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HJ : HB 174

[¶ 987]

Fees

Sec. 6.203. (1) A person required to file notification shall on or before January 31 of each year pay to the [Administrator] an annual fee of \$10 for that year.

(2) Persons required to file notification who are sellers, lessors, or lenders shall pay an additional fee at the time and in the manner stated in subsection (1) of \$10 for each \$100,000, or part thereof, in excess of \$100,000, of the original unpaid balances arising from consumer credit sales, consumer leases, and consumer loans made in this State within the preceding calendar year and held either by the seller, lessor, or lender for more than 30 days after the inception of the sale, lease, or loan giving rise to the obligations, or by an assignee who has not filed notification. A refinancing of a sale, lease, or loan resulting in an increase in the amount of an obligation is considered a new sale, lease, or loan to the extent of the amount of the increase.

(3) Persons required to file notification who are assignees shall pay an additional fee at the time and in the manner stated in subsection (1) of \$10 for each \$100,000, or part thereof, of the unpaid balances at the time of the assignment of obligations arising from consumer credit sales, consumer leases, and consumer loans made in this State taken by assignment during the preceding calendar year, but an assignee need not pay a fee with respect to an obligation on which the assignor or other person has already paid a fee.

PART 3—COUNCIL OF ADVISORS ON CONSUMER CREDIT

[¶ 988]

Council of Advisors on Consumer Credit

Sec. 6.301. (1) There is hereby created the Council of Advisors on Consumer Credit consisting of [16] members, who shall be appointed by the Governor. One of the Advisors shall be designated by the Governor as Chairman. In appointing members of the Council, the Governor shall seek to achieve a fair representation from the various segments of the consumer credit industry and the public.

(2) The term of office of each member of the Council is [4] years. Of those members first appointed, [four] shall be appointed for a term of [1] year, [four] for a term of [2] years, [four] for a term of [3] years, and [four] for a term of [4] years. A member chosen to fill a vacancy arising otherwise than by expiration of term shall be appointed for the unexpired term of the member whom he is to succeed. A member of the Council is eligible for reappointment.

(3) Members of the Council shall serve without compensation but are entitled to reimbursement of expenses incurred in the performance of their duties.

[¶ 989]

Function of Council; Conflict of Interest

Sec. 6.302. The Council shall advise and consult with the Administrator concerning the exercise of his powers under this Act and may make recommendations to him. Members of the Council may assist the Administrator in obtaining compliance with this Act. Since it is an objective of this Part to obtain competent representatives of creditors and the public to serve on the Council and to assist and cooperate with the Administrator in achieving the objectives of this Act, service on the Council shall not in itself constitute a conflict of interest regardless of the occupations or associations of the members.

[§ 990]

Meetings

Sec. 6.303. The Council and the Administrator shall meet together at a time and place designated by the Chairman at least twice each year. The Council may hold additional meetings when called by the Chairman.

[PART 4—ADMINISTRATIVE PROCEDURE AND JUDICIAL REVIEW]

[§ 991]

[Applicability and Scope]

[Sec. 6.401. This Part applies to the Administrator, prescribes the procedures to be observed by him in exercising his powers under this Act, and supplements the provisions of the Part on Powers and Functions of Administrator (Part 1) of this Article and of the Part on Regulated and Supervised Loans (Part 5) of the Article on Loans (Article 3).]

[§ 992]

[Definition: in Part]

[Sec. 6.402. In this Part (1) "Contested case" means a proceeding, including but not restricted to one pursuant to the provisions on administrative enforcement orders (subsection (1) of Section 6.108) and licensing, in which the legal rights, duties, or privileges of a party are required by law to be determined by the Administrator after an opportunity for hearing.

(2) "License" means a license authorizing a person to make supervised loans pursuant to the provisions on authority to make supervised loans (Section 3.502).

(3) "Licensing" includes the Administrator's process respecting the grant, denial, revocation, suspension, annulment, withdrawal, or amendment of a license.

(4) "Party" means the Administrator and each person named or admitted as a party, or who is aggrieved by action taken and seeks to be admitted as a party.

(5) "Rule" means each rule specifically authorized by this Act that applies generally and implements, interprets or prescribes law or policy, or each statement by the Administrator that applies generally and describes the Administrator's procedure or practice requirements or the organization of his office. The term includes the amendment or repeal of a prior rule but does not include

(a) statements concerning only the internal management of the Administrator's office and not affecting private rights or procedures available to the public;

(b) declaratory rulings issued pursuant to the provisions on declaratory rulings by Administrator (Section 6.409); or

(c) intra-office memoranda.]

COMMENT

These definitions are derived from Section 1 of the Uniform Law Commissioners' Revised Model State Administrative Pro-

cedure Act (hereinafter referred to as the "Revised Model Act").

[§ 993] [Public Information; Adoption of Rules;
Availability of Rules and Orders]

[Sec. 6.403. (1) In addition to other rule-making requirements imposed by law, the Administrator shall:

(a) adopt as a rule a description of the organization of his office, stating the general course and method of the operations of his office and the methods whereby the public may obtain information or make submissions or requests;

(b) adopt rules of practice setting forth the nature and requirements of all formal and informal procedures available, including a description of all forms and instructions used by the Administrator or his office;

(c) make available for public inspection all rules and all other written statements of policy or interpretations formulated, adopted, or used by the Administrator in the discharge of his functions:

(d) make available for public inspection all final orders, decisions, and opinions.

(2) No rule, order, or decision of the Administrator is valid or effective against any person or party, nor may it be invoked by the Administrator for any purpose, until it has been made available for public inspection as herein required. This provision is not applicable in favor of any person or party who has actual knowledge thereof.]

COMMENT

This Section is derived from Section 2 of the Revised Model Act.

[§ 994] [Procedure for Adoption of Rules]

[Sec. 6.404. (1) Prior to the adoption, amendment, or repeal of any rule, the Administrator shall

(a) give at least 20 days' notice of his intended action. The notice shall include a statement of either the terms or substance of the intended action or a description of the subjects and issues involved, and the time when, the place where, and the manner in which interested persons may present their views thereon. The notice shall be mailed to all persons who have made timely request of the Administrator for advance notice of his rule-making proceedings and shall be published in [here insert the medium of publication appropriate for the adopting State],

(b) afford all interested persons reasonable opportunity to submit data, views, or arguments, orally or in writing. In case of substantive rules, opportunity for oral hearing must be granted if requested by 25 persons, by a governmental subdivision or agency, or by an association having not less than 25 members. The Administrator shall consider fully all written and oral submissions respecting the proposed rule. Upon adoption of a rule the Administrator, if requested to do so by an interested person either prior to adoption or within 30 days thereafter, shall issue a concise statement of the principal reasons for and against its adoption, incorporating therein his reasons for overruling the considerations urged against its adoption.

(2) No rule is valid unless adopted in substantial compliance with this section. A proceeding to contest any rule on the ground of non-compliance with the procedural requirements of this section must be commenced within 2 years from the effective date of the rule.]

COMMENT

This Section is derived from Section 3 of the Revised Model Act.

[§ 995] [Filing and Taking Effect of Rules]

[Sec. 6.405. (1) The Administrator shall file in the office of the [Secretary of State] a certified copy of each rule adopted by him. The [Secretary of State] shall keep a permanent register of the rules open to public inspection.

(2) Each rule hereafter adopted is effective 20 days after filing, except that, if a later date is specified in the rule, the later date is the effective date.]

COMMENT

This Section is derived from Section 4 of the Revised Model Act.

[§ 996] [Publication of Rules]

[Sec. 6.406. (1) The [Secretary of State] shall compile, index, and publish all effective rules adopted by the Administrator. Compilations shall be supplemented or revised as often as necessary.

(2) Compilations shall be made available upon request to [agencies and officials of this State] free of charge and to other persons at prices fixed by the [Secretary of State] to cover mailing and publication costs.]

COMMENT

This Section is derived from Section 5 of the Revised Model Act.

[§ 997] [Petition for Adoption of Rules]

[Sec. 6.407. An interested person may petition the Administrator requesting the promulgation amendment, or repeal of a rule. The Administrator shall prescribe by rule the form for petitions and the procedure for their submission, consideration, and disposition. Within 30 days after submission of a petition, the Administrator either shall deny the petition in writing (stating his reasons for the denials) or shall initiate rule-making proceedings in accordance with the provisions on procedure for adoption of rules (Section 6.404).]

COMMENT

This Section is derived from Section 6 of the Revised Model Act.

**[§ 998] [Declaratory Judgment on Validity or
 Applicability of Rules]**

[Sec. 6.408. The validity or applicability of a rule may be determined in an action for declaratory judgment in the [. . . court], if it is alleged

that the rule, or its threatened application, interferes with or impairs, or threatens to interfere with or impair, the legal rights or privileges of the plaintiff. The Administrator shall be made a party to the action. A declaratory judgment may be rendered whether or not the plaintiff has requested the Administrator to pass upon the validity or applicability of the rule in question.]

COMMENT

This Section is derived from Section 7 of the Revised Model Act.

[§ 999] [Declaratory Rulings by Administrator]

[Sec. 6.409. The Administrator shall provide by rule for the filing and prompt disposition of petitions or declaratory rulings as to the applicability of any statutory provision or of any rule of the Administrator. Rulings disposing of petitions have the same status as decisions or orders in contested cases.]

COMMENT

This Section is derived from Section 8 of the Revised Model Act.

[§ 1000] [Contested Cases; Notice; Hearing; Records]

[Sec. 6.410. (1) In a contested case, all parties shall be afforded an opportunity for hearing after reasonable notice.

(2) The notice shall include:

- (a) a statement of the time, place, and nature of the hearing;
- (b) a statement of the legal authority and jurisdiction under which the hearing is to be held;
- (c) a reference to the particular provisions of the statutes and rules involved;
- (d) a short and plain statement of the matters asserted. If the Administrator or other party is unable to state the matters in detail at the time the notice is served, the initial notice may be limited to a statement of the issues involved. Thereafter upon application a more definite and detailed statement shall be furnished.

(3) Opportunity shall be afforded all parties to respond and present evidence and argument on all issues involved.

(4) Unless precluded by law, informal disposition may be made of any contested case by stipulation, agreed settlement, consent order, or default.

(5) The record in a contested case shall include:

- (a) all pleadings, motions, intermediate rulings;
- (b) evidence received or considered;
- (c) a statement of matters officially noticed;
- (d) questions and offers of proof, objections, and rulings thereon;
- (e) proposed findings and exceptions;
- (f) any decision, opinion, or report by the officer presiding at the hearing;

(g) all staff memoranda or data submitted to the hearing officer or members of the office of the Administrator in connection with their consideration of the case.

(6) Oral proceedings or any part thereof shall be transcribed on request of any party [, but at his expense].

(7) Findings of fact shall be based exclusively on the evidence and on matters officially noticed.]

COMMENT

This Section is derived from Section 9 of the Revised Model Act.

§ 1001 [Rules of Evidence; Official Notice]

[Sec. 6.411. In contested cases:

(1) irrelevant, immaterial, or unduly repetitious evidence shall be excluded. The rules of evidence as applied in [non-jury] civil cases in the [. . . court of this State] shall be followed. When necessary to ascertain facts not reasonably susceptible of proof under those rules, evidence not admissible thereunder may be admitted (except where precluded by statute) if it is of a type commonly relied upon by reasonably prudent men in the conduct of their affairs. The Administrator shall give effect to the rules of privilege recognized by law. Objections to evidentiary offers may be made and shall be noted in the record. Subject to these requirements, when a hearing will be expedited and the interests of the parties will not be prejudiced substantially, any part of the evidence may be received in written form;

[(2) documentary evidence may be received in the form of copies or excerpts, if the original is not readily available. Upon request, parties shall be given an opportunity to compare the copy with the original;]

(3) a party may conduct cross-examinations required for a full and true disclosure of the facts;

(4) notice may be taken of judicially cognizable facts. In addition, notice may be taken of generally recognized technical or scientific facts within the Administrator's specialized knowledge. Parties shall be notified either before or during the hearing, or by reference in preliminary reports or otherwise, of the material noticed, including any staff memoranda or data, and they shall be afforded an opportunity to contest the material so noticed. The Administrator's experience, technical competence, and specialized knowledge may be utilized in the evaluation of the evidence.]

COMMENT

This Section is derived from Section 10 of the Revised Model Act.

§ 1002 [Decisions and Orders]

[Sec. 6.412. A final decision or order adverse to a party in a contested case shall be in writing or stated in the record. A final decision shall include findings of fact and conclusions of law, separately stated. Findings of fact, if set forth in statutory language, shall be accompanied by a concise and explicit statement of the underlying facts supporting the findings. If, in accordance with rules of the Administrator, a party submitted proposed findings of

fact, the decision shall include a ruling upon each proposed findings. Parties shall be notified either personally or by mail of any decision or order. Upon request a copy of the decision or order shall be delivered or mailed forthwith to each party and to his attorney of record.]

COMMENT

This Section is derived from Section 12 of the Revised Model Act.

[§ 1003]

[Licenses]

[Sec. 6.413. (1) When the grant or denial of a license is required to be preceded by notice and opportunity for hearing, the provisions of this Part concerning contested cases apply.

(2) No revocation, suspension, annulment, or withdrawal of a license is lawful unless, prior to the institution of proceedings by the Administrator, he gave notice by mail to the licensee of facts or conduct which warrant the intended action, and the licensee was given an opportunity to show compliance with all lawful requirements for the retention of the license.]

COMMENT

This Section is derived from Section 14 of the Revised Model Act.

[§ 1004]

[Judicial Review of Contested Cases]

[Sec. 6.414. (1) A person who has exhausted all administrative remedies available before the Administrator and who is aggrieved by a final decision in a contested case is entitled to judicial review under this Part. This section does not limit utilization of or the scope of judicial review available under other means of review, redress, relief, or trial de novo provided by law. A preliminary, procedural, or intermediate action or ruling of the Administrator is immediately reviewable if review of the final decision of the Administrator would not provide an adequate remedy.

(2) Proceedings for review are instituted by filing a petition in the [. . . court] within [30] days after [mailing notice of] the final decision of the Administrator or, if a rehearing is requested, within [30] days after the decision thereon. Copies of the petition shall be served upon the Administrator and all parties of record.

