debate regarding the role of the FRS in the Great Depression. The purpose of this review is to provide one justification for the question undertaken in this dissertation. The postwar debate over the role of the FRS in the downturn of 1929--33 began with the publication in 1963 of A Monetary History of the United States, 1867-1960, by Milton Friedman and Anna J. Schwartz. Friedman and Schwartz (hereafter F-S) lay the blame for the origin and severity of the Great Depression squarely on the shoulders of the Federal Reserve Board. They hold the contractionary monetary policy pursued prior to the stock market crash responsible for transforming a mild downturn into a great contraction. They also blame the F.R. Board for the severity of the downturn since in the course of the Depression FRS behavior was inconsistent with policies followed in the downturns of the preceding decade.

According to the interpretation of F-S, FRS officials were principally concerned in the 1920's with meeting domestic objectives. The FRS in this period, under the leadership of the gifted and influential Benjamin Strong, Governor of the Federal Reserve Bank of New York, recognized and understood the effects of FRS actions and in particular the effects of open market operations, on the domestic economy. In the course of the 1923-24 and 1926-27 economic downturns in the U.S., the FRS undertook open market purchases of government securities. These purchases, F-S argue, were directed at and successful in reviving the domestic economy.

The performance of FRS officials in the Great Depression was abysmal by comparison. In particular, the policies of the FRS were not sufficiently expansionary, F-S claim, to avoid the banking crises of 1930, 1931 and 1933. These banking crises led to a dramatic decrease in the supply of money through downward pressure on the deposit-currency and deposit-reserve ratios. The decrease in the supply of money led to a corresponding reduction in the level of money income. The absence of a strong, expansionary policy to counteract these events is attributed to the unfortunate death of Benjamin Strong, the reorganization of the open market decision-making committee (to include all 12 Governors of the Federal Reserve Banks), and the power shift within the FRS from

the New York Bank to the "inept" Federal Reserve Board.[3] The most accurate

> explanation for the contrast between Federal Reserve policy before 1929 and after, and hence for the inept policy after 1929...is the shift of power within the System and the lack of understanding and experience of the individuals to whom the power shifted.[4]

Had Benjamin Strong lived, F-S contend, he would have been able to guide the System toward more appropriate policy in the 1930's.

Friedman and Schwartz maintain that adoption of the view that monetary policy was impotent was misguided. Friedman has consistently maintained that the Great Depression provided "tragic testimony to the power of monetary policy--not, as Keynes and so many of his contemporaries believed, evidence of its impotence."[5]

A Monetary History drew numerous critical responses. Most have been concerned with the section on the Great Depression. The response of Peter Temin in his book Did Monetary Forces Cause the Great Depression? has been among the most influential. The purpose of this work was to evaluate both the monetarist explanation of F-S, and that

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[3]Milton Friedman and Anna J. Schwartz, A Monetary History of the United States, 1867-1960. (Princeton: Princeton University Press, 1963), pp. 409-19.

[4]Ibid., p. 411.

[5]Milton Friedman, "The Role of Monetary Policy," The American Economic Review 58 (March, 1968): 2.

of its main rival--the "spending hypothesis" or Keynesian explanation. Temin frames the issue in terms of whether the stock of money fell because of a fall in supply (the claim of F-S) or because of a fall in the demand for money, instigated by a reduction in autonomous expenditure (the claim of the Keynesian group). The "monetary hypothesis", Temin claims, can be criticized on three counts. First, since the real supply of money did not change in 1929-31 it cannot be used as an explanation for the change in real income for the same period. Secondly, the "monetary hypothesis" of F-S predicts rising interest rates as a result of a reduction in the supply of money. Short-term interest rates, however, did not rise but instead fell consistently over the course of the Depression. Finally, the F-S explanation requires that the banking crises that allegedly turned a normal downturn into the Great Contraction be independent of interest rate and income changes. They were not.[6]

The "spending hypothesis", in contrast, which relates the downturn to the level of autonomous spending, appears to fit the available evidence better according to Temin.

Temin observes that a sharp drop in the average propensity to consume seemed the most likely cause of the fall in spending that triggered both the fall in gross

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[6]Peter Temin, Did Monetary Forces Cause the Great Depression? (New York: Norton, 1976), p. 84-95.

national product and in the stock of money. A number of other factors, e.g. the oversupply of housing at the end of the decade and falling agricultural prices, contributed to the decline.

The fall in autonomous consumption cannot be accounted for completely. A fraction can be explained through the effect that the decrease in wealth associated with the stock market crash had on consumption. The long-standing notion that consumption expenditures decreased due to the development of pessimistic expectations following the stock market crash, however, is discounted. Consumer expectations do not appear to have changed significantly until the autumn of 1930. The change was largely due to "the failure of business to pick up in the fall of 1930 rather than the decline in stock market prices in 1929."[7] This conclusion is supported by evidence on the attitudes found in contemporary press reports and the ratings of agencies providing bond ratings. The bond rating agencies, e.g. Fitch, Moody's, Poor's, and Standard Statistics, "were staffed by experts in the various fields in which bonds were outstanding, and they therefore were in a position to make informed judgements about the future."[8] These sources indicate that throughout 1929 and the first

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[7]Ibid., p. 82.

[8]Ibid., pp. 79-80.

part of 1930 most Americans did not expect a major contraction.

Although Temin is unable to fully explain the severity of the Great Depression on the basis of the "spending hypothesis", he maintains that this explanation is superior to the 'monetary hypothesis' which is clearly at odds with the historical record.

In connecting the downturn of 1929-33 to a decline in autonomous spending, Temin follows in a well-established tradition. Most of Temin's predecessors though based their explanation on a decrease in investment spending. R.A. Gordon, for example, concludes that the "chief immediate cause" of the Great Depression was the depressing effect on short-term expectations generated by the overinvestment that had occurred in the housing and automobile industries at the end of the decade.[9] The stock market crash in October, 1929 reinforced the growing pessimism while "removing a cheap source of long-term capital, and reducing consumers' demand for luxuries and durable goods."[10] Temin's comparison of the downturns of 1920-21 and 1937-38 with the downturn of 1929-33, however, reveals that the initial fall in investment spending in the Depression was not as significant as in the other two contractions. It

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[9]Robert Gordon, Business Fluctuations (New York: Harper and Row, 1952), pp. 405-406.

[10]Ibid., p. 406.

is difficult then, to explain the severity of the contraction of 1929-33 by relying solely on the exhaustion of investment opportunities.

Whereas Temin has taken issue with the explanation of the Depression offered by F-S, a number of other authors have responded by examining in greater detail the behavior of the FRS in the interwar period. One group has focused on the interwar goals accepted by FRS officials. In the view of F-S, domestic considerations dominated in the 1920's. Accordingly, FRS behavior following 1929, the alleged ineptitude in dealing with the Depression, was inconsistent with the successful actions System officials undertook in the downturns of the twenties. The main counterargument to this interpretation has been put forth by Elmus Wicker. He contends that the principal considerations of the FRS in the period 1922-33 were international ones, specifically the re-attainment and maintenance of the international gold standard. Wicker states that

> [c]ontrary to the view expressed by C.O. Hardy and by Milton Friedman and Anna Schwartz... I maintain that domestic considerations were significant for the determination of monetary policy only when they happened to coincide or did not conflict with international considerations, namely, the maintenance of gold convertibility of European currencies.[11]

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[11]Elmus Wicker, "Federal Reserve Monetary Policy, 1922-33: A Re-interpretation," Journal of Political Economy 73 (August, 1965): 327.

The confusion over the relative weight accorded international goals, as opposed to domestic ones, Wicker maintains, centers around a misunderstanding of the so-called "managed money interlude" of 1922-25. In this period FRS officials, as indicated in the Tenth Annual Report of the Federal Reserve Board, set out new criteria on which to judge the supply of credit, since the gold standard was temporarily inoperative. Although these steps were taken in this "interlude" one cannot then assume, as F-S do, that FRS officials freed themselves completely from international considerations after 1925. According to this interpretation the timing of the open market purchases and discount rate reductions in 1923-24 and 1926-27 was determined principally by the desire to reduce the interest rate differential between New York and London. The volume of open market purchases was a function of the volume of gold imports coupled with "the desire to replenish the inventory of securities in the investment account as a safeguard against future inflation arising from continued gold imports."[12] Happily, these actions were consistent with the needs of the domestic economy. Since the international gold standard was not in immediate danger in 1930 there existed no pressing need for FRS officials to act. When the U.S. experienced large gold drains in September and October 1931, following Britain's

[12]Ibid., p. 326.

departure from gold the rediscount rate was increased. This move cannot be regarded as inconsistent with previous FRS policy if FRS officials were paying close attention throughout 1924-31 to the reattainment and maintenance of the gold standard.

The hypothesis of F-S, that had Benjamin Strong lived he would have been able to convince his colleagues that a more aggressive policy was necessary in the course of the downturn, is dismissed. The open-market tradition developed by Strong and staff members W. Randolph Burgess and W. W. Riefler at the New York Bank in the 1920's, which was labelled the Burgess-Strong-Riefler tradition, did not call, in the early part of 1930, for open market purchases. Under this tradition open market purchases were primarily intended to limit the indebtedness of member banks in the Chicago and New York districts. In the first six months of 1930 the amount of indebtedness in both districts "was only slightly above the corresponding figures for 1924 but substantially below the amount during the 1927 recession."[13] Additionally, the Burgess-Strong-Riefler tradition was not accepted by the remainder of the members of the Open Market Investment Committee. Several of these individuals instead believed in an overproduction theory of business movements which suggested that a

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[13]Ibid., p. 331.

down-turn was the natural result of the excesses of the preceding boom and hence called for some entirely proper liquidation. The inaction of the FRS consequently cannot be blamed on the reorganization of the Open Market Investment Committee to include all twelve Bank Governors.

Karl Brunner and Allan H. Meltzer address what they term as the failure of monetary policy in the Great Depression in their 1968 article "What Did We Learn from the Monetary Experience of the United States in the Great Depression?". Brunner and Meltzer (hereafter B-M), in responding to Wicker, find fault with his argument regarding the role of the FRS in the Great Depression on two separate counts. First, Wicker "fails to provide a clear statement of the principles to which they consistently adhered or a measure by which to judge the direction of their action or its consistency."[14] Second, and in their estimation more damaging, is the evidence on gold flows during the downturns of 1923-24 and 1926-28. The major portion of the bills and securities bought in the 1923-24 downturn were purchased after the trough, "while most of the gold inflow came before the trough of the recession."[15] Additionally, B-M "find that the cumulative

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[14]Karl Brunner and Allan Meltzer, "What Did We Learn from the Monetary Experience of the United States in the Great Depression," Canadian Journal of Economics 1 (May, 1968): 336.

[15]Ibid., pp. 336-337.

gold inflow was close to its maximum well before the Federal Reserve began to purchase securities and acquire bills."[16] This evidence, B-M argue, materially damages the argument advanced by Wicker that security purchases were primarily intended to counteract the gold inflow.

Brunner and Meltzer find little fault with the work of Friedman and Schwartz. They do argue, however, that Friedman and Schwartz, neglect the principal reason for the post-1929 policy failures, "a mistaken belief that low and/or falling interest rates were a sign of "easier" policy."[17] The key policy indicator used by FRS officials, according to B-M, was a domestic one, that is, short-term interest rates. Low or falling interest rates, B-M assert, were consistently taken by officials of the FRS to be an indication of monetary ease. In 1923-24 and 1926-27 short-term rates were considered too high. Officials of the FRS responded by lowering the discount rate and by making a series of open market purchases. The first twenty months of the Great Depression, in contrast, was a period of falling interest rates. Consequently, members of the Open Market Committee felt that a situation of monetary ease already existed and no expansionary policy was undertaken. Brunner and Meltzer conclude that

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[16]Ibid., p. 337.

[17]Ibid., p. 347.

FRS behavior was consistent in 1923-33, being dominated by domestic considerations.

A number of writers have utilized a variety of approaches in an attempt to resolve the issue of the consistency of interwar FRS behavior. Some have done so through the development and estimation of reaction functions of FRS behavior. In his Ph.D. dissertation Marshall E. McMahon attempts explicitly to resolve the issue of the objectives and consistency of early FRS behavior in a similar fashion. McMahon attempts to formulate a disutility function which relates positively the differential between desired and actual values of "certain target variables" and FRS disutility. More specifically, "the disutility of the policy maker is increased in proportion to the square of the difference between actual and desired values of certain target variables."[18] The problem is to minimize the function given a set of constraints which in this case embody the views of FRS officials regarding the workings of the economy. The disutility function is formulated in two ways. In the first, short-term interest rates are assumed to be the indicator FRS officials used to evaluate money market conditions. In the second formulation a set of "ultimate

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[18]Marshall McMahon, "Federal Reserve Behavior, 1923--31", Ph.D. Dissertation, Vanderbilt University, 1972, p. 58.

target variables" is chosen.[19] These variables are the gold stock of the U.S., the level of total output, and the level of commodity and stock market speculation. The constraint equations are based on McMahon's interpretation of the Burgess-Strong-Riefler doctrine.

McMahon concludes that, in the period 1924-29, FRS officials attempted to achieve both domestic and international goals. From the end of 1927 until October 1929, however, international goals were subordinated to the task of limiting speculation in the stock market. After the stock market crash domestic concerns again dominated. Open market purchases were limited due to the fear of reviving speculation and a condition of monetary ease as indicated by falling interest rates. McMahon attributes the increase in the discount rate in late 1931 to the desire on the part of FRS officials to maintain the gold supply of the United States.[20]

Paul B. Trescott employs a counterfactual approach to ascertain if FRS behavior after 1929 deviated from that exhibited in the period 1924-29. Trescott divides open market operations into "defensive" and "dynamic" groups. "Defensive" open market operations comprise those operations designed to offset disturbances which alter bank reserves. The disturbing variables include gold and

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[19]Ibid., p. 61.

[20]Ibid., p. 157.

currency flows, and changes in member bank borrowing. "Dynamic" open market operations, in contrast, are intended to alter bank reserves in an effort to meet a pre-determined objective, e.g. counteracting business cycle movements.

As a first step Trescott regresses the volume of FRS holdings of open market securities against both "defensive" and "dynamic" variables. The open market operations of the FRS in 1924-1929 are found to be "defensive" in nature.[21] Simulated values for the volume of open market securities held by the FRS for the period 1930-33 are then generated using the "defensive" pattern established in the years preceding the Great Depression. Trescott finds that "beginning in December 1929, actual policy deviated in a deflationary way from what the Federal Reserve would have done, had they maintained the 1924-29 pattern."[22] He concludes that the principal reason behind this change was the reorganization of the 5-man Open Market Investment Committee into the Open Market Policy Committee on which the Governors for all 12 Reserve Banks were represented.[23] Also, because "a number of newly enfranchised banks were outspokenly hostile to

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[21]Paul B. Trescott, "Federal Reserve Policy in the Great Contraction: A Counterfactual Assessment", Explorations in Economic History, 19 (July, 1982): 213.

[22]Ibid., p. 212.

[23]Ibid., pp. 218-19.

expansionary measures, the change may have tilted policy in the restrictive direction."[24] Trescott unfortunately ignores the evidence presented by Wicker on the record of the members of the original Open Market Investment Committee which indicates that in June 1930 three of these individuals voted against additional purchases.[25]

Lester Chandler addresses the issue of the role of the FRS in the Great Depression in his book American Monetary Policy, 1928-41. Chandler began the modern literature on FRS thinking in 1956 with his biography of Governor Benjamin Strong of the Federal Reserve Bank of New York. In his later work, rather than join the debate over the consistency of FRS behavior in the Great Depression, Chandler attempts to pick up where he ended his biography of Strong. According to his interpretation, in order to fully understand FRS policy it is important to recognize "the economic, financial, political and intellectual environments of the period."[26] In this light the inaction of the FRS in the Great Depression resulted because FRS officials

> differed on the causes of the depression, on the nature of the adjustments required for recovery,

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[24]Ibid., p. 219.

[25]Wicker, "Federal Reserve Monetary Policy, 1922:33: A Re-interpretation," p. 331.

[26]Lester V. Chandler, American Monetary Policy, 1928-41 (New York: Harper and Row, 1971): 93.

> on the responsibilities of the Federal Reserve, and on the effects that would flow from Federal Reserve actions. Under these circumstances it was impossible for the System to agree upon and carry out a unified and ambitious expansionary policy.[27]

The inaction that F-S relate to the "ineptitude" of the Federal Reserve Board is attributed instead to the different levels of understanding and the internal conflicts within the System. Chandler acknowledges that the death of Strong reduced the quality of leadership in the System. His analysis of the events of the interwar period does not depend, however, to the same degree that the analysis of F-S does, on the death of Governor Strong.

Chandler's explanation stresses that there was no one view within the FRS that consistently dominated the formation of policy. Rather, a range of diverse views coexisted and competed for influence. There was no one generally accepted economic theory of business movements in the Great Depression and the "state of economic understanding [within the System was] as varied, confused, and conflicting as that outside."[28]

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[27]Ibid., p. 146.

[28]Ibid., p. 129.

Method

A decline in consumption expenditure (either autonomous or induced by a fall in income or money supply) has been held by almost all writers to have played a major role in the Depression. Many have examined the behavior of FRS officials in the Depression. No one, however, has examined the view of FRS officials toward consumption and consumer credit. This dissertation is devoted to that task.

It is my contention that a knowledge of these attitudes contributes to an understanding of the context of policy-making and to an understanding of the policies pursued by the FRS in the course of the Great Depression. Since the drop in consumption spending was an integral part of the downturn of 1929-1933 an understanding of FRS views toward consumption and consumer credit will provide a better understanding of the role of the FRS in the Great Depression.

The approach adopted in this dissertation is similar to that employed by Chandler. This approach is based on the notion that the attitudes of individuals are consistent with those of the society around them. One's attitudes are certainly formed in a particular context. As a result in order to fully understand the views of FRS officials toward consumer credit they must be examined as part of contemporary attitudes. In this approach the

attitudes and changing views of socially-defined groups, such as organized labor, and the banking, academic and business communities are examined. This is, I believe, a superior approach to those that treat tastes and preferences of individual FRS officials as given and beyond explanation.

The central question of this study involves several secondary questions: What were the new institutions developed to provide the consumer with access to credit? Were statistics on consumer credit and consumption available to FRS officials in this period? How did the views of early FRS officials on consumer credit relate to the views of other groups in society, e.g. bankers, organized labor, professional economists? Each of these will be addressed.

Evidence for this dissertation will come from both primary and secondary sources. The most influential figures in the FRS during this period were the Governors of the principal Reserve Banks, i.e. New York, Philadelphia, Chicago, and Boston, and the members of the Federal Reserve Board. It is to these individuals that the term "Federal Reserve officials" refers. Due to the scarcity of available evidence no claim is made here that the views of all FRS officials are represented. It is clear though that many of the remaining FRS officials agreed with the views of these dominating individuals. Evidence on the

views of FRS officials is taken from the minutes of Federal Reserve Board meetings, the minutes of the various open market policy committee meetings, and the personal papers of several prominent FRS officials. The Federal Reserve Board Bulletin, Annual Report of the Federal Reserve Board, and the publications of the New York, Chicago, Philadelphia, and Boston Reserve Banks are readily available for the interwar period and have also been employed.

The origin of consumer credit in America is not a subject familiar to most readers. It will be necessary, therefore, to begin in Chapter II by presenting an abbreviated account of the consumer credit industry in the United States. This chapter will serve to introduce terms and provide an historical backdrop against which the attitudes of FRS officials can be set. An indication of the statistics on consumer credit available to FRS officials during the interwar period will also be provided.

The chapters that follow will be devoted to a presentation of the views of FRS officials in the interwar period. Since the purpose of studying these views is to shed additional light on policy-making in the interwar period, particularly in the Great Depression this work will concentrate on the late 1920's and early 1930's.

The evidence on FRS attitudes toward consumer credit divides neatly into two areas. Chapter III deals with the first of these. It examines the participation of FRS officials in the 1925-27 debate generated by the rapid development of consumer credit, in particular instalment credit, in the 1920's. This debate, which included participants from business, banking, government, labor and intellectual circles, became the focus of an ongoing social debate generated by the rising material abundance of post-Industrial Revolution America. Chapter IV deals with the second group of material. It presents an account of the debate that arose in the course of the interwar period between members of the F.R. Board and its staff and officials from various Reserve Banks, members of Congress, and representatives of consumer credit agencies over the eligibility for rediscount of the paper of consumer credit agencies. This dialogue, and the question of the eligibility of consumer credit agencies for membership in the FRS, yields additional information on the response of FRS officials to the developments in the consumer credit field.

A final chapter sets out the conclusions of this dissertation.

CHAPTER II

AN ACCOUNT OF THE PRINCIPAL DEVELOPMENTS IN CONSUMER CREDIT IN THE UNITED STATES AFTER THE CIVIL WAR

Introduction

This chapter has two objectives. The first is to present a brief account of the principal developments in consumer credit in the United States prior to WWII. This presentation will serve to introduce terms and provide an historical backdrop against which the attitudes of FRS officials can be set. The second objective is to discuss the statistics on consumer credit available to FRS officials during the interwar period. This discussion will also be helpful in making the arguments presented in later chapters. It should be noted that throughout this chapter, and the remainder of the dissertation, consumer credit will be taken to mean that credit "granted to families and to individuals for use in their capacity as consumers."[1]

The Development of Consumer Credit in the United States Prior to World War II

The account that follows will be divided into three subsections covering the antebellum, postbellum and inter-

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[1]Rolf Nugent, Consumer Credit and Economic Stability (New York: Russell Sage Foundation, 1939), p. 29.

war periods. Although credit was extended to households for consumption purposes as early as colonial times, little need be said regarding the period before the Civil War for the volume of credit extended to consumers was relatively insignificant. Banks and note-shavers did extend a limited amount of credit to households. The former made accommodation (single payment) loans to consumers "who were property owners or depositors, or who could obtain a satisfactory endorser."[2] The latter were unlicensed small-scale lenders who "took notes which bore interest at the maximum legal rate but subtracted commissions and charges for various services and expenses from the amount given the borrower."[3] Pawnbrokers lent sums to borrowers caught in an emergency.

