CONSUMER CREDIT PROTECTION ACT

HEARINGS

BEFORE THE

SUBCOMMITTEE ON CONSUMER AFFAIRS

OF THE

COMMITTEE ON BANKING AND CURRENCY

HOUSE OF REPRESENTATIVES

NINETIETH CONGRESS

FIRST SESSION

ON

H.R. 11601

A BILL TO SAFEGUARD THE CONSUMER IN CONNECTION WITH THE UTILIZATION OF CREDIT BY REQUIRING FULL DISCLOSURE OF THE TERMS AND CONDITIONS OF FINANCE CHARGES IN CREDIT TRANSACTIONS OR IN OFFERS TO EXTEND CREDIT; BY ESTABLISHING MAXIMUM RATES OF FINANCE CHARGES IN CREDIT TRANSACTIONS; BY AUTHORIZING THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM TO ISSUE REGULATIONS DEALING WITH THE EXCESSIVE USE OF CREDIT FOR THE PURPOSE OF TRADING IN COMMODITY FUTURES CONTRACTS AFFECTING CONSUMER PRICES; BY ESTABLISHING MACHINERY FOR THE USE DURING PERIODS OF NATIONAL EMERGENCY OF TEMPORARY CONTROLS OVER CREDIT TO PREVENT INFLATIONARY SPIRALS; BY PROHIBITING THE GARNISHMENT OF WAGES; BY CREATING THE NATIONAL COMMISSION ON CONSUMER FINANCE TO STUDY AND MAKE RECOMMENDATIONS ON THE NEED FOR FURTHER REGULATION OF THE CONSUMER FINANCE INDUSTRY; AND FOR OTHER PURPOSES

AND RELATED BILLS

PART 2

AUGUST 15, 16, 17, AND 18, 1967, AND APPENDIXES

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STATEMENTS

CONSUMER CREDIT PROTECTION ACT

TUESDAY, AUGUST 15, 1967

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CONSUMER AFFAIRS
OF THE COMMITTEE ON BANKING AND CURRENCY,
Washington, D.C.

The subcommittee met, pursuant to recess, at 9:35 a.m. in room 2128, Rayburn House Office Building, Hon. Leonor K. Sullivan (chairman of the subcommittee) presiding.

Present: Representatives Sullivan, Gonzalez, Minish, Annunzio, Bingham, Dwyer, Halpern, Wylie, and Williams.

Mrs. SULLIVAN. The Subcommittee on Consumer Affairs will come to order.

We have set our hearing forward a half hour this morning in order to accommodate Mr. Louis Rothschild, executive director of the Menswear Retailers of America. Mr. Rothschild was to have testified yesterday morning, but by the time we had reached him, I was the only member of the subcommittee still in attendance because the House had gone into session at noon and the other members had to leave. I was perfectly willing to stay yesterday morning into the lunch hour to hear Mr. Rothschild but I did not think it was fair to him to have only one member present to hear his testimony, so I gave him the choice of testifying then or coming in at this hour this morning.

We have been working very hard over the past 10 days on this legislation with morning and afternoon sessions, and it is a real sacrifice for the members to come this early in the morning when there is so much to do in our own offices. We will now hear you, Mr. Rothschild, with the understanding that shortly before 10 o'clock we will have to turn to the witnesses who have come from out of town for the scheduled hearing this morning at 10 o'clock on section 207 of H.R. 11601 dealing with commodity futures.

STATEMENT OF LOUIS ROTHSCHILD, EXECUTIVE DIRECTOR, MENSWEAR RETAILERS OF AMERICA

Mr. ROTHSCHILD. Thank you, Madam Chairman. I am extremely appreciative to you and the other members of the committee to take time out of your busy schedule to be here this morning.

I am Louis Rothschild, executive director of Menswear Retailers of America—for over 50 years the nationally recognized trade association of men's and boys' wear retailers with over 3,300 members in all parts of the Nation. Our industry is typical of small retailing constituting an important part of our economy to which Congress and the administration has so often pledged its support. We are acutely

aware of the difficult problems now being faced by small business in its continual battle for survival and growth. The last Census Bureau showed that 3,000 small men's wear stores disappeared from the economic picture in the past 5 years preceding the 1963 business census. To a substantial degree, we feel that we appear here today not only as the spokesman for men's wear retailers, but for all small retailing.

Madam Chairman and gentlemen of the committee, my presentation will be necessarily blunt, possibly untactful, possibly reactionary in the eyes of many—but definitely sincere. May I assure the committee and the Congress that our effort to get back to fundamentals are made with the highest regard for the integrity and ability of the fine individuals who are serving our Nation in the important administrative and legislative positions. Our association has repeatedly confirmed by our resolutions committee, by our board of directors and by our membership at annual meetings our opposition to unwarranted Federal controls. This was last recorded in a formal resolution adopted at our convention in Dallas on February 18, 1966, which read:

> The Menswear Retailers of America is unalterably opposed to the extension of the onerous burdens imposed upon the retailers by the continued expansion of Government regulations and controls on purely local retail businesses. We reiterate our continued opposition to legislative proposals . . . which would establish unnecessary and unrealistic controls on credit sales.

In the Senate hearings and the hearings before this subcommittee, we have been seriously distressed as the representatives of large, mammoth, interstate retailing have voiced their approval of Federal control of credit sales. There is only one conclusion to reach: these mass merchandisers who fear the adoption of more stringent and varied legislation in the States—where primary jurisdiction should exist—are sacrificing small, independent retailers in favoring the principles involved in the sweeping legislation now being considered by this subcommittee. It is our firm opinion that these voices of large retailers are selling the small retailers down the river for their own protection and interest.

H.R. 11601 is not a proposal to regulate economic stability and currency and moneys of this country but is a sweeping effort to regulate and control the business morals of this country. This is not a truth-in-credit bill—it is a business control measure. I respectfully submit that the present proposal is not within the jurisdiction of this subcommittee but is more properly within the jurisdiction of other committees of the Congress charged with regulation of commerce within the jurisdiction of the Constitution of the United States. The provision included in H.R. 11601 regulating the advertising of credit, I respectfully submit, is proof positive of this point of argument. The question as to whether this committee has jurisdiction in garnishment would appear to me, as a longtime student of government, to be more properly within the jurisdiction of the Committee on the Judiciary, which has charge of the bankruptcy laws and legislation pertaining to it.

It is my sincere recommendation to this committee as an experienced trade association executive as well as an attorney that this committee obtain studied legal opinion as to the constitutionality of the proposals now being considered.

Following are the basic points surrounding the constitutional question:

First, the proposals are of doubtful constitutionality, in my opinion, because they will attempt to regulate purely local, intrastate commerce. The individual dealings between a customer and retailer in Wichita, Kans., are hardly within the province of the Federal Congress. It is as individual as the price of the garment, the fit of the garment, and the manner in which it is delivered to the customer.

A second point of doubtful legality is that the Federal Government is encroaching upon the basic right of freedom of contract between two individuals neither of whom are engaged in interstate commerce. It was my privilege to hear Mr. Margolius yesterday, and on page 8 of his statement:

> But the question before this country today is whether we should permit laws which enable unscrupulous sellers to take advantage of innocence and trust.

In other words, he favors that the Congress veto the legislation of the 50 States—the legislation which has been adopted in those States to regulate the business in intrastate commerce in those States.

If the proposed legislation is amended to apply only to those mass merchandisers, those giant chains of department stores, to the great mail-order houses, all of whom are unquestionably in interstate commerce and whose spokesmen have told this subcommittee that they basically favor Federal Government control of their credit transactions—then, of course, independent, local retailers could have no objection to the proposed congressional action.

But, to subject hundreds of thousands of small retailers who are not in interstate commerce to Federal Government regulation and control; to require them to have the same technical know-how in complying with the law, adds an unholy burden to their day-to-day operations.

This subcommittee must be aware that the small business in this country is fighting a losing battle for survival, despite the efforts of the Congress and the administration which are intended to help. This proposed legislation adds still another barrier to survival for the small retailer. The small retailer has been forced to go into credit selling in order to compete with the large, mass distributors. He is not in the credit business by choice.

Finally, there has been substantial testimony before this subcommittee concerning the accepted fact that the unfortunate poor in this country are particularly victimized by unscrupulous businesses, including retailing, and, particularly, in the credit field. We know that in many cases these charges are true. We are familiar with the "dollar down and dollar when I catch you" merchants operating in poorer sections of metropolitan cities.

This deplorable situation—and we heard the horror stories from Mr. Margolius yesterday. I, personally, in my distant youth, ran a better business bureau for 12 years and know considerably of these so-called horror stories—often recited before the Congress by those favoring the proposed legislation, adds weight to our argument that this legislation has the primary purpose of promoting economic stability and regulating the currency and moneys of this Nation, but is a direct legislative attempt to regulate business integrity and practices.

Unfortunately, those who favor this legislation to correct the evil of unscrupulous operators of this type face certain disappointment.

May I interpose to say that many of these cases that were heard yesterday involve fraud—violation of the present law. Fraudulent operators will violate any law—thieves will always be thieves. The way to correct it is to enforce the present law, and there are many facilities existing for the correction and prosecution of fraud.

The committee is aware of the historic fact that the law has never defined "fraud" because the capacity of the human mind is such that those who want to perpetuate fraud find ways to evade all statutes.

The questionable credit clothing stores operating in the slums of America and feeding off the poor and the illiterate normally do not make a charge for credit. In many instances, they blatantly advertise "no charge for credit." They take advantage of the poor in the exorbitant charges made for the merchandise. A legitimate store will normally sell a suit costing the merchant $50 for about $85. This store, extending credit beyond a 90-day period, normally levies a service charge of 1½ percent on the unpaid balance. The questionable credit operator will buy a much inferior suit for $35 and will sell it on the "dollar down and dollar a week" basis for $100 or higher—no charge for credit. The proposals now under consideration will not correct this existing evil but rather will promote its growth.

As a matter of fact, if this legislation passes, many legitimate stores will discontinue service charges for credit. They will find the provisions too burdensome and too difficult to comply with. The easy road is to eliminate a charge for credit. The expense of credit will be hidden in the markup on merchandise. This means the cash buyer will be penalized and will be paying for the credit extended to the credit buyer. The cost of credit will be driven underground.

For these reasons—because of the fundamentals of Americanism and respect for our great Nation's constitutional principles—I sincerely feel it is my duty as a spokesman for Menswear Retailers of America to oppose the proposed legislation.

We realize our arguments differ sharply from the many leaders of American big business engaged in interstate commerce who have preceded us to the witness stand. The explanation is simple. The problems of survival for small, independent, local business differ sharply from their large counterparts.

Thank you very much, Madam Chairman and members of the committee.

Mrs. SULLIVAN. Thank you, Mr. Rothschild.

We are glad to have your statement, for we believe all sides should be heard on a matter of this kind. However, I do not agree that this committee has neither the jurisdiction nor the competence to look into these issues.

You say that most of your members make a monthly service charge of only 1½ percent, usually, for credit beyond 90 days. Does that mean—as I hope it does—that most of them make no charge at all for the 90-day period, considering that a cash transaction?

Mr. ROTHSCHILD. That's correct, in most cases. There is no uniformity. Approximately, among our membership today, 70 percent of the sales are made on credit. Of that 70 percent, 50 percent is made on the

basis of a 30-day charge account which sometimes lapses into 90 days with no charge. Then there are 3-month charge accounts, 6-month charge accounts, 1-year credit terms on which there are service charges. A few of our stores are in revolving credit.

Mrs. SULLIVAN. Would it not solve some of your problems in competing with the unscrupulous credit outfits if we eliminated garnishment as a crutch for firms which oversell on credit to bad credit risks, so that they cannot use the courts as weekly or monthly collection agencies? We are just as anxious as you are to end the misuse of credit by both the seller and the buyer.

Mr. ROTHSCHILD. The easy answer, Madam Chairman, and may I say that while I do not think this committee has jurisdiction, I did not question the competence of the members of the committee.

The easy answer to your last question is "Yes." If we are going to stand on principle, what right has the Federal Government to regulate State laws of the 50 States on the matter of garnishment which is a local matter within the jurisdiction only of the States? I may be awfully reactionary in this modern day and age in making such a firm statement. But if I am going to appear here on principle, on the basic principle against the growing encroachment of the Federal Government on small local business, I have got to appear all the way.

Mrs. SULLIVAN. May I refer you to the material I placed in the Congressional Record last night containing the testimony given to us last Friday morning by four referees in bankruptcy from all across the country. They reported to us on the basis of some 54 years of experience in personal bankruptcies in the Federal courts. I wish you would read that testimony.

Mr. ROTHSCHILD. I read the newspaper report. I will be pleased to read that testimony. I do not think it changes the fundamental. The fundamental is that credit and collection laws in the State of Missouri are within the jurisdiction of the legislature of the State of Missouri and not within the jurisdiction of the Federal Government.

Mrs. SULLIVAN. My only comment on that, Mr. Rothschild, is that we are no longer a stationary people. We are a mobile people and we move from place to place, and there should be some uniformity.

Mr. ROTHSCHILD. Let us then amend the Constitution and change our form of government, which we are doing by indirection.

Mrs. SULLIVAN. We have about 2 minutes remaining for this period. Do you, Mrs. Dwyer, or any of the other members have any questions for Mr. Rothschild? Mr. Gonzalez?

Mr. GONZALEZ. I have one question. You do have the Wool Products Labeling Act, the Flammable Products Act, the Fur Products Labeling Act and the Textile Fiber Products Identification Act which in a way regulates your constituents in having to identify and give information to the consumer as to the product, its quality, and its identification.

Mr. ROTHSCHILD. That's correct, Mr. Gonzalez. Those laws specifically read, affecting interstate commerce. The Federal Trade Commission Act itself is different.

Mr. GONZALEZ. To be effective they would have to come under some purview of Federal jurisdiction somewhere—constitutional or statutory authority.

Mr. ROTHSCHILD. That's correct.

Mr. GONZALEZ. Even if this proposed act would have to come under that general definition.

Mr. ROTHSCHILD. We have all forgotten about the old *Schecter* decision, NRA, but I am not sufficiently acquainted with the technicality of the language, but if the language in this bill is such that it construes a credit contract as affecting interstate commerce, I think it opens the door for litigation in the future. But it does provide an excuse for constitutionality of the bill. However, the fact remains that you are interfering in the rights of local people.

(Mr. Rothschild subsequently submitted the following letter pertaining to Mr. Gonzalez line of questioning:)

MENSWEAR RETAILERS OF AMERICA,
Washington, D.C., August 17, 1967.

Hon. HENRY B. GONZALEZ,
House of Representatives,
Washington, D.C.

MY DEAR MR. GONZALEZ: We deeply appreciate the interest you have demonstrated in the hearings on the Truth and Lending legislation and, particularly, concerning the problems of the small independent merchants who comprise a large portion of this Association.

During the course of my testimony on Tuesday morning, August 15th, you directed a very intelligent question to me concerning the point we have raised over Federal controls on purely intrastate businesses.

In this question, you cited as an example the regulations contained in the Wool Products Labeling Act, the Flammable Products Act, the Fur Products Labeling Act and the Textile Fiber Identification Act as being an existing example of Federal regulation of our constituents.

While I attempted to answer your question for the hearing record during my appearance and referred to the distinguishing features of the Federal Trade Commission Act, it seems to me, on further reflection, a more important difference should have been cited by me in response to your question.

The various forms of regulations noted in your question place the primary compliance responsibility with the manufacturer of the product who, in most cases, is engaged in interstate commerce. There is not a practical day to day compliance problem on the part of small merchants.

We would be delighted if you would care to insert this letter as an appendix to our statement as it appears in the printed hearings.

Respectfully,

LOUIS ROTHSCHILD,
Executive Director.

Mr. WILLIAMS. Mr. Rothschild, I want to compliment you on an excellent presentation, and you have been asked the question, if garnishments were removed, would that not take something away from the small unscrupulous businessman? My question is, if you remove garnishments as a tool of collection, what protection is the small businessman going to have against the person who is overextending their credit using perhaps the excuse that they are poor to buy more than they really should be buying?

Mr. ROTHSCHILD. The creditor, in his legal efforts for collection today is handicapped. The small claims courts of this country are consumer-oriented today. I have had considerable experience in the picture and in my distant youth I practiced law and handled collections and made some garnishments. It is a tool—a last-resort tool for the legitimate creditor to try to collect from the deadbeat debtor.

Mr. WILLIAMS. Do you think this is a tool that the small businessman needs to have available to him in his effort to stay in business?

Mr. ROTHSCHILD. I think it is a proper legal instrument for the enforcement of a judgment.

Mrs. SULLIVAN. Thank you, Mr. Rothschild.

Mr. ROTHSCHILD. Thank you.

SECTION 207.—COMMODITY FUTURES MARGINS

Mrs. SULLIVAN. I would now like to call to the witness table the representatives of the commodity exchanges interested in section 207 of H.R. 11601.

Nearly all of our witnesses who have expressed any interest whatsoever in section 207 of H.R. 11601 up to this point in our hearings on the Consumer Credit Protection Act have voiced either uncertainty or dismay about having this particular section in a bill dealing primarily with consumer credit and truth in lending. Some have said that if there is any need to regulate margins in commodity futures trading, it should be done in some other bill—not on the truth-in-lending measure, regardless of how broad that measure might be.

Others have testified—including the Vice Chairman of the Federal Reserve Board which would have the regulatory power over margins under section 207—that they just don't know anything about the subject. Perhaps, they said, the Department of Agriculture should regulate margins on commodity futures—including, presumably, on futures trading in zinc, rubber, copper, silver, platinum, and even bags of silver dollars, along with those agricultural commodities like pork bellies, live cattle, coffee, and sugar which are now traded in futures contracts without any form of regulation by any agency of the Federal Government.

It is true that the Department of Agriculture's Commodity Exchange Authority regulates trading in a number of agricultural commodity futures, but it does not have any jurisdiction over margins set by the various exchanges. It has requested such authority from time to time—but not this year, when a new administration bill was sent up to amend the Commodity Exchange Act. It has reported that the question of margins is still being studied, following the receipt of a still-secret economic report on the subject by a private consulting firm.

The Committee on Banking and Currency has no jurisdiction over the Commodity Exchange Act, and seeks none. We are not attempting to decide what agricultural commodities now traded on futures exchanges but not subject to the Commodity Exchange Act should be placed under that act—although I, as an individual Member of Congress, have introduced bills on that subject for the past 13 years, with only one hearing during all of that time—and no action. But that does not directly concern this committee or the Consumer Affairs Subcommittee.

We are, however, interested in—and responsible for—legislation dealing with gyrating prices of consumer products and essential defense materials. The Defense Production Act comes within the purview of the Committee on Banking and Currency, and this act originally contained authority for price regulation and for standby powers in the Federal Reserve Board over consumer and real estate credit. And, of course, the Federal Reserve Act comes under the Banking Committee.

In a comprehensive piece of legislation dealing with all aspects of credit, including defense emergency standby powers over consumer

credit, some of us sponsoring H.R. 11601 felt that it was time—and long past time—that Congress took a critical look also at futures trading practices on very low margin which lead to great gyrations in prices of foodstuffs and essential defense materials. I do not consider bags of 1,000 silver dollars as essential defense articles, although silver, of course, certainly is. So are the other metals and nonagricultural commodities traded on futures markets, and so, of course, are those raw and partly processed agricultural commodities also traded in futures contracts but not now subject to any futures trading regulation.

Hence the inclusion of section 207 in this bill. We want to know why this large segment of our economy—unlike the stock exchanges—is outside of the scope of investor protection and economic stabilization powers. If the Federal Reserve doesn't know enough about futures trading even to hazard a guess as to how to regulate margins, should the job go to the SEC? Or—as the witnesses today will undoubtedly maintain—should this type of trading continue to go on in rubber, zinc, lead, copper, platinum, silver, tin, mercury, and so on, with no Government agency looking over the shoulders of speculators or manipulators, even though the effects of their operation may determine the prices paid by the Defense Department for equipment or the prices paid by consumers for essential items?

And on the agricultural commodities—whether regulated or not, and many of them are not regulated—should the relative ease with which contracts can be purchased or sold on little or no cash be of no concern to the Government either?

This subcommittee has had occasion in previous years to look into spirals in two important consumer items—coffee and sugar. In both instances, frantic speculative activity in unregulated futures trading set off a spiral of consumer prices. Ironically, it was trading primarily in foreign sugar futures—sugar which would never come to the United States—which pulled up domestic sugar prices in 1963 to the highest level in many, many years. In 1954, a deliberate hoax about a Brazilian coffee shortage provided the atmosphere for a rigged futures market, and sent the price of a pound of coffee here in the United States to $1.32.

That is the backdrop on which we have set up this hearing this morning. We want to know why there is something so special and unusual and mysterious about futures trading that the public has no right to set limits on gambling with borrowed money in this area, even though the public must pay the consequences of speculative excesses.

We invited a representative group of the major exchanges—not just in grains and other agricultural commodities, but in the metals and minerals—to send representatives here this morning, and most of them quickly accepted. Other exchanges also asked to be included, and we invited them, too. Several have since had a change of heart and the group here this morning represents the hardy survivors who have agreed not only to tell us why we should not enact section 207 but also to answer our questions and let us learn something about their operations. We are glad to have all of you.

Before calling the witnesses, I want to insert in the record a most unusual document in the light of most of the testimony we will receive this morning. It is a letter addressed to me by the president of an ex-

change which completely and enthusiastically endorses and supports that section of H.R. 11601 which relates to it. It goes all the way in favor of our bill—or rather of one section.

It is from Mr. Keith Funston, president of the New York Stock Exchange, and he completely endorses section 203, and I am delighted that this exchange, at least, likes something in H.R. 11601. Section 203, I might add, is the one which exempts "transactions in securities or commodities in accounts by a broker-dealer registered with the Securities and Exchange Commission" from the annual percentage rate credit disclosure requirements of H.R. 11601. A similar provision was included in S. 5 as it passed the Senate, and is in H.R. 11602, also. So, on that point, there is no controversy.

Mr. Funston's letter will be inserted at this point.

(The letter referred to follows:)

NEW YORK STOCK EXCHANGE,
New York, N.Y., August 9, 1967.

HON. LEONOR K. SULLIVAN,
Chairman, Subcommittee on Consumer Affairs, House Committee on Banking and Currency, Rayburn House Office Building, Washington, D.C.

DEAR CHAIRMAN SULLIVAN: As the Sub-Committee on Consumer Affairs begins its consideration of S. 5, HR 11601 and HR 11602, I would like to take this means to explain why the Exchange believes the provision in Section 8 of S. 5 and HR 11602 and Section 203 of HR 11601 which exempts "transactions in securities or commodities in accounts by a broker-dealer registered with the Securities and Exchange Commission" is well founded.

The securities industry is one of the most regulated businesses in the United States. The most significant aspect of securities regulation, however, is the self-regulatory influence exerted by groups within the industry itself, such as the stock exchanges and the National Association of Securities Dealers, Inc. For many years, this system of self-regulation, supplemented by government oversight, has worked to keep the securities industry acutely aware of the interests of investors.

Being mindful of the Exchange's self-regulatory responsibility in this area of margin account interest rates, the Board of Governors addressed itself to the subject in July, 1966. As the result of Board action taken at that time, the staff was directed to undertake an educational program designed to encourage member organizations carrying margin accounts to voluntarily disclose to customers the interest rates charged on debit balances. A follow-up survey made in September, 1966 indicated that 67% of member organizations carrying margin accounts showed or intended to show interest rates.

After providing a period of time for member organizations to begin disclosing margin account interest rates on a voluntary basis, the Board of Governors, at its July, 1967 Policy Meeting, adopted an amendment to Exchange Rules making disclosure of interest rates mandatory. This proposal was, of course, submitted to the Securities and Exchange Commission before being adopted by the Board. The text of the amendment together with an explanation of its application are included in the enclosed circular which has been sent to all members and member organizations of the Exchange.

The affirmative steps taken by the Exchange's Board of Governors in this instance provides an excellent example of how the self-regulatory system can and does fulfill its responsibility to the investing public and the securities industry. This action obviates the need for the Congress to direct such disclosure. Further, it demonstrates that the exemption in S.5, HR 11601 and HR 11602 is fully justified and should be retained.

Yours very truly,

G. KEITH FUNSTON, *President.*

Mrs. SULLIVAN. Now, to go back to the arena of controversy, we will ask our witnesses this morning to group themselves around the table. May I suggest that the representatives of each exchange who are present take turns in identifying themselves for the official reporter and for us, list the name of the exchange, the commodities traded

thereon, the volume of trading a year in each item, the average value of a contract in dollars, and also in tons, pounds, ounces, or whatever the trading unit is, what the current margin is in percentage of cost of a contract, what that represents in dollars, and then we will go on from there and you can make your statements.

I am sure there will be some repetition in the statements which perhaps can be overcome by telling us about the unique differences which may exist among the products traded on the various exchanges.

First, however, if you will identify your exchange and give the information I requested; that is—and I'll read this more slowly—the commodities traded on your exchange, the volume of trading a year in each item, the average value of a contract in dollars and the size or quantity of the trading unit, what the current margin is in percentage of cost of a contract and what that represents in dollars. Let us start with the chairman of the New York Mercantile Exchange, Mr. Llewellyn Watts, Jr., whose statement, I believe, was the first to arrive. Will you tell us, Mr. Watts, what commodities are handled on your exchange and give the information I requested about them.

Mr. WILLIAMS. Could I suggest also that it might be helpful to the committee to know to what extent credit was involved in these transactions?

Mrs. SULLIVAN. Credit is, of course, margin.

Mr. WILLIAMS. There may be some disagreement on that point.

Mrs. SULLIVAN. Would the first gentleman to my left identify himself and then we will continue from left to right in the order in which you are seated.

STATEMENTS OF ROGER W. GRAY, PROFESSOR, STANFORD UNIVERSITY, CALIFORNIA; WILLIS C. THEIS, PRESIDENT, BOARD OF TRADE OF KANSAS CITY, MO.; WILLIAM F. BROOKS, ON BEHALF OF THE NATIONAL GRAIN TRADE COUNCIL; MAURICE MOUND; ESQ., REIN, MOUND & COTTON, NEW YORK, N.Y.; J. S. CHARTRAND, EXECUTIVE VICE PRESIDENT, KANSAS CITY BOARD OF TRADE; F. MARION RHODES, PRESIDENT, NEW YORK COTTON EXCHANGE; LLEWELLYN WATTS, JR., CHAIRMAN OF THE BOARD OF THE NEW YORK MERCANTILE EXCHANGE; AND ALEX C. CALDWELL, ADMINISTRATOR, COMMODITY EXCHANGE AUTHORITY, U.S. DEPARTMENT OF AGRICULTURE

Mr. MOUND. My name is Maurice Mound. I am counsel for the New York Cotton Exchange and the New York Mercantile Exchange. I am here to assist my clients. I am a member of the firm of Mound, Rein & Cotton, New York.

Mrs. SULLIVAN. The next gentleman?

Mr. WATTS. My name is Llewellyn Watts, Jr. I am chairman of the Board of the New York Mercantile Exchange.

Mr. RHODES. I am F. Marion Rhodes, president of the New York Cotton Exchange.

Mr. GRAY. I am Prof. Roger W. Gray, Stanford University. I am appearing on behalf of the Grain & Feed Dealers National Association,

which is not an exchange but whose members are members of the numerous exchanges.

Mr. THEIS. My name is Willis C. Theis. I am president of the Board of Trade of Kansas City, Mo.

Mr. CHARTRAND. My name is J. S. Chartrand, and I am executive vice president of the Kansas City Board of Trade.

Mr. BROOKS. I am William F. Brooks. I am president and general counsel of the National Grain Trade Council. We are all users of futures markets.

Mrs. SULLIVAN. Now, we would like the information that I outlined. Please give us the commodities, value of the contracts, and so on, traded on your exchanges.

Mr. Watts, would you begin?

Mr. WATTS. I have asked if I would yield to Professor Gray because of limitation of time.

Mrs. SULLIVAN. Before Mr. Gray begins his testimony could we get from you, Mr. Watts, the commodities traded on your exchange?

Mr. WATTS. Potatoes and platinum. Potatoes are regulated; platinum is not.

Mrs. SULLIVAN. The volume of trading last year in each of these items?

Mr. WATTS. Approximately a half million contracts of potatoes, and 1,200 to 1,500 contracts of platinum. I haven't the figures with me.

Mrs. SULLIVAN. The average value of the contract in dollars and the size or quantity of the trading unit?

Mr. WATTS. Potatoes will average $1,500 a contract or less, and the average margin on money to be placed for the protection of the clearinghouse or clearning member is approximately 15 to 18 percent.

Mrs. SULLIVAN. Is that unusual?

Mr. WATTS. What?

Mrs. SULLIVAN. Is that 15 or 18 percent unusual, or is that a normal percent of margin?

Mr. WATTS. It is with us. We also have an escalating clause; as the price goes higher the margin becomes higher.

Mrs. SULLIVAN. The percentage of margin becomes higher, or the amount?

Mr. WATTS. The amount goes higher. You see, these are futures contracts, not cash markets—when the market reaches a cash basis, then we ask for $150 more each contract—whatever it is—if the margin is up then to around $300 or $350 we ask for another $150 to insure that the contracts will be properly carried out.

Mrs. SULLIVAN. You mentioned that the contract in dollars for potatoes runs to about $1,500?

Mr. WATTS. That's right.

Mrs. SULLIVAN. What is the size or quantity of the unit?

Mr. WATTS. 50,000 pounds.

Mrs. SULLIVAN. And in platinum?

Mr. WATTS. Fifty ounces.

Mrs. SULLIVAN. And the value?

Mr. WATTS. The value—it is pretty high right now—50 ounces—I don't trade in platinum much.

Mrs. SULLIVAN. You can supply that for us.

(The information requested follows:)

1966 Platinum volume 1,033 50-ounce contracts.
Minimum margin $300, long or short.
Value range $5,000–$6,500.
Limit permitted daily fluctuation $5 per ounce or $250 per contract.
Minimum price change 5 cents per ounce or $2.50 per contract.

Mrs. SULLIVAN. Mr. Rhodes, can you give us those answers for your commodities?

Mr. RHODES. New York Cotton Exchange trades in cotton futures. The cotton futures market has been almost destroyed in the last 15 or 20 years by the operations of the Commodity Credit Corporation in the Department of Agriculture. As you probably know, the Department of Agriculture has programs under which they make loans on raw cotton, they take over the loans at the end of the year, and they have it in their own inventory, list it in a catalog, and offer it for sale at a fixed price. Recently they have been announcing their price for as much as 2 years in advance. Everybody in this country and in foreign countries knows the price at which they can purchase CCC inventory stocks of cotton. When the market is completely dominated by the Government there is no need or a place for a futures market. So our market in the last 3 years has been almost defunct.

As you probably know, the New Orleans Cotton Exchange closed up completely and liquidated its assets as a result of this Government program. Now it looks like the worm has turned. Cotton prices now have gone above the loan level established by the Government and cotton trading is beginning again. In March we opened up a new contract based on Middling $1\frac{1}{16}$-inch staple cotton. This contract is beginning to move quite well during the last 6 to 8 weeks. Now after many years of inactivity, we are at a position where our market is needed again by the textile mills and by the merchants of this country. We hate to see anything done that would destroy the start that we have made.

Specifically to your questions, a contract in cotton is 100 bales—roughly today's price of cotton is about 20 cents, so that the value of a contract would be around $10,000. Both the buyer and seller of a futures contract are required to put up margin, so both sides would put up $500 margin to guarantee their contract. The volume of sales in the last year was about 2,000 cotton contracts.

Mrs. SULLIVAN. Does that margin of $500 vary, or is it a flat $500, or a percentage which comes out to $500 on a $10,000 contract?

Mr. RHODES. $500 for some time. The board of directors has the power to change it any time it has reason to change it. But it is our belief that margins should be as low as it is possible for them to be to promote the maximum amount of trading, because that makes our market more fluid and more liquid and of more use to the public.

Mrs. SULLIVAN. I am sorry that the New York Coffee and Sugar Exchange representatives are not here this morning. They have sent a statement. Back in 1963 they were before our subcommittee on sugar and in 1964 on coffee. We were also in New York to watch the bidding on this and some of the other exchanges, and then we did some investigative work on sugar futures. It was very enlightening.

Mr. RHODES. I might add that I have been on both sides of the cotton market. I spent 27 years in the Department of Agriculture where I

administered the Government's cotton program. I grow cotton myself out in Missouri and I am now on the futures market side of it. So I know from personal experience that a futures market has a very important part to play, not only to the Missouri cotton farmer, the consumer of cotton, the merchant and, millowner. I do have a statement which I assume will be put in the record. But since I received your letter I thought it would be better to give one person ample time to explain the operations of a commodity market than to have me take more time.

Mrs. SULLIVAN. Your prepared statements will be placed in the record in full.

Mr. Theis, will you tell us about the commodities traded in Kansas City?

Mr. THEIS. Madam Chairman, as stated, my name is Willis C. Theis, president of the Board of Trade of Kansas City, Mo.—4800 Main Street in Kansas City, Mo.

We are now trading, actively trading in wheat, corn, grain sorghums, and feeder cattle. The volume of trade, if you would like to know the volume—do you want to know the volume of the contract or the total amount of trading during the year?

Mrs. SULLIVAN. Total volume of trading in each contract, and then an approximation of the value of a contract, and the physical size of the contract in terms of tons or bushels or whatever.

Mr. THEIS. I will just ramble on. The wheat, grain sorghum, and corn contracts are of a unit of 5,000 bushels or multiples thereof.

The value of the contracts vary as to the level of price, but approximately today the wheat contract, the 5,000 unit, is worth approximately $7,500. The corn contract of the same size has an approximate value of $6,000. The milo grain sorghum contract has a value of approximately $5,500.

I have not mentioned the size of the feeder cattle contract, but it is one of 25,000 pounds and this unit today has a value of approximately $6,500.

Now, as to the percent of the margin that is asked on all of these—I should back up here. As of last year, we do not have this year's record because the trading year has not been completed. But in the year 1966 we had a total volume in wheat of 929,292,000 bushels.

In corn we had a volume of 30,900,000 bushels.

Mrs. SULLIVAN. When you give us these totals can you tell us there how many contracts these represented for the year?

Mr. THEIS. We will divide by 5,000, and let's say there are about 200,000 contracts of wheat. Let's call the milo about 600,000—that is the corn. About 6,000 contracts there and about 6,500 contracts in grain sorghums and actually 596 contracts in the feeder cattle last year.

Now, as to the margins. They average approximately 5 percent of the value of the contract. This is true for all of the contracts, with the exception of the feeder cattle, and I would request that I be given the opportunity to furnish this to the committee on accurate records, because these prices do not stay with me on feeder cattle.

Mrs. SULLIVAN. We will be happy to have you do that.

Mrs. SULLIVAN. Mr. Chartrand—oh, you are with Mr. Theis, and would have the same information.

Mr. CHARTRAND. Except there is no credit extended. Margins are charged, required—maintenance and initial margins are required, but no credit is extended.

Mrs. SULLIVAN. Mr. Brooks?

Mr. BROOKS. We don't do any trading. Our members do.

Mrs. SULLIVAN. I am interested in the margin that is needed in order to buy and sell in the futures market because we found that, in the case of sugar, when an investigation was made under subpena—the brokers asked to be subpenaed so they could divulge their information without breaking confidence with their customers—that speculators who had never ever been in the sugar market before were coming into it in 1963 to try to make a fast dollar. For a few hundred dollars they could trade on futures contracts worth many thousands. Many of them came out well heeled, while others went broke. But because of the speculative fever involving so many people who had never been into this kind of trading before, the price was pushed up to the highest level in 40 years. Our reason for going into this in 1963 was the doubling of sugar prices. Users of sugar—the confectioners, the soft drink people, and others—pleaded with the Congress to do something to help stabilize a commodity whose price was completely out of control. By the time we started our investigation, sugar had gone to something like 13.9 cents on the world market. Today if I recall the last figures I have seen it is something like 2 cents.

Mr. THEIS. Madam Chairman, I would like to make one statement as to margins and percent that were mentioned to you and given to your committee.

Please understand that those are minimum margins. As far as margins are concerned on the Kansas City Board of Trade in their contracts they are governed by the board of directors and also looked over and scrutinized by the business conduct committee in the action of our members, and they are set at a minimum level as to the times. They do fluctuate and they have been known to fluctuate, and we have a complete schedule showing how they have fluctuated. This is the margin through the years.

Mrs. SULLIVAN. I do not know about the other committee members, but I think most of us are fairly ignorant of how the futures market works on grains and other regulated commodities. The only experience we have had as a subcommittee have been, as I said, in coffee and sugar futures. Neither of those commodities are under any regulation at all. After the Federal Trade Commission investigated coffee prices at my request, I put in a bill to regulate coffee futures trading, as the FTC had recommended. In 1965, I added sugar to the bill because of what we had learned in our own study into the 1963 spiral. Then this year, based on what I learned as a member of the National Commission on Food Marketing in 1965 and 1966, I also included livestock and livestock products.

Now, if Dr. Gray will proceed with his statement, we will proceed from there.

Mr. GRAY. Thank you, Madam Chairman, members of the committee.

I am Roger Gray, a professor at Stanford University, where for the past 13 years my research and teaching have been concentrated in the area of commodity markets and prices. I have consulted with several commodity exchanges and members firms on commodity marketing problems, and testified before Congress on previous occasions on legislative proposals affecting commodity markets. Today I am appearing in behalf of the Grain and Feed Dealers National Association, a nationwide association of individual marketing and processing firms, most of which rely heavily upon commodity futures markets for hedging and price determination.

Section 207 of H.R. 11601 is evidently based upon a very widespread misconception. It reads in part that "the Board of Governors of the Federal Reserve System shall prescribe regulations governing the amount of credit that may be extended on any (futures) contract." The plain fact of the matter is that credit is not extended or maintained on futures contracts. This being the case, one might simply say that section 207 is innocuous or meaningless, and let it go at that. I prefer to elaborate, however, because I think that I know what is intended in this section, I think that the misconception which it reflects needs to be cleared up, and I share with the sponsor of this section a concern that futures markets be properly understood and regulated.

I believe that it is commonly accepted that this section intends to say that margin levels in commodity futures should be prescribed by the Board of Governors. I think further that it assumes that "margins" in commodity markets resemble "margins" in the securities markets, where in fact credit is extended and where the "margin" level governs the amount of such credit. This assumption is mistaken, however, notwithstanding the fact that it is commonly held. Let me then first explain why futures margin regulation is not credit regulation, then proceed to consider other aspects of futures margin regulation which are suggested in the other wording of section 207.

When the Assistant Secretary of Agriculture, Mr. George Mehren, testified before the Domestic Marketing and Consumer Relations Subcommittee of the House Agriculture Committee on April 4, 1966, he said, "There is a difference between the purpose of margins in the security and commodity markets." I agree emphatically with this statement; I should like to spell out briefly what the difference is. The purpose of what we call margin in the security markets is clearly stated in the Securities and Exchange Act of 1934 under the heading Margin Requirements: "For the purpose of preventing the excessive use of credit for the purchase or carrying of securities, the Federal Reserve Board shall prescribe rules and regulations with respect to the amount of credit that may be initially extended and subsequently registered on a national securities exchange." Clearly, margin in this context refers to the required level of down payment on credit purchases of securities. In other words, the purchase of securities on margin is a credit transaction, entailing transfer of the right to use and enjoy capital assets—common stocks—and also entailing the lending of funds. In contrast, the purchase or sale of a futures contract on margin is not a credit transaction. A futures contract entitles its owner to exercise a later option to receive or deliver commodities. If this option is later exercised, which it rarely is, then the right to use and enjoy the

capital asset—the commodity involved—is conveyed in a transaction requiring full immediate cash payment. The only capital asset involved is the commodity itself, which can only be owned and used after delivery occurs, at which time ownership is otherwise financed through otherwise established credit facilities, chiefly the banking system. Since no title is conveyed prior to delivery and no loan is extended, no credit can be involved in a futures transaction, hence the word "margin" has an entirely different meaning in this context, and the purpose of margin is different.

The purpose of margins on futures transactions is to assure the transfer of funds from those who incur losses to those who profit from futures price movements. They are always established at levels intended to cover the prospective price change. These profits and losses must be exactly equal, as there can be no net gain or loss to all participants in futures trading—which there can be, and often is, to all owners of securities. Not only is there a short position opposite every long position in futures, as there is not in securities, but the short sale of a futures contract is exactly symmetrical with the purchase of a futures contract, which is also not true of stock transactions but is true of the purchase and sale of options to buy or sell securities, referred to as "puts" and "calls."

Let me sum this up with an illustration. When I buy a $100 share of stock by depositing $70 margin with a commission firm, the commission firm loans me the other $30. I may receive dividends which manifest my use and enjoyment of the capital assets which I have purchased. But when I buy a corn futures contract entitling me to receive 5,000 bushels of corn next December by depositing $500 with a commission firm, neither that firm nor anyone else loans me any money. I have purchased no capital assets, hence I cannot receive any earnings or other manifestations of the use and enjoyment of a capital asset. From this it is already clear that futures margins are much different from security margins and that the purposes for which the Board of Governors controls the latter could be in no way served by vesting commodities futures margin control in the Board of Governors.

It should also be noted that the relationship between price and the current earning capacity of the capital asset being priced cannot fluctuate over such a wide range, or be distorted over such a long interval, in futures as in the stock market. The price-earnings ratio of the stocks in the Dow Jones industrial average has ranged from 6.4 to 51.5 since 1933, indicative of how far stock prices can range from the true current earning capacity of the physical assets they represent. This fact in itself is hardly reassuring on the point of efficacy of stock margin controls, but the more salient fact is that this has not occurred and could not occur in commodity futures. Commodity futures prices can depart from the true expected earning capacity of the physical asset which they represent also, but this departure is necessarily brief and limited. Prices of commodity futures contracts must come to the actual commodity price from four to 12 times a year, depending upon the number of delivery months.

The question of credit expansion, then, has utterly no relevance to commodity futures. The question of excessive speculation may be said

to remain, although it remains only in the context of appropriate regulation of futures markets, not in the context of credit controls. If and when excessive speculation should occur in commodity futures, the price level could be temporarily distorted, either upward or downward, depending on whether buying or selling was excessive. The questions then become (1) How prevalent are temporary price distortions that result from excessive speculation? and (2) How effective would margin controls be in correcting any such distortions? Our studies of price behavior on numerous futures markets have shown that price movement tends to excessiveness on those markets which have inadequate speculation. The thin futures markets, relatively little used, tend to produce two kinds of price distortion. One kind is the relatively large dips and bulges caused by transactions, since the market is not broad and liquid, buyers have to bid the price up to find sellers, sellers have to offer the price down to find buyers. The other kind of price distortion is the persistence of prices which are too low or too high, as thin markets tend to be lopsided, owing to more persistent trading efforts by one side or the other. The reasons for this imbalance vary from one market to another, but the fact is well established that some thin futures markets evoke persistent underestimates and others persistent overestimate of price. In contrast, prices on the larger futures markets, with more speculation, display smaller dips and bulges and no general tendency to overestimate or underestimate subsequent price levels. The conclusion must be that, in general, larger amounts of speculation are desirable, for reducing prices, price distortions of the kinds described.

In specific instances, of course, the mistaken ideas of speculators may carry prices to an incorrect level, even on the largest market. These infrequent distortions can be identified in a careful retrospective analysis after all the facts have emerged, but it would be virtually impossible to identify them while they are occurring. In April of this year, for example, a front-page article in the Wall Street Journal analyzed wheat prices in relation to the weather and pointed to the likelihood that prices would rise to $2 per bushel from the $1.75 level then prevailing. Instead, as the weather improved, prices subsequently declined to $1.50 per bushel. If speculation had carried prices to $2, we can now see that it would have been a mistake. Yet in April it would have required clairvoyance to make that judgment.

The implications for margin controls may now be summed up. There is no general case for higher margin levels. Existing levels have provided the protection sought whereas higher levels, to the extent that these would discourage futures trading, would be a disservice to the economy. Raising margins on occasion, to discourage temporary excesses of speculation, is not feasible because it is not possible to identify excessive speculation at the time of its appearance. Nor should the fact be ignored that futures markets are essentially hedging markets used by commodity firms because of the great economy of trading futures. Anything which reduces that economy necessarily raises the cost of doing business, which must be reflected in higher consumer prices and lower prices to growers.

I conclude that excessive speculation in futures contracts is rare, that it has no significant effect upon consumer prices, that consumer

prices would likely be inflated if margins were raised for the purpose of curtailing speculation, that margin control is not a form of credit control and that credit is not extended nor maintained on commodities futures contracts; hence there can be no need for the Board of Governors to regulate the amount of such credit.

Mrs. SULLIVAN. Thank you, Dr. Gray; your statement will be printed in full.

(The full statement of Mr. Gray follows:)

STATEMENT OF ROGER W. GRAY FOR GRAIN AND FEED DEALERS NATIONAL ASSOCIATION

I am Roger Gray, a professor at Stanford University, where for the past thirteen years my research and teaching have been concentrated in the area of commodity markets and prices. I have consulted with several commodity exchanges and member firms on commodity marketing problems, and testified before Congress on previous occasions on legislative proposals affecting commodity markets. Today I am appearing in behalf of the Grain and Feed Dealers National Association, a nationwide association of individual marketing and processing firms, most of which rely heavily upon commodity futures markets for hedging and price determination.

Section 207 of H.R. 11601 is evidently based upon a very widespread misconception. It reads in part that "the Board of Governors of the Federal Reserve System shall prescribe regulations governing the amount of credit that may be extended on any (futures) contract". The plain fact of the matter is that credit is *not* extended or maintained on futures contracts. This being the case, one might simply say that Section 207 is innocuous or meaningless, and let it go at that. I prefer to elaborate, however, because I think that I know what is intended in this section, I think that the misconception which it reflects needs to be cleared up, and I share with the sponsor of this section a concern that futures markets be properly understood and regulated.

I believe that it is commonly accepted that this section *intends* to say that *margin* levels in commodity futures should be prescribed by the Board of Governors. I think further that it assumes that "margins" in commodity markets resembles "margins" in the securities markets, where in fact credit *is* extended and where the "margin" level governs the amount of such credit. This assumption is mistaken, however, notwithstanding the fact that it is commonly held. Let me then first explain why *futures margin* regulation is *not credit* regulation, then proceed to consider other aspects of futures margin regulation which are suggested in the other wording of Section 207.

When the Assistant Secretary of Agriculture, Mr. George Mehren, testified before the Domestic Marketing and Consumer Relations subcommittee of the House Agriculture Committee on April 4, 1966, he said, "There is a difference between the purpose of margins in the security and commodity markets." I agree emphatically with this statement; I should like to spell out briefly what the difference is. The purpose of what we call margin in the security markets is clearly stated in the Securities and Exchange Act of 1934 under the heading "Margin Requirements": "For the purpose of preventing the excessive use of credit for the purchase or carrying of securities, the Federal Reserve Board shall prescribe rules and regulations with respect to the amount of credit that may be initially extended and subsequently registered on a national securities exchange". Clearly, margin in this context refers to the required level of down payment on credit purchases of securities. In other words, the purchase of securities on margin is a *credit transaction*, entailing transfer of the right to use and enjoy capital assets—common stocks—and also entailing the lending of funds. In contrast, the purchase or sale of a futures contract on margin is *not* a credit transaction. A futures contract entitles its owner to exercise a later option to receive or deliver commodities. *If* this option is later exercised, which it rarely is, *then* the right to use and enjoy the capital asset—the commodity involved—is conveyed in a transaction requiring full immediate cash payment. The *only* capital asset involved is the commodity itself, which can only be owned and used after delivery occurs, at which time ownership is otherwise financed through otherwise established credit facilities, chiefly the banking system. Since no title is conveyed prior to delivery

and *no loan is extended*, no credit can be involved in a futures transaction, hence the word "margin" has an entirely different meaning in this context, and the purpose of margin is different.