(3) The filing of the petition does not itself stay enforcement of the decision of the Administrator. The Administrator may grant, or the reviewing court may order, a stay upon appropriate terms.

(4) Within [30] days after the service of the petition, or within further time allowed by the court, the Administrator shall transmit to the reviewing court the original or a certified copy of the entire record of the proceeding under review. By stipulation of all parties to the review proceedings, the record may be shortened. A party unreasonably refusing to stipulate to limit the record may be taxed by the court for the additional costs. The court may require or permit subsequent corrections or additions to the record.

(5) If, before the date set for hearing, application is made to the court for leave to present additional evidence, and it is shown to the satisfaction of

the court that the additional evidence is material and that there were good reasons for failure to present it in the proceeding before the Administrator, the court may order that the additional evidence be taken before the Administrator upon conditions determined by the court. The Administrator may modify his findings and decision by reason of the additional evidence and shall file that evidence and any modifications, new findings, or decisions with the reviewing court.

(6) The review shall be conducted by the court without a jury and shall be confined to the record. In cases of alleged irregularities in procedure before the Administrator, not shown in the record, proof thereon may be taken in the court. The court, upon request, shall hear oral argument and receive written briefs.

(7) The court shall not substitute its judgment for that of the Administrator as to the weight of the evidence on questions of fact. The court may affirm the decision of the Administrator or remand the case for further proceedings. The court may reverse or modify the decision if substantial rights of the appellant have been prejudiced because the administrative findings, inferences, conclusions, or decisions are:

- (a) in violation of constitutional or statutory provisions;
- (b) in excess of the statutory authority of the Administrator;
- (c) made upon unlawful procedure;
- (d) affected by other error of law;
- (e) clearly erroneous in view of the reliable, probative, and substantial evidence on the whole record; or
- (f) arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion.]

COMMENT

This Section is derived from Section 15 of the Revised Model Act.

[§ 1005]

[Appeals]

[Sec. 6.415. An aggrieved party may obtain a review of any final judgment of the [. . . court] under this Part by appeal to the [. . . court]. The appeal shall be taken as in other civil cases.]

Article 7.—Reserved for Future Use

Note: Provisions concerning consumer credit counseling agencies are being considered by the Special Committee and, if approved by the National Conference after 1968, will be proposed as Article 7 of the Uniform Consumer Credit Code.

Article 8.—Reserved for Future Use

Note: Provisions concerning wage earner receiverships are being considered by the Special Committee and, if approved by the National Conference after 1968, will be proposed as Article 8 of the Uniform Consumer Credit Code.

§ 1005

Article 9.—Effective Date and Repealer

[¶ 1006] Time of Taking Effect; Provisions for Transition

Sec. 9.101. (1) Except as otherwise provided in this section, this Act takes effect at 12:01 a. m. on [].

(2) To the extent appropriate to permit the Administrator to prepare for operation of this Act when it takes effect and to act on applications for licenses to make supervised loans under this Act (subsection (1) of Section 3.503), the Part on Regulated and Supervised Loans (Part 5) of the Article on Loans (Article 3) and the Article on Administration (Article 6) takes effect [].

Note: Insert in lieu of brackets at the end of subsection (2) either "immediately" or the earliest time possible under the constitutional or statutory requirements of the enacting State.

(3) Transactions entered into before this Act takes effect and the rights, duties, and interests flowing from them thereafter may be terminated, completed, consummated, or enforced as required or permitted by any statute, rule of law, or other law amended, repealed, or modified by this Act as though the repeal, amendment, or modification had not occurred, but this Act applies to

(a) refinancings, consolidations, and deferrals made after this Act takes effect of sales, leases, and loans whenever made;

(b) sales or loans made after this Act takes effect pursuant to revolving charge accounts (Section 2.108) and revolving loan accounts (Section 3.108) entered into, arranged, or contracted for before this Act takes effect; and

(c) all credit transactions made before this Act takes effect insofar as the article on remedies and penalties (Article 5) limits the remedies of creditors.

(4) With respect to revolving charge accounts (Section 2.108) and revolving loan accounts (Section 3.108) entered into, arranged, or contracted for before this Act takes effect, disclosure pursuant to the provisions on disclosure (Section 2.310 and Section 3.309), shall be made not later than 30 days after this Act takes effect.

COMMENT

The 30-day period in subsection (4) is derived from CCPA Section 127(e).

[¶ 1007] Continuation of Licensing

Sec. 9.102. All persons licensed or otherwise authorized under the provisions of [list statutes] on the effective date of this Act are licensed to make supervised loans under this Act pursuant to the Part on Regulated and Supervised Loans (Part 5) of the Article on Loans (Article 3), and all provisions of that Part apply to the persons so previously licensed or authorized. The Administrator may, but is not required to, deliver evidence of licensing to the persons so previously licensed or authorized.

COMMENT

This section provides automatic licensing under Article 3, Part 5, for all lenders previously licensed under the State's licensed lender statutes prior to the effective date.

No application or administrative action is required and the formal license under the prior statute, which will be repealed, will be a license under Part 5 of Article 3. The Administrator may, at such time as his new

duties under the Code permit him an opportunity, substitute new licenses for those in the lenders' possession, but this is entirely a ministerial act.

[§ 1008] Specific Repealer and Amendments

Sec. 9.103. (1) The following acts and parts of acts are repealed:

- (a)
- (b)
- (c) [and so on]

(2) The following acts and parts of acts are amended:

- (a)
- (b)
- (c) [and so on]

Note re Repealer and Amendatory Provisions

This Act is a comprehensive statute designed to regulate most aspects of consumer credit, maximum charges that may be made for consumer credit and rates of interest generally. Consumer credit covered includes sales credit related to the sale to consumers of goods or services, consumer loan credit, some credit related to the sale or financing of homes and some agricultural credit. All States have one or more acts regulating consumer credit and rates of interest and in many States additional provisions performing the same function appear in various

other acts. To accommodate existing law to this Act, each State enacting this Act will need to repeal one or more existing acts or particular provisions in acts and may have to amend one or more other acts. The purpose of this Note is to suggest to the statutory revisor or other person preparing this Act for introduction into a particular State Legislature the acts which should be repealed or amended. To produce the uniformity which the Commissioners believe desirable, acts should be repealed or amended as recommended in this Note.

Acts to Be Totally or Substantially Repealed

Subject to other specific suggestions of this Note, certain existing acts devoted primarily to regulating consumer credit should be repealed in their entirety. The revisor or draftsman should insert in this section the appropriate statutes or provisions to be repealed. To help guide the search for these acts or provisions, a list of some of the common popular names of these acts follow, although there may be others in any particular jurisdiction:

Small loan acts, personal loan acts, consumer loan acts and acts licensing personal

loan lenders, sales finance companies and consumer finance companies.

Instalment loan laws.

Retail instalment sales acts, motor vehicle instalment sales acts, all goods acts.

Revolving sales credit acts, revolving loan acts.

Truth-in-lending acts.

Home solicitation sales acts.

Home improvement sales and loan acts.

Insurance premium financing acts.

Acts Imposing Maximum Charges for Credit and General Usury Acts

Repeal of the above listed consumer credit regulatory acts will automatically repeal provisions in these acts imposing maximum charges for the types of credit dealt with in the acts. In addition, all general usury statutes and all other provisions in acts imposing maximum charges for loans, for-

bearance or the extension of credit should be repealed, excepting only provisions, if any, for maximum charges to be made by pawnbrokers.

Statutes providing for a "legal rate" of interest, that is, the rate to be applied for judgments, notes and other cases where

there is no agreed rate or no agreement is possible (as in a judgment) should not be repealed. If these statutes are so intertwined with maximum contract rates, *e.g.*, usury provisions, that it is difficult to separate the two types of provisions, total repeal of the usury and legal rate statute plus the

addition of the following provision in this Act or elsewhere in the State statutes may be in order:

"If there is no agreement or provision of law for a different rate, the interest of money shall be at the rate of six percent per annum."

Provisions of Existing Statutes Affecting Powers of Organizations

In some States provisions relating to rates of interest are intertwined with provisions relating to powers of particular types of organizations, *e.g.*, small loan and sales finance companies, commercial banks and thrift institutions. In these cases provisions should be repealed, preserved or amended to comply with Section 1.108 of this Act. As indicated in Section 1.108, provisions relating to maximum charges should be repealed in all cases (subsection (1) of Sec-

tion 1.108), provisions prescribing maximum amount or duration of any consumer credit sale or consumer loan should be repealed in statutes applicable to sellers, small loan companies, commercial banks and trust companies (subsection (2) of Section 1.108), and other provisions granting or limiting powers of organizations should be preserved (subsections (3) and (4) of Section 1.108).

Industrial Banks, Morris Plan Banks and the Like

As a result of evolutionary development industrial banks and Morris Plan banks made small loans at effective rates and in a manner similar to small loan companies but they also have power to receive deposits. In statutes providing for banks of this

type, only those provisions prescribing maximum rates and regulations of the kind applied to small loan companies should be repealed. Provisions authorizing the organization of these banks and the receipt of deposits by them should be preserved.





THE IMPACT OF A CONSUMER CREDIT INTEREST LIMITATION LAW

WASHINGTON STATE: INITIATIVE 245

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CHAPTER I

INTRODUCTION

Purpose of the Study

This research was designed to determine the economic impacts of Initiative 245. The Initiative was passed by a vote of the people of the State of Washington in the general election of November 5, 1968. Its principal provision limited the interest rate (or "service charge") which could be assessed legally on various kinds of consumer credit to 12 per cent per year computed monthly at a rate of 1 per cent per month. It related to installment plans, revolving credit plans and credit cards whether these devices were used by retailers or financial institutions. The state has a basic usury law, limiting interest to 12 per cent annually, which had been amended earlier to permit a charge of 18 per cent per year (1 1/2 per cent per month) on retail credit contracts.¹ Bank credit cards were classified in an opinion by the Washington Attorney General as "retail contracts," making them eligible for the 18 per cent charge.² Initiative 245 reduced the maximum rate on retail credit from 18 to 12 per cent.

The Initiative did not affect the rates charged by small loan companies. They still may charge 3 per cent per month (36 per cent per year) on loans under \$300, 1 1/2 per cent per month (18 per cent per year) on loans between \$300 and \$500, and 1 per cent per month (12 per cent per year) on loans over \$500. Further, since state usury laws already limited banks to 12 per cent per year--except for credit cards which have a legal status similar to other forms of retail credit--the effect on banks was the removal of the retail credit exception to the usury laws.

¹R.C.W. 63.14.120.

²"Banks and Banking--Sale--Regulation of Bank Credit Card Transactions," Attorney General Opinion 1968, No. 6, State of Washington, Olympia, Washington, February, 1968.

Study Objectives

The study set out to determine:

1. What changes in credit policies, due to management decisions, have occurred as a result of the passage of the law.
2. What price changes, if any, are related to the new law.
3. What changes stemming from the new law have occurred in retail sales patterns (such as total retail sales and cash/credit sales relationships).
4. What effects on consumers can be inferred from the information obtained.

Procedure

There were five principal elements of the study. These were (1) a survey of the literature, (2) a field survey of retailers, banks and small-loan companies utilizing personal interviews, (3) a series of price-comparison studies in which identical items were priced in Seattle and Los Angeles to determine the extent of price movements during the second quarter of 1969 with the objective of relating price changes to the law, (4) a number of surveys of aggregative data sources as a check against questionnaire responses and intra-firm data of several kinds, and (5) certain special studies to see to what extent data on topics such as credit insurance, auto dealer pricing and gross margins, auto and appliance financing methods and sales contract registrations with county auditors could provide by way of evidence of the impact of the law.

Survey of the Literature. The literature was examined for both theoretical and empirical content.

Field Survey (personal interviews) of Retailers, Banks and Small Loan Companies. This was carried out during the third quarter of 1969. The questionnaires which were used are shown in the Appendix.

The business firms surveyed were as follows: (in some cases a complete census approach was used)

1. Census of banks.
2. Census of department stores.

3. Census of chain small loan institutions and a sample of smaller ones.
4. The largest furniture and appliance stores and a sample of smaller ones.
5. Sample of new auto dealers.
6. Sample of used auto dealers.

Responses to the questionnaires were obtained through personal interviews. The specific respondents selected, by institution, were:

1. Banks: Vice President (or other title designating chief officer) for consumer credit division
2. Department Stores: Credit Manager
3. Small Loan Companies: President or Manager
4. Large Furniture and Appliance Stores: Credit Manager
5. Small Furniture and Appliance Stores: Owner or Manager
6. Large Auto Dealers: Credit Manager
7. Small Auto Dealers: Owner or Manager

When data had been gathered from these questionnaires, they were tabulated and analyzed.

Pricing Studies of Credit Sensitive Items. Working from a list of brands (by specific model numbers) prices were recorded from price books and/or sales tags on refrigerators, washing machines, dryers, cooking ranges, and colored television sets in stores in Seattle and Los Angeles. The list was made up by the comparison shopping bureau of a large retailer. The list included descriptions, brand names, model numbers, pictures and additional identification materials. Items were "shopped" in conventional department stores, Sears Roebuck and J. C. Penney department stores, discount houses and appliance stores. This procedure, which was used in the first two price surveys (April 1969 and August 1969) was found to have the weakness that too few of specific model numbers appeared in both markets. Hence in the third price survey (January 1970) a new list of specific model numbers was prepared through field work in Seattle and which permitted the identification of 30 or more models of particular appliances in both Los Angeles and Seattle markets.

Survey of Aggregative Data Sources. To determine the extent to which published and unpublished data from secondary sources verified the survey results, data were collected, tabulated and analyzed. Relevant data were obtained from the following sources:

1. Federal Agencies. In addition to a variety of publications additional information was obtained through calls on the offices of the Federal Reserve Board and the Federal Deposit Insurance Corporation.
2. State Agencies. These included all of the agencies dealing with financial institutions, retailing institutions, insurance institutions, motor vehicles and general economic information. Existing publications of the agencies were supplemented with special tabulations available from computer storage but not yet published.
3. Relevant trade associations.

The kinds of data were quite varied and in addition to the verification purpose mentioned above, were used to determine changes in local economic conditions and, for purposes of comparison, the state economy with the national economy.