The most significant antebellum development in consumer credit was the beginning of the instalment business. In 1807 the New York firm of Cowperthwait and Sons began to sell furniture on an instalment basis by extending credit to the purchaser of a set of household goods and allowing the individual to repay the cost in a series of deferred payments.[4] Other New York furniture dealers,

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[2]U.S. Board of Governors of the Federal Reserve System, Consumer Instalment Credit, (Washington, D.C., U.S. Board of Governors, 1957), p. 23.

[3]Ibid. p. 23.

[4]E.R.A. Seligman, The Economics of Instalment Selling (New York: Harper and Row, 1927), p. 14.

witnessing the success of this practice, quickly began to imitate the example of Cowperthwait and Sons.

In the course of the antebellum period selling on an instalment basis spread to industries providing other high-priced home furnishings. The diffusion of instalment selling has been attributed to its adoption in the sewing machine industry. The Singer Sewing Machine Company had adopted the instalment plan by mid-century, forcing its competitors to do the same. By the 1870's sewing machines could be purchased with a $1 downpayment and 50 cents per week thereafter.

The postbellum period witnessed the innovation of several new types of consumer finance agencies: in particular, the small loan company, the credit union, and the industrial banking company. Nugent attributes these postwar developments in consumer finance to the movement of labor

> from intimate communities, in which they had enjoyed the security of partial self-sufficiency and the protection of family and neighborhood facilities for mutual assistance, to impersonal cities, where their means of subsistence depended on the continuous flow of paychecks, and their nearest neighbors were usually anonymous.[5]

In short, households could no longer draw upon the resources of the close-knit communities to which they had

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[5]Nugent, Consumer Credit and Economic Stability, p. 66.

previously belonged. The development of these credit institutions was certainly also related to the demand for the new products that became available in the course of the industrial revolution.

The unregulated small loan business appears to have begun in Chicago in the 1870's and spread rapidly to the major urban centers of the Mid-West and East coast. Nugent explains that,

> [t]here were two principal types of business. One group of lenders lent sums ranging from $10 to $200 on the security of chattel mortgages on household furniture at rates ranging from 6 to 15 per cent a month. Another group lent sums ranging from $5.00 to $50 on wage assignments at rates ranging generally from 10 to 40 per cent a month. A few lenders made both types of loans. But, for the most part, the furniture and salary loan business remained distinct.[6]

The difficult position of the borrower allowed the lender to charge exorbitant interest rates.

To a degree the unregulated small loan business arose in response to the credit needs of individuals buying merchandise on an instalment basis. The default of an instalment contract could have far-reaching effects. This included possible dismissal from employment if the instalment contract was attached to wage payments. Under this arrangement the employer could become liable for the

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[6]Nugent, Consumer Credit and Economic Stability, p. 73.

balance of the contract if the employee became unable to pay. The employer was liable even after the dismissal of the worker. As a result of this arrangement the business of the small loan agent expanded with the postbellum growth in instalment lending.

The abuses of the unregulated small loan business were a direct cause, after the turn of the century, of the regulation of the small loan business, or personal finance company, and the development of the credit union and the industrial banking company.

Credit unions were first introduced into the U.S. in 1909 in Massachusetts. Unlike the regulated small loan business, the credit union had no direct, indigenous predecessor. A credit union is a cooperative enterprise that gathers funds by pooling the savings of its members, individuals employed by the same firm, or by selling shares in the cooperative. It can then undertake to provide lending services to its members, who would not otherwise have access to bank credit, on the security of endorsed notes.[7]

With the help of Alphonse Desjardins the first general credit union law was passed in Massachusetts in 1909 during the tenure of state Bank Commissioner Pierre Jay.

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[7]Nugent, Consumer Credit and Economic Stability, p. 77.

In his 1908 report to the Massachusetts legislature Jay recommended that

> it would be wise to provide by law for some form of organization through which persons of moderate means might associate themselves for these purposes, after the manner of the credit unions and peoples banks of the European countries, India and Canada.[8]

Interestingly Pierre Jay went on to become the President of the Federal Reserve Bank of New York in 1914. The papers of Mr. Jay, which are held by the Federal Reserve Bank of New York, do not provide any evidence, however, that Jay continued his positive interest in consumer credit as President of the New York Bank.[9]

The state of New York followed Massachusetts in 1913 with the enactment of a credit union bill designed by the Russell Sage Foundation. North Carolina authorized the operation of credit unions in 1915. Five years later six states had credit union laws.[10]

The beginnings of the industrial banking business are somewhat obscure. It is clear, however, that the expansion of this institution was due to the efforts of Arthur Morris of Virginia. Morris established the Fidelity

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[8]R.F. Bergengren, Cooperative Banking; A Credit Union Book (New York: Macmillan and Company, 1923), p. 53.

[9]Pierre Jay. Papers. Federal Reserve Bank of New York, New York.

[10]Nugent, Consumer Credit and Economic Stability, p. 76.

Savings and Trust Company of Norfolk, Virginia in 1910 (as much for philanthropic reasons as for profit). The system of the Norfolk company was copyrighted and subsequent Morris plan companies were modelled after it. By 1922 94 such banks were operating in approximately half the States.[11]

These companies were organized to grant small amounts of credit, i.e. less than $1000, primarily for consumption purposes. Unlike commercial banks the Morris plan companies were willing to accept as endorsers individuals of approximately the same economic status as the borrower. Repayment of the typical loan was done in instalments into a hypothecated deposit account (thus avoiding the restraints of the usury statutes). A promissory note would be drawn up by the bank specifying the amount and date on which the total sum was to be repaid. The borrower was required to make a monthly deposit with the bank until the total deposit equalled the principal of the loan. At that point the accumulated deposit was used to pay off the loan and the cancelled note was surrendered to the borrower. Since the legality of this practice was questionable, special enabling legislation was later enacted in a number of states in order to permit this type of transaction. Systems similar to the Morris Plan were begun throughout

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[11]Nugent, Consumer Credit and Economic Stability, pp. 76-77.

the country in the early years of the 20th century, e.g. the Hood System in North Carolina and the Morgan Plan in the South.[12]

The development of these institutions and of similar organizations such as the limited dividend company or remedial loan association did not stop the abuses of the unregulated small loan business. Public-spirited groups turned to legislative solutions. Efforts by the Russell Sage Foundation, individual communities, and other groups led to the enactment of small loan legislation at the state level. Massachusetts led the way in 1911, New Jersey followed in 1914 and New York, Ohio and Pennsylvania enacted small loan legislation in 1915. Nineteen states had enacted enabling legislation for the small loan business by 1921 and 41 had done so by 1941. The maximum value of a loan, for example, was set by the individual States. For 12 states this amount ranged between $1000 and $5000, for the remainder the maximum value ranged between $300 and $500. The regulated small loan business was set up to make small personal loans, using the same type of security as its unregulated predecessor, but

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[12]Nugent, Consumer Credit and Economic Stability, pp. 77-78.

charged rates of only 2-3.5 per cent per month on the unpaid balance.[13]

The Russell Sage Foundation was instrumental in the small loan legislation movement. It began by undertaking studies of the remedial loan business in 1907 and 1908. The publication of the completed studies revealed the abuses of this business to the public and focused attention on the field. In 1916 it designed a model Uniform Small Loan Law which became the basis for most subsequent state legislation.[14]

In the postbellum period several changes occurred in the already existing instalment business. Credit was increasingly extended to individuals with lower incomes through the liberalization of terms. Nugent attributes this development to the rising competition between lenders.[15] In similar fashion local merchants found it both useful and necessary to adopt a deferred payment plan to meet the practices of itinerant salesmen. Selling on an instalment basis also expanded geographically and into diverse branches of merchandising. The early high-grade instalment business had been conducted with durable goods

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[13]U.S. Board of Governors of the Federal Reserve System. Consumer Instalment Credit, (Washington, D.C.: U.S. Board of Governors, 1957), pp. 40-41.

[14]Nugent, Consumer Credit and Economic Stability, p. 74.

[15]Nugent, Consumer Credit and Economic Stability, p. 67.

having a high resale value. In the postbellum period selling on an instalment basis was extended to semi- and non-durables. Nugent indicates that

> [i]n the late 1870's specialized instalment furniture houses began to sell all kind of household equipment, including bedding, rugs, clocks, sets of dishes, and kitchenware, on instalment payments; and a few clothing stores began to specialize in sales of suits, coats, and dresses on contracts which called for a downpayment of one-fifth of the purchase price and weekly payments over a period of two months.[16]

This expansion in the instalment business coincided with an increase in fraud and abuse. Delivered goods were often of lower quality than those viewed at the time of purchase. Another abuse was the use of the add-on contract. This was a system whereby "goods previously purchased were included as additional security for the payment of a new instalment contract."[17] Default meant the repossession of both sets of goods. Lenders justified this system by arguing that it placed additional leverage on the consumer to adhere to the time-honored value of thrift. The stigma attached to instalment selling resulted in part from the abuses of the postbellum period.[18]

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[16]Nugent, Consumer Credit and Economic Stability, p. 67.

[17]Nugent, Consumer Credit and Economic Stability, p. 71.

[18]Nugent, Consumer Credit and Economic Stability, p. 72.

Open book credit continued to be extended, accounting for the largest portion of consumer credit. Quality retail stores that shunned the use of instalment credit frequently were forced through competition with stores and agents selling merchandise on the basis of a deferred payment plan to become more liberal in their extension of open book credit. There was a gradual increase in the volume of accommodation loans made by commercial banks between the Civil War and World War One.[19]

In contrast to the gradual growth in the period from the end of the Civil War to WWI the volume of consumer credit doubled between 1923 and 1929. It rose from approximately 11 to 19 per cent of total private debt. The number of industrial banking companies grew from 190 in 1923 to 620 in 1929, and the number of credit unions rose from 200 in 1923 to over 1,000 by 1929. The loan balances of the industrial banking companies increased 6-fold in this period.[20] The number of regulated small loan offices rose from approximately 500 in 1920 to 600 in 1923, and finally to over 3,500 by 1929. The loan balances of the small loan business increased 6-fold in

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[19]Nugent, Consumer Credit and Economic Stability, p. 81.

[20]Nugent, Consumer Credit and Economic Stability, p. 100.

this period.[21] This development was due in large part to the extension of the services of small loan company chain offices. Although there was a sharp increase in cash lending by the latter in the twenties the operation of personal finance companies was constrained by their lack of access of capital markets. In 1928 however the Household Finance Corporation was able to sell an issue of preferred stock through a respected underwriting house. This opened the door to easier financing for these companies.

As the sale of merchandise on an instalment basis increased in volume new methods for the financing of customer receivables had to be developed. Industries in which agents sold goods for the manufacturer, e.g. sewing machines and book sets, were able to use their own capital which could be supplemented by commercial bank loans to finance customer receivables. In industries in which the goods were sold by the dealer, as in the furniture and piano business, the immediate seller, did not have access to the necessary amounts of capital with which to carry customer receivables. A new financial intermediary, between the banks and the dealer arose, the sales finance company. Sales finance companies, which were not subject to general usury statutes, did not extend credit directly

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[21]Nugent, Consumer Credit and Economic Stability, p. 100.

to the consumer. The first sales finance companies made loans principally to wholesalers and manufacturers with the assignment of trade accounts receivables as security. In time, however, "some companies began to buy retail open-book accounts and then retail instalment accounts.[22]

The first instalment finance company in the U.S. was organized in 1904 as a subsidiary of the Foster-Armstrong Company, a piano manufacturer in Rochester, New York. Its purpose was to purchase retail instalment contracts from Foster-Armstrong dealers. In 1907 the subsidiary changed its name from the Fidelity Contract Company to the Commercial Security Company and began to purchase the instalment paper of other piano manufacturers. Within a few years it had added phonograph paper to its business and in 1915 the Bankers Commercial Corporation, an affiliate, began to finance the retail sale of automobiles. Nugent indicates that "[m]anufacturers of carriages, stoves, furnaces, plumbing equipment, and washing machines followed in the footsteps of the piano industry in financing dealer's receivables."[23]

The rapid growth of sales finance companies is largely attributable to their role in the growth of the automobile industry. In the first decade and a half of

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[22]Nugent, Consumer Credit and Economic Stability, p. 79.

[23]Nugent, Consumer Credit and Economic Stability, p. 80.

the twentieth century cash payment for automobiles had been standard operating procedure. Commercial banks were wary of supporting the sale of these sport and pleasure vehicles. In 1910 the Seattle insurance firm of W.P. Smith and Company began to finance the sale of commercial vehicles. In 1913 the L.F. Weaver Company of San Francisco became the first enterprise to make the financing of passenger automobile sales a regular business. The growth of automobile financing was accelerated in 1915 when several already established sales finance companies, i.e. the Commercial Credit Company of Baltimore (established 1912) and the Commercial Investment Trust of New York (established 1908) began to purchase dealers' automobile paper. By 1917 25 enterprises had been established to finance instalment sales of automobiles. By the end of 1922 approximately 1,000 sales finance companies were financing 17 per cent of total automobile sales. By 1925 their number had risen to 1,700, but by 1929 it had fallen to 1,300, with the oldest and largest finance companies doing the majority of the business.[24]

Competition between finance companies in the 1920's led to a general easing of financing terms and dealer arrangements. The banking community believed this trend to be unsound. In response to pressure from the banking

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[24]U.S. Board of Governors, Consumer Instalment Credit, pp. 38-39.

community the National Association of Finance Companies in 1924 "adopted standards of a minimum downpayment of one-third of the cash price for new cars and two-fifths for used cars, with a maximum maturity of 12 months for both" in an effort to limit the trend toward easier terms.[25] Before 1924 finance companies purchased automobile paper from dealers only on a "full recourse" basis, i.e. only with the endorsement of the dealer. Many independent finance companies, however, then

> began to purchase 'without recourse', relieving the dealer of all responsibility for the completion of the contract. This gave these companies a competitive advantage over the factory owned or controlled finance companies which continued to require dealer recourse. The latter companies then countered by returning to the dealer as a bonus the excess of the loss reserve over actual losses incurred in financing that dealer. Soon the nonrecourse companies began to compete by including a dealer's bonus or reserve in the arrangements with dealers.[26]

It was not until the second half of the 1930's that commercial banks were to directly finance automobile sales on a large scale. But by 1941 they held approximately one-third of the outstanding volume of instalment credit. Throughout the 1920's, albeit indirectly, they had been

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[25]U.S. Board of Governors, Consumer Instalment Credit, p. 27.

[26]U.S. Board of Governors, Consumer Instalment Credit, p. 27.

supplying the major portion of the funds of the instalment finance companies.

The success of selling automobiles on an instalment basis led in the 1920's to an increase in the respectability of instalment selling. Individuals from all income groups increasingly bought goods on a deferred payment basis. Buyers became more willing to incur debt once it became the practice of sellers to assume that all buyers were potential instalment credit purchasers. The practice was subsequently extended to the financing of other consumer durables, especially new items such as the radio and electric vacuum cleaner. Lawrence M. Jones, Chairman of the Board of The Jones Store Company, one of the largest department stores in Kansas City, relates the successful practice of his firm,

> [i]f you can meet the credit requirements, which are high enough to protect us but not high enough to keep many people who feel they should buy furniture from buying, you have the privilege of paying the amount of the bill one-tenth down and one-tenth monthly for nine months ... You have the privilege, of course, of using the furniture while you are paying for it--all for the addition of only 4% to the regular cash cost. On a $120 purchase, that is, you pay $16.80 when you get the furniture and $12 a month for 9 months thereafter.
>
> The extra 4% charge, we have figured very carefully, covers the actual interest on money tied up, losses of all kinds(which amount to almost nothing), the proper share of the premium on the blanket insurance policy we carry for goods sold in this way, and the clerical labor and all other costs incident to the plan. Since our normal

> profit comes out of the regular price of the goods, we do not feel it necessary to ask more.[27]

Despite the extension of instalment selling to diverse branches of industry the volume of instalment sales of automobiles continued throughout the interwar period to constitute the largest portion of total instalment sales.

As already noted commercial banks were long wary of extending credit to the consumer. In fact part of the postbellum expansion of consumer credit can be viewed as a response by profit-seeking individuals to the vacuum left open by the formal banking system. A few city banks in North Carolina, Virginia, and Connecticut began in 1917-18 "to make loans to salaried people on terms similar to those offered by industrial banking companies. Loans were made on endorsed notes payable over the period of a year, and interest and an investigation fee were discounted. Installment payments were usually credited to a hypothecated deposit account."[28] Nugent estimated that by 1920 as many as 30 banks, mostly in rural areas, engaged in instalment lending. In 1920 the American Bank and Trust Company of Bridgeport started to provide small co-maker loans which were repayable in instalments. In 1924 the

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[27]Lawrence M. Jones, "We Have A Policy That Pushes Our Business Forward And Has For 30 Years," Nation's Business, 1926, p. 412.

[28]Nugent, Consumer Credit and Economic Stability, p. 82.

Louisville National Bank and Hudson County National Bank of Jersey City opened personal loan departments. The growth of such departments was stimulated in 1928 when the National City Bank of New York, at the time the country's largest bank opened a personal loan department. In the next year over 200 commercial banks, including the Bank of America in San Francisco, opened similar departments. Most banks however still maintained their traditional aversion to consumer credit throughout the twenties.[29]

In the second half of the 1920's, with the extension of instalment selling to semi-durable industries, e.g. clothing, individuals and groups, perhaps most vocally within the banking community, became increasingly concerned with the methods employed in instalment lending. As will be discussed in greater detail in Chapter III a significant amount of public debate ensued. In the midst of this discussion the establishment of the American Rediscount Corporation in 1927 was one tangible response.

As a result of a 1926 survey the Advisory Committee on Finance and Industrial Credit announced that an institution, the American Rediscount Corporation, was to be established.[30] The Advisory Committee on Finance and

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[29]Nugent, Consumer Credit and Economic Stability, p. 100.

[30]"Formation of Nation-Wide 'Reserve' System for Instalment Credits Under Name of American Rediscount Corporation," Commercial and Financial Chronicle, January 1, 1927, p. 4.

Industrial Credit was a private organization made up of bankers from prominent stock exchange firms and commercial credit houses. The 1926 survey of the experience of 34 industries which sold goods on the instalment plan, resulted from concern within the banking community that instalment selling had exceeded sound boundaries.[31]

The new institution was to act as a watchdog and nationwide discounting agency for the member finance companies which complied with the published regulations of the corporation. The institution was to be capitalized at $31.5 million under a charter from the laws of the state of Maryland. The American Rediscount Corporation was to be headed by Lawrence H. Hendricks, the comptroller of fiscal agencies for the Federal Reserve Bank of New York. Member finance companies were to maintain a uniform system of bookkeeping, which would be subject to periodic audit, and were to maintain a 15 per cent cash reserve against all outstanding loans. Those companies financing the sale of automobiles would limit the length of the instalment contract to 12 months. A limit was placed on the amount of used car paper that a company could purchase. The American Rediscount Corporation would rediscount, for member finance companies, one-fourth of the amount of

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[31]"Banker's and Credit Experts Plan to Stabilize Credits--Committee Concludes Survey of 34 Industries Showing Need for Effective Organization of Nation-Wide Scope," Commercial and Financial Chronicle, December 18, 1926, p. 3130.

paper that that institution was allowed to borrow. This limitation was established so that the new institution would not compete with private banking interests. Finally, a permanent department to deal with the making of fraudulent or "improper" contracts by member institutions was to be established.[32]

A similar institution was established for industrial banks. The Morris Plan Corporation of America was set up in the second half of the 1920's to serve as a rediscount agency for Morris Plan banks "whenever their local credit facilities proved insufficient."[33] Both rediscounting institutions were the responses to concerns over the growth in consumer credit.

Consumer credit rose consistently for the remainder of the 1920's. As shown in Table 1.1 consumer debt outstanding in real per capita terms reached $540.28 in 1929. It then fell consistently, bottoming out at $349.95 in 1933--an amount still above the level reached in 1924. The different types of consumer credit began their fall at different times. Credit for automobile financing and other consumer durables was the first to contract. This was followed by a contraction of open book credit after the

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[32]"Formation of Nation-Wide 'Reserve' System for Instalment Credits Under Name of American Rediscount Corporation," Commercial and Financial Chronicle, January 1, 1927, p. 4.

[33]Peter Herzog, The Morris Plan of Industrial Banking, (Chicago: A.W. Shaw, 1928), p. 46.