The purpose of margins on futures transactions is to assure the transfer of funds from those who incur losses to those who profit from futures price movements. They are always established at levels intended to cover the prospective price change. These profits and losses must be exactly equal, as there can be no net gain or loss to all participants in futures trading. (Which there can be, and often is, to all owners of securities.) Not only is there a short position opposite every long position in futures, as there is not in securities, but the short sale of a futures contract is exactly symmetrical with the purchase of a futures contract, which is also not true of stock transactions (but is true of the purchase and sale of options to buy or sell securities, referred to as "puts" and "calls").

Let me sum this up with an illustration. When I buy a $100 share of stock by depositing $70 margin with a commission firm. the commission firm loans me the other $30. I may receive dividends which manifest my use and enjoyment of the capital assets which I have purchased. But when I buy a corn futures contract entitling me to receive five thousand bushels of corn next December by depositing $500 with a commission firm, *neither that firm nor anyone else loans me any money.* I have purchased no capital assets, hence I cannot receive any earnings or other manifestations of the use and enjoyment of a capital asset. From this it is already clear that futures margins are much different from security margins and that the purposes for which the Board of Governors controls the latter could be in no way served by vesting commodities futures margin control in the Board of Governors.

It should also be noted that the relationship between price and the current earning capacity of the capital asset being priced cannot fluctuate over such a wide range, or be distorted over such a long interval, in futures as in the stock market. The price-earnings ratio of the stocks in the Dow Jones industrial average has ranged from 6.4 to 51.5 since 1933, indicative of how far stock prices can range from the true current earning capacity of the physical assets they represent. This fact in itself is hardly reassuring on the point of efficacy of stock margin controls, but the more salient fact is that this has not occurred and could not occur in commodity futures. Commodity futures prices can depart from the true expected earning capacity of the physical asset which they represent also, but this departure is necessarily brief and limited. Prices of commodity futures contracts must come to the actual commodity price from 4 to 12 times a year, depending upon the number of delivery months.

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In specific instances, of course, the mistaken ideas of speculators may carry prices to an incorrect level, even on the largest market. These infrequent dis-

tortions can be identified in a careful retrospective analysis after all the facts have emerged, but it would be virtually impossible to identify them while they are occurring. In April of this year, for example, a front page article in the Wall Street Journal analyzed wheat prices in relation to the weather and pointed to the likelihood that prices would rise to $2 per bushel from the $1.75 level then prevailing. Instead, as the weather improved, prices subsequently declined to $1.50 per bushel. If speculation had carried prices to $2, we can now see that it would have been a mistake. Yet in April it would have required clairvoyance to make that judgment.

The implications for margin controls may now be summed up. There is no general case for higher margin levels. Existing levels have provided the protection sought whereas higher levels, to the extent that these would discourage futures trading would be a disservice to the economy. Raising margins on occasion, to discourage temporary excesses of speculation, is not feasible because it is not possible to identify excessive speculation at the time of its appearance. Nor should the fact be ignored that futures markets are essentially hedging markets used by commodity firms because of the great economy of trading futures. Anything which reduces that economy necessarily raises the cost of doing business, which must be reflected in higher consumer prices and lower prices to growers.

I conclude that excessive speculation in futures contracts is rare, that it has no significant effect upon consumer prices, that consumer prices would likely be inflated if margins were raised for the purpose of curtailing speculation, that margin control is not a form of credit control and that credit is not extended nor maintained on commodities futures contracts, hence there can be no need for the Board of Governors to regulate the amount of such credit. (2)

Is it your desire now, Mr. Theis and Mr. Brooks and Mr. Chartrand, to read your statements?

Mr. THEIS. In compliance with a letter we have received from you in the past week I believe it would not only be proper to ask that our statement be submitted for the record, however, I would like to have the opportunity to give a short résumé of what is within the statement.

Mrs. SULLIVAN. That will be fine. Without objection, your full statements will be placed in the record, and we will be very happy to have you summarize them. We will then place in the record following these proceedings the statements we received from other exchanges not represented here in person today.

Mr. THEIS. Thank you. As stated in the prepared statement before the committee, the Kansas City Board of Trade was officially designated a "contract market" under the original Grain Futures Act on May 5, 1923, by Henry C. Wallace, then Secretary of Agriculture.

We have listed the different titles here, and we have analyzed section 207 of H.R. 11601 and shall direct our remarks specifically to the effects of section 207 to commodity futures contract trading.

In the first part of the statement we have referred to the title of section 207 which is entitled, "Regulation of Credit for Commodity Futures Trading." Here we again believe that the intent was to call attention and ask for control in the setting of margins, and not of credit. Our entire thinking is contained within that first paragraph. Also, we attach an appendix A which is our thinking and we accept the premise of the paper—written by Dr. Gray some few years ago—when we also now for the record accept the statements and make them a part of our feeling today as well.

Going on to part 2 of our statement, where the excessive speculation is used within the section itself, we allude to the fact that excessive speculation is what we believe you are calling volume trading. We have

made the same statements more or less in the same line of thinking as Dr. Gray's today, that excessive speculation or volume trading is not detrimental as far as the action of the market or the type of the market or the dips and curves are concerned. Our fear is in the light of limited speculation or light trading, thin markets.

We have gone on and stated in section 3 of our statement where the Federal Reserve System is asked to prescribe the regulations—this matter has been done by our board for some 90 years, 45 years not under regulation and the last 45 years under the regulation or the supervision of the Commodity and Exchange Authority. We further state too that margin levels are set by our board of directors and that, in addition, our business conduct committee supervises and observes the regulations and rules pertaining to margins and the conduct of our members thereto.

In the fourth part of our statement we refer to the inflating of consumer prices, and we submit that in excessive speculation, and again we call it volume trading, that this does not have a tendency to inflate consumer prices. In fact, it has just the reverse; it does just the opposite.

We draw for you an illustration of what would happen if there would not be volume trading or speculators in operations of futures markets as we know them today wherein buyers and sellers—they are speaking of buyers and sellers of the grain firms, processing firms, exporters and such within our industry—would have to build into their price factor the risk that they now have assumed within the futures contract itself.

We believe that without the trading, and if the trading would be limited by excessive margins, that the consumer's prices would be inflated and that the producer's prices would be deflated.

Further than that, Madam Chairman, the whole statement itself tells our story.

I would like to mention to you and your committee a recent operation within the commodity markets, and especially the Kansas City market as it pertains to wheat.

Last Friday, and again up through the marketing session of this past Monday, one of the flour businesses was conducted—in fact, the major flour mills entered into contracts with the major bakeries in the United States up through December 31, 1967. This is a sizable forward contract as it pertains to volume. The market's reaction was fantastic, it was extremely accepted and it absorbed all of the volume that was done at our market as of Monday and it closed a cent and a half lower than where it had been on Friday. This afforded people to do volume business in the future without upsetting the market.

Please visualize what would have happened if the market had not been there—the futures market had not been there for this operation and if the buyers and sellers would have to meet to consummate business that would project itself into the next 4 months.

Thank you very much.

Mrs. SULLIVAN. Thank you very much, Mr. Theis, your full statement will be inserted at this point.

(The statement referred to follows:)

STATEMENT OF WILLIS C. THEIS, PRESIDENT, BOARD OF TRADE OF KANSAS CITY, MO.

My name is Willis C. Theis, and I appear on behalf of the Board of Trade of Kansas City, Mo., a contract market regulated under the provisions of the Commodity Exchange Act. The Board of Trade of Kansas City, Mo., was officially designated as a contract market under the original Grain Futures Act on May 5, 1923, by Henry C. Wallace, then Secretary of Agriculture.

We have analyzed Section 207 of H.R. 11601, and shall direct our remarks specifically to the effects of Section 207 to commodity futures contract trading.

I. TITLE OF SECTION 207

H.R. 11601, Section 207, is entitled "Regulation of Credit for Commodity Futures Trading."

The title refers to regulation of "credit" and in the body of Section 207, p. 24, line 9, "The Excessive Use of Credit" is referred to, and p. 24, line 13, the "Amount of Credit," which operations do not exist on the trading of any commodity futures contracts on the Kansas City Board of Trade. In Mrs. Leonor K. Sullivan's letter to Mr. J. S. Chartrand under date of August 2, 1967, it is suggested in the second paragraph that there is one section of H.R. 11601 which directly affects the operations in commodity futures contracts and that under the legislation, the Federal Reserve Board would have the same powers to set "margins" in such trading transactions as it does now in establishing "margins" for trading in the stock exchange. We believe that it is the intent of Section 207 to authorize the Federal Reserve Board to set *margins* and not to regulate *credit*.

A general misconception is that "margins," by virtue of being down payments on credit transactions, should be set at levels comparable to those on stock purchases. A commodity futures contract is not a capital asset, however, nor is a future transaction a credit transaction. We respectfully refer the Committee's attention to Appendix "A" document, published by Dr. Roger W. Gray, Food Research Institute, Stanford University, in 1964 entitled "Margin Requirements in Commodity Futures Transactions." The paper deals with the nature of a futures contract, its origin and actions, and outlines the purposes of margins. Further, the document deals at great length on the fact that futures contracts are not credit transactions, and the due consequences of prohibitive margin requirements for commodity trading. There is a supplementary statement attached to Appendix "A" pertaining to stock margin regulations, which clearly shows that margin requirements of the Federal Reserve System governing transactions in the stock market serve entirely different purposes from those of the margins used in the commodity futures market.

II. EXCESSIVE SPECULATION

One of the stated purposes of Section 207 is for preventing excessive speculation in and the excessive use of credit for the creation, carrying, or trading in commodity futures contracts. "Excessive Speculation" is not defined nor has it ever been truly defined as it pertains to trading in commodity futures in large volume of trading (some believe to be excessive speculation) which can cause price changes on occasions. But, light trading (inadequate speculation), the more common condition, has its price effect also. Prices are poorly defended on markets with inadequate speculation where the cost of trading tends to be high. Most futures markets suffer from "inadequate speculation." A renowned economist made a comment recently, where in part he said, "It is all right for policemen to watch for traffic violations—but the answer is not to forbid traffic. The function of the cop is to enable more traffic, not to complain that it tends to excess. To be sure, his position would be *easier* if there were not traffic, or as little as possible."

III. FEDERAL RESERVE SYSTEM SHALL PRESCRIBE REGULATIONS

The regulations which the Federal Reserve System shall prescribe, allude to the setting of margins and their maintenance on any commodity futures contract, and further, the regulations may exempt any transactions the Board may deem unnecessary, and regulations setting differentials amongst commodities, trans-

action borrowers, and lenders. There is no definition as to the level of margins, and, therefore, we must assume that in view of the proposed purpose of margins to control excessive speculation, the Federal Reserve System would set the margins at prohibitive levels. High margins will drive the public from the marketplace, and the contract markets will not be able to function and serve the public as they have for nearly a century. Mandatory margin requirements have been in effect in the Kansas City market for many years and have been determined and enforced by the Board of Trade. The practice of requiring mandatory margins is now well established, embodied in the permanent rules of our exchange, and enforced by resolutions. As long ago as 1877 the Kansas City Board of Trade had a rule regarding margin requirements, which was changed from time to time as current conditions required. The duty empowered to establish appropriate margins is lodged with the Board of Directors, and, in addition, our Business Conduct Committee supervises the observance of rules and regulations pertaining to margins.

IV. INFLATING CONSUMER PRICES

The purpose of Section 207 of preventing excessive speculation is said to have the effect of not inflating consumer prices. It is our contention that without volume trading, consumer prices would be more inflated when there is light trading. A thin market increases cost to the traders and all sections of the grain industry, and ultimately the increased cost to the consumer and the decreased value to the producer. A truer, more realistic market value is established when the price is determined by competition from many sources other than a few, and this is what we call a volume trading liquid market. With a thin trade or no trade at all, handlers and processors of grain must build into their purchase price additional cost—that is the estimated cost of risk they must assume as to price fluctuation—which the futures market protects.

For example, if a flour mill could not have the use of the commodity futures market as an insurance policy, wherein they could purchase deferred future contracts to establish price for future requirements, and which they could use for the establishment of future sales, it would be necessary for them to build within their purchase and sales prices the "risk factor." The moneys which they could pay for current inventories and futures inventories would have to be reduced to afford them the differential which might well exist from the time of harvest when there was grain available up through the winter and spring months when grains became less plentiful, awaiting the new harvest. This reduced buying price would directly affect and cause a deflated producer value. Likewise, the miller would have to build into his sales price the "risk factor" as to what grains would cost him in the future in relation to what he should be getting for his flour in the future. In this area the consumer would be affected inasmuch as flour and bread prices would necessarily be inflated.

The Board of Trade of Kansas City, Mo., thanks the Committee for the opportunity to appear and to express its views with regard to Section 207 of H.R. 11601, and respectfully requests that said Section be withdrawn and canceled.

Thank you.

APPENDIX "A"

MARGIN REQUIREMENTS IN COMMODITY FUTURES TRANSACTIONS

The nature of a futures contract: Its origins and uses

A futures contract obligates its holder to receive or deliver a commodity during some specified future month. It is a contract with the clearing house for a highly standardized description of the commodity, and is therefore highly marketable and very secure. Its marketability derives from the general availability of the commodity and the organized trading in it. Its safety derives from its marketability as well as the financial integrity of the clearing house.

Futures trading arises from the necessity and convenience of making forward purchase and sales commitments in commodities. Efficient coordination of the production, transportation, storage, processing, and consumption of commodities requires forward commitments. Futures contracts are used as temporary substitutes for intended later merchandising contracts. Because they are traded openly on central markets and deal with representative grades of the commodity, they greatly facilitate the pricing of these forward commitments.

Futures markets arise out of the situation in which forward purchase and sales commitments are already being undertaken. A clearing house is established which

becomes one party to all purchase and sale contracts, thereby providing greater security of contract and also enabling the fulfillment of contract by offset. The trading so organized becomes so convenient that nearly all contracts are offset, ordinary merchandising contracts being still used for nearly all transfers of ownership. Under these circumstances most transfers of commodity ownership entail a double transaction; the hedging transaction in commodity futures and the subsequent merchandising transaction for which it has substituted. Since transactions costs are important in the bulk commodity trade, where large volumes and small profit margins prevail, it is very important that the substitute transaction in commodity futures be accomplished at minimum cost—low enough to justify the common practice of making two transactions instead of one. The major benefit of futures markets to the commodity trade is the provision of continuous competitive prices at which they can buy or sell with confidence; sparing them the necessity of costly shopping and negotiations. Also, because the substitute transaction is undertaken in conjunction with a purchase or sale of the actual commodity, their risk is in "basis" changes rather than flat price changes. That is to say, their only prospect of profit or loss from price change is in the divergence or convergence of spot and futures prices. For this reason, financial institutions are able to lend them considerably more money than would otherwise be warranted.

The very great economy of futures trading is important from two standpoints. If more capital had to be tied up in futures contracts, then the very advantage which futures trading achieves, of increasing capital availability to commodity firms, would be eliminated. Secondly, the economy with which speculators can trade helps induce them to broaden the market. Without their participation, commodity firms find futures markets little different from ordinary markets, and are required to resort to costly shopping and negotiation. Markets which enjoy higher levels of speculative participation provide more reliable price estimates at lower transactions cost than markets which attract less speculation.

The purpose of margins

The clearing house, as a party to all futures contracts, needs to insure the validity of all contracts. By requiring that all members deposit margin against their net (long or short) contractual position, the clearing house protects itself, and thereby protects all who have contracts with it. The clearing house establishes margins for this purpose, and occasionally changes the margin requirements in furtherance of this purpose. In so doing, another purpose may be incidentally served. When the clearing house raises margins because the possibility of wider price movements is anticipated and hence more protection is deemed necessary, it may incidentally discourage public participation in the trading which could contribute to excessive price change.

Given the purpose of margin requirements, the appropriate margin level is one which is geared to (1) prospective price changes and (2) prospective basis changes. The margin requirements for speculators, whose risk is in price change, should be geared to prospective changes in the price level. Margin requirements for hedging firms, whose risk is limited to basis changes, is more appropriately geared to the prospect of change in this relationship.

No precise margin levels can be derived from these considerations, as the prospective price change is inherently uncertain, but guideposts which suggest the correct order of magnitude are readily available, and margin levels can be established on the safe side of such guideposts without impairing the usefulness of the markets.

The determination of proper margin levels is comparable, in its concept, to the determination of life insurance premiums on an actuarial basis. The probability of price changes of any given magnitude can be estimated from recorded experience in the various commodities. The relevant factors to be taken into account are (1) daily price change (close to close) (2) continuity of price change from day to day, and (3) the speed and efficacy of margin calls. In practice, these factors enter into the judgment of the exchange governors who establish margins, but statistical estimates of the probabilities are not computed. Data are readily available from which such estimates could be made, however, and the Commodity Exchange Authority (or the exchanges) could make such analyses at modest cost, particularly if the information were punched onto IBM cards.

Since limitations on daily price changes are already in existence, a reasonable expedience would be to establish margin levels directly in terms of those limits.

The limits are not entirely consistent, from market to market, with the recorded experience of price change, however, so that margins should be different multiples of daily trading limits in different commodities. Perhaps preferably, both the trading limits and the margins should be based upon an actual (say, ten-year) record of price changes. Sugar futures prices, which have been volatile in recent years, require both higher limits and higher margins, relative to the contract value, then for wheat or corn, which have experienced relative price stability. Under the conditions of recent years, margins of 10¢ per bushel for wheat and 8¢ for corn (the daily limits) are more than ample for hedging transactions, and probably adequate for speculative transactions. But margins of 50¢ per hundred pounds of sugar (also the daily limit) are clearly inadequate: probably four times this level would be desirable for speculative transactions. The trading limits in some commodities impose a slight tendency toward continuity in daily price change, as they suppress the daily change on some occasions, postponing it to the following day. In those markets which have been studied under unrestricted conditions, however, continuity of price change is not a problem.

The incidental accomplishment of margin level adjustments—that of encouraging or discouraging public participation in the trading—does not deserve much attention in the establishment of margin levels. Speculation is inadequate on many futures markets, but lower margin reuirements do not offer a desirable means of increasing speculation. Little speculation is responsive to such a consideration; whereas that which would be attracted by lower margins would not be of the most desirable sort. But by the same token, occasional increases in margin levels to deter speculation are easier to justify because they deter the least desirable sort of speculation.

While basic guideposts can be established from the record of price behavior, it is important to retain some flexibility in order to meet unusual circumstances that can be recognized by exchange governors. And while margin levels should be on the safe side, it is important that they be no higher. It is not only wasteful to idle funds upon margins that serve no purpose, but it is crucial not to discourage the use of the markets. There is ample evidence in economic studies that the markets which are used most provide the best estimates of price, and provide an extra margin of safety in the ease with which transactions can be made, which minimizes the role of margins.

Margin requirements for different classes of traders

Members of the clearing house own stock in the clearing house, which provides extra assurance of their financial integrity. In general, margin requirements for clearing members can safety be very low. It might be useful to require a minimum level of ownership of clearing house stock, and also to require a minimum capital ratio or other evidence of soundness.

Members and non-members of the exchanges, who are not clearing members, must clear transactions through clearing members. They are required to deposit at least the clearing house minimum margin requirements with clearing members. Most clearing members police these deposits very well, but there has been little policing of them by the exchanges, probably because the margins deposited by clearing members are deemed adequate to protect the exchange. It would be desirable if margin enforcement and policing could be improved, particularly as an alternative to higher margin levels.

Speculative contracts should be margined at higher levels than hedging contracts, because of the greater risk involved. In general, margin requirements equalling the maximum price change expected over any two-day interval would be sufficient for speculative contracts. In certain extreme instances, where the daily limit price move in one direction might occur on more than two successive days, even higher speculative margins would be justified. Margins on bona fide hedging positions should be no more than half those on speculative positions, and in some instances could safely be still lower. Anticipatory hedging, as defined in Sec. 4(3)(C) of the Commodity Exchange Act, should be subject to speculative margin requirements, as the same risk considerations apply.

In sum, since the only purpose of margins is to protect the clearing house, they can safely be established by the clearing house at quite low levels. For hedging transactions in which the risk of flat price change does not apply, margins can be lower than for speculative transactions. For clearing members who are subject to other safety factors as well, margins can be lower than for non-clearing members.

Futures contract not a credit transaction

There is no transfer of ownership in a futures contract—only an obligation to transfer ownership at a later date, through the clearing house, for full cash payment at the time of transfer—and this obligation is nearly always cancelled before a transfer occurs, by undertaking an opposite obligation vis-a-vis the clearing house. Thus a futures contract does not represent a credit transaction, in which ownership of an asset is transferred. The holder of a futures contract owns something of value insofar as he may be later entitled to receive a commodity of greater value, or to deliver a commodity of lesser value, than that agreed upon in the contract. He earns no right to the use or enjoyment of the commodity, or to income from it, so long as he holds the futures contract; nor does he earn such rights through the normal settlement of such contracts by offset. A contract entitling one to receive or deliver a commodity at exactly its market value has zero value, since by definition this can be done without such a contract. A futures contract has zero estimated value at the time it is entered into, in that the price agreed upon for the future transaction is the market's best current estimate, by definition, of what the value of the commodity will be at delivery time. In fact, the long time average value of the futures contracts actually bought and sold in the major grain markets does not differ significantly from zero; although any particular contract may take on positive or negative value.

Usually more than one half of all futures contracts outstanding are in the hands of hedgers, and of these substantially more than one half are sales contracts. In these instances the hedger owns a physical asset, changes in the value of which bear an orderly relationship to the value of his futures contract. If he should decide to deliver the physical commodity against the futures contract, full cash payment is required at the time of delivery, and this is the only transfer of ownership. Yet even this transfer of ownership in *satisfaction* of futures contracts is infrequent.

Margin deposits on futures contracts are in no sense down payments on credit transactions. The margin deposit is intended to represent full payment at all times for the value of the futures contract, which inheres in the uncertain, but statistically definable prospect of price change. This is the most important of several reasons why commodity futures margins differ from stock margins. Purchase of a stock certificate *does* transfer ownership, and the margin on such a purchase *is* a down payment on a credit transaction. It is because stock purchases on margin are *credit* transactions, and because it is deemed to be in the public interest to control the amount and kinds of credit, that authority to establish margins on stock purchases is vested in the Board of Governors of the Federal Reserve Banking System, and margin levels are much higher than those on commodity futures. The word "margin" has an entirely different meaning in the two contexts. If an analogy with stock trading is sought, a closer one exists in trading options to buy or sell stock at a later date. These so called "put" and "call" options bear the resemblance to commodity futures contracts that they do not transfer ownership; hence the payment made for them is not a down payment on a credit transaction. The prices of options to buy or sell stock at a later date are roughly comparable to margin levels on speculative transactions in commodity futures; i.e., about 10 per cent of the market value of the stock as compared to margins equalling about 10 per cent of the market value of the commodity described in a futures contract. Even though this similarity exists, the purpose of the payments differs in that no protection against insolvency of the holder of stock options is required. He has an option to buy if he chooses, whereas the holder of a futures contract has an *obligation* to buy (or sell), unless he offsets the obligation in the futures market. The purpose of margins on futures transactions is to guarantee this obligation.

A major reason for controlling credit purchases of stock is the concern to prevent such a stock market collapse as occurred in 1929, after stock prices had been carried to very high levels, partly through purchases made on short term credit.[1] There are two reasons, in addition to the fact that commodity futures transactions are not credit transactions, why a similar concern does not apply here. The first is that commodity futures transactions are absolutely symmetrical with respect to buying and selling, as stock transactions are not. In-

[1] See the Supplementary Statement on Stock Margin Regulations attached at the end of this statement.

vestment capital flows to the commodity futures markets on the selling side in exactly the same way as on the buying side, so there is no reason to fear inflationary consequences of such a flow. An increased flow of capital into the stock market, on the other hand, necessarily raises stock prices, as the new investment capital comes on the buying side. It is possible, in a rather cumbersome procedure, to sell stock short by borrowing stock certificates; but this device is by no means the equivalent of selling futures contracts.

The second reason why the inflationary concern does not apply to commodity futures transactions is that their prices must come to the actual commodity price from four to twelve times a year, depending upon the number of delivery months. The price-earning ratio of the stocks in the Dow-Jones Industrial average has ranged from 6.4 to 51.5 since 1933, indicative of how far stock prices can range from the true current earning capacity of the physical assets they represent. Commodity futures prices can depart from the true expected earning capacity of the physical assets which they represent also; but this departure is necessarily temporary and limited because of the delivery provisions. Occasionally a commodity futures price is forced above the true economic value of the commodity in a delivery month squeeze; but such actions are severely punished on other than inflationary grounds, and indeed their general economic impact is trivial.

The consequence of prohibitive margin requirements for the commodity trade

Consider a merchant who carries large stocks of grain, hedged in futures contracts, margined with the clearing house at approximately 5 per cent of the value of the grain represented in the futures contract. He borrows 90 per cent of the value of the grain from his banker, on the condition that it be so hedged. His banker's practice is to require 25 per cent credit margin on unhedged grain inventory. Now if the futures margin is raised to even 16 per cent, the balance has been tipped against hedging. The merchant can finance his inventory unhedged for 25 per cent, or hedged for 26 per cent (16 per cent futures margin plus 10 per cent credit margin.) Moreover, his minimum capital requirement has been raised from 15 per cent to 25 per cent.

He prefers to hedge, of course, for other reasons than the lower margin requirements on bank credit which it assures him. So he might approach his banker and request some compensatory reduction in credit margins to enable him to continue hedging with higher futures margins. But his costs have been increased in any event, and if the futures margin were set still higher, at say 25 per cent or more, he would almost certainly stop hedging. Then he might approach his banker to request lower credit margins on unhedged grain. The banker could conceivably respond to the merchant's plight by granting lower credit margins conditioned upon (1) hedging in forward commitments, instead of futures contracts, (2) relating credit margins to price changes in the inventory, thus in effect taking on one of the functions of the grain trade, which is to watch grain prices.

These are, of course, backward steps in economic development; for these were the practices that had to be followed before the futures markets evolved. Forward sales are more costly and less reliable than futures contracts (in fact, it is not uncommon to use the futures market for hedging against contract concellations.) A hedged position in futures is a much cheaper way for the banker to guard against inventory price fluctuations than actual day-to-day study of the prices of all the various categories of inventory that serves as loan collateral. Moreover, with the departure of the commercial firms from the futures markets, these markets would soon wither and die, so that the banker would have no reliable source of price information to watch, even if he chose to study prices.

The consequences of higher margins for some growers

Commodity futures contracts are used by some farmers to protect the price for a growing crop, or for a crop which has been harvested and placed in storage. This is particularly advantageous to growers of a crop like potatoes, for which there are no government price supports and which are subject to wide price fluctuations. Oftentimes the grower may have to borrow margin money from his local bank, whereas in other cases a dealer may handle the commodity futures transaction in conjunction with a contract to buy the farmer's potatoes at harvest time. The economy of futures trading is of particular importance to the potato grower. If margins were substantially increased he would revert to a system of forward contracting which places him at a bargaining disadvantage vis-a-vis dealers.

The impact upon the economy of discouragement of futures trading

The most serious impact upon the economy, if futures trading were discouraged, would be loss of efficiency in marketing. The greater cost of marketing commodities would be borne by producers and consumers alike.

Another serious impact would stem from the fact that an increasing amount of international trade in commodities has been facilitated by our futures markets. The European or Japanese importer of our grains uses our markets increasingly. The exporters of tropical products to the United States also use our markets. Not only would this business be lost to the United States, but in some instances futures markets in other countries would pick up the business, possibly in addition to business now being done by our domestic commodity trade, which would be transferred to foreign markets. This would not only adversely affect our balance of payments, but would tend to undermine our world leadership in the organization and financing of commodity trade. If the needs of a trade which is international in scope are better served in other countries, the trade will shift to those countries. Last year the Chicago Board of Trade had $55 billion business volume, making it, as it has been for many years, the world's foremost commodity market. This distinction could pass to Liverpool or Rotterdam or Tokyo in the future if our markets are unduly restricted.

Conclusion

There is no doubt but what margin levels substantially higher than present ones would discourage hedging, force resort to other more costly marketing methods, and put futures markets out of business to the detriment of producers and consumers alike. Futures trading grew out of just the marketing methods to which the commodity trade would necessarily revert if the costs of futures trading were made arbitrarily prohibitive. It grew out of those methods as a refinement and improvement of them, in the very sense that it enables marketing at lower cost, which it can only provide with low margins aimed at protecting the clearing house. In the words of one banker who had had much experience financing the grain trade in the manner here illustrated, futures trading is "one of the major economic creations of all time."*

Supplementary statement on stock margin regulations

As supplements to general methods of influencing credit, selective methods, of which margin requirements are the most important, make it possible for the Federal Reserve to reach specific credit areas without imposing stronger general credit measures that might otherwise be appropriate. For example, if an unhealthy use of credit for stock market speculation develops at a time when credit for production and trade is expanding no more than would be considered normal, and when the application of general instruments of regulation (open market operations, change of discount rate and reserve requirements) might do more harm to the country's overall economic activity, the power of the Federal Reserve to regulate stock market credit can be invoked.

The Securities Exchange Act of 1934, Sec. 7. (a), under the heading "Margin requirements" says:

"For the *purpose of preventing the excessive use of credit* for the purchase or carrying of securities, the Federal Reserve Board shall . . . prescribe rules and regulations with respect to the amount of credit that may be initially extended and subsequently registered on a national securities exchange" ([2] p. 399).

For initial extension of credit such rules and regulations must be based upon a certain standard set forth in the act, but the board is authorized to prescribe such requirements lower than the standard as it "deems necessary or appropriate for the accommodation of commerce and industry having due regard to the credit situation of the country," and such higher requirements as it may "deem necessary or appropriate to prevent the excessive use of credit to finance transactions in securities." ([3] pp. 35–36.)

The control effected by margin requirements, although bearing directly on the lender, puts restraint upon the borrower and dampens demand. It can be

*Harry L. Wuerth, Vice President, Commerce Trust Company, Kansas City, Missouri, "A Banker Looks at Futures Trading," Proceedings of the Banking Seminar, Chicago Board of Trade, 1961.

[2] *Federal Reserve Bulletin*, June, 1934.

[3] *Annual Report* of the Federal Reserve Board, 1934.

used accordingly to keep down the volume of stock market credit even though lenders are able and eager to lend. ([4] p. 59.)

Another effect of high margin requirements is to restrict the amount of pyramiding that can take place in a rising market. In other words they limit the extent to which traders may add to their holdings, when the market is rising, by borrowing against additional market value of securities already held in their accounts without putting up additional money on rising stock prices as well as on growth of credit employed in the stock market. ([4] p. 59.)

The Federal Reserve in describing its purpose and functions points out that by regulation of margin requirements the danger of excessive use of credit in the stock market, which caused serious disturbances to the economy in the past, has been minimized. Thus it is felt that a speculative stock market boom financed by credit, like the one that culminated in 1929, could hardly have occurred except on the basis of very low stock purchase margins. A boom and collapse in the stock market is always possible, but without the excessive use of credit it is not likely to assume proportions or to have the effects it has had on some occasions in the past.

Aside from having to do with a specific use of credit, the authority with respect to security loans differs from other Federal Reserve System powers in that it reaches outside the Federal Reserve System to banks that are not members of the system and to brokers and dealers in securities. It is closely related, however, to other regulatory powers of the Federal Reserve authorities, because the use of credit for purchasing or carrying securities has an important bearing upon its use for business purposes in general. ([4] p. 60.)

On the whole one may say that margin requirements should be regarded as one of the instruments of Federal Reserve action which serves the general purpose of regularizing the flow of money and credit, fostering a stable dollar, and providing an effective monetary mechanism that will be conducive to the country's growth. This is evidenced by a brief account of the margin requirement changes from their institution in 1934 to the middle 1950's.

For several years before the war, the Board's regulations required margins of 40 per cent. During the war the requirements were raised to 50 per cent, then to 75 per cent, and in 1946 to 100 per cent. The 100 per cent requirement was in effect from early 1946 to early 1947, when it was reduced to 75 per cent, making it possible for banks and brokers to lend 25 per cent of the value of the collateral. The margin requirement was reduced to 50 per cent in the spring of 1949 at a time of moderate business recession and was restored to 75 per cent early in 1951 when inflationary pressures following the outbreak of the Korean war were at their peak. In early 1953, when these inflationary dangers had begun to abate, the margin requirement was again reduced to 50 per cent. ([4] pp. 58–59.)

As an example of how the use of credit in the stock market influences the decisions of the Board in setting margin requirements, the commentary to the July 10 reduction in margin requirements from 70 to 50 per cent, in the *Federal Reserve Bulletin* of July, 1962, p. 840, was:

"In making this change the Board took into account a sharp reduction in stock market credit in recent weeks and the abatement in speculative psychology. Bank loans to customers for the purpose of purchasing or carrying registered stocks declined more than 5 per cent in June to a level of $1.3 billion. Furthermore, preliminary data indicate a $600 million drop in borrowing by stock exchange member firms from banks on customer collateral, the largest decline in the postwar period."

The Board's regulations require the lender to obtain the specified margin in connection with the purchase of the security. If the collateral security for the indebtedness subsequently declines in value, the regulations do not require the borrower to put up additional collateral or to reduce the indebtedness. However, the banker or broker making a loan may require additional collateral if he deems it necessary. ([4] p. 58.)

It thus seems clear that the margin requirements of the Federal Reserve System governing transactions in the stock market serve entirely different purposes from those of the margins used in the commodity futures markets. Where the latter are used to protect the clearing house, the former is a means for influencing the credit conditions in the economy in general and use of credit on the securities market in particular. Where margins are used in the securities

[4] *The Federal Reserve System,* Purpose and Functions, Washington, D.C., 1954.

market for the protection of bankers and brokers in case of price changes, they are not subject to regulations by the Federal Reserve but are up to the discretion of the bankers and brokers themselves.

Mrs. SULLIVAN. I want to advise the members of the subcommittee that we have in the audience Mr. Alex Caldwell, who is the Administrator of the Commodity Exchange Authority in the Department of Agriculture. He is here, not to testify for or against this provision of H.R. 11601, but to be available to provide us with any technical information we may ask him for. He is here as a technical expert, not an advocate, and I am grateful to Secretary Freeman for assigning him to us for that purpose.

Mr. Caldwell, will you join these gentlemen?

Thank you.

I have a series of questions to ask the witnesses, but I will defer mine until the other members are finished, and I call on Mr. Stephens first.

Mr. BROOKS. Can I make my statement?

Mrs. SULLIVAN. I am sorry. I thought your statement was included with that of Mr. Theis. But it is Mr. Chartrand, who is here with Mr. Theis from Kansas City. I am sorry, Mr. Brooks. Please go ahead.

Mr. BROOKS. I have a summary which has been distributed. Our organization subscribes to all the remarks and recommendations of Dr. Gray and Mr. Theis as he is speaking for the Kansas City Board of Trade.

I would like also to make a request before I run through this briefly, Madam Chairman. I would hope that the record might be kept open so that those of us who have not had a chance to read and analyze the subcommittee's statement which you read this morning may have a chance to do so and to comment on this favorably or otherwise.

Mrs. SULLIVAN. We will be happy to do that. We will leave it open until the 25th of August.

Mr. BROOKS. Thank you very much.

My name is William F. Brooks and I am here today to represent the National Grain Trade Council. We appreciate this opportunity to express our views in opposition to section 207 of the pending legislation which is designed to give the Federal Reserve System the same powers to set margin requirements in connection with futures transactions on commodities that the System now holds in the setting of margins for credit transactions on the stock exchange.

For 20 years we have consistently opposed proposals to grant to the Government or Government officials authority to set margin requirements on futures transactions in commodities. We have opposed this grant of authority because in our considered judgment no public official or group of public officials such as the Board of Governors, are so omniscient as to determine when speculation might become excessive in commodity transactions and to determine when any degree of speculation in commodity futures contracts would have the effect of inflating consumer prices.

We note that the Board of Governors of the Federal Reserve, through its Vice Chairman, Mr. Robertson, on August 7 advised the subcommittee in effect that the Federal Reserve Board would not be the most appropriate agency to administer such commodity market legislation as is contained in section 207 of the pending bills. Mr.

Robertson stated the Board's belief, which we share, that relatively little credit is used in connection with futures trading.

The proposal embodied in section 207 is based on a misconception of the nature of commodity contracts markets, on the nature of trading in commodity futures contracts, and on the functions of margins in connection with the commodity futures contracts when attempts are made to draw an analogy between them and the downpayment required to obtain title to stock or goods and chattels or real estate.

My statement develops the thesis that there is no analogy between the margin required to enter into a contract for the future sale or purchase of a commodity and the downpayment required to obtain title to stick, or goods and chattels, or real estate.

My statement reviews for the subcommittee the studies and action by this and other committees of Congress when similar proposals to the pending proposal have been considered in the past.

We are now here today faced with a proposal to grant authority to the Board of Governors of the Federal Reserve which, according to their spokesman, they do not wish to have and are not qualified to administer. This subcommittee is, in effect, considering a proposal which in substance has been considered by other committees and subcommittees in prior Congresses and found wanting. We recommend that this subcommittee make a similar finding.

We oppose this grant of authority because we are convinced that this method of attempting to prevent inflated consumer prices will not work. We oppose this grant of authority because an attempt by the Government to exercise control over margins may well cause a breakdown in the entire marketing structure leaving State trading as the only alternative. Raising margins will not keep prices from going up. It seems to be admitted that commodities that have no futures market are usually more erratic in price than those that have. By raising margins, you can reduce and eliminate volume of trading. But you cannot control prices. And you might wreck the market structure.

I shall be glad to answer any questions which anyone cares to ask.

Mrs. SULLIVAN. Thank you very much, Mr. Brooks. Now I will call upon Mr. Stephens to start the questioning.

Mr. STEPHENS. Thank you, gentlemen, for coming to be with us. I appreciate having the opportunity to have the material Dr. Gray has presented of the circumstances involving transactions that you deal in.

I perhaps should point out to you that I have introduced a bill similar to the Senate bill that does not include in the bill the control of the commodity exchanges.

Also, you are familiar with the statement made by Governor Robertson that he did not consider your transactions as credit transactions. One thing I would like to ask for my own understanding is this: Suppose that I put $500 into futures market. Maybe Mr. Rhodes can give me the answer. If I should buy or put down a margin of $500 on a cotton futures contract that would mean that I would be able to buy 100 bales of cotton. Now, when would I have to buy the 100 bales of cotton?

Mr. RHODES. That would depend on which month you bought. The futures market operates 18 months in advance, in the case of cotton. You can buy January, March, July, October, or January 1969, cotton futures today. If you decide you want to buy December 1968 you would

put up your $500, you would purchase a contract for 100 bales, and then when the December 1968 contract becomes the current month you would, if you were still holding the contract, take delivery of the 100 bales of cotton and pay the full purchase price within 24 hours. The $500 that you put down is merely put up as a margin to protect the clearinghouse which handles the contract.

Mr. STEPHENS. I will get a specific price per bale?

Mr. RHODES. Let me explain that should the market go against you and the $500 has been used up, they would call on you to put up additional margin.

Mr. STEPHENS. If the price should rise?

Mr. RHODES. That's right.

Mr. STEPHENS. Suppose the time came within the period of time for me to buy the balance of it—for me to buy it.

Mr. WILLIAMS. Mr. Stephens, could I make one point? You would be required to put up the additional price if the cotton dropped.

Mr. RHODES. If the price went against him.

Mr. WILLIAMS. Yes. Some comment was made that margin was required if the price went up.

Mr. STEPHENS. Yes. What I am trying to get across in my mind is this: Suppose I do not buy any cotton? Suppose I just buy a $500 futures contract, and then when the time comes, do I forfeit that if I do not buy the balance of the contract within a specific time? What happens to that $500 if I do not want any cotton at all?

Mr. RHODES. You do not put it up until you want to purchase the contract. If you want to purchase a contract, a hundred bales of cotton, that is when your broker will call on you to put up the $500. You put it up at that time and the normal situation is, you buy back the other side of the contract before it matures. If you purchase December 1968 cotton, 99 times out of 100, those are the statistics at least, the purchaser will sell a December 1968 contract before it matures. Then one contract wipes out the other, and you get your $500 back, assuming the price has not changed. The $500 margin is there to guarantee the clearinghouse which handles the contract in the event that the market goes against you. It goes to protect the clearinghouse which handles the contract in the event that the market goes against you, regardless of whether you are a seller or purchaser.

Mr. STEPHENS. I am not sure I know what happened to my $500.

I appreciate your being before the committee, and from your experience as you outlined, you ought to know every way in which cotton men can go broke.

Mr. RHODES. I would like to make one very short statement if I may. I don't desire to summarize my statement, but I do want to point out that we should not overlook the fact that if excessively high margins are imposed to discourage the use of futures exchanges in this country, that the business of hedging may well be transferred to futures markets in other countries which have established markets or which very well can establish markets. By doing that we could very well lose the leadership which we now enjoy in this type of business.

Just this morning I received a letter from the Indian Forward Market Commission asking me to write an article for their publication explaining our No. 2 contract which they understand is getting started

again. There are cotton futures markets in Liverpool, Japan, and India. If action is taken that would make our markets ineffective in this country, it would result in our business moving to these other markets.

At the present time we have a wool market in New York and much of that business is being transferred to the wool market in Sydney, Australia.

Mr. STEPHENS. In other words, what I understand you to say is that this is a real competitive field, this market business, and that regulation of the price that consumers will pay, if you take that competition out, will make the consumer pay more. Is that what?

Mr. RHODES. That's right.

Mr. STEPHENS. One other question, Madam Chairman.

From what Mr. Rhodes has said about the volume of the cotton business, he could consider it more or less a thin market as contrasted with grain, which would be a larger market, is that right, Mr. Gray?

Mr. GRAY. It would, unfortunately, be such an example. As recently as 1953 the cotton futures market was the world's largest futures market, and incidentally, to further confirm what Mr. Rhodes said, we did publish a study in about 1960 in which we explained the demise of the cotton futures market and its demise was owing directly to the fact that the Government assumed the marketing function.

Mr. STEPHENS. That would give price support to the farmer producing the cotton?

Mr. RHODES. Yes.

Mrs. SULLIVAN. Dr. Gray, the fact still remains, does it not, that the objective sought in playing the commodity market is to maximize gains or minimize losses?

Depending on the ability of the processors to pass on costs, which are extensive, any losses experienced as a result of playing the commodity futures market are passed on ultimately to the consumer.

Given an economic situation characterized by inflation or inflationary pressures, or the prospects of inflation, commodity prices will be bid up. To the extent that restrictions are placed on commodity futures trading—in terms comparable to margin requirements on stock purchases—to this extent pressures to bid up commodity prices, above any justified economic price, will be eliminated. This has been true as far as stocks are concerned, and I do not see how anyone can argue that the same could not be true regarding speculation in the commodity markets.

Mr. GRAY. If that is a question, Madam Chairman, the answer in a word would be "No." If I may elaborate.

Mrs. SULLIVAN. Please do.

Mr. GRAY. The commodity futures markets simply represent the most efficient price-determining mechanism that has ever been devised. If you interfere with the function of the commodity futures markets, then you encounter much greater likelihood of establishing incorrect prices at either too low or too high levels.

If I may illustrate with a couple of recent cases. The Congress did prohibit futures trading in onions in 1958. Subsequent to that time we analyzed the price variability in cash onions.

Prior to the period when there was active futures trading in onions and subsequent to the period when there was active futures trading in onions, we published the results of this study, the price variability was much greater prior to futures trading and after futures trading than it was during the era of active futures trading.

One other example. In November 1965 Secretary of Defense McNamara took the tripartite action to halt what he considered to be an unjustified rise in copper prices. He released, I believe, it was 200,000 tons of copper from the stockpile which of course had the immediate effect of causing the weakness in copper futures and spot copper prices. He raised margins in copper futures trading to prohibitive levels, and he took some steps with regard to the importation and exportation of copper. Having prohibited by raising the margins to prohibitive levels futures trading in copper really had simply the effect of breaking the thermometer but it didn't keep the temperature from rising.

Subsequently, in April 1966, copper futures and cash copper reached the alltime high level in history. He didn't stop the price rise. He did not change the law of supply and demand. He simply deprived copper users and copper consumers and copper sellers of the opportunity to protect themselves against price change which the futures market had provided. (See p. 632.)

Mrs. SULLIVAN. Can you say that that held true also in the sugar market of 1963?

Mr. GRAY. I did not, Madam Chairman, personally conduct an investigation into sugar futures prices at the time of the rise. I am quite willing to say that from studies that I have done of many commodity futures markets, that without the sugar futures market you still would have had—because of the basic underlying shortage of sugar supplies in the world—you would have had the price rise that you had. The futures markets provide the best device known to enable people to adjust to the facts of life and price. If you had closed down the sugar futures market you would have left sugar users and sugar producers in a much poorer position than they were in because they could protect themselves against the price rise and against the subsequent decline which occurred, of course, after the supplies had once again been built up.

Mrs. SULLIVAN. I certainly have not been proposing an end to speculation in the futures markets. I want to see it regulated in order to protect the public, not end it.

Mr. GRAY. Indirectly, my fear is that the proposal may amount to that, particularly insofar as any analogy is drawn and this analogy continues to be drawn, even in the financial community. Between trading in stocks and trading in commodity futures, it is of the utmost importance that the commodity futures margins be kept as low—at the lowest level possible. The essential reason for this, going back to part of my statement, these are essentially hedging markets. They enable the firms that I am representing here to protect themselves and thereby operate on a smaller profit margin than they otherwise could do.

Now, from their standpoint, they always use a futures contract as a hedge, which means they use it as a temporary substitute for an intended later transaction in the cash commodity. So they routinely

engage in two transactions instead of one. And if you much raise the price of engaging in the futures transactions, they will simply have to resort to a kind of transaction pattern that is more costly that preceded futures trading before this device came along, and that has got to be passed along to the consumer in the form of higher prices because this margin, their marketing margins, would go up.

Mrs. SULLIVAN. Again I go back to the only market in which we have made any kind of study, and that is sugar. In 1963 there was excessive speculation in sugar futures leading to a sharp rise in both world and domestic futures and in cash prices also. The large users of sugar, like confectionery firms and so forth, came in to see us to ask for help and ask what should they do. Because if they had bought ahead as they normally do, they would have had to raise the price of everything that they were producing in the line of bakery goods, and in all products that used sugar—candy, soft drinks, and so forth.

In the hearings that we held and the studies that were made, there was definite proof that there was overspeculation. Brokers had been enticing people to come in and turn over a fast dollar on very low margin. This definitely increased the price of sugar at that time.

Mr. WILLIAMS. Madam Chairman.

Mrs. SULLIVAN. I will give you your time in a few minutes, Mr. Williams. I cannot speak about grains, Dr. Gray, or other commodities, because we have not made a study of them. That is why we asked you gentlemen to come here and give us your advice. But I cannot see how overspeculation in these commodities ultimately does not go down to the consumer in higher costs of the things we buy, particularly in the unregulated commodities.

Mr. GRAY. Madam Chairman, when prices rise there is no doubt in my mind that these prices must be passed on to the consumer. The question before us is whether in general there is any tendency to speculating in commodity futures to cause undue price fluctuations, either upward or downward, because we have got to be concerned with the appropriate price levels for producers as well as consumers.

The answer to that, as best as we can do in general terms—and it is my experience at Stanford University for a number of years and they have studied their cases—this has been studied intensively for a period of some 35 years, and the best general answer is that price fluctuations are minimized with futures trading rather than exaggerated. I am sorry that I cannot speak directly to your one counterexample of sugar. I did not make a study of that particular price rise.

Mrs. SULLIVAN. The hearings revealed that while there was much talk of a world shortage of sugar, it was only an estimate of what the world would need in sugar, and there was really no shortage. And the same thing happened back in 1954 in coffee from Brazil; and there was no shortage of coffee. It was manipulation in coffee futures that caused the coffee price increases in 1954 to the consumer, just as it was the fear of a scarcity of sugar in the world market that caused the excessive speculation in sugar in 1963 and the subsequent price increases.

