CONSUMER UNDERSTANDING

Both the Consumer Credit Protection bill (H.R. 11601) and Truth in Lending bill (S. 5) state that the informed use of credit, particularly instalment credit, will enhance economic stabilization, increase sound competition between firms providing credit facilities, and give consumers a simple and clear method of comparing credit costs, particularly, between competitive offers.

To analyze these two bills and to report on their effect on consumers, we employed the services of Dr. Albert Haring, Professor of Marketing, Graduate School of Business, Indiana University. Dr. Haring, a specialist in the field of consumer credit, has served as a consultant to many business firms and to several national associations. In 1960, and again in 1961, Dr. Haring testified on the Truth In Lending bill before the Senate subcommittee.

Dr. Haring converted the purposes of H.R. 11601 and S. 5 into more specific language and suggested the following approach as a practical method for evaluating the particular provisions of the proposed bills:

1. Consumers are to be protected through disclosure of details of credit transactions and proposals; such disclosure should be in the form or forms best understood by consumers.
2. To make it possible for consumers to shop effectively for credit, all competitive offers should be stated in identical terms or in an identical manner.
3. Stabilization of the economy means more stability at high levels of output, employment and gross national product. If 10,000,000 units of product X were marketed annually prior to such legislation, the goal would be to have 10,000,000 units (or more) marketed annually after the legislation, presumably at a lower credit cost to the public or, at a minimum, a more intelligent use of credit by the public.
4. Stabilization of the economy also means relatively constant prices or a minimum of inflation. Since all costs must eventually be paid by the consumer or public, changes caused by the proposed statutes should handicap business and increase costs as little as possible. Hopefully, once adjustments have been made, costs will be no greater than those of the earlier time before such legislation.

Consumer Understanding Varies with Size of Credit Transaction

1. Small sized transaction. Where the amount of credit extended is small and the installment repayment period short—a battery or tire in the case of cars, or a toaster or iron in the case of minor appliances—the most helpful information to the consumer is the total *dollar and cents* cost of the credit and the dates of repayment. The "annual percentage rate" is likely to be very high, its calculation is difficult, and there is some reason to believe that consumer confusion may occur in a considerable number of cases. Here, however, the small independent businessman faces a difficult and expensive problem which, it is believed, has greater economic costs than the possible gains for the consumer.

In my testimony before the Senate Subcommittee on Production and Stabilization in 1960, I gave the illustration of the factory worker who had to buy a new battery to start his car to get to work. The breakdown is on Monday and he agrees to pay the service station manager every payday. Paydays are every other Friday. The cash price of the battery is $20; the time price is $22, five dollars each paycheck for four paychecks and then two dollars. What is the annual interest rate? To the worker, on this small purchase, the important thing is not the percentage rate but the $2 time price differential—having the battery today is or is not worth it.

The fact that the annual rate is somewhere between 110% and 130% is not important to the customer and may be quite confusing to both customer and service station. In small transactions, the consumer is most interested in knowing the credit cost in dollars and cents, and such information is about all that many small retailers can accurately furnish.

2. Very large transactions. Where the credit involved is very large and the repayment period long—a new car or a home—the most helpful information to the consumer is the total cost of credit (all costs which would have been avoided if the purchase had been made for cash) in terms of *annual percentage rate* stated in percent and/or in dollars per hundred. The consumer needs such information because both sellers and financial agencies compete in this area; unless terms are quoted identically, the public has difficulty making valid comparisons.

Total dollar costs of credit, particularly in the case of purchasing homes, may create consumer confusion. A $21,000 house with 10 percent down, $1,000 closing