Special Studies. In addition to data from the State Insurance Commissioner and insurance trade associations, data were obtained from private insurance companies involved in credit insurance. We were thus provided with data on all of the credit insurance business done in the state for 1968 and 1969.

Since two large automobile dealers were willing to open their records, a detailed study of auto dealer sales contracts was made for the periods 1968 and 1969 to determine changes that had occurred in types of credit employed, credit criteria and the credit roles of the firms involved.

One large national manufacturer of automobiles provided complete records for the state necessary to determine dealer pricing and gross margin changes. It also provided similar information on the State of Oregon which does not have a credit limitation law.

A complete tabulation of installment sale registrations was made from the records of the King County (which includes Seattle) Auditor's records. The

periods covered were the twelve months prior to December 5, 1968 (before the law took effect) and the twelve months following. These data showed the types of financial institutions involved and the firms from which purchases were made. This was followed by a re-survey of the institutions making the registrations to determine the extent to which management policies were responsible for observable trends.

Economic Environment of the Study

Ideally, for purposes of investigating the impacts of Initiative 245, the study would have been conducted in an environment in which all other economic factors would have remained somewhat equal. Unfortunately, this was not the case. Attempts to verify the statements of businessmen obtained in field interviews through analyzing external or aggregative data were made difficult by the changes in the economy other than the Initiative and its effects. The impacts which might have been expected from the change in the law were in the same direction as impacts which might be expected from the tightness and cost of money, economic recession in the area, and inflation. The first two (interest rates and recession) were strongly influenced by federal monetary policy, and the third--inflation--seemed beyond the reach of federal monetary policy during the period of the study. Hence, it is important at this point to describe the economic environment pertaining at the time of the research for this report.

There is ample evidence available on the behavior of the Washington state and the United States economies since January of 1968 to suggest that a number of highly adverse economic influences have prevailed. That is, from the point of view of the businesses in the state all costs of doing business have continued to spiral on the supply side and the growth of revenues has noticeably slackened in most sectors on the demand side.

The behavior of these elements in the economy is affected by many economic variables which add to the results from the reduction of business revenues with the imposition of a 12 per cent interest rate ceiling. Needless to say, it is difficult to sort out, quantify, and measure the pure effects of rate ceiling change when other economic factors introduce high degrees of variability.

It is the purpose of this section then to point out the behavior of several of the more indicative and influential macro-economic factors at work in the environment during the period in which this study analyzed the impacts from Initiative 245.

On the supply side the wholesale price index nationally for durables continued to climb. In January 1968 it was 103.0 for furniture and household durables and by January of 1969 it had risen to 105.3, up 2.3 points. As of June 1970, it was 108.6, up 5.6 from the beginning of the time period under study.

By the same token, the lowest possible cost of money to business (the prime rate) rose from 6.0 per cent in November 1967 to 7.0 per cent by January 1969, and to the high of 8.5 per cent on June 19, 1969. (See Table I-1.)

TABLE I-1

THE PRIME RATE

Date	Prime Rate
November 20, 1967	6.00%
April 19, 1968	6.50
September 25, 1968	6.00-6.25
November 13, 1968	6.25
December 18, 1968	6.75
January 7, 1969	7.00
March 17, 1969	7.50
June 19, 1969	8.50
March 25, 1970	8.00
September 25, 1970*	7.50

*Prediction as of September 23, 1970.

Source: Manufactures Hanover Trust Special Report,
June 1970.

This represents an increase of at least 2.5 per cent in the cost to businesses of financing inventories, trade credit and consumer credit during the study period.

On the demand side the economic indicators are as equally bleak. Tables I-2, I-3 and I-4 clearly indicate a substantial decline in buying power both at the state and national level with above average increases in the unemployment rate occurring at the state level. While the unemployment rate increased through 1969 at the state level it remained quite stable through 1969 at the national level. When both 1968-1969 and 1969-1970 changes are compared for Washington state it is found that while the unemployment rate in 1969 was only 4.09 in January of 1968, it was 4.65 in 1969 and continued to rise to 5.29 in January of 1970.

There is evidence that unemployment rates might be worse if businessmen reacted more strongly to their problems. The Seattle-First National Bank Newsletter in mid-1970 stated:

Everyone talks about higher costs (labor) and the squeeze on profits; inventories are being closely controlled and staff has been reduced here and there; quite a number of retail establishments have absorbed cost increases; the consumer is getting a break.¹

Since the beginning of the study the state unemployment rate has always been higher and climbing at a faster rate than that of the national average. Hence, the impact on demand of goods and services could conceivably be quite large.

The Consumer Price Index (Tables I-5, I-6 and I-7) reflect the behavior of prices in the Seattle area when compared with the U.S. average. Traditionally, Seattle indices are higher than national averages. As demand slackens it is to be expected that the state and national indices will more nearly equate and that occurred in early 1970 (see Table I-5). Throughout the period of the study the Seattle consumer price index for all goods has declined relative to U.S. averages to reflect the depressed demand situation that faces state businesses.

¹Seattle-First National Bank, *Summary of Pacific Northwest Industries*, July, 1970, p. 4.

TABLE I-2

WAGE AND SALARY EMPLOYMENT
WASHINGTON AND UNITED STATES

Month	1968		1969				1970			
	Wash.	U.S.**	Wash.	Per Cent Change Over 1968	U.S.**	Per Cent Change Over 1968	Wash.	Per Cent Change Over 1969	U.S.**	Per Cent Change Over 1969
January	1086.5	66720	1113.8	+2.5	69199	+3.7	1138.7	+2.2	70992	+2.6
February	1088.6	67165	1114.4	+2.4	69487	+3.5	1131.8	+1.6	71135	+2.4
March	1089.9	67286	1123.6	+3.1	69710	+3.6	1114.3	-0.8	71256	+2.2
April	1086.8	67466	1125.2	+3.5	69992	+3.7	1108.0	-1.5	71163	+1.7
May	1092.0	67550	1128.5	+3.3	70172	+3.9	1097.4	-2.8	70852	+1.0
June	1094.6	67816	1128.8	+3.1	70347	+3.7	1086.8	-3.7	70598	+0.4
July	1102.7	67945	1126.2	+2.1	70400	+3.6	1082.3	-3.9	70455	+0.1
August	1108.6	68088	1123.9	+1.4	70497	+3.5	n.a.		n.a.	
September	1105.9	68195	1127.0	+1.9	70567	+3.5	n.a.		n.a.	
October	1109.7	68427	1129.0	+1.7	70836	+3.5	n.a.		n.a.	
November	1112.2	68664	1129.0	+1.5	70808	+3.1	n.a.		n.a.	
December	1116.1	68875	1128.8	+1.1	70842	+2.9	n.a.		n.a.	

*Thousands of persons

**Adjusted

Source: Washington: Washington State Employment Security Department. United States: *Economic Indicators*, Dates.

TABLE I-3

UNEMPLOYMENT*
WASHINGTON AND UNITED STATES

Month	1968		1969				1970			
	Wash.	U.S.	Wash.	Per Cent Change Over 1968	U.S.	Per Cent Change Over 1968	Wash.	Per Cent Change Over 1969	U.S.	Per Cent Change Over 1969
January	55.4	2795	64.7	+16.8	2645	-5.4	75.6	+16.8	3172	+19.9
February	55.2	2929	66.5	+20.5	2627	-10.3	80.6	+21.2	3427	+30.5
March	57.4	2881	62.0	+8.0	2728	-5.3	97.8	+57.7	3657	+34.1
April	59.4	2774	61.2	+3.0	2845	+2.6	98.2	+60.5	3948	+38.8
May	59.8	2810	62.7	+4.8	2809	+0.0	117.7	+87.7	4106	+46.2
June	61.4	2914	63.7	+3.7	2763	-5.2	119.3	+87.3	3900	+41.2
July	59.7	2897	65.1	+9.0	2858	-1.3	129.8	+99.4	n.a.	
August	58.8	2776	69.3	+17.9	2846	+2.5	n.a.		n.a.	
September	59.3	2847	72.4	+22.1	3131	+10.0	n.a.		n.a.	
October	59.4	2798	74.6	+25.6	3078	+10.0	n.a.		n.a.	
November	60.8	2654	77.8	+28.0	2851	+7.4	n.a.		n.a.	
December	59.0	2603	76.5	+29.7	2846	+9.3	n.a.		n.a.	

*Thousands of persons, seasonally adjusted.

Source: Washington: Washington State Employment Security Department. United States: *Economic Indicators*, Dates.

TABLE I-4
 UNEMPLOYMENT RATE*
 WASHINGTON AND UNITED STATES

	1968		1969				1970			
	Wash.	U.S.	Wash.	Change	U.S.	Change	Wash.	Change	U.S.	Change
January	4.09	3.5	4.65	+0.56	3.4	-0.1	5.29	+0.64	3.9	+0.5
February	4.06	3.8	4.77	+0.71	3.3	-0.5	5.64	+0.87	4.2	+0.9
March	4.21	3.7	4.43	+0.22	3.4	-0.3	6.86	+2.43	4.4	+1.0
April	4.35	3.5	4.35	+0.00	3.5	+0.0	6.95	+2.60	4.8	+1.3
May	4.38	3.6	4.47	+0.09	3.5	-0.1	8.36	+3.89	5.0	+1.5
June	4.46	3.7	4.55	+0.09	3.4	-0.3	8.53	+3.98	4.7	+1.3
July	4.36	3.7	4.66	+0.30	3.5	-0.2	9.19	+4.53	5.0	+1.5
August	4.29	3.5	4.93	+0.64	3.5	0.0	n.a.		5.1	+1.6
September	4.31	3.5	5.14	+0.83	3.8	+0.3	n.a.		n.a.	
October	4.31	3.5	5.29	+0.98	3.8	+0.3	n.a.		n.a.	
November	4.39	3.4	5.49	+1.10	3.5	+0.1	n.a.		n.a.	
December	4.26	3.3	5.39	+1.13	3.5	+0.2	n.a.		n.a.	

*Seasonally adjusted.

Source: Washington: State Employment Security Department. United States: Bureau of Labor Statistics.

TABLE I-5
 CONSUMER PRICE INDEX--
 WASHINGTON AND UNITED STATES

	1968		1969		1970	
	Seattle	U.S.	Seattle	U.S.	Seattle	U.S.
February	120.2	119.0	125.9	124.6	132.2	132.5
May	121.1	120.3	127.6	126.8	133.9	134.6
August	123.2	121.9	129.5	128.7	n.a.	n.a.
November	124.5	123.4	130.0	130.5	n.a.	n.a.

Source: U.S. Department of Labor, Bureau of Labor Statistics, The Consumer Price Index 1968, 1969, 1970.

TABLE I-6

CPI--HOUSEHOLD FURNISHINGS AND OPERATION*
SEATTLE AND UNITED STATES

	1968		1969		1970	
	Seattle	U.S.	Seattle	U.S.	Seattle	U.S.
February	109.4	111.2	112.7	115.8	116.3	120.8
May	110.9	112.5	113.3	117.4	117.4	122.5
August	110.5	113.3	113.2	118.5	n.a.	n.a.
November	112.0	114.8	114.5	119.6	n.a.	n.a.

*The household furnishings and operation category of the CPI includes the following items: Household furnishings (textiles, furniture and bedding, floor coverings, appliances, housekeeping supplies and services).

Source: U.S. Department of Labor, Bureau of Labor Statistics, The Consumer Price Index 1968, 1969, 1970.

TABLE I-7

CPI--PRIVATE TRANSPORTATION *
SEATTLE AND UNITED STATES

	1968		1969		1970	
	Seattle	U.S.	Seattle	U.S.	Seattle	U.S.
February	119.2	116.4	121.1	119.3	123.3	123.3
May	118.4	116.8	120.0	121.2	124.0	125.9
August	120.7	117.7	121.8	121.3	n.a.	n.a.
November	121.1	118.9	119.3	122.7	n.a.	n.a.

*The private transportation category of the C.P.I. includes new and used autos, gasoline, tires, oil, repairs, insurance, registration, parking fees.

Source: U.S. Department of Labor, Bureau of Labor Statistics, The Consumer Price Index 1968, 1969, 1970.

TABLE I-8

GENERAL ECONOMIC INDICATORS
WASHINGTON VS. UNITED STATES

		1968		1969				1970			
		Wash.	U.S.	Wash.	U.S.	1968 vs. 1969 Per Cent Change		Wash.	U.S.	1969 vs. 1970 Per Cent Change	
						Wash.	U.S.	Wash.	U.S.	Wash.	U.S.
Bank Loans (Millions \$)	1st Qtr	2675	233570	3089	264970	+15.5	+13.4	3321	288230	+7.5	+8.8
	2nd Qtr	2759	244580	3179	283850	+15.2	+16.1	3314	293280	+4.2	+3.3
	3rd Qtr	2886	251920	3184	284300	+10.3	+12.9				
	4th Qtr	2972	265259	3222	295547	+8.4	+11.4				
Bank Debits (Millions \$)	1st Qtr	58058.0	7218700	67446.3	8723500	+16.2	+20.8	69979.3	9842900	+3.8	+12.8
	2nd Qtr	57974.8	7948500	76666.7	9384800	+32.2	+18.1	69650.6	10143900	-9.2	+8.1
	3rd Qtr	62831.1	8368400	83657.8	9737200	+33.1	+16.4				
	4th Qtr	67118.1	8755800	73561.4	9560400	+ 9.6	+ 9.2				
Demand Deposits (Millions \$)	1st Qtr	2091	168420	2139	180610	+ 2.3	+ 7.2	2209	189230	+3.3	+4.8
	2nd Qtr	2055	182807	2190	199426	+ 0.5	+ 9.1	2109	190110	-3.7	-4.7
	3rd Qtr	2111	179020	2137	188160	+ 1.2	+ 5.1				
	4th Qtr	2200	204911	2169	212760	- 1.4	+ 3.8				
Time Deposits (Millions \$)	1st Qtr	2157	n.a.	2342	n.a.	+ 8.6		2340	n.a.	-0.1	
	2nd Qtr	2190	n.a.	2362	n.a.	+ 7.9		2439	n.a.	+3.3	
	3rd Qtr	2265	n.a.	2320	n.a.	+ 2.4					
	4th Qtr	2317	n.a.	2313	n.a.	- 0.2					
Personal Income (Millions \$)	1st Qtr	968	55195	1062	59948	+ 9.7	+ 8.6	1120	64168	+5.5	+7.0
	2nd Qtr	1013	57236	1110	62263	+ 9.6	+ 8.8	1140	65000	+2.7	+4.4
	3rd Qtr	1045	58455	1137	62290	+ 8.8	+ 6.6		(est.)		(est.)
	4th Qtr	1058	59755	1136	64032	+ 7.4	+ 7.2				

TABLE I-8 (Continued)

		1968		1969				1970			
		Wash.	U.S.	Wash.	U.S.	1968 vs. 1969		Wash.	U.S.	1969 vs. 1970	
						Per Cent Change				Per Cent Change	
Help Wanted	1st Qtr	208	194	218	231	+ 4.8		186	194	-14.7	
Index-Seattle	2nd Qtr	182	197	235	228	+29.1		186	175	-20.9	
vs. U.S.	3rd Qtr	207	218	204	235	- 1.4					
1957-59 = 100	4th Qtr	220	225	199	217	- 9.5					
Building Permit	1st Qtr	99.1		80.2		-19.1		68.2		-15.0	
Seattle-King	2nd Qtr	102.0		108.2		+ 6.1		64.5		-40.4	
County Only	3rd Qtr	99.4		78.6		-20.9					
(Millions \$)	4th Qtr	98.6		79.7		-19.2					
Mortgages	1st Qtr	8698		7709		-11.4		4698		-39.1	
Recorded	2nd Qtr	10785		9013		-16.4		5127		-43.1	
King County	3rd Qtr	9688		7051		-27.2					
(by number)	4th Qtr	8864		6054		-31.7					
Deeds Recorded	1st Qtr	10601		12328		+16.3		10054		-18.4	
King County	2nd Qtr	11906		14613		+22.7		10526		-28.0	
(by number)	3rd Qtr	12771		13346		+ 4.5					
	4th Qtr	13950		11678		-16.3					

Source: Economic Research Department, Seattle First National Bank, Economic Indicators, Federal Reserve.