Mr. WILLIAMS. I did not want to ask any questions, I wanted to make one point.

Mrs. SULLIVAN. If you will pardon me, Mr. Williams.

Mr. BINGHAM. Regular order.

Mr. WILLIAMS. At the same time my time is being sacrificed.

Mrs. SULLIVAN. Please, Mr. Williams. You will receive your turn. Mr. Halpern?

Mr. WILLIAMS. We started on the 5-minute rule some time ago and the past half hour we have heard from two people.

Mr. HALPERN. Madam Chairman.

First, I would like to commend the distinguished panel in enlightening us on many phases of this legislation which I am sure will be most helpful to us.

I might add, as a little sidenote, that while the subject of commodity futures is rather dull to most people, I was interested in seeing a recent story in Playboy magazine that puts sex appeal into a rather little known and complex subject.

Professor Gray, since the commodity markets are fairly complex institutions, perhaps you would be so kind to answer some basic questions as to the operation of these markets.

First, precisely, what function do these markets perform that could not be achieved by direct transactions between the producers of the products and the commercial purchasers?

Mr. GRAY. Several functions, Mr. Halpern.

First, and most importantly, they enable better adjustment, a better allocation of the commodity over time which would be impossible with only cash or spot transactions which is possible but made very awkward and expensive with forward contracts, forward contracting which is done, so futures affect this allocation of the commodity through time with much greater economy and efficiency than any other market.

Secondly, the job of price determinations and where you have a well-used futures market for any commodity, then the price of the commodity is actually determined on the futures market and all of the cash or spot transactions are geared to or related to it. The advantage here is the centralization, the bringing together of all of the supply and demand influences into one marketplace so that you get a more accurate, continuing reflection of supply and demand in price at any one time.

Finally, and particularly from the standpoint of the firms that I am representing here today, hedging, which would be impossible or prohibitively expensive if you didn't have commodity futures markets, enables these firms, for example, to obtain financing of their inventories at considerably more favorable rates from the banks than they otherwise could do. Hence, reducing the marketing margin—hence reducing the cost of doing business. And again, it is only because they can trade these contracts very cheaply with minimal deposits for protection of all parties to the trading, that it is possible for them to achieve this economy.

Mr. HALPERN. Could you tell us exactly what the relationship is between the price I pay for wheat futures contracts on the commodity exchange and the price paid for a bushel of wheat by a commercial baker?

Mr. GRAY. The relationship is very close, and it is guided essentially by the question of what we call carrying charges. If, for example, at the present time you looked at wheat prices in say the Kansas City

Board of Trade you would find—and I am speaking first of cash wheat prices and let's suppose for illustration they are $1.50 a bushel, you might find the September contract for future delivery would be $1.55 a bushel or $1.53. If that were the case then the market would be reflecting a carrying charge, the cost of carrying a bushel of wheat from now until the September delivery date.

In other circumstances when there is a current shortage of commodity this relationship is still guided by the same consideration, but it may turn out to be an inverse carrying charge because there is need to pull the commodity out of storage now and use it. So the futures are always guiding present usage versus future usage, and thereby again performing this allocative function of the commodity and thereby, incidentally, achieving a diminution in price variation through time.

Mr. HALPERN. You suggest that more rather than less speculation tends to stabilize prices, yet there have been times when speculation has been destabilizing and has driven commodity prices upward.

I have two queries in this regard.

If margin requirements are not the proper vehicle for regulating such speculation, what is?

Second, what sort of controlling, if any—what sort of control, if any, has in the past been exercised over excessive destabilizing speculation by the Commodity Exchange Commission?

Mr. GRAY. I did say in my statement that margin control would be ineffective because one can really only ascertain in retrospect whether the price change that occurred was warranted or not by supply and demand conditions.

But if you should encounter instances, which you will rarely, on the well-used futures markets where the price change that occurred is subsequently seen to be upward—unwarranted or could be demonstrated to be unwarranted, this would typically be for one or two reasons, either because the market was mistaken in its aggregate judgment. It makes a collective judgment and it can make mistakes. About that, sir, I think you can't do anything. You cannot legislate against people making mistakes if they are honest mistakes.

Alternatively, occasionally this may occur because of manipulative endeavors on the part of users of the market. We do have at present the Commodity Exchange Authority which is at all times concerned to prevent these efforts. We further have the business conduct committees on the exchanges which are also concerned to prevent these efforts. The penalties are severe for those who attempt this. Most such attempts fail. Most such attempts do not change prices. But those attempts that do succeed in changing prices I think are usually caught under the present law. Moreover, the bill which the Department is now introducing further tightening regulations over commodity exchange trading includes one provision of making the penalty more—the penalty for manipulative attempts more severe, making this a felony, and that provision I support and that provision the grain and feed dealers national association supports. I support and they support every constructive effort to improve the regulation of the commodity markets.

Mr. HALPERN. I have one more question.

Mr. GRAY. Excuse me. I am just reminded of one other point. I also support the inclusion of other commodities under the Commodity

Exchange Act. So your initial statement referring to the entire panel, I can't speak for all of them, but for me it is incorrect.

Mr. HALPERN. You tend to identify speculation with volume trading. Yet, is there not a difference between stabilizing speculation which leads to a balanced market and destabilizing speculation which tends to overemphasize trends in one direction or another?

Mr. GRAY. There can be that distinction. I tried in my statement to draw the distinction a little bit differently. I think that the chronic difficulty with some of our thin futures markets is inadequate speculation. Now, this gets to be something of a hen and egg proposition. Did the pricing go up because somebody traded, or did the price go up because when somebody traded there wasn't a sufficiently large body of speculators in that market to defend that price? And I think most of the evidence would suggest that the latter is a better interpretation of the events. If you have a large body of professional speculators, they will generally be right on the price. The market is more likely to be right on the price. The price fluctuations are likely to be smaller in those circumstances which is, still, of course, not to deny that you can find circumstances when the best collective judgment of traders will be mistaken for a period of timing and that there you have the ultimate safeguards that it is supply and demand of a commodity that brings the futures price ultimately back into line.

Mr. HALPERN. My time is up. Thank you very much.

Mrs. SULLIVAN. Mr. Gonzalez?

Mr. GONZALEZ. Thank you, Madam Chairman.

As to wheat grain futures and the activity in that market, did the recent depletion of the storage quantities have any effect upon the market?

Mr. GRAY. I was thinking the Kansas City man could speak more accurately, and he may wish to expand on my statement.

The depletion of wheat stocks—it has been my impression the wheat stocks has improved the opportunity for trading in wheat so that the volume has gone up. Not to the extent, however, that it has in other grains where the extent or degree of Government interference into pricing is still less than it is in wheat.

Mr. GONZALEZ. Do you recall any recent manipulative efforts in this market, say, within a year, within the past year?

Mr. GRAY. No, I do not have any; no, sir.

Mr. GONZALEZ. Could you explain to us how a manipulation is accomplished? What are the usual tricks of the trade?

Mr. GRAY. To cite an example of a case in which the CEA did obtain, as I recall, a consent decree for alleged manipulation of wheat futures prices in 1959, two people—two men employed by a brokerage firm endeavored to run up the price of the May wheat futures on the Chicago Board of Trade simply by heavy concentrated buying. This effort did cause prices to be briefly distorted—they were too high for awhile because of the buying. The punishment for this effort was first the people who were in a position to move wheat to Chicago, recognizing that this price was too high, did so and delivered the wheat to people who had to pay too high a price for it, so it cost them, and second, they were penalized by the Commodity Exchange Authority, and I have forgotten what the penalty was. This was just concentrated buying to

brokers and the commissions firm, just lined up lots of customers with lots of money and tried to push the market price up, and temporarily achieved this.

Mr. GONZALEZ. Thank you.

Mr. Caldwell, do you recall any recent efforts at manipulation in this market, wheat grain, or any strong fluctuations that resulted in price increases to the consumer?

Mr. CALDWELL. We haven't had any within the past year. The most recent case in which we have brought charges involved wheat in 1963. That case has not yet been settled.

Mr. GONZALEZ. Thank you very much.

Mrs. SULLIVAN. Mr. Williams?

Mr. THEIS. Madam Chairman, could I address an answer to Mr. Gonzalez' question?

Mrs. SULLIVAN. Surely.

Mr. THEIS. I believe you asked if the depletion of the Government stocks in the past few years—referred to the wheat stocks—had any implication on the futures contract market.

Mr. GONZALEZ. Was it a factor?

Mr. THEIS. Yes, it was, and I shall quote you figures from the Kansas City market.

In 1962 the volume of speculative trades were more or less the same as the volume of speculative trades on the Kansas City market in wheat in the year 1966. However, the volume of contracts in hedging in 1962 were approximately 25 million bushels, whereas in 1966 they were almost double. They were more than double. They were 58 million bushels. So this brings the grain industry into play where they are carrying the grains on a hedge basis rather than having the grains carried by the Government in the case of surplus.

Mr. GONZALEZ. Thank you very much.

Mrs. SULLIVAN. Mr. Williams?

Mr. WILLIAMS. Thank you, Madam Chairman.

Dr. Gray, I would like to say that I think it would be helpful to this committee if you would take the case raised by Mr. Stephens where he has $500 to invest in cotton futures and describe the various things that can happen to Mr. Stephens' $500, and I would like to suggest that you submit that for the record.

Mr. GRAY. All right, I'll endeavor to do that.

(The material requested follows:)

DISPOSITION OF MARGIN DEPOSITS

Take the price of December corn futures to be $1.00 per bushel, and the margin requirement to be $500 for a 5000 bushel futures contract. When a December futures contract is purchased (or sold) at $1.00 per bushel, the opposite side of the bought (or sold) position is taken by the clearing house, which therefore holds the seller's (delivery) obligation toward all buyers, and the buyer's (receipt) obligation toward all sellers. The basic purpose of margins is to protect the clearing house in the event of price change; so that it can meet its seller's obligation in the event of price decline, or its buyer's obligation in the event of price rise.

If prices rise to $1.05 per bushel, half of the seller's margin has been impaired, so he would be called upon to deposit $250 additional margin. If prices rise further to $1.10, he would be required to deposit an additional $250 margin, etc., so long as prices continue to rise. If prices *declined*, then *buyers* would be required to deposit additional margin according to the same schedule ($250 for each 5¢ price decline). Thus at all times the clearing house is protected.

The market determined value of a futures contract at the moment it is bought (sold) is zero. Only as its price may subsequently rise or fall does it acquire any value to buyers (sellers). Margins are established and maintained to assure that any increments in value are transferred from buyers to sellers (or vice versa) if and when they occur.

As to what happens, then, to Mr. Stephens' $500, the following happens:

(1) If price does not change, his margin is returned to him, minus approximately $20 commission fees, when his contract is offset in the pit.

(2) If price changes in his favor, his margin plus $50 for each one-cent change in price is returned to him, minus $20 commission fees, when his contract is offset in the pit.

(3) If the price changes against him, his margin *minus* $50 for each one-cent change in price is returned to him, minus $20 commission fees, when his contract is offset in the pit.

(4) If his contract is not offset in the pit, then a cash delivery transaction results, and the remaining margin is applied to this transaction.

Congresswoman Sullivan submitted the following news release from Office of Assistant Secretary of Defense (Public Affairs)

NOVEMBER 17, 1965.

Secretary of Defense Robert S. McNamara stated that our greatly increased defense efforts in Vietnam and recent international political disturbances threaten to disrupt and distort the market for copper despite the best efforts of the industry to supply the market. This market disruption can lead to strong inflationary developments not only in copper essential to defense needs, but also more generally throughout our economy. Such developments would seriously impair our defense efforts in Vietnam. To avert them, the Government, after discussion with members of the industry, is initiating the following action:

a. Arrangements are being made for the orderly disposal of at least 200,000 tons of copper from the National Stockpile.

b. Exports of copper and copper scrap from the U.S. will be controlled for an indefinite period in order to conserve domestic supply.

c. Legislation will be requested of the Congress by the Administration to permit the suspension of import duties on copper which at present amount to 1.7¢ per pound.

d. Discussions will be held with the directors of the New York Commodity Exchange urging them to curb excessive speculation in copper trading by raising the margin requirements for copper from the current level of approximately 10% to a figure more comparable to that required for trading on the New York Stock xchange.

Mr. WILLIAMS. I am quite certain you are familiar with the International Wheat Agreement which comes under the jurisdiction of this committee, and we have the International Coffee Agreement which comes under the jurisdiction of another committee. I believe these agreements were entered into with the understanding that the international price and production controls would eliminate undue speculation which would tend to decrease severe fluctuations in prices. However, leaving out the considerations of foreign policy and foreign aid, is it not true that these agreements have actually resulted in American housewives paying much higher prices?

Mr. GRAY. It is unquestionably true that where we enter into agreements to support the prices of the imported tropical commodities which we do as a consuming, importing country, that this is the effect, it is unquestionably true that the leading cause of continued high sugar prices for the American housewife is the sugar quota system which is in effect. It is unquestionably true that the payment which flour millers make in excess of the price of wheat which they purchase from farmers to pay for the market—for the farmer's marketing certificates ultimately increases the prices of flour and, therefore, of bread.

Mr. WILLIAMS. That is all I have. Thank you.

Mrs. SULLIVAN. Mr. Minish?

Mr. MINISH. Thank you, Madam Chairman.

Mr. RHODES. Did I understand you to say earlier that you worked for the Agriculture Department?

Mr. RHODES. I did from 1934 to 1960.

Mr. MINISH. 1960? Did you not also say that they just about wrecked the cotton futures market?

Mr. RHODES. Yes.

Mr. MINISH. Is that while you were there or after you left?

Mr. RHODES. Part of it was done while I was there and it was finished off after I was there.

Mr. MINISH. Did you administer the cotton program?

Mr. RHODES. I administered the cotton program in the Department of Agriculture from 1952 to 1960 under the supervision of the then Secretary Ezra Taft Benson.

Mr. MINISH. Do you feel the actions of the Agriculture Department might have resulted in higher costs to the consumer?

Mr. RHODES. The price-support programs of the Department of Agriculture unquestionably increased the cost to the consumer. I don't think there would be any question whatever about that because the price of cotton during the years that I was in the Department was held up in the neighborhood of 32 cents to 35 cents a pound in this country, and it was being sold throughout the world from the low to middle 20 cents a pound. It is the chief ingredient in most household products.

Mr. MINISH. Do you want equal time, Mr. Caldwell?

Mr. CALDWELL. Mr. Rhodes is more familiar with that since I did not come under the cotton authority jurisdiction.

Mr. MINISH. Mr. Rhodes, you mentioned earlier the foreign markets—do they set margins in foreign countries?

Mr. RHODES. Yes; sure, they have margins.

Mr. MINISH. Can you tell us what they are?

Mr. RHODES. No, sir; I wouldn't be capable of telling you what the margin in India or Japan or even Liverpool is. The Liverpool market is very, very thin, too, now.

Mr. MINISH. Dr. Gray, I note that the New York Commodity Exchange filed a statement with the committee but did not come in. Do you feel that the trading of silver which is important to this committee had a bearing on the speculation in silver?

Mr. GRAY. I don't understand your question. I am sorry.

Mr. MINISH. The New York Commodity Exchange filed a statement but did not come in. They trade in silver, which is very important to this committee. Would you or any of the other gentlemen say that the speculation last May or June had any impact in the increase in the price of silver?

Mr. GRAY. The speculation in silver futures provided the opportunity for people to adapt to the inevitable price rise in silver. Silver users and producers could adapt to that rising price rise if they had the wisdom to do so by trading in future contracts.

Mrs. SULLIVAN. Mr. Bingham?

Mr. BINGHAM. Thank you, Madam Chairman. I am interested in the comments made by Mr. Theis about the necessity of controlling

margins. He referred to them on page 4 of his statement. I see you have a very detailed appendix on that subject. Could you quickly tell us what are the criteria by which the proper margins are set? Does it have to do with control of excesses of speculation?

Mr. THEIS. No, sir. As far as the criteria for the setting of the margin, I would like to go a bit deeper than what has been said here as to the operation of the Kansas City Board of Trade and a little deeper than what is in the paper.

The minimum margins are set by the board of directors of the Kansas City Board of Trade—for the minimum margins to guarantee that contract. However, we have the Kansas City Grain Clearing Co. who takes the opposite side of these contracts, and all the trades are cleared through them. They have margin requirements for that clearinghouse. Therefore, the members of the Kansas City Board of Trade who are also clearing members are obliged to bring in the margin of either one, whichever is the highest.

As far as the directors of the Kansas City Board of Trade are concerned in the setting of minimum margins for our members, we review them, we review them quite often, we also look at the criteria: Is this level high enough to guarantee the contract—is it also low enough to afford the public and the hedger to come in and make full use of the margin?

We sincerely believe the more forces we have in the marketplace dictating their thoughts as to the price up or down establishes what we consider to be a true market price.

Mr. BINGHAM. Is there any parallel between the downpayment made on a real estate contract at the time of signing of the contract and what you refer to as margins in futures trading?

Mr. GRAY. I think the closer parallel, sir, might be with a deposit of earnest money rather than downpayment. Because the futures margin is not a downpayment. The title to no capital asset has been made when a futures contract is established by a transaction between buyer and seller.

Mr. BINGHAM. That is also true in real estate. The downpayment in a real estate contract is, in effect, earnest money.

Mr. GRAY. Yes. If, in the final analysis, if it were true, sir, that the futures contracts culminated in delivery of the product, then the margin could serve retroactively or retrospectively—it could serve as a downpayment and the balance over and above that margin would be what—would have to be paid in cash to purchase and own the actual commodity. To that extent you could say there is a parallel. But the important point is, the usefulness of markets is for hedging purposes—people who hedge do not ordinarily intend to take delivery. Speculators rarely do. Therefore, some 99 percent, I suppose, in the well-used futures markets are offset before they mature and, therefore, you don't have the commodity changing hands through this instrument, and if you look at that in retrospect you couldn't say that this margin deposit was a downpayment because there was no transaction.

Mr. BINGHAM. Let me ask you this question, Dr. Gray. It seems to me it is a rather key question.

I take it from what you have said before that you would agree that excessive speculative buying in futures can force up the futures

price. That is pretty clear. Now, the $64 question seems to me is, will that ever affect the price at time of delivery?

Mr. GRAY. Typically not.

Mr. BINGHAM. Why not?

Mr. GRAY. In the illustration I cited earlier what was the excessive and manipulative in one contract in 1959, the ultimate effect on the price of cash wheat was that a small proportion of the total amount of wheat was delivered in satisfaction of these contracts. That being the case, the prices on those contracts was too high—to the same extent that the futures pricing had gone too high.

More usually, in the event of excess speculation in futures this would I think correct itself before maturity and would not usually culminate in delivery at those prices, though this would vary from case to case.

I really also feel, sir, that the key question here is to the extent or frequency of excessive speculation and there again most of our evidence suggests that with the futures markets, a more precise job of pricing is done, because you have brought all the supply and demand forces to bear at one place in determining this price you have and you have an improved opportunity for getting the correct prices established.

Mr. BINGHAM. What if anything does the Commodity Exchange Authority have to say about this?

Mr. CALDWELL. The Commodity Exchange Authority has nothing to do with margins at the present time.

Mr. BINGHAM. Before yielding back my time, I would like to express a welcome to those gentlemen who are here from New York City. These markets do play an important role in the financial life of the city, and I thank them for appearing here today.

Thank you, Madam Chairman.

Mrs. SULLIVAN. I have a few question that I would like to ask.

First, one of the witnesses—Dr. Gray—recommended placing all of the agricultural commodities under regulation. Do all of you gentlemen favor placing the additional agricultural commodities under regulation, and also would you approve some similar type of regulation for nonagricultural products? Is there anyone that objects to placing all commodities under some form of regulation?

Mr. RHODES. I wouldn't say I object. I think it is highly questionable whether commodities that are grown entirely in foreign countries and traded on foreign futures markets can logically be put under supervision in this country.

Mr. WATTS. The New York Mercantile Exchange finds no fault with regulation by Commodity Exchange Authority. We welcome it.

Mr. BROOKS. As you added the commodities to the responsibilities of the Department of Agriculture, and you get away from agricultural forestry products and as the volume of trade, because of the economic situation, seems to increase, there comes a point in our judgment where the Congress might well look at establishing an independent regulatory agency—call it the Commodity Exchange Commission—divorced from a commission composed of Cabinet members—not unlike that established in the securities field—but you have to look at this only when you get to the point in our judgment, are these commodities peculiarly agricultural or forestry?

Mrs. SULLIVAN. Mr. Watts, what in the world makes bags of 1,000 circulated or uncirculated silver dollars proper items for futures

trading? I note that a contract of this nature will go up on your exchange on August 21.

What is the rationale for that?

Mr. WATTS. It is not a futures contract. It is a spot contract. We refuse to write a contract for futures trading in silver dollars.

This was asked by several of our members, this spot-cash market was asked for by several of our members in order to, shall we say, bring order out of chaos in the market for these silver dollars. It seems that there is a considerable premium on some silver dollars and some not. That is just—we just don't let them—it is a cash contract, not a futures contract.

Mrs. SULLIVAN. Professor Gray, we on this subcommitee all recognize, I am sure, the legitimate role of the speculator in any commodity exchange. Normally, these are knowledgeable people who buy and sell as a regular thing, keeping up with the market, knowing the range of trading values, and providing a base for the trade to hedge. But what of the doctors and lawyers and merchants and schoolteachers and others who are touted by their brokers into taking a flyer on some commodity which is suddenly spurting upward—people who have no idea of how the market operates but who are pulled in by dreams of sudden riches—and often end up with a big hole in their bank accounts as the market suddenly shifts?

What legitimate role do such plungers play in an orderly market?

Mr. GRAY. Well, Madam Chairman, you have used some fairly colorful expressions in that question—being touted by brokers to the extent that this does occur, and if they are not well informed and responsibly treated by their brokers it is objectionable, at least from the standpoint of the participant.

Now, if this is, say, a doctor or dentist as you indicated—people with fairly high incomes in this economy and if this affects a transfer payment from that segment of the economy to the wheat or potato segment of the economy, I wouldn't pass a moral judgment on that as being bad. It is probably an inefficient way to do it.

More importantly, Madam Chairman, the marketplace is a continuing screening process. Those who do succeed are obviously doing a good job of forecasting prices and those who venture into this without proper preparation, without proper understanding are, I suppose, by and large, apt to pay a price for that venture; no differently, I think, however, from ventures into any kind of investment if they are ill advised or ill timed or not properly prepared. We can't—I think we cannot legislate against foolishness. I think we cannot legislate against people lacking wisdom and intelligence. To the extent, however—to repeat this—to the extent that it is irresponsible touting by brokers, for example, I think it is squarely objectionable.

Mrs. SULLIVAN. In asking this question, I was thinking back again to our hearings and our study in 1963 in sugar because this is what happened. And it was obvious that in the end the public does pay a price for this and we did pay for it in sugar and we paid for it in coffee when that market soared. Going over the records in the brokers' accounts, it was clear that many people who had never before speculated in anything like this were pulled into the market on the promise of a fast buck—I hate to use that slang expression—but that was the only

reason they got into it. They had been led to believe they could make it big overnight. And we found that it took a very small amount of money, comparatively, to play for big stakes. The broker would allow them to come in with a few hundred dollars and buy or sell contracts worth thousands of dollars. Do not tell us it did not raise the price of sugar to the user, because it did.

Mr. GRAY. Madam Chairman, may I comment on that?

Again, I apologize for not being able to deal in any depth with your single counterexample of sugar and futures trading. I simply am not informed as to that particular price movement.

I would say, however, that during the course of that I personally was visiting with a commodity broker in San Francisco on another matter and a young man came in and said to him that he would like to buy a sugar futures contract and this broker said, "What makes you think you would like to buy a sugar futures contract?" He said, "My friend bought some and told me if I would get $300 and invest in that, that I would make some money." The broker said, "In the first place, I would not accept your account with $300, and secondly, I strongly advise you against trading futures and if you are going to trade them you will have to do it some place else than with me."

This is the distinction I am trying to draw between ethical and responsible brokerage firms and those who may have, and I didn't have the evidence you evidently had, those who may have touted people to do this irresponsibly.

Mrs. SULLIVAN. We are all aware of the need for, and the use of, the futures market by the knowledgeable regular traders, whether they be individuals who enter as speculators or producers or users of the commodity who are hedging. We are not trying to interfere with orderly trading.

Frankly, this section 207 was put in this bill so that we could develop more information about futures trading and thus have a better understanding of what happens when the futures market was entered into by people who knew nothing about it—who are led to believe it is a way of making money fast. Often they find it is just as easy to lose it fast. That is their problem, perhaps, except that when such amateurs aggravate a volatile market, we all feel the consequences.

Mr. Stephens?

Mr. STEPHENS. Madam Chairman, one thing I want to do, and that is to not just leave in the record the answer to Mr. Minish's question about the support price for cotton as raising the price of cotton goods to the consumer. Just by itself it sounds as if that is a great fault in the price of cotton supported by the Government. I think the record should explain the fact that the support is an incentive one to make it profitable for farmers to continue to raise cotton in America. It is to supply the producer with a reasonable return for his work and for his investment in order for us to continue to have textile mills that will employ people in America so that we can compete with people in other countries at a higher wage level than countries abroad and also in order for us to support the worker in the garment industry in New York and Mr. Minish's district—which we intend to maintain—and I want to have it maintained, at a high level of employment, a high level of wages for people in the cotton textile field. If we want

to do this we have to provide an incentive for them in America to grow cotton.

We have chosen the method of cotton supports because the only alternative to that would be in getting back to where we were many, many years ago when we had terrific battles over tariffs. We either had to raise the tariff to prevent these goods from coming in or provide the incentives that would make the farmer get what he gets. So, if we are going to have prosperity in the whole field of textiles then the consumer is going to have to pay a little higher price.

Now, to get back to some of the impressions I got from our sugar investigation. The first was the fact that Cuba had gone out of the market of supplying the United States. This made a lot of people think that sugar was going to be scarce and they should get into the market. That was one of the things.

The other thing that I remember that was brought out in the discussion we had was the fact that sugar was going to have to be produced in quantities in other places; that there was going to have to be placed in the field of sugar production some incentive and the American people were going to have to adjust to a higher price if they wanted to make people in other countries go into the production of sugar so they could pay higher wages and pay for the cost of investing in sugar plants. It was not because of speculation, there were other effects and that is what you had in mind, was it not, Professor Gray?

Mr. GRAY. Yes, sir.

Mr. STEPHENS. Mrs. Sullivan did not enter into the whole matter. There were other factors involved around the whole thing, not just the one factor of speculators getting into the market. Those are other things, too.

Mr. RHODES. Madam Chairman, I would like to say that I appreciate Congressman Stephens' bringing this point up again. My answer was very short and it may have been misinterpreted. I am not opposed to the cotton program. In fact, I have supported it and have benefited from it for 25 years. It is only the way in which it has operated that it has affected the futures market. On August 1, 1966, the Government had in its inventory over 14 million bales of cotton out of a total carryover of 16.7 million bales in the country. The Government owned and had in store over 14 million bales of cotton which they were offering for sale.

If you take cotton, in a cotton shirt that sells for $6 or $8, the cotton would be worth about 27 to 29 cents. So if you increased the price 50 percent you are only talking about 6, 7, or 8 cents on that cotton shirt. But it has increased the cost.

But I didn't mean to infer that it was bad. Our farmers should have an income comparable to other people's.

Mr. STEPHENS. I did not mean to imply you were giving an erroneous answer. I did not want to leave in the record a statement that we had cotton price supports without the fact that we had them in there with some good explanation.

Mrs. SULLIVAN. Did the Government take over that amount of cotton in order to support the price of cotton?

Mr. RHODES. The Government makes loans on cotton to the farmer.

Mrs. SULLIVAN. It was to support the price the farmer receives.

Mr. RHODES. At the end of the loan period, if the farmer has not paid off the loan, plus interest and carrying charges, they take over the commodity. On the 1st of August 1966, they took over about—nearly 6 million bales of cotton and they already had 8 million bales from prior years.

Mr. STEPHENS. In other words, the Government increased the inventory of cotton in warehouses.

Mrs. SULLIVAN. If the Government had not done it, what would have happened? Would the price of cotton have gone down?

Mr. RHODES. Present law which the Congress passed in 1965 changes the way it is handled. Now the payments are made to the producer directly and the cotton is allowed to move through channels of trade and be handled as it is normally in other commodities.

Now, I, as a cotton farmer sell my cotton to anyone I can sell it to for the best price. I get my additional income in the direct payment from the Government, not by having the inflated loan rate and having them take over the commodity.

Mrs. SULLIVAN. Mr. Bingham?

Mr. BINGHAM. I just wanted to pursue a little bit with Dr. Gray the question that Mr. Williams raised about the cotton and sugar international agreements, particularly in regard to coffee. I do not know whether you intended to suggest that you were opposed to the coffee agreement, Dr. Gray, did you?

Mr. GRAY. I have no ax to grind in this matter, Mr. Bingham. If one assesses these agreements in terms of their economic efficiency, I should say that they are not very efficient economically.

Mr. BINGHAM. May I suggest that there are other considerations?

Mr. GRAY. That is why I limited it to just that consideration.

Mr. BINGHAM. The stability of the country producing these commodities, for example.

Mr. GRAY. I am not opposed—I say if we limit our consideration, because the question which came to me was as to the effect of price on consumers. If we limit it to that consideration we would have to say it is inefficient economically.

Mr. BINGHAM. Is there not also a very good argument to the effect that if you do not try to regulate, for example, the prices governing coffee, in Brazil, that you may have such wild swings in prices, such wild swings in production that you end up not serving the interests of anybody, not even the consumer of the United States?

Mr. GRAY. This is, sir, an argument that is made in defense of this type of agreement. I should say in general the answer must be that the extent to which the producers in such a country as Brazil do give their response to market prices and who respond rationally to higher or lower prices producing less from the prices lower and more from the price that is higher, to that extent the most efficient thing would be to rely on the free market system, assuming there is adequate financing here, and so on.

But to the extent that that is not true and to the extent that other considerations such as considerations of political stability, considerations of hemispheric relations coming into play, then these obviously must be weighed into the total attitude about this.

I am in total not opposed to or a proponent of the coffee agreement. If I look at it just from the standpoint, from the economic standpoint, I think I can indicate what the results will be.

Mr. BINGHAM. For the record I would like to say that there are many who say that we should have trade and not aid for the developing countries. If we are going to have trade with the developing countries, you have to encourage trade in those commodities that they can effectively produce, and it is better in my judgment when there is some restraint on the wild fluctuations in price.

Mrs. SULLIVAN. I would like to comment on that, too. During the debate on the coffee agreement—and there was a very hot debate on the floor—those of us who worked on this problem had the feeling, and the assurance, in fact, from our consumers, that consumers were willing to pay a fair price for any product that was wholly imported. But they were not willing to pay the kind of high price that was the result of manipulation of the market, such as happened back in 1953 and 1954 when, through a hoax on the consumer, the Brazilian coffee people tried to frighten the American processors with exaggerated reports about the scarcity of coffee. It was this kind of hoax we are opposed to. We knew that if the supply of coffee was stabilized to a certain degree under an international agreement, the price might be raised to the consumer. But we would be giving these underdeveloped countries a chance to stabilize their economies by stabilizing their most important product. And I think some of them have done it. We recognize that an agreement on supply puts a floor on the price of coffee, and we would want it to be a fair price.

When a market is misused and manipulated, however, we have the obligation to investigate and to try to correct the situation.

This was the reason we went into those two products, coffee and sugar.

We appreciate the willingness of you gentlemen to come here and help us understand more about this subject. It may very well be true, as you have all stated, that margin on a commodity futures contract does not mean exactly the same thing as margin on a stock market transaction. But it means something very similar, in this respect: people can come into your markets and buy and sell contracts worth many, many times the amount of money they put for margin. Their margin can be wiped out in a single day's trading. They can't always get out of the market unless somebody is willing to buy them out. I think the term you use is "locked in." They can be locked in during enough days of trading to be ruined financially. That is their worry, perhaps.

But when people who are jaded by the slow pace of stock market changes see a chance to make a quick killing for a small downpayment, and are recruited into your markets by brokers who tempt them with vast riches at small risk, they contribute not stability but chaos to your markets, and I'm sure this happens periodically.

You have pointed to technical deficiencies in the language of our bill to accomplish what we seek to do. I am sure if we were to correct the language technically, you would still want us to drop any provision of this nature from the bill. We will take your advice under advisement.

I am hoping that before we mark up H.R. 11601 the Department of Agriculture will have made public the Nathan report on this subject, and will have some recommendations on the general subject of margins on agricultural commodities, at least. Depending on the research findings, it seems to me that what would be important for agricultural futures would be important also for the defense materials also traded in the futures market.

I want to thank you, Mr. Caldwell. I appreciate your coming here this morning and though we did not make very much use of your broad knowledge and experience, I felt better in having you here as a backstop.

We will place in the record at this point a letter just received from the Secretary of Agriculture on the general subject of margins, explaining that the Department has not changed its position on margins, but is still studying the new report before making any recommendations.

(The letter referred to follows:)

DEPARTMENT OF AGRICULTURE,
Washington, August 15, 1967.

HON. LEONOR K. SULLIVAN,
House of Representatives,
Washington, D.C.

DEAR MRS. SULLIVAN: I regret the delay in responding to your letter on H.R. 11601, your bill to provide comprehensive consumer credit protection. I had hoped to have more specific information regarding section 207, the proposal to give the Federal Reserve Board authority to regulate commodity futures margins, as a result of a special study of this subject which we commissioned.

As I indicated in the departmental report on the bill, we have supported margin controls in the past, and we have not changed that position.

We are still in the process, however, of evaluating the study. It examines the nature of speculation in grain futures contracts, and represents a pioneering effort to determine both the bearing of "excess speculation" on commodity price fluctuations, and the effect of margin requirements on speculative activity and prices.

More questions were raised by the study than were answered, and we want to assess these carefully before drawing any conclusions or making any recommendations based on the study.

Let me cite a number of questions to illustrate my point. We are reviewing the basic data available for the study to make certain that it does not contain errors which could weaken or nullify some findings. We need to clarify how the various futures positions—such as anticipatory hedging, offsetting transactions and others—were classed for the study to determine their relative price influence.

We are working with the firm which made the study to resolve these and other questions, and we are hopeful that this final phase of the study can be completed by early September.

Until this phase is completed, we do not feel that reasonable judgments can be made, or that qualified recommendations should be attempted.

At that point we will be more than happy to discuss the study and report with you and your subcommittee. We feel it represents a substantial accomplishment in an extremely complex area as it is the first effort to obtain meaningful answers to the questions of speculative activity by economic analysis.

Prior to then, we will be happy to have the officials from the Commodity Exchange Commission be present at your hearings to discuss margin regulation.

Sincerely yours,

ORVILLE L. FREEMAN, *Secretary.*

Mrs. SULLIVAN. With that I want to say that tomorrow morning we meet at 10 o'clock for a full morning and if we can, for a full afternoon, too. It is a big schedule which I hope we can complete. We will have in the morning, Mr. Leon Keyserling, former Chairman of the

President's Council of Economic Advisers; witnesses from the National Retail Merchants Association, and also from the National Senior Citizens Association, and Mr. David Caplovitz, author of "The Poor Pay More"; and in the afternoon at 1:30 we will hear from the National Consumers League and the National Retail Furniture Dealers Association, and from Prof. Vern Countryman of Harvard University Law School.

With that we thank all of you who contributed to this interesting discussion.

(The complete statements of Mr. Brooks, Mr. Rhodes, and Mr. Watts and a statement submitted by the New York Commodity Exchange, Inc., follow:)

STATEMENT OF WILLIAM F. BROOKS, PRESIDENT, NATIONAL GRAIN TRADE COUNCIL

My name is William F. Brooks. I am President and General Counsel of the National Grain Trade Council. We appreciate this opportunity of registering our views against the approval, by this Subcommittee or the Committee on Banking and Currency, of Section 207.

The stated purpose of this section is to prevent "excessive speculation in and the excessive use of credit for, the creation, carrying or trading in commodity futures contracts, having the effect of inflating consumer prices." To accomplish this, the Board of Governors of the Federal Reserve would prescribe regulations which, according to the Chairlady, would give the Federal Reserve System the same powers to set margin requirements in connection with trading in commodity futures contracts that it now holds in the setting of margins for credit transactions on the stock exchanges.

On a number of occasions Congressional committees have studied proposals which would grant to government officials authority to set margin requirements on futures transactions in commodities. We have opposed this grant of authority because in our considered judgment, no public officials or group of public officials, such as the Board of Governors, are so omniscient as to determine when speculation might become excessive in commodity transactions and to determine when any degree of speculation in commodity futures contracts would have the effect of inflating consumer prices.

We are convinced that speculative transactions have little effect on the price paid by consumers for commodities and that speculation is not a basic factor in determining the general level of prices in the long run. We doubt that it is an appreciable factor even in the short run.

We note that the Board of Governors of the Federal Reserve, through its Vice-Chairman, Mr. Robertson, on August 7 advised the Subcommittee in effect that the Federal Reserve Board would not be the most appropriate agency to administer such commodity market legislation as is contained in section 207 of the pending bills. Mr. Robertson stated the Board's belief, which we share, that relatively little credit is used in connection with futures trading.

Our recollection of his answer to one question put to him by the Chairlady—whether he thought the Department of Agriculture should regulate stock market margins on General Foods or other food companies—is that Mr. Robertson stated that the Department of Agriculture was probably as ill-equipped to deal with security margins as the Board of Governors would be to deal with margins on commodity futures contracts.

We agree with that observation.

The proposal embodied in section 207 is based on a misconception of the nature of commodity contract markets, on the nature of trading in commodity futures contracts, and on the functions of margins in connection with the commodity futures contracts when attempts are made to draw an analogy between them and the down payment required to obtain title to stock or goods and chattels or real estate.

Organized contract markets are recognized commercial institutions. Most of the commodities for which futures trading is available, are subject to the Commodity Exchange Act. Additional commodities may become subject to this Act.

These recognized commercial institutions make possible an orderly movement of agricultural commodities from production to consumption. Their operations

assure a rough equality on the buying and selling sides of the market. The availability of futures contracts makes substantial contributions to the financing of crops as they are planted, harvested, and start thereafter through the marketing channels to ultimate end users. Speculation within the commodity markets makes hedging possible and permits the operation of the Nation's low-cost efficient grain marketing system.

The grain marketing system, because of the availability of futures markets where people trade in futures contracts covering grain, is a highly competitive, low-cost marketing system. The function performed by futures markets is to register the forces of supply and demand by open public trading. In doing this through the medium of futures transactions, producers, processors, exporters, and others are offered an opportunity to obtain price insurance that today they may agree to deliver in the future something they may not now own or that today they may agree to take delivery in the future of goods they may now anticipate they will need, or that today they may obtain a price certain for commodities they are buying or have bought and intend to carry awaiting sales or use for processing. Through trading on exchanges, a steady flow of commodities moves from production into consumption.

The rules of futures markets require that the users of these markets deposit collateral in the form of margins, to guarantee the performance of their contract. The minimum margin to be deposited is determined by the governing boards of contract markets. Futures commission merchants can and often do require deposits in excess of the minimum established by governing boards. The minimums required are subject to constant review. They vary by commodities, by type of trade, and may be different for different delivery months.

Attempts are at times made to draw an analogy between the margin required to enter into a contract for the future sale or purchase of a commodity, and the down payment required to obtain title to stock, or goods and chattels, or real estate.

There is no analogy between these transactions.

In speculative securities transactions actual title to the number of securities traded passes from the seller to the buyer. The speculator in securities deposits his own money in the amount required by the Federal Reserve Board to obtain title to the securities, and his broker then loans the balance, either from his own funds or from a lending bank to complete payment for the transactions. In speculative transactions actual title to securities, evidencing the acquisition or disposal of an equity in a corporate entity, passes from a seller to a buyer.

So too, as to transactions involving goods and chattels or real estate. There purchasers obtain a title by making a down payment and arrange to pay the balance either with the seller or through a bank on terms satisfactory to the buyer, the seller, and the bank. The buyer receives a title to something tangible—something he can use—something he can deal with—subject, of course, to the rights of his lender—the seller or the bank—as those rights may be defined in a chattel mortgage or mortgage deed.

In transactions covering agreements to sell or buy commodities for future delivery or receipt, no title passes to the buyer and no title passes from the seller. Each party to such a contract entered into on a commodity exchange deposits with his broker an amount of earnest money to assure compliance with the contract when, in the future, it matures, or until an offsetting contract is entered into. Only if the contract is completed by delivery, when it matures, does a title pass. And then, contrary to the practice in transactions involving securities or goods and chattels or real estate, full payment must be made.

Implicit in each futures transaction is an intention on the buyer's part to make delivery, and on the seller's part to take delivery. These obligations often are liquidated by offsetting trades. To the extent that they are not so offset, delivery will be made by the seller and title to the grain covered by the contract will be accepted by the buyer.

The experience of late 1947 as to grain prices, indicates that in commodity markets, where the volume of speculative trading has been limited, prices react in response to supply and demand factors. In October of 1947, as demanded by the President, a 33⅓ percent margin was set by the exchanges for speculative transactions. At that time May (1948) wheat at Kansas City was selling at $2.64¼. May wheat continued upward, reaching nearly $3. During this period the markets lost much if not all their liquidity, and such trades as were available to hedgers—processors or exporters, country and terminal handlers—caused rather wide changes in prices.

No compelling public interest existed during World War II to require the Government to attempt to govern the margin requirements necessary to contract, as a speculator, for the purchase or sale of commodities for future delivery. It was not until April 1946 that the OPA attempted to exercise such authority. At that time this agency decreed that margins on new speculative trades in cotton futures should be $50 a bale on transactions based on a price above 28 cents a pound. If news stories describing the promulgation of this order are accurate, the then Secretary of Agriculture signed the order after he had been "ordered by Economic Stabilizer Bowles to sign it." Mr. Bowles at that time stated as the reason for the order "the prevention of further speculative rises in cotton." Why he then had to order the Secretary of Agriculture to sign is conjectural. The order to sign may have been required because the then Secretary of Agriculture believed then, as we do now, that it is not necessary but rather harmful and dangerous for the Government, through the exercise of control over margins in speculative contracts for future delivery, to interfere with the mechanism of free, open, competitive markets, and that attempts to control prices through this interference will not work.

It is significant that shortly thereafter, and before the decree became effective, Congress repealed the law under which the decree issued.

This decision of Congress to remove (from the control sphere of the Government) control over margins was undoubtedly a decision based on full consideration of the merits of the question whether the Government should have authority to set margins on future transactions in commodities. Whatever the Congressional reason then, it is obvious that in view of subsequent legislative events Congress has been consistently convinced thereafter that there was little or no merit in the request that the Government should have this authority.

In 1947 the Joint Committee on the Economic Report held extensive hearings on prices throughout the country and in Washington. During these hearings people connected with all segments of those industries that make use of futures markets testified on the operation of those markets. They explained the operation of those markets; the function of the speculator; the contribution he makes to a market's liquidity, the use of markets, in view of their liquidity, by producers, handlers, processors, exporters, and others, in buying, storing, processing, and exporting to insure inventories; and how, in view of these uses, sellers of the Nation's grains are not left to the mercy of a few or a single buyer; and buyers of the Nation's grains, as it moves from production into consumption, are not left to the mercy of a few or a single seller.

All opposed the suggestion that the Government should be granted the authority to set margins on speculative transactions. At that time, as now, the proponents of the suggestion stated that this authority was needed to prevent excessive speculation by small nonprofessional traders. They agreed then, and they agree now, that futures markets, including speculation, perform an economic function in moving crops for, by them, hedging is possible. They agreed then, and seem to agree now, that speculation is a stabilizing force and that its presence in open regulated marketplaces "focuses all of the forces that affect price in one place where everybody can see it."

Since that date responsible Committees of Congress have studied proposals to grant control to the Government to set margin requirements in connection with trading in commodity futures contracts.

In February 1948 the Senate Committee on Agriculture held hearings on a bill which, if enacted, would have granted margin control authority. Hearings on this bill (S. 1881, 80th Congress, 2d session) extended over four days with a number of witnesses from the administration, the farm groups and industry interested in futures trading, appearing before the Committee. This Senate Committee after hearings and study of the testimony produced at them, took no action.

In the 81st Congress, companion bills, H.R. 4685 and S. 1751, embodying the same proposal, were referred to appropriate committees.

Neither bill was reported.

A Subcommittee of the House Committee on Agriculture was named to study H.R. 4685 and conducted an investigation into the operation of commodity exchanges. Thereafter this Subcommittee recommended that no new and additional regulation of commodity exchanges appeared necessary.

In 1950 and 1951, in connection with the Defense Production Act and its extension, the House and Senate Committee on Banking and Currency considered proposals to grant to the Government authority to set margins in connection with

trading in commodity futures contracts. Congress did not approve the grant of this authority.

In 1966 a Subcommittee of the House Committee on Agriculture held hearings on a bill which would have granted a number of authorities to the Secretary of Agriculture, including the authority to set margins on commodity futures contracts. According to the U.P. ticker of April 6, 1966, Congressman Matsunaga, after the hearings had been concluded, told newsmen that if this committee approved any part of the bill it would only be in greatly modified form. The same news item reported that comments by other subcommittee members indicated the margin control section of the bill was not expected to survive.

That subcommittee did not report a bill.

We are now here today faced with a proposal to grant authority to the Board of Governors of the Federal Reserve which, according to their spokesmen they do not wish to have and are not qualified to administer. This subcommittee is in effect considering a proposal which in substance has been considered by other committees and subcommittees in prior Congresses and found wanting. We recommend that this subcommittee make a similar finding.

We oppose this grant of authority because we are convinced that this method of attempting to prevent inflated consumer prices will not work. We oppose this grant of authority because an attempt by the government to exercise control over margins may well cause a breakdown in the entire marketing structure, leaving State trading as the only alternative. Raising margins will not keep prices from going up. It seems to be admitted that commodities that have no futures market are usually more erratic in price than those that have. By raising margins, you can reduce and eliminate volume of trading. But you cannot control prices. And you might wreck the market structure.

STATEMENT SUBMITTED FOR INCLUSION IN THE HEARING RECORD BY THE NEW YORK COMMODITY EXCHANGE, INC.

My name is Matthew S. Fox. I am President of Commodity Exchange, Inc., 81 Broad Street, New York City. I reside at 201 East 19th Street, New York City.

I have been authorized by the Board of Governors of Commodity Exchange, Inc. to appear before this Committee to express the views of the Board with respect to H.R. 11601 and, in particular, with respect to Section 207 of the Bill. Before doing so, I should like to give the Committee a brief picture of the operations of our Exchange and its background.

The Exchange is a non-profit membership corporation which operates a trading floor at 81 Broad Street, New York City, to enable its membership to engage in the purchase and sale of futures contracts for the following commodities: copper, lead, mercury, silver, tin, zinc, hides and rubber. The Exchange does not buy or sell commodities or futures contracts for its own account. It merely provides the trading floor and facilities for the operation of a futures market.

Transactions executed on the floor of the Exchange are reported by ticker service to all areas of the United States and other countries, providing instant dissemination of information as to the price of each purchase and sale. Trade interests and others who have need to follow the price movements of the commodities on the Exchange are thus provided with continuous price quotations as a guide to marketing policy.

All transactions on the Exchange are entered into as the result of open outcry at rings at which the floor brokers gather. It is a true auction market with bids and offers freely and openly made. It thus reflects with great accuracy the relative impact of demand and supply upon the price of a given commodity at any given moment. In a true sense the Exchange provides an accurate instrument in a free marketing system.

We wish to call the attention of the Committee to the following considerations:

1. The purpose of the Bill, as set forth in the introductory paragraph, is, among other things, to authorize the Board of Governors of the Federal Reserve System "to issue regulations dealing with the excessive use of credit for the purpose of trading in commodity futures contracts affecting consumer prices".