1929 Christmas season ended. It was not, however, until the end of 1930 that the loan balances of the specialized lending agencies began to decline consistently.[34]

The post-depression expansion likewise began at different times for different types of credit. Automobile financing again dominated instalment credit in the 1930's. This was due to the extension of average maturity terms from the 12 months which reigned in the 1920's, to 17 months by June 1937, and the sharp increase in used car financing. Commercial banks and small loan companies began to buy retail automobile paper after the depression, fueling the expansion of instalment credit in the mid-1930's.[35]

The loan balances of credit unions and personal loan departments of commercial banks began to rebound in the summer of 1933, and those of industrial banking companies in early 1934. The Federal Credit Union Act (1934) enabled credit unions to organize under federal charter in every state without the constraint of the general usury statutes. With the exception of small loan companies in New York and New Jersey (where the liberalization of small loan legislation in 1934 led to some increase) the loan

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[34]Nugent, Consumer Credit and Economic Stability, pp. 103-104.

[35]Nugent, Consumer Credit and Economic Stability, p. 107.

balances of small loan companies did not rebound until 1935.

The overall expansion continued until the Spring of 1937 when instalment credit again fell, albeit slowly at first.[36] Instalment credit rebounded strongly reaching a new high in 1941 of $6 billion. Instalment credit rose until Regulation W, issued by the Federal Reserve Board in 1941, which sought to set maximum maturities and minimum down payment levels for instalment credit sales of durable goods in order to restrain consumer spending in World War Two.[37]

The 1930's was a period of diversification for existing consumer credit agencies. Small loan companies and industrial banking companies began to purchase retail receivables and to make loan on the security of automobiles. Mail-order houses began to actively sell goods on deferred payment plans. The customer receivables of mail-order houses increased 4-fold between 1932 and August 1937. Quality department stores and furniture dealers became increasingly willing to extend instalment credit. There was an extension of instalment selling to a still wider range of goods through consolidation of semi-durable and perishable household supplies purchases. By the end

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[36]Nugent, Consumer Credit and Economic Stability, pp. 106-107.

[37]U.S. Board of Governors, Consumer Instalment Credit, p. 25.

of the 1930's some Morris plan banks had begun to take on many of the functions of commercial banks, accepting deposits subject to check and providing single-payment loans to individuals from higher income groups.[38] Morris Plan banks and other similar institutions had been made eligible for membership in the FRS with the Banking Act of 1933 (the reaction of FRS officials to this change will be treated in detail in Chapter V), and by 1934 became eligible for deposit insurance with the Federal Deposit Insurance Corporation. With the admittance to the Federal Reserve System the paper of Morris Plan banks could serve as security against short-term advances. Individual Morris Plan banks, however, could apply to the Federal Reserve Board and receive an exemption from the ruling.

Commercial banks increasingly became directly involved in instalment lending to households in the 1930's. Many had done a successful business of extending federally-insured repair and modernization loans to households under Title 1 of the National Housing Act. With sizable excess reserves, and a simultaneous decrease in earnings on business loans and investments, many previously hesitant banks were led to take a more active role in consumer credit.[39] The number of personal loan

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[38]U.S. Board of Governors, Consumer Instalment Credit, p. 38.

[39]Nugent, Consumer Credit and Economic Stability, pp. 108-109.

departments nearly tripled between 1933 and 1936, increasing from 236 in 1933 to 679 by 1936. The loan balances of these departments increased from $32.7 million in 1933 to $129.3 million by 1936.[40]

To conclude, consumer credit rose from $237.15 per capita real (1972) dollars in 1919 to $620.95 per capita real (1972) dollars twenty years later. It was in these years that consumer credit became a significant, permanent feature of the United States economy. It was also in these years that the extension of consumer credit became a topic for public debate. This was a debate, as will be shown in Chapter III, in which several FRS officials took part. The debate regarding consumer credit focused on instalment lending. This was due in part to the growth in this arrangement, in part due to the fact that the goods sold on the instalment plan, principally the automobile, came on the scene on a large scale for the first time in this period.

A Summary of the Statistics and Academic Analysis Available to Officials of the Interwar Federal Reserve System

The purpose of this section is to provide a summary of the academic analysis and statistics regarding consumer

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[40]D. Jennings, The Consumer in Commercial Banking. (New York: Consumer Credit Institute of America, 1939), p. 18.

credit available in the interwar period. In this way an indication can be given of the body of data and scholarly analysis available to FRS officials.

The first work done on consumer credit appears to have been undertaken by philanthropic organizations such as the Russell Sage Foundation, and individual state-banking offices such as the office of the Bank Commissioner of the state of Massachusetts, prior to World War One. Their research focused on the abuses in the unregulated small loan business. The Russell Sage Foundation, for instance, undertook studies in 1907 and 1908, of the salary and chattel loan businesses. The publication of these studies, which revealed the unsavory practices of these businesses to the public, resulted in widespread civic attempts to deal with the problems in this field, and as noted earlier, in the year following the release of the latter study, the first industrial banking company and credit union were organized in the United States.

A number of limited studies were done after the war by trust companies, consumer credit associations and banking associations. Economic textbook writers virtually ignored the development of consumer credit. One exception among the best-selling authors of the period was Henry Clay. In his Economics: An Introduction for the General Reader Clay

briefly, but strongly, rebukes individuals who use personal loans for consumption purposes.[41]

A limited amount of research was conducted by officials of the Federal Reserve Banks of New York and Boston on department store use of instalment selling during 1925-27. In 1925 the Federal Reserve Bank of New York undertook a limited study of the instalment business. The study was confined to instalment sales by department stores in New York City. The study indicated that "[i]n general, installment sales in this city are still only a small part of the total volume of department store business."[42] The study consequently concluded that that practice of instalment selling was not a cause for immediate concern. The Federal Reserve Bank of Boston began in 1925 to record the monthly average instalment sales of a select group of New England department stores. These figures were related to total sales. The monthly average instalment sales recorded in 1925 came to 5.2 per cent of total sales, in 1926 to 6.2 per cent, and in 1927 to 6.7 per cent. On the basis of these figures officials of the Boston Reserve Bank concluded, as had New York

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[41]Henry Clay, Economics: An Introduction for the General Reader, (New York: Macmillan, 1921), p. 323.

[42]"Wool Men Attack Installment Sales--Say We Deny Ourselves Clothes to Buy Radio Sets and Autos by Deferred Payments," Commercial and Financial Chronicle, December 5, 1925, p. 2705.

officials, that instalment sales were as yet only a minor part of the total credit scene.[43]

As will be discussed in greater detail in Chapter III the increase in instalment lending in the course of the 1920's generated widespread popular debate regarding the practice of selling merchandise on a deferred payment plan. This discussion reached a peak in the years 1925-27. The majority of what was written in this debate concentrated on a specific aspect of the instalment business and presented only fragmentary and inconsistent figures on consumer credit.

The first large-scale treatise was completed in 1926 by Milan V. Ayres, a statistician with the National Association of Finance Companies. Ayres presented statistics on the total volume of instalment credit and the collection experience of lenders of instalment credit. He was addressing the often-made criticism that instalment loans would become uncollectible in a business contraction. It was argued that instalment lending should be curtailed since it could act to aggravate a recession in business. Ayres showed that, in the business downturns of 1914 and 1921 the collection experience of finance companies had been generally good. Although Seligman was to seriously question his work in 1927,

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[43]Report of the Committee on Recent Economic Changes of the President's Committee on Unemployment. (Washington, D.C.: National Bureau of Economic Research, 1929), p. 399.

Ayres' study is the pioneering attempt to organize data on consumer lending.[44]

E.R.A. Seligman's two-volume The Economics of Instalment Selling represents the first large-scale scholarly study on consumer credit. Released in 1927, this study will be dealt with at some length since there is evidence that FRS officials relied on some of Seligman's findings. Seligman's work was summarized for the Federal Reserve Board in the Board's "Weekly Review of Periodicals" in 1928. His analysis was later to form the basis of an examination undertaken by the Board's Division of Research and Statistics in 1930 at the request of Board Member George R. James on the issue of cash buying offsetting instalment sales during the Great Depression. In reporting the findings of the study, E.A. Goldenweiser, the Director of the Division of Research and Statistics notes that Seligman's data had been used due to the authority of Seligman's figures and the difficulty of collecting accurate independent data.[45]

Seligman disclosed that his study was written in response to the popular view that the economics profession had ignored the development of instalment credit.

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[44]U.S. Board of Governors, Consumer Instalment Credit, p. 237.

[45]U.S. Board of Governors. Minutes of the Federal Reserve Board, Washington, D.C., v. 16, p. 441, and v. 17, p. 78.

Seligman notes in the preface that

> [s]ome time ago there appeared in a weekly periodical an article which sang a funeral dirge over political economy, and which declared that the bankruptcy of economics was illustrated by the failure of its votaries to attack the subject of instalment selling.[46]

Seligman's purpose was to provide a scholarly examination of instalment credit--in the midst of the wider, looser public debate--upon which sound conclusions could be made. Seligman noted that

> the views hitherto formulated have been the unconscious reactions of the interests, the fears, the desires and the prejudices of the individuals concerned. To the merchant [for example] whose business seems actually to suffer from the introduction of the new methods, instalment selling appears a dangerous innovation.[47]

Seligman accordingly focused on the questions that arose in the course of the popular discussion of the issue.

The work is divided into two parts. The first part deals with

> the subject historically and seeks to present an account of actual methods as well as of the extent which the system of instalment selling has attained. The second part attacks the more difficult topic of attempting to judge its real significance in modern economic life. We accordingly designate

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[46]E.R.A. Seligman, The Economics of Instalment Selling, (New York: Harper and Row, 1927), p. v.

[47]Ibid., pp. 123-24.

> the first part as historical and descriptive, and the second as analytical.[48]

The historical section describes the major developments in instalment credit and attempts an estimation of the extent of instalment selling.

In the analytical section the effects of instalment selling on the consumer, business conditions and the credit structure are discussed. In his analysis of the effects of instalment selling Seligman relies on the framework of marginal utility theory. Accordingly, consumer decisions are taken to be based on utility or the satisfaction of wants. Through the use of the instalment plan the consumer

> really pays in each periodic instalment for something which he will utilize in the future; and that this situation persists until the final payment, when he finds himself in possession of a commodity which will still be of value to him for a considerable period.[49]

The chief benefit of the instalment plan was to break up the payments on high-priced durable items--placing them within the reach of households of "moderate" income--to match the continuing utility derived from the consumption of these items.[50]

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[48]Ibid., p. vii.

[49]Ibid., p. 256.

[50]Ibid., p. 258.

Seligman notes three "hindrances" to the proper use of the instalment buying by the consumer. First, some consumers might be tempted into irrational purchases on the instalment plan. Seligman suggests that this problem is minimized due to the fact that the high-priced goods sold on the instalment plan will be purchased by those in the higher income groups who are more rational than individuals in the lower income groups.[51] A second problem lay in the unfamiliarity of some households with credit arrangements. This problem however would be reduced automatically over time with the increasing use of the instalment plan. Lastly, outright deception on the part of the seller compromises the correct use of instalment buying. Seligman maintains that these abuses have decreased over time and have been limited to the low-grade instalment business.

Two of the criticisms of instalment selling relate directly to the consumer. One concerned the effect of instalment selling on the level of savings, the other on luxury spending. The increase in instalment selling to that point had not had a detrimental effect on the level of savings bank deposits.[52] The relationship, Seligman argued, between individual saving and instalment selling was in actuality a positive one. This was due to the fact

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[51]Ibid., p. 267.

[52]Ibid., p. 273.

that if a commodity is a useful one then ownership of that item should increase both the capacity and desire of the individual to save. The popular criticism of instalment selling based on the claim that it supports unnecessary, luxury expenditure is also discounted. The purchase of a good, e.g.an automobile, must be evaluated in light of the utility that it provides its owner. The boundaries of luxury spending are relative. The definition of luxury is specific to each generation. There will accordingly be a process of adjustment, Seligman notes, to any good like the automobile which is in the "early stages of its adoption."[53]

With regard to the effect of instalment selling on business conditions a positive conclusion is again reached. In fact "at both ends of the business structure instalment selling exerts a well-defined beneficial influence."[54] On the supply side the development of the finance company, supporting, for example, the movement of automobiles, has allowed production to be done on an increasingly even level. This had contributed to an increase in the scale of production and reduction in costs. On the demand side "instalment credit put such potentially productive goods at the disposal of the

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[53]Ibid., p. 246.

[54]Ibid., p. 299.

consumer at an earlier date than would otherwise have been possible implies an increase of his efficiency which will soon be translated into an increasing flow of income."[55]

The popular argument that instalment credit accentuates the severity of the business cycle is discounted. First, Seligman argues, the amount of instalment credit was not significant in absolute terms. Second, wages and salaries which support instalment payments varied less over the business cycle than profits. In the depression year 1921 combined wages and salaries fell nine and one-half percent, while profits fell thirty percent.

Finally, not surprisingly, Seligman noted that "the so-called dangerous effects of instalment selling upon the credit structure have probably been much exaggerated."[56] In a survey covering the years 1919-25, conducted on the losses on automobile paper incurred by banks, Seligman determined that by 1925 these losses equalled two-tenths of one percent of the total value of this form of paper-an amount similar to that incurred on other types of credit.[57]

Several negative features of instalment credit are revealed. One was the danger inherent in the general easing of instalment terms. The percentage of losses on

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[55]Ibid., p. 283.

[56]Ibid., p. 330.

[57]Ibid., pp. 301-302.

instalment paper, Seligman maintained, were directly related to the length of the payment period. Accordingly, he suggested that maximum maturity terms be set for both new and used automobiles. Secondly, finance companies obscure the actual value of the finance charge in several ways. One was to determine the finance charge before the down payment has been deducted. A second was to make no allowances for payments made over less than a year, charging instead a yearly rate. The abuses of instalment selling would decrease as the household became increasingly knowledgeable about the practice, and competition between companies offering consumer field continued.

This analysis of instalment credit was the only detailed scholarly work on the practice in the 1920's. Seligman's purpose was to provide informed answers to the questions raised in the course of the popular debate. While approving of instalment selling, he also had a number of specific criticisms. The final word belonged to the individual consumer: "[i]f the practice of instalment selling continues to approve itself to the consumer, it means that the cost more that pays for itself in ultimate satisfactions."[58]

A limited number of scholars, following Seligman, addressed the topic of instalment selling before larger events at the end of the decade took their interests into

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[58]Ibid., p. 294.

other areas. Waddill Catchings and William T. Foster were arguably the most widely-read of these. A number of FRS officials were acquainted with their ideas. The papers of Eugene Meyer, Governor of the Federal Reserve Board from September 1930 to March 1933, reveal that Waddill Catchings maintained a correspondence with Meyer during his tenure on the Board, sending Meyer reprints of articles he had co-authored with William T. Foster.[59]

Catchings and Foster were principally concerned with explaining business movements. It was their contention that, during an expansion, firms produced more goods than consumers could purchase. This resulted from the fact that business did "not pay consumers as much money as it expect[ed] consumers to pay for its products--as much as consumers must pay if business is to expand and prosper. In other words, business ... [was] conducted at a profit."[60] Profits, to Catchings and Foster, constituted a leakage from the domestic flow of income. This shortfall in spending could hypothetically be filled by the liquidation of savings. The historical record, unfortunately, proved that this option was not viable since savers, historically, had increased "their savings,

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[59]Eugene Meyer. Papers. Library of Congress, Manuscript Division, Washington, D.C.

[60]Waddill Catchings and William Trufant Foster, "Installment Selling and Future Buying," Nation's Business, August, 1926, p. 47.

year in and year out, in war and in peace, in depression and in prosperity.[61]

In order to maintain spending and production, business developed selling to the consumer on a deferred payment basis. Instalment selling, however, was only a temporary solution since the leakages of profit-taking and saving had not been overcome. Catchings and Foster concluded that instalment selling did make possible a higher standard of living than was otherwise possible, but that this temporary gain had to weighed against the undesirable increase in consumer debt.[62]

John Maurice Clark of Columbia University dealt with the problems and benefits of instalment selling in an address before the Academy of Political Science in 1927. Clark concluded that "[t]he services of installment buying are probably not as generally understood as its dangers."[63] Selling on the instalment plan, if properly utilized, encouraged thrift and led to a reduction in costs through an increase in the scale of production.[64] Adhering to a few simple rules would ensure the soundness

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[61]Ibid., pp. 47-48.

[62]Ibid., p. 48.

[63]John Maurice Clark, "Control of Trade Practices by Competitive and Other Forces." In Problems in Prosperity: The Development of Installment Selling, edited by Parker Thomas Moon (New York: Academy of Political Science), p. 105.

[64]Ibid., p. 106.

of the practice of selling on a deferred payment basis. Specifically, "[c]ustomers should be selected from among those who are capable of using this dangerous device without being exploited by it. Initial payments should be substantial, and the period of credit limited well within the useful life of the goods. Rates of interest should be kept within bounds and, preferably, indicated in the contract."[65]

The 1927 study of instalment selling by Wilbur C. Plummer is the only pre-Depression work which approached that of E.R.A. Seligman in scope. Plummer, with most of his contemporaries, found instalment selling to be a useful practice, but one that had to be guarded from abuse. Plummer suggested that instalment selling had received more attention than it deserved. In point of fact "[t]he difference between instalment selling and the immense volumes of other kinds of credit, as far as the effects on price levels, production and over-expansion of credit in a business boom are concerned, is one of mere quantity rather than one of difference in kind."[66] Accordingly, both producer and consumer credit deserved careful, but equal attention.

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[65]Ibid., p. 107.

[66]W.C. Plummer, "Social and Economic Consequences of Buying on the Instalment Plan," Supplement to Annals of the American Academy of Social and Political Science 129 (January 1927): 56.

N.R. Danielian of Harvard University, responding in the American Economic Review to the conclusions of E.R.A. Seligman, was the most critical of the economic commentators on instalment selling in the late twenties. Danielian, in contrast with Seligman, charged instalment selling with increasing the severity of the business cycle. In an expansion instalment selling contributed to the over-expansion of output since it gave firms "deceptive notions about profits and rates of increase in volume of sales."[67] Instalment selling exacerbated a downturn "because the purchasing power of the community ... [is reduced by] the additional amount of outstanding consumers' credit."[68] Lastly, Danielian discounts the arguments of Seligman pertaining to the relationship between instalment selling and consumer satisfaction, and the positive influence of instalment credit on industrial productivity.[69]

To sum up, all writers recognized both negative and positive elements in the practice of selling on a deferred payment basis. The most influential study of the period, that of Seligman, stressed the benefits derived from the practice. In absolute terms the amount of research

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[67]N.R. Danielian, "The Theory of Consumers' Credit," The American Economic Review 19 (September, 1929): 411.

[68]Ibid., p. 411.

[69]Ibid., p. 410.

devoted to instalment selling by economists prior to the Great Depression was minimal. It was extensive enough, however, to provide FRS officials with an indication of the volume of instalment selling in the different industries.

Consumer credit statistics began to become more detailed in the course of the 1930's but little additional academic research was done on the topic until the end of the decade. The Russell Sage Foundation continued to collect and on occasion supply the Federal Reserve Board with statistics on consumer debt. Evans Clark, Director of the Twentieth Century Fund, an organization devoted to the improvement of economic and social conditions, wrote a brief, descriptive account of consumer credit in 1930. With the help of the Russell Sage Foundation Clark presented a fairly detailed account of the size and operation of each of the agencies that provided consumer credit.[70] The National Recovery Administration began a national study of consumer debt, which was subsequently taken over by the Russell Sage Foundation when the NRA ended operation. There is also some fragmentary evidence that several state banking offices began in the early 1930's to request information on the extent of personal loan departments in their state.

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[70]Evans Clark, Financing the Consumer (New York: Harper and Brothers Publishing, 1930).

No organized statistics were kept by a national authority, however, until the end of the decade. The Office of the Comptroller consistently refused pointed suggestions by individuals at the end of the 1930's to collect statistics on the operations of commercial bank personal loan departments. In 1938, however, the Department of Commerce set up an Instalment Credit Unit under the supervision of the Bureau of Foreign and Domestic Commerce in an effort to disseminate knowledge on instalment lending. In the same year the National Bureau of Economic Research began a comprehensive survey. These studies will not be dealt with since they were published after the period under study here.

CHAPTER III

THE RESPONSE OF FEDERAL RESERVE SYSTEM OFFICIALS TO INSTALMENT CREDIT

Introduction

At least three decades before the rapid growth of consumer credit in the 1920's, Americans were debating a set of interrelated issues generated by the rising material abundance of American society. Concern was expressed with regard to the effect of society's increased wealth on the spending habits of the laboring classes, the weakening of the economic and moral standard of thrift, and the effect of changes in retail selling methods and advertising techniques on the cost of living. In the second half of the 1920's the rapid development of consumer credit, in particular instalment credit, became the focus of this ongoing debate. The participation of several FRS officials in this discussion constitutes the initial public response of System officials to consumer credit. The purpose of this chapter is to examine this response.

This chapter begins with a brief survey of the attitudes toward household spending from the end of the 19th century to the start of the Great Depression. These attitudes are examined because they directly influenced the contours of the discussion of consumer credit in the

second half of the 1920's. The second section of this chapter presents material on the discussion of instalment financing in 1925-27 and the views expressed by FRS officials on this topic during the same period.

A Survey of Attitudes Toward Household Expenditure, 1890-1929

The rising material abundance enjoyed by American society in the second half of the 19th century, which was the result of industrialization, generated a number of issues which became important subjects for popular and professional debate at the end of the nineteenth century and the first two to three decades of the twentieth century. Real gross national product per capita in the United States (in constant $1958) increased from an average of $531 in 1869-78, to $1,011 in 1900, to $1,315 in 1920 and $1,671 in 1929.[1] This rise in real income represented an unprecedented increase in the standard of living for a large portion of the American public.