Table I-8, which lists a variety of indicators, further supports the decline in demand proposition and in a number of instances where the U.S. rates are up substantially the state rate is significantly declining. A case in point is demand deposits where in March of 1969 deposits had increased 2.3 per cent in Washington and 7.2 per cent for the U.S. In December of 1969 demand deposits had declined to 1.4 per cent below that of 1968 and the national figure remained 3.8 per cent above demand deposit levels in 1968.

A basic problem in utilizing financial data such as appear on Table I-8 is that some of the adjustments which have been made by businessmen have been in the form of what might be called "credit portfolio adjustments." That is, businessmen in many cases changed internally the relative proportions of various types of credit business (such as open book, installment credit, revolving credit, and credit card sales). Such changes may not be visible in general economic data. For example, the recorded figures for volumes of business done by banks and/or consumer finance companies might show little change in total, even though relatively drastic measures affecting consumers might have been taken by the financial institutions. Financial institutions have tightened up on credit-granting procedures, which has taken certain consumers out of the market for some intended purchases. At the same time, the efforts of retailers to decrease their credit costs might have shifted more credit business to the financial institutions, thus keeping up the volume of loans made by financial institutions. These counter-balancing actions on the part of the two groups of businessmen might result in a fairly stable aggregative figure for loans from financial institutions even though there may have been some serious effects on consumers who happened to be marginal credit risks. By the same token, an increase or a decline in aggregative volume would not necessarily warrant conclusions that any such changes resulted from Initiative 245, because:

1. The portfolio adjustments might be invisible,
2. The portfolio adjustments and other responses might have been in reaction to money supply or interest rate increases, or
3. The portfolio adjustments (which in the current period would tend to diminish volumes of loans by financial institutions)

might be counterbalanced by shifting of the credit burden from retailers to financial institutions or--to some extent--by the shifting of the credit burden from one financial institution to another (e.g., from banks to consumer finance companies).

Table I-8 points out many other such declines that are indicators of the behavior of the marketplace which directly or indirectly affect the ability of businessmen to perform in their economic environment. Further, the impacts of these economic changes are bound to be felt throughout the state economy.

In summary, the general economic environment has contributed many complexities and introduced a number of barriers to the drawing of firm conclusions from available external economic data concerning Initiative 245. Whereas, the nation moved into a recession during the period of the study, full-blown depression struck at the state of Washington. The anomaly of a depression at a time of inflation and high interest rates wiped out the neat condition of "all other things being equal" which economists like to see when studying specific issues.

Hypotheses

Based on the theoretical knowledge of the researchers, supplemented with a consideration for theoretical and empirical research into credit limitation laws, the following hypotheses were developed for the original study. As a result of the credit limitation law it was hypothesized that:

Prices of merchandise frequently sold on a credit basis have gone up.

Leasing of similar merchandise has increased.

Banks and merchants are doing less business on a credit basis.

Lenders are diverting business to the most profitable types of loans or credit arrangements.

Small-loan companies are doing more business.

Credit losses have decreased.

Different products and businesses have been affected in different ways by the new laws.

More poor people have been affected by the new law than middle or upper income people.

Marginal credit standing has been redefined to exclude some higher risks.

Some people have not been able to buy such products as used cars because of the law (sales have been adversely affected).

Financing charges other than interest rates have increased.

Businessmen have become more strict in the application of rules on delinquent accounts.

Organization of the Report

The balance of this report is divided into four chapters. Chapter II is a summary of the findings. Chapter III presents the relevant prior research. Chapter IV deals with the credit implications of the law and Chapter V covers the product related impact of the law. Following a brief concluding chapter, the Appendix includes a definition of terms and the questionnaires used in the field interviewing program.

CHAPTER II

SUMMARY OF FINDINGS

Scope of This Summary

This summary reports on findings from the survey of retailers, financial institutions and secondary sources of information.

The retail survey included the sixty-five retailers in the State which do the vast majority of business in credit-sensitive ("big-ticket") merchandise. The survey also covered all of the chain banking units in the state, banks in cities of 10,000 or more population, a sample of single-unit banks in smaller towns, all chain consumer finance companies and a sample of smaller firms, a sample of other financial institutions, a sample of auto dealers selling both new and used cars, and a sample of auto dealers selling only used cars. The managements of these institutions were interviewed as to the actions that they had taken in response to Initiative 245.

The implications for consumers are drawn from the changes businessmen made. The feasibility of surveying consumers was tested, but the results indicated that useful information could not be readily or easily obtained from this source. An opportunity existed to determine the accuracy of the consumer responses that were obtained and it was found that these responses were grossly undependable.

In addition to the survey of businessmen, the research involved the study of secondary sources of information in an attempt to verify or negate the kinds of conclusions which might be drawn from the survey. Data were gathered from federal, state and local governments, national finance and merchandise firms operating in the state, individual firms which volunteered to provide information, and previous studies. The government data of course covered all units (for example, all commercial banks, all savings institutions, all credit unions, all consumer finance companies and all retailers including auto dealers).

Based on the field interview results, the verification studies, and the analysis of the information available from all sources, certain conclusions

seem warranted. For purposes of exposition, the brief statements of this summary are organized under the following headings:

Availability of credit

Price of credit

Price of products and services

The conclusions take the form of series of statements concerning impacts and changes occurring after the passage of Initiative 245 followed by selections from the research data which support the statements.

Availability of Credit

Since Initiative 245 reduced the income retailing and financial institutions could achieve from credit charges, they could be expected to make up their loss of income by either reducing costs related to retail credit transactions or by developing new sources of income to compensate for the loss--or some combination of these actions. A prime potential for reducing a retailer's costs is to reduce risk through restricting his own credit granting, by switching consumers from more expensive (for the retailer) to less costly types of credit, and by sending consumers to some other source of credit. There is evidence of all three forms of risk and cost reduction and the net effect of these actions appears to have been a reduction in the availability of retail credit.

Consumers considered "marginal" or "slow pay" credit risks are increasingly being rejected when they apply for retail credit financing

Sixty-six per cent of the sample of retailers report that they now must reject applicants whom they would have accepted prior to Initiative 245.

Credit application rejection rates of retailers increased by an average of 9 per cent in 1969 as compared with 1968.

The increase in rejection rates for bank credit card applicants was 4.1 per cent for 1969, but the increase was much higher in the last half of the year, averaging 8.6 per cent and reaching 13 per cent in December.

Forty-two per cent of the auto dealers reported an increase of 14 per cent in the rejection rate (on both new and used cars) of credit applications in 1969 over 1968.

New customers for bank credit cards are given lower credit lines than those granted prior to Initiative 245.

Credit lines represent lower percentages of consumers' incomes. Acceptance criteria (such as length of time on the job, or in the city) have also been strengthened.

Many customers, who might have obtained "open book" (or free) credit prior to Initiative 245 now are unable to get such credit and must use revolving or instalment forms of credit instead.

Of 47 retailers offering open book credit prior to Initiative 245, 17 per cent have eliminated this form of credit.

An additional 13 per cent have cut 60- and 90-day open-book accounts to 30 days, after which maximum interest is charged.

Of the total 65 retailers, 43 per cent have encouraged consumers to switch from one type of credit to another. Over 50 per cent of furniture and appliance dealers have encouraged consumers to switch from using their credit to cash sales.

Consumers are often being asked by retailers to get outside financing for their purchases of durables.

Financing from outside sources become cash sales for retailers. The sources to which consumers are turning include credit unions, banks, and small loan companies.

Among auto dealers, 13 per cent report advising consumers to arrange their own financing. They reported an increase in the practice of "mousing" (consumers putting together multiple small loans either to make a downpayment or pay in full to the dealers).

Retailers in the sample show an average decrease of 3.8 per cent in the ratio of credit to total sales in 1969 as compared with 1968 (first quarter). Changes in the ratio of credit to total sales were reported by 26.2 per cent of the retail merchants in the sample. Of these 7.7 per cent reported an average increase in the ratio of 6.8 per cent, with a range of +1 to +20 per cent increase. However, 18.5 per cent reported an average decline of 13.4 per cent, with a range of -1 to -30 per cent decline.

Some marginal credit risk consumers, formerly able to get credit, now must forego making purchases of products that require loans.

These consumers have been taken out of the market because of an inability to borrow from any source on terms that would permit them to handle repayments out of future income.

The Price of Credit

Some of the ways in which retailers can reduce their risks or recover the credit income losses incurred with the passage of Initiative 245 can involve higher costs to consumers. The switch from open book to revolving credit can mean a consumer pays interest charges which he did not pay before. If a consumer must go to a small loan company, he will pay as high as 36 per cent annual interest, as opposed to the 12 per cent he would pay if he received retail or bank credit, or the 18 per cent he might have paid for revolving credit prior to Initiative 245. If a consumer must pay a higher downpayment, and/or if loan maturities are shortened, he may be forced to forego purchases he otherwise could afford. If fees other than interest charges are raised, and if consumers must pay charges (such as filing fees and insurance premiums) not required prior to Initiative 245, the finance-related costs to him may increase despite the attempt of the law to reduce interest charges.

Some low risk consumers are paying more for purchases made on credit.

By means of switching customers from open book to revolving credit plans retailers have passed on higher credit costs to low-risk customers who were previously being subsidized by cash customers and users of other credit plans (instalment and revolving).

Consumers now pay an increased minimum service fee on revolving accounts.

In some cases consumers are charged the minimum revolving credit fee of one dollar on a purchase if their balances are less than \$50 and greater than \$2.

In a number of cases, retailers and banks have instituted minimum service fees or increased existing fees since passage of Initiative 245. (The law allows a service charge of \$10 as an alternative to computing the 1 per cent per month on balances.)

Some creditworthy consumers who bought on credit before and after the passage of the Initiative may have benefited from the law.

To the extent that price adjustments on merchandise usually bought on credit may not have been large enough to balance the consumers' savings in interest payments due to the reduction from 18 per cent to 12 per cent per year in the cost of credit, credit customers may have gained.

Price adjustments which were made were not necessarily made on the specific merchandise sold on credit. In fact, the majority of

respondents to the interview survey reported that they raised prices on all merchandise. By this means they could recover losses in credit income without raising prices just on those items frequently sold on a credit basis. This could provide creditworthy customers a net reduction in total cost (including interest costs) for goods bought on credit.

To the extent that retailers may have become more efficient in response to credit income losses, consumers in general may have benefited.

The reduction in gross profit margins due to the reduction in interest rates has also probably worked to the advantage of consumers by encouraging businessmen to strive for greater efficiency in their operations.

Businessmen have to some extent improved procedures and reduced waste in order to achieve cost reductions and thereby re-establish the gross profit margins in effect prior to the passage of the law.

Cash customers of stores selling credit items are in all likelihood paying somewhat higher prices but receiving no benefits.

The actions of retailers to raise prices, to institute new or higher charges for ancillary services, and to increase gross margins through adjustments in merchandise offerings will increase net costs to cash customers. Those persons who were on open book accounts prior to the passage of the law and who are still in the same category have been effected in essentially the same manner as have cash customers.

Consumers considered to be marginal credit risks may now pay more for money that they borrow.

Banks and merchants will no longer grant credit or, in effect, lend to them at the new lower rates, hence they may have to obtain funds from small loan companies (at rates up to 36 per cent) or from illegal lenders (at unlimited rates).

Retailers have moved to shorten maturities to reduce risks and the costs of selling sales contracts.

In selling paper, retailers have had their situation change from 2 per cent participation to 2 per cent discount per year on the average. They shorten maturities to lessen discount costs.

Among auto dealers, 18 per cent reported shortening maturities by an average of six months.

Consumers are having to pay higher downpayments on durable goods purchases.

Sixty per cent of auto dealers reported an average increase of downpayments on new cars of 11 per cent and 15 per cent for marginal credit risk buyers.

Sixty-nine per cent of the used car dealers surveyed increased downpayments an average of 21 per cent, but downpayments for marginal risk buyers were raised 31 per cent.

More consumers who make instalment contracts are being asked to purchase credit life and credit health and accident insurance.

There was an increase of 20 per cent in the number of retailers requiring credit insurance.

Retailers and banks not only reduce their risk with credit insurance, but they derive revenue from premiums amounting to 40 per cent of the premium as well.

Thirty-five per cent of the auto dealers state they have been "pushing credit insurance harder" since Initiative 245 became law.