It is a misconception of the mechanics of futures trading to speak of the "excessive" use of credit. When a man buys or sells a futures contract, his broker requires a deposit of original margin in an amount specified by the Exchange. This deposit is a down payment on the contract. The full purchase

price is paid only when a buyer takes delivery. The full sales price is realized only when the seller makes delivery. Thus, trading in commodity futures is essentially different from the purchase or sale of securities where the entire purchase price is payable ordinarily within four days of the execution of the trade and where the broker furnishes a part of that purchase price, thus extending credit to the customer. Such credit is never extended by the broker who handles the actual delivery at maturity of the futures contract. At that point the customer, who is a buyer, must place the broker in funds for the full amount of the purchase price. It is obviously a misconception of the functioning of the commodity futures markets to relate the margin deposits which are required under the Rules of the Exchanges with the use of credit.

2. The futures markets perform an economic function which can only be served properly if these markets have sufficient breadth and liquidity to enable hedgers to buy or sell their requirements without causing price distortions. It is unnecessary to elaborate upon this function beyond saying that excessive margin requirements imposed by any Governmental agency will inevitably restrict the amount of trading and thus impair the economic functions which the markets perform. This result does not serve to lower the price to the consumer; on the contrary, it invariably results in sharper price fluctuations because of the inability of the producer, dealer and consumer of the commodities traded to hedge their respective requirements and positions and thus reduce their inventory risks.

3. The proposal to give the Federal Reserve Board authority to deal with this problem is inappropriate in any case. It would place the Federal Reserve in a position of conflict with the CEA and would impose upon the Board responsibilities for policing these markets which it has neither the personnel nor the expertise to discharge adequately.

In conclusion, we respectfully submit that there is no need for the proposed legislation and no justification for it in the light of conditions now prevailing in our commodity futures markets. We do not believe that it is in the interest of the users of these markets or the public that Section 207 of the proposed Bill should be enacted.

STATEMENT OF F. MARION RHODES, PRESIDENT, NEW YORK COTTON EXCHANGE

The New York Cotton Exchange files this statement in opposition to Section 207 of H.R. 11601 which confers on the Federal Reserve Board the power to set margins on commodity futures contracts.

We submit that the proposed legislation is based upon misunderstanding of the economic function of a futures market and a misconception of the purpose of margins in a futures transactions.

The wording of the bill clearly shows that it is based on the assumption that excessive speculation on commodity markets has the effect of inflating consumer prices and that by increasing margins speculation will be discouraged. A statement of the Chairman of the Subcommitte in announcing the introduction of H.R. 11601 likens the credit extended on stock exchange transactions to the margins required in commodity futures transactions.

It is our purpose to explain to the Committee that the function of margins on a futures exchange is entirely different from its function on a stock exchange and that if speculators are discouraged from trading on a commodity exchange by the raising of margins the effect will not be to lower prices to consumers but rather to disrupt the operations of the market and destroy the ability of hedgers to utilize the future market. This will increase the costs of production and marketing of agricultural products and will have an adverse effect on prices to consumers.

In order to develop our argument I would like to outline briefly the operations of a commodity futures exchange. It is recognized by economists and by the Department of Agriculture that a futures exchange performs a valuable economic function in the public interest. Risks in business must be paid for. They are generally passed on to the consumer. To the extent that they can be eliminated or reduced, the consumer benefits. It is the function of a commodity futures market to eliminate or reduce the risk of price fluctuations in the process by which a commodity moves from grower to consumer. This is done by hedging on the exchange. The hedging facilities afforded by a futures market reduce the cost

of marketing and thereby permit the farmer to obtain a better price for his produce and enable the consumer to obtain products at lower cost.

Among those who use a futures exchange for hedging, citing cotton as an example, are growers, shippers, merchants and manufacturers. Since there are not an equal number of hedgers taking long and short positions on the exchange, speculators are necessary to a futures market and, for an expected profit, they act as insurers for those who deal with the actual commodity.

The hedger who purchases, sells, or holds, a commodity obtains protection against a change in price by taking an opposite position on a futures exchange. If he is a farmer or a merchant who holds cotton he hedges by selling a futures contract. If the price of his cotton goes down he liquidates his futures contract and what he loses on his cotton he makes up on his futures transaction. It is the speculator who generally takes the position opposite to the hedger and performs the function of the insurer. Markets which enjoy higher levels of speculative participation provide more reliable price protection. A market with fewer speculators is less effective, less liquid and less useful to a hedger. If margins are increased to drive out the speculator the functioning of the futures market will be impaired and the benefits of hedging to the country's economy will be lost.

There is little similarity between the operation of a stock exchange and a commodity exchange. On a stock exchange when a person buys a security he receives it within a few days and must pay the seller the full price in cash. If he requires credit to finance his purchase he borrows from his broker. The margin is the amount of cash he puts up which is the difference between the purchase price and the amount borrowed. Lower margins mean higher buying power. Thus, when margins are low there is a greater demand for stock and this has a tendency to increase prices. When the Federal Reserve Board is of the opinion that excessive speculation on the stock exchanges is causing an excessive increase in prices, margins are increased and it is believed that the effect is to reduce the demand for stocks and thus stabilize the market.

Margin on a futures exchange is based on an entirely different concept. It has nothing to do with the amount of money made available to purchase commodities. It is not a downpayment on the price. A futures contract is a contract to purchase and sell a commodity for delivery in the future. Most contracts are liquidated by offsetting contracts before the delivery date. Delivery is the exception. In those cases where delivery is made, the purchaser pays cash and the margin put up on his futures trade is not related to the cash which he pays. The margin on a future exchange is merely security to guarantee to the clearing member the obligations of the trader when he buys or sells a futures contract.

What is that obligation? When a customer buys a futures contract he owes nothing. If the price changes in his favor he owes nothing. It is only when there is an adverse change in price that he incurs an obligation. When he offsets his contract by a contra-contract he must pay his loss. The margin is to guarantee to the clearing member that he can pay this loss. The amount of the margin is fixed in relation to the loss which he may sustain as a result of an adverse change in price. When the price changes so that the margin is partially used up additional margin is called for and this additional margin is also merely to guarantee to the clearing member that the customer will be able to pay the loss resulting from an adverse change in price. When the governing board of an exchange sees a likelihood of large price fluctuations, initial margins are increased by the exchange because it is anticipated that there will be a larger obligation to pay for an adverse variation in price.

We have discussed the margin applicable to the buyer. Every transaction on a futures exchange involves a seller and buyer. Generally both parties are required to put up margin. In a normal transaction on a stock exchange, margin is required only of the buyer because the seller's transaction is completed. On a futures exchange every single transaction involves a short sale and there are speculative shorts as well as speculative longs. The amount of the margin is and should be geared to the obligation of the trader which is to pay for the variation in price when he closes out his transaction whether he is long or short.

When the purpose of margin on a commodity exchange is understood—that t is not a downpayment on the price—it should be apparent that an increase or eduction in margins will not be effective to control prices. However, any increase n margins beyond the point necessary to guarantee the obligation of the trader nay interfere with the operations of a futures exchange in facilitating the

marketing of products by discouraging speculators from performing their functions as insurers of the risk of a change in price. And, if higher margins were applied to hedgers as well as speculators it would be more expensive for the farmer and others who deal in commodities to protect the value of their crops and products.

The history of trading on the New York Cotton Exchange does not bear out the contention that prices rise when speculation increases. Cotton prices have risen when the speculative interest has been low. And when margins have been increased by the Board of Managers of the Exchange prices have still gone higher.

The manner in which a futures market operates requires special knowledge. If the Federal Reserve Board were to increase margins when commodity prices increase, in the mistaken belief that increased margins would reduce prices, the economic function performed by futures exchanges for the benefit of growers and processors and therefore for the benefit of the ultimate consumer will have been destroyed.

We should not overlook the fact that if excessively high margins are imposed to discourage the use of futures exchanges in this country the business of hedging may well be transferred to futures markets which exist or can be established in foreign countries. The leadership the United States currently enjoys in world commodity trade would be threatened.

I think the record will show, that in general the exchanges have done a good job in the establishment and enforcement of margins. The Board of Managers and their administrative committees are ideally equipped to determine minimum margins and keep them adjusted to current trading conditions.

STATEMENT OF LLEWELLYN WATTS, JR., CHAIRMAN OF THE BOARD OF THE NEW YORK MERCANTILE EXCHANGE

In response to the invitation of Hon. Leonor K. Sullivan, Chairman of the Subcommittee on Consumer Affairs, I am submitting herewith our views on Section 207 of H.R. 11601 which purports to confer on the Federal Reserve Board the power to fix margins on commodity futures exchanges.

A bill introduced in the last Congress at the request of the Commodity Exchange Authority, H.R. 11788, representing a comprehensive amendment of the Commodity Exchange Act, contained a provision giving power to the Secretary of Agriculture to prescribe minimum margins on futures exchanges. That bill was the subject of extensive hearings in April 1966, before the Subcommittee on Domestic Marketing and Consumer Relations of the House Committee on Agriculture at which representatives of commodity exchanges, growers, processors, cooperatives and others appeared and explained to the Committee why it would not be in the public interest to have governmental control over margins on futures contracts.

As a result of that hearing the Department of Agriculture sought further light on this subject by ordering an economic report by an independent firm of economists. The results of that report are not known. However, the Department of Agriculture has sponsored a new bill, H.R. 11930, to amend the Commodity Exchange Act which was introduced in the House on July 31, 1967 by Congressman Poage and this bill no longer contains a provision for the control of margins on futures exchanges.

The attempt to invest the Federal Reserve Board with control over margins on commodity markets shows even less understanding of the subject than that exhibited by the Department of Agriculture in advocating governmental margin control last year. H.R. 11601 is based upon a misconception of the operations of a commodity futures market and a misunderstanding of the function of margins on commodity exchanges.

Taken literally, Section 207 of the bill does not accomplish its stated purpose. In its public statement of July 20, 1967 announcing the introduction of the bill, the Subcommittee said:

"Another section of the bill gives to the Federal Reserve System the same powers to set margin requirements in connection with trading in commodity futures contracts that it now holds in setting margins for credit transactions on the stock exchanges."

While that is undoubtedly the intent of the bill it fails to carry out that intention and its failue is a result of a lack of knowledge of the character of margins on commodity exchanges. Nowhere in the bill is the word "margin" used; it deals with "credit." The draftsmen have confused margins with credit arangements because the word "margin" is used on stock exchanges to represent the difference between the price of a security and the amount of credit extended to purchase or hold the security and have assumed that the same meaning is ascribed to the word "margin" on a commodity exchnge. Thus the bill gives the Federal Reserve Board power to "prescribe regulations governing the amount of credit that may be extended or maintained on any [futures] contract."

Since no credit is extended on futures contracts as far as commodity exchanges are concerned, the proposed regulations would have no effect. But if the bill should become law and if it should be interpreted, as its draftsmen do, to permit regulations governing margins on commodity exchanges, we are concerned that the same misunderstanding as to the margins utilized on futures exchanges would prevail to the end that commodity futures markets might lose their economic usefulness.

The operation of a commodity futures market is technical and intricate. But one does not have to be a n expert in its intricacies to understand the difference between margins on stock purchases and margins on futures exchanges. The former regulates the amount of credit that may be extended on the purchase of a security; the latter has nothing to do with credit on purchases and is merely a fund to guarantee the customer's obligation to his clearing member when there is a variation in price.

When a person buys a security on a stock exchange the transaction is closed within a few days and he must pay for the stock and receive it. He may borrow from his broker or other lender a portion of the purchase price and must put up the balance in cash. What he puts up in cash is called margin in stock transactions. When the margin is 10% he may borrow 90%; when the margin is 70%, as now, he may borrow 30%. Thus when the Federal Reserve Board increases margins it decreases the credit permitted on stock purchases.

The economic theory behind governmental control over margins on stock exchanges is that when credit is easy, more stock is purchased, and when there is more buying, there is a tendency for prices to increase. Thus margin controls for stock purchases is believed to have the effect of preventing excessive prices for stocks. It is also believed that such controls are necessary to prevent stock market collapses such as occurred in 1929 when margins were very low and stock prices reach very high levels.

We have no quarrel with these economic theories. It is our purpose to show that they have nothing to do with commodity futures trading. A stock market is a place where people buy stock with convenience. It is undoubtedly wholesome for the economy generally and for the purchasers in particular for the government to prevent them from over-extending their credit. A commodity futures market is not set up as a place where people buy commodities. It is an intricate device for reducing the risks of price changes by affording growers, producers, processors and merchants an opportunity to hedge those risks.

When a person enters into a contract to purchase a commodity on a futures exchange (which is a contract for delivery at a fixed time in the future), he does not incur an obligation to pay for that commodity within a few days as in the case of a stock purchase. If he retains his contract until the delivery date, which he rarely does, he pays the full purchase price in cash. The margins contemplated by the bill have nothing to do with those transactions which culminate in delivery and are the exception. In the usual transaction and almost always in the case of a speculator, against whom the bill is aimed, the person who contracts to buy will actually not purchase the commodity but will instead discharge his obligation to purchase by an offsetting contract to sell an equivalent amount of the commodity.

The margin which a purchaser of a contract on a commodity exchange is required to put up by exchange rules is not a down payment on the purchase price, as in the case of stock. It has a different function. It is to protect the clearing member of the exchange, against loss resulting from the customer's transaction. What is that loss? It is the variation in price during the period between the date the customer entered into the contract to purchase and the date he cancelled his contract by an offsetting sale. If there is a price change

adverse to the customer during this period, he will sustain a loss on the liquidation of his contract. That loss will be paid by his clearing member. To secure his clearing member for his obligation to pay the amount of the loss, he puts up cash in advance and this cash is called "margin" on a commodity exchange. The amount of the margin required is measured by the probable amount of the obligation to pay for the price differential. It has nothing to do with the purchase price and it is not a down payment on the purchase price.

The raising of margins on a stock exchange will discourage purchases because less credit against the purchase price is permitted; but there is no credit against the purchase price in a purchase on a commodity exchange. To raise margins on commodity trading is to force the customer to give excessive security to his broker. This excess is not needed and would merely act as a penalty without relation to its purpose.

If more were needed to demonstrate the erroneous thinking behind this bill, we might consider the case of a seller. Unlike the situation on a stock exchange, every contract to purchase on a commodity futures exchange involves a short sale and sellers are required to put up the same margin as buyers. This is so because the margin is to secure the broker against variations in price and a seller who liquidates his position stands to lose as much as a purchaser by reason of changes in price. Since margins should be the same for sellers and buyers, the raising of margins beyond the point necessary to secure the broker, would discourage sellers from entering the market with the result that (if the market were still alive) prices would presumably rise.

Assuming that experience has proved that increases in margins for stock purchases has been effective to halt increases in prices, the experience on the commodity exchanges has been to the contrary. Without burdening the Committee with details, we refer to the testimony submitted last year at the hearings on H.R. 11788 which showed that when margins were increased for copper, grain and cotton, prices did not decline. Prices may have risen because of the discouragement of short sellers by making it more expensive for them to trade or for other reasons. In theory, however, there is no reason why increased margins should prevent increased prices because they are not a part payment on the price and are unrelated to the extension of credit.

Inherent in the thinking behind this bill is the assumption that speculation is the root of all evil and that excessive speculation causes higher commodity prices. Thus, the bill states that control is to be given to the Federal Reserve Board to prevent "excessive speculation . . . . in commodity futures contracts having the effect of inflating consumer prices."

This is a myth which again results from confusing stocks with commodity futures. Speculation may be detrimental when it has the effect of increasing the price of stocks. But speculation is an absolute necessity for the functioning of a futures market.

Commodity futures exchanges are recognized by economists as important mechanisms in the production, processing and marketing of agricultural products. The government also recognizes this value and an entire bureau of the Deaprtment of Agriculture is devoted to the regulation of futures exchanges. The economic good performed by futures markets is the reduction of risks resulting from changes in price. If these risks were not reduced, it would cost more money to bring the product from farmer to consumer and such increased costs would be passed on to the consumer.

Growers, merchants and manufacturers hedge their commitments by taking a long or short position on an exchange. Someone must take the opposite position. This is done by the speculator who for an expected profit provides price insurance for the hedger. A market without speculators cannot function. A market with a large speculative interest provides more reliable price protection to the hedger because it is more liquid. Where there are more bids and offers the range of price fluctuations is narrower.

If higher margins are to be imposed on speculators as a penalty, it will drive them out of the market and the hedging process will be weakened or destroyed to the detriment of the nation's economy and at the ultimate expense of the consumer.

The price of the actual commodity is not determined by the price on the futures market. Even if we assume that the activities of speculators can drive a price up over a short period (and we must remember that the price can also be driven down, for there are speculative shorts as well as speculative longs) this cannot

have much effect on the price of the actual commodity because the day of reckoning comes in futures markets, from four to twelve times a year, when the commodity must be delivered and must be received by those speculators who remain in the market. In the delivery month, the price of the future becomes the price of the actual commodity, which price is established by the natural forces of supply and demand.

Your Chairman has stated that H.R. 11601 contains many provisions for the protection of consumers. There does not seem to be any reason why Section 207 should remain a part of this bill when so much doubt has been cast upon the efficacy of governmental controls over commodity futures margins as evidenced by last year's hearings on the Department of Agriculture's bill to control margins.

Mrs. SULLIVAN. We will place in the record at this point a letter from the New York Produce Exchange and statements filed by the New York Coffee & Sugar Exchange, Mr. Robert L. Martin, chairman of the Chicago Board of Trade and others interested in section 207 of H.R. 11601.

(The material referred to follows:)

NEW YORK PRODUCE EXCHANGE,
New York, N.Y., August 11, 1967.

Hon. LEONOR K. SULLIVAN,
Chairman, Subcommittee on Consumer Affairs of the Committee on Banking and Currency, House of Representatives, Washington, D.C.

DEAR MRS. SULLIVAN: This will acknowledge receipt of and thank you for your letter of August 1, 1967 concerning H.R. 11601, the Consumer Credit Protection Act, and particularly Sec. 207 thereof.

Mr. William F. Brooks, President of the National Grain Trade Council, of which this Exchange is a member, plans to appear before your Subcommittee and will present the viewpoints of the Council which we, of course, endorse without reservation, and he will therefore also be presenting our position on Sec. 207. In addition to Mr. Brook's testimony and statement we submit the following statement for the record of your hearing and refer solely to Sec. 207 of H.R. 11601:

> We are opposed to Sec. 207 and we urge in the strongest possible terms that it be deleted from the Bill.

Sec. 207 would vest in the Federal Reserve System certain powers "For the purpose of preventing the excessive speculation in and the excessive use of credit for the creation, carrying, or trading in commodity futures contracts having the effect of inflating consumer prices . . . . .".

Excessive speculation in commodity futures contracts has already been declared by Congress as an undue and unnecessary burden on interstate commerce and the Congress has vested exclusive authority in this area in the Commodity Exchange Commission, specifically by Section 4a of the Commodity Exchange Act as amended. The Commodity Exchange Act and the regulations issued thereunder provide ample authority for such regulation as is deemed necessary in compliance with the Act by an independent agency of the Government composed of persons far more knowledgeable in the field of commodity futures marketing than are those who are officials of the Federal Reserve Board. We refer to recent testimony before your Subcommittee by Mr. J. L. Robertson, Vice Chairman of the Board of Governors in which he states in effect that the Federal Reserve does not have the knowledge or expertise to regulate margins on commodity futures transactions.

On the other hand the Commodity Exchange Commission and the Commodity Exchange Authority, having been vested by the Congress with the responsibility as indicated above, have frequently in the past issued orders fixing speculative trading position limits covering various commodities.

You will note that the authority given to the Commission resulted in action related to trading and position limits and not related to margin controls. The reason we believe is obvious. Trading and position limits may be fixed specifically for specific purposes which on the other hand margin controls affect every person or organization making transactions in commodity futures. Margins should therefore be set in the light of their purpose which is in the nature of a payment for a contract for future delivery, not a stock or a cash commodity, as a protection against price depreciation or appreciation as the case may be.

Margins are presently set in all commodity futures markets by the governing boards of the respective exchanges. They should continue to be so set as they are fixed and changed from time to time as circumstances demand and by those persons in the industry who are the most knowledgeable and the most responsible.

Margin controls do not constitute credit controls. There is no analogy or similarity in margin requirements for securities and margin requirements for commodity futures transactions. Margin payments on commodity futures transactions do not constitute a down payment for equity and no possession of a commodity nor title to a commodity is passed at the time a commodity futures transaction is executed. Transfer of title to a commodity occurs at the time the contract matures and is delivered at which time full payment must be made for the commodity involved. On the other hand, margins (down payments) paid for stock transactions constitute credit transactions as the purchaser of the security immediately becomes the owner thereof and from that time is entitled to all benefits such as equity in the issuing company, dividends, stock splits, rights or warrants, etc., while still owing a part of the purchase price. Margin controls on commodity transactions have absolutely no effect on the extension of credit.

High margins or low margins have no effect in inflating consumer prices. The price of a commodity future comes to its relative value with the price of the same cash commodity when the delivery month becomes current. The price of the commodity future at that time does not dictate the value of the actual commodity but to the contrary, and therefore commodity futures prices cannot inflate consumer prices.

Here again, the difference in any potential inflation factors arising out of purchases of securities and purchases or sales of commodity futures becomes apparent. When commodity futures transactions are entered into, money paid in terms of margins comes from both sides of the transaction and when the future month matures the purchaser receives the commodity and pays its full value to the seller. That transaction is then out of the market and the investment capital ratio has not changed. When, however, purchases of securities are arranged, money flows into the securities market as the money entering on the purchase side of the transaction is ordinarily new capital moving from savings or other investments into the stock market.

We therefore conclude that the adoption of Sec. 207 would be unwise, unnecessary and undesirable.

We appreciate the opportunity you have afforded us to be heard.

Sincerely yours,

C. R. BERG,
Managing Director.

STATEMENT SUBMITTED FOR HEARING RECORD BY NEW YORK COFFEE AND SUGAR EXCHANGE, INC.

The New York Coffee and Sugar Exchange Inc., wishes to go on record as opposed to Section 207 of proposed H.R. 11601, (a Bill to safeguard the consumer in connection with the utilization of credit) for the following reasons:

1. *Margins as applied to commodity trading are not credits.* A transaction does not result in immediate dollar obligations, since such obligations only become existent when the previously purchased goods are delivered in the future. As in any buying and selling transaction, *the buyer is asked to deposit* with the brokerage firm *as a sign of good faith, a sum related to the value of the contract.* He is also asked to maintain the amount of this payment should market fluctuations erode the commercial value of his purchase. This is not a credit inasmuch as the brokerage firm does not make up the difference between the amount of the deposit and the total value of the transaction. In no sense can this practice be called a "credit".

2. *The Seller is also asked to deposit this evidence of financial responsibility* and he, in turn, is obligated to maintain the dollar amount should the market value be higher than the original sale; but clearly, since the seller will eventually receive payment upon delivery, *his "binder" is not a "credit" in any sense of the word.*

3. *The ultimate determination of price is the relationship of supply to demand.* Commodity trading reflects the changing opinions on supply-demand from day to day, month to month. *Trading in itself, does not change the supply-demand situation* which determines the prices of commodities which go into consumption.

4. The investor who buys a commodity for market appreciation must sell it to someone else in order to realize a profit. The user is always the *ultimate buyer. The investor purchaser does not reduce the overall physical supply of the commodity.* Thus, *the control of commodity exchange margins* as a tool to keep consumer prices down is *not a practical measure.*

5. Such control would not prevent the investor from purchasing directly from the producer for future delivery under the usual "cash-on-delivery" or "cash-on documents" terms without any margin whatsoever and without going through any exchange.

6. That we are correct in our premise is attested to by *Dr. Roger W. Gray* of the Food Research Institute of Stanford University in his *testimony before a Subcommittee* of the House Agriculture Committee on April 5, 1966, in which he said in part: "* * * *Commodity futures transactions are absolutely symmetrical with respect to buying and selling, as stock transactions are not.*"

7. *Coffee and sugar are international commodities which are traded on foreign exchanges,* notably in London. Margin requirements that would be considered unreasonable or expensive, or both, would simply transfer futures trading to foreign exchanges, where margin requirements are practically non-existent.

8. *The principal business now of our Exchange is trading in world sugar futures contracts.* These contracts are in world prices. And this commodity is not deliverable in the United States. *Imports of sugar into the United States are under import quotas* established by the U. S. Department of Agriculture. The amount of domestic sugar production and the quantity of imports are controlled by the government. The domestic price of sugar is thus manipulated by the government in controlling the domestic demand-supply situation.

9. The New York Coffee and Sugar Exchange conducts an active market in world sugar futures contracts, but *we have only a negligible activity in domestic sugar and coffee futures contracts.* We believe that the existence of government authority to establish and make changes in margin requirements would, in due course, result in the transfer of our world sugar futures market in its entirety to the European exchanges. *Trading in coffee futures has already shifted to the more favorable trading climate of London.*

10. We believe that the curtailment in the United States of trading in sugar and coffee futures contracts may result in discontinuance of American offices of some foreign coffee and sugar firms; the loss of an estimated 15 million dollars per year to local commission houses; business losses to American banking institutions incident to their participation in transactions worth millions of dollars annually; and the consequent loss of tax revenue, both corporate and individual income, to the U. S. Government from the closing of businesses and loss of jobs. It could force American firms to meet foreign competition on foreign soil with a resultant investment in dollars having adverse effect on the balance of payments.

The Board of Managers of the New York Coffee and Sugar Exchange therefore urges the elimination of Sec. 207 from H.R. 11601 for the protection of the sugar and coffee industries, and the American consumer.

STATEMENT SUBMITTED BY ROBERT L. MARTIN, CHAIRMAN, CHICAGO BOARD OF TRADE

The Chicago Board of Trade appreciates the opportunity to file this statement regarding H.R. 11601 and H.R. 11602, the important consumer protection measure now before your Subcommittee.

The Board enthusiastically endorses the view that consumers should be provided with full and complete information on the cost of credit. For that reason we favor most of the provisions of this legislation. I am sure, however, that, like other commodity exchanges, we were asked to comment in this instance primarily on Section 207 which provides for Federal Reserve Board regulations of commodity futures margins.

We are opposed to Section 207 because we feel it is unwise and undesirable to attempt to affect commodity prices by Federal control of commodity futures margins. In our view the Federal Reserve Board function regarding securities margins is not comparable and it would be inappropriate for the Federal Reserve Board to exercise this authority.

Because of the ample coverage of Section 207 during hearings before the Subcommittee, the reasons for our views will be summarized briefly here. Our com-

ments are necessarily restricted to agricultural commodities as our experience is limited to this field.

Commodity futures plan an essential role in the distribution of agricultural products to consumers. First, they provide a continuous pricing mechanism which guides future production and regulates the rate of consumption. Secondly, commodity futures protect both farmers and processors against the risk of price change. Thus, the farmer, whose crop is still in the ground, can assure that he will receive a known price for it by selling a contract for future delivery and shifting the risk of a future price decline to the buyer. Similarly, elevator operators and processors can plan for the future with certainty by hedging their stocks or requirements.

This redounds to the benefit of consumers. It provides a form of price insurance which allows everyone from the farm to the store to operate at narrower profit margins than would be possible if they were subject to the hazards of future price fluctuations.

The commodity futures market, however, is dependent on traders representing the speculative interest for its strength and its stability. A thin market is a volatile market, and price instability is more likely to result from under-speculation than from over-speculation. Our experience leads us to concur with the views presented to your Subcommittee by distinguished economists and representatives of the futures markets, and apparently held by a majority of the House during previous consideration of margin control legislation. Essentially, these views are summed up by a statement made on the House floor by a former Agriculture Committee Chairman: "where there has been a relatively small volume of trading the increase in prices tends to be even larger than where there are many traders and much activity in the market." 96 Cong. Rec. 11754. Or, as Representative Boggs stated in the same debates: "the idea that by controlling margins and commodity exchanges, price advances can be controlled has no foundation in fact." 96 Cong. Rec. 11759.

Interestingly enough, this point of view was underscored several years ago when the possibility of the Federal Reserve Board setting margins for commodity futures contracts was first raised. At that time Chairman William McChesney Martin, Jr. stated:

> The Federal Reserve Board does not view its function as one of controlling security prices and has not used its margin requirement authority for this purpose. I think it would be similarly undesirable or even dangerous for any Government agency to vary margin requirements in the commodity markets for this purpose. (Letter to Senator Williams, January 13, 1964.)

It is possible that some confusion arises from use of the term "margin" itself. In the securities market, under certain circumstances, a down payment is made for securities purchased on credit. In the commodity futures markets a payment is made when a futures contract is bought or sold. Each of these payments is called a "margin", but any similarity between them is more apparent than real.

The securities down payment is a partial payment, and the part not paid is financed with credit. In a commodities futures contract no credit is involved: the margin payment is 100% of the value of the margin at the time, and later, if delivery is taken, the purchaser pays 100% of the value of the commodity purchased. This is no mere legal or economic distinction. It is a basic fundamental difference of function. One "margin" is no more like the other "margin" then "security" meaning a share of stock is like "security" meaning a protected condition. Testimony from governmental as well as private witnesses before your Subcommittee has served to emphasize this point.

Further it is our view that it would be inappropriate as a matter of functions as well as jurisdiction for the Federal Reserve Board to regulate commodity futures margins. The Board itself has been the first to point this out. Its position has been consistent from the statement of Chairman Martin referred to herein to the more recent testimony of Governor Robertson before your Subcommittee: "We have no knowledge that equips us from any point of view to administer such legislation."

Perhaps more conclusive is the point, also referred to by Governor Robertson, that because commodity futures margins do not involve credit they are outside the jurisdiction of the Federal Reserve Board, the authority of which is limited to transactions involving credit.

For the foregoing reasons we would urge that Section 207 be eliminated from H.R. 11601 and H.R. 11602. In the view of experience as well as economic theory, it would not serve the important consumer interest it is intended to protect.

STATEMENT SUBMITTED FOR HEARING RECORD BY FRANK KNELL, PRESIDENT OF THE WOOL ASSOCIATES OF THE NEW YORK COTTON EXCHANGE, INC.

The Wool Associates of the New York Cotton Exchange, Inc., located in the City of New York, wishes to register its objection to Sec. 207 of H.R. 11601.

Inasmuch as the proposed legislation is cited as the "Consumer Credit Protection Act", it is difficult to understand why the authors of this bill would include in it a provision granting authority to the Board of Governors of the Federal Reserve System to prescribe regulations governing the minimum margins the various commodity futures markets must require. The grant of power proposed appears to be based upon a lack of appreciation of the economic function of a futures market and a misconception of the purpose of margins in a futures transaction. Mr. J. L. Robertson, Vice Chairman of the Board of Governors of the Federal Reserve System, before this very Committee, stated that margins as related to commodity futures markets were not credit.

The arbitrary raising of commodity margins—by, no matter what outside agency—will not and can not have any effect to quell inflationary credit tendencies in the economy. It is generally recognized by economists that a futures exchange performs a valuable economic function in the public interest. If margins are raised to levels that deter speculation, the hedger loses his insurer and must assume a greater risk. This added risk is, of necessity, paid for by his customer and ultimately the consumer; thus adding to the spiral of inflation.

History has proven that the Governing Boards of the various commodity exchanges, being on the scene, have been effectively able to control margins in all contingencies. With this in mind, and with the protection of the consumer being the object of this bill, it behooves this Committee to delete Section 207, for it can only be reiterated commodity margins are not credit.

AMERICAN TEXTILE MANUFACTURERS INSTITUTE, INC.,
Washington, D.C., August 24, 1967.

HON. LEONOR K. SULLIVAN,
Chairman, Subcommittee on Consumer Affairs, House Committee on Banking and Currency, U.S. House of Representatives, Washington, D.C.

DEAR MRS. SULLIVAN: The purpose of this letter is to express the concern of the American Textile Manufacturers Institute over Section 207 of H.R. 11601.

The Institute is the central organization of the textile manufacturing industry. Its member mills have traditionally used commodity futures markets to minimize the losses that would occur from price fluctuations in the normal course of accumulating inventories of raw cotton and wool to sustain regular manufacturing operations.

Section 207 of H.R. 11601 would direct the Board of Governors of the Federal Reserve System to establish regulations governing margins on the commodity futures markets in a manner similar to those now governing the purchase and sale of corporation stocks.

We agree with others who have pointed out the very distinct difference between (a) commodity margins in futures transactions on commodity exchanges and (b) stock margins in credit transactions of stock certificates on the stock exchanges.

The Federal Reserve Board is properly concerned with the volume and terms of credit transactions in which there is transfer of ownership such as a transfer of stock certificate ownership. However, a commodity futures transactions on margin is not a credit transaction since there is no transfer of ownership but an obligation to transfer later with one day cash settlement. Other differences can be pointed out which suggest that regulation of commodity transactions should not be the function of the Federal Reserve Board.

Growers, merchants, manufacturers, or others who are involved in the handling or processing of basic commodities, including cotton and wool, are, of

course, not speculators. To the contrary, they are protected from disasterous price fluctuations by an abundance of legitimate speculators. Because there are unequal numbers of hedgers seeking commodity price protection at any given time, the speculators are necessary for efficient functioning of the futures markets. Unduly high margin requirements could reduce the number of speculators, thus serving to render futures markets less effective in their functions.

After careful study of Section 207 we strongly recommend that this section be eliminated from the Bill.

Respectfully,

ROBERT C. JACKSON,
Executive Vice President.

NATIONAL COTTON COUNCIL OF AMERICA,
Washington, D.C., August 25, 1967.

Representative LEONOR K. SULLIVAN,
Chairman, Committee on Banking and Currency, Subcommittee on Consumer Affairs, U.S. House of Representatives, Washington, D.C.

DEAR MRS. SULLIVAN: The National Cotton Council, the overall organization of the cotton industry, adopted at its Annual Meeting in February, 1967, a resolution which urges that an environment be maintained that will permit and encourage the efficient function of the cotton futures exchanges.

The efficient marketing and processing of raw cotton requires a marketing system under which the risk of wide price fluctuation does not have to be borne by the merchant or processor. During the past 10 or 12 years, Government cotton programs have all but eliminated the risk of price fluctuation since these programs have set both a ceiling and a floor on the price of cotton within a very, very narrow range. The floor was set by a non-recourse, price support loan offered to farmers. The ceiling was set by the government offering to sell its huge stocks of cotton at a price just slightly above the "floor".

With no immediate risk of any significant price change, there was no opportunity to speculate in cotton futures. In addition there was no need to hedge against a price change. The two purposes of a futures exchange are to offer the opportunity to speculate on a price change and to hedge against one.

During the period when speculation and hedging were no longer possible or needed, the New Orleans Cotton Exchange closed and only very limited trading took place on the New York Cotton Exchange.

But stocks of cotton have been reduced to a point where the surplus will be gone by next August 1. Before the 1968 crop is harvested, it seems almost certain that there will be a shortage of cotton stapling 1 1/16 inch and longer. As a matter of fact the price of this kind of cotton is reported to have gone up 25 to 35 per cent above the government floor. Accordingly, the government program no longer results in a ceiling on price.

Recently, the New York Cotton Exchange established a new futures contract for trading in cotton stapling 1 1/16 inch. There has been considerable activity in this contract as merchants and processors sought to minimize the risk of price fluctuation of this type of cotton. This means that it now is very important that cotton futures trading not be saddled with Government regulations that prohibit it from functioning properly. It is for this reason that the National Cotton Council opposes Section 207 of H.R. 11601.

We feel the transfer of authority to set margin requirements from the commodity exchanges to the Federal Reserve Board would discourage the efficient functioning of the cotton futures markets.

The commodity exchanges themselves are in a better position to judge what is an adequate margin than is an outside body. The various commodity exchanges find it to their own interest to set margins at a safe level, high enough to prevent an unduly high volume of spectulative transactions and low enough to encourage legitimate use of the futures market for hedging purposes.

Some compare a commodity futures market with a stock exchange. There is a fundamental conceptional difference between the futures market and the stock markets and futures markets' regulations ought not to be patterned after stock markets' regulations. Futures markets transactions represent price protec-

tion while stock market transactions represent actual changes of property ownership.

It would be appreciated if you make this letter part of the record.

Sincerely,

J. BANKS YOUNG,
Washington Representative.

ROBERT MOORE & CO.,
New York, N.Y., August 11, 1967.

Hon. LEONOR K. SULLIVAN,
Chairman, Subcommittee on Consumer Affairs of the Committee on Banking and Currency, Washington, D.C.

DEAR MRS. SULLIVAN: I regret that I will be unable to be in Washington to appear before your Committee, but I respectfully request that my objections to Section 207 of H.R. 11601 be presented to your Committee.

Thanking you for this courtesy,

Very truly yours,

PERRY MOORE.

RE H.R. 11601—REGULATIONS OF CREDIT FOR COMMODITY FUTURES TRADING, SECTION 207

The use of credit to regulate and dictate prices is basically unsound. The law of supply and demand is the correct, proper and established approach to control prices. To give any governmental body the power to control prices is a mistake.

Should Section 207 of this Bill become law, it would defeat the purpose for which futures Exchanges were established and have proven during the century they have existed, to be beneficial to the consumer. For example, let me use the New York Cotton Exchange as an illustration. I can do so with the knowledge that my forefather was one of its founders.

As a result of the war between the States, cotton had become so scarce that its price had advanced to over $1. per pound. As production was resumed prices fell precipitously, causing serious losses to the business world and banks. In that era a great lapse of time was required before cotton could move from producer to mills and consumers. Hence, a great price risk was incurred. The futures market enabled the trade to reduce this risk and hence lower the cost to the consumers.

The fundamentals of our modern business are based on forward contracts, or the anticipation of consumers' needs in the months ahead. Thus it is obvious that credit and price risks are involved in all types of general business. As prices are determined by the amount of money needed in business operations, and as interest rates are a realistic instrument in the cost of goods to consumers, any power other than that controlled by the law of supply and demand presents an unknown factor that will disrupt business.

The futures markets are the medium through which many commodities that make up consumers' necessities of life are distributed. Therefore, any arbitrary power given to any group of individuals—as in Section 207 of H.R. 11601—is not in the National interest, and should not be adopted.

The Free Enterprise system that made this country so great, cannot thrive when its operations are subject to bureaucratic dictation, regardless of how well the intention of these regulations are. If there is any proof needed for this statement, we refer you to the AAA of 1933, when Secretary Wallace started off to help the producers of farm commodities by killing the little pigs and plowing up our cotton. Since that time the taxpayers have been called upon to pay 56 BILLION DOLLARS, with the problem still unsolved!

We find today that food prices to consumers are sky high, while the prices farmers are receiving are correspondingly low. This is especially so if one will consider the labor necessary to produce our food crops. Eastern farmers are receiving only $1.35 per bushel for wheat; $1.40 for corn, and 40¢ per dozen for eggs. Where and why is the spread? Taxes, high priced labor, cost of packaging—including selling—account for a large part of the spread between the two prices.

Forward or future contracts are the basic factors in the business world. If a Government body is given the power that "shall prescribe regulations governing

the amount of credit that may be extended or maintained on any contract", then no contract can be deemed binding on either party because the board of governors of the Federal Reserve system will have the right to change the terms of the contract. Therefore, this Section of the Bill should be opposed by those who will defend the private enterprise system.

Respectfully submitted.

PERRY E. MOORE,
ROBERT MOORE & Co.

CHICAGO, ILL.

Hon. LEONOR SULLIVAN,
Chairman, Subcommittee on Consumer Affairs, Committee on Banking and Currency, U.S. House of Representatives, Washington, D.C.:

Thank you for your invitation to appear tomorrow before your important subcommittee. Sudden illness in family prevents my appearance. However, urge your deleting futures margin section from important truth-in-lending bill. Free futures markets mean lower prices to consumers and higher prices to producers through intensification of competition, and you have constituents in both categories. Commodity margins completely different from securities margins: Former earnest money, latter equity. Believe exchanges best qualified to determine proper margins but if additional controls must come margins on agricultural commodities would be more appropriate under USDA. Will be in Washington later this week to testify before House Ag Committee if able and will telephone you.

EVERETT B. HARRIS,
President, Chicago Mercantile Exchange.

MINNEAPOLIS, MINN.

Hon. LEONOR K. SULLIVAN,
House of Representatives, Washington, D.C.:

The Grain Workers Union is on strike against some elevators operating in this market making it impossible for me to attend scheduled hearings on section 207. Please place in the record, my letter to you August 12, 1967, to show the Minneapolis Grain Exchange is unalterably opposed to granting "margin control" to the Federal Reserve Board as is proposed in section 207 of H.R. 11601.

GEORGE WILKINS,
Executive Vice President, Minneapolis Grain Exchange.

MINNEAPOLIS GRAIN EXCHANGE,
Minneapolis, Minn., August 12, 1967.

Hon. LEONOR K. SULLIVAN,
House of Representatives,
Washington, D.C.

DEAR MRS. SULLIVAN:

* * * * * * *

It should be clearly understood by all members of your Committee, this Exchange, (I'm sure all other Exchanges will adopt the same position) is opposed to adoption of Section 207. Reports in earlier years filed with Congressional Committees considering margin control, document why we believe margin control should rest with the organized Exchanges not with a Department of the Federal Government.

Sincerely,

GEORGE WILKENS,
Executive Vice President.

Mrs. SULLIVAN. The subcommittee will be recessed until 10 a.m. tomorrow morning.

(Whereupon, at 12:15 p.m., the subcommittee recessed, to reconvene Wednesday, August 16, 1967, at 10 a.m.)

CONSUMER CREDIT PROTECTION ACT

WEDNESDAY, AUGUST 16, 1967

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CONSUMER AFFAIRS
OF THE COMMITTEE ON BANKING AND CURRENCY,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10:05 a.m. in room 2128, Rayburn House Office Building, Hon. Leonor K. Sullivan (chairman of the subcommittee) presiding.

Members of the subcommittee present: Representatives Sullivan, Stephens, Gonzalez, Hanna, Annunzio, Bingham, Dwyer, Fino, Halpern, and Wylie.

Also present: Representative Widnall, member ex-officio of the subcommittee.

Mrs. SULLIVAN. The Subcommittee on Consumer Affairs will come to order.

We have a very heavy hearing schedule today on the consumer credit bills, and I am very much afraid from what I was told last night that we will not obtain permission for the subcommittee to sit this afternoon. Had we completed action in the House yesterday on the civil rights bill, there probably would have been no problem, for I had cleared with the leadership on both sides the question of holding our hearing during general debate on the social security bill.

To our witnesses scheduled for this afternoon, and particularly those from out of the city, all I can suggest is that you join us in keeping our fingers crossed that we can proceed as scheduled.

One of the best things about our hearings so far has been the good attendance of the members of the subcommittee, and I certainly appreciate that. Most of them have been very faithful in attendance even though this has left very little time for necessary work in the Members' offices. However—and this is no complaint, I assure you—the fact that we do have such a good turnout of members means that whenever we all take all of our prorated time in questioning, this could mean up to an hour of questioning for each witness.

This morning, to assure an opportunity to each witness to make his oral presentation, and then to assure an opportunity to each member to question, I am going to ask all of the witnesses to come to the table together, make their summarizations in 10 minutes or so—and I'm sure all of you can do that—and that will leave time for each of us on the subcommittee to question any or all of you. We have used this method several times in these hearings and I think it is the most

efficient way to utilize the witnesses' knowledge and also provide opportunity to each member to use his questioning time as he sees fit. Of course, if we have additional time left after the first round of questioning, we will go as far around again as possible.

Our witnesses this morning are a distinguished group: Mr. Leon H. Keyserling, former Chairman of the Council of Economic Advisers under President Truman; Mr. George H. Kimball, president of Kimball's in Portsmouth, N.H., representing the National Retail Merchants Association; Mr. John W. Edelman, president of the National Council of Senior Citizens, Inc.; and Dr. David Caplovitz of Columbia University, author of the book, "The Poor Pay More."

Congressman Wyman of New Hampshire would like to introduce his constituent to us, and we are happy to have you do that now, Mr. Wyman.

We also want to hear from Mrs. Sarah Newman, of the National Consumers' League.

I would ask all of you whose names I called to come up to the witness table where you will find your name cards.

Congressman Wyman, would you introduce Mr. Kimball to the committee and to the audience?

Mr. WYMAN. Madam Chairman, and members of the subcommittee, I won't take a minute of your time, but I did want to come here today to present to you a personal friend of mine for many years who happens to be the representative of the National Retail Merchants Association, a member of the board of directors of that association, the president and general manager of the largest general retail dry-goods outlet in Portsmouth, N.H., who does a very substantial business—a man who has testified before Senate committees, other committees in this field for more than three times, a man on whom I have depended for advice for many years as an attorney general and as a Member of the House and a man whose opinions I respect very highly.

I think you will find that Mr. Kimball's testimony will be a valuable contribution to the deliberations of your subcommittee, Madam Chairman, and I commend him to you very highly.

Thank you.

Mrs. SULLIVAN. Thank you very much, Congressman. We are glad to have you bring Mr. Kimball into this hearing and to introduce him.

I wish you could stay—if you can we would like to have you.

I believe, Mr. Kimball, you have two gentlemen accompanying you, including, if I am not mistaken, Mr. James Wooley, who appeared last week also with the American Retail Federation and Mr. Cianca.

Mr. KIMBALL. He is not here. Just Dr. Wooley is with me this morning.

Mrs. SULLIVAN. We will start with Mr. Caplovitz, since he is at the end of the table.

Can you and will you please summarize your statement in about 10 minutes so that we get the high points of it?

Dr. CAPLOVITZ. I will do my very best.

STATEMENT OF DR. DAVID CAPLOVITZ, NEW YORK CITY, N.Y., AUTHOR OF THE BOOK, "THE POOR PAY MORE"

Dr. CAPLOVITZ. The phenomenal growth of installment credit has brought in its wake a sharp rise in deceptive and fraudulent marketing practices. Insofar as market transactions depended on cash, sellers had less opportunity and incentive to employ deception and fraud.

The consumer who could afford to pay cash for an automobile or an expensive appliance was probably more deliberate and sophisticated in his shopping behavior and there was no point in trying to convince the person without cash to make an expensive purchase. All this changed with the advent of installment credit.

Whether or not the consumer can afford the purchase has become largely irrelevant. Once the contract is signed, the seller can count on the law to enforce his right to payment. Appropriate changes in the laws governing consumer credit have lagged far behind the growth of our credit economy.

The signed contract is treated as sacrosanct in courts of law and the fraudulent techniques used to obtain the consumer's signature, so difficult to prove in court, are largely ignored. It is a sad fact that the laws in most States are now heavily biased in favor of the creditor; his rights are much better protected than those of the debtor.

I shall skip to save time.

I cannot stress too strongly the need for Government to do everything in its power to stamp out consumer fraud and exploitation. The need is particularly great today when our cities are being torn asunder by ghetto riots.

Last year, when I testified before another congressional subcommittee, I suggested that resentment against consumer exploitation was one of the many grievances that find expression in riots. I am even more convinced of this today. Numerous newspaper accounts have quoted ghetto residents as rationalizing the looting on the grounds that they have been victimized and robbed by the merchants for many years.

The common thief is severely sanctioned when apprehended, but the credit merchants who abuse the law to bilk the unsuspecting consumer run little risk of punishment. Untold millions of dollars are stolen each year from consumers by disreputable used car dealers, home repair firms, vacuum cleaner firms, and many other types of firms. But instead of being met with criminal sanctions, the perpetrators of this kind of thievery more often than not become wealthy men respected in their communities.

How can we expect the disadvantaged to learn respect for the law when those in positions of responsibility do not themselves respect the law? And how can we expect the disadvantaged to obey the law when we do not enforce the law for their protection? I believe the time has come when society can no longer tolerate a dual system of law, one set of laws for the disadvantaged and another set for those in respected positions of responsibility.

It is in the light of these observations about the compelling need for consumer protection that I shall comment on the proposed legislation. I wholeheartedly endorse the provision for full disclosure of credit

costs in terms of a true annual rate. The arguments for this reform are so cogent and are so well known that I need not repeat them. I should only add that I particularly approve of the provision to include the cost of insurance that the debtor is required to buy as part of the credit cost.