American society was not alone in experiencing the changes that resulted from industrialization, nor in reacting to the corresponding changes in the standard of living. In fact,

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[1]U.S. Department of Commerce. Historical Statistics of the United States, Colonial Times to 1970. (Washington, D.C.: Government Printing Office, 1975), p. 224.

> [t]he definition of consumption as a social problem is an old story and not an exclusively American one. Concern about the moral consequences of new patterns of consumption has persisted with remarkable tenacity from early in our history. From New England Puritans of the seventeenth century to contemporary social scientists, Americans have worried about the self-indulgence of consumers and the consequences of comfort, affluence, and luxury.[2]

The record of sumptuary laws to regulate consumption dates back to the thirteenth century. All societies have attitudes that pertain to the amount and distribution of goods. Technological changes, such as those accompanying the Industrial Revolution, which alter the amount and distribution of the material product of a society, often necessitate that adjustments be made in these attitudes.

Numerous historians have offered interpretations of the effects of the increased material abundance on American society in the second half of the 19th century.[3] John Hollitz and Daniel Horowitz have dealt directly with

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[2]Daniel Horowitz, The Morality of Spending: Attitudes toward the Consumer Society in America, 1875-1940, (Baltimore: Johns Hopkins University, 1985), p. xvii.

[3]See, for example, Daniel Boorstin, The Americans: The Democratic Experience (New York: Macmillan, 1973; Ray Ginger, The Age of Excess; The United States from 1877-1914 (New York: Macmillan, 1975); John E. Hollitz, "The Challenge of Abundance: Reactions to the Development of a Consumer Society in America, 1890-1920," Ph.D. Dissertation, University of Wisconsin-Madison, 1981; Daniel Horowitz, The Morality of Spending: Attitudes toward the Consumer Society in America, 1875-1940 (Baltimore: Johns Hopkins University, 1985).

the effects of these changes on contemporary attitudes toward household spending. The remainder of this section consequently relies heavily on their work.

In The Morality of Spending: Attitudes Toward the Consumer Society in America, 1875-1940, Daniel Horowitz was concerned with the process through which society reacted to and was affected by the new material abundance resulting from industrialization. Horowitz's contribution to the question of the timing and impact of a "consumer economy" lies in his interpretation of an untapped area of evidence, the data and language of early household budget studies. In particular he used studies from the Report of the Massachusetts Bureau of Labor Statistics in 1875 and the more sophisticated studies of the interwar period, represented by the work of Jessica B. Peixotto at the University of California-Berkeley. Through a reliance on this block of evidence and the work of major contemporary social critics, such as Simon Patten, Stuart Chase, and Helen and Robert Lynd, Horowitz argues that different, yet related brands of moralism have always colored the response of individuals to the improving standard of living. Prior to WWI a "conservative" brand of moralism underlay the view that household budget investigators and social critics adopted toward household spending. "Conservative" moralists focused their criticism on what they viewed as a lack of self-control exhibited in the

injudicious spending patterns of the poor and working classes, and in the extravagant ethnic traditions of immigrants. These analyses were often tainted by the middle-class origins of the writer. Writers, such as Francis Wayland and Carrol D. Wright, in offering a solution to these excesses, prescribed a life of "hard work and plain living", of increased thrift and frugality.[4]

At the end of the second decade of the twentieth century, however, a "modern" moralism began to develop. Writers in the twenties and thirties, in contrast with their predecessors, began to express concern that industrial capitalism had given rise to "a nation of conforming, indulgent, and passive people."[5] Therefore, while maintaining their forerunners' fear of materialism and an individual loss of self-control, these later moralists praised those individuals who "lived their lives based on a combination of sophistication and passion."[6] Immigrant groups that had kept alive their distinctive ethnic traditions and intellectuals who rejected mass culture found favor with this later generation of writers. The fictional novel Babbitt by Sinclair Lewis, which merci-

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[4]Horowitz, The Morality of Spending, p. xvi.

[5]Horowitz, The Morality of Spending, pp. xvii-xix.

[6]Horowitz, The Morality of Spending, p. xix.

lessly excoriates the empty, conformist life led by the title character, is a prime example of this literature.[7]

In his Ph.D. dissertation, "The Challenge of Abundance: Reactions to the Development of a Consumer Economy, 1890-1920," the argument presented by John Hollitz rests on the notion that by the 1920's a "consumer economy" had arrived for, and been accepted by most, but not all Americans. American society was able to accept the arrival of a consumer economy, i.e. one characterized by a high level of consumer spending, because of the adjustments in the attitudes of different groups in society, e.g. businessmen, bankers, organized labor, and economists, that were made in the two or three decades prior to the 1920's. By the conclusion of WWI "few Americans were prepared to question the role played by consumer demand--stimulated by advertising and satisfied by high wages" in maintaining economic growth.[8] Although this overstates the degree to which attitudes changed in this period a significant amount of adaptation to the rising material abundance can clearly be noted. The adaptation to society's new-found material abundance is evidenced by a change in the conception of the term thrift itself. Roy E. Blakely, in a

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[7]Sinclair Lewis. Babbitt (New York: New American Library, 1922).

[8]John E. Hollitz, "The Challenge of Abundance: Reactions to the Development of a Consumer Economy, 1890-1920," Ph.D. Dissertation, University of Wisconsin-Madison, 1981, p. 305.

speech made before the American Academy of Political and Social Science in 1920, maintained that as a result of the wartime experience of the United States

> [t]hrift was ... impressively shown to Americans in its true light. Instead of suggesting stinginess, it came to connote proper use, the use of means in such a way as to achieve the greatest results. It was closely associated with effectiveness, loyalty, patriotism, and victory.[9]

Two events played a significant role in the course of this adjustment to a higher standard of living. The first was the rise in the cost of living that occurred in the first two decades of the 20th century. The second was the First World War.

The Consumer Price Index, developed by the Bureau of Labor Statistics, shows that prices fell consistently from the conclusion of the Civil War until the turn of the century. The Consumer Price Index fell from its peak of 47 in 1864 (1967 = 100) to 25 during 1895-1901.[10] Prices rose gradually for about a decade and a half, averaging 27 for the first decade, before undergoing a rapid increase in the war period, averaging 38 for the second decade.[11]

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[9]Roy E. Blakely, "America's New Conception of Thrift." Annals of the American Academy of Political and Social Sciences, January 1920, p. ix.

[10]U.S. Department of Commerce, Historical Statistics, p. 191.

[11]U.S. Department of Commerce, Historical Statistics, p. 191.

The rise in the cost of living, after three decades of falling prices, stimulated numerous explanations. Its causes were the subject for popular discussion and professional debate. Specific discussion of this issue went on within the American Academy of Political and Social Science, the American Economic Association, and numerous state and federal legislatures. The views of the participants can be grouped into two categories.

One group attempted to blame this development on the new system of retail distribution that arose at the end of the 19th century. In short, a new set of middlemen and retail selling practices appeared to contemporaries to add nothing to production, but certainly to add to both costs and material wants, and, therefore, to prices. Advertising costs, for example, appeared only to add to the cost incurred by the consumer.[12] Advertising was also charged with generating excessive wants for unnecessary goods which contributed to the increased standard of living. The practice of selling pre-packaged goods, rather than buying in bulk, also appeared to add only to prices.[13]

To a second group the rising standard of wants and consequent increase in the cost of living was explained by the "moral backsliding" or increasingly thriftless

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[12]Hollitz, "The Challenge of Abundance," p. 123.

[13]Hollitz, "The Challenge of Abundance," p. 123.

behavior of American society.[14] To illustrate the link that was made between extravagant consumption and the cost of living, Hollitz quotes a statement from the Report of the Massachusetts Commission on the Cost of Living:

> The recent period of rising prices has been marked by a tendency toward extravagance among all classes, never before shown in this country ... in the desire to meet the standard of some neighbor or social set all idea of thrift has been abandoned.[15]

Additional evidence of this position can be offered. Senator Peter McCumber, a Republican from North Dakota, in discussing the proposal for a food embargo before his Senate colleagues, maintained that "[t]he high cost of living ... is largely due to American extravagance."[16]

The serious consideration accorded the growth of luxury expenditure is evidenced in the comments of one writer who drew a parallel between the extravagant expenditure of turn-of-the-century America and the

> feverish desire for the acquisition of wealth, not so much for a possession as for the means of lavish and unique expenditure, [which] was a distinctive mark of the closing days of the Roman Republic.[17]

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[14]Hollitz, "The Challenge of Abundance," p. 104.

[15]Hollitz, p. 244.

[16]"Moral Dangers Resulting from our Orgy of Opulence," Current Opinion, April 1917, p. 267.

[17]"Highways and Byways," Chautauquan, March 1901, p. 574.

The writer offered no solution to these excesses but reserved

> the right to hope that the loss of ideals and the degeneracy of spirit which were attendant characteristics of the rivalry in expenditure that raged in Rome before it fell from its high place among the nations are not inevitable, inseparable accompaniments of the lavish use of money for social purposes in the American republic in its preliminary period of world empire building.[18]

Some commentators laid the blame for society's increasingly extravagant spending on the shoulders of the lower classes and ethnic minorities. These were often

> [m]iddle-class observers ... [who] attacked what they saw as the profligacy of workers and immigrants, a habit that they believed resulted from the abandonment of the prudential virtues of persistence in work and self-restraint in pursuit of pleasures.[19]

Others railed at the wasteful expenditure of the upper class. As one writer points out,

> [a]n unprecedented era of prosperity, with a very epidemic of millionaires whose expenditures are marked by a prodigal ostentation and a swiftly increasing pace of luxury in the style of living ... [has] caused foreboding.[20]

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[18]Ibid. p. 574.

[19]Horowitz, The Morality of Spending, p. 134.

[20]Ralph D. Paine, "Are Riches Demoralizing American Life," World's Work, September 1903, p. 3913.

A significant number of writers blamed "idle" or "parasitic" women for the rise in wasteful extravagance. This was the message of a 1908 article published anonymously in The Independent.[21] The article, written by an ordained minister and businessman, describes the break-up of his marriage which the writer claims was due to problems arising over the spending habits of his "young luxury-loving bride." The writer intended the article to serve as a "warning" to any young man considering matrimony.[22]

In this discussion the terms "luxury" and "extravagance" were not defined similarly by all. One writer, for example, in referring to the extravagance of American society, maintained in a January 1915 issue of the Literary Digest that "a significant symptom of all this ... [is] the dancing-mania that has swept over the country during the past two years."[23] The automobile was considered by many Americans to be a luxury item well into the twenties.

Beyond its role in contributing to the increased cost of living, luxury expenditure was condemned on several

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[21]"A Lesson in Extravagance," Independent, May 21, 1908, pp. 1131-34.

[22]Ibid., pp. 1131-34.

[23]"If Every One Could Save," Literary Digest, January 9, 1915, p. 72.

additional counts. Spending on luxury items reduced the ability of society to save. It was accordingly condemned on the basis of the notion that saving lay at the foundation of economic prosperity. The most frequent complaint was that spending for "luxury" goods was morally improper. Judson Harmon, Attorney-General under President Cleveland, is quoted in Current Opinion as declaring that, "[i]t is not the accumulation but the waste and misuse of wealth that makes men decay."[24] Many writers expressed fear that a "period of unrest" would result from the dissipation of society's wealth in luxury expenditure.

There were also, it should be noted, a number of commentators who explicitly defended "luxury" expenditure. Charles Johnston wrote in Harper's Weekly that

> '[l]uxury' is only possible because a vast army of people are set to work, and are paid for their work. The rich man is merely a focus of redistribution, and the distributing process must go on all the time.[25]

Johnston went on to argue that the wealthy have attained their position in society because they have earned it--there are no rich fools. In the first place, the rich man did not reach his position through his ability to save. The wealthy individual only becomes so through his "two-

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[24]"Moral Dangers Resulting from our Orgy of Opulence," p. 267.

[25]Charles Johnston, "The Rich Man and His Money," Harper's Weekly, March 7, 1908, p. 24.

fold power of seeing what is to be done, and of coordinating workers to do it."[26] Therefore "what we call capital is merely the register of that power."[27]

Defenders of luxury spending quoted rising levels of saving as evidence that "luxury" expenditure had not eroded "the economic power of the nation". Although defenders agreed with some critics that some luxury expenditure, in particular expenditures on race-track betting and ostentatious jewelry, are "irrational," much of the so-called "luxury" expenditure has positive social benefits. Playing golf and going boating, for example, provide healthy exercise for the upper as well as the lower classes.[28] Ralph D. Paine, along with Johnston rested part of his defense of luxury expenditure on the argument that luxury expenditure was spending which created employment for a large number of individuals. Critics, many of them economists, replied that the labor time put in by this labor could have been better employed productively, e.g. in building social overhead capital, such as bridges and roads.[29]

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[26]Ibid., p. 24.

[27]Ibid., p. 24.

[28]Paine, "Are Riches Demoralizing American Life," pp. 3913-19.

[29]Richard T. Ely, T.S. Adams, Max O. Lorenz, A.A. Young, Outlines of Economics. 3rd. edition. (New York: Macmillan Company, 1916); H.R. Seager, Introduction to Economics, (New York: Holt, 1904).

To those who related the rising cost of living to injudicious spending, the solution to this development lay in a return to the virtues of thrift and self-denial. There was increased emphasis on thrift in formal education systems. In 1910 the Massachusetts legislature instructed teachers to "teach thrift" in the classroom, and the establishment of many turn of the century thrift movements were a reaction to the increases in the cost of living after 1904.[30]

Charity organizations joined in the campaign to "teach thrift" to the public. Mary Willcox Brown, General Secretary of the Henry Watson Children's Aid Society of Baltimore, declared in 1900 that the very purpose of a charity organization was to teach thrift to the poor. Saving was a means to an end, and that end was to be self-reliant. Brown declared that "[t]he working classes are willing to provide for themselves if an unwise charity does not offer a bonus to incompetence."[31]

These thrift movements received a powerful stimulus from the possibility of, and eventual American involvement in, the First World War. As part of the overall program instituted to conserve resources necessary to the war effort and to support the Liberty Bond campaigns on which

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[30]Hollitz, "The Challenge of Abundance," pp. 113-19.

[31]Mary Wilcox Brown, The Development of Thrift (New York: Macmillan Company, 1900), p. 9.

government borrowing rested, the federal government took steps to stimulate the habit of saving. War Saving Stamp and Thrift Stamp campaigns, for example, were begun in late 1917. The Federal Reserve System was enlisted in the saving campaign. Federal Reserve officials strongly supported the thrift movements and bond campaigns of World War One. Benjamin Strong, for example, made several speeches and wrote a number of articles urging Americans to save by purchasing Liberty Bonds.[32]

In the course of World War One, businessmen and bankers, joined the federal government and individuals from other groups such as the National Education Association and the Y.M.C.A. in calling for additional thrift on the part of the public. Bankers were often in the fore-front of these movements. S. W. Strauss, a Chicago investment-banker, and President of the American Society for Thrift, in an address before the National Education Association, argued that thrift was not only a necessary component in maintaining economic prosperity, it was also "an index of character and a builder of character."[33]

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[32]Benjamin Strong, Interpretations of Federal Reserve Policy in the Speeches and Writings of Benjamin Strong, edited by W. Randolph Burgess (New York: Harper and Row, 1927), pp. 38-62.

[33]S.W. Strauss, "Thrift as an Investment-Banker Sees It," Literary Digest, March 25, 1916, p. 576.

A number of writers, in contrast, responded adversely to the wartime thrift campaigns. As Hollitz states, "if attitudes about consumption lay quietly submerged in the generation before the First World War, the war itself brought them noisily to the surface of American life."[34] The degree to which American society had been persuaded by the notion that prosperity depended on spending is indicated by the numerous calls for "business as usual" during World War One.[35] Worried over the effects of the wartime thrift movement some commentators argued for the maintenance of peace-time styles and levels of production, or "business as usual." Writers justified the maintenance of "business as usual" in several ways. Some argued that the curtailment of the production of luxury goods such as the automobile and jewelry would reduce the economic welfare of the individuals involved in the production and distribution of these goods. Others argued that increased saving would result in a slowdown in business activity which in turn would limit the ability of the private sector to support the war effort.[36] Surprisingly, several bankers joined in arguing for a relaxation of the drives for economy. Charles Sabin, President of the Guaranty Trust Company, for example, cautioned that miserly saving

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[34]Hollitz, "The Challenge of Abundance," p. 248.

[35]Hollitz, "The Challenge of Abundance," p. 249.

[36]Hollitz, "The Challenge of Abundance," pp. 266-67.

was not desirable. Sabin states, in a speech reprinted in a 1918 Literary Digest article, that individuals in "non-essential" enterprises

> are among those who invest largely in the Government's war-loans and who pay taxes. Between the fallacy of 'business as usual' and the threat of 'drying up business,' there must certainly lie a sane middle course, namely, one of wise economy and business conservation which would neither exploit nor wreck, but maintain and protect, our business system.[37]

The counterattack against the "business as usual" movement was vigorous. Benjamin Strong joined the counter-offensive in a number of speeches and articles. In an article published in the April 1918 issue of North American Review entitled "War Loans vs. Business as Usual" Strong conceded that business would have to endure some short-run losses as a result of wartime adjustments. He maintained that the alternative, however, of a lessened war effort, was a far worse fate. "Business as usual", or

> unnecessary consumption must be reduced or stopped, else this bidding of individual against government will advance prices of labor and materials to prohibitive levels. Expansion in bank loans and deposits and inflation of currency issues will be a necessary accompaniment, and the whole economic structure will be undermined.[38]

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[37]"Rational Thrift That Avoids Parsimony," Literary Digest, February 28, 1918, pp. 85-86.

[38]Strong, Interpretations of Federal Reserve Policy, pp. 56-57.

Strong concluded that the war could be most effectively prosecuted through limited governmental control of resources, a reliance on thrift and the elimination of unnecessary credit.[39]

Although the First World War was a watershed in the process of adjusting to a higher standard of living, the dominant view that prevailed in American society prior to and after World War One was that the practice of thrift, or saving, lay at the heart of economic prosperity. It was widely believed, as one writer declared in Munsey's Magazine, that "[w]hen money is saved and employed for a definite purpose, it becomes the most constructive agency of human progress.[40] This view was confirmed by the writings of contemporary economists. Thomas Nixon Carver, Professor of Political Economy at Harvard University, put it succinctly: "All large masses of people who have really progressed industrially, and improved their economic conditions, have done so by practising the economic virtues of industry, thrift, forethought, economy, and mutual helpfulness."[41] The banking community supported this view of thrift. One individual declared in the September 1908 issue of Banker's Magazine that "[t]he working

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[39]C. Thompson, "The Development of Thrift," Munsey's Magazine, January 1913, p. 641.

[40]Ibid., p. 641.

[41]Thomas Nixon Carver, "The Trend Toward Socialism," Independent, July 31, 1913, p. 266.

capital is greater, the producing capacity enlarged, and the wealth of the nation increased by every dollar that the thrifty man places in the savings bank."[42] To the banker additional saving on the part of the public meant larger savings deposits which could lead to higher business profits through investing and lending. The banker routinely agreed with the doctrine of thrift--explicitly or implicitly, adherence to a particular set of ideas is often not unconnected with one's own interests.[43]

Horowitz finds this emphasis on thrift in the language of early household budget analyses. The Report of the Massachusetts Bureau of Statistics of Labor was one of the earliest attempts to systematically collect and organize information of the household budget on the laboring classes. This study was influential in serving as a model for later budget studies. The Report, written by Carroll D. Wright, who was later to be named U.S. Commissioner of Labor, found that, in contrast to the typical opinion of the day, workers were not prone to extravagant, uncontrolled spending. Based on a sample of 397 families, each headed by an employed male, Wright found that the low level of income garnered by members of the working class limited their ability to consume in an extravagant

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[42]W.H. Kniffen, "Saving in the Schoolroom," Banker's Magazine, September 1908, p. 371.

[43]Hollitz, "The Challenge of Abundance," p. 313.

fashion, or even, for that matter, to save. Even with this clear evidence regarding the spending habits of the working class, however, the Report still "finds room to chastise" members of the laboring class with regard to their spending habits.[44]

In contrast to those who preached the virtues of thrift and frugality, a few advertisers, labor leaders, and manufacturers began, at the conclusion of the 19th century, to "identif[y] 'progress' with an ever-increasing level of material wants and high levels of spending.[45] Businessmen increasingly came to believe that the economic survival of the individual firm depended on household spending stimulated by advertising rather than patterns consistent with the judicious practice of thrift. This is evidenced by the rise in advertising receipts from $10 million in 1867 to $71 million in 1890 and $150 million by 1900.[46] The idea that spending was an important factor in economic prosperity is reflected in the following editorial comment from Nation's Business: "If the consumer will buy not one new hat in three years, but three new hats in one year, all is well in the world of business."[47]

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[44]Horowitz, The Morality of Spending, p. 18.

[45]Hollitz, "The Challenge of Abundance," p. 313.

[46]Hollitz, "The Challenge of Abundance," p. 49.

[47]"The Luxury Market," Nation's Business, June 1928, p. 12.

Organized labor had consistently employed the argument that economic prosperity depended on a high level of spending, which could be assured by a high level of wages."[48]

The traditional view of thrift as a source of progress still held considerable sway, however, during the interwar period. Bankers, for example, continued throughout the interwar period to preach the value of thrift. Alvin P. Howard, Vice-President of the American Banker's Association, re-affirmed the banker's faith in saving in a 1925 article in Nation's Business. Referring to small-scale savers Howard maintained that "[w]ith these savers, we have a country and are safe. Without them, we have neither."[49]

The moral practice of thrift continued to be contrasted with the immorality of extravagant spending. George F. Johnson, in discussing how workers should distribute the income received from his company's profit-sharing plan, states unequivocally that:

> [e]xtravagance is, to a certain extent, criminal. All crimes are not punishable by law. That form of extravagance which works to the injury of yourself and others is truly criminal. You have

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[48]Hollitz, "The Challenge of Abundance," p. 313.