Price of Products

The most direct means for retailers to recover the credit earnings lost due to Initiative 245 is to raise prices on the products usually bought on credit. If the market permits, this approach probably also is easiest of the various alternatives open to them. Another approach is to raise the prices on all merchandise in a store. The effective net price of the product to the consumer may also be raised by raising the price for ancillary services, or instituting charges for services which formerly were free. A third method of raising the net price to the consumer is to lower the discounts given for trade-ins in businesses where trade-ins are appropriate. Evidence of all of these approaches to increasing revenue were found in the study.

In one form or another consumers are paying higher prices for merchandise as a result of Initiative 245.

The majority (56 per cent) of retailers said that they raised prices on all merchandise on the average of 5 per cent in response to the passage of Initiative 245.

Sixty-four per cent of furniture and appliance dealers said that they raised prices on "credit-sensitive" items. Thirty-one per cent of department stores said that they did the same.

Several retailers stated that they were adjusting their merchandise offerings to obtain higher average mark-ups than existed prior to Initiative 245.

Forty-three per cent of auto dealers reported raising prices (net realized price) on new cars. Those that reported the magnitude had increases averaging 5.3 per cent.

Forty-one per cent of used car dealers reported raising prices. The average increase of those reporting the magnitude of increase was 11 per cent. Checking auction prices showed that wholesale prices of one-year old cars increased by 5 per cent in 1969 compared with 1968 in both Seattle and Denver. Six-year-old cars, however, are significantly lower priced in Seattle than in 1968-- and are significantly lower than prices in Denver. This suggests that dealer margins increased percentage-wise on older used cars.

A special compilation of dealer margins covering 15 per cent of used cars sold in Washington in 1968 and 1969 (entire years) showed an increase of dealer gross margins of 13 per cent in 1969 over margins received in 1968.

Some retailers have instituted fees for services which were given to the consumers free of charge prior to Initiative 245.

The product-related fees for services formerly furnished free of charge have been assessed on check cashing, wrapping and packaging, lay-away, parking (in some cases parking fees were simply increased), delivery and product installation.

Tentative Conclusions

On the basis of the evidence that we have gathered, a number of conclusions appear warranted.

The low-income people who are marginal credit risks seem to have suffered the most so far from the enactment of Initiative 245. Since prices have been raised, customers who pay cash have suffered. At the time of the surveys (summer, 1969), the burden of supplying a service (credit), the cost of which may exceed the price that can be charged for it, seemed to have fallen on the merchants and possibly the banks. The merchants and banks had taken some steps to maximize their revenue, given the constraints under which they must work,

but they did not have a great deal of leeway. They also appeared to have made efforts to reduce their costs, but once again there appear to be significant limits to what can be done along these lines. The merchants and banks seem to be placing their main hope in raising the rate that they can charge. If this does not materialize, it seems to us that the banks and merchants will have to take what might be called drastic actions and these actions would, in all likelihood, have an adverse affect on a significant number of borrowers and cash buyers. We anticipate that these drastic steps would involve price rises, tighter restrictions and decisions not to do business on a credit basis for small sums (i.e., something less than \$200, \$300 or \$500 per transaction or per year). Buyers in this category would be encouraged to borrow directly from personal finance companies, credit unions or other financial institutions. In fact, merchants might very well decide to get into the small-loan business, since it can be handled profitably.

It seems unlikely that merchants will be able to institute dramatic price increases in order to make up for the revenues lost as a result of the imposition of the 12 per cent rate ceiling. If they were to do this, they would put themselves at a disadvantage on readily comparable merchandise vis-a-vis those merchants who stress cash sales, which, of course, could be consummated at lower prices. Rather, it is likely that merchants will opt for a combination of moves including some price raises, adjustment of credit portfolios and merchandise assortments, tightening credit-granting criteria and raising charges or instituting new charges on ancillary services.

It seems to come down to this: the resolution of the banks and merchants' dilemma calls for drastic action on their part in the face of the very substantial decline in the interest rates (service charges) that they are allowed to charge their customers. Banks and merchants have taken many of the small steps that can be taken but their basic problem is still unresolved because its solution requires more than that. Some consumers (notably, the credit-worthy) may be benefiting as a result of the inertia that banks and merchants have displayed since Initiative 245 became law. One of two things has to happen. The rate ceiling will have to be raised or banks and merchants will have to reduce costs and/or increase revenues from other sources.

CHAPTER III

RELEVANT PRIOR RESEARCH

The General Importance of Interest Rates

Economists always have favored a free market for money or credit as well as for products and services. As Milton Friedman has said: (commenting on the writings of Jeremy Bentham in 1787 in which Bentham opposed interest limitation laws)

I know of no economist of any standing from that time to this who has favored a legal limit on the rate of interest that borrowers could pay or lenders receive--though there must have been some. I know of no country that does not limit by law the rates of interest--and I doubt that there are any.¹

This quotation highlights a problem that is basic to this study. Economists regard interest rates as a regulating mechanism in a free market economy and think they should be free to respond to market forces; government bodies, on the other hand (even those which strive for free market prices in general), tend to set legal limits on the price (interest rate) which may be paid or received on money or credit. These limits are set for political and generally non-economic reasons although justification of such acts are usually couched in economic terms.

The theoretical essence of the economic issue involved in legal limitations on interest is rather simple and straightforward. It is that regulating the price of one key component in a market economy inevitably causes dislocations in the system and results in misallocations of resources.

The importance of the role of interest rates in an economy can be seen in macro economics (i.e., economics of the total economy) where there is general agreement that interest rates affect not only the monetary system, but the rest

¹Milton Friedman, "On Defense of Usury," *Newsweek*, April 6, 1970, p. 79.

of the economy as well. The usual measure of the status of a total economy is the Gross National Product for the nation. On the expenditure side, it includes consumption (which usually accounts for nearly two-thirds of GNP), business investment (plant and equipment plus net change in inventories--called "Gross Private Domestic Investment"), government expenditures (federal, state and local) and net exports (exports minus imports). The first "general theory" to describe the total economic system was that of J. M. Keynes. Although arguments have raged concerning Keynesian economics, if certain additional factors (such as stocks of money and real assets and varying employment levels) are added to the Keynesian system, it is quite compatible with classical economics. In simplified form, Keynes related key factors in an economy as follows:

With the supply of money given:

Money Supply is equal to the Demand for Money (Liquidity Preference) applied to the Interest Rate and Income.
(Money Supply and Demand for Money in relation to each other determine the Interest Rate.)

Consumption is a function of Income and the Interest Rate.

Investment is a function of the Interest Rate and Consumption.

Consumption plus Investment equals Income.

In practical terms, this means that consumption expenditures can be increased by decreases in the rate of interest or decreased by increases in the rate of interest that consumers must pay, all other things being equal. Since the total economy really revolves around consumption expenditures, and business investment is derived from consumption spending (i.e., businessmen raise or lower investment according to their perceptions as to whether the markets for their goods and services are going up or down), it is clear that interest rates can affect the total economy through inducing gains or declines in consumer buying activity. Likewise, in a free market, declines in expenditures induced through high interest rates tend toward reducing interest rates. The lower interest rates then induce higher expenditures. Thus, interest rates can play an adjustment, or equilibrating, role in the economy.

In practical terms, low interest rates also induce business investment. A businessman who has determined that there is an additional market for his products will evaluate the desirability of additional investment to handle this market. He will try to estimate the "marginal efficiency of capital," or the return on investment, and if there is a chance that the estimated return will be negated or seriously reduced by the cost of the money necessary for making the investment, the investment will not be made.

The Purpose of Interest Limitation Laws

Each law or regulation on interest strives to favor one side of, or one party to, a financial transaction. For example, the typical usury law is intended to benefit the borrower (or, in the case of consumer credit, the purchaser of goods and services). Since such a law usually takes the form of setting a fixed interest percentage rate, or fixed scale of rates, it necessarily disregards the overall supply of, and demand for, money or credit. Further, it disregards the cost of money to the lenders and the non-interest costs (such as higher prices and extra charges) to borrowers. A usury law in one state cannot control rates in other states and, even more important, it does not control prices of goods and services. Since money is mobile, it can move to other states at the expense of businesses and consumers in the state with the usury law in question. And since prices of goods and services are, in general, not controlled, they can be adjusted to make up for the costs or losses due to limitations on interest on credit--again at the expense of businesses and consumers in the state with particular laws.

As in the case of laws, limits on interest which are set by regulation have similar weaknesses. The current Federal Reserve regulation which limits the interest commercial banks can pay for deposits to 4½ per cent for small savers and 7 per cent for \$100,000 depositors disregards supply, demand and costs (although the higher rate for large deposits presumably is based on economies of scale). Such limits may tend to favor banks by restraining competition for funds, but a bank which needs funds and can afford to pay depositors higher rates is unable to do so. In a market where potential bank depositors can earn much more through other forms of employment of their funds, the Federal Reserve regulations may impair the banks' supply of money. Further,

the interest limitation on savings is at the expense of the depositor, particularly the small saver who does not have feasible alternatives for earning a better return on his funds, and contributes to inflation by discouraging saving. One economist has commented on this problem as follows:

Controls on rates payable by financial agencies ignores the welfare of savers who invest through these agencies. Such savers perform a vital function in the economy. Rate controls deny many low income savers the right to a competitive loanable funds market. High income savers can bypass the controlled market by investing in equities, etc., but if rate controls cause them to divert funds or to lose interest income, their contribution to economic product is reduced.¹

The Effectiveness of Interest Limitation

But the most serious limitation of the powers of interest limitation laws or regulations is that none of them, nor all of them together, really can control the price of money or credit. Taken individually, they control only a portion of particular transactions: the portion which formally states an interest rate. But in any such transaction, the true price of money or credit can exceed the legal limit one way or another. For example, in a mortgage transaction, the lender can capture a higher rate than specified by government regulation by means of "discounting" the loan. In a commercial loan, the bank can insist on a "reserve" (or compensating balance) on a loan which effectively raises the rate on the money actually received by the borrower. On a consumer credit purchase, the seller can raise the price of goods or services, he can increase the charges for peripheral services and/or add new charges, he can reduce the allowance on trade-ins where trade-ins are accepted, he can change his assortments of goods to increase his average gross margin, and he can insist on life and/or disability insurance which raises the cost of credit to the consumer and increases the "credit" earnings of the seller. If the interest limitation causes the seller to refuse any longer to deal in credit, or to refuse credit to increased proportions of "marginal credit risks,"

¹Clifton B. Luttrell, "Interest Rate Controls--Perspective, Purpose and Problems," Review-Federal Reserve Bank of St. Louis, September, 1968, Reprint Series No. 32.

consumers may be sent by suggestion or necessity to a financial institution to negotiate a direct loan. Since some of these institutions, for example, can legally charge up to 36 per cent annual interest, the consumer protection motive of the interest limitation law is thwarted and the consumer may end up paying higher interest than he paid prior to the interest limitation law or regulation.

Paul A. Samuelson has pointed out that in setting ceilings too low on small loan interest rates, funds for the poor may even become unavailable or are supplied by loan sharks at very high interest rates:

The concern for the consumer and for the less affluent is well taken. But often it has been expressed in a form that has done the consumer more harm than good. For fifty years the Russel Sage Foundation and others have demonstrated that setting too low ceilings on small loan interest rates will result in drying up legitimate funds to the poor who need it most and will send them into the hands of the illegal loan sharks. History is replete with cases where loan sharks have lobbied in legislatures for unrealistic minimum rates, knowing that such meaningless ceilings would permit them to charge much higher rates.¹

Since questions might be raised concerning the setting of a relatively high rate ceiling as would be the case under the Uniform Consumer Credit Code, or allowing the market to set its own rate, it is significant that a study of actual rates charged by two large finance companies operating in several states suggested that the high ceiling would not necessarily cause rates all to move to that ceiling. Robert Johnson reported that:

In states where the ceiling rates were \$6 per \$100 of unpaid balance per year, almost 18 per cent of the contracts were at the ceiling. In contrast, where the ceiling was \$9 per \$100 per year, less than 2/10ths of one per cent of the contracts were at the ceiling.²

Blitz and Long point out that historically there have been three objectives of usury legislation: ". . . protecting the small borrower

¹Paul A. Samuelson, statement in *Major Statements in Support of the Uniform Credit Code Filed with the Massachusetts Committee on the Judiciary, January 29, 1969* (Boston: National Conference of Commissioners on Uniform State Laws, Chicago, Illinois, 1969), p. 32.

²Robert W. Johnson, "Why Rate Ceilings in the U.C.C.C.?" *Industrial Banker*, March, 1969, p. 18.

. . . curbing the monopoly power of the creditor . . . and regulating the allocation of resources. . ."¹ They conclude that on the first issue ". . . it is not possible to determine a priori which group of borrowers will be the main beneficiaries. . ." On the second, they argue that usury legislation is "not particularly effective" in control of a credit monopolist "when the monopolist is free to discriminate in a nonhomogeneous market."² On the allocation of resources issue, they feel that capital markets are affected by interest regulation in a manner that is "mostly other than intended and frequently adverse." On the question of resource allocation they point out:

A well-functioning capital market is likely to promote change, while a capital market encumbered by an enforced interest rate of zero is more in keeping with stagnation. In the latter system there is no interest-rate differential to attract capital to the more dynamic sectors of the economy. . . Recognizing that usury legislation may be aimed toward other goals, we would still point out that, in periods of rapid change, restraints on the price system, such as a ceiling interest rate, are likely to be a barrier to the efficient allocation of resources and to growth.³

The nature of the inefficiency is brought out by Clifton B. Luttrell in this quotation from an article in the *Review* of the Federal Reserve Bank of St. Louis:

All ceilings which alter normal flows of funds retard economic growth. Low usury ceilings prohibit the higher rates necessary to offset the higher risks of business and individual innovators. Credit tends to be channeled into well-established, low-risk functions. Low ceilings on rates payable by financial agencies tend to restrict the flow of funds through usual credit channels. Loan funds supplies are thereby reduced, affecting borrowers adversely. . .⁴

Michael Kawaja, in an analytical essay on the economics of statutory ceilings on consumer credit, dealt with fixed rates (which set the exact rate

¹Rudolph C. Blitz and Millard F. Long, "The Economics of Usury Legislation," *Journal of Political Economy*, December, 1965, p. 609.