From the vantage point of the consumer, this is part of the price he must pay for credit and it makes little sense to exclude it from the calculation of that cost. Moreover, it may well have the additional advantage of bringing down the exorbitant charges that are now being made for this type of insurance. I feel less strongly about the provision to fix a ceiling on credit charges. With full disclosure of cost, perhaps the market mechanism will be sufficient to keep credit charges at a reasonable rate.

I am in complete agreement with the provision to abolish confessions of judgment. The confession of judgment assumes that the transaction was scrupulously carried out and that the debtor has no defenses for defaulting on payments. Needless to say, this is not always the case. My own research has shown that many debtors stop payments when they believe they have been cheated. Since fraud is not uncommon in credit transactions, the debtor should not be deprived of his day in court.

Perhaps the most controversial feature of the proposed act is title II which would abolish wage garnishments. I share the committee's view that this remedy of the creditor is frequently abused and often results in severe hardships for the debtor, particularly when he loses his job because of the garnishment.

Studies have shown that some of the hard-core unemployed are, in fact, unemployable because they have garnishment records. Not only does garnishment impose a burden upon the debtor, but also it is quite costly for the employer as well.

I see little point in making America's employers into collection agents for the creditor. Nor, for that matter, should the courts have as much of that responsibility as they now have. Studies have shown that many of the minor courts in various States do little more than collection work, and in some States the minor judiciaries make their living from the fees charged on the debts collected.

Doing away with garnishment might well make the more unscrupulous creditors more hesitant in foisting heavy debt burdens on the consumer.

But all this notwithstanding, I am not yet convinced that doing away with garnishment is either feasible at this time or would have the desired effects even if it were possible to pass such a law.

For example, garnishment is not permitted in Pennsylvania and yet credit merchants are thriving in that State and consumer fraud is just as prevalent there as elsewhere. The creditors in Pennsylvania do not hesitate to attach both personal and real property, and sheriff's sales of furniture and even homes are quite common. To lose one's home because of a consumer debt is certainly as harsh a consequence as losing one's job.

Although eliminating garnishment is probably a desirable long run objective, I would urge the committee to consider a more modest proposal now—the adoption of a stronger version of the New York

State law which prohibits employers from firing employees because of garnishments. The New York law now applies only to the first garnishment, but there is no reason why such a law should not cover two or even three garnishments. Moreover, if the abolishment of garnishment is not yet feasible, attention should also be given to the amount of income that is exempt from garnishment. Many States have harsh garnishment laws, while some States permit garnishment on only a small percentage of income. It should be noted that personal bankruptcy rates are higher where garnishment laws are harsh.

Although problems may arise in trying to abolish garnishments now, there is hardly any justification for wage assignments which circumvent the courts entirely. I would strongly recommend that the act do away with wage assignments which are not permitted in a number of States.

If I may, I should now like to call attention to some aspects of the consumer credit problem that are not covered in the proposed legislation. One of the major abuses in the legal procedure leading up to garnishment has to do with inadequate service of process. All too frequently the debtor has no idea that he is being sued until his employer informs him of the garnishment, for the simple reason that he was never properly notified.

In some jurisdictions—New York, for example—improper service, known as "sewer service", is quite common. Needless to say, failure to notify the defendant of the lawsuit is a fundamental violation of our whole legal structure, and yet this happens all too often. Many suggestions have been made about correcting this abuse; one is to have process served by registered mail. I am not sure what the best solution is, but I would suggest that the committee look into this problem.

As you know, the State of Massachusetts has recently passed a very progressive consumer credit law and there are two provisions of that law that I would strongly urge be adopted in the proposed legislation.

One attempts to control the frequent abuses that occur in door-to-door selling by introducing a cooling off period.

In Massachusetts the consumer is given 24 hours in which to rescind the contract in direct selling. In England, the comparable law provides for a 72-hour cooling off period. I believe that a cooling off period in direct selling would go some way toward reducing the abuses associated with this method of selling.

The second feature of the Massachusetts law that I think should be adopted in this act has to do with the assignment of contracts to third parties. Under the "holder in due course" clause, these third parties are not responsible for any defenses the consumer may have against the original seller.

According to the law, they are entitled to payment, whatever the fraud involved in the transaction. As a result, many finance companies do not hesitate to buy the contracts of unscrupulous merchants who employ deception to obtain the consumer's signature on the contract. These fly-by-night credit merchants could not long survive without the finance companies that buy their paper.

Thus, one way of controlling fraud and increasing the protection of the consumer would be to do away with the holder-in-due-course doctrine and make the assignee also responsible for the transaction.

This may have the beneficiary effect of making the finance companies behave in a more responsible fashion.

As I noted earlier, our society can no longer afford to condone the crass exploitation of consumers that is now so prevalent. If consumer fraud is to be done away with, it is essential that there be strong enforcement machinery and that the perpetrators of such fraud be confronted with criminal sanctions. This is not the case today. The attorney generals of some 23 States now have consumer fraud bureaus modeled after the one set up in New York by Attorney General Lefkowitz.

But for all his investigation of consumer complaints and his efforts to negotiate them, the attorney general of New York does not have the power to prosecute the perpetrators of fraud.

To my knowledge, not a single businessman in New York has been put in jail for cheating his customers. Until strong enforcement machinery is instituted, I see little hope of making much headway in eliminating fraud. One of the merits of the proposed law is that it does provide for criminal penalties for violations.

I would like to suggest that these penalties be strengthened and made to cover even more offenses. In this connection, I would also like to suggest that the responsibility for enforcement of the various provisions of the act be placed in the hands of the U.S. attorneys' offices rather than in the central office of the U.S. Attorney General.

The U.S. attorneys are much closer to the local scene in which the violations occur and they should not have to wait for authority from the Attorney General to act.

In closing, I commend the committee for attempting to come to grips with one of the major problems confronting America today.

(The entire statement of Mr. Caplovitz follows:)

STATEMENT OF DAVID CAPLOVITZ, ASSOCIATE PROFESSOR OF SOCIOLOGY, COLUMBIA UNIVERSITY

I am most grateful for this opportunity to testify before the House Subcommittee on Consumer Affairs on the proposed "Consumer Credit Protection Act". I commend the Committee for doing its utmost to increase the protection of consumers in credit transactions. Such protection is long overdue and the need for it has never been greater.

Several generations ago, Americans had a negative attitude toward debt. The person in debt was viewed as somewhat less than an upstanding citizen. This is, of course, no longer true. Consumer credit has become the fuel of our so-called affluent society. Americans in *all* walks of life see nothing wrong with buying now and paying later. The growth of consumer credit since World War II has been extraordinary, far outstripping the growth in population. In 1945, the amount of outstanding *installment* debt was 2.5 billion dollars; in 1955, it climbed to 29 billion and by 1965, it had soared to 66 billion. Today installment debt stands at 74 billion.

The phenomenal growth of installment credit has brought in its wake a sharp rise in deceptive and fraudulent marketing practices. Insofar as market transactions depended on cash, sellers had less opportunity and incentive to employ deception and fraud. The consumer who could afford to pay cash for an automobile or an expensive appliance was probably more deliberate and sophisticated in his shopping behavior and there was no point in trying to convince the person without cash to make an expensive purchase. All this changed with the advent of installment credit. Whether or not the consumer can afford the purchase has become largely irrelevant. Once the contract is signed, the seller can count on the law to enforce his right to payment. Appropriate changes in the laws governing consumer credit have lagged far behind the growth of our

credit economy. The signed contract is treated as sacrosanct in courts of law and the fraudulent techniques used to obtain the consumer's signature, so difficult to prove in court, are largely ignored. It is a sad fact that the laws in most states are now heavily biased in favor of the creditor; his rights are much better protected than those of the debtor.

My own research on the consumer problems of the poor has convinced me that the poor, more than any other group in society, are victims of abuses arising from consumer credit. They are particularly prone to exploitation by unscrupulous credit merchants who now operate with virtual immunity as a result of loopholes in current legislation and the absence of enforcement machinery. The poor, more than any other group, are apt to be misled by the false promises of the credit salesmen, by the "bait ads" that appear in the mass media, and by the misrepresentation of price and quality by high-pressure salesmen. It is not uncommon for the poor consumer to be sold reconditioned merchandise that is misrepresented as new, and yet this obviously fraudulent practice is almost never punished by our law enforcement agencies. Should the poor consumer protest the fraud by withholding payments, he soon discovers that his wages are being garnisheed and by that time he has great difficulty protecting his job, let alone his legal rights in the transaction.

I cannot stress too strongly the need for government to do everything in its power to stamp out consumer fraud and exploitation. The need is particularly great today when our cities are being torn asunder by ghetto riots. Last year, when I testified before another congressional subcommittee, I suggested that resentment against consumer exploitation was one of the many grievances that find expression in riots. I am even more convinced of this today. Numerous newspaper accounts have quoted ghetto residents as rationalizing the looting on the grounds that they have been victimized and robbed by the merchants for many years.

The common thief is severely sanctioned when apprehended, but the credit merchants who abuse the law to bilk the unsuspecting consumer run little risk of punishment. Untold millions of dollars are stolen each year from consumers by disreputable used car dealers, home repair firms, vacuum, cleaner firms and many other types of firms. But instead of being met with criminal sanctions, the perpetrators of this kind of thievery more often than not become wealthy men respected in their communities. How can we expect the disadvantaged to learn respect for the law when those in positions of responsibility do not themselves respect the law? And how can we expect the disadvantaged to obey the law when we do not enforce the law for their protection? I believe the time has come when society can no longer tolerate a dual system of law, one set of laws for the disadvantaged and another set for those in respected positions of responsibility.

It is in the light of these observations about the compelling need for consumer protection that I shall comment on the proposed legislation. I wholeheartedly endorse the provision for full disclosure of credit costs in terms of a true annual rate. The arguments for this reform are so cogent and are so well known that I need not repeat them. I should only add that I particularly approve of the provision to include the cost of insurance that the debtor is required to buy as part of the credit cost. From the vantage point of the consumer, this is part of the price he must pay for credit and it makes little sense to exclude it from the calculation of that cost. Moreover, it may well have the additional advantage of bringing down the exorbitant charges that are now being made for this type of insurance. I feel less strongly about the provision to fix a ceiling on credit charges. With full disclosure of cost, perhaps the market mechanism will be sufficient to keep credit charges at reasonable rates.

I am in complete agreement with the provision to abolish confessions of judgment. The confession of judgment assumes that the transaction was scrupulously carried out and that the debtor has no defenses for defaulting on payments. Needless to say, this is not always the case. My own research has shown that many debtors stop payments when they believe they have been cheated. Since fraud is not uncommon in credit transactions, the debtor should not be deprived of his day in court.

Perhaps the most controversial feature of the proposed act is Title II which would abolish wage garnishments. I share the Committee's view that this remedy of the creditor is frequently abused and often results in severe hardships for the debtor, particularly when he loses his job because of the garnishment. Studies

have shown that some of the "hard-core" unemployed are in fact unemployable because they have garnishment records. Not only does garnishment impose a burden upon the debtor, but also it is quite costly for the employer as well. I see little point in making America's employers into collection agents for the creditor. Nor, for that matter, should the courts have as much of that responsibility as they now have. Studies have shown that many of the minor courts in various states do little more than collection work, and in some states the minor judiciaries make their living from the fees charged on the debts collected. Doing away with garnishment might well make the more unscrupulous creditors more hesitant in foisting heavy debt burdens on the consumer. But all this notwithstanding, I am not yet convinced that doing away with garnishment is either feasible at this time or would have the desired effects even if it were possible to pass such a law. For example, garnishment is not permitted in Pennsylvania and yet credit merchants are thriving in that state and consumer fraud is just as prevalent there as elsewhere. The creditors in Pennsylvania do not hesitate to attach both personal and real property and sheriff's sales of furniture and even homes are quite common. To lose one's home because of a consumer debt is certainly as harsh a consequence as losing one's job.

Although eliminating garnishment is probably a desirable long-run objective, I would urge the Committee to consider a more modest proposal now, the adoption of a stronger version of the New York State law which prohibits employers from firing employees because of garnishments. The New York law now applies only to the first garnishment, but there is no reason why such a law should not cover two or even three garnishments. Moreover, if the abolishment of garnishment is not yet feasible, attention should also be given to the amount of income that is exempt from garnishment. Many states have harsh garnishment laws, while some states permit garnishment on only a small percentage of income. (It should be noted that personal bankruptcy rates are higher where garnishment laws are harsh.)

Although problems may arise in trying to abolish garnishments now, there is hardly any justification for wage assignments which circumvent the courts entirely. I would strongly recommend that the Act do away with wage assignments which are now permitted in a number of states.

If I may, I should now like to call attention to some aspects of the consumer credit problem that are not covered in the proposed legislation. One of the major abuses in the legal procedure leading up to garnishment has to do with inadequate service of process. All too frequently the debtor has no idea that he is being sued until his employer informs him of the garnishment, for the simple reason that he was never properly notified. In some jurisdictions—New York, for example—improper service, known as "sewer service", is quite common. Needless to say, failure to notify the defendant of the law suit is a fundamental violation of our whole legal structure, and yet this happens all too often. Many suggestions have been made about correcting this abuse; one is to have process served by registered mail. I am not sure what the best solution is, but I would suggest that the Committee look into this problem.

As you know, the State of Massachusetts has recently passed a very progressive consumer credit law and there are two provisions of that law that I would strongly urge be adopted in the proposed legislation. One attempts to control the frequent abuses that occur in door-to-door selling by introducing a cooling-off period. In Massachusetts the consumer is given 24 hours in which to rescind the contract in direct selling. In England, the comparable law provides for a 72-hour cooling-off period. I believe that a "cooling-off" period in direct selling would go some way toward reducing the abuses associated with this method of selling. The second feature of the Massachusetts law that I think should be adopted in this Act has to do with the assignment of contracts to third parties. Under the "holder in due course" clause, these third parties are not responsible for any defenses the consumer may have against the original sellers. According to the law, they are entitled to payment—whatever the fraud involved in the transaction. As a result, many finance companies do not hesitate to buy the contracts of unscrupulous merchants who employ deception to obtain the consumer's signature on the contract. These fly-by-night credit merchants could not long survive without the finance companies that buy their paper. Thus, one way of controlling fraud and increasing the protection of the consumer would be to do away with the holder-in-due-course doctrine and make the assignee also responsible for the transaction. This may have the beneficiary effect of making the finance companies behave in a more responsible fashion.

As I noted earlier, our society can no longer afford to condone the crass exploitation of consumers that is now so prevalent. If consumer fraud is to be done away with, it is essential that there be strong enforcement machinery and that the perpetrators of such fraud be confronted with criminal sanctions. This is not the case today. The Attorney Generals of some 23 states now have Consumer Fraud Bureaus modelled after the one set up in New York by Attorney General Lefkowitz. But for all his investigation of consumer complaints and his efforts to negotiate them, the Attorney General of New York does not have the power to prosecute the perpetrators of fraud. To my knowledge, not a single businessman in New York has been put in jail for cheating his customers. Until strong enforcement machinery is instituted, I see little hope of making much headway in eliminating fraud. One of the merits of the proposed law is that it does provide for criminal penalties for violations. I would like to suggest that these penalties be strengthened and made to cover even more offenses. In this connection, I would also like to suggest that the responsibility for enforcement of the various provisions of the Act be placed in the hands of the U.S. Attorneys' offices rather than in the central office of the United States Attorney General. The U.S. attorneys are much closer to the local scene in which the violations occur and they should not have to wait for authority from the Attorney General to act.

In closing, I again commend the Committee for attempting to come to grips with one of the major problems confronting America today.

Mrs. SULLIVAN. Thank you, Mr. Caplovitz.

Mr. Kimball, do you think you could summarize your paper?

Mr. KIMBALL. I most certainly will.

STATEMENT OF GEORGE H. KIMBALL, PRESIDENT, KIMBALL'S, PORTSMOUTH, N.H., REPRESENTING THE NATIONAL RETAIL MERCHANTS ASSOCIATION; ACCOMPANIED BY JAMES WOOLEY

Mr. KIMBALL. Since Congressman Wyman introduced me I will skip over the introduction and you know what the National Retail Merchants Association is.

I will say that we are a group of reputable businessmen and the large portion of our membership is composed of businesses doing $75,000 to $2 million annually which is considered small business.

Since the original introduction of the first truth-in-lending bill in the Senate, the National Retail Merchants Association has been working with and appearing before committees in an attempt to develop legislation which can be considered fair and equitable to all concerned.

Our policy during this entire period has been and remains as follows:

Consumer credit is an indispensable element of a sound and prosperous American economy. It has enabled the American consumer to enjoy a standard of living unparalleled in the history of the world—a standard of living which could not have attained without the liberal availability of consumer credit.

NRMA member stores extend credit in response to the needs and desires of their customers. We accept a responsibility to accurately and fully present to the consumer all the important facts pertaining to the merchandise and its use, including the terms of purchase. We support the principle of full disclosure of credit terms in a manner which is truthful, complete, and meaningful to the consumer.

Any legislation which seeks to regulate consumer credit should be consistent with the principle stated above. It should not encumber the retailer with impossible, burdensome requirements that might tend to limit the availability of credit to the consumer. It should give recognition to the fact that the costs of extending consumer credit represent more than simply the cost of money, and give due regard to all of the

costs of extending credit in establishing any minimum or maximum rates.

I appear here today in the same spirit to discuss my views on H.R. 11601 and H.R. 11602.

With respect to H.R. 11601 we find it difficult to understand how all the time and effort spent by the Senate can be ignored. The Senate hearings reports are filled with testimony showing that an accurate annual rate cannot be applied to revolving credit. This, in fact, was one of the major reasons for the great delay in the passage of the bill.

H.R. 11601 would be detrimental to my business, to the livelihood of my employees, to the community of Portsmouth, N.H., and to the entire country. Its enactment is unnecessary, as at the present time we are furnishing our customers credit information, and the additional amount of information required by H.R. 11601, such as the "annual percentage rate" would only confuse and bewilder the consumer.

Credit is a very important tool of the modern retailer, and he cannot survive without it. At Kimball's 65 percent of all sales are transacted on our optional credit plan, referred to in H.R. 11601 as a revolving or open end credit plan.

Without the extension of this amount of credit, two things would happen that would put Kimball's into red ink immediately. Anything that would prevent consumers from using our credit plan would immediately reduce our sales volume, reduce our gross profit, while our fixed costs would remain the same. Our net profit would become a minus figure instead of a plus figure. At the merchandising level, the consequent reduction in volume would increase markdowns, decrease selection, and further reduce our ability to employ citizens of Portsmouth, N.H., and to purchase merchandise from manufacturers throughout our Nation.

To be specific, I would like to discuss section 203(d), starting on line 22 of page 11 of H.R. 11601. Under part (2) the bill requires a store like Kimball's to furnish, prior to the extension of credit, a statement declaring "the annual percentage rate of the finance charge to be imposed."

I submit our invoice which we mail to each customer every 5 weeks. In the lower left corner we clearly explain about optional credit accounts. We tell the customer exactly how much she is expected to pay. Then we state "The only charge for this credit is 1½ percent of amounts owed for 35 or more days per billing period of 35 days." At the bottom we repeat that there will be a service charge on a previous past due balance—this in bold print.

Kimball's does not have the only unique system in the country, and I do not think it would be fair to subject all stores to present a customer with a general figure which would represent all system as the same as all others. We are already clearly stating to our customer, in a language she can understand, that our service charge is 1½ percent of ending balance per billing period. As it is, our customers are smarter than we are. They charge at the beginning of each cycle and pay at the end of each cycle, thereby obtaining almost 70 days of credit without any service charge. Believe me, this is not the 18 percent that H.R. 11601 would have me tell my customers, but can be less than 8 or 9 percent on a simple annual rate.

I am very much opposed to the statement of an annual percentage rate, as it confuses the shopping public between the words "service charge" and "interest." Even the Internal Revenue Service claims that only one-third of the service charge can be used as an interest deduction on individual income tax returns. Under revolving credit, we supply our customers with extra service for which there is a just charge made. This charge discourages excessive charging, and it also has the tendency to make customers pay their bills more promptly. For example, we can send seven invoices to a customer for the purchase of one $30 dress.

I show you the chart here:

PURCHASE MADE APR. 5, 1966

Invoice date	Payments on account	Balance due	Service charge
May 10, 1966	$5.00	$25.00	$0.38
June 14, 1966	5.00	20.38	.31
July 19, 1966	5.00	15.69	.23
Aug. 23, 1966	5.00	10.92	.17
Sept. 27, 1966	5.00	6.09	.09
Nov. 1, 1966	5.00	1.09	
Dec. 6, 1966	1.09		
Total			[1] 1.18

[1] 3.9 percent of sale.

You can observe by the chart that she bought a dress on April 5 for $30, and we sent out statements every 35 days. The customer made regular payments of $5, the total service charge of this transaction was $1.18, or 3.9 percent of the sale cost. Thus Kimball's does have a unique system working on a 10-month annual plan. The above transaction necessitated sending this customer seven separate bills. The cost to the store was at least 25 cents per invoice or a total of $1.75. We charged our customer $1.18 or 3.9 percent of the actual sale. It actually cost the store 57 cents more than the customer paid in service charges.

Over 50 percent of my customers want and use revolving credit. They have little or no objection to the service charge, such as we use. They only expect it to be expressed in a language they can understand. They know what their ending balance is, and they can multiply this figure by 1½, and know that their service charge has been accurately computed. If they do not want to pay the charge, they always have the option of paying the bill within 35 days, and thereby avoiding any charge.

H.R. 11601 would take me into a proven nonworkable area by insisting on inclusion of the annual rate disclosure for all types of credit transactions.

The NRMA endorses, as stated in H.R. 11602, the exemption prescribed for the closed-end or installment credit from annual rate disclosure transactions in which the total finance charges do not exceed $10. This feature originally recommended by the Federal Reserve Board will be a definite assistance to the smaller or specialty store where they are forced, for reasons of economics, to maintain only an installment-type of account. This feature is not included in H.R. 11601.

Other areas not relating directly to specific credit transactions have been included in H.R. 11601. Areas such as advertising of credit

terms, standby controls, ban on garnishment of wages, usury and a national commission on consumer credit, should not be considered as part of a bill of this nature.

As brought out by previous witnesses before this committee, including Miss Betty Furness, the President's Adviser on Consumer Affairs, Under Secretary of the Treasury Joseph W. Barr, and J. L. Robertson, Vice Chairman, Federal Reserve Board, most of these items are already under study by separate groups.

In conclusion we must state that we are opposed to H.R. 11601. It encompasses many areas which in our opinion are not truly related to truthful and accurate credit disclosure and its powers of enforcement given to the Federal Reserve Board far exceed normal needs. The Board itself has said many times that it does not want this authority.

H.R. 11602 eliminates all of these additional and unrelated proposals and in the area of enforcement leaves the major part of civil suits, limiting the Board's responsibility to regulating methods of disclosure and establishing reasonable tolerances of accuracy.

In addition we must continue to oppose H.R. 11601's requirement for full disclosure of an annual percentage rate for revolving credit. As previously described at length this provision would create false and misleading information thus creating a situation which we believe would be completely contrary to the desires of the Congress.

H.R. 11602 does not meet with the full approval of all of our members. In fact, as brought out in testimony by NRMA before the Senate Banking and Currency Committee on June 23, 1967, there are sections concerning the distinction between open-end credit plans which we do not feel are conducive to developing a proper competitive situation within the industry. However, H.R. 11602 represents a compromise developed from 7 years of work and study. We would hope to further improve upon its provisions. However, if left with a choice between accepting H.R. 11602 or regressing to H.R. 11601 we express the view of the majority of our members, which would be acceptance of H.R. 11602.

(The full statements of Mr. Kimball follows, as well as a sample invoice:)

STATEMENT OF GEORGE H. KIMBALL ON BEHALF OF THE NATIONAL RETAIL MERCHANTS ASSOCIATION

Madame Chairman and members of the Committee, my name is George H. Kimball, a resident of New Castle, New Hampshire. Kimball's store is a family-owned store specializing in women's and children's apparel. We employ 55 women and 5 men on a regular full-time basis, and peak periods have as many as 90 people on the payroll. Our annual volume of business is around $950,000. Our payroll amounted to $191,160 last year. These people pay approximately $40,000 in Federal income taxes. The store also pays $15,000 a year in State and Municipal taxes. I would classify Kimball's as a small industry in a small community in a small state.

I come here today representing the National Retail Merchants Association, a non-profit trade association with its executive offices at 100 West 31st Street, New York, New York. I am a member of the Board of Directors of NRMA and am speaking with the authority of that body.

There are over 2,000 members of NRMA representing more than 15,400 retail store units throughout the United States and in more than 50 other countries. These stores range in size from the largest to the smallest retailers. Approximately 65 per cent of its members are store owners with individual sales volumes ranging from under $75,000 to $2 million annually. The members of NRMA engage in retail credit transactions and are, of course, deeply concerned as to

any developments in this area. Since the original introduction of the first "Truth in Lending" bill in the Senate, the National Retail Merchants Association has been working with and appearing before committees in an attempt to develop legislation which can be considered fair and equitable to all concerned.

Our policy during this entire period has been and remains as follows: "Consumer credit is an indispensable element of a sound and prosperous American economy. It has enabled the American consumer to enjoy a standard of living unparalleled in the history of the world—a standard of living which could not have been attained without the liberal availability of consumer credit."

NRMA member stores extend credit in response to the needs and desires of their customers. We accept a responsibility to accurately and fully present to the consumer all the important facts pertaining to the merchandise and its use, including the terms of purchase. We support the principle of full disclosure of credit terms in a manner which is truthful, complete, and meaningful to the consumer.

Any legislation which seeks to regulate consumer credit should be consistent with the principle stated above. It should not encumber the retailer with impossible, burdensome requirements that might tend to limit the availability of credit to the consumer. It should give recognition to the fact that the costs of extending consumer credit represent more than simply the cost of money, and give due regard o all of the costs of extending credit in establishing any minimum or maximum rates.

I appear here today in the same spirit to discuss my views on H.R. 11601 and H.R. 11602.

With respect to H.R. 11601 we find it difficult to understand how all the time and effort spent by the Senate can be ignored. The Senate hearings reports are filled with testimony showing that an accurate annual rate cannot be applied to revolving credit. This, in fact, was one of the major reasons for the great delay in the passage of the bill.

H.R. 11601 would be detrimental to my business, to the livelihood of my employees, to the community of Portsmouth, New Hampshire, and to the entire country. Its enactment is unnecessary, as at the present time we are furnishing our customers credit information, and the additional amount of information required by H.R. 11601, such as the "annual percentage rate" would only confuse and bewilder the consumer.

Credit is a very important tool of the modern retailer, and he cannot survive without it. At Kimball's 65% of all sales are transacted on our optional credit plan, referred to in H.R. 11601 as a revolving or open-end credit plan.

Without the extension of this amount of credit, two things would happen that would put Kimball's into red ink immediately. Anything that would prevent consumers from using our credit plan would immediately reduce our sales volume, reduce our gross profit, while our fixed costs would remain the same. Our net profit would become a minus figure instead of a plus figure. At the merchandising level, the consequent reduction in volume would increase markdowns, decrease selection, and further reduce our ability to employ citizens of Portsmouth, New Hampshire, and to purchase merchandise from manufacturers throughout our nation.

To be specific, I would like to discuss section 203(d), starting on line 22 of page 11 of H.R. 11601. Under part (2) the bill requires a store like Kimball's to furnish, *prior* to the extension of credit, a statement declaring "the annual percentage rate of the finance charge to be imposed."

I submit our invoice which we mail to each customer every five weeks. In the lower left corner we clearly explain about Optional Credit Accounts. We tell the customer exactly how much she is expected to pay. Then we state "The only charge for this credit is 1½% of amounts owed for 35 or more days per billing period of 35 days." At the bottom we repeat that there will be a service charge on a previous past due balance . . . this in bold print.

Kimball's does not have the only unique system in the country, and I do not think it would be fair to subject *all* stores to present a customer with a general figure which would represent all systems as the same as all others. We are already clearly stating to our customer, in a language she can understand, that our service charge is 1½% of ending balance per billing period. As it is, our customers are smarter than we are. They charge at the beginning of each cycle and pay the end of each cycle, thereby obtaining almost 70 days of credit without any service charge. Believe me, this is not the 18% that H.R. 11601 would have me tell my customers, but can be less than 8 or 9 per cent on a simple annual rate.

I am very much opposed to the statement of an annual percentage rate, as it confuses the shopping public between the words "service charge" and "interest."

Even the Internal Revenue Service claims that only one-third of the service charge can be used as an interest deduction on individual income tax returns. Under revolving credit, we supply our customers with extra service for which there is a just charge made. This charge discourages excessive charging, and it also has the tendency to make customers pay their bills more promptly. For example, we can send seven invoices to a customer for the purchase of one $30 dress. I show you in the chart here:

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The NRMA endorses, as stated in H.R. 11602, the exemption prescribed for the closed-end or installment credit from annual rate disclosure transactions in which the total finance charges do not exceed ten dollars. This feature originally recommended by the Federal Reserve Board will be a definite assistance to the smaller or specialty store where they are forced, for reasons of economics, to maintain only an installment type of account. This feature is not included in H.R. 11601.

Other areas not relating directly to specific credit transactions have been included in H.R. 11601. Areas such as advertising of credit terms, standby controls, ban on garnishment of wages, usury and a National Commission of Consumer Credit, should not be considered as part of a bill of this nature. As brought out by previous witnesses before this committee, including Miss Betty Furness, the President's advisor on consumer affairs, Undersecretary of the Treasury Joseph W. Barr, and J. L. Robertson, vice-chairman, Federal Reserve Board, most of these items are already under study by separate groups.

In conclusion we must state that we are opposed to H.R. 11601. It encompasses many areas which in our opinion are not truly related to truthful and accurate credit disclosure and its powers of enforcement given to the Federal Reserve Board far exceed normal needs. The Board itself has said many times that it does not want this authority.

H.R. 11602 eliminates all of these additional and unrelated proposals and in the area of enforcement leaves the major part to civil suits, limiting the Board's responsibility to regulating methods of disclosure and establishing reasonable tolerances of accuracy.

In addition we must continue to oppose H.R. 11601's requirement for full disclosure of an annual percentage rate for revolving credit. As previously described at length this provision would create false and misleading information thus creating a situation which we believe would be completely contrary to the desires of the Congress.

H.R. 11602 does not meet with the full approval of all of our members. In fact, as brought out in testimony by NRMA before the Senate Banking and Currency Committee on June 23, 1967, there are sections concerning the distinction between open-end credit plans which we do not feel are conducive to developing a proper competitive situation within the industry. However H.R. 11602 represents a compromise developed from seven years of work and study. We would hope to further improve upon its provisions. However, if left with a choice between accepting H.R. 11602 or regressing to H.R. 11601 we express the view of the majority of our members, which would be acceptance of H.R. 11602.

STATEMENT OF NATIONAL RETAIL MERCHANTS ASSOCIATION SUPPORTING THE EXEMPTION OF CREDIT SERVICE CHARGES OF LESS THAN $10 FROM DISCLOSURE IN TERMS OF AN ANNUAL RATE

Governor Robertson recommended an exemption from annual rate disclosure of credit transactions under $100 or where the credit service charge is $10 or less. He said ". . . a small finance charge—in dollar amount—is not of great significance to the credit user regardless of the effective rate of finance charge."

The disclosure of credit service charges in terms of an annual rate may be desirable on large credit transactions, particularly where the terms of repayment extend for periods as long as five years. It has no meaning or importance on small sales with maturities of less than one year. For the small retailer careful control of costs is necessary to remain competitive. He has neither the personnel, the equipment, nor the time in connection with each small sale to convert credit service charges into an annual interest rate. His customers would neither appreciate nor tolerate the delay in being waited-on. Furthermore, such conversion and disclosure would be more confusing than helpful to the consumer.

Certain basic facts about credit should be considered. Most significant, there are fixed initial costs of processing each credit application and credit transaction which are constant regardless of the amount of the account balance or the amount of the particular purchase. Such costs include initial interviewing and credit investigation, clerical and bookkeeping costs, and collection expense. Because of small purchases these fixed costs are spread over a smaller dollar amount, they are disproportionate in percentage terms to the same costs on larger transactions. *The disproportionate fixed cost element of extending credit for short periods on small sales is an economic fact which cannot be disregarded, and it should be viewed properly as a service charge, rather than an interest charge for the use of money.*

If retailers who sell small-ticket items almost exclusively are required to quote a dollar and cents service charge in terms of a simple annual interest rate on transactions that liquidate in periods considerably shorter than one year, that rate would appear to be disproportionately high. It would place these sellers at a competitive disadvantage with those who include all or part of the credit costs in their cash pricing. *When such disclosure discourages customers from making the more valid comparison of time price against time price, they may find that in the end they have gotten poorer value for their money.*

Let us consider this illustration. A $12 soft-goods sale with a small service charge of $1.50 may pay out in three installments. A merchant who competes by maintaining a low cash pricing policy with minimal mark-up needs that service charge to defray the costs of extending credit. Yet, by quoting an annual rate of 75% he may lose a minor but important segment of his business. His customer, motivated by shock rather than reason, could pay as much or more by patronizing a firm that includes credit servicing costs in its original pricing. In this instance, the unwary shopper—most in need of protection—would be the most vulnerable.

Annual rate disclosure will adversely affect small retailers, and consumers as well, in another important respect. Nearly all retail installment credit plans allow the buyer to add subsequent purchases to his account. Retailers with small-ticket add-ons do not customarily refinance the entire package because of the time and expense involved. The credit service charge is imposed on each separate sale under its original terms and when the payment term of prior purchases is extended by virtue of add-on purchases, no additional service charge is assessed to the buyer for the extended time allowed. Should the seller be required to compute an annual rate on small sales of $100 or less, and be forced to bear the expense of this additional work, there would be no reason for him

not to refinance all add-on transactions under a new blanket contract. This would result in a greater charge to the buyer, measured by the period of time from the due date of the last installment on each prior purchase to the due date of the last installment of the combined balance.

While the motion of having a simple, common denominator for all credit service charges has tremendous appeal to the erudite among us, it is really not that simple. Consumer credit, which is an important tool of mass marketing in our present day complex economy, takes many forms and each form has separate facets. The spectrum is very broad, ranging from amounts of a few dollars to many thousands of dollars; from maturities of a few months to as many as 60 months or more. At the lower end of this spectrum severe distortion is apparent when our "simple" common denominator is used. The impact of this one, "simple" denominator may well disrupt sound competitive practices if it is applied across the board without proper regard for the interplay of all of the factors that enter into the pricing of all of the goods, soft as well as durable, in the market place today.

19-25 MARKET STREET
PORTSMOUTH, N. H. 03801
Phone: 436-1200

PLEASE DETACH AND RETURN UPPER PORTION OF THIS STATEMENT WITH YOUR REMITTANCE AMOUNT_____

BILLING DATE	PREVIOUS BALANCE	PURCHASES	RETURNS	PAYMENTS	BALANCE DUE

PAYMENTS RECEIVED AND MERCHANDISE RETURNED AFTER BILL CLOSING DATE WILL APPEAR ON YOUR NEXT STATEMENT

OPTIONAL CHARGE ACCOUNTS

UPON RECEIPT OF BILL, PAY AS MUCH AS YOU WISH BUT NOT LESS THAN SHOWN BELOW:

WHEN YOUR BALANCE IS	MINIMUM PAYMENT IS
UP TO $60.00	$10.00
$ 61.00 TO $100.00	15.00
101.00 TO 140.00	20.00
141.00 TO 170.00	30.00
171.00 TO 200.00	50.00
201.00 TO 250.00	55.00
251.00 AND OVER	¼ OF BALANCE.

"THE ONLY CHARGE FOR THIS CREDIT IS 1½% OF AMOUNTS OWED FOR 28 OR MORE DAYS PER BILLING PERIOD OF 28 DAYS."

IMPORTANT. YOUR ORIGINAL SALES CHECKS AND RETURNS ARE ENCLOSED. PLEASE SAVE THEM AS THEY CANNOT BE DUPLICATED. PRESENT THEM WITH THIS STATEMENT IF THERE IS ANY INQUIRY, OR IF TELEPHONING, PLEASE ASK FOR THE BILL ADJUSTMENT DEPARTMENT.

ACCOUNTS ARE DUE UPON PRESENTATION—A SERVICE CHARGE WILL BE MADE ON A PREVIOUS BALANCE PAST DUE.

Mr. KIMBALL. I have with me today Dr. James Wooley of the New York office of the accounting firm of Touche, Ross, Bailey & Smart. Dr. Wooley will explain to the committee using a group of accounts

at random the results of a study to determine the actual percentage of service fee on revolving accounts over a 12-month period.

Mrs. SULLIVAN. Thank you, Mr. Kimball.

Mr. Keyserling, I don't believe you submitted a prepared statement. Do you think you can pick out the points of the bill that you would like to discuss in 10 to 15 minutes' time?

STATEMENT OF LEON H. KEYSERLING, WASHINGTON, D.C., FORMER CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS, CONSULTING ECONOMIST AND ATTORNEY, AND PRESIDENT, CONFERENCE ON ECONOMIC PROGRESS

Mr. KEYSERLING. Madam Chairman and members of the subcommittee, I want to apologize for not having a prepared statement. This is the first time in 35 years of appearances before congressional committees that I have not had one for the benefit of the committee.

I set aside some time last week to do this and was called to Israel at the request of the Prime Minister for an economic conference, and just got back at the end of this week. So I am very sorry not to have a prepared statement.

I can summarize my views within the prescribed time.

I heartily favor the bill H.R. 11601 in all basic respects. I think if is long overdue. I think it is well considered, I think it is imperatively needed.

I am not impressed with any of the objections to it that I have thus far heard.

I would like to say that I am even more strongly in favor of the provision for a ceiling upon the rate charged than the provision for disclosure although I favor both. The fact of the matter is, that the poor and the oppressed and deprived are in a position that impels them to borrow money at whatever cost, because they have to. Disclosing what the cost is may help them, but taken alone, it doesn't help them enough. The even more important thing is to see that they do not pay too much for a commodity that they have to use; that is, borrowed money.

I think that the 18-percent rate is much too high, and is a sad commentary as to the extent to which all of our national credit policies, private and public, have tended to impose the smallest burdens upon those who need help least and the harshest burdens upon those who need help most.

One defense which some may offer for the 18-percent rate may be that other interest rates have gotten so high, so unconscionably high, that a practical spread must be maintained between other interest rates and these particular interest rates.

For this reason, I would like to call to the attention of the committee that, while this bill is essential and imperative, it is absolutely impossible to accomplish nearly enough in the way of making credit available to low-income people at reasonable costs, unless and until the broader problem which is also within the jurisdiction of this committee is tackled.

I think it is in some respects and I do not ascribe this to this committee, rather ironic and even tragic, that we should be attempting to

impress upon private business the responsibility to be honorable and just and fair and socially minded in its credit policies, even while these characterizations, in my considered judgment, do not apply to the credit and monetary policies of our Federal Government, and above all, to the policies of the Federal Reserve System. The policies of the Federal Reserve System have perpetrated a veritable outrage against low-income borrowers from 1952 to date. The wrongful attitude of the Federal Reserve people is well indicated by their unwillingness to assume the responsibilities that this legislation would impose upon them.

I am not in favor of the protests against the abolition of garnishment, because I believe that garnishment is a clear example of people who are unable to protect themselves that are being subjected to much more rigorous penalties and procedures than others much higher up on the income scale who have many ways of avoiding analogous remedies; and for the same reason, I am against or I would be against legislative prohibition of assignments of wages.

Goodness knows, the people who are affluent or rich have countless ways of assigning their income and property for legitimate and illegitimate reasons, and prohibition of assignment of wages would represent the tendency of tightening up most on those who need help most.

I would like to say just a few words about the relationship between the credit policies embodied in this bill and the more general question of credit and interest-rate burdens and policies, because I believe that this relationship is controlling in many respects. There is naturally, under the very nature of our economic system, a spread between the interest rate charged on Federal obligations, the interest rate charged on State and local obligations, the interest charged on home mortgages, the interest rate charged on business loans, and the interest rates charged on consumer credit. Consequently, so long as the Federal Government persists deliberately in a long-range policy of tolerating an upward trend in the interest charges on its own borrowings, although it is sovereign and ultimately controls the money supply, it is a major culprit in the increased interest burden being imposed all along the line by everybody else.

In order to show this more clearly, and how it relates to the specific problem now before the committee I am going to cite a few facts and computations that I have made in the course of studies I have undertaken over many years.

First of all, today, looking at the increased interest charges in the Federal budget alone, representing aplication to the actual debt of the interest-rate increases since 1952, when, in my view, the infamous "accord" between the Federal Reserve Board and the Treasury took place, the annual interest charge against the Federal budget now in 1967 is about $6 billion higher than if the 1952 level of interest rates had been maintained.

Applying the same method of computation, the increased interest costs to State and local governments are now more than a billion dollars a year. The increased interest costs to all private borrowers, including borrowers on consumer credit, are now running at an annual rate of $10 to $12 billion. Thus, the American people are now paying these increased interest costs at an annual rate of from $17 to $19 billion. And

all this represents, by deliberative national policies, a transfer of income mainly from those who have not to those who have, a transfer of income from those who borrow to those who lend, a transfer of income from those who cannot protect themselves to those who can protect themselves.

The increased interest rates, since 1952, on all one- to four-family, nonfarm, home mortgages are now imposing an additional cost upon homeowners of about $2 billion at an annual rate.

And this in itself means that, on a $10,000 house which might be bought by a $5,000 family, the increased interest payout by that family over a 25-year mortgage is about $2,000, or about 40 percent of the family's annual income before taxes.

The increased interest rates on total consumer credit, which is most directly within the scope of this hearing, may now be costing these types of borrowers as much as $2 billion at an annual rate.

As I have said, the excess interest costs in the Federal budget alone are now at an annual rate of about $6 billion. Here we are, a nation with riots in the streets fiddling while Detroit burns, claiming that we are unable to afford adequate expenditures for slum rebuilding or education or health services or most other needs of high national priority, or even for the kind of employment programs that might be created with the right kind of expenditures, and yet tolerating these fantastic interest tributes to those who lend money to the Government itself. The annual excess interest cost of $6 billion in the Federal budget alone is much more than twice the proposed fiscal 1968 Federal budget outlays for education; about 30 percent higher than outlays for health services and research; about twice outlays for public assistance; almost four times outlays for labor, manpower, and other welfare services; about twice outlays for agriculture and agricultural resources; six times our outlays for housing and community development—even though we have proclaimed this lack as a source of all of the trouble in our cities—80 percent higher than outlays for natural resources; and about 3½ times outlays for the Office of Economic Opportunity.

Now, over the next 10 years, and I have estimated that as of now the nationwide increased interest costs are $17 to $19 billion at an annual rate—over the next 10 years, with the increases in interest rates which are still in process, but more importantly because more and more debts which were not covered by the rising interest rates will be refinanced at the higher rates, I estimate as a minimum, that over the next 10 years, at least $25 billion a year, or $250 billion over the next 10 years, will be transferred from those who borrow to those who lend through the rising interest rate policy alone.

This comes to estimates of about $80 billion over the next 10 years in the Federal budget, about $20 billion over the next 10 years on State and local budgets, and about $150 billion over the next 10 years on all private debts. As I figure it on the interest-bearing consumer debt, it averages at $2 to $2½ billion annually, or $20 to $25 billon over the next 10 years.

What does the average annual excess interest cost of $8 billion a year over the next decade in the Federal budget alone—which I estimate to be more than likely unless the prevalent monetary policy is drastically changed—really mean? This figure comes to about eight

times the fiscal 1968 Federal budget proposal for housing and community development, about 2⅓ times the proposal for natural resources, almost three times the proposal for education, about 80 percent higher than the proposal for health services and research, about five times the proposal for labor, manpower, and other welfare services, about 2⅔ times the proposal for agriculture and agricultural resources, and more than four times the proposal for the Office of Economic Opportunity.

And what does my estimate of a nationwide excess interest cost, public and private, in the neighborhood of $25 billion annually over the next decade really mean? This is roughly equivalent to $3,600 per year for every American family of four. Less than half this annual amount would measure the difference between the current incomes of all of the more than 30 million poor families in the United States and the incomes that all of these people would need to rise above the poverty-income level. This shows dramatically how much we could easily afford to do, if only we redirected our efforts along lines of economic commonsense and social justice.

Now, what are the reasons given for this monetary travesty? The first reason given is that it stops inflation. I do not understand how it stops inflation to increase the cost of that precious commodity which everybody in need has to use, even though everybody does not have to use bread and some would be better off if they do not use it.

A second reason given is that it is necessary to slow down the rate of economic growth. As a matter of fact, our economy has been in a period of stagnation for the last couple of years. And now we are in a fantastic position where we are asked to enact a 10-percent surcharge, which will bear down excessively upon the low- and middle-income families who have already been so seriously hurt by these rising interest rates, on the alleged ground that we need to increase taxes in order to be able to have lower interest rates. This is one of the most fantastic economic propositions ever conjured out of the minds of misguided people.

If a large portion of the American people are being burdened too heavily, relative to their resources, and relative to the wealth and power of the U.S. economy, how do we help them by taking one step forward and one step backward, by increasing the tax burden on them in exchange for lowering the interest rate burden on them, even assuming that the Federal Reserve Board in its construction of good conscience would respond to the increased taxes by lowering the interest rates, which it has not done before?

Actually, the dollar amounts by which the tax burden on the lower middle income people would be increased by the proposed 10 percent surcharge would be much greater than the dollar amounts by which these same families would benefit from any conceivable reduction in interest rates which might follow in consequence of the proposed tax increase.

The truth of the matter is that the Federal Reserve System, which in recent years has proved itself unworthy of the trust imposed upon it by the Congress to deal with monetary policy, is now taking over fiscal policy as well. Having succeeded in disengaging itself from its appropriate duty to cooperate with the purposes of the fiscal policies of the Federal Government, the Federal Reserve System has

now taken the additional step of pointing a pistol at the Federal Government, and threatening to increase interest rates still more unless the Federal Government increases taxes as quick and as much and along such lines as are thought desirable by the Chairman of the Federal Reserve Board. A Federal Reserve System not responsible to the President, and not truly responsible to the Congress, and therefore, not responsible to the people of the United States, although that system is a public instrumentality created by the Congress, has assumed the role of being the most powerful arbiter of the economic policies of the Nation. This is dangerous beyond description.

There has hardly been a time during the last decade and a half when the Federal Reserve Board has not used the bogy of "inflation" to inflate the fat and starve the lean, to repress the rate of economic growth, and to hold the level of unemployment, especially among the vunerable groups, to dangerously high levels. Today, with our cities in turmoil, and our nationwide tranquility and domestic accord more seriously jeopardized than at any time during this century, and with a direct relationship between these troubles and the economic distress and unemployment which afflicts scores of millions of our people, the Federal Reserve System, with a vengeance is again frustrating those national policies which might repair the situation and dedicate us to our great national purposes and priorities.

I believe that we need to consider these varieties of problems carefully. I cite them first in reenforcement of the imperative need to take the small but important step toward helping these people in the ways provided in the proposed legislation. And even more important, I am firmly convinced that, unless we stop engaging in the dream of solving great national problems with extremely limited, though worthy programs, with programs which grab hold of only one-fiftieth or one one-hundredth of the real problem, unless as part of this process we move toward a just and American and fair and decent and honorable credit and interest rate policy for the Nation as a whole, which can be provided only through the action of the Government and the Federal Reserve System, we will not accomplish very much by dealing only with one specific aspect of the problem as represented by the proposed legislation, although I compliment this subcommittee for tackling this aspect of the problem so forthrightly, courageously, and constructively.

Mrs. SULLIVAN. Thank you very much, Mr. Keyserling. Every time you appear before us you give us food for thought. I think you have given us a lot this morning.

Next we have Mr. John W. Edelman, president of the National Council of Senior Citizens. I think you are accompanied by Mr. Hutton. Do you both have statements?