[49]Alvin P. Howard, "Thrift--A Common-Sense View," Nation's Business, September 1925, p. 62.

> no right to injure yourself or others, even though the law permits. It is quite as bad to break a moral law as it is one made by legislatures.[50]

The thrifty worker was perceived as being the more stable, more productive worker. C.L. Brown, President of the Associated Companies, i.e. United Telephone Company and United Light and Power System, who had established an obligatory program of thrift for his company's employees declared that

> [t]here is no question about it--the employee who keeps out of debt and lays aside something each month does better work than the one who spends all that is earned. The employee who systematically practices thrift builds integrity of character and has a truer realization of the duties of true citizenship.[51]

H.K. Brooks, a Vice-President of the American Express Company believed this point to be self-evident:

> Everyone knows that workers who are involved in irregular financial transactions are less efficient than those who are in fairly easy circumstances. An employee caught in the net of a loan shark, or one who speculated in wild-cat securities, is not in a frame of mind to attend strictly to business.[52]

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[50]George F. Johnson, "A President's Letters To His Workers, How Should Profits Be Distributed," System, The Magazine of Business, December 1924, pp. 724-25.

[51]C.M. Harger, "Why Our Men Have The Thrift View-Point," System, The Magazine of Business, September 1925, p. 301.

[52]H.K. Brooks, "Our Worker's Organize a Credit Union," System, The Magazine of Business, September 1925, p. 301.

A number of companies organized obligatory saving programs for their workers. The Gaw-O'Hara Envelope Company required non-homeowning employees with families to lay aside part of their paycheck, normally about $5 each weekly pay period. Gaw-O'Hara would then match the amount of the employees' savings. This money was intended by both sides to be put toward the purchase of a house. It was believed that such a plan reduced labor problems.[53] George F. Johnson of the Endicott-Johnson Company (a leather and leather shoe firm), in discussing the profit-sharing plan of his company, made this point more directly: "A contented workman ... [is] one who is saving money, who is not influenced by silly babble and fool talk of agitation (including political)."[54] The advocation of thrift by businessmen, then, was based not only on their view of the workings of a market economy, but also Consideration closer to home. For some businessmen thrift was associated with sound economic growth and, at the individual level, integrity of character. Thrifty habits on the part of one's laborers were associated with the productiveness and political stability of labor.

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[53]George D. Gaw, "This Idea and $500 Resulted in a Profitable Business," System, The Magazine of Business, April 1923, pp. 450-520.

[54]Johnson, "A President's Letters to His Workers," p. 724.

To conclude, the adjustment to a higher standard of living had been going on for at least three decades prior to the rapid growth of consumer credit in the 1920's. Two events played a significant role in this adjustment. One was the rise in the cost of living that developed in the United States in the first two decades of the twentieth century, the second was the First World War. By the late 1920's a part of American society, led by organized labor and a significant part of the business community, had moved away from the traditional view that thrift was the basis for economic prosperity toward the notion that economic growth was dependent on a high level of spending. The response to the development of consumer credit in the second half of the 1920's, however, revealed that the process of adaptation to a higher standard of living was far from complete.

Attitudes Toward Instalment Financing, 1925-33

In the second half of the 1920's concern over the changes brought about by the increased level of material wealth began to focus on the topic of instalment buying. In fact "many of the economic debates and moral reservations about spending in the generation before the First World War were by the middle of the 1920's confined

increasingly only to the practice of buying on credit."[55] The arguments made in the course of the 1925-27 debate over the economic and moral soundness of instalment selling, accordingly, was based on many of the arguments that had been made in previous debates pertaining to the relation of economic prosperity to saving and spending.

Popular and professional publications in the mid-1920's were filled with articles on instalment credit. In the years 1925-29, Nation's Business, which was published by the U.S. Chamber of Commerce, published 20 articles on the topic of instalment credit. Printer's Ink, a magazine of the advertising trade ran over two dozen, and The Commercial and Financial Chronicle ran a total of 39 articles. Single payment loans were provided by commercial banks to property owners, or individuals who had a satisfactory endorsement, and were not subject to the same criticism as instalment credit.

Instalment debt in the 1920's was only a fraction of total household debt. It was, however, a highly visible, and rapidly growing form of credit. The array of new consumer durable goods that came on the market in the 1920's were sold largely on an instalment basis. E.R.A. Seligman estimated that between 75 and 80 per cent of all automobiles, and 80 per cent of all washing machines and phonographs were sold on a partial payment basis in

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[55]Hollitz, "The Challenge of Abundance," p. 308.

1925.[56] A number of these goods, e.g. the automobile and the phonograph, were considered luxury items. The reaction to instalment credit in the second half of the 1920's was directly related to the association of instalment buying with this new set of goods and their character as luxuries. There was a significant easing of terms in instalment contracts in the first half of the twenties along with the extension of instalment selling to industries which had previously shunned the practice. These developments increased the uneasiness of groups in society toward instalment selling, most intensely within the banking community.

Different groups in society reacted to the growth in instalment credit in different ways. The business community was deeply divided on the topic of instalment credit. A significant part of the interwar business community continued to hold the view that the thrifty nation was the prosperous nation. This view directly influenced their view of instalment credit. Instalment credit was charged with allowing the thriftless consumer to purchase luxury items such as the automobile. According to Oswald Knauth, Vice-President of R.H. Macy, instalment

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[56]E.R.A. Seligman, The Economics of Instalment Selling (New York: Harper and Brothers, 1927), pp. 104-11.

selling tended "to make possible the easier buying of luxuries."[57]

Fear over a perceived lack of thrift on the part of the public, however, rarely stood alone in criticisms of instalment selling. Firms were perhaps more directly worried that instalment buying for the new line of durable goods would reduce the funds left over for expenditure on their products (which were not sold on the instalment plan). This charge was often levelled at the automobile industry. In particular, it was charged that the auto industry was using up "an undue share of the national resources."[58] Representatives responded to this assertion by citing existing evidence on the volume of saving. Alfred P. Sloan, Jr., President of General Motors Corporation, replied that in the period of the most rapid expansion of instalment selling, saving deposits had not fallen--they had been rising.[59]

The fear expressed over the increasingly lax attitude of the public toward instalment buying was frequently coupled with comments relating this development to larger social conditions. A prominent department store owner was

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[57]Oswald W. Knauth, "Where the Danger Lies in Instalment Buying," American Banking Association Journal, April 1928, p. 796.

[58]Alfred P. Sloan, Jr. "I believe in time payments--Why?," Nation's Business, April 1926, p. 18.

[59]Ibid., p. 18.

quoted in an article appearing in Nation's Business, indicating that he had "a feeling that the discontent that will arise from time to time from inability to meet instalments and increased pressure by the creditors will result in social trouble."[60] One businessman worried that the liberalization of terms of instalment selling, e.g. the decreasing amount of the initial down payment for goods, had led to a rise in the volume of stolen merchandise. As E.H. Brown claimed in Nation's Business, "[t]he practice of deferred payments now in vogue has attracted an army of confidence bandits who have turned from the dangerous business of outright robbery to safe, genteel and profitable instalment selling."[61] Brown relates several anecdotes of thieves stealing merchandise they had acquired by paying only a fraction of the total value in the form of a down payment, then leaving town with the goods from a number of stores.[62]

In contrast, a group within the business community argued that the instalment plan was a sound, profitable method of selling goods. Businessmen commonly held forth in business publications with anecdotes relating the success their business enjoyed under a partial payment-

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[60]"Installments Have a Safety Line," Nation's Business, May 1925, p. 101.

[61]E.H. Brown, "Instalment Selling Hazards," Nation's Business, April 1928, p. 164.

[62]Ibid., p. 164.

plan. Lawrence M. Jones, Chairman of the Board of The Jones Store Company, a large Kansas City department store states his store's household club plan "has been a fine business-builder for us, and is a sound arrangement, we are convinced from every point of view."[63]

Executives from the automobile industry were at the forefront of the defense of instalment credit. John J. Raskob, Chairman of the Finance Committee of General Motors, for example, was a consistent defender of instalment selling. While recognizing the potential for abuse, Raskob indicated that the yearly losses on instalment credit in the 1920's for the General Motors Acceptance Corporation never exceeded one percent of total credit extended.[64] Raskob maintained that instalment credit "when prudently contracted creates an incentive to work and produce more."[65] The higher level of consumption that instalment selling afforded led to a higher level of production. Together, "[h]igh production and consumption bring about a greater degree of individual progress and

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[63]Lawrence M. Jones, "We Have A Policy That Pushes Our Business Forward and Has For 30 Years," System, The Magazine of Business, October 1926, p. 412.

[64]John J. Raskob, "The Development of Instalment Selling." In Problems in Prosperity: The Development of Installment Selling, edited by Parker Thomas Moon (New York: Academy of Political Science, 1927), pp. 119-24.

[65]Ibid., p. 119.

happiness."[66] Alfred P. Sloan, Jr., President of General Motors, indicated in 1926 that he had "complete confidence in the present situation and future development of instalment selling."[67] The approval of instalment selling, then, was supported at times by the theory that prosperity was a function of spending, rather than saving. It is not possible to draw a tight distinction between those who mouthed this theory as justification, and those who believed it was an accurate description of reality.

The response of a faction within organized labor to instalment credit is somewhat unexpected. One would suppose that since the task of organized labor was to collect for the worker a higher standard of living, then instalment credit provided to the laborer-as-consumer, should have been viewed as a positive economic development. This was not the case. As evidenced by a warning issued by the President and Secretary of the International Typographical Union to its members, organized labor viewed instalment credit as a threat. According to these individuals the extension of instalment credit was a key component in the determination of the cost of living. Union officials argued that unwise expenditures often result from the ability to buy on apparently easy credit terms. The increased spending served to increase the cost of

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[66]Ibid., p. 119.

[67]Sloan, "I Believe in Time Payments -- Why?," p. 19.

living, causing the worker to demand "unnecessary" and hence difficult to justify wage increases. Other labor leaders worried over the effects of instalment credit on the worker's willingness to strike. Instalment contracts were frequently tied to the wage share of the worker. A worker's inability to meet his schedule of payments meant that the debt became the responsibility of the employer. Workers could expect automatic dismissal from employment if unable to make the regular payments. Accordingly instalment contracts created an incentive for workers to remain on the job. To labor leaders, then, workers over-burdened with meeting the regular payments of an instalment contract reduced their ability to effectively threaten or maintain a strike action.[68]

The attitude of bankers toward consumer credit before World War One is not a surprising one. In the period before World War One bankers were only willing to supply credit directly to the consumer in emergencies if that individual could meet the same requirements as those required of a firm seeking a commercial loan, i.e. if tangible assets or the endorsement of an acceptable third party were included in the contract. The requirement was supported by a view that a household incurring debt for reasons other than an emergency was both morally and

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[68]"Too Much Credit Not Good For the Worker," Literary Digest, August 1, 1925, p. 5.

economically destructive. Many bankers believed that instalment selling had been proven to be unprofitable by existing cost accounting studies. This attitude prevailed in some quarters of the banking community after the First World War as well.[69]

In the 1920's bankers continued to uphold the notion that thrift was the cornerstone of economic progress. Oscar Wells, President of the American Banker's Association, in an address before the Southern Newspaper Publisher's Association at Asheville, N.C., noted

> that bankers have urged the people to save for future needs. We have praised the frugal and have held them up as examples to be emulated. Since the war particularly we have taught that thrift is an attribute greatly to be sought. There is no consistency in preaching this doctrine on the one hand and on the other encouraging an indulgence in buying on the instalment plan at a cost ranging from fifteen to forty percent for the privilege.[70]

J.H. Tregoe, executive manager of the National Association of Credit Men, in a statement to the 30,000 members of the Association, maintained that instalment credit led to a "cheapening" of the entire credit system. He asked

> [w]hat moral right has any one to go into debt when his credit is not complete and there are

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[69]Nugent, Consumer Credit and Economic Stability, p. 100.

[70]"Oscar Wells on Extravagance and Abuses of Installment Selling," Commercial and Financial Chronicle, 1927, p. 526.

> grave chances that the debt cannot be extinguished. If under pressure commodities are exchanged for an incomplete or deficient credit, there is a cheapening of the medium. It doesn't matter what the seller may gain, the transaction lacks moral stamina and if default happens economic waste occurs, and the pride in performing honestly one's obligation is forfeited.[71]

The arguments regarding the viability of instalment credit, as with those pertaining to thrift and luxury expenditure, were not only economic but moral as well.

There were, in contrast, a significant number within the banking community who believed instalment credit, if properly handled, was a sound and profitable feature of the U.S. credit system. J.E. Barber, Vice-President of the First National Bank of Los Angeles, in a report on instalment selling submitted to the Economic Council of the California Banker's Association in May 1926, maintained that "[p]roperly handled and safeguarded, there is a legitimate place in our national business and national finance for instalment selling."[72] The group in favor of instalment credit increased in number in the course of the interwar period and eventually came to dominate its

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[71]"J.H. Tregoe, of the National Credit Men, Says Cheapening Credit Through Some Installment Selling Plans Injures Nation's Moral Stamina," Commercial and Financial Chronicle, 1927, p. 526.

[72]J.E. Barber, "Opinion on the Volume of Instalment Paper," Commercial and Financial Chronicle, June 5, 1926, p. 3156.

opponents. One could take the growth in the existence of personal loan departments in commercial banks as additional evidence of this assertion. In the course of World War One a number of city banks in North Carolina, Virginia, and Connecticut began "to make loans to salaried people on terms similar to those offered by industrial banking companies."[73] Personal loan departments were opened in several banks in the mid-1920's. The practice expanded rapidly after the opening of an office in the country's largest bank, the National City Bank of New York, in 1928. In the next year over 200 commercial banks opened similar departments. As indicated in Chapter II in the course of the 1930's and after the Second World War the growth in direct consumer instalment lending by banks continued.

Bankers defended the instalment plan on several counts. Bertram Lewis, Vice-President of the Kanawha Bank and Trust Co. of Charleston West Virginia argued in Banker's Magazine that instalment selling made four positive contributions to the social and economic environment: (1) it taught the buyer to budget his expenditures and thereby increased his awareness of the value of thrift; (2) instalment selling allowed greater production and satiation of wants than would occur if buyers were forced

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[73]Nugent, Consumer Credit and Economic Stability, p. 82.

to save first and then purchase; (3) it stabilizes employment by evening out the flow of production; and (4) thereby stimulated industries which did not rely directly on the instalment plan as the basis for selling goods to the consumer.[74]

The views expressed by economists regarding instalment selling during this period have already been set out in Chapter II. To summarize, while few unequivocal statements were made, most economic writers maintained that it the injudicious use of the practice by all participants was kept to a minimum instalment selling was, and would continue to be, a sound credit practice.

The views expressed in the 1925-27 debate over the soundness of instalment credit indicate the degree to which American society had adjusted to an increased standard of living. The provision of credit for consumption purposes was denounced without exception prior to the turn of the century. By the mid-twenties, however, instalment credit had found a number of stalwart defenders. These advocates came not only from the industries aided by instalment selling, but from the dispassionate halls of academia as well. While a number of writers continued to excoriate the practice the general consensus at the conclusion of the decade was that selling on an instalment

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[74]Bertram Lewis, "Installment Facts Refute Installment Fancies," Banker's Magazine, March 1926.

basis was a sound credit practice if kept free from abuse.

Federal Reserve officials followed the public debate regarding instalment credit closely. Direct evidence supporting this contention can be found in the personal papers of Charles S. Hamlin, a Board member during 1914-36. The diaries and scrapbooks of Hamlin are one of the most detailed sources on FRS thinking during the interwar period. During 1925-27 Hamlin collected a large number of articles concerned with the development of instalment selling.[75] These articles were taken from publications, such as The New York Times, The American Bankers Association Journal, and Banker's Magazine, which were certainly read by other FRS officials as well.

A number of FRS officials participated directly in the 1925-27 debate regarding instalment credit. The most complete and direct source on the attitudes of FRS officials toward instalment buying in this period are the writings and speeches of Governor George W. Norris of the Federal Reserve Bank of Philadelphia. In 1925-27 Norris made a number of speeches and wrote several articles focusing directly on instalment selling. Although cautious in his evaluation of instalment buying, Norris believed that the benefits of instalment selling were heavily outweighed by the costs.

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[75]Charles S. Hamlin. Papers. Library of Congress, Manuscript Division, Washington, D.C.

There were several disadvantages to the instalment plan. First, "[t]here can be little question that the easy terms upon which goods so sold may be purchased encourage the purchase of unnecessary goods or of unnecessarily expensive goods" which in turn reduce the ability of the community to save.[76] It is clear that he believed individuals should save first, then purchase their desired basket of goods. Instalment selling, however, being "born of the seller's passion for volume and the buyer's passion for indulgence" led individuals to purchase goods prior to saving.[77]

A second drawback to instalment selling was that the practice contributed to higher prices. The interest charge on instalment loans approximated 20 per cent, and

> [t]his additional charge must be borne by someone. Either it comes out of dealer's profits--which we know it does not--or else is borne by the customer, in which case the interest burden must be added to the cost of distribution, and therefore to the consumer's price.[78]

Lastly, Norris charged that the ability of the instalment plan customer to repay his debt is dependent solely on his future stream of earnings--which will

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[76]George Norris, "Elements of Danger in Instalment Selling." In Debate Handbook: Instalment Buying of Personal Property, edited by E.C. Buehler. (Manhattan, Kansas: University of Kansas Press, 1929), p. 209.

[77]Ibid., p. 212.

[78]Ibid., p. 209.

certainly decrease in the course of an economic downturn--because of his lack of ownership of existing assets. Although the Federal Reserve "has made acute panics or crises impossible", the business cycle remained an "inevitable" feature of market economies. In other words,

> if we are to accept history and experience as reliable teachers, we must believe that business depressions and periods of partial unemployment are among the inevitable evils that we must still anticipate.[79]

Consequently, as with many of his contemporaries Norris maintained that in the event of a business downturn much of this debt would become uncollectible.

Part of the blame for the excesses of instalment selling, according to Governor Norris, could be laid at the door of the advertising trade. This argument was made in a 1926 article published in Printer's Ink, a prominent magazine of the advertising trade. The article was a reprint of a speech that had been given by Governor Norris before the 1926 meeting of the Second District of the International Advertising Association. Norris' purpose in this address was to convince members of the advertising industry of the ill effects of instalment sales and their partial responsibility in maintaining the soundness of business transactions in this field. Norris declared that

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[79]George Norris, "Instalment Selling's Future Is Up To the Advertising Man," Printer's Ink, October 1926b, p. 106.

there are essentially four groups of individuals involved in the instalment selling business. These include the seller, the finance company, the bank from which the finance company obtains capital, and the general public, i.e. the ultimate buyers. In comparison with the rest of the groups involved in instalment transactions the average buyer was at a distinct disadvantage. In comparison with these other groups "[t]he general public is a hundred million in number. It is composed of persons of all degrees of intelligence, and includes some of little or no intelligence."[80] He repeats his contention later, stating that "the average instalment buyer is a man of small means, and of limited business experience."[81] In light of this fact, Norris concluded that "this instalment method of selling seems to me to impose a special responsibility upon the seller and upon those who are co-operating with him."[82]

In this speech Norris made a clear connection between instalment sales and, not only the soundness of business transactions, but also, the moral fibre of society. He also noted the psychological impact, i.e. the "loss of hope and courage" on the debtor. In referring to the advertising of a client's product Norris argued that

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[80]Ibid., p. 105.

[81]Ibid., p. 108.

[82]Ibid., p. 106.

> while it is perfectly proper for you [meaning advertisers] to describe his goods in the most attractive way, and help him in any legitimate selling campaigns, it is not good morals, nor--in the long run--good business, for you to help him sell things to people who have no business to buy them.[83]

Norris acknowledged that by 1926 there existed no evidence for the case that instalment buying led to a reduction in the volume of aggregate savings. Citing a study undertaken by the Savings Bank Division of the American Bankers Association Norris hesitatingly pointed out that the evidence shows

> a very regular curve in the total savings and other time deposits in all banks for the last twenty-five years ... it therefore seems to me to be fair to say that instalment selling has not yet had a bad reaction on the accumulation of savings, but that it remains to be seen whether it will have such an effect.[84]

These facts, however, did not inhibit his condemnation of instalment selling.

Norris concluded that instalment selling was a sound practice

> when applied to houses and house furnishings, farm implements automobiles, sewing machines, pianos, and other things which (a) add to the earning power of the purchaser, or to his permanent or semi-permanent assets; (b) are or may be necessary or very useful, and (c) involve a larger amount of

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[83]Ibid., p. 106.

[84]Norris, "Elements of Danger in Instalment Selling," pp. 210-11.