²*Ibid.*

³*Ibid.*, p. 619.

⁴Luttrell, *op. cit.*

to be charged) and ceilings (which are set as outer limits to rates). He suggested that the usual goals of usury legislation can be better achieved by less direct methods:

The main findings of this analysis follow. First, there are no demands or cost-entry conditions inherent in the consumer industry that would justify rate fixing. Second, rate ceilings may serve worthwhile purposes in those segments of the credit market in which there are entry restrictions, but even in these cases they have serious drawbacks. Third, the disadvantages of ceilings on finance rates in competitive credit markets outweigh their advantages. And, fourth, the goal of rate ceilings in competitive credit markets is ill-defined and does not provide a basis for selecting the level of the rate ceiling or judging its efficacy. These conclusions point to the possibility and desirability of making the consumer credit industry more competitive and substituting the market mechanism for price ceilings. Therefore, all regulatory efforts should now be focused upon bringing about the conditions requisite to the development of effective competition in the industry.¹

Thus, the general conclusions from the literature on effectiveness of interest limitation are that it has certain noble purposes, that these purposes are not achieved, and that undesirable effects may be incurred by individual consumers and by society in general.

The Effects of Interest Limitations on Buyers and Sellers

To some extent the effects of interest limitation laws on buyers and sellers can be anticipated on a priori grounds. For example R. W. Johnson² has pointed out the differences between cash credit and vendor credit:

If legislation is properly drawn, the cash lender has no place to conceal his finance charge and no source of additional income for his credit services. In contrast, the vendor offering both a time price and a cash price may juggle these prices any way he chooses.²

¹Michael Kawaja, "The Economics of Statutory Ceilings on Consumer Credit Charges," *Western Economic Journal*, March, 1967, p. 167.

²Robert W. Johnson, "Regulation of Finance Charges on Consumer Installment Credit," *The Michigan Law Review*, Vol. 66, No. 81 (November 1967), p. 98.

In a footnote to this comment, he explains some of the implications of this relationship as follows:

This adjustment, however, is not made without cost either to the retailer or his customers. The demand for credit is derived from the demand for goods and services financed. Since the finance charge is a relatively small portion of the total time price and monthly payment, consumers are probably not as sensitive to changes in the price of credit as they are to changes in the cash price of goods or services financed. In economic terminology, the demand for credit is probably less elastic than is the demand for the good or service.

Assume that without rate ceilings a retailer has achieved his optimum market strategy by allocation of the total time price between the cash price and finance charge. An imposition of rate ceilings forces him to redistribute a portion of the finance charge to the cash price. Because the demand for the good is more elastic than the demand for credit, this shift will reduce the number of cash sales by an amount greater than any resultant increase in credit sales. Thus, not only are total sales likely to be less, but also the credit sales gained are more costly to service than the cash sales lost. The resultant reduction in profits will force some marginal retailers out of the market.¹

Although the majority of the authors in the field of credit limitations favor either a free market for interest rates or a ceiling much above the market rates, proponents of credit limitation such as William Warren, point out that this relative insensitivity to credit costs poses a hazard for the consumer:

The danger of ceding to the dealer the choice of financing agency lies in the fact that a dealer, in exercising his choice, is likely to be more influenced by the size of the finance-charge rebate accruing to him than by the reasonableness of the charge which the buyer will have to pay.²

Maurice B. Goudzwaard, in an article on the impact of rate ceilings on the availability of credit, provides empirical evidence that in states having the highest small loan rates, credit loss rates are higher than in states with intermediate or low small loan rates. He concludes as follows:

¹*Id.*, pp. 98-99.

²William D. Warren, "Regulation of Finance Charges in Retail Installment Sales," *The Yale Law Journal*, Vol. 68, No. 5 (April, 1959), p. 846.

Lenders appear more willing to accept higher credit losses and more marginal credit risks if their rate is sufficient to compensate for bad debt, investigation, and collection expenses. In effect, higher rate ceilings enlarge credit availability to poorer risks and allow lenders to adjust credit standards to accommodate rate ceilings. Since lenders have no control over price, low ceilings force them to reduce costs and restrict lending to the better risk classes, thereby discriminating against the less creditworthy and significantly reducing their credit opportunities. . . . But the analysis does demonstrate that any rate ceiling will very likely affect consumer credit allocation and that price controls have important economic and credit rationing effects on credit availability at consumer finance companies.¹

Since a knowledge of theory and a minimum of observation would suggest a hypothesis that the incidence of impact from credit limitation laws would vary between classes of consumer borrowers, it is logical to anticipate differences based on the relative creditworthiness of consumers. It would seem reasonable to expect that a credit rate limitation set below the charges in existence before a law took effect would have a marked effect on persons at the margin of acceptable creditworthiness. The effect on the marginal credit risk would, of course, be negative. At the same time, it might be reasonable to expect that the initial effects of such a law on the fully creditworthy consumer would be positive--that, until the full impact of the law struck home with businessmen, and they adjusted to it, the creditworthy person would benefit from a reduced interest cost.

There are of course many facets of the question over and above the mere interest rate which can create benefit or injury to all classes of consumers. F. Thomas Juster presented the argument that consumers are not "economic men" in their use of credit, which leads to the inference that less creditworthy consumers may use monthly payments as the principal criterion regardless of interest rates. If such consumers do look principally to the monthly payment amount, then it follows that they could incur an unreasonably high rate of interest. On the other hand, the people who could obtain the credit they want could afford to select sources of credit on the basis of interest rates. Juster concludes that:

¹Maurice B. Goudzwaard, "Price Ceilings and Credit Rationing," *Journal of Finance*, March, 1968, pp. 183-185.

Thus the model predicts that the minimum available monthly payment is a highly relevant proxy for the "real" cost of credit in an economy where all consumers are rationed [able to borrow less than they would prefer] in the sense just described. But in an economy where all consumers are unrationed [actual and preferred borrowings equal], monthly payments are irrelevant and finance rate is the relevant price. Thus the marginal borrowing cost model predicts that consumer response to finance rates will depend on the relative importance of unrationed consumers in the population.¹

Although questions have been raised concerning the nature of Professor Juster's research, the concept of differing attitudes toward interest by different classes ("rationed" and "unrationed") of consumers is important because of its implications which are outlined in the following quotation:

These results suggest the necessity for qualification of the widely held view that consumers are unresponsive to changes in the finance rates on installment credit contracts. Most consumers are in fact unresponsive, but only because they are constrained to accept shorter contract maturities than they would prefer. . . consumers appear to be unresponsive to finance rates because they do not have access to anything like a perfectly competitive capital market. The closer capital markets come to this analytical ideal, the more sensitive will consumers be to the cost of funds.²

On the business side, Paul Douglas points out that the apparent behavior of finance company lenders is such that raising and lowering finance rates may not bring about increases or declines in their profit:

Higher or lower rate ceilings do not raise or lower finance company profits but rather, determine credit availability. The higher the ceiling, the more marginal risk borrowers can be accommodated. This is confirmed by data showing a high positive correlation between the rate ceiling and bad debt charge-offs. The higher the ceiling, the riskier the loans and the higher the incidence of bad debts.³

¹F. Thomas Juster, "Consumer Sensitivity to the Price of Credit," *Journal of Finance*, May, 1964, p. 227.

²*Ibid.*, p. 233.

³Paul H. Douglas, statement in *Major Statements in Support of the Uniform Consumer Credit Code Filed with the Massachusetts Committee on the Judiciary January 29, 1969* (Boston: National Conference of Commissioners on Uniform State Laws, Chicago, Illinois, 1969), p. 11. Douglas footnotes this comment

The real question to any business is the relationship between costs, revenues and volumes, so that for consumer credit institutions costs of money must be related to allowable interest rates. If the ceilings are relatively low, or the costs of money relatively high, consumer finance companies and others can adjust their profits by changing credit granting criteria. Profits could literally be increased as long as there is a margin between costs and revenues by making credit less available to people most likely to cause losses. Thus it is possible for finance companies to increase profits in the face of low interest rate ceilings and tight money.

Several other empirical studies have concluded that credit rate limitations create real problems for grantors of consumer credit and that these problems are passed along to the consumers.

Jan Robert Williams who studied the Arkansas situation found that the Arkansas constitutional 10 per cent limitation on credit charges has caused serious problems for both businessmen and consumers. From an examination of cost-revenue relationships of retailers, Williams concluded:

Credit costs are greater than credit revenues generated by maximum legal service charges. This condition has a profound influence on the general store operations of retailers and the customers purchasing merchandise both on credit and for cash.¹

Williams reports that retailers limited their credit business, even though they saw credit as a device to increase sales. One form of limiting credit business was to set rigid standards for credit granting which made it impossible for many marginal credit applicants to obtain credit. In this regard, he points out that:

These would-be purchasers either are unable to purchase or they must seek borrowed funds under conditions which may allow lenders to take advantage of the borrower's situation.²

with a reference to Robert P. Shay, "State Regulation and the Provision of Small Loans," in John M. Chapman and Robert P. Shay (eds.), *Consumer Finance Industry* (New York: Columbia University Press, 1967), p. 100.

¹Jan Robert Williams, *An Analysis of Retail Credit Costs of Selected Retail Stores in Arkansas* (Unpublished Doctoral Dissertation, University of Arkansas, 1970), p. 125.

²*Ibid.*, p. 126.

The merchants were hurt by having to "receive undesirable terms in the financing of installment accounts with banks and other financial institutions. These terms included high rates of discount, large compensating balances, and full recourse arrangements."¹

One of the worst effects of the Arkansas rate limitation was the "credit subsidy," described by Williams as follows:

The credit subsidy is perhaps the greatest inequity caused by the 10 per cent limit on service charges in the State. Simply stated, the cash price of goods must be increased in order to cover losses on credit operations which result when credit costs exceed credit revenues. . . The credit subsidy, which is equal to the increase in the cash price to cover credit losses, is paid by the cash buyer and received by the credit customer.²

Williams also concludes that the credit limitation law had restrained economic development in the state, particularly in border areas. Firms were discouraged from entering business in Arkansas and the law also "hurt the further expansion of stores already located in Arkansas."

Gene C. Lynch also studied the Arkansas case and had similar conclusions relative to the retailers' costs of credit. He also discussed the problems of financial institutions and provided evidence that credit availability was restricted in Arkansas. In addition, he did a survey of prices on major appliances in Little Rock, Arkansas, and cities in states in the "Arkansas Region" (including Texarkana, Texas, Monroe, Louisiana, Greenville, Mississippi, Memphis, Springfield, Missouri, Tulsa and Denver). He found that if Little Rock were given an index of \$100, the indexes of the other cities ranged from about \$93 to \$97.³ Lynch suggests that these and other price data show the retailers' response to credit rate limitation:

The only factor that can logically account for the higher cash prices in Arkansas is the ten per cent usury limitation. The cause of higher prices is not higher absolute costs, but

¹*Ibid.*

²Williams, *op. cit.*, pp. 126-127.

³Gene C. Lynch, *Consumer Credit at Ten Per Cent Simple: The Arkansas Case* (Fayetteville, Arkansas: College of Business, University of Arkansas, 1969), p. 16.

lower revenues from credit sales. The legal finance charge differential between Arkansas and surrounding states is too great not to have an effect on store pricing policies.¹

In the Lynch study, prices were found to be higher in the state (Arkansas) with the lowest limit on credit charges in the region, although questions might be raised as to whether a causal relationship between the interest rate limitation and product prices had been established.

A number of studies have been made of the credit cost-revenue relationships for retailers and financial institutions. The basic conclusion is that consumer credit is not a very profitable business even in the absence of low rate ceilings on credit charges. The Federal Reserve Bank studies show that there are economies of scale in loans and that breakeven loan sizes decrease with the length of maturity and increase as interest rates decline. It is rather obvious that as the cost of money rises the break-even size of loans increases considerably at any given rate of interest charged. When this situation is capped by a credit limitation law at a relatively low figure (12 per cent per year) as is true in Washington there is a cost-price squeeze on the credit-granting institutions.

The best-known study of retail credit costs and revenues is that sponsored by the National Retail Merchants Association, a department store trade group. In 1963 and again in 1963, the accounting firm of Touche, Ross, Bailey and Smart gathered credit operating data from department stores, and in the 1968 study an economic analysis of the data was provided by Robert W. Johnson.² The study showed that the stores lost money on all three forms of credit (30-day charge account, revolving credit and installment accounts). Conclusions included:

Study findings indicate that providing credit in the department store field was a costly undertaking. . . It is clear, therefore, that credit must be justified economically by the department store

¹*Ibid.*, p. 26.

²Robert W. Johnson, "Economic Analysis of Credit Revenues and Costs in Department Stores," in Touche, Ross, Bailey and Smart, *Economic Characteristics of Department Store Credit* (New York: National Retail Merchants Association, 1969).

as a selling tool--not as a separate business venture. . . The small stores had greater deficiencies of revenue over costs.¹

An unpublished study by Touche, Ross, Bailey and Smart on costs in stores in the state of Washington for the fiscal year ending January 31, 1966 also found that there were losses in all forms of credit.²

The importance of credit to furniture and home appliance retailers was stressed in an empirical study which included the city of Spokane, Washington. The study, which covered Boise, Idaho as well, was published in 1963 and reported the following:

All of the furniture and appliance retailers in the two cities granted credit to their customers. All of the retailers sold merchandise under conditional sales contracts. All but two retailers gave credit on open account. In approximately one-third of the establishments the credit business was a major enterprise both from the volume of credit and the income from the credit business, which was treated as a separate department in a few instances. An analysis of opinions expressed by retailers indicates that essentially all of the retailers realize that credit operations are very important to their overall operations and may be important even as a separate enterprise.³

The study was made at a time when the most common rates charged by the banks for short-term borrowings by retailers was 6 per cent and the range was from 5 to 8 per cent per annum. On paper carried by financial institutions, the rates charged by banks averaged 14.5 per cent and that carried by consumer finance companies averaged 22.3 per cent. Bank rates ranged from 8 to 23 per cent and finance company rates ranged from 11 to 40 per cent and "there were isolated cases beyond these limits."⁴ If the average bank rate of 14.5 per cent, or 8½ per cent above the "most common" short-term rate to retailers, was

¹*Ibid.*, pp. 50-51.