STATEMENT OF JOHN W. EDELMAN, NATIONAL COUNCIL OF SENIOR CITIZENS, INC., AND WILLIAM R. HUTTON, EXECUTIVE DIRECTOR

Mr. EDELMAN. Madam Chairman, as it happens, I am presiding officer of two national organizations that are appearing here today. The National Consumers' League will be represented by Mrs. Newman and the National Council of Senior Citizens by Mr. William Hutton.

The National Consumers' League is an organization 70 years old—it is in effect, a kind of elite organization which has been concerned with problems in this area for many, many years while the National Council of Senior Citizens which is a mass organization representing many very poor elderly people who are peculiarly oppressed by the evils of ill-administered credit arrangements.

I simply wish to commend these colleagues of mine to this committee and I will not take up any further time.

(The prepared statement of Mr. Hutton follows:)

STATEMENT OF WILLIAM R. HUTTON, EXECUTIVE DIRECTOR OF THE NATIONAL COUNCIL OF SENIOR CITIZENS, WASHINGTON, D.C.

Madame Chairman, my name is William R. Hutton, I am Executive Director of the National Council of Senior Citizens. It is an honor and a privilege to be associated with John Edelman who has been such a stalwart of the consumer movement for so many years.

As you have heard, the National Council's position on Truth-in-Lending calls for full and complete disclosure of the cost of consumer credit as President Johnson requested in his consumer message to Congress early this year. Members of the National Council of Senior Citizens are solidly behind H.R. 11601, the consumer protection bill backed by the charming and courageous Subcommittee Chairman and five other subcommittee members, Congressmen Henry B. Gonzalez of Texas, Joseph G. Minish of New Jersey, Frank Annunzio of Illinois, Jonathan Bingham and Seymour Halpern, both of New York.

Members of the National Council of Senior Citizens urge the House of Representatives to plug the gaping holes in the Proxmire Truth-in-Lending measure that has passed the Senate. We are particularly disturbed at the failure of the Proxmire bill to deal with charge accounts (revolving credit), first mortgage loans and credit transactions involving less than $10 and garnishments.

Older Americans encounter all the consumer problems that plague the young and middle aged. In addition, they have special problems of their own.

With few exceptions, incomes of the elderly are fixed. The great majority of the 19,000,000 who are 65 or over live on social security. Approximately 15 per cent get industrial pensions in addition to social security but this extra income is often pitifully small. More than 60 per cent of those 65 or over have cash or other assets amounting to less than $1,000.

The social security recipient getting $84 a month—a little over $20 a week—the average old age and survivors' benefit, or the couple getting $126 a month—or a meagre $31 a week, the average for recipient and spouse, must make every penny count. They want the biggest bang for their buck when they go shopping.

Millions of elderly frequently face the grim choice of getting enough to eat or paying for costly prescription drugs they need to stay alive. Those fortunate enough to own homes often have to choose between food purchases and spending for essential home maintenance. Many lonesome retirees must go without food and other essentials so they can visit their children or close relatives.

Our nation's accent on youth, which consigns even those 40 or 45 years old who become unemployed to the industrial scrap heap, forces the great majority 65 or over to live on a razor's edge of financial insecurity.

Today's retirees are the men and women who began their productive years during the Great Depression of the 1930's. For most of them, low wages and recurring unemployment have meant scandalously inadequate social security benefits.

Unlike today's wage earners, who can look forward to 30 years' uninterrupted employment and constantly rising wages promising top social security and money in the bank upon retirement, the elderly are by and large without adequate incomes and lack savings or other cash assets to see them through an emergency.

Because the elderly are so often without cash, they are more and more forced to rely on costly store credit. Every dollar exacted from them in exorbitant interest payments for credit purchases leaves them with one dollar less for food or medication.

The young may be swindled and outsmarted by conniving merchants and

money lenders but what they lose can often be made up from future earnings. The vast majority of those 65 or over depend on infrequent social security increases for improvement of their economic situation. Social Security increases of 7½ per cent in 1958 and 7 per cent in 1965 did not even keep up with the rise in living costs.

The National Council of Senior Citizens is campaigning for the 20 per cent over-all social security increase recommended by President Johnson but with full knowledge that an increase in this amount would be but a step toward a level of payments sufficient to assure elderly poor a modest but adequate standard of living.

The House Ways and Means Committee, which recently reported out a social security bill, refused to go along even with the modest increase asked by the President.

The National Council of Senior Citizens feels strongly that Congress and the nation owe older Americans, who helped make today's affluence possible, a great deal more than the inadequate social security package that has come out of the House Ways and Means Committee.

Members of the National Council are well aware of the requirements of the Vietnam War and the additional cost of needed domestic improvements, but they are saddened and angered at the spectacle of those who would play politics with human misery by using the Vietnam situation as an excuse to hold down needed social security benefits, Medicare and Medicaid improvements and to cripple or destroy the anti-poverty program and other much needed domestic programs.

The leaders of the Senior Citizens clubs affiliated with the NCSC are absolutely astounded at those lawmakers who have even gone so far as to refuse, with whoops of hilarity that will haunt them, a modest appropriation for control of rats that spread disease and inflict injury in our city slums.

We of the National Council would like to point out that the main opposition to truth-in-lending and other consumer protection legislation comes from those who obey the dictates of the business interests that insist they should decide the ethics of the marketplace regardless of the harm done the consumer.

The National Council of Senior Citizens is a non-partisan organization enjoying support of leading Senators and Congressmen of both major parties but we believe in calling a spade a spade.

We invite those Senators and Congressmen who have a sincere interest in economy and are not simply using this issue as a club to beat down all pro-public legislation, to consider the need for a strong Truth-in-Lending law, for here is an area that involves absolutely no expenditure of Federal funds other than the comparatively insignificant amounts that might be required for enforcement.

The National Council further points out that as a nation we may soon be called upon to pay more Federal taxes. By enacting a strong Truth-in-Lending measure and other needed consumer legislation, Congress could offset any tax increase that may be imposed on the taxpayer by helping him or her save by stretching their spending money.

We are happy to note that the Subcommittee Chairman's bill duplicates the coverage of the original Truth-in-Lending bill sponsored by former Senator Paul Douglas of Illinois for many years in the Senate and that it plugs the loopholes in the Proxmire Truth-in-Lending bill that recently passed the Senate.

The harmful effect of costly revolving credit and garnishment on wage earners is expressed in many letters on these subjects received by the National Council of Senior Citizens.

Here is a letter from an Illinois member on revolving credit:

"I'm glad the Senate passed the Truth-in-Lending bill but I was surprised to see there is nothing in it on store credit. I used to charge what I bought until I found out that I was paying 24 per cent a year on what I owed. That's four times the amount of interest you pay on an ordinary bank loan. Not many people realize what they cost and that explains why there are so many charge accounts. Here's hoping, when the Truth-in-Lending bill is finally passed it will have something in it to control the interest people pay for store credit."

A California member writes on garnishment:

"I see where the Senate has passed a Truth-in-Lending bill. That's good. But, from what I understand it has nothing in it about getting garnisheed. I'm retired, but, when I was younger, I had my pay garnisheed just for getting a little behind on one installment payment. I nearly lost my job. Now, my son, who has a wife and five kids, is being garnisheed, and it's murder. His take-home pay is cut

in half and his family is having a real tough time. I think the Senate should have put the clamps on garnisheeing a man's pay when it passed the Truth-in-Lending bill."

Members of the National Council of Senior Citizens, who have written on Truth-in-Lending, agree with Congressman Jacob Gilbert of New York, who said in a speech on the House floor that ". . . perhaps no proposal (before Congress) has more to recommend it than the Truth-in-Lending." They ask with Congressman Gilbert:

"How can any Member of Congress dedicated to the public interest be against regulations designed to assure honesty in the marketplace? . . ."

Consumer credit has become an area of the most severe exploitation of the poor. It takes the form of deception often leading to garnishment often with the loss of jobs. Even when disaster does not result, exhorbitant interest charges are a constant drain on family income.

The lenders' profit from consumer credit is not peanuts. Consumers now owe $95 billion of which $75 billion is for installment credit. The interest charge on this debt is a whopping $13 billion a year.

The relationship between consumer credit and garnishment is highly important. Even the threat of garnishment is enough to compel a wage earner to pay through the nose for a deceptively sold product because, frequently as not, garnishment can cause loss of employment.

It is no accident that states with the harshest garnishment laws usually have the most consumer bankruptcies. For example, California authorized garnishment up to half of a debtor's wages. It has a bankruptcy rate five times greater than New York which allows garnishment up to no more than 10 per cent of wages.

Increasingly, due to high pressure advertising, desperate debtors go to a small loan company to "consolidate" their debts. Highest charges for credit are charged by these outfits. The people who pay them can least afford to pay these charges.

Interest rates are set by state law at 2 to 3½ percent a month on small loans. This is the equivalent of 24 to 42 percent interest a year. Typical is the 3 per cent a month charge on loans ranging from $150 to $300.

Some of the most pitiable victims of the burgeoning small loan industry are the elderly on whom some of these loan company blood-suckers show no compassion whatever.

The National Council of Senior Citizens joins with Betty Furness, the recently named Special Assistant to the President for Consumer Affairs, in insisting that: "At a time when our lives are run more and more on credit, the least we can do is permit a borrower to know exactly how much he is paying for a loan or credit purchase."

Mrs. SULLIVAN. Mrs. Newman, I think you have a statement. Can you summarize yours in 10 minutes?

Mrs. NEWMAN. I will be glad to try.

STATEMENT OF SARAH H. NEWMAN, GENERAL SECRETARY, NATIONAL CONSUMERS LEAGUE

Mrs. NEWMAN. One of the things that have impressed me is that we don't argue any longer about whether we ought to have truth in lending or not. Apparently industry has joined consumers in their recognition that this is actually needed.

The important thing now is to decide how—what kind of bill we are going to get out of the Congress.

I think the best way to summarize my statement is to indicate the ways in which we prefer H.R. 11601 over the bill passed by the Senate, S. 5.

Our main objection to S. 5 is that it exempts a large part of revolving credit transactions from having to disclose the annual rate.

One of the arguments used to persuade the Senate committee to exempt this segment of the industry was that revolving credit constitutes

a very small percentage of consumer credit. While this may be true, the picture is changing every day.

Senator Douglas has pointed out earlier in these hearings that the amount of revolving credit jumped while the Proxmire bill was under consideration from $3½ billion to $5 billion.

And a member of the banking industry has predicted that in 5 years revolving credit will represent 50 percent of all consumer credit in this country. My prediction is that if we get S. 5 or H.R. 11602 instead of H.R. 11601, the rise, changeover to revolving credit will be even more rapid, and you couldn't blame the merchants for doing this because they don't want to be discriminated against.

I was glad to hear the representative of the American Bankers Association say that "uniformity is essential if the consumers are to be given a means by which to compare costs of credit, and if the credit industry is to be permitted to operate without optimum effectiveness" and we agree with him completely, although we do disagree with the ABA in their preference for the monthly rate.

Another argument is that if revolving credit charges be disclosed by an annual rate it woudn't be telling the consumers the truth. I was not able to be present when Dr. Wooley presented his tables the other day but I have heard others trying to make this same pitch; namely, that consumers charged at a one-and-a-half-percent monthly rate end up paying less than 18 percent a year and, therefore, would not be getting the truth if they were told the annual rate was 18 percent.

But none of these avid seekers of truth was able to prove that one and a half percent monthly rate was any truer than the 18-percent annual rate.

Credit costs should be figured from the date the service charge begins and not from the date of purchase. If calculated in that way the annual rate is always 12 times the monthly rate.

Actually, if you pay on the first day after the charge is imposed you may be paying not 18 percent, but as high as 540 percent. Such examples, of course, are never given. Of course, they don't show figures like that and most people wouldn't pay off that way. But it is just an indication that what we need is an annual rate which we can all understand.

One of the witnesses today and also the ABA witness said that the monthly rate would give the consumer all the information he needs for comparing credit costs because he could easily convert the monthly rate into an annual rate by multiplying by 12. It really is that easy and it shouldn't be any harder for the merchant or the extender of credit to do that multiplication than it is for the consumer to do it.

We feel that the 1½ percent monthly rate misleads the consumer into thinking he is getting a much lower rate charged him.

I have here a bill which is issued by one of the stores—Klein's—in this area using revolving credit and I would like to put this in with my statement for the record. It shows on the back of the bill—

> You may at any time pay the entire balance or more than payment due. No service charge if payment in full received within 30 days of billing date.

That's very clear and anybody who buys at this store knows that within that 30-day period he can pay off the whole amount without paying any service charge.

Then on the right-hand side, No. 4, it defines the service charge—1½ percent of the balance at the beginning of the monthly billing period. Also indicated is a minimum charge and what the monthly balance is.

When I deal with this merchant I have two choices. I can either pay off during that period when I am not going to have a charge imposed or I can decide that I am going to take advantage of the credit plan.

If I don't have the cash I have further choices to make. Should I use the merchant's credit plan or should I take the money out of the savings account or borrow the money from a credit union and pay before the credit period starts?

In order to make an intelligent decision on these alternatives I have to know the relative cost of these procedures. If I am getting only 4 percent from my savings and loan institution it would be foolish to pay 18 percent for the use of the credit at this store. But how would the ordinary consumer compare 4 percent advertised by the savings institution with 1½ percent stated by the store.

Here are two figures he looks at. What consumer could easily tell whether it is cheaper to take a loan at an add-on rate of $5 per hundred or pay 1½ percent a month on the revolving credit account?

A former vice president in charge of finance for the Ford Motor Co. testified once at a Senate hearing, and I quote:

> The variety and complexity of finance and insurance arrangements, and the charges for them, are such as to almost defy comprehension. It is impossible for the average buyer to appraise the rates offered, as compared with alternatives available elsewhere.

Members of the committee, there are over $5 billion of revolving credit now outstanding. To give the fastest growing segment of consumer credit preferential treatment would not only be discriminatory legislation—including a Montgomery Ward and exempting Sears, Roebuck; including a bank but exempting a department store—it would strike a blow at the very heart of the protection this legislation should be extending. Disclosure must be on a uniform basis for all types of credit, so that the consumer can make easy and accurate comparison between different types of credit available to him.

H.R. 11601 differs from S. 5 also by including those transactions in which the credit charge is less than $10. The National Consumers League is opposed to the exemption of such transactions. We have no figures to show what proportion of credit sales would be included in this arbitrary exemption but, as has been pointed out already in these hearings, it would be very easy to break down larger purchases into a series of contracts each of which would be exempt.

Actually, fairly large items would be exempt, up to about $100. For many consumers, a large proportion of their purchases would thus be exempted from the disclosure. For instance, take the purchase of a $50 chair and a $30 appliance bought for $10 down and 12 monthly payments of $6.60. The buyer will pay $89.20—$10 down plus $79.20 in monthly payments. The finance charge is $9.20. The rate of interest on the $70 credit comes to over 26 percent, but since the total interest charge is less than $10, this rate would not have to be disclosed under the provisions of S. 5.

It is just as important for consumers to have full information in this type of transaction as it is for someone who buys an expensive suite of furniture. It is specious to argue that the requirement to give such information will either make credit unavailable to the poor, or will cut down significantly on purchases. A consumer needing the merchandise will still buy it. He may just look elsewhere for his credit arrangements or decide to save up the money and buy for cash. If the poor need help in getting cheaper sources of credit, other Government programs are already working in this area.

H.R. 11601 would also extend the disclosure requirements to advertisement of credit, and the National Consumers League strongly endorses this provision. Just the other day, on my way to these hearings, I heard an ad from a finance company urging those harassed by a multiplicity of credit payments to come to them for a loan which would be sufficient to pay off all other creditors.

At no time was any mention made of how much the loan would cost, nor that the consumer would probably merely be adding onto his total indebtedness by the loan. Newspaper ads and store window signs constantly lure customers with so-called easy credit terms, but rarely, if ever, do they quote interest rates. Advertisements of credit should be required to give all the information required in the actual transaction so that consumers are not misled into believing what is not in fact true.

By including revolving credit, and all transactions large and small, and providing for truth-in-credit advertising, H.R. 11601 provides for disclosure which will be meaningful, and of tremendous value to the beleaguered consumer in the jungle of today's credit world.

The National Consumers League is also in favor of including home mortgages in the disclosure provisions of the act. While it has been the custom to quote the interest rate on mortgages in terms of the simple annual rates on the outstanding balance, consumers rarely are aware of the total cost of the mortgage. For many home buyers, such knowledge might well lead to larger down payments. Nor are home buyers generally aware of the many charges they face at time of settlement. As was so eloquently urged by Mr. Barr earlier in these hearings, it is high time some uniformity of disclosure in this area was imposed on real estate transactions.

On the provision to prohibit garnishments of wages, the league would recommend a somewhat different approach. There is no question about the devastating effect of garnishment on the lives of many. I understand you were given some hair-raising testimony on this last Friday when I was, unfortunately, not able to be present at the hearings. We feel that garnishments should be regulated in such a way as to act as a significant deterrent to the present unwise extension of credit.

We have no exact figure to recommend but suggest that only a small percentage of a wage earner's salary should ever be taken in garnishment action. We are well aware of the tremendous cost in time and personnel of our courts taken up by garnishment procedures, and hope that this committee will be able to come up with a provision, short of prohibition of garnishment which would cut down on these costs. Merchants should be required to pay the court costs. Having our courts act as collection agencies for those who extend credit without any consideration of the ability of the buyer to pay is a costly burden on all of

us who do pay our debts. It is unfair competition to those who extend credit more carefully. I have seen data which show that in some cities, one or two merchants are involved in most of the garnishment procedures. Restrictions on garnishment should be such as to make it unprofitable for merchants to extend credit too loosely.

The league also endorses the provisions for establishment of a bipartisan National Commission on Consumer Finance. We would hope that there would be adequate consumer representation on the Commission, and that it would look into many of the questions which have been raised at these hearings.

The league has no position on the section of H.R. 11601 which deals with the regulation of credit for commodity futures trading. This is a very technical question, which we have not looked into sufficiently to formulate a policy. Likewise, we have no position on standby consumer credit controls, or on the provision for an 18-percent ceiling. My personal feeling on the latter is that it might easily result in 18 percent being a floor as well as a ceiling, which would be most undesirable.

I do want to commend you, Mrs. Sullivan, and all the members of the committee for the very serious attention that you are giving this vital problem for consumers and we are delighted to have a chance to present our point of view here.

Mrs. SULLIVAN. Thank you, Mrs. Newman.

I know you have been in attendance at these hearings for the past 10 days, and a very interested listener.

(The full statement of Mrs. Newman and S. Klein card follow:)

STATEMENT OF SARAH H. NEWMAN, GENERAL SECRETARY, NATIONAL CONSUMERS LEAGUE

Mr. Chairman, my name is Sarah H. Newman. I am the General Secretary of the National Consumers League, an organization which since its formation in 1899 has concerned itself both with protection of the consumer and with the responsibility of the consumer to those who produce the goods and services which we purchase and use. The League has always operated by first investigating the facts, then educating its membership and, when necessary, campaigning for solutions to the problems. Long before President Kennedy announced as one of the four fundamental rights of the consumer the "right to be informed", the League was convinced that only with full information could consumers be equipped to carry out their responsibility to themselves, to their families, and to the nation. We are, therefore, very pleased to appear before you today in support of H.R. 11601, a bill which would substantially improve the consumer's right to be informed of the cost of credit.

I have been tremendously impressed during these hearings with the fact that there is hardly any dissent as to the desirability and need for enactment of a credit disclosure bill. After long years of lengthy detailed hearings in which the opposition to Truth-in-Lending seemed adamant and almost monolithic, it is as if a fresh breath of spring has swept through the atmosphere, and we can now all get down to working out the details of a bill which will really do the job.

So I will not take your time to list all the reasons which justify enactment by the Congress of a bill which will bring back more effective competition in the lending industry and enable consumers to make a rational choice in this multi-billion dollar area of expenditures. Instead, I would like to address myself to the provisions of H.R. 11601 which differ from S. 5 as it passed the Senate. The National Consumers League does not believe that S. 5 will provide consumers with the information they really need. Although we are indeed pleased that the Senate has finally passed a credit bill, and although we understand why compromises were made in that bill, we are grateful to you, Mrs. Sullivan, and to these other members of the House, for introducing H.R. 11601 and giving us another opportunity to obtain the kind of disclosure which will eliminate the confusing terminology and practices that have arisen in the credit industry.

Our main objection to S. 5 is that it exempts a large part of revolving credit transactions from having to disclose the annual rate. One of the arguments used to persuade the Senate Committee to exempt this segment of the industry was that revolving credit constitutes a very small percentage of all consumer credit. While this may still be true, the picture is changing every day. As Senator Douglas pointed out in his testimony before you, the amount of revolving credit jumped while the Proxmire Bill was under consideration from $3.5 billion to $5 billion. A member of the banking industry has predicted that in five years revolving credit will represent 50% of all consumer credit in this country. And if Congress passes credit legislation which gives revolving credit this special exemption, I predict it will rise even more rapidly. Merchants will be changing over to revolving credit as fast as they possibly can. And they could not be blamed for it, because otherwise they would be forced to operate under a law which discriminated against them in favor of their competitors.

I was glad to hear the representative of the American Bankers' Association say that "uniformity is essential if the consumer is to be given the means by which to compare costs of credit, and if the credit industry is to be permitted to operate with optimum effectiveness." And I join him in urging that you provide a "single, non-discriminatory system of time disclosure to be uniformly applied to all creditors and all types of credit," even though I disagree with the ABA in their preference for the monthly rate.

Another oft-repeated argument against the provision that revolving credit charges be disclosed by an annual rate is that to label a 1½% monthly rate an 18% annual rate would not be true. I was unfortunately not able to be present when Dr. Wooley presented his tables, but I have heard others who tried to make the same pitch—namely, that consumers charged at a 1½% monthly rate end up paying less than 18% a year, and therefore would not be getting the truth if they were told the annual credit charge was 18%. But none of these avid seekers of truth was ever able to prove that a 1½% monthly rate was any truer than the 18% annual rate.

Credit costs should be calculated from the date the service charge begins, not from the date of purchase. If calculated in that way, the annual rate is always 12 times the monthly rate. This is the true basis for the charge, and we don't have to worry about the fact that consumers do not all pay at the same time during the period. Actually, if you pay on the first day after the charge is imposed, you may be paying not 18% for a 1½% monthly charge, but as high as 540%. Such examples, of course, are never given. The important information for the consumer to know is the *annual rate* at which the charge is calculated, and when it begins. The ABA witness suggested that the monthly rate would give the consumer all the information he needed for comparing credit costs because "he could easily convert the monthly rate into an annual charge simply by multiplying by twelve" (p. 6). It really *is* that easy, and it should not be any harder for the extender of credit to make that multiplication than for the consumer to do it. Let's not mislead the consumer into thinking he is getting cheap credit by quoting a low monthly rate.

I have here a bill which is issued by one of the stores in this area which uses revolving credit. As you can see on the reserve side of the monthly statement, there is an explanation. In the lower left hand corner it states very clearly, "No service charge if payment in full received within thirty days of billing date." Item 4, on the right, states that the service charge is "1½% of the balance at the beginning of the monthly billing period." H.R. 11601 would require only one change—viz., that the Service Charge also be stated as 18% per year. It would be very easy for this store to make this change, and the new figure would be just as true as the one they now use. We feel it is important that the charge be stated as an annual rate for precisely the same reason given by the ABA witness—viz., that the consumer could then compare credit costs from different sources of credit. When I deal with this merchant, I have two choices. I can pay off the entire amount within 30 days of billing date and pay no service charge, or I can elect to defer payment and incur the charge. If I do not have the cash, before I can make an intelligent decision as to whether I should use the merchant's credit plan, or take the money out of a savings account, or borrow the money from a credit union and pay before the credit period starts, I must know the relative costs of these procedures. If I'm getting only 4% for my savings in a savings loan institution, it would be foolish to pay 18% for the use of credit at the store. But how do you compare 4% advertised by the savings institution with 1½% stated by the store? What consumer could easily tell whether it is cheaper to

take a loan at an add-on rate of $5 per $100, or pay 1½% a month on the revolving credit account? A former Vice President in charge of finance for the Ford Motor Company testified at a Senate Hearing once, "The variety and complexity of finance and insurance arrangements, and the charges for them, are such as to almost defy comprehension. It is impossible for the average buyer to appraise the rates . . . offered, as compared with alternatives available elsewhere."

Members of the Committee, there are over $5 billion of revolving credit now outstanding. To give the fastest growing segment of consumer credit preferential treatment would not only be discriminatory legislation (including a Montgomery Ward and exempting Sears Roebuck; including a bank but exempting a department store), it would strike a blow at the very heart of the protection this legislation should be extending. Disclosure *must be on a uniform basis* for all types of credit, so that the consumer can make easy and accurate comparison between different types of credit available to him.

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H.R. 11601 would also extend the disclosure requirements to advertisement of credit, and the National Consumers League strongly endorses this provision. Just the other day, on my way to these hearings, I heard an ad from a finance company urging those harassed by a multiplicity of credit payments to come to them for a loan which would be sufficient to pay off all other creditors. At no time was any mention made of how much the loan would cost, nor that the consumer would probably merely be adding on to his total indebtedness by the loan. Newspaper ads and store window signs constantly lure customers with so-called easy credit terms, but rarely, if ever, do they quote interest rates. Advertisements of credit should be required to give all the information required in the actual transaction so that consumers are not misled into believing what is not in fact true.

By including revolving credit, and all transactions large and small, and providing for truth in credit advertising, H.R. 11601 provides for disclosure which will be meaningful, and of tremendous value to the beleaguered consumer in the jungle of today's credit world.

The National Consumers League is also in favor of including home mortgages in the disclosure provisions of the Act. While it has been the custom to quote the interest rate on mortgages in terms of the simple annual rates on the outstanding balance, consumers rarely are aware of the total cost of the mortgage. For many home buyers, such knowledge might well lead to larger down payments. Nor are home buyers generally aware of the many charges they face at time of settlement. As so eloquently urged by Mr. Barr earlier in these hearings, it is high time some uniformity of disclosure in this area was imposed on real estate transactions.

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The League also endorses the provisions for establishment of a bi-partisan National Commission on Consumer Finance. We would hope that there would be adequate consumer representation on the Commission, and that it would look into many of the questions which have been raised at these hearings.

The League has no position on the section of H.R. 11601 which deals with the regulation of credit for commodity futures trading. This is a very technical question, which we have not looked into sufficiently to formulate a policy. Likewise, we have no position on stand-by consumer credit controls, or on the provision for an 18% ceiling. My personal feeling on the latter is that is might easily result in 18% being a floor as well as a ceiling.

We wish to commend you, Mrs. Sullivan, and all the members of this Subcommittee, for your serious efforts to get an effective consumer credit bill. As Mrs. Dwyer said, your concern must be the welfare of the American consumer, his right to full information and to protection against what is deceptive and misleading. We feel that the provisions of H.R. 11601 which we have endorsed would achieve that objective. The National Consumers League thanks you for the opportunity to present its view on this legislation.

312927

S. KLEIN
ON THE SQUARE

SEE REVERSE SIDE FOR EXPLANATION

P. O. BOX 999, STAMFORD, CONN.

- Payments and Purchases received after BILLING DATE will appear on next month's statement.
- Mail remittance with payment card in envelope provided.
- When paying in person present payment card with remittance.
- Payments due on receipt of statement and should be received no later than [redacted]

S M NEWMAN
1411 HOPKINS NW
WASH DC 20036 312927

BILLING DATE	DATE DUE
5/05/67	6/05/67

ACCOUNT NUMBER 8102-368824

(If address is incorrect, please correct on payment card.)

1 PREVIOUS BALANCE	2 TOTAL PURCHASES	3 TOTAL CREDITS	4 SERVICE CHARGE	5 BALANCE	6 AMOUNT DUE
	2407			2407	1000

AMOUNT PAID 24.07 DATE 5/30 #8492 PLEASE PAY THIS AMOUNT

OPTIONAL PAYMENT SCHEDULE

IF BALANCE IS	MINIMUM PAYMENT
0-$9.99	ENTIRE BALANCE
$10.00 TO $100.00	$10.00
$100.01 AND OVER	10% OF BALANCE

YOU MAY AT ANYTIME PAY THE ENTIRE BALANCE OR MORE THAN PAYMENT DUE (OR MINIMUM PAYMENT). NO SERVICE CHARGE IF PAYMENT IN FULL RECEIVED WITHIN THIRTY DAYS OF BILLING DATE.

EXPLANATION OF STATEMENT

ITEM

1. PREVIOUS BALANCE: Total balance as of Previous Billing Date.
2. TOTAL PURCHASES: All merchandise purchased from the Prior Billing Date to the Present Billing Date.
3. TOTAL CREDITS: All payments, adjustments, and merchandise returned from the Prior Billing Date to the Present Billing Date.
4. SERVICE CHARGE: 1 1/2% of the balance at the beginning of the monthly Billing Period-Minimum charge 50¢. (The amount shown in the 1st column "PREVIOUS BALANCE".)
5. BALANCE: Total Amount Owed.
6. AMOUNT DUE: Amount due this month.

Mrs. SULLIVAN. The next witness is Dr. James Wooley to discuss the approximate annual percentage rate on revolving charge.

STATEMENT OF J. W. WOOLEY, NEW YORK, N.Y.

Mr. WOOLEY. Thank you, Madam Chairman.

First let me apologize for appearing again. My colleague who was due to appear was unable to come and I'm a last minute fill-in. Therefore, I do not have a prepared statement and I am sorry for this.

Mrs. SULLIVAN. You are welcome to explain the chart, which is a different one from the one you presented last week.

Mr. WOOLEY. I would like to read a couple of paragraphs and summarize with it.

My testimony is restricted to the problems of calculating an annual effective percentage rate for service charges under the terms of the bill. In order to determine the applicability of this provision of the bill to actual customer transactions, a sample of 40 customer accounts was drawn from a department store.

The annual percentage rate under the bill was calculated on the basis of the customer's balances, periods of time covered and service charges imposed. A year's history was developed for each customer, covering transactions from February 1, 1966, to January 31, 1967.

The illustration which I used last week was drawn from one of these 40 accounts selected from this sample.

The sample was randomly selected, with about 20 customer records taken from the beginning of the alphabet and the remaining records chosen from the alphabetical segment beginning with the letter R. The initial sample included 42 records, one of which was eliminated because no transactions were conducted during the year and another was eliminated due to an apparent machine malfunction in calculating service charges. This left 40 usable customer records.

Finance charges are one and a half percent a month calculated on the opening monthly balance.

The finding of the calculations were arranged by annual service charge rate. They reveal some interesting findings. For example, there is a wide "scatter" of rates, so that no single rate can be deemed "representative." The range is from 19-plus percent for one account to zero finance charges for four accounts. The latter are due to the use of the 30-day option privilege to eliminate finance charges.

Looking at the annual service charge rate incurred most often, there is again no clear picture. Five customers paid 16-plus percent, while four customers paid 17-plus percent, four paid 14-plus percent and four did not pay any finance charges.

The impossibility of pinpointing one true annual service charge rate for all customers is reflected in this sample and supported by the following points:

Mrs. SULLIVAN. When people don't pay any rate at all, that is perfectly understandable—they pay their bill on time and don't have to pay a service charge.

Mr. WOOLEY. I would agree with you.

Mrs. SULLIVAN. But if it is a charge of 1½ percent and it is for 1 of 12 months in a year it is still 18 percent.

Mr. WOOLEY. No, Madam; it is not. It is not 18 percent, because regardless of the fact that the individual pays this, it is not. The fact still remains he is making use of the store's money or funds until such time as he does pay his bill. The store is paying, carrying him in essence and so there is a charge to the store for letting him use it whether or not he pays it or not.

Mrs. SULLIVAN. That has been done forevermore—the department stores have done this as long as they have been in business. It is to encourage the customer to come in and do more buying, knowing they don't have to pay for it until the end of the month.

Mr. WOOLEY. No question about it, but the fact still remains that the store is still carrying the individual.

The rate as compared to an annual true rate, under H.R. 11601, this is the rate which would be required on the statements of the retail establishment as they issue. This charge shows you actual rates paid for by customers in the store, in this particular store. These are the 40 accounts. They range from zero to slightly above 19 percent.

Let me emphasize:

1. No customer paid 18-plus percent, the presumed annual rate if the 1½ percent monthly charge were to be multiplied by 12, as the bill suggests.

2. Nearly half of the accounts paid less than 10 percent.

3. Three-fourths of the accounts paid less than 15 percent.

4. Four persons, or 10 percent of those sampled, did not incur any finance charges, although transactions were made.

If you insist on requiring people to say that they are charging 18 percent, these individuals who actually paid less than 18 percent would be deceived if they went to other sources and paid charges at higher than the rate, that you would actually be doing a disservice to such a consumer rather than a service by telling him he is paying 18 percent when in reality he is paying a much lower percent. This is a randomly selected sample.

It was not drawn out simply to illustrate our point. It was drawn out on an impartial basis and as a result of this drawing we calculated these percents. I think the illustration is very clear and points out again the impossibility of stating in advance the 18-percent figure.

Thank you.

Mrs. SULLIVAN. Mr. Fino?

Mr. FINO. What is the highest figure you have there?

Mr. WOOLEY. 19.4.

Mr. FINO. Can you give us an illustration of that type of account?

Mr. WOOLEY. I think I could fall back to Mrs. Newman's comment where she said if an individual happened to pay the day after the service charge were imposed it could go as high as 540 percent.

The fact is that this customer happened to pay just a little bit ahead of the billing cycle and as a result went slightly over 18 percent. What does happen, though, as illustrated by this chart, most people do not pay in that manner. Most people are around the 10-percent category.

Mrs. SULLIVAN. Let us go back to Mr. Kimball's charge account billing record.

Here he gives an example on the monthly or 35-day statement which

says if your bill reaches a certain amount you must pay a certain amount each month.

Now, do all of the stores from which you took these 40 examples that you have on the chart—and I am not referring to Mr. Kimball's store, for he has already answered this for his store—but do the others in their revolving charge accounts tell each customer how much they have to pay a month?

Mr. WOOLEY. To the best of my knowledge, and Mr. Cianca, who wasn't here is here now, he is probably better qualified to answer this question than I am—but to the best of my knowledge most stores require a certain minimum payment as the balance reaches different dollar levels. The minimum payment that I have been familiar with is a $10 minimum per month.

Mrs. SULLIVAN. I have had charge accounts in every store in St. Louis and every store up here in Washington and I have never had one of them tell me how much I have to pay a month.

Mr. KIMBALL. Madam Chairman?

Mrs. SULLIVAN. Mr. Kimball.

Mr. KIMBALL. The purpose of this——

Mrs. SULLIVAN. I see your purpose. You are telling the people what they have to do.

Mr. KIMBALL. No, this is to encourage them to bring the total amount outstanding down. Most retailers, when they allow credit to different people put ceilings on what their ability to pay is. We don't want them to get overindebted to us.

If a person should say, start charging $100 a month and making $15 payments and continue to charge $100 a month, at the end of 5 or 6 months he would be up to $400 or $500. He would be extended over 24 months, maybe, and we don't want to get involved with our accounts and most reputable merchants don't want to get involved with their accounts, so as the balance goes up we encourage them to pay more so they will be more open to buy and come back and do more shopping.

The main purpose of the service charge is to encourage them to pay faster and we find this is actual practice.

Mrs. SULLIVAN. Are there any other retail men in the audience who have any knowledge about the practice of other stores in telling customers how much they should pay each month?

(No response.)

Mr. STEPHENS. I am not a retail man but in the years I have been paying this money, I know that everyone that I have received—a bill like one from Sears, Roebuck carries that on the back and I believe most of them carry the minimum amount and tell you exactly what you are required to pay in order to stay in business. Most of the bills that I have had do give that information.

Mrs. SULLIVAN. I have never seen it on a Sears or Montgomery Ward bill.

Mr. KIMBALL. You had a witness here from the discount department store in Boston recently, and in their credit application they have something very similar to this, only their requirement is a 10 to 1 ratio where my minimum is 6 to 1.

This form that we have is copied from Gimbel's in New York.

Mrs. SULLIVAN. Is that on the monthly invoice or is that just on the form the customers fill out when they sign up?

Mr. KIMBALL. The discount department store that testified here at your committee has it on their application and also has it on the forms like this, that they have it throughout the store and give it to customers. As a matter of fact, I took the time to go into this store in Boston and tried to apply for a charge account and this is the information they gave me. They spoke nothing of an annual rate at all. They just told me what my monthly rate would be and how much the payment would be required if I bought a sewing machine or radio or television and it varies. Some stores have a 10-to-1 ratio, some have a 12-to-1 ratio. Ours happens to be 6-to-1 ratio.

Mrs. SULLIVAN. Did you go in there before——

Mr. KIMBALL. This was a month or so ago.

Mrs. SULLIVAN. Mr. Willett Smith was in here Monday from Lechmere's in Cambridge.

Mr. KIMBALL. This is the store that I am referring to.

Mrs. SULLIVAN. He showed us where they do show an 18-percent annual percentage rate on their statements.

Mr. KIMBALL. It is on their application but I went in as a customer. I didn't go in as Mr. Smith. I went in as a customer for the purpose of buying an appliance and the clerk told me to go to the credit department which I did. They gave me a form, an application form which in very condensed type on the left-hand side did state, not in numbers but in letters the words "18 percent" spelled out.

On the right-hand side of the application was this information, similar to what we have done here and the girl taking my credit application told me that my payments should be at this rate which was one and a half percent of the unpaid balance. She said nothing about 18 percent.

Mr. WYLIE. Will the Chairman yield?

Mrs. SULLIVAN. Mr. Wylie.

Mr. WYLIE. I have a question for anyone. Perhaps Dr. Wooley should respond because he has been referring to it. It might be more appropriate.

Could not each seller using revolving credit state an average annual rate?

Mr. WOOLEY. I think——

Mr. WYLIE. What I am thinking here is, the Chairman has indicated that revolving accounts set up on the basis of 1½ percent per month should state interest rates on the basis of an annual rate of 18 percent. You say that is not possible. Is it possible to show an average annual rate in each store?

Mr. WOOLEY. This could be calculated for prior year periods. I have no doubt about that. We do have some slight samples of this and it comes out around 10 to 11 percent as the actual rate that is paid. Something that could be worked out but it would have to be historical. It would not tell a customer in advance what he had paid.

Mr. WYLIE. I was thinking it might be done from the previous year's accounts.

Would it be possible for a member of this committee or a member of the staff of this committee to go into a store to check accounts to demonstrate this is not a stacked deck?

Mr. KIMBALL. I live in Portsmouth, N.H. We are on the New Hampshire seacoast; we have delicious lobsters. I would be most happy to invite you as our guests to Portsmouth to a nice shore dinner and I would take you into my store. We have 7,000 charge accounts. They make 200 payments per day; they have 4,000 charges per day, entries made. We cannot tell prior to anybody's account when they are going to come in to buy anything, make a charge. We cannot tell when they are going to make a payment. They can make it on the 23d day or 32d day. We never know when the collections are going to come in.

It is impossible prior, as your bill requires, the explanation, and I note also your definition on page 6 of "annual percentage rate"—says U.S. rule by an actuarial method. I assume that is what we learned in grammar school. That means on the per diem basis. If the customer makes five payments during the course of a month—they pay by the week—it is impossible for me to know whether they are going to pay me $2, $5, or $10 and tell them any percentage rate according to the way this bill reads and, as a matter of fact, in my store it wouldn't be 18 percent anyway.

Mrs. SULLIVAN. I am going to let Mr. Wylie have his time now; we will all have time to question.

I would just like to reply to what you said though, by pointing out that we don't know how much interest we are going to get when we put money in a bank, either, because we don't know at that time how long we are going to leave it in. They tell us they are going to pay us so much but it all depends on what we do.

Mr. KIMBALL. If you take your money out of the bank you don't get any interest. But if you do put it in the bank on a certain day they tell you if you put it in by the 10th of the month or by the 1st they will pay you 4½ percent providing you leave it in for 3 months or 6 months. This is something they tell you you are going to do. But it is impossible—I have been down to the Douglas hearings and Proxmire hearings and I asked the committee—I am most willing to explain to my customers in the language they can understand and disclose all of the information if you will just tell me how to do it. Nobody has been able to tell me or any other merchant how to compute it.

Mrs. SULLIVAN. Mr. Wylie?

Mr. WYLIE. Would you have objection to stating in dollars and cents in cash how much a customer has paid out over a year's period in interest and/or service charges?

The point of my question is this: I doubt if stating an interest rate on a monthly basis or an annual basis is very meaningful to most customers. And showing charges in dollars and cents, in cash, how much they have paid out is much more meaningful.

What would be your feeling about that?

Mr. KIMBALL. I think the consumers, when they are trying to buy something, they are trying—let's say they are buying a dress—they are primarily interested in whether the dress fits, whether the material is what they want, how good it looks on them, and then they are going to buy the dress. They are not interested in the rate of interest at that point. They are buying the dress which they like. However, when they get the bill at home at the end of the month they want to be able to figure out what the service charge of 38 cents was on their bill.

Why was the 38 cents? And the average consumer can multiply the ending balance by one and a half—if they owed us $25, multiply that by 1½ and it comes out to 38 cents and they know they haven't been gypped at all. This is what they want to know.

Mr. WYLIE. But the point is they want to know the amount—38 cents.

Mr. KIMBALL. That's why on our invoice we tell them this.

Mr. WYLIE. They want to know how much they paid out, not the percentage.

Mr. KIMBALL. On the invoice we say balance due, $25, service charge 38 cents, new purse, something else. And the new ending balance.

Mr. WYLIE. I have just been handed a U.S. savings bond, a series E bond and on the back of it it says if you hold it to maturity you get $100. It is a $75 bond which returns an interest of 4.15 percent. But if you cash it at the end of the first half year you get $75; no interest, in other words if you cash the bond between the first half of the year to the first year, $75.84 is paid. That is meaningful. This amounts to 1 percent, approximately.

I don't think it would have much meaning if they just said 1 percent. I think we are getting more actual knowledge if we say how much you're actually receiving or how much you pay out in dollars and cents.

Mr. KIMBALL. We state to the customer what the service charge is each month and we tell them how we compute it.

Mr. WYLIE. Thank you, Madam Chairman.

Mrs. SULLIVAN. Mr. Bingham?

Mr. BINGHAM. Thank you, Madam Chairman.

First of all, I would like to join in complimenting the witnesses. I have great respect and admiration for Mr. Keyserling and have known him for many years and I think he is one of the most provocative and imaginative commentators on economics of our time.

I am also glad to see Mr. Edelman and Mr. Hutton here. They do a splendid job, and I have enjoyed working with them on various matters.

I would like to direct my questions to Dr. Wooley, however.

Dr. Wooley, I take it your position essentially is that 18 percent is not an accurate statement of an annual applied rate, but, if that is so, why isn't it just as inaccurate to say 1½ percent a month?

Mr. WOOLEY. We covered this in quite a bit of detail when I was here. But the point is, when you try to annualize a figure you are assuming a percentage rate on an annualized basis, the service charge is simply a charge applied at a point of time. It does not take into account what has occurred before or after that time—only as it applies to the balance at that point in time. One and a half percent on the beginning balance does not take into account what has occurred before that got to that balance or in most cases what occurred after it got to that balance.

That is an entirely different thing than stating 18 percent.

Mr. BINGHAM. I understand what you say. But the fact is that some of the stores refer to it as a 1½-percent monthly charge. I presume you would have to agree that 1½ percent doesn't represent the earned interest or the yield but it is the applied charge.

Mr. WOOLEY. It is an applied charge, yes.

Mr. Hanna brought this point out last week.

Mr. BINGHAM. It is not the yield. In the same way, 12 times 1½ percent is the applied charge on an annual basis.

Mr. WOOLEY. I think Mr. Bingham, the problem comes in the other areas where you have an installment contract. What you are stating is an effective interest rate and this is what you are after.

If you want to be consistent you have got to be able to apply an effective rate for the revolving credit account, too. You can't state to the retailer, you have to state yourself on an applied rate while the others are establishing theirs on an effective rate. This will confuse the consumer, won't help him.

Mr. BINGHAM. This is what you want to do. You want to state the charge as an applied rate on a monthly basis but you don't want to multiply that by 12 because 18 percent looks a lot higher than 1½ percent.

Mr. WOOLEY. I am not saying that at all. We are using the applied rate, not an effective rate and if you make it appear that it is an effective rate rather than an applied you are going to confuse people, not going to help them.

Mr. BINGHAM. The bill can indicate that it is the applied rate that is required to be stated and I think it should and it shouldn't indicate anything about the actual yield. That is quite unpredictable—I agree with you there. You can't possibly state that either beforehand or after. But you can state accurately what the applied rate is.

Mr. WOOLEY. In that case Mr. Bingham, how is a consumer to compare interest rates? What possible chance can he have if he is applying in applied rate versus an effective rate on another contract?

Mr. BINGHAM. Between stores he can compare what he is going to be paying.

Mr. KIMBALL. What is my rate?

Mr. BINGHAM. As you indicated it is 1½ percent on a 35-day period. I don't know if that comes out equally or evenly for a year.

Mr. KIMBALL. There are 52 weeks in a year and we send out bills every 5 weeks.

Mr. BINGHAM. Why do you use a 35-day period?

Mr. KIMBALL. The principal reason we went into this was when the 3-cent stamp went into the 4-cent stamp and the 4-cent stamp went to the 5-cent stamp and now you people are taking it up to 6 cents.

Our billing costs are going up constantly. When you think how much it costs for the piece of paper and envelope and the girls' time to make the statement and do her posting, if I can send out 10 statements instead of 12 statements a year I think I have made a savings of almost 16 percent in billing costs and now you want to pass a law to make me tell my customers something that isn't true at all.

Mr. BINGHAM. My time has expired.

Mrs. SULLIVAN. Mr. Halpern?

Mr. HALPERN. Madam Chairman.

First, I would like to compliment our distinguished panel this morning on their valuable presentations which I am sure will contribute greatly to this committee's efforts to come up with meaningful legislation.

I commend you and certainly welcome you here this morning.

Mrs. Newman raised an interesting point. I think she pointed out that the 1½ percent interest, monthly interest is misleading and likewise a statement of 18 percent annually could be misinterpreted; is that right?

Mrs. NEWMAN. What I said was, that the 18 percent is no less true than the 1½ percent, and actually, it is what we are being charged, not what we have to pay that we want to know.

Mr. HALPERN. Since Sears, Roebuck was mentioned this morning I would like to ask whether it is true that under its billing system either monthly or annual interest is mentioned?

Can you answer that possibly?

Mr. WOOLEY. I received a bill from Sears, Roebuck just last week.

Mr. HALPERN. If this is not so, is it true with other consumer credit retailing?

Mr. WOOLEY. With the permission of the chairman I would like to introduce Mr. Cianca who is an expert in retailing who is responsible for a number of retail clients who can answer the question which you directed and which is also related. He is here, sitting right in back of me. I would like to have him answer the question.

Mr. CIANCA. Thank you. All invoices on revolving credit will state 1½ percent. It also will state what the service charge was for a month. They will have opening charge, new purchases, credits, final balance. They also will state what is required of a payment from a customer on a revolving credit term. Each customer is appraised for credit purposes and the store tells the lady she may buy $100 worth of purchases over a period, 6 months, say.

If she pays one-sixth each month she can then buy another sixth. So the $100 goes as revolving credit. She buys and pays and buys and pays. Those terms are spelled out on the statement she gets monthly. It is also spelled out in the application she makes whenever she comes in for her credit.

This is pretty generally true of all the chain stores.

Mr. HALPERN. Isn't she allowed to buy more than that $100? Buy and buy?

Mr. CIANCA. Not on her credit. She is given the credit limit of $100. If she goes over it they will stop her buying. If she pays—for instance, the first month if she pays one-twelfth of that hundred dollars they may buy that again. If she doesn't pay that one-twelfth, she can't buy until the $100 is down. She can only buy up to that $100 limit.