> money than the average person of small means is able to lay out at one time.[85]

If the groups on the selling side of the instalment business cease to "devote themselves to the sole object of selling to the inexperienced purchaser, then instalment selling will continue to develop, and will be, on the whole a good thing for everyone concerned."[86]

Norris' concern regarding the growth of instalment selling played a role in the view he adopted toward FRS policy in the course of the Great Depression. Norris, the Directors of the Philadelphia Reserve Bank, and several other members of the Open Market Committees, adhered to an overproduction theory of business movements. In a memorandum read before the Open Market Policy Conference on September 25, 1930, Norris stated that

> [i]t must be admitted ... that the decline in commodity prices is almost wholly the result of over-production, which is evident not only in wheat, cotton, coffee, rubber, sugar, copper, cement, coal, and automobiles, but in various other commodities, some agricultural and some individual.[87]

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[85]Norris, "Elements of Danger in Instalment Selling," p. 211.

[86]Norris, "Instalment Selling's Future is Up to the Advertising Man," p. 108.

[87]National Archives. Files of the Federal Reserve System. Minutes of the Open Market Policy Conference. Meeting of September 25, 1930. File 333.-c-2, box 1436, p. 1.

He goes on to note that

> "[t]his over-production did not manifest itself until a year ago, because, under the stimulus of instalment buying and an unreasoning belief in long-continued and unprecedented prosperity, over-buying kept pace with over-production. The consequences of such an economic debauch are inevitable. We are now suffering them."[88]

According to Norris during the boom phase of a business cycle there developed excesses, fueled in part by excessive instalment selling, which must "inevitably" be reckoned with. As a result of this view Norris suggests that

> the correction must come about through reduced production, reduced inventories, the gradual reduction of consumer credit, the liquidation of security loans, and the accumulation of savings through the exercise of thrift.[89]

Norris was accordingly opposed to any "artificial" easing actions which were intended to bring the downturn to an end. In reference to the reductions in the discount rate of the System since the fall of 1929, Norris maintained

> that there are emergencies and exceptional combinations of circumstances when it is the part of wisdom to abandon even the best of rules, but we cannot see that this is one of those cases, or that the continuation of the present policy can be productive of anything but harm.[90]

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[88]Ibid., p. 2.

[89]Ibid., p. 2.

[90]Ibid., p. 1.

Officials of the Federal Reserve Bank of New York in contrast had already realized in 1930 that the situation was "exceptional", but it would take at least another year for this view to gain wider credence.

The concern shown toward instalment credit by Governor Norris and the Directors of the Philadelphia Reserve Bank during the Depression was not exhibited by their FRS colleagues. Instead, for a number of reasons, most FRS officials ignored the role of consumer credit in the downturn and preceding boom.

A number of other FRS officials did however express concern publicly over the development of instalment credit during 1925-27. In 1926, George R. James, a member of the Federal Reserve Board, in a speech before the Annual Convention of the Cotton States Merchants Association in Memphis, Tennessee, stated that "there is no development of recent years that has a more important bearing on this question of distributing merchandise than does the practice of buying and selling on the instalment plan."[91] James had previously been President of the Wm. R. Moore Dry Goods Company of Memphis. Like many other businessmen, James was concerned over the extension of instalment selling in the second half of the twenties to a set of goods previously sold largely on a cash-and-carry basis:

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[91]National Archives. Files of the Federal Reserve System. George R. James. File 000.411, box 9, p. 4.

> I have given a great deal of thought and study to this matter of instalment buying and I confess that there are many features of it which I can and do commend. On the other hand, I cannot refrain from a feeling that to a very great extent the practice is being carried to excess, -in fact, to an extent that I regard as extremely dangerous.[92]

In part James' worry over the extension of instalment selling into areas that had previously operated on a cash basis was related to the notion that in the case of non-durables, in the advent of the consumer's inability to meet the payment schedule, there would be nothing left for the seller to reclaim.

James worried that instalment buying might be proven unsound in a business depression, which would in turn increase the severity of a downturn. His conclusion, however, was that instalment selling could be operated on a sound basis. He maintained that the viability of instalment selling rests on the individual. James concluded that the

> answer to the question 'Is instalment buying good or bad' depends upon the individual. For one who fails to budget his income and expenses and who does not provide a cash reserve of not less that twenty percent of his total indebtedness, instalment buying is certainly very bad; in fact, in my opinion it is a very dangerous procedure.[93]

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[92]Ibid., pp. 4-5.

[93]Ibid., p. 6.

This individual reserve parallels the effective system of bank reserves of the Federal Reserve System.

Although expressed two years after his departure from the FRS, the views of H. Parker Willis, the first Secretary to the Board and Director of the Board's Division of Research and Statistics, toward instalment selling, remain of interest due to his impact on the thinking of other early System officials and members of the banking community. Dorfman notes that in "the last two decades of his life he probably wielded as great an influence on American banking education and legislation as any individual could."[94] His writings provide useful evidence on the viewpoint of a strict advocate of the real bills doctrine. Although most FRS officials believed that this doctrine had been compromised by the experience of the U.S. in the immediate postwar expansion a number continued to adhere to it throughout the twenties.

In evaluating instalment financing in his book Federal Reserve Banking Practice, Willis comments on credit extended by finance companies to retailers in order to support the sale of merchandise on the instalment plan. He states that

> from the point of view of soundness of the general credit structure, this financing method is employ-

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[94]Joseph Dorfman, The Economic Mind in American Civilization, 1865-1918, (New York: Viking Press, 1949), p. 314.

> ed in case an ultimate consumer has been found, and is then supplied to a dealer who would not be a heavy bank borrower, hence does not compete with the banks. Such objection as has been raised is moral and social, rather than technical.[95]

Willis' view of instalment selling appears to have been modified fairly quickly, due perhaps to the growing public expression of concern. The principal problem, according to Willis, was that instalment selling had not yet been tested in a business downturn. He declared in a 1925 article on automobile instalment paper that

> if employment should be greatly reduced or break down, due to panic or business depression such as had occasionally developed in recent years, a great deal of this instalment paper would be difficult of collection.[96]

That Willis' negative article was printed in a publication of the automobile trade indicates the respect accorded Willis as well as the outlook of at least part of the automobile trade that their selling methods were in need of reform.

The seriousness of the problem of credit soundness in a downturn would have been mitigated, according to Willis, if automobile dealers had obtained loans from long-term

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[95]Henry Parker Willis, and William Steiner, Federal Reserve Banking Practices, (New York: Appleton and Company, 1926), p. 240.

[96]Henry Parker Willis, "Automotive Installment Paper--Has the Limit of Safety Been Reached?," Automotive Industries, October 8, 1925, p. 608.

investors in an effort to finance their activity. Willis was alarmed that

> [t]he present situation, however, is not that, because the great burden of such loans has been transferred largely to the banks...[in fact] in a good many small banks anywhere from 5 to 10 or even 20 percent of their holdings of 'purchased paper' is in this form.[97]

One result was "a growing amount of uneasiness among bank examiners because of the steady invasion of bank portfolios by obligations of this sort."[98] Willis concludes, with regard to the position of bank portfolios in 1925, that

> [w]hat is certain is that thoughtful minds regard the present financial situation of instalment paper as unsound ... [and that] the present state of affairs has grown up without very much thought, largely as a result of opportunity and circumstance.[99]

Willis suggested five ways in which the system of instalment selling could be improved. First, increase the amount of the standard down payment. Second, reduce the maturity period of instalment paper. Next, make sure of the credit standing of the buyer. Willis also suggested that the firms involved with the financing of automobiles in particular should have a connection to the manufactur-

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[97]Ibid., p. 609.

[98]Ibid., p. 609.

[99]Ibid., p. 609.

ing firms of the industry. This would serve to reduce the direct involvement of banks in the process of instalment selling. Lastly,

> [d]iscourage unduly extensive or close financing at banks, cut down lines of long credit there to the lowest figure possible, and above all, distribute the borrowings among many banks on a basis which will enable them to have some knowledge at least of the responsibility of the makers of the paper.[100]

Willis' concern over the volume of instalment paper in bank portfolios is traceable to his adherence to the real bills doctrine and to his consequent view of the proper type of paper to be held by banks. According to this doctrine commercial or real bills should be the principal type of paper held by commercial banks. In this way the banking system would supply funds for productive, or commercial purposes. The key characteristic of commercial paper was that this paper was used to support commercial transactions. Commercial transactions involved the movement of goods from manufacturer to wholesaler to retailer. Short-term commercial paper supported this movement of goods directly. Since instalment paper was not used in commercial transactions, proponents of the real bills doctrine such as Willis felt that commercial banks should not purchase this type of instrument.

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[100]Ibid., p. 609.

A number of FRS officials, then, became involved in the public discussion regarding instalment credit in the second half of the 1920's. In this period a few Federal Reserve officials also expressed concern in private regarding the increase in instalment selling. Governor Strong of the New York Bank was among them. In his customary report as Chairman of the Open Market Investment Committee before the Governor's Conference on November 1925, Governor Strong took serious notice of the recent increase in instalment credit. Strong indicated that there were several "features in the business situation" which could develop into serious problems.[101] He argued that both the automobile and building industries were reaching their respective saturation points. Their further development could lead, he suggested, to an eventual slowdown in business activity. He also suggested that the FRS should be wary of the recent increase in instalment selling. Strong noted that

> [t]here has been for some years past a steady increase in instalment buying, involving the pledge of future income and the building up of what we may call consumer inventories. It is clear that this has created a situation in which any extended period of unemployment or any change in the psychology might lead to a considerable diminution of

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[101]National Archives. Files of the Federal Reserve System. Minutes of the Open Market Investment Committee. Meeting of November 2nd, 1925. File 333.-b-2, box 1436, p.1.

> activity in those industries serving the consumer directly.[102]

Although Strong advocated continued observation in each of these areas he concluded that,

> [i]n none of these three areas is there any evidence of an immediate change in the situation. The prospect is for sound substantial business at a high level for some months to come, but it is equally clear that the presence of these uncertain factors makes the continuance of a conservative temper in business most desirable.[103]

As a consequence he suggested that no change in open market policy be undertaken in the near future. No change in policy occurred. By his report before the Open Market Investment Committee on September 10, 1926, nearly a year later, Strong was less concerned with regard to the extent of instalment selling. He indicated that

> [i]n the main business continues to be conducted in conservative fashion and there is little evidence of over-production or of speculative tendencies outside of the securities markets. The business public appears to be critically-minded to observe any unwholesome tendencies in the business situation, as ... may be found in the critical attitude toward the extension of terms for instalment selling, in the continuance of hand-to-mouth buying, and in the stability of prices of other than agricultural commodities.[104]

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[102]Ibid., p. 1.

[103]Ibid., p. 2.

[104]National Archives. Files of the Federal Reserve System. Minutes of the Open Market Investment Committee. Meeting of September 10th, 1926. File 333.-b-2, box 1436, p. 3.

He concluded that "[i]t is difficult to discover any grounds for serious business disturbance in the immediate future."[105] Due to the limited amount of evidence an adequate explanation of the modification in Strong's position cannot be given. It is perhaps related to the positive report on instalment sales made by the Federal Reserve Bank of New York at the end of 1925. Benjamin Strong and the other members of the Open Market Investment Committee, then, were cognizant and at times watchful over the increase in instalment selling in the course of the 1920's. This concern did not become significant enough in the twenties, however, to influence policy.

A final piece of evidence on FRS views toward instalment credit in 1925-27 is a pamphlet from the general correspondence files of the New York Bank entitled "The Credit Situation."[106] The pamphlet, which was probably written by a member of the New York Bank's research staff and was intended for internal consumption, groups instalment buying with several other 'unfavorable' factors, such as the possible end to the building boom, the then current bout of real estate speculation, and possible overproduction. The pamphlet reported that

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[105]Ibid., p. 3.

[106]Federal Reserve Bank of New York. General Correspondence Files. "The Credit Situation," 1926, p. 4.

> [i]nstalment buying has increased and the terms offered have in many cases become extreme. The result is a large consumer inventory. If there should be a reduction in the people's income the burden of paying for goods bought on instalment would check current consumption and lock up some credit.[107]

Later in the pamphlet this concern was expressed again. As with real estate speculation, the pamphlet informed the reader that "[i]nstalment buying has also placed in banks finance paper which might in part become frozen if there were a business recession."[108]

At the end of the Report, in a section entitled "Proposals for the Future", it was suggested that the volume of instalment credit could not be affected without simultaneously affecting other types of credit as well: "Any action which the Reserve Banks may take applies generally to the total volume of credit and cannot be directed at particular situations, except in a very limited degree."[109] This view of credit control parallels closely the thinking of other officials at the Federal Reserve Bank of New York, including Benjamin Strong and W. Randolph Burgess, who argued repeatedly that the FRS was only able to effect the total volume of credit and not

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[107]Ibid., p. 4.

[108]Ibid., p. 7.

[109]Ibid., p. 9.

individual parts of the total. This view formed the basis of the criticisms that officials of the New York Bank put forth in 1928-29 regarding the controversial F.R. Board policy of direct pressure to control stock market speculation.

To conclude, a limited number of Federal Reserve officials became concerned over the rapid development of instalment credit in the 1920's. Several expressed this concern publicly in 1925-27, becoming engaged in an ongoing debate which included participants from banking, business, and organized labor. Several FRS officials expressed their concern privately, within the System itself. In both cases the views of FRS officials paralleled those expressed by individuals from other parts of society. Governor Norris of the Philadelphia Bank, for example, expressed some concern that instalment credit was fueling extravagant expenditure, and although each System official worried about the possible effects of outstanding instalment debt in an economic downturn these concerns were also shown by bankers and professional economists. The attention paid to the soundness of instalment credit in an economic downturn was, of course, related to the concern FRS officials had for the soundness of member bank assets. The concern shown by these FRS officials in the course of the 1925-27 debate, however, was nothing unusual for the time. Federal Reserve officials became concerned

over the rapid development of instalment credit in the 1920's for largely the same reasons that others in American society did. Instalment selling was associated with a new set of durable goods, many of which were considered luxury items. This association, coupled with the general easing of instalment terms in the early 1920's, generated significant uneasiness among bankers, businessmen, and intellectuals, as well as officials of the Federal Reserve System.

CHAPTER IV

ON THE ELIGIBILITY OF CONSUMER CREDIT PAPER AND CONSUMER CREDIT AGENCIES FOR MEMBERSHIP IN THE FEDERAL RESERVE SYSTEM

Introduction

The purpose of this chapter is two-fold. The first is to examine the discussion among members of the Federal Reserve Board, the staff and officials of various Federal Reserve Banks, members of Congress, and representatives of the consumer credit industry over the eligibility of the paper of consumer credit agencies for rediscount at the Reserve Banks. According to the interpretation of the Federal Reserve Act followed by the Federal Reserve Board in the years 1914-33, the paper issued by consumer credit agencies, in particular that of sales finance companies and Morris Plan Banks, was not eligible for rediscount at Federal Reserve Banks. The rate of discount commercial banks applied to this paper was as a consequence higher than that applied to paper eligible for rediscount at Federal Reserve Banks. This policy reduced the profitability of operating consumer credit agencies. Accordingly, soon after the opening of the Federal Reserve Banks and continuing until 1937 a dialogue went on between the

groups mentioned above over the issue of the eligibility of consumer paper.

The second part of this chapter discusses the issue of the eligibility of particular consumer credit institutions for membership in the FRS. In the early thirties both Morris Plan Banks and banks engaging exclusively in the personal loan business applied for membership in the System. The initial application attempts were unsuccessful. The turning point in this discussion came with the Banking Act of 1933 which made Morris Plan Banks eligible for membership in the System. With this change the Federal Reserve Board became willing to approve the membership application of different institutions engaged in extending consumer credit.

The Substance of the Dialogue Over the Issue of the Eligibility of the Paper of Consumer Credit Institutions

Consumer credit and the institutions extending it were neglected in the original version of the Federal Reserve Act. In part this is attributable to the fact that the amount of credit extended to the household for consumption purposes by these institutions was small compared to the total amount of credit extended by formal banking institutions. A second, more important reason involves the fact that the designers of the Federal

Reserve Act were attempting to foster the use of a particular type of financial instrument, i.e. short-term commercial paper, as the basis for credit creation. The purpose behind this design was to create an environment in which the real bills doctrine could function effectively. The exclusion of consumer credit agencies was a result of the fact that the latter did not handle short-term commercial paper.

As already noted, a dialogue commenced almost immediately after the opening of the Reserve Banks regarding the eligibility for rediscount of the paper issued by consumer credit agencies. The response of the Board and its staff on this issue was based largely on their interpretation of the meaning and intent of the Congress as found in the Federal Reserve Act. The origins and character of this piece of legislation will therefore be examined.

The Federal Reserve System was established in 1913 with the passage of the Federal Reserve Act through Congress. Economic historians are generally agreed that the FRS was organized in an effort to deal with the recurrent problem of financial panics that had existed under the National Banking System. It has also been argued that the FRS was entrusted with a second goal, that of strengthening the position of the United States in the

international economy by operating in a manner consistent with the rules of the gold standard.[1]

Throughout the course of the 19th century the U.S. economy had been subjected to periods of severe financial instability, characterized by severe contractions of credit, bank closings, and sharp declines in commodity and security values. These problems were often blamed on the National Banking System. In the course of the last third of the 19th century numerous explanations and reform proposals were put forth to account for and rectify the inadequacies of the National Banking System. West argues that after the panic of 1893 most influential writers on monetary matters began to concentrate on the problem of the inelasticity of note issue. It was widely accepted that the problem could be solved through the adoption of a system which distributed notes based on bank assets in contrast to the previous bond-based system.[2]

Those writers of the late 19th and early 20th centuries who argued for an asset-based currency system have tended to be labelled as followers of the real bills

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[1]Robert Craig West, "Real Bills, the Gold Standard, and Central Bank Policy," Business History Review 50 (Winter 1976): 503.

[2]Robert Craig West. Banking Reform and the Federal Reserve, 1863-1923 (Ithaca, New York, Cornell University Press, 1977), p. 42.

tradition.[3] West, however, points out that crucial to an understanding of the reform movement and theoretical framework underlying the Federal Reserve Act is the recognition that there existed sharp differences within this general consensus. West divides thinkers on these matters into two groups, those who advocated the real bills doctrine and those belonging to the credit reform school. According to West the real bills doctrine should be taken to represent the notion that:

> banks should invest primarily in short-term commercial bills (bills which represent actual production), and furthermore, that such a practice will allow the needs of trade to regulate the supply of credit without causing inflation or deflation.[4]

Advocates of the real bills doctrine argued that the financial panics which had been an irregular occurrence in the American economy in the 19th century could be avoided by the setting up of an institution which would supply notes for the legitimate needs of trade through the discounting of short-term commercial bills, i.e. two-name bills of exchange and one-name promissory notes, in other

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[3]Lloyd Mints. A History of Banking Theory (Chicago, University of Chicago Press, 1945), pp. 198-256.

[4]West, Banking Reform and the Federal Reserve, 1863-1923, p. 138.

words bank assets. Under this system flexibility was to be introduced by allowing the supply of circulating media to respond to the volume of trade or production.

Advocates of the real bills doctrine believed that such a system would not only ensure that the proper amount of notes were distributed, but also provide an automatic regulation of the amount of commercial credit. There was essentially no recognition on their part of the role that bank deposits played in the credit creation process. Legitimate bills, presented for rediscount, explicitly represented a set of goods which would be sold at some point in the near future, typically less than 90 days. The proceeds of the sale, it was believed, would in turn be used to liquidate the original bill. This system of supplying credit for commercial transactions was accordingly believed to be self-liquidating.[5]

Members of the opposing credit reform school agreed that note issue should be based on bank assets, in particular on short-term commercial bills. However, both those with practical banking experience, like Paul Warburg (later a member of the original Federal Reserve Board), and economists, such as A. P. Andrew and O. M. W. Sprague, maintained that such a discounting system would not be

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[5]West, "Real Bills, the Gold Standard, and Central Bank Policy," p. 504.

self-regulating since more than one bill of exchange could be drawn against a single set of goods. This group accordingly took an active stance toward policy, arguing that the volume of discounts should be made to correspond to various measures of production.[6]

As a practical matter both groups found much that they could agree upon in the Federal Reserve Act, but they differed fundamentally with regard to the self-regulating character of a discount system based on short-term commercial bills.

The individuals most closely associated with the drawing up of the Federal Reserve Act, Carter Glass, chairman of the House Committee on Banking and Currency, J. Laurence Laughlin, and Henry Parker Willis, a student of Laughlin's and expert to the House Committee, were firm advocates of the real bills doctrine. As a consequence this theory became the underlying theoretical foundation of the Federal Reserve Act.[7]

The section of the Federal Reserve Act that is of direct concern here is Section 13. Section 13 dealt with the powers of the Board and the Reserve Banks over the discounting of commercial paper. In Section 13 the Board was given "the right to determine or define the character

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[6]West, Banking Reform and the Federal Reserve, 1863-1923, pp. 148-53.

[7]West, "Real Bills, the Gold Standard, and Central Bank Policy," p. 504.

of the paper thus eligible for discount, within the meaning of this act."[8] Federal Reserve Banks were charged with evaluating the existing credit conditions and character of the business carried on by the applying bank in making their decision regarding whether or not to discount the paper presented. Even though a member bank might own and present eligible paper at a Federal Reserve Bank, that Bank had the power to refuse to rediscount it if the Reserve Bank judged the business carried on by the applying member bank to be of an unacceptable character.

The real bills doctrine is clearly embodied in the eligibility requirements of the Federal Reserve Act. As West notes "Willis and others viewed the Federal Reserve Act as legislating the real bills doctrine as a policy guide."[9] Eligible paper was to be limited to short-term commercial paper, not to exceed ninety days, exclusive of days of grace. A general exception was made for paper drawn for agricultural purposes or based on live stock. This paper could be discounted with a maturity of six months, exclusive of days of grace. This exception was more the result of a political compromise rather than a conscious theoretical retreat from the tenets of the real

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[8]U.S. Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, (Washington, D.C.: Government Printing Office, January 1913), p. 14.