²Touche, Ross, Bailey and Smart, "Study of Consumer Credit Costs in Retail Stores in Washington (Unpublished report to Washington Retail Council, 1966).

³Norman Nylooten, Ralph H. Farmer, Russel L. Chrysler and Paul O. Groke, *Credit Practices of Retailers and Financers of Furniture and Home Appliances in Two Northwest Cities* (Moscow, Idaho: University of Idaho, May, 1963), p. 75.

⁴*Ibid.*, p. 82.

based on reasonable net earnings for the banks, then reasonable net earnings for banks in 1970 would require an average rate of at least 18 per cent or more. Hence, it is logical to assume that the rate ceiling of 12 per cent per year imposed by Initiative 245 provides additional evidence that it is unlikely that credit grantors in general can provide consumer credit without incurring operating losses.

Summary

In summarizing the concepts from extant literature, it should be kept in mind that the issue of rate ceilings, or any particular form of ceiling, is controversial. It seems to the researchers in this study, however, that the weight of opinion favors certain key concepts:

1. The objectives of credit rate limitation by law or regulation usually are to protect the small borrower (assumed to lack power and/or knowledge to handle his own financial affairs), to limit the monopoly power of creditors and lenders (assumed to have a bargaining advantage in dealing with borrowers), and to foster a more rational and equitable allocation of resources than would occur without regulation. The majority opinion seems to be that legal rate limitations fail in all three objectives.
2. Economists generally see the interest rate as an equilibrating mechanism which should function in a manner resembling the free markets preferred for goods and services. They consider restrictions on the free money market as a source of maladjustment and misallocation of economic resources.
3. Rate restrictions tend toward restrictions on the availability of credit, particularly for small, less creditworthy borrowers and also tend to lead to increases in rates for small borrowers when their only alternatives are consumer finance companies (with higher legal rates) or illegal lenders (who can charge what the traffic will bear).
4. Low rate ceilings cause creditors and lenders to try to make up for loss of interest income through other means. For example,

the retailer who is faced with rates too low to cover his costs (or with a decline in interest income whatever his cost) tends to recoup his losses by raising prices on merchandise, raising charges on ancillary services, or by shifting the consumer to outside sources of credit.

5. Where interest ceilings are to be used, economists favor setting the ceilings distinctly higher than ordinary market rates of interest, so that a relatively free market can operate without reaching the ceilings.

Empirically, it has been shown that retailers probably lose money (in terms of cost/revenue relationships) on all forms of credit, even where the rate charged is higher than 12 per cent per year. It is evident, moreover, that financial institutions suffer from a cost-price squeeze, particularly in this period of high interest rates and tight money. The break-even size of loans for banks is much above the amount needed for purchases of virtually any durables except housing and automobiles.

The cash customer may be forced to provide a subsidy for credit customers through paying higher prices on goods and services.

Creditworthy consumers who bought on credit before and after the passage of the Initiative may have benefited through a net reduction in interest costs. The benefits could derive from the possibility that the stores from which they made purchases may not have adjusted completely to the Initiative, or from the possibility that the stores may have been trying to recover credit income losses through a combination of reducing costs (including credit granting costs) or by raising prices on all items, or on items not ordinarily bought on credit. The raising of prices on all items, or on items not ordinarily bought on credit, would tend to subsidize the credit customers at the expense of cash customers by giving them a net reduction in total cost (including interest) on goods purchased.

CHAPTER IV

CREDIT RELATED EFFECTS

Credit Related Hypotheses

The credit related hypotheses established at the outset of this study were as follows:

Banks and merchants are doing less business on a credit basis.

Lenders are diverting business to the most profitable types of loans or credit arrangements.

Small loan companies are doing more business.

Credit losses have decreased.

More poor people have been affected by the new law than middle- or upper-income people and marginal standing from a credit standpoint has been redefined to exclude some individuals classified as higher risks.

Financing charges other than interest rates have increased.

Businessmen have become more strict in the application of rules on delinquent accounts.

The passage of Initiative 245 resulted in a number of changes in the manner in which a large number of firms do business on a credit basis with their customers. These effects were felt primarily in three major areas:

1. The volume of sales done on a credit basis by retailers and financial institutions.
2. The charges imposed by retailers and financial institutions as well as the costs of providing credit services for customers.
3. The credit-related effects of the new law on consumers generally.

Each of these three major headings will be discussed in this chapter.

The Volume of Business

The 12 per cent interest ceiling which became effective with the enactment of Initiative 245 does not apply to direct consumer loans obtained from consumer finance, or "small loan" companies, as they are sometimes called. Automobile finance companies such as GMAC are restricted to the 12 per cent interest limit. The latter organization and its counterparts in the auto and appliance fields are also sometimes called "captive" or sales finance companies.

The volume of business that banks and consumer finance companies are doing in indirect loans to consumers that originate with retail merchants has, as might be expected, declined. Sixteen out of 23 retailers made changes tending to diminish indirect loans and Table 4 shows an overall decline in indirect loans. This decline is attributable primarily to a falling off in the volume of business done between financial institutions and furniture and home appliance retailers. A sample representing a substantial proportion of the total indirect dealer paper purchased by the state and national banks in Washington revealed a 41 per cent decline in the number of appliance and home furnishings contracts purchased in 1969 when compared to 1968. The total dollar volume decline amounted to 33 per cent. Indirect dealer paper in automobiles declined 10 per cent in the number of contracts and 5 per cent in dollar volume. Indirect marine (boat and motor) paper declined 6 per cent in number of contracts, but increased 25 per cent in dollar volume. In all three categories, the number of contracts declined by 15.5 per cent and the dollar volume by 5.8 per cent and the average size of contract increased. That these events can probably be attributed to Initiative 245 also seems to be indicated by the fact that the experience of the banks and finance companies in Washington State apparently runs counter to the experience of similar institutions in the rest of the country. The extent of this divergence is shown below in Tables 1, 2 and 3. A survey representing approximately 60 per cent of bank consumer loans in the State of Washington in 1968 and 1969 is summarized in Tables 4 and 5.

There was also a decline of 15 per cent in filings of retail installment contracts in King county in 1969 compared to 1968. Table 6 shows in the last six months of 1969 an even sharper 25 per cent decline in filings by retailers and 33 per cent by banks. Small loan companies, however, showed a decline of only 12 per cent, which was less than the total or average decline. This

TABLE IV-1

COMMERCIAL BANKS, CONSUMER FINANCE AND SALES FINANCE COMPANIES

INDIRECT LOANS -- 1968 and 1969
(millions of dollars)

	EXTENDED			OUTSTANDING (Dec. 31)		
	1968	1969	% Change	1968	1969	% Change
Washington	\$203.9 ^a	\$192.3 ^a	-5.7	\$172.4	\$182.0	+5.6
United States	\$13,313*	\$14,272*	+7.2	\$39,907	\$42,567	+6.7

^aDoes not include consumer finance company data for state.

*Includes all finance companies.

(Commercial banks are omitted--data unavailable)

Sources: Washington: Division of Banking, Sales Finance Companies, Commercial banks. United States: Federal Reserve

TABLE IV-2

ALL FINANCE COMPANIES

INDIRECT LOANS -- 1968 and 1969
(millions of dollars)

	EXTENDED			OUTSTANDING (Dec. 31)		
	1968	1969	% Change	1968	1969	% Change
Washington	n.a.	n.a.		\$34.9	\$35.6	+2.0
United States	\$13,313	\$14,272	+7.2	\$15,794	\$17,030	+7.8

Sources: Washington: Sales Finance Companies, Supervisor of Banking Report (Consumer Finance Companies). United States: Federal Reserve.

TABLE IV-3

SALES FINANCE COMPANIES

INDIRECT LOANS -- 1968 and 1969
(millions of dollars)

	1968	1969	% Change	1968	1969	% Change
Washington	\$16.4	\$15.8	-3.7	\$14.0	\$14.5	+3.7
United States	\$12,011	\$12,942	+7.8	\$14,835	\$16,049	+8.2

Sources: Washington: Sales Finance Companies. United States: Federal Reserve.

TABLE IV-4

NEW CONSUMER LOANS MADE BY SELECTED
BANKS IN THE STATE OF WASHINGTON
1968-1969

	1968		1969		Per Cent Change 1969 over 1968		
	No.	\$ (000)	No.	\$ (000)	No. (%)	\$ Volume (%)	Average Loan Size (%)
Direct							
Auto	36,166	69,389	31,916	63,399	-11.8	-8.6	+3.5
Personal	62,753	54,577	47,061	47,558	-25.0	-12.9	+16.2
Total Direct	98,919	123,966	78,977	110,957	-20.2	-10.5	
Indirect							
Auto	78,514	170,826	70,781	161,900	-10.0	-5.0	+5.1
Appliance	18,334	10,688	10,837	7,157	-40.9	-33.0	+13.3
Marine	2,679	5,973	2,521	7,485	-6.0	+25.0	+33.1
Total Indirect	99,527	187,487	84,139	176,542	-15.5	-5.8	

Source: Survey of Banks in Washington State.

TABLE IV-5

CONSUMER LOANS OUTSTANDING IN SELECTED
BANKS IN THE STATE OF WASHINGTON
1968-1969

	1968		1969		Per Cent Change 1969 over 1968		
	No.	\$ (000)	No.	\$ (000)	No. (%)	\$ Volume (%)	Average Loan Size (%)
Direct							
Auto	48,556	65,883	45,742	63,358	-5.8	-3.8	+2.1
Personal	50,182	50,063	40,784	45,314	-18.7	-9.5	+11.3
Total Direct	98,738	115,946	86,526	108,672	-12.4	-6.3	
Indirect							
Auto	80,994	123,023	84,725	131,546	+4.6	+6.9	+2.2
Appliance	17,771	7,908	14,098	6,620	-20.7	-16.3	+5.5
Marine	3,425	6,485	3,703	8,223	+8.1	+26.8	+17.3
Total Indirect	102,190	137,416	102,526	146,389	+3	+6.5	

Source: Survey of Banks in Washington State.

TABLE IV-6
KING COUNTY U.C.C. FILINGS^a
1968 vs. 1969

	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Total (Last 6 mos.)	Total (Annual)
Finance:														
1968	2690	2651	2441	2603	2690	2519	2772	2580	1791	2255	2026	3126	14550	30144
1969	2402	2402	2349	2349	2193	2240	2183	2132	1962	2065	1786	2717	12845	26780
													(-12%)	(-11%)
Banks:														
1968	210	206	244	286	310	244	329	213	221	254	195	167	1379	2879
1969	159	184	253	303	271	262	203	174	133	160	134	125	929	2361
													(-33%)	(-18%)
Retail:														
1968	843	706	781	738	754	800	883	841	777	926	773	884	5084	9706
1969:	602	763	719	860	820	729	691	562	597	708	659	604	3821	8314
													(-25%)	(-15%)
Credit Union:														
1968	132	145	150	129	163	158	170	159	157	147	105	143	881	1758
1969	91	129	121	139	140	159	115	126	150	99	96	105	691	1470
													(-22%)	(-17%)
Savings & Loan:														
1968	13	17	20	13	14	9	8	10	10	9	13	16	66	152
1969	29	18	19	13	26	18	12	13	16	20	10	16	87	210
													(+32%)	(+38%)
Other^b														
1968	114	101	111	115	155	122	163	138	95	124	105	182	807	1525
1969	151	116	123	168	168	207	142	118	169	144	118	184	875	1808
													(+ 8%)	(+18%)
Total:														
1968	4002	3826	3747	3884	4086	3852	4325	3941	3051	3715	3217	4518	22767	46164
1969	3434	3612	3584	3832	3618	3615	3346	3125	3027	3196	2803	3751	19248	40943
	-14%	-6%	-5%	-2%	-12%	-6%	-33%	-21%	-1%	-14%	-13%	-17%	-15.5%	-12%

^aContracts on sales of untitled goods--"FS" only. ^bOther category includes mortgage companies.
Source: King County Records.

combination of percentages suggests a relative shift of installment credit business from banks and retailers to small loan companies.

The decline in the total of installment credit financing, and particularly the greater decline in bank and retailer business in this field, appear related to Initiative 245. Since state records do not show a decline in retail sales for the 1969 period covered in Table IV-6, and since a resurvey of firms which filed contracts revealed no change in policy regarding filings in 1969 versus 1968, it is obvious that many purchases which might have been financed through installment credit in 1968 were financed by other means in 1969. Of the twenty-eight retailers who said that they encouraged consumers to switch from one form of credit to another, eleven reported that they now ask the customer to arrange his own financing. Another stopped granting extended credit and required his customers to pay cash in thirty days. In all twelve of these cases, some customers were undoubtedly getting direct loans from credit unions and small loan companies which had no connection with the merchandise purchases, and were using the loan proceeds to make "cash" purchases at the retail stores. In other cases, even where there was no effort to suggest alternative forms of credit, people considered marginal credit risks were turned down for credit by banks and retailers and had to obtain the funds for "cash" purchases from small loan companies. Further, although the interviews with retailers did not turn up a trend toward switching people from installment credit to bank credit cards, later research suggested that many retailers did shift other forms of credit to bank credit cards.