Mr. HALPERN. May I go back to Dr. Wooley?

Mr. WIDNALL. Will the gentleman yield? I would like to ask Mr. Cianca a question.

My son and my son-in-law, who live in two entirely different places, have told me about their experiences with Sears, Roebuck in trying to establish a normal credit account—not a revolving fund account. On two different occasions they made applications for such an account and they never received approval of such an account. One purchased some furniture, with the understanding that he was to pay within 30 days. He was billed and the bill included interest. A revolving fund account was established—not at his behest, but set up by the store. My son-in-law had exactly the same experience when

d to establish a normal credit account. They both receive good ...ries, they can prove their credit standing completely, but they have not been able to establish a normal credit account with Sears, Roebuck.

I would like to have the answer.

Mr. CIANCA. I don't know.

Mr. WIDNALL. I will furnish you the documentation of it. The whole question is, Are you going to have a revolving account or not?

Mr. CIANCA. Certain stores have an option account whereby you have the option to use the revolving credit or pay off in 30 days.

Mr. KIMBALL. Madam Chairman?

Mr. CIANCA. And you are given credit to use either the revolving credit account.

Mr. WIDNALL. Do you have any kind of normal credit account that doesn't end up as a revolving account?

Mr. CIANCA. Sure.

Mr. WIDNALL. It is possible to delay payment beyond 30 days without being charged interest?

Mr. CIANCA. In Sears, particularly, I don't know.

Mr. KIMBALL. Madam Chairman.

Mr. HALPERN. I will yield further.

Mr. KIMBALL. In Kimball's store when they come in and apply for a credit account we ask them to fill out the application, we give them this form. We tell them there is only one type of charge account we have. It is known as an optional credit account. They can do what they want with it. They can pay in 35 days, we give them 5 days of grace over most stores and there is no service charge ever put on their account.

If they want to extend it into 6 months or 12 months payment plan, that is their option. We do tell them, as Mr. Cianca said, we do put a ceiling on their account. We tell them they can go to $200, $500, $100, and when they get up there and start going over it our credit manager will call them and tell them they will have to make bigger payments to get their outstanding amount down. We only have one account and to my knowledge Sears, Roebuck has only one type of account, and that is the optional.

So, if you want the option of paying in 30 days you pay in 30 days.

Mr. WIDNALL. I would certainly think that a person who applies for credit at a store fills out a formal credit application, and does it twice, two different times over a period of months, would at least be entitled to an answer from the store at one point or another.

Mr. KIMBALL. I agree with you. They are entitled to an answer and should be explained clearly. My girls are instructed to explain to each and every customer who applies just exactly how this works.

As far as I know they do a satisfactory job because we don't get many complaints. There are human beings and individuals working in large corporations like Sears, Roebuck and the human factors comes in and if they get—just like the girl at Lechmere Sales—she didn't tell me and yet the law requires in Massachusetts that she should tell me 18 percent.

Mrs. SULLIVAN. Mr. Cianca, there is some confusion here about your affiliation. We thought you were from Sears but, apparently,

you are not. Would you introduce yourself for the record, and tell us who you represent?

Mr. CIANCA. I am a partner in the New York office of Touche, Ross, Bailey & Smart.

Mr. HALPERN. Mr. Cianca, if this customer was stopped at $100 and she is paying 1½ percent, isn't that 18 percent a year?

Mr. CIANCA. You are going to get me involved in the applied and effective rate. It is applied at 18 percent. The effective rate would be something different. All I say is, you take my 1½ percent on the $100, at that period—my billing is usually on the 17th of a month. When I get my bill on the 17th of the month, that 1½ percent is applied to the balance. That is an applied rate, that 1½ percent.

Mr. HALPERN. I would like to go back to Dr. Wooley if I may.

Dr. Wooley, I listened to your presentation and it may be that no one customer paid 18 percent per annum on their revolving accounts. How many of those customers actually paid 1½ percent per month?

Mr. WOOLEY. I don't have that answer—1½ percent on their monthly balance? All of those but four who paid zero percent had some service charge account attached. Exactly how many payments I don't know. I can't recall. There are 40 records with a multiplicity of items.

Mr. HALPERN. Mr. Kimball, I would like—incidentally, I would like to thank Mrs. Newman for her emphasis on what is probably the major point to bear in mind in terms of annual rate on revolving credit accounts; that is, whatever arguments can be mustered against a statement of an 18-percent annual rate would apply equally to the 1½-percent monthly rate.

Now, Mr. Kimball, first, on what grounds can you suggest that 1½ percent is more accurate when the validity of this rate will also depend completely on the time limit of purchases and payments and is it not true that if the purchaser is paying 1½ percent a month he is also paying 18 percent a year?

If he is not paying 18 percent a year neither is he paying 1½ percent per month.

Mr. KIMBALL. In answer to the first question, I think what we tried to do as merchants is to serve our customers and explain to them in the language they can understand. Now, we have many customers each day in our store and so does every store in the country, and they can find fault with the paper bags, they can find fault with the way zippers are put in, they can find fault with the way certain things last or garments wear, and we try to make every operation with our customer so that we don't get into any arguments with them.

By saying 1½ percent per month, a customer can understand this. We tell them we are going to put a service charge on their account and whatever their ending balance is, we multiply that by 1½ percent and we say service charge, 38 cents on a $25 balance. This a customer can understand.

Secretary Barr came to the Senate hearing with a table like this. I don't think any of the Senate committee could ever understand it.

Mrs. SULLIVAN. Mr. Kimball, he didn't apply that to revolving charges. I want to keep the record straight.

Mr. KIMBALL. How can you explain to a customer that you are charging him 18 percent when you are not charging him 18 percent

and the majority of the cases this chart shows that 39 out of 40 cases never even reached 18 percent?

Mrs. SULLIVAN. Mr. Keyserling, I wonder if you, as a distinguished economist, would want to get into this and comment on the 1½-percent monthly rate as against 18 percent a year.

Mr. KEYSERLING. I would like to comment on it, although I don't know whether I am annoyed or confused by some of the statements just put forth.

It seems to me that a very simple and elementary proposition is involved in the proposed legislation.

If I buy a Government bond or if I deposit money in the bank and they tell me they are going to pay me 3 percent per annum, compounded semiannually, they can also tell me how much I will get if I leave it there a year.

Now, it is perfectly true that neither they nor I know what I am going to get, because I might cash it in earlier, or I might miss out on a semiannual compounding by 1 or 2 days, and so forth. It is simply true they have—they are telling me on a yearly basis what this will earn.

Now, if I borrow money in the form of getting consumer goods on credit, and I start out at a 1½-percent monthly interest rate, I am starting out at an 18-percent annual rate, and not all the spinning of hairs around all the needle points in the world can destroy that fact. And this plain truth has nothing to do with the fact that very few customers may pay the 18 percent, because most of them liquidate the debt before the year is out. That has nothing to do with it. If they were charged 8 percent a month, they ought to be told they are being charged at the horrendous rate of 96 percent a year, and it would be no answer to that to say they might not have to pay the 96 percent because they might pay off in 6 months or 3 months.

That is a simple, elementary thing. I understand the questioning of the committee—I don't equally understand the answers.

I would say a word on service charges. It is very easy to get into a confusion by semantics. Let me call attention to the fact that the Government of the United States pays interest on the national debt. What do they call it? They call it servicing the national debt. So, in reality, the basic economic concept is how much it costs to borrow money—whether they borrow it to finance Government programs or to build a plant or whether they borrow it to finance consumer purchases. What hits them economically, what takes money out of their pocket, is how much it costs them. You can have all kinds of refinements and divisions between service costs and interests costs, but the fact remains that it is the cost of borrowing the money that counts. And if you have a system where it costs 1½ percent a month—just to take an arbitrary case—if you pay it back in 1 month, and if you hold it a second month you pay 1½ percent the second month plus a service charge, and if you hold it 3 months you pay 1½ percent for 3 months plus another service charge, the fact is that it is not unfair to add the whole thing up and say that this is the cost of borrowing over 3 months, and by the same token it can be translated into an annual basis.

I think it fair, sound, and right that the purchasers should know hypothetically what it will cost them to buy something on credit if they pay it back over a year, regardless of whether they may pay it back in 3 months, 6 months, and regardless of the fact that there may be a difference in the cost per month if they pay it back over different periods of time. I don't see all the complexity. Maybe I don't understand it.

Furthermore, the regulatory agency, if it be the Federal Reserve Board or any other, will have the brains, if it has the will, to work out the details of the question of exactly what is the correct computation on an annual basis, and if 18 isn't the right computation, then there is nothing in the legislation that conflicts with that. All the legislation says, as I understand it, is that there shall be a proper translation of the shorter period charge to an annual basis; 1½ comes to 18, as I see it. If it comes to 17½, I take it that it would equitably meet the purpose of the proposed legislation to tell the customer that it is 17½ on an annual basis.

So, I don't really understand what all the excitement is about.

Mrs. SULLIVAN. Thank you, Mr. Keyserling. This is exactly what we have been trying to do—to stop the confusion for the people who borrow the money or use somebody else's money for the things they would like to purchase. They have gone over this argument again and again for 7 full years in the other body. There is never going to be any meeting of the minds among those who are going to use the figures in a different manner from that in which they are customarily applied. We have gone into this numerous times in the last 10 days and we have gotten no closer to changing the minds of the retailers on this, nor have they come any closer to changing the minds of those of us who feel as Mr. Keyserling does.

So, I would like to go on to some other aspects.

Mr. HALPERN. Madam Chairman. I had the time and I certainly welcome the point that you raised with Mr. Keyserling. My time is up. But I had some questions that I did want to propose to Mr. Keyserling. I received the answers in the expressions of views that he just made and I certainly want to thank you for your very forthright and most welcome and valuable expression that you have just made.

Mrs. SULLIVAN. Mr. Stephens?

Mr. STEPHENS. I have one question I would like to ask and, of course, Mr. Kimball, I do not anticipate that you can answer it now but you might supply it for the record.

I have mentioned this to some other witnesses, too.

We are trying to get a comparative kind of figure so the consumer can see what he is paying for his money. That's the purpose of the legislation. Why would it be too much of a burden upon you to supply the historical account of the figures like Mr. Wooley has provided?

Would it be excessively burdensome costwise for you to provide at the end of the year what the customer actually paid out in the form of service charges? If we had this charge in retrospect? If the average was roughly 10 percent? How much extra charges would it cost to you? What would the cost to you be if you gave the consumer that information? The reason I asked that question is because if we are going to consider the fact that we are seeking to educate the consumer in the things that he should know, we don't have to do it by

an educational process of telling him ahead of time, we can begin the education now by saying at the end of the year, "We will let you know whether you paid 10 percent or 18 percent?" I would like to know how burdensome you would consider that?

You might not want to go into it now but would want to think about it a little bit and provide it for the record.

Mr. KIMBALL. I have an answer.

The majority of stores in this country are small stores. They are stores that do anywhere from $75,000 to a million dollars annual volume. We don't have computers, we don't have large staffs. Our margin of profit is very minute when compared to the total volume of business we have to do.

Just as I have to control my billing costs and saving on postage stamps and envelopes, any additional information such as you suggest—our machines do not have totals—could give us the total service charge. Our card has no space and Kimball's is a modern store. There are little "Pop and Mom" stores that don't have any machines at all.

Mr. STEPHENS. How many of the kind of stores that you have talked about use revolving credit?

Mr. KIMBALL. A great deal of them. This is becoming more and more prevalent because people are asking for extended terms. In other words, if they would pay their bills in 35 days or 60 days it wouldn't be too burdensome. But when they want the credit extended over 6 months or 10 months or a year we have to put a service charge on to encourage them to pay their bills faster.

But for me to keep a record, I have 7,000 accounts and then to take a total of each customer's purchases for a year and the total service charges and then figure that out and everyone would be a different answer, believe me—simple annual rate. If you came up with a formula—it would be complicated.

Mr. STEPHENS. Let me point this out.

Mr. KIMBALL. It would be very burdensome to the small stores of the country.

Mr. STEPHENS. I agree personally that you can't tell a man ahead of time how much he is going to pay. I agree with the thoughts of Mr. Wooley. I also would like to comment on the fact that I agree with what Mr. Keyserling says, too. That sounds like it is a paradox but it is not. We are not going to tell the customer the truth in the sense of what the retail merchant would consider a fair competitive interest rate if we tell him what you would have if you let his account go for the entire year and paid 1½ percent—it will amount to 18 percent if you go the whole year.

I can see the merchant's standpoint on it. Because the man looks at that and says if I am going to pay 18 percent I am going to borrow the money someplace else. But what you are saying is, he is not going to pay 18 percent if you have these other factors and I think that the answer to the thought that I had and the purpose that I have in mind in supporting any truth in lending proposition was to give the man an opportunity to compare, but I don't think it has to be in prospect. It can be in retrospect.

To conclude what I have to say, and pertinent to our inquiry, is the story I heard which concerned a man that had a country store. He gave credit to a farmer for his food and fertilizer as well as all the items

that he needed for his crop. At the end of the year the farmer didn't pay and he came and got a year's extension of his time. At the end of 2 years the farmer came in and paid in cash for all he owed. Then he went across the road to his creditor's competitor and loaded up his entire wagon with all kinds of goods and paid the competitor cash for everything. The first merchant accosted the farmer and told him he couldn't understand it. He said he carried him for 2 years and now when he had some cash money he went to his competitor to trade. The farmer looked at him in surprise and said, "I didn't know you sold for cash."

Mr. KIMBALL. This is true with customers. If they don't have the money they sometimes go to a store which loads the credit charge into the price of their merchandise and they say they don't put any service charge on their accounts at all but they have loaded the price and the customer, so long as he needs the credit will go to that store.

When he has cash he will go to a cash discount store, let's say, and he will do his purchasing there because he can buy it cheaper.

Mr. STEPHENS. To conclude, I wish you would give a little more thought to providing an answer. If you could, break it down into an annual cost to you in money as to what this would be. If you can do that, I could see what we are requiring if that is the method we should devise.

Mr. KIMBALL. I will see if our association can gather some figures for you.

Mrs. SULLIVAN. We are not quite finished with you, gentlemen. You have all so much to give us on this legislation that it is a shame that we can't ask all the questions we would like.

However, if we can submit further questions to you in the next few days I hope that you will be able to give us written answers for the record when you correct your transcript.

In the meantime, please stay where you are seated and I will ask our afternoon witnesses to join you. We have learned that we can't meet this afternoon. The two witnesses that we were going to hear then are here in the audience, so we will call them now—Prof. Vern Countryman and Mr. Charles S. Stapp. I wonder if you two gentlemen would come up to the table.

Mr. Countryman, if you can summarize your statement in 10 minutes, we will then start the questioning with Mr. Fino and Mrs. Dwyer who haven't had a chance to do any questioning. We will keep on going until the bells ring, calling us to the House floor.

Mrs. Dwyer, would you like to introduce your constituent, Mr. Stapp?

Mrs. DWYER. Madam Chairman and members of the subcommittee, it is a special pleasure for me to welcome our next witness, Mr. Charles D. Stapp, president of the National Retail Furniture Association. Mr. Stapp is from Westfield, N.J., a valued constituent, and one of my congressional district's most outstanding citizens and civic leaders.

Mr. Stapp has distinguished himself greatly in his chosen field. President of Koos Bros. of Rahway, N.J., one of the East's great retail furniture establishments, Mr. Stapp has also served as chairman of the board and, for three terms, as president of the New Jersey Furniture Association. In recognition of his leadership in the industry, he was presented the New Jersey association's annual award and

he has also received the "All American Merchant Award" and the "Annual Achievement Award for Retailing in New Jersey."

But Mr. Stapp has also applied his talents and leadership to the broader problems of good citizenship. He is a director of the New Jersey region of the National Conference of Christians and Jews, chairman of its finance committee, and a member of its advisory board on police training. On two occasions, he has received that organization's Brotherhood Award—in 1966 for distinguished service in the field of human relations, and in 1964 for community organization.

Mr. Stapp's credentials both as citizen and industry leader are excellent, and I am sure the subcommittee will benefit greatly by his testimony today on an issue that affects all Americans so very directly.

We appreciate your being with us, Mr. Stapp.

Mrs. SULLIVAN. Mr. Stapp, will you summarize your statement?

STATEMENT OF CHARLES D. STAPP, PRESIDENT, KOOS BROS., RAHWAY, N.J., AND PRESIDENT, NATIONAL RETAIL FURNITURE ASSOCIATION

Mr. STAPP. Madam Chairman and members of the committee, I am Charles D. Stapp, president of Koos Bros., of Rahway, N.J. I am a retail furniture dealer and president of the National Retail Furniture Association whose members operate more than 9,000 independent home furnishings speciality stores throughout the United States. I will not read our full written statement, but with the help of a few charts, I will summarize our position.

Today, I am appearing on behalf of the National Retail Furniture Association and five other national associations: The National Appliance Radio & TV Dealers Association, the National Association of House to House Installment Companies, the National Association of Music Merchants, Inc., the National Retail Hardware Association, and the National Sporting Goods Association.

Accompanying me here today are: Spencer A. Johnson, director of government relations for the National Retail Furniture Association, Richard D. Heuser, credit sales manager, of Duff & Repp, Kansas City, Mo., representing the National Retail Furniture Association; A. F. Ramsey, comptroller, Campbell Music Co., Washington, D.C., representing the National Association of Music Merchants; James Fulford, president of Fulford's-Colony Radio & Television Co., Washington, D.C., representing the National Appliance Radio & TV Dealers Association, and Hardy Rickbeil, chairman of the board of Rickbeils, of Worthington, Minn., representing the National Retail Hardware Association.

I am speaking for a group of independent retail merchants who operate more than 45,000 stores up and down the main streets of cities and towns throughout the United States. They are the hometown merchants who support the local little league baseball teams, and who serve as block captains for the United Fund Campaigns, and who buy the ads in the high school yearbook. Most of these 45,000 stores are and always have been family-owned businesses.

Our associations agree with the idea of full disclosure of credit service charges. We support the basic objectives of the truth-in-lending bills. We encourage our members to provide a detailed expression of credit charges to all customers.

We have joined together as a group to represent the noncomputer retail stores who are concerned about the unfair treatment that would be arbitrarily thrust upon them under the provisions of the truth-in-lending bill passed by the U.S. Senate, S. 5.

Because we are presenting the common views of six associations, we are prepared to discuss only the features of the bills that concern credit disclosure. We have not had time to fully study and reach inter-association agreement on the other provisions of H.R. 11601.

Our noncomputer stores are concerned about the revolving credit compromise which is a special formula that gives those who offer revolving credit a competitive advantage over those who sell on installment credit. In effect, S. 5 is a regulation of installment credit only and does not offer customers the opportunity to compare credit service charges offered under different credit plans. Our noncomputer stores are concerned about the way that S. 5 discriminates between two types of revolving credit.

In passing S. 5, the Senate defined three different types of credit and has given special treatment to one type of revolving credit plan—the plan used principally by our giant chainstore competitors. Most of our specialty stores, however, use installment credit and are forced to disclose an annual rate under the terms of S. 5. Even those of our specialty stores that do use revolving credit plans face a competitive disadvantage in that they typically retain title and have to disclose the annual rate while their large store competitors who do not retain title, are free to disclose the monthly rate of 1½ percent. We agree with the statement Secretary Barr gave earlier in these hearings, that the special exemption given to revolving credit does discriminate against our small independent specialty stores.

In the minds of customers, rates of 1½ percent a month and 18 percent a year are not identical. The difficulty of explaining the two different rates to customers is a practical one. Mr. A. G. Bassham in his testimony before the Senate in behalf of the National Retail Furniture Association related his firm's experience in explaining credit rates to about 200 new customers. In the study done in his store, some customers were told the credit service charge on the new account they were about to open would be 1½ percent a month, while other customers opening new accounts under the same terms were told the credit service charge would be 18 percent a year. Each time the store's credit counselor quoted the 18 percent rate he was involved in a 30- to 45-minute discussion of what it was going to cost the customer, but when the credit counselor quoted the 1½ percent rate it was quite readily understood and accepted by the customer.

We are convinced, therefore, that the definition of three different types of credit in S. 5 does not aid easy consumer understanding and does not permit the customer to readily understand, compare, and determine which credit plan is the cheapest. In fact, S. 5 does just the opposite. It really makes it more difficult for customers to compare credit costs.

In addition to the need for provisions in a truth-in-lending bill that will permit easier consumer understanding of credit charges, any legislation enacted by Congress should have universal application to all consumer credit transactions.

S. 5 would require annual rate disclosure for nearly all credit sales made in our smaller specialty stores but would barely touch the credit

sales of our big competitors. Mr. William M. Batten of J. C. Penney Co. disclosed this when he testified in the Senate that his company had $400 million on their revolving credit accounts but only $40 million on their time payment or installment-type accounts.

On page 18 of our written statement there is a chart that compares two similar transactions of $400—one on a revolving credit plan without title retention, the other on an installment credit plan. On the revolving plan where the credit service charge would be $13.50, the store could quote a rate of 1½ percent. But, on the installment plan with the 90 days of free time that is a general and widely used practice in many small independent specialty stores particularly those in the furniture industry, there would be no credit service charge at all—yet the store would be required to quote a rate of 18 percent merely because the store retains title to the merchandise until it is paid for.

Problems like this would be eliminated by any bill that provides for the universal application of an identical rate for all consumer credit transactions. Universal application of an identical rate would automatically eliminate the false standards such as title retention, length of terms, and method of repayment that have been established in S. 5 to separate the various types of credit plans.

Although we want to point out the discrimination contained in S. 5, we did not come here today merely to talk about what we don't like. We are here to suggest solutions to the problem of discrimination within revolving credit itself. There are four basic methods for eliminating the discrimination. Each method provides for the universal application of a single disclosure method for all consumer credit transactions.

One solution is dollars and cents disclosure, or a variation in the form of dollars per hundred per year or cents per $10 per month. The Governor of Illinois has recently signed into law a bill that requires disclosure in dollars and cents.

A second solution is a monthly percentage rate for all transactions. A monthly rate can be computed for installment credit merely by dividing the annual rate by 12.

The third solution is a combination of both monthly and annual disclosure for all transactions. This is the type of disclosure that S. 5 now requires for the so-called "installment open credit plans," the revolving credit plans with title retention. The annual rate is determined by multiplying the monthly rate by 12.

The fourth solution shown in the one least understood by customers. It is an annual percentage rate for all transactions.

No segment of retailing should be given by law a competitive merchandising advantage over any other segment selling similar goods by being allowed to disclose credit service charges in a more favorable manner.

If Congress really wants consumer understanding of credit terms—

If Congress really wants meaningful disclosure—

If Congress really wants to eliminate discrimination in the marketplace—

If Congress really wants to provide equitable treatment for small independent merchants as well as for the giant mercantile establishments—

Then, we believe, this committee will not accept the discriminatory provisions of S. 5, but will require all consumer credit transactions to disclose credit service charges on a similar basis.

Our six associations, and the more than 45,000 members we represent, will support any of the four credit disclosure proposals that is given universal application to all consumer credit transactions.

We urge the committee to support our recommendations for fair-play and to put all stores, both the giant merchantile establishments and the small independent noncomputer specialty stores, on an equal footing in the method of disclosing credit service charges. In this way, customers can be given a basis to compare and determine which is the cheapest rate available in the marketplace.

(The full statement of Mr. Stapp follows:)

STATEMENT OF CHARLES D. STAPP, PRESIDENT, KOOS BROS., RAHWAY, N.J., AND PRESIDENT, NATIONAL RETAIL FURNITURE ASSOCIATION

I am Charles D. Stapp, President of Koos Brothers of Rahway, New Jersey. I am a retail furniture dealer and President of the National Retail Furniture Association whose members operate more than 9,000 independent home furnishings specialty stores throughout the United States.

Today, I am appearing in behalf of the National Retail Furniture Association and five other national Associations: the National Appliance Radio & TV Dealers Association, the National Association of House to House Installment Companies, the National Association of Music Merchants, Inc., the National Retail Hardware Association, and the National Sporting Goods Association. I am speaking for a group of independent retail merchants who operate more than 45,000 stores up and down the main streets of cities and towns throughout the United States. They are the home-town merchants who support the local little league baseball teams, who serve as block captains for the United Fund campaigns, and who buy the ads in the High School yearbook. Most of these 45,000 stores are and always have been family-owned businesses.

Our Associations agree with the idea of full disclosure of credit service charges. We support the basic objectives of the Truth In Lending bills. We encourage our members to provide a detailed expression of credit charges to all customers.

We have joined together to represent the non-computer retail stores who are concerned about the unfair treatment that would be arbitrarily thrust upon them under the provisions of the Truth In Lending bill passed by the U.S. Senate, S. 5.

Because we are presenting the common views of six Associations, we are prepared to discuss only the features of the bills that concern credit disclosure. We have not had time to fully study and reach inter-association agreement on the other provisions of H.R. 11601.

Our non-computer stores are concerned about the revolving credit compromise which built into S. 5 a special formula that gives those who offer revolving credit a competitive advantage over those who sell on instalment credit. In effect, S. 5 is a regulation of instalment credit only and does not offer customers the opportunity to compare credit service charges offered under different credit plans. Our non-computer stores are also concerned about the way that S. 5 discriminates between two types of revolving credit.

And so we are here today to do three things. First, to ask the committee to put all consumer credit transactions on an equal footing by requiring stores using credit service charges of any type to disclose these charges on an identical basis. A common denominator applied to all forms of credit is the only standard which will enable consumers to compare and determine which is cheapest. Second, we are here to suggest methods for eliminating the discrimination contained in S. 5. And third, we are here to offer the support of the more than 45,000 independent retail stores for a consumer credit disclosure bill that applies universally to all consumer credit transactions.

During the past seven years, there has been much discussion about the need to give the customer information about consumer credit charges that will let her compare credit costs so she can make wise use of credit. Any bill to assist the customer to do this should be based on two underlying characteristics: Consumer Understanding and Universal Application.

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

costs, and a 30 year mortgage calculated at 6¼ percent (not necessarily the annual rate as prescribed by the proposed statutes) involves an interest cost of $23,993.00. (S. 5 Senate Hearings 1967, p. 593). This total dollar interest assumes that the family involved can avoid such a charge by not purchasing the home. This is unrealistic. If the family continues to rent a home or an apartment, a significant portion of the monthly and annual rental is comparable "interest" on the landlord's investment. Since the Congress, through FHA and many other statutes, has endeavored to increase home ownership by individual families, total dollar interest charges on mortgages may, without detailed explanation, create substantial consumer misinformation. The annual interest rate alone would appear to be most helpful to the public, in comparing alternate sources of credit and whether to continue renting or to buy.

3. Intermediate sized transactions. Where the credit involved is intermediate in size—major appliances, clothing, home furnishings, musical instruments, and the like—there is maximum competition between credit grantors, both retail and financial agency, and the consumer has the greatest variety of alternate credit plans available. Full disclosure of all details which distinguish the credit service charge from the cash price are essential. Two questions of major importance then arise: (a) what method of stating credit service charges is most useful to the public; (b) what method of stating credit service charges maintains effective competition best and discriminates least between competitors?

Where a large group of items falling in the intermediate classification are purchased at one time, the credit is commonly multi-year and the likelihood of substantial prepayment small; such might be the complete furnishing of of a new home. Here the most appropriate statement of the credit service charge would appear to be some sort of rate. Percentages mean more to some people; dollars-per-hundred appear to mean more to others. And this technique does not appear to upset the competitive situations between retail credit grantors and financial institutions.

For the convenience of both customer and credit grantor, various types of revolving or "open-end" credit have been developed and have grown rapidly during the last twenty years. Characteristically, these give the customer a "free ride" or limited period after purchase without credit service charge; up to a credit limit, the customer can add-on purchases at her discretion; credit charges are calculated currently each month or billing period; the customer can pay in full during any month without credit charge for the month of liquidation.

In the case of the individual consumer, the monthly cost is vital because the consumer can avoid further finance charges during any month by paying in full before the next billing date. The annual equivalent rate may be helpful in some comparisons but is believed to be definitely secondary in this particular consideration.

When competition between credit grantors is considered, the major consideration is that each competitor (retailer or financial institution) be required to quote the consumer identically for the same credit offer. In dealing with people, in addition, identical offers have both factual and psychological sameness and differences. Rates of 1½ percent a month and 18 percent a year are not psychologically identical to consumers.

As Dr. Haring has pointed out, the difficulty of explaining the two different rates to customers is a practical one. Mr. A. G. Bassham in testimony on S. 5 in behalf of the National Retail Furniture Association related his firm's experience is explaining credit rates to about 200 new customers. He told the Committee that some of his store's more experienced credit counselors were asked to alternate their method of disclosing the cost of their credit plan to customers. Some customers were told the credit service charge on the new account they were about to open would be 1½ percent a month, while other customers opening new accounts under the same terms were told the credit service charge would be 18 percent a year. Each time the credit counselor quoted the 18 percent rate he was involved in a 30 to 45 minute discussion of what it was going to cost the customer, but when the credit counselor quoted the 1½ percent rate it was quite readily understood and accepted by the customer.

Another furniture store using a revolving credit plan has developed a small chart (attached as Exhibit A) designed to illustrate to the customer the amount of the credit service charge and how it is computed. The chart is a copy of a customer account card that shows the amount of the purchase, the monthly payments, and the amount of the credit service charge added each month by the store on a typical revolving charge account. By adding up the monthly credit service charges, which are listed in a special column, the store demonstrates that

the 1½ monthly service charge amounts to $8.40 for a year on an original balance of $100. This provides the store credit personnel a convenient way to explain to the customer that this credit charge is less than the $10 per $100 per year on the original balance charged by competing stores on instalment credit sales.

To meet the purposes stated for both H.R. 11601 and S. 5, therefore, it is important that credit service charges be disclosed in an equitable and identical manner that will meet the one basic test: consumer understanding.

UNIVERSAL APPLICATION

In addition to the need for provisions in a Truth In Lending bill that will permit easier *consumer understanding* of credit charges, any legislation enacted by Congress should have *universal application* to all consumer credit transactions. If disclosure of the credit service charge as a monthly percentage rate is to be required for one type of revolving credit plan, then all consumer credit transactions—including other types of revolving credit plans and instalment credit plans—should be required to disclose the credit service charge as a monthly percentage rate.

The Senate passed bill S. 5, however, does not have universal application to all types of credit, but discriminates against the small non-computer stores.

S. 5 permits the large stores using revolving credit to quote their credit service charge as a monthly rate, but forces small stores using installment credit to quote an annual rate. As a result, the effect of S. 5 is one of regulating installment credit solely, while permitting certain types of revolving credit to disclose their credit service charge in monthly terms that the customer cannot conveniently compare with alternative sources of credit that are required to be disclosed in annual percentage rates.

COMPARISON OF CREDIT SERVICE CHARGE DISCLOSURE REQUIREMENTS UNDER THE S. 5 "COMPROMISE"

Type of credit plan:

Installment Credit—with or without title retention, 18 percent a year.

Revolving Credit—without title retention, 1½ percent a month.

Installment Credit—with or without title retention. 18 percent a year.

The Senate itself recognized the discrimination contained in the bill, but because of the delicate political "balance" that had been arranged to get the bill out of committee and to the Senate floor, the Senate was not able to make changes in the bill. However, several Senators, including some members of the Senate Banking and Currency Committee pointed out the discrimination during the Senate floor debate. One of them, Senator Thomas J. McIntyre of New Hampshire pointed out the discrimination in S. 5 by saying:

". . . almost every witness before the Committee indicated that creditors disclosing in monthly terms will be given a competitive advantage over the others . . . . I think that it is unfortunate that those merchants generally able to qualify for monthly disclosure will be the large, well-financed enterprises who will be directly competing, in some product lines, with the small, poorly financed, local small businesses such as furniture stores, auto accessory dealers, and others who will be required to disclose in annual terms. I think that this is truly unfortunate consequence of the present bill."

Another member of the Senate Banking and Currency Committee, Senator Charles H. Percy of Illinois, called attention to the discrimination within the two types of revolving credit "in the hope that some solution will ultimately be worked out, as the bill proceeds through the legislative process." The Senator pointed out that S. 5 defines two different types of revolving credit—revolving credit plans in which the title to the merchandise passes to the buyer at the time of the purchase, and revolving credit plans in which the seller retains title to the merchandise until the customer has made the final payment for it. Under the provisions of S. 5, the seller using a revolving plan without title retention is permitted to disclose a monthly percentage rate, while in an identical transaction under the same repayment terms, the seller using a revolving plan with title retention will have to disclose an annual percentage rate.

Senator Percy gave this illustration:

"This is an area in which the customer will have great difficulty trying to compare credit charges. On one side of the street, for example, a . . . (large merchantile) . . . store could state that the finance charge on a $300 sofa would be 1½ percent per month, while across the street a . . . (specialty) . . . store selling the same $300 sofa on the same repayment terms with the identical

finance charge would have to tell the customer the finance charge would be 18 percent a year."

"The two disclosure requirements result from the fact that in one case the seller retains title to the merchandise until it is paid for and in the other case he does not. This kind of discrimination is to be regretted, despite the fact that the committee worked diligently to find a way to work out the most equitable answer to a truth-in-lending bill that is aimed at giving consumers the kind of protection that experience has found is required in our present economy."

The inequity of the use of title retention (security interest) as a characteristic in determining the method of disclosure is also pointed out by our economic consultant Dr. Albert Haring:

"Nothing about open-end credit plans or revolving credit plans, as methods of granting and administering credit, appear to be tied to passing title to the buyer immediately, to the size of the credit, or to the amount of the minimum monthly payment. Although certain stores commonly pass title immediately under their revolving credit plans, certain other types of retailers, mainly independent specialty stores do this less frequently. The same problems of "free ride" and monthly consumer choice about payment (above minimum) affect the equivalent annual interest rate. Regardless of what decision the Congress may reach about these problems, avoiding serious discrimination between credit grantors offering the public comparable credit arrangements should, it is believed, have a high priority.

"Large stores and smaller specialty stores are direct competitors in both merchandise and services, and credit is an important service. Customers who make frequent purchases in a store, because of the many departments within the store, have a high degree of interest in maintaining their credit rating with that store and, therefore, the need for title retention is greatly lessened. On the other hand, in specialty stores with a single line of merchandise, where customers purchase less frequently, there is a greater need for title retention. Stores with many departments often include a furniture department, an appliance department, a musical instrument department, a sporting goods department, a hardware department; each of these major departments can be considered as a specialty store within the large store (and sometimes such departments are leased to specialty store operators). The consumer knows this and shops at both the special departments of these stores and at the specialty stores. Should not both be required to quote identical credit terms for the same credit offer to the public?"

The economic advantage that the discriminatory provisions of S. 5 will give to large stores using revolving credit plans is confirmed in a recently completed study by a research firm that analyzed why the consumer buys where she does.

The $120,000 study, commissioned by the National Retail Furniture Association and 17 other organizations in the home furnishings field, was conducted by three research firms: National Family Opinion, Inc., Toledo, Ohio; Social Research, Inc., Chicago, Ill.; and Arthur D. Little, Inc., Cambridge, Massachusetts.

The results of the study—reported at a special conference here in Washington, D.C., this week—demonstrate that the customer makes her decision on where to shop for home furnishings largely on the basis of store reputation. The study reveals that home furnishings shoppers will not visit a store that does not have a "good" reputation in the community. Thus, S. 5, which would permit large stores selling home furnishings to quote a monthly rate of 1½ percent would give furniture stores quoting an annual rate of 18% a reputation of being "bandits" who charge a high credit service charge, even though the actual credit charges are the same in both stores.

Retailers for many years have been divided into two groups, large mercantile stores and smaller specialty stores. The stores our Associations represent here today are in the smaller specialty group. Yet, both groups carry many of the same items for sale. Of the many competitive services offered, credit is high on the list. More and more specialty retailers are responding to customer demand by switching to revolving credit. If Congress permits stores to continue to respond to customers desires—and does not establish road-blocks to hinder this movement—I am sure that there will be even more progress in this direction in the years ahead.

Years ago the 30-day charge account was beset with the problem of paying in full each month and out of this problem grew the option to pay in full or monthly. So it took on aspects of the time payment instalment plan. The main difference was that the service charge was computed monthly. At the same time, the instalment sales plan moved toward an open-end plan with the service charge computed monthly.

Today the two plans are essentially the same. The principle difference between our specialty stores and the large mercantile stores is the size of the transactions, and in some cases, title retention.

SPECIALTY STORE REVOLVING CREDIT

Specialty store revolving credit plans (with title retention) today have all the payment characteristics of typical large mercantile store revolving credit without title retention. Specialty store plans require an initial revolving credit account agreement to be signed the same as on a large mercantile store revolving account. The customer has a free time period or "free ride" during which the account can be paid in full with no credit service charge applied. This free time can run from 30 days up to 59 days, or even longer. As in typical revolving credit plans, the credit service charge is payable and applied after the free time has expired, at a rate of typically 1½% a month. The customer may pay any amount she wishes each month, either the agreed minimum payment, which often is as low as $5.00, or any larger amount. Many customers pay their accounts up well ahead of time, thus reducing their credit service charges. The store sets only minimum payments. These specialty store open-end revolving accounts are identical with large mercantile store open-end revolving credit with the single exception that they retain title until the goods are paid for. Otherwise, there is no distinction between them, and it is discriminatory to require disclosure of the credit service charge at an annual rate on a revolving account which has title retention, and permit disclosure at a monthly rate if the revolving account does not involve title retention. Title retention has nothing to do wih disclosure of the cost of credit. Therefore, we recommend that any bill approved by your Committee have universal application to all credit transactions without regard for whether or not title (or any security interest) is retained until the merchandise is paid for.

Any treatment that is universally applied to all consumer credit transactions wil eliminate the need for establishing false standards such as title retention, length of terms, and method of repayment; and at the same time will accomplish the goal of helping customers determine which credit plan is the cheapest.

Attached to this statement as Exhibit B is a copy of a monthly account statement used by one of our member stores, Breuner's, of Sacramento, California. The statement form has all of the characteristics of a statement of a typical large mercantile store open-end revolving account statement—except that under the Breuner Revolv-A-Count, the title to the merchandise remains with the store until it is paid for.

WHY SPECIALTY STORES RETAIN TITLE

Many questions have been asked about why our specialty stores do not just give up title retention and offer a revolving credit plan without title retention. This, we are told, would permit specialty stores to compete with large mercantile store revolving credit plans under the provisions of S. 5.

It would be impractical for us to do so. We are in no position to compete in this way with the retail giants who have the sales volume and financial resources to offer two or three types of credit plan.

Our non-computer stores are essentially small independent family-owned businesses that could not afford to install the kind of expensive bookkeeping and computer equipment needed to operate several kinds of accounts.

Our stores operate in a much smaller universe of credit than do the retail giants. Many large stores with open-end credit, some with large national chain operations, are able to "spread the risk" of their credit operation over a wide universe and into many various types of merchandise. Our stores, on the other hand, have a much smaller number of customers and a limited line of merchandise. Therefore, there is a much smaller universe of credit over which to spread the risk. As a result, our stores must maintain a more direct security interest in the merchandise until it is paid for.

In addition, if title retention was dropped many "marginal credit risks", the very people the Truth In Lending bills are designed to help, would be screened out and denied credit which is now available to them under title retention credit plans.

In general, the stores we represent have over a long period of time established a method of doing business that fits their type of merchandise and satisfies the customer by giving her what she wants. Such methods of doing business, carefully worked out in an industry, are not changed instantly merely by the enactment of a new federal law.

CONSUMER COMPARISON

The difficulty the customer will face in comparing the costs of credit under the provisions of S. 5 can be illustrated by a comparison of similar transactions. For example, take a sale of $400 to be repaid in 4 regular payments. On a typical revolving account, the customer would get the first month as "free time" with no credit service charge. The second month the credit service charge would be $6.00, the third month $4.50, and the fourth month $3.00, for a total credit service charge of $13.50. Under the provisions of S. 5, the customer would be told the credit service charge is 1½ percent a month. On the same sale on an instalment account at a typical specialty store, the customer would get 90 days "free time". A "free time" period of 90 days is a general and widely used practice in independent furniture and other specialty stores. Therefore, by making four payments of $100 each, one at the time of the transaction and one each 30 days thereafter, the customer would pay no credit service charge at all. Yet under the provisions of S. 5, the customer would have to be told that the credit service charge is 18 percent a year—merely because the store retains title (security interest) in the merchandise until it is paid for.

	Revolving, 1½ percent, 30 days free time		Installment, 18 percent, 90 days free time	
	Amount	Credit charge	Amount	Credit charge
1st payment	$100.00	0	$100.00	0
2d payment	106.00	$6.00	100.00	0
3d payment	104.50	4.50	100.00	0
Final payment	103.00	3.00	100.00	0
Total		13.50		0

There is no basic difference in the specialty store open-end revolving account and the large store open-end revolving account. What minor differences there are certainly do not warrant putting a whole new restrictive provision on this type of consumer credit. The distinction between these two types of credit is not in the area of title retention. The difference between them is in whether the entire credit service charge is computed at the time of the transaction and applied as an "add-on" to the amount to be financed, or whether the credit service charge is computed monthly and billed to the customer on her monthly statement.

To provide for truly universal application, not only should the two types of revolving credit be required to disclose their credit service charges in similar terms, but similar disclosure terms should apply as well to retailers who sell under conventional instalment credit plans.

DISCRIMINATION BETWEEN INSTALMENT AND REVOLVING CREDIT PLANS

It would be most unfair and confusing to customers to require retailers who sell on conventional installment plans to state an 18% *annual* percentage rate, while at the same time permitting retailers selling the same goods on an open-end revolving credit plan to state a *monthly* rate of 1½% even though they amount to the same thing. This would be a severe form of discrimination against retailers selling on conventional instalment sales contracts, particularly the smaller retailers who have not yet changed over to revolving credit.

A store using an open-end credit plan is not limited as to the type of merchandise that may be charged to it. All kinds of items can be charged, big ticket items as well as small ticket items. The big difference is that 80 or 90% of the goods sold in our specialty stores are durable goods whereas 80 or 90% of those sold in the large stores are consumable goods. For example, Mr. William M. Batten of J. C. Penney Company testified in the Senate that they had $400 million on their regular revolving credit accounts and only $40 million on their time-payment accounts.

The stated objective of the legislation has long been to enable consumers to shop for credit and to make meaningful comparisons of the cost of credit offered by competitors. Requiring one merchant to state an annual percentage rate on a mattress and box spring set, for example, and allowing his competitor across the street selling the same mattress and box spring set to quote only a monthly rate, is not the way to make it easier for consumers to shop for credit and make meaningful comparisons of the cost of credit.

To the uninitiated, the wide difference between 1½% and 18% would cause decisions to be made in favor of large mercantile stores over principal competitors. The end cost to the customer is the same. To the small business man, the independent specialty store owner, the result could be disastrous. He has neither the personnel nor the time nor the technical knowledge to convince customers that the annual percentage rate and the monthly percentage rate result in the same cost. Even more seriously, the different forms of disclosure could actually mislead the customer who is denied the information she needs for making a wise choice of credit terms. We urge you to abandon this approach.

SOLUTIONS TO THE PROBLEMS OF DISCRIMINATION

Although we want to point out the discrimination contained in S. 5, we did not come here today merely to talk about what we don't like. We are here to suggest solutions to the problem of discrimination between revolving and instalment credit and discrimination within revolving credit itself. There are four basic methods for elminating the discrimination between revolvng and instalment credit and, at the same time, eliminating the discrimination between the various types of revolving credit. Each method provides for the universal application of a single disclosure method for all consumer credit transactions.

One solution is dollars and cents disclosure, or a variation in the form of dollars per hundred or cents per $10 per month. Customers readily understand credit service charges that are expressed in dollars and cents. It has been demonstrated that disclosure in dollars and cents can be written into a credit disclosure bill. In Illinois, for example, the Governor recently signed into law a bill that requires disclosure of credit service charges in dollars and cents. Section 27 of the new Illinois statute stipulates the amount in dollars per hundred per year that can be charged on various dollar levels of credit. Section 28 specifies the amount in cents per ten dollars a month that can be applied as a credit service charge on revolving charge accounts.

If the Committee decides that a percentage rate should be disclosed, in addition to dollars and cents, our second suggested solution is a monthly percentage rate for all transactions. A monthly rate can be computed for instalment credit simply by *dividing* the annual rate by 12.

The third solution we suggest is a combination of monthly and annual disclosure for all transactions. This is the type of disclosure that S. 5 now requires for the so-called "instalment open-end credit plans"—the revolving credit plans with title retention. Here, the annual rate is determined by *multiplying* the monthly rate by 12.

Our fourth solution is the one least understood by customers—an annual percentage rate for all transactions.

SUPPORT UNIVERSAL APPLICATION OF DISCLOSURE

As I stated at the opening of my statement, the non-computer stores represented by the Associations I speak for today are sympathetic to full disclosure of credit service charges on consumer credit transactions.

There should be no discrimination in disclosure requirements against retailers who sell under conventional instalment plans and in favor of retailers selling the same goods under various forms of revolving credit plans.

No segment of retailing should be given by law a competitive merchandising advantage over any other segment selling similar goods by being allowed to disclose credit service charges in a more favorable manner.

If Congress really wants consumer understanding of credit terms . . .

If Congress really wants meaningful disclosure . . .

If Congress really wants to eliminate discrimination in the marketplace . . .

If Congress really wants to provide equitable treatment for small independent merchants as well as for the huge national mercantile establishments . . .

then, we believe, this Committee will not accept the discriminatory provisions of S. 5, but will require all consumer credit transactions to disclose credit service charges on a similar basis.

Our six Associations, and the more than 45,000 members we represent, will support any credit service charge disclosure proposal that requires the universal application of either dollars and cents or an identical rate for all credit grantors whether it be monthly, monthly and annual, annual, or any other rate that will enable customers to compare and determine which is the cheapest rate available in the marketplace.

We urge the Committee to support our recommendations for "fair play" and to put all stores, both large and small, on an equal footing in the method of disclosing credit service charges on consumer credit transactions. In this way customers can best be assured of a sound basis for comparing credit costs whether it be in dollars and cents or as a percentage rate.

NAME Mrs. John Customer ACCT. NO. 1225

ADDRESS

TERMS: WEEKLY MONTHLY $ 9.00 DUE DATE 1st

	DATE	PURCHASES	PAYMENTS	CREDIT	BALANCE	TRANS.
1	Aug 1-66	113.30	13.30		100.00	
2	Sep 2-66		9.00		91.00	
3	9/6/66	1.36	CR. SERV. CHG.		92.36	
4	Oct 3-66		9.00		83.36	
5	10/6/66	1.24	CR. SERV. CHG.		84.60	
6	Nov 1-66		9.00		75.60	
7	11/7/66	1.14	CR. SERV. CHG.		76.74	
8	Dec 3-66		9.00		67.74	
9	12/6/66	1.02	CR. SERV. CHG.		68.76	
10	Jan 3-67		9.00		59.76	
11	1/6/67	.90	CR. SERV. CHG.		60.66	
12	Feb 1-67		9.00		51.66	

IT IS AGREED THAT ANY AND ALL PAYMENTS MADE HEREIN SHALL BE APPLIED AS A CREDIT AGAINST MY GENERAL ACCOUNT AS A WHOLE.