[9]West, Banking Reform and the Federal Reserve, 1863-1923, p. 147.

bills doctrine. As H. Parker Willis and William Steiner wrote in their book Federal Reserve Banking Practice, which was meant to be a "practical handbook" on FRS operation for the banker, "the Federal Reserve Act was framed primarily with industry and commerce, not agriculture, in mind."[10]

The key characteristic of eligible paper was its commercial character. Commercial transactions included the sale of goods between manufacturer, wholesaler and retail dealer. In other words, paper supporting commercial transactions was associated with the movement of goods between firms. The typical contrast was with financing arrangements which supported purchases of securities and fixed plant and equipment. Notes, drafts, or bills of exchange presented to a Reserve Bank were explicitly ineligible if they had "been used or are to be used for permanent or fixed investments of any kind, such as land, buildings, or machinery ...[or] for investments of a purely speculative character."[11] The latter included privately-issued stocks, bonds and other securities.

The Board elaborated its views on eligibility and other subjects in a set of regulations. Regulation A sets

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[10]Henry Parker Willis and Wm. Steiner, Federal Reserve Practice, (New York: Appleton and Company, 1926), p. 213.

[11]U.S. Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, (Washington, D.C.: Government Printing Office, July 1917), p. 539.

out in detail the statutory eligibility requirements for paper presented to Federal Reserve Banks. It should be noted that the wording of Regulation A was altered over time. In the original statement of Section II of Regulation A, reported in the Annual Report of 1916, it is stated that the

> Federal Reserve Board, exercising its statutory right to define the character of a note, draft, or bill of exchange eligible for rediscount at a Federal Reserve Bank has determined that--
> (a) It must be a note, draft, or bill of exchange the proceeds of which have been used or are to be used in producing, purchasing, carrying, or marketing goods in one or more of the steps of the process of production, manufacturing, or distribution.[12]

The wording of this section of Regulation A was altered over time in order to clarify the intent of the F.R. Board regarding the eligibility of paper the proceeds of which were to be lent to a third party, as for example with finance company paper. Section II(a) of the series published in 1922 read as follows: "It must be a note, draft, or bill of exchange which has been issued or drawn, or the proceeds of which have been used or are to be used in the

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[12]U.S. Board of Governors of the Federal Reserve System, Annual Report, (Washington, D.C.: Government Printing Office, July 1917), p. 267.

first instance, in producing, purchasing, carrying, or marketing goods."[13] This wording was revised again, making the intent of the Board unmistakable in the version of Regulation A issued in 1923. This version states that, in order to be eligible, paper "must not be a note, draft, or bill of exchange the proceeds of which have been or are to be advanced or loaned to some other borrower."[14] This part of Regulation A remained unchanged until it was superseded by the changes of the Banking Acts of 1933 and 1935. The remaining requirements for eligibility included the endorsement of the paper by a member bank, and the requirement that the total amount of paper discounted for one firm or individual "shall at no time" be in excess of one-tenth of the unimpaired capital and surplus of the associated member bank.[15]

The Federal Reserve Board was frequently asked to rule on questions pertaining to specific parts of the Federal Reserve Act. Along with other significant rulings the interpretation of the Board regarding the issue of the

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[13]U.S. Board of Governors of the Federal Reserve System, Annual Report, (Washington, D.C.: Government Printing Office, 1923), p. 251, emphasis added.

[14]U.S. Board of Governors of the Federal Reserve System, Annual Report, (Washington, D.C.: Government Printing Office, 1924), p. 267.

[15]U.S. Board of Governors of the Federal Reserve System, Annual Report, (Washington, D.C.: Government Printing Office, 1924), p. 267.

eligibility of finance company paper was reproduced in the monthly Federal Reserve Bulletin under the heading "Informal Rulings of the Board". These "Rulings" reported "information believed to be of general interest to Federal Reserve Banks and member banks of the system."[16] In more practical terms the Board wished to minimize the number of requests it received for interpretations of the Federal Reserve Act.

The earliest published ruling on the eligibility of finance company paper was reproduced in the June 1, 1915 issue of the Bulletin. It stated briefly, in reply to a letter from an anonymous Reserve Bank official who had inquired whether or not the paper of finance companies could be eligible for rediscount, that:

> The Board feels that paper of the kind referred to does not afford sufficient evidence of the nature of the transaction which gave rise to it, while the obligation itself presented by one of these finance companies is certainly not inherently a commercial one. You are therefore informed that it is not considered desirable to encourage the offering of such paper by member banks.[17]

Commercial transactions traditionally included only the movement of goods from manufacturer to wholesaler to

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[16]U.S. Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, (Washington, D.C.: Government Printing Office, March 1918), p. 267.

[17]U.S. Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, (Washington, D.C.: Government Printing Office, June 1915), p. 72.

retailer. The paper of a finance company, the proceeds of which were employed in extending credit to the household-as-consumer was accordingly judged to be arising out of a non-commercial transaction.

In the March 1, 1918 issue of the Federal Reserve Bulletin the Board supported its earlier ruling by arguing that "Congress has made a very evident distinction between these two kinds of paper", i.e. finance company paper and that eligible for discount under the terms of the Federal Reserve Act.[18] The Bulletin stated that

> this distinction was emphasized when an amendment to the Federal Reserve Act was passed last year, expressly authorizing Federal Reserve Banks to discount the note of a member bank when secured by eligible paper, but this amendment was specifically limited to notes of a member bank and can not be construed to authorize the rediscount of notes of any other sort of financial institution, even though most adequately secured by paper which is itself eligible for rediscount.[19]

This note, published in the "Informal Rulings of the Board" section was drafted in reply to a letter of inquiry on this topic from a member bank. This inquiry was concerned with the possibility of the eligibility of the paper of sales finance companies, if secured by eligible

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[18]U.S. Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, (Washington, D.C.: Government Printing Office, March 1918), p. 197.

[19]U.S. Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, (Washington, D.C.: Government Printing Office, March 1918), p. 197, emphasis added.

paper. It should be noted that Reserve Banks could make advances to member institutions on the basis of their promissory note, for a period not exceeding 15 days, secured by paper meeting the eligibility requirements found in Regulation A. At the conclusion of the "Ruling" the Bulletin states that this was a question that had been "presented to the Federal Reserve Board for its consideration on several occasions and a similar ruling had been made in each case, owing to the obvious limitations contained in the law."[20] The members of the Federal Reserve Board clearly interpreted the intent of Congress, as found in the Federal Reserve Act, to be that the paper of finance companies was ineligible. The Board consistently adopted the position, in this regard, that its function was to interpret the Federal Reserve Act, and according to its interpretation the paper issued by consumer credit agencies did not "in the first instance" arise from a commercial transaction. Changes in the eligibility status of different types of paper would require an amendment to the Federal Reserve Act, and this was clearly "a matter of legislative policy for Congress to decide" and was consequently not within the Board's power to alter.[21]

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[20]Ibid., p. 197.

[21]U.S. Board of Governors. Minutes of the Meetings of the Federal Reserve Board. Washington, D.C., Vol. 201, p. 606.

This narrow, legalistic interpretation of its powers by the Board with regard to the eligibility of the paper of consumer credit agencies was supported by the belief of FRS officials that this paper should not be made eligible for rediscount. Members of the Board not only felt that the paper of consumer credit agencies was ineligible for discount under the terms of the existing Federal Reserve Act; they did not recommend that the law be altered so as to include it.

The Board continued to receive requests for information regarding the eligibility of various types of financial paper, including that of consumer credit agencies, throughout the course of the twenties and early thirties. In response to letters from Reserve Bank officials, representatives of the consumer credit industry, and Congressional inquiries the Board consistently replied that the paper in question was ineligible for rediscount at the Reserve Banks. The public record and minutes of the Federal Reserve Board indicate that the number of requests for information on this topic received by the Board rose in the course of the Depression years. The actual number of requests received by officials of the System was probably several times the amount recorded since individual Reserve Bank officials, informed by their own legal counsel, sent official replies to inquiries on this matter on their own.

At the end of the 1920's the National Association of Finance Companies made a concerted effort to alter the eligibility of finance company paper. Overtures regarding this subject were initially made by the Association to the Federal Reserve Board. The minutes of the Federal Reserve Board make reference to a number of letters sent by the General Manager of the National Association of Finance Companies. A formal petition on this issue was received by the Board in late 1931. When these attempts met with the traditional response of the Board the matter was brought before the Congress. At a hearing of a Senate Subcommittee of the Committee on Banking and Currency in January 1933 the matter of finance company paper eligibility was considered directly. Testimony was given that pertained to two proposed amendments to Section 13 of the Federal Reserve Act. Senate bill #4454 proposed to amend Section 13 by allowing for the discount of the notes of automobile finance companies by Reserve Banks. The National Association of Finance Companies requested an opinion regarding this bill of the Federal Reserve Board. A second Senate bill, #4550, proposed a broader change that would have made the notes of all finance and credit companies eligible for rediscount. An opinion regarding this bill was requested of the Treasury Department.

Testimony was given by finance company representatives, in particular Nathan Boone Williams, Counsel for

the National Association of Finance Companies, Lewis W. Cass, Counsel and Vice President for the Federal Services Finance Corporation, as well as Governor Eugene Meyer of the Federal Reserve Board. The testimony offered by Meyer was given with the consent of the rest of the Board.

Nathan B. Williams began the testimony of expert witnesses. He opens with the statement that

> [t]he necessity for this legislation, as we appreciate, comes from the fact that the Federal Reserve act, and the interpretation and rules of the Federal Reserve Board with respect thereto, was instituted at a time before the development of this more modern, and at present essential method of financing all purchases of goods, wares, and merchandise.[22]

Williams recognized that the purpose of the Federal Reserve Act was to make "eligible for rediscount those particular activities that grow out of commercial transactions."[23] He explains that "the development of finance companies has [simply]put one more cog into the machinery of distribution."[24] In other words, in Williams' definition of the term, finance company paper arose from "commercial" activity.

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[22]U.S. Congress. Senate. Committee on Banking and Currency. Amendments to Federal Reserve Act Permitting the Discounting of Notes of Finance and Credit Companies. 72nd Cong., 2nd sess., 1933. S.4454 and S.4550.

[23]Ibid., p. 3.

[24]Ibid., p. 4.

Williams argued that finance companies extended legitimate, sound credit to "the small business man, the small merchant, [and] the small manufacturer", that is, to firms that would be unable to acquire access to adequate bank credit.[25] This credit was of a useful variety since it was often, in turn, applied to the purchase of capital equipment which serves to increase the productiveness of the individual business and hence allow it to charge a lower price for its wares.

Williams responded to the oft-made criticism that the instalment credit agencies would be unable to weather a severe business depression. Williams claimed that to that point in the Great Depression "not one finance company has had to be closed up, within my knowledge, or within the knowledge of the association that I represent."[26] At a later point Williams conceded that a few finance companies had "voluntarily liquidated". He concluded, though, that these were few in number and that taken as a whole finance companies had been able to weather the depression relatively well. Williams attributed this to the fact that the lending of finance companies was based on the earnings capacity of the borrower.

Williams noted that banks, wary over the future, began to restrain the amount of credit extended to finance

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[25]Ibid., p. 4.

[26]Ibid., p. 7.

companies at the end of the 1920's. This in turn made it difficult for finance companies to supply legitimate credit to small businesses in need. He concluded that if the proposed amendment was passed it would allow finance companies easier access to bank credit. This would allow finance companies to help support the activity of businesses (that were unable to acquire access to commercial bank credit), and thereby aid in the nation's recovery from the Great Depression.[27]

A statement was also made at the hearing by Lewis W. Cass, Vice President and Counsel for the Federal Services Finance Corporation:

> [t]he question of admission or nonadmission of finance company paper to discount by Federal Reserve Banks should be determined by...[w]hether or not these finance or credit companies render a material and essential service to the public... [w]hether or not the finance companies offering the paper are organized, financed, and operated on such sound principles and approved methods as to give assurance that the paper offered is as safe as the common run of other commercial paper accepted by banks; and...[w]hether or not the same service may be rendered the public through or by some other and better existing means than by finance companies.[28]

Expectedly, Cass' claim is that the service that finance companies deliver to the public is an essential one. These institutions were organized on sound credit prin-

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[27]Ibid., pp. 5-8.

[28]Ibid., p. 13.

ciples, and provided their services more effectively than commercial banks. Like Williams, Cass cited evidence from a representative of the National City Bank of New York, and a former President of the Chicago and Cook County Banker's Association, on the positive evaluation of finance company paper.[29]

The opinion of the Federal Reserve Board and Acting Secretary of the Treasury A.A. Ballantine on these bills was expressed in a pair of letters sent to the Senate Committee on Banking and Currency. These letters, which are near duplicates of one another, are recorded in the minutes of the Senate Committee hearing on S.4454 and S.4550. The letters note that

> the amendments to the Federal reserve act contained on the act of February 27, 1932, known as the Glass-Steagall Act, now enable Federal reserve banks to make advances to member banks on the security of assets otherwise ineligible when they are without adequate amounts of eligible and acceptable assets to enable them to obtain sufficient credit accommodations through discounts or advances under other provisions of the Federal reserve act; and for this reason particularly there is no necessity for the immediate consideration of further amendments broadening materially the classes of paper eligible for discount.[30]

Governor Meyer was also present at the Senate hearing. He reiterated that the Board and Treasury Department did not

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[29]Ibid., p. 14-15.

[30]Ibid., p. 2.

feel that a change in the eligibility requirements of the Act so as to include the paper of finance companies was desirable at this time. He declared that "naturally neither the banks nor the system are hostile to it in any sense of the word."[31] In later questioning Meyer again notes that the Board maintained "no unfriendliness to the paper or the companies, or what they are doing or presenting at all."[32] Meyer argued that,

> the total rediscounts at the present time are about $250,000,000 and the eligible paper apart from government obligations is many times that, and of course Government obligations, which are held by the banks in large amounts, are eligible.[33]

Consequently the amount of eligible paper at the present time, without the proposed changes in eligibility, was more than adequate to support the current needs of business.

Instead, Meyer made two recommendations to the Subcommittee regarding the eligibility sections of the Federal Reserve Act. Meyer maintained that the Board had consistently made these two recommendations. First, he recommended that "the maximum maturity of direct advances

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[31]Ibid., p. 16.

[32]Ibid., p. 17.

[33]Ibid., p. 16.

to member banks on the security of eligible paper be changed from 15 to 90 days."[34] Second, he reiterated the statement made in the letters mentioned above by recommending

> that consideration might well be given to making permanent section 10(b) of the Federal reserve act, as amended by the Glass-Steagall Act, which authorizes advances to member banks on otherwise ineligible security when they have exhausted their eligible paper, or, in any event, of extending the provision for at least a year beyond March 3, 1933.[35]

The proposed amendments to the Federal Reserve Act (S.4454 and S.4550) were not enacted. Presumably, although there is no direct evidence for the claim, the letters from the Treasury and the Federal Reserve Board and Meyer's testimony played a role in this decision. Instead, the Glass Steagall Act was extended for an additional year in March 1933 following the suggestion of the Board. The section of the Act allowing the use of ineligible assets to act as security for advances was extended for an additional year and finally made permanent in the Banking Act of 1935. The view of the Board on the proposed amendments was consistent with the opinion expressed in the 1920's. Finance company paper was not considered commercial in character, and was therefore ineligible.

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[34]Ibid., p. 16.

[35]Ibid., p. 16.

Despite the negative Congressional treatment of Senate bills #4454 and #4550 the Secretary of the Treasury and Federal Reserve Board continued to receive requests for information on the issue of the eligibility of finance company paper. In answer to two letters received from Mr. Edgar Bauman, President of the Madison Industrial Corporation of New York City, the reply from the Board states that

> this subject is one which has been considered by the Federal Reserve Board at various times in the past and that the Board has been advised uniformily by its counsel that such paper is not eligible for rediscount by Federal Reserve Banks under the terms of the Federal Reserve Act.[36]

The reply again draws attention to

> the Glass-Steagall Act, as amended by the Act of March 9, 1933, authorizing advances to member banks which are without adequate amounts of eligible and acceptable assets to enable them to obtain sufficient credit accommodations under other provisions of the Federal Reserve Act, and to the Act of March 24, 1933, providing for loans by Federal Reserve Banks to nonmember State banks and trust companies on the security of eligible or ineligible paper. The reply further stated that the security accepted by the Reconstruction Finance Corporation for loans which it has made both to member banks and non-member banks has not been confined to paper which would be eligible for discount by Federal Reserve Banks.[37]

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[36]U.S. Board of Governors. Minutes of the Meetings of the Federal Reserve Board. Washington, D.C., Vol. 20.1, p. 605.

[37]Ibid., p. 605.

Federal Reserve Board members and their staff continued to reply in similar fashion throughout the course of the Great Depression.

In 1937 Regulation A of the Federal Reserve Act, which includes the eligibility requirements for paper presented at Federal Reserve Banks was altered to (among other things) make the paper of sales finance companies eligible for rediscount at Federal Reserve Banks and as security for short-term advances. The Board, by a unanimous vote at the meeting of September 14, 1937, approved the revision of Regulation A. The revision became effective October 1, 1937. The Federal Reserve Bulletin of October 1937 states that

> [i]n the new regulation the requirement that the proceeds of eligible paper must be used 'in the first instance' for the purpose of producing, purchasing, carrying, or marketing goods has been eliminated, and it is likewise no longer required that the proceeds of eligible paper must not be advanced or loaned to some other borrower. Under the new regulation, therefore, notes, drafts, or bills, the proceeds of which have been advanced or loaned to some other borrower for a commercial, agricultural, or industrial purpose are eligible for discount, provided they comply with the usual requirements as to maturity. The principle underlying this interpretation by the Board is that paper whose proceeds are used for an eligible purpose in the hands of a second borrower is not rendered ineligible by the intervening transaction.[38]

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[38]U.S. Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, (Washington, D.C.: Government Printing Office, October 1937), p. 977-78.

The remainder of the Regulation, regarding the length of maturity of the paper, etc., remained unchanged.

In the December 1937 issue of the Federal Reserve Bulletin, under the section entitled "Law Department", the Board sets out more clearly the meaning of the revision of Regulation A, which superseded the defunct "Informal Rulings of the Board" section. In revising Regulation A so as to include the paper of finance companies, the Board reinterpreted the definition of the term commercial. The note states that

> "[i]t is the opinion of the Board that a borrowing for the purpose of making a purchase of goods is a borrowing for a commercial purpose, whether the borrower intends to use the funds himself or to resell them."[39]

Commercial transactions were interpreted to include all sales--not just those from manufacturer to wholesaler, or wholesaler to dealer. This was a distinct change from the underlying basis of discount rate policy prior to the Depression. The revision finally accepts the point made repeatedly by representatives of the sales finance companies. For example, the 1933 testimony of N.B. Williams before the Senate Committee on Banking and Currency, 1933 noted that "the final step in the distribution of goods

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[39]U.S. Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, (Washington, D.C.: Government Printing Office, December 1937), p. 1190.

... [was] the sale to the consumer."[40] The redefining of the term commercial in this manner was directly related to the change in the view society as a whole adopted toward consumer credit. As time passed consumer credit was increasingly accepted as a permanent, useful part of the nation's credit environment. This change went hand-in-hand with the widening perception that the movement of goods into the hands of the ultimate consumer was more similar to the movement of goods between firms than dissimilar.

An explanation for the revision is provided in the minutes of the meeting of the Federal Reserve Board of September 14, 1937. It is suggested that this revision was executed

> in order to bring the Board's regulation regarding discounts for and advances to member banks by Federal Reserve banks into conformity with the various amendments to the law on this subject which have been enacted in recent years.[41]

The Board interpreted the changes in the law, brought about by the Banking Acts of 1933 and 1935, as

> reflect[ing] a definite change in the intention of Congress as to the character of assets which may be used as a basis for credit accommodations at a Federal Reserve bank. Under the original Federal

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[40]Ibid., p. 1191.

[41]U.S. Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, (Washington, D.C.: Government Printing Office, 1938), p. 206.

> Reserve Act the conception of the rediscount function of the reserve banks was limited to providing member banks with credit on short term paper arising out of specific commercial, industrial and agricultural transactions, particularly to meet seasonal requirements; whereas under the more recent amendments to the law it is provided that any assets of a member bank which are satisfactory to a reserve bank may be used as a basis for obtaining credit. Accordingly, the new regulation establishes rules which in effect permit any sound assets of member banks to be used as a basis for advances by Federal Reserve banks.[42]

It is noted that member banks, which hold not only demand but time deposits as well, invested a part of their capital in long-term paper. Therefore, "in case of need", this paper should be eligible for discount at Federal Reserve Banks. The minutes of the Board, partially reprinted in the Annual Report for 1937, state that

> [e]xperience has demonstrated that the solvency of banks is better safeguarded by careful regard to the quality of the paper taken, and that greater emphasis on soundness and less emphasis on form is a sound banking principle. The Board was also guided in its determination of eligibility requirements by the recognition of the fact that at a time of a deflationary trend it is important for the Federal Reserve System to lend with the greatest freedom consistent with safety. At such times technical limitations on the character of eligible paper endanger rather than protect the safety of the banking structure.[43]

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[42]Ibid., p. 206.

[43]Ibid., pp. 206-207.