Further, the price that the banks and finance companies charge the dealers with whom they do business is not controlled by law and it has gone up, reflecting the rising cost of money to these financial institutions. (See Table IV-7.) Instead of paying dealers "participation," a practice which involved having the bank share the interest proceeds received from the consumer loan with the merchant, the financial institutions began instead to discount dealer paper. In the case of auto dealers, for example, 19 out of the 24 dealers who responded to a question on participation stated that at the time of the survey (summer, 1969) they had lost an average of two per cent in revenues on indirect paper. In other words, if they had been receiving one per cent participation (or "commission") on the business they took to banks and finance companies, by the

TABLE IV-7

MARKET INTEREST RATES AND THE PRIME RATES

	Prime Rate	3 Mos. Treasury Bill	Finance Paper (3-6 Mos.)	Daily Av. Bkers. Accepts. (90 Day)	Federal Funds
Jan., 1964	4.50	3.52	3.82	3.70	3.48
Dec. 6, 1965	5.00	4.37	4.60	4.55	4.32
Mar. 10, 1966	5.50	4.58	5.02	4.96	4.65
June 29, 1966	5.75	4.50	5.39	5.39	5.17
Aug. 15, 1966	6.00	4.95	5.63	5.67	5.53
Jan. 26-27, 1967	5.50-5.75	4.72	5.50	5.23	4.94
Mar. 27, 1967	5.50	4.26	5.01	4.68	4.53
Nov. 20, 1967	6.00	4.72	5.17	4.98	4.12
April 19, 1968	6.50	5.37	5.60	5.75	5.76
Sept. 25, 1968	6.00-6.25	5.20	5.61	5.63	5.78
Nov. 13, 1968	6.25	5.45	5.75	5.97	5.81
Dec. 18, 1968	6.75	5.94	5.86	6.20	6.02
Jan. 7, 1969	7.00	6.13	6.14	6.46	6.30
Mar. 17, 1969	7.50	6.01	6.38	6.66	6.79
June 19, 1969	8.50	6.43	7.25	7.99	8.90
Mar. 25-6, 1970	8.00	6.63	7.68	7.60	7.76

Source: "How Interest Rates Got So High," *Special Report* by Manufacturers' Hanover Trust Company, June, 1970.

summer of 1969 they were paying a 1 per cent discount on this indirect paper. Both the participation prior to Initiative 245 and the discounts charged after the Act took effect tended to vary between dealers. At the time of the survey, small used-car dealers reported paying discounts as high as 5 per cent.

The principal reason for this shift in policy on the part of the financial institutions was that the paper generated as a result of credit transactions between consumers and retail dealers now carried an interest rate of only 12 per cent. Prior to the enactment of Initiative 245 on December 5, 1968, retail credit contracts could have been written with up to 18 per cent per annum. Thus the dealers were being forced to assume the burden of the mandatory reduction through the discounting of the contracts. Understandably the net result has been a decline in the volume and number of new indirect loans through the consumer and sales finance companies and commercial banks.

In addition to the reluctance of retail merchants to pay so much for money that they suffer losses on credit, some of them have also been affected by changes in the lending policies of the banks with whom they do business. These modifications are not uniform throughout the banking system but, for example, many banks will no longer handle indirect loans for older model automobiles, particularly those five years of age and older. When older model cars are still financed on an indirect basis, it is because the automobile dealers involved are especially important customers of the bank. A small number of banks no longer make indirect loans for amounts of less than \$500 average loan size. This particular policy change affects furniture and appliance dealers primarily. One large bank with several branches is no longer handling any indirect paper from any household goods dealer in the state and another bank no longer handles consumer paper emanating from any appliance dealer. A third bank has cut out indirect paper originating with the hospitals in its community. Still another will handle only indirect paper when it originates with an individual who is also a depositor of the banks as well as a customer of the merchants.

The foregoing observations imply that the volume of business that banks do, both directly and indirectly, with consumers has been adversely affected except perhaps for credit cards. As mentioned earlier, indirect loans primarily for furniture and home appliances declined significantly (40.9 per cent for appliances) even though such loans have risen substantially on the national

level. The total volume of automobile loans in 1969 handled by Washington banks through automobile dealers declined 10 per cent in number and 5 per cent in volume below the level that it was prior to the enactment of Initiative 245. At the national level, however, indirect bank auto loans outstanding rose by 5.6 per cent in volume. (See Table IV-1.)

Direct consumer loans made by major Washington banks declined in 1969 relative to 1968. Direct auto loans declined 11.8 per cent in number of contracts and 8.6 per cent in dollar volume. Personal loans declined 25 per cent in number and 12.9 per cent in dollar volume. The total of direct bank consumer loans declined 20.2 per cent in number of loans and 10.5 per cent in dollar volume in 1969 relative to 1968. There were similar, though less pronounced, declines in the amount of consumer loans outstanding in 1969 relative to 1968. The total outstanding consumer loans declined 12.4 per cent in number and 6.3 per cent in dollar volume. In all of the above categories of loans, there was an increase in the average loan size. Although the average size of auto loans increased only 3.5 per cent, the average size of personal loans increased 16.2 per cent due largely to the setting of higher minimum loan sizes and a shift toward more affluent customers.

The dollar volume of new indirect consumer loans made by commercial banks, consumer finance companies and sales finance companies combined in 1969 was 5.7 per cent less than in 1968. There was a slight increase in indirect loans by consumer finance companies, but not enough to materially affect the above figure.

Information obtained about the first quarter of 1969 from interviews with automobile dealers throughout the state during the third quarter of 1969 led us to believe that there had been a significant movement toward the financing of automobiles through consumer finance companies, especially in the case of older used cars because of the difficulty encountered in financing these automobiles through banks. Some corroborating evidence was uncovered when it was observed that a number of automobile dealers said that they had experienced an increase in the number of cars sold for cash. It would appear reasonable to assume that in those instances where this was observed or encouraged by the dealers, direct loans from small loan companies were the most probable source of funds, although credit unions and banks may have been involved.

TABLE IV-8

UNITED STATES CONSUMER INSTALMENT CREDIT OUTSTANDING BY
 TYPE AND BY HOLDER, 1969 BY MONTHS
 (in millions of dollars)

	All Finance Companies Combined	Commercial Banks	Other Financial Institutions	Automobile Dealers	Total
<u>Automobile Paper</u>					
December (1968)	10,124	19,318	4,368	320	34,130
January (1969)	10,087	19,268	4,339	319	34,013
February	10,098	19,270	4,366	319	34,053
March	10,124	19,392	4,426	320	34,262
April	10,232	19,661	4,515	325	34,733
May	10,384	19,908	4,609	329	35,230
June	10,577	20,184	4,710	333	35,804
July	10,673	20,315	4,758	335	36,081
August	10,703	20,372	4,834	336	36,245
September	10,687	20,407	4,891	336	36,321
October	10,822	20,511	4,928	338	36,599
November	10,854	20,501	4,958	337	36,650
December	10,866	20,404	4,996	336	36,602

Source: National Consumer Finance Association, April 6, 1970, p. 49.

On the other hand, an examination of the operating results of small loan companies in the state for the entire year did not reveal any appreciable growth in the dollar total of loans made during the year. This was a somewhat surprising finding. There is, of course, evidence of a relative shift in available consumer credit business toward consumer finance companies as compared with retailer and bank financing. The installment contract filings referred to earlier in the chapter showed that total installment filings declined, but that the decline in consumer finance filings was less than the average decline and that the decline in retailer and bank filings were much above average. In the face of an increased opportunity it was expected there would be an increase in the volume of business that these small loan companies would transact. Instead, the small loan companies appear to have taken advantage of the opportunity to improve the risk quality of their loan portfolios. Net earnings before interest on borrowed funds was up by more than 10 times the average increase during the previous three years and the change in the number and amount of loans charged off was up by about 11 per cent and 14 per cent respectively. A five year summary of the small loan company operating results in Washington is shown in Table IV-9.

Charges and Costs

The retail businessmen and financial institutions have, as expected, tried to reduce the costs associated with credit transactions and loans and to the extent possible to maximize the potential revenue obtainable under the law. Since these affected businessmen have been unable to do much on the revenue producing side, they have understandably enough devoted their primary efforts to cost reduction, at least as far as the strictly financial side of the matter is concerned. The major emphasis in trying to achieve an upward revision of revenues has taken place in the area of product price adjustments. This activity is discussed in the following chapter.

One of the ways in which commercial banks have made an effort to reduce costs is in the handling of loans for small amounts, i.e. under \$500. Such loans have been made on their credit card systems whenever possible. The main reason for this development appears to be the lower cost of handling loan transactions of that size in this manner. Service charges and other fees such

TABLE IV-9

FIVE-YEAR ANALYSIS OF SMALL LOAN COMPANIES

	1965	1966	1967	1968	1969
Number of Licensed Offices	252	258	265	271	286
Number of Offices Reporting	251	258	265	271	286
Total Loans Made	185,255	175,608	176,680	184,940	185,552
Amount of Loans Made	\$ 98,648,377	\$ 93,602,730	\$ 97,139,667	\$103,979,909	\$109,101,461
Total Loans Outstanding	164,665	171,447	174,503	181,524	189,058
Amount of Loans Outstanding	\$ 76,498,429	\$ 79,276,833	\$ 82,160,588	\$ 87,557,136	\$ 92,704,367
Number of Contracts (Indirect)	32,011	39,984	41,795	64,153	68,339
Amount of Contracts (Indirect)	\$ 7,170,699	\$ 11,252,947	\$ 13,037,682	\$ 20,994,248	\$ 21,128,176
Number of Other Loans (Indirect)	5,899	7,288	8,683	8,487	7,023
Amount of Other Loans (Indirect) (12% loans, i.e., over \$500)	\$ 12,138,211	\$ 13,529,029	\$ 15,542,635	\$ 15,499,419	\$ 12,031,459
Total Assets	\$119,244,126	\$128,316,772	\$135,970,123	\$146,718,231	\$149,694,907
Net Earnings Before Interest on Borrowed Funds	\$ 5,154,839	\$ 5,208,337	\$ 5,273,576	\$ 5,350,203	\$ 6,124,868
Monthly Rate Collected	2.13%	2.08%	2.10%	2.13%	2.11%
Number of Loans Charged Off	5,819	6,074	6,286	6,719	7,440
Amount of Loans Charged Off	\$ 2,138,160	\$ 2,329,656	\$ 2,463,840	\$ 2,687,767	\$ 3,059,731

Source: Supervisor of Banks, State of Washington.

as those for late payment have also been either raised or instituted wherever they are allowed and have not heretofore been in effect.

Banks have also attempted to lower their costs of doing business by making qualitative changes in their consumer loan portfolio. Virtually all financial institutions and retailers have tightened their lending policies in one or more of the following areas:

1. Down payment requirements have been increased.
2. Maturities on loans have been shortened.
3. The discretion of local lending officers to waive requirements on consumer loans such as minimum uncommitted monthly income, minimum residence, and minimum length of time on the job has been substantially curtailed.

The impact of these policy changes has been reflected in operating results. One bank reported that their bad debt losses, for example, had been reduced by one-third.

Additional evidence concerning the efforts of businessmen to increase the monetary size of credit transactions is also furnished from a review of the installment sales contracts filed in King County. The average size of these contracts increased from \$589 in 1968 to \$670 in 1969. These data may also be an indication of the success that banks have had in switching consumers to bank cards which, as we pointed out before, appear to be a form of credit which is less expensive administratively from the lending institutions point of view.

Retailers as well as financial institutions appear to have made a serious attempt to reduce the time period over which they are willing to do business on a credit basis. Eight auto dealers reduced maturities by six months, and one reduced maturities for marginal buyers from a possible 36 months to spans of 2-6 months. By doing so they are able to reduce the dollar amount of the discount on the paper that they sell to financial institutions.

In addition to the reduction in the amount of interest permitted, retailers have also had to contend with a reduced service charge ceiling on consumer loans. The amount allowed prior to the enactment of the law was \$15; this was reduced to \$10 or 1 per cent per month on the unpaid balance. On the other hand, according to our survey, many banks and retailers have apparently

instituted such charges for the first time in their efforts to generate additional revenues. In this connection it may also be noted that some retailers have raised their interest charges to 12 per cent in those cases where they had been charging consumers less.

Most large-scale retailers have not found it feasible to eliminate the free credit granted to a significant portion of their retail customers as a result of a tradition of open-book accounts. What has happened, however, is that the time period granted to customers on open-book accounts has been reduced. Merchants who were offering 90-day open book accounts say they have cut this to 60 days and the 60-day accounts have been cut to 30. Regular accounts as well as slow pay accounts have been encouraged to switch to sales contracts, revolving accounts or bank cards.

Retailers, and particularly the automobile dealers, have also compensated for their decline in income on credit transactions by selling more of their customers credit life and credit health and accident insurance policies. Around one-third of the auto dealers reported that they were pushing much harder to sell credit insurance, and in some cases began to require customers to purchase the insurance after the passage of the Initiative. The consumer who purchases either a health and accident and/or life insurance contract incurs an additional cost to himself that is determined by the amount of the loan that he has negotiated and the applicable rate for the coverage involved. The maximum legal rate established for credit life insurance in Washington is 60 cents per \$100 per year. The rate for health and accident insurance coverage on credit transactions varies with the benefits offered in the particular policy.

In addition to a desire to increase their revenues (through receiving 40 per cent of the premiums), there are other reasons why retailers have emphasized the sale of these types of insurance. First of all in the event of sickness or disability on the part of the consumer his payments are made by the insurance company. Second, the contract between the merchant and the consumer is also more salable if credit insurance is associated with it. Many finance companies will either reject the paper or discount it an additional point if the purchaser is not insured.

About one-third of the automobile dealers interviewed reported that they increased their emphasis on credit insurance in connection with the sale of automobiles. Secondary sources of information representing about 90 per cent of the auto credit insurance transactions in the state also substantiate these dealer responses. The evidence is even more convincing when Washington and the neighboring border states of Oregon and Idaho are compared. As may be seen from an examination of Table IV-10 the amount of life and health insurance premiums on automobile sales in Washington increased by 23 per cent in 1969 while there was only a negligible increase in both Oregon and Idaho. Table IV-11 shows the changes between 1968 and 1969 in total credit insurance. Table IV-12 provides data on northwest states and the United States for credit life insurance in force in the years 1958 through 1969.

TABLE IV-10
CREDIT LIFE AND HEALTH INSURANCE PREMIUMS ON AUTOS
(in thousands of dollars)

	1968	1969	Per Cent Change
Washington	\$1666	\$2056	23%
Oregon	\$ 739	\$ 741	0%
Idaho	\$ 272	\$ 273	0.4%

Source: Major insurance companies specializing in automobile credit insurance.

TABLE IV-11

NEW CREDIT INSURANCE BUSINESS
STATE OF WASHINGTON
1968 AND 1969

Type	1968	1969	Per Cent Change
Individual Life	\$ 205,067	\$ 135,534	-43.9%
Group Life	<u>\$8,902,190</u>	<u>\$9,384,760</u>	+ 5.4
Total Life	\$9,107,257	\$9,520,294	+ 4.5
Group A & H	\$2,732,741	\$3,438,749	+25.8
Other A & H	<u>\$ 141,097</u>	<u>\$ 12,095</u>	--
Total A & H	\$2,873,838	\$3,450,844	+20.0
Total Credit Insurance	\$11,981,095	\$12,971,138	+ 8.3

Source: Life insurance company annual reports.