The Board made three recommendations outlining "certain minimum standards" for acceptable instalment paper.[44] First, the holder of the obligation should retain a title to the goods in case the debt becomes unpayable. Second, the goods should have a long enough life so that in the event that the goods must be resold "it may reasonably be expected that the sum realized will be substantially greater than that necessary to liquidate the amount of the obligations then unpaid, including interest and all charges."[45] This recommendation corresponds to the concern of many commentators in 1925-27 that instalment selling was unjustifiably extended to the sale of semi-durables and non-durables. A final recommendation was that "[m]ember banks should take reasonable steps to satisfy themselves that the payments and other requirements of the obligations will be met in accordance with their terms."[46] Thus, although moving toward a change in the view taken toward consumer credit, FRS officials remained wary.

One factor that aided in the fashioning of the revision was the reorganization of the Federal Reserve Board in 1935 with Marriner Stoddard Eccles as Chairman. Friedman

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[44]Ibid., p. 207.

[45]U.S. Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, (Washington, D.C.: Government Printing Office, 1937), p. 990.

[46]Ibid., p. 990.

and Schwartz note that Eccles was a consistent advocate of deficit spending in bringing about economic recovery.[47] It is reasonable to assume that Eccles would accordingly be more open than his predecessors to supporting the efforts of finance companies which in turn supported consumer credit.

A legitimate question regarding the changing views that Congress and FRS officials adopted toward the eligibility of instalment paper involves the extent to which this change was influenced by the wishes of the member banks of the System. A significant literature exists on the symbiotic relationship between the regulator and the regulated. Gerald Epstein and Thomas Ferguson have applied this framework in a study of the FRS. They argue that the profit margins of bank portfolios may have influenced the course of open market policy in 1932. Specifically, they argue that with amount of loans decreasing in the course of the Great Depression commercial banks attempted to maintain their earnings by purchasing relatively safe short-term government securities. The expansionary open market purchases of government securities in the spring of 1932 contributed to a reduction in the rate on these instruments. The rate on 3-6 month Treasury notes and certificates, which was 3.4 per

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[47]Milton Friedman and Anna J. Schwartz, A Monetary History of the United States, 1867-1960, (Princeton: Princeton University Press, 1965), p. 534.

cent in November 1929, had fallen to 0.34 per cent by June 1932. Epstein and Ferguson argue that this development was the principal influence in the decision to halt open market purchases in the summer of the same year.[48]

The paper of consumer credit agencies such as sales finance companies and Morris Plan Industrial Banks formed part of the portfolios of member banks. Therefore, an examination of the view of the commercial banking community toward this paper and its eligibility could prove useful.

Unfortunately, exact figures on commercial bank holdings of instalment paper are not available for the majority of the interwar period. Data is available for the final year of the period. In 1941 commercial banks held approximately one-third of automobile instalment paper outstanding, amounting to $786.5 million. In the same year commercial banks held approximately 16 per cent of all other consumer instalment paper outstanding, amounting to $308.6 million.[49] Commercial banks also provided direct loans to institutions in the consumer credit industry. The broadening of Regulation A, then,

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[48]Epstein, G. and T. Ferguson, "Monetary Policy, Loan Liquidation, and Industrial Conflict: Federal Reserve System Open Market Operations in 1932," Journal of Economic History 44 (December 1984): 957-84.

[49]U.S. Board of Governors of the Federal Reserve System, Consumer Instalment Credit, (Washington, D.C.: Government Printing Office, 1957), pp. 29-31.

was consistent with the needs of the commercial banking system. The FRS, in providing a market for instalment paper, created additional security for the portfolios of member institutions. Of course, this leaves open the question of why they did not do so earlier.

The Issue of the Eligibility of Consumer Credit Agencies for Membership in the Federal Reserve System

The Federal Reserve Act did not include provisions for allowing institutions in the consumer credit field to become members of the System. These institutions were excluded principally because they did not engage in commercial banking. There is a limited amount of evidence that in the early 1930's several of these institutions applied to the Federal Reserve Board for membership in the FRS. The initial application attempts were unsuccessful.

One example was the application of the Personal Loan and Savings Bank of Chicago, Illinois in early 1933. In a discussion during the meeting of April 1, 1933, the Federal Reserve Board concluded that this bank was "not engaged in the type of business contemplated by the Act for a member bank and that its application for membership in the Federal Reserve System should not, therefore be approved."[50] A letter, approved by the Federal Reserve

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[50]U.S. Board of Governors. Minutes of the Meetings of the Federal Reserve Board. Washington, D.C., Vol. 20.2, pp. 6-7.

Board on April 17, 1933, was sent to Mr. Stevens, the Federal Reserve Agent at the Chicago Reserve Bank, which related this decision. The letter stated that the Personal Loan and Savings Bank of Chicago was "engaged in the business of making personal loans repayable in instalments and does not do any commercial banking business."[51] This part of the letter was significant enough to be sent to all Federal Reserve Agents along with the reiteration that "it seems clear that the Act did not contemplate the admission to membership of institutions of this class."[52] In this correspondence the Board adheres to its traditional definition of the term commercial, and to its role as interpreter of the Federal Reserve Act.

On June 15, 1933 Mr. Stevens of the Chicago Bank again sent a letter to the Board "requesting advice as to what steps may be necessary in the event the institution decides to renew its application."[53] The Board requested that the form of loan agreements, the nature of the banks' deposits, the average maturity of loans and the character of the collateral obtained by the bank be included along with the standard information as contained in the application as outlined in the Federal Reserve Act. On November

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[51]U.S. Board of Governors. Minutes of the Meetings of the Federal Reserve Board. Washington, D.C., Vol. 20.2, p. 118.

[52]Ibid., p. 119.

[53]Ibid., p. 522.

2, 1933, the application of the Personal Loan and Savings Bank of Chicago, Illinois was approved.

In making this about-face the Board was following the changes that new legislation brought to the Federal Reserve Act. On June 16, 1933 President Roosevelt signed the Banking Act of 1933 into law. This legislation amended the Federal Reserve Act so as to allow Morris Plan Banks and "similar institutions" to become members of the Federal Reserve. The provision making these institutions eligible for membership was a minor part of the Banking Act of 1933. More significant were the sections establishing the Federal Deposit Insurance Corporation and those proclaiming the separation of commercial and investment banking. The provision pertaining to Morris Plan Banks was not debated before the House or the Senate; the deposit insurance scheme was.

The provision making Morris Plan Banks eligible for membership in the FRS was not a suggestion of FRS officials. Officials of the FRS were limited participants in the reform debate that preceded the Banking Act of 1933. Officials of the FRS appeared before both Senate and House Committees on Banking and Currency in 1930-33. These committees were addressing the problem of bank failures (which had plagued the banking system in the twenties) and the utility of branch and chain banking as part of the solution. On March 29, 1932 Governor Eugene Meyer of the

Federal Reserve Board appeared before the Senate committee, which was chaired by Carter Glass. Meyer explained that in the view of the Board the bank failures of the 1920's were largely a result of competition between the member institutions of the FRS and the weaker, non-member-state banks. At the end of his testimony Meyer "was requested to suggest a constitutional method of creating a unified banking system in the United States."[54] The Federal Reserve Board took this request to mean "bringing all commercial banking business in the United States into a single banking system subject to effective regulation and supervision by the Federal Government."[55]

The essential point is that the Federal Reserve Board continued to interpret the term commercial in the same way and its task to be the management of the commercial banking system. As indicated in the response of the Board to the Federal Reserve Agent at the Chicago Bank the support of commercial activity was not part of the business of institutions engaged in making small-scale personal loans repayable in instalments. Morris Plan Banks performed this type of lending. The Board was consequently opposed to allowing this type of institution into the FRS.

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[54]U.S. Board of Governors of the Federal Reserve System, Federal Reserve Bulletin (Washington, D.C.: Government Office, March 1933), p. 166.

[55]Ibid., p. 166.

The Board indicated that it did not believe that the paper of Morris Plan Banks was commercial in character in a reply to a letter from Mr. Bertram Chesterman, the President of the Morris Plan Bank of Washington, D.C. Mr. Chesterman had suggested that the paper of Morris Plan Banks might be interpreted as eligible. The reply of the Board states

> that a broadening in the eligibility requirements in the manner suggested would be inconsistent with the purposes for which the Federal Reserve System was established; that it is contemplated by the Federal Reserve Act that the paper rediscounted for member banks should arise out of commercial or agricultural transactions which ordinarily will be consummated within a comparatively short period of time and out of which will be derived funds to pay the paper at maturity; and that the paper of Morris Plan banks is not of this character.[56]

The Board maintained that Morris Plan Banks and similar institutions did not support commercial activity. It believed that these institutions should not be eligible for membership in the FRS. The provision pertaining to Morris Plan Bank eligibility was instead part of the attempt by Congress to protect the small borrower. The Banking Act of 1933 required member institutions to subscribe to the Federal Deposit Insurance Corporation (FDIC). By providing Morris Plan Banks and similar institutions the opportunity of joining the Federal

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[56]U.S. Board of Governors. Minutes of the Meetings of the Federal Reserve Board. Washington, D.C., Vol. 20.2, p. 90.

Reserve Congress was providing protection to the small-scale depositor in these institutions. The FDIC was set up to protect the small-scale depositor. It offered protection of deposits up to $2,500. At the end of the 1930's the Federal Reserve Act was amended again, giving Morris Plan banks the option of remaining independent of the Federal Reserve and the Federal Deposit Insurance Corporation.

The conclusion of this chapter complements the principal conclusion of Chapter III. Federal Reserve officials clearly did not believe that the FRS should become involved with the regulation of consumer credit agencies. It was Congress that accepted these institutions, bringing a number of them, e.g. Morris Plan Banks and personal loan banks, into the Federal Reserve System. Although Federal Reserve officials had freed themselves from the real bills notion that the proper amount of credit would be assured by the automatic rediscounting of all eligible paper, most continued to agree that commercial paper should form the backbone of a commercial bank's portfolio. Since consumer credit institutions did not support commercial activity FRS officials believed that they should be excluded from the System.

CHAPTER V

CONCLUSIONS

The Great Depression will continue to be regarded as one of the pivotal events of the 20th century. The economic theories and policies that were developed in response to this event continue to shape market economies around the globe. The purpose of this dissertation has been to examine the views of FRS officials toward consumer credit during the interwar period and to determine what influence these views had on the policies of the System, particularly in the course of the Great Depression. Direct evidence on the thinking of the leading figures within the interwar Federal Reserve has been used to illuminate this issue. This group includes the members of the Federal Reserve Board and the Governors of the principal Reserve Banks, specifically, at New York, Philadelphia, Chicago and Boston.

The principal conclusion of this dissertation is that the interwar development of consumer credit did not significantly influence the policies pursued by the System during the interwar period. Different officials within the FRS, for different reasons, did not appreciate the role of consumption and consumer credit in the 1920's and early 1930's, and, consequently, could not have purposefully acted so as to limit the drastic decrease in

consumption spending in 1929-33. Interestingly, a number of plans designed to revitalize the economy through the use of consumer credit agencies were presented to the Federal Reserve Board in 1929-33. Each plan was dismissed.

Officials of the FRS were certainly aware of the development of consumer credit during the 1920's. As indicated in Chapter III the papers of Charles S. Hamlin reveal that FRS officials followed the 1925-27 debate regarding instalment selling closely. As participants in American society these individuals were exposed to consumer credit, along with the rest of society, during this intense public debate. The development of instalment credit was one of the most pressing economic and social issues of the 1920's. As indicated in Chapter III a number of FRS officials became directly involved in this debate, most notably Mr. James, a member of the Federal Reserve Board during 1923-36, and Governor George W. Norris of the Philadelphia Reserve Bank. While James' participation appears to have been limited to a single speech, Governor Norris made a number of speeches and had several articles published on the topic of instalment selling during 1925-27. Norris expressed some concern over the possible effects of instalment selling in an economic downturn, the potential effect of instalment selling on saving, and the relationship between instalment

selling and luxury expenditure. These concerns were ones that he shared with individuals from diverse parts of society. The implication of this finding is that in order to fully understand the thinking of officials within the FRS economic historians must recognize that these individuals were part of a larger society. This society, made up of businessmen, bankers, organized labor, politicians, and intellectuals, directly influenced the views of individuals within the Federal Reserve. As Chandler maintains, it is only possible to understand FRS behavior within the context of "the economic, financial, political and intellectual environments of the period."[1] As a consequence approaches based on utility theory, which ignore the influence of the social context FRS officials operate in, are inadequate in addressing issues that pertain to this institution.

Concern over the rapid development of instalment credit was also shown, albeit privately, within the System. As indicated in Chapter III Governor Strong of the New York Reserve Bank worried briefly over the development of this new credit practice. Officials at the Federal Reserve Bank of Boston were concerned enough to undertake an independent study of instalment selling by department stores in their district. Despite this public and private

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[1]Lester V. Chandler. American Monetary Policy, 1928-41. (New York: Harper and Row, 1971), p. 26.

show of concern, developments in consumer credit failed to influence policy-making in the 1920's. The Federal Reserve Board, hypothetically, could have adopted a policy toward consumer credit in the 1920's similar to the policy of direct pressure which singled out member institutions extending speculative loans in 1928-29. The Federal Reserve Board, through the policy of direct pressure, or moral suasion, attempted in 1928-29 to curtail loans made by member banks which supported stock market activity. The Board could have singled out loans by member banks to consumer credit agencies. It did not.

There are a number of reasons for the lack of interest shown by a considerable number of FRS officials toward consumer credit during the 1920's. Prior to 1933 consumer credit agencies were not eligible for membership in the Federal Reserve. In the 1920's the regulation of these agencies was performed instead at the state level, by state legislatures and state banking commissioner offices. It was not until the 1930's that officials at the federal level were authorized to oversee a number of the agencies in the consumer credit industry. The Banking Act of 1933, for example, extended the privilege of FRS membership to Morris Plan Banks. The change in the membership guidelines of the Federal Reserve Act appears to have resulted from an attempt by Congress to allow Morris Plan Banks access to federal deposit insurance through FRS member-

ship. This change did not result from FRS action. The Federal Reserve Board adopted the view that consumer credit agencies did not engage in any commercial banking business and therefore could not become members of the System. Accordingly, prior to 1933, FRS officials did not view these institutions as their responsibility.

Federal Reserve officials viewed their responsibilities in very narrow terms. Evidence for this statement can be taken from the views expressed by a number of Federal Reserve Board members in the course of the debate over the policy of direct pressure. A number of Federal Reserve Board members, most notably Charles S. Hamlin, Adolph Miller, and E.H. Cunningham, consistently maintained in conversations with critics, that it was not the intention of the Federal Reserve Board in this period "to intervene and break the stock market."[2] The objective of the Board "was to prevent the diversion of Federal Reserve credit into the stock market."[3] Concern was not shown for the role of non-FRS institutions in the build-up of stock market speculation. Both Miller and Cunningham were in agreement with this position. It should be noted, however, that a least one member of the Board, Vice-Governor Platt, vigorously disagreed. It appears that a number of

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[2]Charles S. Hamlin. Papers. Library of Congress, Manuscript Division, Washington, D.C., Diary-Index, 1929, p. 45.

[3]Ibid., p. 45.

FRS officials, although clearly not all, did not accept responsibility for credit supplied by financial institutions outside the System.

Prior to the Banking Act of 1933, the paper issued by finance companies was not eligible for rediscount at the Reserve Banks. As a result this type of paper was not held in the portfolios of the Federal Reserve Banks. As Governor Strong of the New York Bank noted in his testimony before the House Committee on Banking and Currency during the Price Stabilization Hearings of April 1927, since the paper of firms involved in instalment lending was not eligible for rediscount at Federal Reserve Banks, there was no way for this paper to get into FRS channels. Since the use of instalment paper could not impair the liquidity of the portfolios of the Reserve Banks FRS officials did not need to be closely concerned with developments in this area. Taking this one step further, Governor Benjamin Strong, his successor George Harrison, W. R. Burgess and other staff members of the Federal Reserve Bank of New York, realized that the System could not control the ways in which member institutions utilized the funds that they acquired from the FRS. They recognized that member banks could utilize their usable funds to lend to whomever they chose. Officials at the New York Bank as a result focused on the total supply of credit

rather than the individual ingredients, such as consumer credit.

As a last point, the most reliable studies available to FRS officials indicated that instalment selling was benign. The studies of department store use of instalment selling undertaken by the Federal Reserve Banks of New York and Boston indicated that the volume of instalment credit was relatively insignificant. The most extensive scholarly study of instalment credit in the interwar period, released by E. R. A. Seligman in 1927, concluded that instalment selling, if kept free of abuse, was a sound component of domestic credit. The positive conclusions put forth by these sources acted to lessen the concern of FRS officials toward the instalment business.

In the course of the Great Depression the level of consumption expenditures and the extension of consumer credit to the household decreased dramatically. As indicated in Table 1 outstanding consumer debt per household fell from $540.28 in 1929 to $349.95 in 1933. This development was regarded, in and of itself, as a sound one to a number of Federal Reserve System officials. As indicated in Chapter III a part of American society had long related consumer debt to luxury consumption, and luxury consumption was regarded as morally and economically unwise. The comments of Governor Norris indicate that a number of FRS officials concurred with this view.

Consumer credit agencies were brought into the Federal Reserve in the course of the 1930's. Morris Plan Banks were made eligible for membership by the Banking Act of 1933. Finance company paper was made temporarily eligible by the Glass-Steagall Act, along with other ineligible paper, and made permanently eligible by the Banking Act of 1935. As indicated in Chapter IV these changes were made by Congress, without the approval of FRS officials. These officials consistently maintained that the lending of consumer credit agencies did not support commercial activity and therefore did not qualify for FRS membership. This position was certainly reinforced by the suspicion that was attached to instalment selling in the course of the 1925-27 debate.

The view of FRS officials toward consumer credit during the Depression is revealed by the way in which the Board's Division of Research and Statistics dealt with a request by Mr. George R. James, a Board member in 1931. James asked that the Division of Research and Statistics examine the question of whether or not instalment selling was being replaced by cash buying in the first part of the contraction. Rather than conduct an independent study of instalment selling the Division of Research and Statistics relied on the analysis and data of the investigation undertaken by E. R. A. Seligman in 1926-27! The question was simply not significant enough to warrant an indepen-

dent study by the Board's Division of Research and Statistics. James criticized the handling of this question, but does not appear to have taken the matter any further.

To sum up, developments in consumer credit in the 1920's and 1930's, with one minor exception, did not exert an influence over policy-making in the same period. Only Governor Norris and the Directors of the Philadelphia Reserve Bank took consumer credit into account in the course of forming their policy stance. Accordingly, although falling consumption expenditures and consumer credit played a significant role in the contraction of 1929-33, officials of the Federal Reserve System, as a whole, took no steps to halt the decline.

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APPENDIX

PROMINENT FEDERAL RESERVE SYSTEM OFFICIALS, 1914-38

Membership of the Federal Reserve Board

Chairman (ex-officio)

William G. McAdoo	Aug. 1914 - Dec. 1918.
Carter Glass	Dec. 1916 - Feb. 1920.
David F. Houston	Feb. 1920 - Mar. 1921.
Andrew W. Mellon	Mar. 1921 - Feb. 1931.
Ogden L. Mills	Feb. 1931 - Mar. 1933.
William H. Woodin	Mar. 1933 - Dec. 1933.
Henry Morgenthau, Jr.	Jan. 1934 - Feb. 1936.

Comptroller of the Currency (ex-officio)

John Skelton Williams	Aug. 1914 - Mar. 1921.
Daniel R. Crissinger	Mar. 1921 - Apr. 1923.
Henry M. Dawes	May 1923 - Dec. 1924.
J.W. McIntosh	Dec. 1924 - Nov. 1928.
J.W. Pole	Nov. 1928 - Sep. 1932.
J.F.T. O'Connor	May 1933 - Feb. 1936.

Governor of the Federal Reserve Board

Chas. S. Hamlin	Aug. 1914 - Aug. 1916.
W.P.G. Harding	Aug. 1916 - Aug. 1922.
Edmund Platt(acting)	Aug. 1922 - Apr. 1923.
Daniel R. Crissinger	May 1923 - Sep. 1927.
Roy A. Young	Oct. 1927 - Aug. 1930.
Eugene Meyer	Sep. 1930 - Mar. 1933.
Eugene R. Black	May 1933 - Aug. 1934.

Members of the Federal Reserve Board/Board of Governors

C.S. Hamlin	Aug. 1914 - Feb. 1936.
Paul Warburg	Aug. 1914 - Aug. 1918.
Frederic A. Delano	Aug. 1914 - Jul. 1918.
W.P.G. Harding	Aug. 1914 - Aug. 1922.
Adolph C. Miller	Aug. 1914 - Feb. 1936.
Albert Strauss	Nov. 1918 - Mar. 1920.
H.A. Moehlenpah	Nov. 1919 - Aug. 1920.
Edmund Platt	Jun. 1920 - Sep. 1930.
D.C. Wills(ad interim)	Sep. 1920 - Mar. 1921.
Daniel R. Crissinger	May 1923 - Sep. 1927.
John R. Mitchell	May 1921 - May 1923.

Members of the Federal Reserve Board/Board of Governors

Milo D. Campbell	May 14, 1923 - May 22, 1923.
E.H. Cunningham	May 1923 - Nov. 1930.
George R. James	May 1923 - Feb. 1936.
Wayland W. Magee	May 1931 - Jun. 1933.
J.J. Thomas	Jun. 1933 - Feb. 1936.

[compiled from the Federal Reserve Bulletin, 1915-38]

VITA

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