13	2/6/67	.78	CR. SERV. CHG.		52.44	
14	Mar 2-67		9.00		43.44	
15	3/6/67	.64	CR. SERV. CHG.		44.08	
16	Apr 3-67		9.00		35.08	
17	4/6/67	.52	CR. SERV. CHG.		35.60	
18	May 2-67		9.00		26.60	
19	5/6/67	.40	CR. SERV. CHG.		27.00	
20	Jun 1-67		9.00		18.00	
21	6/6/67	.27	CR. SERV. CHG.		18.27	
22	Jul 1-67		9.00		9.27	
23	7/6/67	.13	CR. SERV. CHG.		9.40	
24	Aug 1-67		9.40		-0-	

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8.4% ON ORIGINAL BALANCE

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ON THIS DATE	FROM YOUR PREVIOUS BALANCE OF	WE HAVE DEDUCTED PAYMENTS OF	WE HAVE DEDUCTED DOWN PAYMENT, RETURNS OR CREDITS OF	CREDIT SERVICE CHARGE	AND ADDED CHARGES OF	LEAVING A NEW BALANCE OF	YOUR MONTHLY PAYMENT, IS	PLEASE PAY THIS AMOUNT
						AS A 30 DAY ACCOUNT Please Pay This Amount		AS A REVOLV-A-COUNT® Please Pay This Amount

PAYMENTS, PURCHASES OR RETURNS MADE AFTER THE ABOVE BILLING DATE WILL APPEAR ON YOUR NEXT STATEMENT.

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THEY TELL HOW WE HANDLED YOUR ORDER. IF YOU WRITE OR COME IN ABOUT THIS STATEMENT, PLEASE BE SURE TO SEND, OR BRING, ALL THESE PAPERS. WE SHALL NEED ALL OF THEM TO ANSWER YOUR QUESTIONS.

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PHONE 444-8051

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One low monthly payment buys anything that Breuner's sell.

You can add on a purchase any time.

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With monthly payment of.....	$10	$15	$20	$30	$40	$50
you purchase up to	200	300	400	600	800	1000
and add amounts equal to payments made.	200	300	400	600	800	1000
Thus your total purchases in 24 months could amount to	400	600	800	1200	1600	2000

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Mrs. SULLIVAN. Thank you, Mr. Stapp. You have given a very thorough yet concise picture of your position on this issue.

Mr. Vern Countryman is a professor of law at Harvard University Law School. Mr. Countryman, please summarize your statement and bring out the important points that you would like to share with us.

STATEMENT OF VERN COUNTRYMAN, PROFESSOR OF LAW, HARVARD LAW SCHOOL

Mr. COUNTRYMAN. I do not appear here to testify on all aspects of H.R. 11601. I am not an expert on consumer credit—a subject I have just begun to study. I have gotten only far enough in my efforts to know that reliable information on the subject is scarce and that there is a real need for the sort of investigation which title III of H.R. 11601 would authorize.

I appear to testify in general support of title II of H.R. 11601, which would prohibit the garnishment of wages, although I have several suggestions to make for changes in the proposal.

The problem with which title II would deal is a nationwide one because nearly all States permit wage garnishment. Some limit the remedy to creditors who have first reduced their claims to judgment, but most permit the creditor to garnishee the employer when suit is initiated. In some States a separate levy is required each payday; in others, the initial levy is a continuing one until the creditor's judgment is paid.

All States exempt some portion of the debtor's wages from garnishment, but the exemptions vary drastically. In some States they are expressed in dollar amounts and they range from $350 for married debtors and $200 for single debtors in Alaska to $50 for all debtors in Rhode Island. In other States they are expressed in percentages and range from 50 percent in Arizona to 100 percent in Florida, Pennsylvania, and Texas. Most exemption laws, also, are confined to residents and afford no protection to the many debtors whose employers can be served with garnishment process outside the State of the debtor's residence.

The best and most recent survey of this bewildering pattern of State wage garnishment laws is an article by Mr. George Brunn, published in volume 53 of the California Law Review in 1965. I have a copy of that article with me and would be happy to submit it to the committee if you would care to have it.

Mrs. SULLIVAN. We will be glad to receive it. We may already have that in record—we will check that later.

(The article referred to may be found in the appendix, p. 1102.)

Mr. COUNTRYMAN. The Consequences of wage garnishment are principally three:

1. If garnishment of the employer is effected outside the State of the debtor's residence, he may find his wages shut off entirely. If it is effected in the State of his residence, he may find himself left to support his family on $50 a month in Rhode Island, $67.50 a month in Kentucky, $20 a week in New Hampshire, or half of his $75 a week wage in Arizona, or 50 percent of his wage or $25, whichever is less, in Vermont.

2. Without regard to the amount of the exemption, the debtor may find himself unemployed. Many employers do not take kindly to the extra bookkeeping required by garnishment levies, particularly if they are repeated. Labor unions have been largely ineffective in protecting their members against such employer retaliation although some collective bargaining contracts give the employee one or two free garnishments before discharge.

3. To save his job and support his family, the debtor may be driven to resort to bankruptcy in many cases where he would not otherwise do so in order to dissolve the garnishment levy or prevent threatened levies. As the number of nonbusiness bankrupticies has increased more than twentyfold, from 8,500 to almost 176,000, between 1946 and 1966, this is a matter of some consequence to the Federal bankruptcy courts.

Precise information on the relationship of wage garnishment to bankruptcy is, of course, not available. But there is enough evidence to support a recent statement of the Bureau of Labor Standards that "There seems to be a direct connection between the number of garnishments and the number of personal bankruptcies." (Debt Pooling and Garnishment in Relation to Consumer Indebtedness, fact sheet No. 4–F (1966).)

Mr. Brunn, in his California Law Review article, made a study of the 10 States with the highest and the 10 States with the lowest per capita personal bankruptcy rates in 1962. The results are so interesting that I reproduce them here.

Personal bankruptcies per 100,000 population

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Colorado	131	Alaska	13

Of the States with the lowest personal bankruptcy filings, Florida, Pennsylvania, and Texas had a 100-percent wage exemption; North Carolina, South Carolina, and South Dakota authorized exemptions up to 100 percent if needed to support the debtor's family; New Jersey had a 90-percent exemption, and Alaska exempted $350 for married and $200 for single debtors. Maryland exempted only 75 percent in some counties and $100 in others, but wage garnishments were little used there because of the necessity of a separate levy every payday.

Of the States with the highest personal bankruptcy filings:

Alabama had a 75-percent exemption.

Oregon exempted $175.

Tennessee exempted $17 per week for the head of a family plus $2.50 per week for each dependent under 16, and $12 per week for debtors who were not heads of families.

Maine allowed garnishment of not to exceed $30 per month but provided that at least $10 should be exempt.

Georgia exempted $3 per day plus 50 percent of the excess.

Arizona had a 50-percent exemption.

California exempted 50 percent but authorized more, up to 100 percent, if needed to support the debtor's family and if the creditor's claim was not for necessaries.

Ohio exempted 80 percent of the first $300 per month and 60 percent of the balance (with a minimum of $150), and $100 for debtors who were not heads of families.

Colorado exempted 70 percent for heads of families and 35 percent for others.

Illinois had the highest exemption in this group—85 percent or $45 per week, whichever was more, with a maximum of $200 per week. But the Illinois experience is instructive further. Until a 1961 amendment to its law, its exemption was only $45 per week. Between 1961 and 1964 Mr. Brunn found that personal bankruptcies in Illinois declined 9 percent, while they were increasing 18 percent nationally. And I find that they have declined another 4 percent in Illinois from 1964 to 1966 while they have increased another 2 percent nationally.

Mr. Brunn also studied the experience of Iowa, which moved in the opposite direction in 1957 by abolishing its 100-percent wage exemption and substituting $35 per week plus $3 per dependent. Since 1957 personal bankruptcies have multiplied 3.6 times in Iowa while multiplying 2.8 times nationally.

It may be said that these figures alone do not prove that wage garnishment is a contributing cause of bankruptcy. It may merely be a series of remarkable coincidences. Or it may be that the financial difficulties which led to garnishment would have led to bankruptcy had there been no garnishment.

But we need not rely on the figures alone. Last week you heard the testimony of three able and experienced referees in bankruptcy from States where wage garnishment is heavily employed (Oregon, Tennessee, and California). They were unanimously of the view that wage garnishments caused bankruptcy filings by many debtors who would not otherwise have filed.

That view is supported also by studies of personal bankruptcies in which the bankrupts were interviewed. In one such study, involving 84 bankrupts in Michigan, 75 percent indicated that garnishment or the threat of garnishment was the reason for their filing in bankruptcy. (Dolphin, "An Analysis of Economic and Personal Factors Leading to Consumer Bankruptcy" (1965), page 18.) In another study in Illinois in which 73 bankrupts were interviewed, 35 said that threat of garnishment or fear of job loss was what caused them to go into bankruptcy. (Stabler, "The Experience of Bankruptcy" (1966), page 7.) Other similar studies which did not include personal interviews with the bankrupts reveal:

Out of 300 cases in Seattle, 69 debtors had suffered one garnishment in the 4 months preceding bankruptcy, 14 more had experienced two garnishments in that period, and four had been garnished three or more times. (Brosky, "A Study of Personal Bankruptcy in the Seattle Metropolitan Area" (1965), page 39.)

Interviews with bankruptcy attorneys in Utah revealed their opinion that most personal bankrupts have either had their wages garnished or have been threatened with garnishment. (Misbach, "Personal Bankruptcy in the United States and Utah" (1964), page 33.)

To this I would like to add my own opinion, based on discussions with many referees in bankruptcy and bankruptcy attorneys, and on the examination of the files in hundreds of bankruptcy cases, that wage garnishment, either actual or threatened, is a precipitating cause in a very substantial number of the personal bankruptcy cases.

I have previously estimated, based on my studies of the official bankruptcy statistics published by the Administrative Office of the U.S. Courts, that over a billion dollars in creditors claims per year is being discharged in bankruptcy cases and more than 90 percent of these cases are personal bankruptcies. (Countryman, "The Bankruptcy Boom"—77 Harv. L. Rev. 1452 (1964).) A more recent analysis of the statistics has persuaded me that my prior estimate was far too low and that the amount of creditors claims discharged is now approaching $2 billion per year.

This figure may not reflect serious damage to the bankers, loan companies, and finance companies whose losses probably do not exceed one-half of 1 percent of loans outstanding, nor to the installment seller operating on a 100 percent markup who breaks even whenever he loses only one-half of his claim. After all, they can shift half of their relatively small loss to the Federal fisc when they make out their tax returns. But there are other small-volume, low-margin creditors for whom the bankruptcy of a debtor is a painful blow.

Moreover, bankruptcy is a catastrophe for the debtor. As one observer has said:

> Although uniformed people may minimize the gravity of the consumer bankruptcy problem by saying that only one-tenth of one per cent of the population goes bankrupt, there is a qualitative dimension in human distress that is understated by such statistics. (Myers, "Nonbusiness Bankruptcies, in Proceedings of 10th Annual Conference, Council on Consumer Information," page 9.)

I would agree, and would add that the studies referred to above, and others, indicate that the typical bankrupt has three or four dependents, so that the human distress is felt not merely by the 176,000 personal bankrupts, but by families whose members number from 700,000 to 880,000.

My conclusions about the relationship of wage garnishments to bankruptcy lead me to my first suggested change in H.R. 11601. I would suggest that the finding in section 201 of the bill be not confined to the effect of wage garnishment on interstate commerce, but that it take account also of the effect of wage garnishment on the Federal bankruptcy system. It is ludicrous, unseemly, and uneconomic to have most of the States providing creditors with a remedy for collection and the Federal bankruptcy system providing debtors with a countervailing remedy to undo what State law has allowed the creditor to do. It's well within the power of Congress to do directly what it now authorizes indirectly and to relieve the Federal bankruptcy system of the burden of cases where bankruptcy petitions are filed only to avoid garnishment.

Second, I would suggest that the term "wages" in the title of title II and in section 201 is probably too restrictive, and that the same is true of "wages or salary" in section 202(a). The compensation of many of those you would want to protect from garnishment is derived, wholly or in part, from commissions and bonuses. I would suggest, instead, that the reference in the title and in section 201 be changed from "wages" to "personal earnings" and that in section 202(a), the opera-

tive section "earnings in the form of wages, salary, commission, or bonus as compensation for personal service" be substituted for "wages or salary due an employee."

I would delete the second reference to "employee" in section 202(a) because of experience with the wage priority under section 64a(2) of the Bankruptcy Act where it three times became necessary to amend the original language, "wages due to workmen, clerks, or servants," once by adding "traveling or city salesmen," again by adding "on a salary or a commission basis, whole or part time," and finally by adding "whether or not they are independent contractors * * * with or without a drawing account."

If this suggestion were followed in its entirety, section 202(a) might read:

> No person may attach or garnish or by any similar legal or equitable process or order stop or divert the payment of earnings in the form of wages, salary, commission or bonus as compensation for personal service.

Third, I am sure it is not the intent of H.R. 11601 to disrupt the operation of wage earner plans under chapter XIII of the Bankruptcy Act. These are purely voluntary proceedings, initiated on the debtor's petition only, by which a wage earner debtor may pay off his debts from future earnings over a 3-year period. But section 611 of the Bankruptcy Act does give the chapter XIII court exclusive jurisdiction over the debtor's earnings during the period of consummation of the plan, section 64b does require that the plan include provisions for the submission of future earnings of the debtor to the supervision and control of the court, and section 658 does authorize the court to order the employer of the debtor to make payments from his earnings directly into court. It would be prudent to indicate, either by a proviso to section 202(a) of the bill or by a statement in the committee report, that section 202(a) was not intended to affect these sections of chapter XIII of the Bankruptcy Act.

Fourth, I doubt the necessity of prohibiting garnishment of all earnings, regardless of size. I see no necessity for immunizing all the income of entertainers, corporate executives, and others whose incomes approach or run into six figures.

I realize the difficulty of fixing a limit. One recent proposal suggests a poverty-level limit of $3,600, which I regard as much too low (Karlen, Exemptions from Execution, 22 Bus. Law. 1167, 1171 (1967). The present working draft of the Uniform Consumer Credit Code, a project of the National Conference of Commissioners on Uniform State Laws which is not yet in final form, would put the limit at $100 per week for debtors with dependents and $65 per week for others (and would limit the protection to consumer credit claims.) This seems too low to me, also, but I have attached to my statement a copy of the pertinent sections of the present draft of the code so that the committee can examine them. (See p. 729.)

The studies of personal bankruptcies to which I have previously referred indicate that the typical bankrupt has an income of about $5,000 per year. I would take that figure as an indication that the protection against garnishment should extend considerably higher.

Figures compiled by John A. Gorman, Associate Chief, National Income Division, Office of Business Economics, U.S. Department of

Commerce, and reported in the Wall Street Journal, May 31, 1967, part 1, column 6, show the following average family incomes.

Year	Amount, actual	Amount, revised
1949	$3,860	($3,945)
1952	4,570	(4,747)
1955	5,000	(5,275)
1958	5,670	(5,839)
1961	6,220	(6,360)
1964	7,325	--------
1965	7,780	--------
1966	8,300	--------

I have been in touch with Mr. Gorman and he advises me that because of a revision in national income accounts the figures for earlier years should be revised as I have indicated in parentheses.

I should suppose that protection against garnishment should also extend well beyond the income of the average family. It therefore seems to me that a figure in the neighborhood of about $15,000, translated into $285 per week, would be appropriate.

Mr. Gorman's figures illustrate another problem, however. That is a problem of obsolescence, since laws like these tend not to get periodic revision—the Connecticut exemption law still saves to a debtor 10 bushels of Indian corn. Obsoleteness accounts for the inadequacy of many of the State wage exemption laws which employ dollar amounts. But the percentage exemption laws produce excessive exemptions for large income debtors and inadequate ones for small income debtors, regardless of the percentage used.

The present working draft of the Uniform Consumer Credit Code would solve this problem by using dollar amounts and authorizing an administrator to change them whenever there is a change of 10 percent or more in the U.S. Bureau of Labor Statistics Consumer Price Index for Urban Wage Earners and Clerical Workers. Under H.R. 11601 the same function might well be assigned to the Federal Reserve Board.

An alternative method of handling this problem would be to tie the exemption to a legislatively fixed figure which does seem to receive periodic revision—the amount of earnings subject to tax under section 209 of the Social Security Act. Currently, that figure is $6,000, although H.R. 5710, as reported out by the House Committee on Ways and Means, would raise the figure to $7,600. An exemption in H.R. 11601 for twice the amount of earnings taxed under the Social Security Act would come very close to the $15,000 exemption I have suggested.

Fourth, and finally, if you go no further than to protect wages from garnishment, you may not accomplish much. In many States the creditor still will be able to reach the debtor's income by taking an advance assignment of future wages at the time of extending credit. And since employers find wage assignments as annoying as garnishments, there will be the same jeopardy to the debtor's job. Again the debtor will be driven into bankruptcy—this time to get the debt discharged so as to free his postbankruptcy earnings from the lien of the wage assignment.

Mr. Justice Fortas, while still a law student, made an exhaustive study of the use of wage assignments in Chicago (Fortas, "Wage Assignments in Chicago," *State Street Furniture Co.* v. *Armour & Co.*,

42 Yale L. J. 526 (1933)). That was followed in 1935 by a statute limiting assignable wages to 25 percent and limiting the effectiveness of the assignment to 3 years. Later reports indicated that the situation was not much improved—see Satter, "Wage Assignments and Garnishment Cited as Major Cause of Bankruptcy in Illinois," 15 Per. Fin. L. Q. Rep. 50 (1961—and in 1961, when Illinois liberalized its exemption from garnishment, it also amended the wage assignment law to limit assignable wages to 15 percent. As previously indicated, the rate of personal bankruptcies in Illinois has consistently declined since 1961. A few States have by statute prohibited such wage assignments and others, like Illinois, limit the amount of wages assignable and the period of time the assignment may cover—see Annotations, 137 A.L.R. 738 (1942); 37 A.L.R. 872 (1925)—but in many States they are valid and enforceable in the courts. Hence, to complete the job, I would suggest a new subsection (b) of section 202 reading:

No person shall take any assignment of the future earnings of another in the form of wages, salary, commission or bonus as compensation for personal service, and all such assignments shall be void and unenforceable.

If the committee were to adopt my suggestion of a limit on earnings protected from garnishment, and considered a similar limit appropriate for wage assignments, the new subsection (b) might read:

No person shall take any assignment of the future earnings of another in the form of wages, salary, commission or bonus as compensation for personal service save for the amount in excess of $285 per week, and no such assignment shall be valid and enforceable save for such excess.

If either of these proposals were adopted, present subsection (b) of section 202 should be redesignated subsection (c) and amended to cover violations of either subsection (a) or subsection (b).

In conclusion let me anticipate that there will doubtless be testimony that the abolition or restriction of wage garnishments and assignments will bring ruin to the institution of consumer credit. Any witness taking this position should be invited to explain data presented to a California legislative committee by the Associated Credit Bureaus of California, and summarized by Mr. Brunn at pages 1239–1243 of volume 53 of the California Law Review, which indicates that installment credit thrives as well in Alabama where 75 percent of wages are exempt from execution, in California where as a practical matter only 50 percent is exempt, and in Colorado which exempts 70 percent for heads of families and 35 percent for single persons, as it does in Texas and New Jersey with 100 percent exemptions, or in New York with a 90-percent exemption, or in North Carolina which exempts up to 100 percent where needed for support of the debtor's family.

Thank you.

Mrs. SULLIVAN. Thank you very much, Mr. Countryman.

(The full statement of Mr. Countryman and a draft of a uniform consumer credit code provision on garnishment follow:)

STATEMENT OF VERN COUNTRYMAN ON H.R. 11601

My name is Vern Countryman. I am Professor of Law at Harvard Law School. I have been teaching the law of creditors' rights and bankruptcy since 1946, save for a four-year period, 1955–1959, when I practiced law in Washington, D.C.

I do not appear here to testify on all aspects of H.R. 11601. I am not an expert on consumer credit—a subject I have just begun to study. I have gotten only far enough in my efforts to know that reliable information on the subject is

scarce and that where is a real need for the sort of investigation which Title III of H.R. 11601 would authorize.

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All states exempt some portion of the debtor's wages from garnishment, but the exemptions vary drastically. In some states they are expressed in dollar amounts and they range from $350 for married debtors and $200 for single debtors in Alaska to $50 for all debtors in Rhode Island. In other states they are expressed in percentages and range from 50% in Arizona to 100% in Florida, Pennsylvania and Texas. Most exemption laws, also, are confined to residents and afford no protection to the many debtors whose employers can be served with garnishment process outside the state of the debtor's residence.

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(1) If garnishment of the employer is effected outside the state of the debtor's residence, he may find his wages shut off entirely. If it is effected in the state of his residence, he may find himself left to support his family on $50 a month in Rhode Island, $67.50 a month in Kentucky, $20 a week in New Hampshire, or half of his $75 a week wage in Arizona, or 50% of his wage or $25, whichever is less, in Vermont.

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Alabama had a 75% exemption.

Oregon exempted $175.

Tennessee exempted $17 per week for the head of a family plus $2.50 per week for each dependent under 16, and $12 per week for debtors who were not heads of families.

Maine allowed garnishment of not to exceed $30 per month but provided that at least $10 should be exempt.

Georgia exempted $3 per day plus 50% of the excess.

Arizona had a 50% exemption.

California exempted 50% but authorized more, up to 100%, if needed to support the debtor's family and if the creditor's claim was not for necessaries.

Ohio exempted 80% of the first $300 per month and 60% of the balance (with a minimum of $150), and $100 for debtors who were not heads of families.

Colorado exempted 70% for heads of families and 35% for others.

Illinois had the highest exemption in this group—85% or $45 per week, whichever was more, with a maximum of $200 per week. But the Illinois experience is instructive further. Until a 1961 amendment to its law, its exemption was only $45 per week. Between 1961 and 1964 Mr. Brunn found that personal bankruptcies in Illinois *declined* 9% while they were increasing 18% nationally. [And I find that they have *declined* another 4% in Illinois from 1964 and 1966 while they have increased another 2% nationally.]

Mr. Brunn also studied the experience of Iowa, which moved in the opposite direction in 1957 by abolishing its 100% wage exemption and substituting $35 per week plus $3 per dependent. Since 1957 personal bankruptcies have multiplied 3.6 times in Iowa while multiplying 2.8 times nationally.

It may be said that these figures alone do not prove that wage garnishment is a contributing cause of bankruptcy. It may merely be a series of remarkable coincidences. Or it may be that the financial difficulties which led to garnishment would have led to bankruptcy had there been no garnishment.

But we need not rely on the figures alone. Last week you heard the testimony of three able and experienced Referees in Bankruptcy from states where wage garnishment is heavily employed (Oregon, Tennessee and California). They were unanimously of the view that wage garnishments caused bankruptcy filings by many debtors who would not otherwise have filed.

That view is supported also by studies of personal bankruptcies in which the bankrupts were interviewed. In one such study, involving 84 bankrupts in Michigan, 75% indicated that garnishment or the threat of garnishment was the reason for their filing in bankruptcy. Dolphin, *An Analysis of Economic and Personal Factors Leading to Consumer Bankruptcy* (1965), p. 18. In another study in Illinois in which 73 bankrupts were interviewed, 35 said that threat of garnishment or fear of job loss was what caused them to go into bankruptcy. Stabler, *The Experience of Bankruptcy* (1966), p. 7. Other similar studies which did not include personal interviews with the bankrupts reveal:

Out of 300 cases in Seattle, 69 debtors had suffered one garnishment in the four months preceding bankruptcy, 14 more had experienced two garnishments in that period, and 4 had been garnished 3 or more times. Brosky, *A study of Personal Bankruptcy in the Seattle Metropolitan Area* (1965), p. 39.

Interviews with bankruptcy attorneys in Utah revealed their opinion that most personal bankrupts have either had their wages garnished or have been threatened with garnishment. Misbach, *Personal Bankruptcy in the United States and Utah* (1964), p. 33.

To this I would like to add my own opinion, based on discussions with many Referees in Bankruptcy and bankruptcy attorneys, and on the examination of the files in hundreds of bankruptcy cases, that wage garnishment, either actual or threatened, is a precipitating cause in a very substantial number of personal bankruptcy cases.

I have previously estimated, based on my studies of the official bankruptcy statistics published by the Administrative Office of the United States Courts, that over a billion dollars in creditors claims per year is being discharged in bankruptcy cases and more than 90% of these cases are personal bankruptcies. Countryman, *The Bankruptcy Boom*, 77 Harv. L. Rev. 1452 (1964). A more recent

analysis of the statistics has persuaded me that my prior estimate was far too low and that the amount of creditors claims discharged is now approaching two billion dollars per year.

This figure may not reflect serious damage to the bankers, loan companies and finance companies whose losses probably do not exceed one-half of one percent of loans outstanding, nor to the installment seller operating on a 100% markup who break even whenever he loses only one-half of his claim. After all, they can shift half of their relatively small loss to the federal fisc when they make out their tax returns. But there are other small volume, low margin creditors for whom bankruptcy of a debtor is a painful blow.

Moreover, bankruptcy is a catastrophe for the debtor. As one observer has said, "Although uninformed people may minimize the gravity of the consumer bankruptcy problem by saying that only one-tenth of one per cent of the population goes bankrupt, there is a qualitative dimension in human distress that is understated by such statistics." Myers, *Non-Business Bankruptcies*, in Proceedings of Tenth Annual Conference, Council on Consumer Information, page 9. I would agree, and would add that the studies referred to above, and others indicate that the typical bankrupt has three or four dependents, so that the human distress is felt not merely by the 176,000 personal bankrupts, but families whose members number from 700,000 to 880,000.

My conclusions about the relationship of wage garnishments to bankruptcy lead me to my first suggested change in H.R. 11601. I would suggest that the finding in Section 201 of the bill be not confined to the effect of wage garnishment on interstate commerce, but that it take account also of the effect of wage garnishment on the federal bankruptcy system. It is ludicrous, unseemly and uneconomic to have most of the states providing creditors with a remedy for collection and the federal bankruptcy system providing debtors with a countervailing remedy to undo what state laws has allowed the creditor to do. It is well within the power of Congress to do directly what it now authorizes indirectly and to relieve the federal bankruptcy system of the burden of cases where bankruptcy petitions are filed only to avoid garnishment.

Second, I would suggest that the term "wages" in the Title of Title II and in Section 201 is probably too restrictive, and that the same is true of "wages or salary" in Section 202(a). The compensation of many of those you would want to protect from garnishment is derived, wholly or in part, from commissions and bonuses. I would suggest, instead, that the reference in the Title and in Section 201 be changed from "wages" to "personal earnings" and that in Section 202(a), the operative Section "earnings in the form of wages, salary, commission or bonus as compensation for personal service" be substituted for "wages or salary due an employee." I would delete the second reference to "employee" in Section 202(a) because of experience with the wage priority under section 64a(2) of the Bankruptcy Act where it three times became necessary to amend the original language, "wages due to workmen, clerks, or servants," once by adding "traveling or city salesmen," again by adding "on a salary or a commission basis, whole or part-time," and finally by adding "whether or not they are independent contractors . . . with or without a drawing account."

If this suggestion were followed in its entirety, section 202(a) might read:

"No person may attach or garnish or by any similar legal or equitable process or order stop or divert the payment of earnings in the form of wages, salary, commission or bonus as compensation for personal service."

Third, I doubt the necessity of prohibiting garnishment of all earnings, regardless of size. I see no necessity for immunizing all the income of entertainers, corporate executives, etc. whose incomes approach or run into six figures.

I realize the difficulty of fixing a limit. One recent proposal suggests a poverty-level limit of $3,600, which I regard as much too low. Karlen, *Exemptions from Execution*, 22 Bus. Law. 1167, 1171 (1967). The present working draft of the Uniform Consumer Credit Code, a project of the National Conference of Commissioners on Uniform State Laws which is not yet in final form, would put the limit at $100 per week for debtors with dependents and $65 per week for others [and would limit the protection to consumer credit claims.]. This seems too low to me also, but I have attached to my statement a copy of the pertinent sections of the present draft of the Code so that the Committee can examine them.

The studies of personal bankruptcies to which I have previously referred indicate that the typical bankrupt has an income of about $5,000 per year. I would take that figure as an indication that the protection against garnishment should extend considerably higher.

Figures compiled by John A. Gorman, Associate Chief, National Income Division, Office of Business Economics, U.S. Department of Commerce, and reported in the *Wall Street Journal*, May 31, 1967, p. 1, col. 6, show the following average family incomes.

Year	Amount, actual	Amount, revised
1949	$3,860	($3,945)
1952	4,570	(4,747)
1955	5,000	(5,275)
1958	5,670	(5,839)
1961	6,220	(6,360)
1964	7,325	--------
1965	7,780	--------
1966	8,300	--------

(I have been in touch with Mr. Gorman and he advises me that because of a revision in national income accounts the figures for earlier years should be revised as I have indicated in parentheses.)

I should suppose that protection against garnishment should also extend well beyond the income of the average family. It therefore seems to me that a figure in the neighborhood of about $15,000, translated into $285 per week, would be appropriate.

Mr. Gorman's figures illustrate another problem, however. That is a problem of obsolescence, since laws like these tend not to get periodic revision—the Connecticut exemption law still saves to a debtor ten bushels of Indian corn. Obsoleteness accounts for the inadequacy of many of the state wage exemption laws which employ dollar amounts. But the percentage exemption laws produce excessive exemptions for large income debtors and inadequate ones for small income debtors, regardless of the percentage used.

The present working draft of the Uniform Consumer Credit Code would solve this problem by using dollar amounts and authorizing an administrator to change them whenever there is a change of 10% or more in the U.S. Bureau of Labor Statistics Consumer Price Index for Urban Wage earners and Clerical Workers. Under H.R. 11601 the same function might well be assigned to the Federal Reserve Board.

An alternative method of handling this problem would be to tie the exemption to a legislatively-fixed figure which does seem to receive periodic revision—the amount of earnings subject to tax under Section 209 of the Social Security Act. Currently, that figure is $6,000, although H.R. 5710, as reported out by the House Committee on Ways and Means, would raise the figure to $7,600. An exemption in H.R. 11601 for twice the amount of earnings taxed under the Social Security Act would come very close to the $15,000 exemption I have suggested.

Fourth, and finally, if you go no further than to protect wages from garnishment, you may not accomplish much. In many states the creditor will be able to reach the debtor's income by taking an advance assignment of future wages at the time of extending credit. And since employers find wage assignments as annoying as garnishments, there will be the same jeopardy to the debtor's job. Again the debtor will be driven into bankruptcy—this time to get the debt discharged so as to free his post-bankruptcy earnings from the lien of the wage assignment. Mr. Justice Fortas, while still a law student, made an exhaustive study of the use of wage assignments in Chicago. Fortas, *Wage Assignments in Chicago—State Street Furniture Co. v. Armour & Co.*, 42 Yale L. J. 526(1933). That was followed in 1935 by a statute limiting assignable wages to 25% and limiting the effectiveness of the assignment to three years. Later reports indicated that the situation was not much improved [see Satter, *Wage Assignments and Garnishment Cited as Major Case of Bankruptcy in Illinois*, 15 Per. Fin. L. Q. Rep. 50 (1961)], and in 1961, when Illinois liberalized its exemption from garnishment, it also amended the Wage Assignment Law to limit assignable wages to 15%. As previously indicated, the rate of personal bankruptcies in Illinois has consistently declined since 1961. A few states have by statute prohibited such wage assignments and others, like Illinois, limit the amount of wages assignable and the period of time the assignment may cover [See Annotations, 137 A.L.R. 738(1942); 37 A.L.R. 872(1925)], but in many states they

are valid and enforceable in the courts. Hence, to complete the job, I would suggest a new subsection (b) of Section 202 reading:

"No person shall take any assignment of the future earnings of another in the form of wages, salary, commission or bonus as compensation for personal service, and all such assignments shall be void and unenforceable."

If the Committee were to adopt my suggestion of a limit on earnings protected from garnishment, and considered a similar limit appropriate for wage assignments, the new subsection (b) might read:

"No person shall take any assignment of the future earnings of another in the form of wages, salary, commission or bonus as compensation for personal service save for the amount in excess of $285 per week, and no such assignment shall be valid and enforceable save for such excess."

If either of these proposals were adopted, present subsection (b) of Section 202 should be redesignated subsection (c) and amended to cover violations of either subsection (a) or subsection (b).

In conclusion let me anticipate that there will doubtless be testimony that the abolition or restriction of wage garnishments and assignments will bring ruin to the institution of consumer credit. Any witness taking this position should be invited to explain data presented to a California legislative committee by the Associated Credit Bureaus of California, and summarized by Mr. Brunn at pages 1239–1243 of volume 53 of the *California Law Review*, which indicates that in stallment credit thrives as well in Alabama where 75% of wages are exempt from execution, in California where as a practical matter only 50% is exempt, and in Colorado which exempts 70% for heads of families and 35% for single persons, as it does in Texas and New Jersey with 100% exemptions, or in New York with a 90% exemption, or in North Carolina which exempts up to 100% where needed for support of the debtor's family.

NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS

UNIFORM CONSUMER CREDIT CODE

(Working Draft No. 4)

Section 1.106. [*Escalation.*]

[Certain dollar amounts in this Act which are designated as subject to escalation pursuant to this section shall be changed from time to time by action of the Administrator in accordance with changes in the United States Bureau of Labor Statistics Consumer Price Index for Urban Wage Earners and Clerical Workers. On or before April 30 of each even-numbered year the Administrator shall compare the index at the end of the preceding calendar year and at [December 31, 1967] and shall calculate the percentage by which the Index has changed. If the change is 10 per cent or more, he shall promulgate a rule changing the dollar amounts in this Act which are designated as subject to escalation pursuant to this section, unless any change required by this section has already been made by the Administrator in a prior rule pursuant to this section. These dollar amounts shall be changed to the extent of the change in the Index, except that they shall be changed only in integral multiples of 10 per cent of the dollar amounts appearing in this Act at the time of its enactment. If the percentage change in the Index is more than an integral multiple of 10 per cent, the fractional portion of the change shall be disregarded. The changes made by the Administrator shall become effective on the July 1 immediately following promulgation of the rule.]

Section 5.105. [*Limitation on Garnishment of Unpaid Earnings.*]

(1) A creditor may not receive in payment of a judgment arising out of a consumer credit sale, a consumer lease or a consumer loan unpaid earnings of the debtor through garnishment or like proceedings directed to a person other than the debtor, except to the extent that the amount received by the creditor represents earnings of the debtor earned from all sources in excess of $100* in any calendar week in the case of a debtor with dependents, and $65* in any calendar week in the case of a debtor without dependents. For the purpose of determining a debtor's weekly earnings, any amounts paid or payable to another creditor because of a previous garnishment or like proceedings directed to a person other than the debtor, or irrevocable assignment of earnings, is not included in the amount earned.

(2) This section does not subject either the levying officer or the person to whom garnishment proceedings are directed to any liability if earnings are paid to the creditor in violation of this section.

(3) Figures in this section marked with an asterisk are subject to escalation pursuant to Section 1.106.

Mrs. SULLIVAN. I want to thank every one of you witnesses for giving us your time and your knowledge this morning. The bells have rung once and are going to ring again and at that point we will have to go to the floor. I just can't tell you how much I appreciate the patience and cooperation of everyone of these outstanding witnesses.

I think all of you have shed light on this legislation.

Unfortunately, we have no time for extended questioning. I promised Mr. Fino, who gave up his time before, that I would call on him. What I am going to ask all of you is, if we have some specific questions to put to you—and I think our committee counsel will certainly want to submit some questions to Mr. Countryman for our further information on the points that you brought out, professor—if we can give these to you quickly, could you get them back to us when you go over your part of the transcript? We would appreciate it very much.

With that I am going to call on Mr. Fino because I promised him an opportunity to question and then we will adjourn.

Mr. FINO. I just wanted to ask Mr. Keyserling one question.

Do you think that the credit unions in this country are doing a good job in supplying loans to members for consumer items?

Mr. KEYSERLING. I think they are helping. I don't think they are completely meeting the unmet need by any means. I think they are a helpful instrumentality.

Mr. FINO. You know for a fact that the credit unions do charge 12 percent per annum interest rates; is that right?

Mr. KEYSERLING. I am not aware of the details of what they charge.

Mr. FINO. You have, if I understood your testimony, expressed some fears about an 18-percent national usury limit.

What would you suggest?

Mr. KEYSERLING. Well, let me explain myself a little bit on that. I don't want to sound extremist, but our whole national conscience on the subject of interest rates has gone absolutely wild, and this is one aspect of it.

Our great corporations get money for their investment purposes without paying anything for the cost of the money, because they finance it out of retained earnings and out of the consumer through the price structure.

Furthermore, they are supplied with extravagant tax bonanzas like depletion and depreciation allowances, which are neither needed nor merited.

So, in effect they are paying a zero or a minus rate of interest.

I read in the papers recently that one of our biggest business corporations—I read this—one of the big corporations, I cannot recall the name, recently obtained money at the rate of 6 or 7 percent, which is the highest they ever paid on record. I could carry this all up and down the line. The point is, it is personally repugnant to me, if no more, that we should regard 18 percent as a proper ceiling for the interest rate—and I won't quibble about the differences between the interest rate and service charges; I have already expressed myself on that—for the poorest and most lowly and most unable to protect themselves, who are under the greatest compulsion to borrow because they other-

wise simply cannot make ends meet, even for necessities. Almost half of the people in our country dissave on net balance—they spend more every year than they earn. So I find it deplorable that we feel bound to set an 18 percent interest rate ceiling for these people, which is three times the rate at which (as I have cited) a powerful corporation can borrow money on bonds while many of our greatest corporations finance themselves and do not have interest costs of large significance.

I think the ceiling should be very much lower. I don't put much stock in the idea that they should pay a higher interest rate because they are a greater risk. They may be a greater risk for profound reasons which should require that they get moneys at lower rates of interest, not higher. Indeed, I don't know that they are a greater risk because in general the records don't show that poor people don't meet their obligations as well as those higher up. It may be the reverse. I can't suggest a particular figure, because it goes to the question of other interest rates. There was a time in my recollection when some of the most conservative Members of the House and Senate joined with me in the idea of setting maximum interest rates on housing loans that were 50- to 75-percent lower than the effective rates now. The whole trend at that time was toward bringing interest rates downward. This was not only socially desirable; it was good for the country, for reasons that I can't elaborate here, due to the shortage of time.

The whole trend since 1952 has been moving in the opposite direction. If I had to pick a figure out of a hat, I would risk it and say that 15 percent or 12 percent would be better than 18.

Now, you will get a lot of objection to this on various grounds, and I couldn't support a precise figure at this moment. But 18 percent seems to me very much too high.

Mr. FINO. Are you telling this committee that at least 12 percent is the necessary figure?

Mr. KEYSERLING. No, sir. I am not saying that. I am saying that 12 percent or 15 percent would be better than 18. I am not going to take the position that even 12 percent is a conscionable interest rate for the kind of people borrowing money for these kinds of purposes. They ought to be able to borrow for much less, even if this requires new public programs.

Mr. FINO. Thank you.

Mrs. SULLIVAN. If any of the witnesses this morning have any other comments that you would like to add to cover the points raised today, please attach them to your transcript when it comes to you. We would be most happy to have them as part of the record.

With that the subcommittee is recessed until tomorrow at 10 when we meet with Secretary Wirtz, Mr. Farris Bryant of the Office of Emergency Planning, and Mr. I. W. Abel, president of the United Steelworkers of America.

(Whereupon, at 12:30 p.m., the subcommittee recessed, to reconvene at 10 a.m., Thursday, August 17, 1967.)

CONSUMER CREDIT PROTECTION ACT

THURSDAY, AUGUST 17, 1967

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CONSUMER AFFAIRS,
OF THE COMMITTEE ON BANKING AND CURRENCY,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10 a.m. in room 2128, Rayburn House Office Building, Hon. Leonor K. Sullivan (chairman of the subcommittee) presiding.

Members of the subcommittees present: Representatives Sullivan, Stephens, Annunzio, Bingham, Dwyer, Fino, Halpern, and Wylie.

Also present: Representative Widnall.

Mrs. SULLIVAN. The Subcommittee on Consumer Affairs will please come to order.

We are approaching the end of 2 long weeks of hearings on H.R. 11601 and H.R. 11602, two very different bills dealing with consumer credit, and we can look back now from this vantage point to see a tremendous amount of progress in delineating the issues involved in the Senate-passed truth in lending bill compared to the Consumer Credit Protection Act.

Again, I want to pay tribute to the faithful attendance of so many members of the subcommittee and the hard work and thought they have devoted during these past 2 weeks to this most important legislation.

Today, we will hear from the last two administration witnesses scheduled to testify on this legislation. We have already heard testimony from an imposing array of top administration leadership—the Secretaries of Commerce and of Housing and Urban Development, the Under Secretary of the Treasury, the Director of the Office of Economic Opportunity, the Administrator of Small Business Administration, the Special Assistant to the President for Consumer Affairs, the Chairman of the Federal Trade Commision, the Vice Chairman of the Federal Reserve Board of Governors, and the Commissioner of the Federal Housing Administration.

Today, we are privileged to have as our first witness the Honorable W. Willard Wirtz, Secretary of Labor, whose eloquence and wit and good hard sense make him one of the best witnesses any congressional committee could ever ask for. He is the only man I know in public life who could possibly have written some of the late Adlai Stevenson's speeches, for he has the same skill with words and concepts which made Mr. Stevenson's prose so delightful to hear.

Following Mr. Wirtz, we will hear from Mr. I. W. Abel, president of the United Steelworkers of America, one of the outstanding leaders of the American labor movement and one who has worked diligently

for the improvement of the conditions of living of all Americans.

Then, later in the morning, Gov. Farris Bryant, of the Office of Emergency Planning, will testify on the section of H.R. 11601 dealing directly with the question of wartime or national emergency standby credit controls—section 208.

The House is going to meet at 11 o'clock this morning. We have been assured, informally at least, that we could get permission to sit while the House was debating the social security bill. But all of us are very anxious to know the details about that bill, which is so important to our constituents. So, what we are going to try to do this morning is to hear all of our witnesses before 12 o'clock, if possible. We will divide most of the time up between Secretary Wirtz and Mr. Abel, with Governor Bryant coming in about 11:15 or 11:30. We have made arrangements for other witnesses who are coming in to present their statements for the record. I think it might be best, Mr. Secretary, if you would try to summarize your statement and then we will cut down the time for questioning by the members to about 3 minutes apiece instead of the usual 5 minutes so that we can make sure everyone has an opportunity to question.

We are particularly interested in your views and those of your Department on title II of H.R. 11601 dealing with the odious and cruel use of wage garnishment by unscrupulous credit or loan companies as a selling tool in extending credit without any attempt at assessing the applicant's ability to repay the debt except through the garnishment of his wages.

Of course, we welcome your views on any and all provisions of the legislation. Again, I want to say how pleased we are that you have accepted our invitation to appear. If you will proceed, Mr. Secretary, we will be very happy to have you start out this morning.

STATEMENT OF HON. W. WILLARD WIRTZ, SECRETARY OF LABOR; ACCOMPANIED BY ESTHER PETERSON, ASSISTANT SECRETARY FOR LABOR STANDARDS

Secretary WIRTZ. I understand the statement I filed will be made part of the record if that is agreeable, and I can summarize very quickly.

Mrs. SULLIVAN. The entire statement will be put in the record.

Secretary WIRTZ. In going over the record of these hearings I have come to two conclusions, (1) that they are very closely related to the proposals at hand, and (2) that they have been eminently constructive as far as the illumination of this subject, indeed so that there is very little left for me to say.

I don't want to burden this record. I don't want to be misunderstood. I incorporate by reference all that has been said by the other witnesses in support of this legislation and really, only add two other things. First, to point out that my particular reason for being here is that under the Department of Labor's organic law the Secretary of Labor is identified as having responsibility with respect to the interest of wage earners, and I know of no interest of a wage earner which is larger than the interest in the protection of his credit.

Because, when you think about it, there is as much importance to him in what his money buys as there is in the money that he gets because he spends most of it and I have pointed out in this statement

that some abuse of credit can have exactly the same effect on a wage earner as a reduction in his wages or a layoff.

It is just the other side of earning it. I pointed out, too, that we try, in our imperfect way, in this society to balance up the odds on the two sides of most bargains that are made in our capacity as producers.

As a producer, the wage earner is typically organized. As a consumer he is not organized. He bargains collectively on his wages but he buys alone. He buys without the advantage of advice of counsel which the other side has and he does it without knowledge of the fine print. I think that this legislation is an important vehicle to try to even up the odds as much as we can.

I would have preferred, as you know, to be testifying in support of even broader provisions than some of those included here. I respect greatly your statement on the floor that your purpose is to introduce some matters that go beyond the immediate prospects of passage.

I should be happy to be testifying in support of all of them. But because of the dictates of practicality, our interests center on the truth-in-lending provisions at this point so it is with respect to those provisions that my testimony is developed.

I have in the statement made reference to some of the other things which were in the original form of S. 5—some of the things which are in H.R. 11601. But I have noted too, that it does not seem to be a a compromise of principle to give reasonable recognition—and by reasonable I mean no more than is practically necessary—to the part which time plays whenever there is a change to be made.

I urge as strongly as I can the enactment of the truth-in-lending provisions, but I also urge that we keep on the agenda the other points that are raised in H.R. 11601.

I would like to say something about garnishment because it has played so large a part in your hearings these last several days, that not to say something about it would be to be misconstrued.

I expect I have a personal bias about garnishment.

I grew up in a small town where my family ran one of the two furniture stores in that town. That furniture store was run by a man who simply refused to bring the authority of the law to bear on his customers. Now, I expect that there was a little of the small town morality in that, and I expect it was not untinged by the realization that in a town that size you do business with people more than once and you just don't hit them the minute they leave the store.

He would never garnish a customer's wage.

There was another store in town which advertised easy credit. I don't remember the name of the competitor, but I remember what we called him around the supper table—it was "easy"—that was the term that was used. He was out of business in about 4 or 5 years, but he had quite an influence on the furniture business in that town and, frankly, I will be very happy to be here when "easy" and all his successors are caught up with because I don't like that way of doing business.

As Secretary of Labor, I know there are a great many people in this country who are denied employment because their wages have been garnished. It is just that simple, just that direct. And whenever there is anything which has the effect of denying employment to those who need it most I don't like it, and I think it is something we must attend to.

It was, therefore, with very great satisfaction that I saw the President's statement, as you did, in his March 14 poverty message in which he set out very clearly the necessity of doing something about garnishment and asked that a study be made by the Attorney General, the Secretary of Labor, and the Director of the Office of Economic Opportunity.

The study is being made and it isn't completed. I think probably it should be completed before there is definitive action in this particular area.

Strongly as I feel about the necessity of correcting this situation, I feel equally strongly we have to do the right thing about it, and by the right thing I mean whatever will be most effective. We know enough of the law on this subject to know that garnishment developed after we had prohibited imprisonment for debt. We left an opening and we don't want to do that again. This is not a simple subject. There are some hard questions. As an illustration, there is the question of whether there should be exemptions to any prohibition, of garnishment in the case of family debts—obligations such as alimony, child care, and so forth. That is not an easy one.

The experience of the States, of course, has been very extensive on this subject. It presents the question of whether there should be a prohibition or whether there should be a protection of a minimum wage. The experience in the States also presents the question of whether another effective remedy would be to prohibit discharge of an employee for having his wage garnished.

I originally thought the later was perhaps the answer. But now I don't think it is. I think that that puts the employer into an impossible position. So, I doubt that that's the answer. I think there is a serious question of what we do about wage assignments if we are going to prohibit garnishment, and I have listed some of those matters in my statement. I only say this, Madam Chairman and members of the committee, I think it is constructive counsel to suggest that there is still some more information to be obtained and some debate to take place with respect to how we may most effectively deal with the garnishment problem.

I suggest that, not as a counsel of delay, but as a counsel of doing the thing right. I come to the conclusion that there is more consideration which should be given to this matter than we can give now.

In concluding this summary, Madam Chairman and members of the committee, I think the country is in your debt for these last 2 weeks of illumination of this subject.

When I look back over the record of these hearings I realize that it is just almost incredible that we have waited this long to be this frank about something so important as this whole credit business.

I wish I could add more to it, and I stop only out of respect for what has already been developed and invite, with Mrs. Peterson, who is experienced in this area, I hardly need mention, whatever questions you have.

(The Secretary's full statement follows:)

STATEMENT OF W. WILLARD WIRTZ, SECRETARY OF LABOR

Madam Chairman and members of the subcommittee, there is legitimate question at this point whether much more can be said, without burdening the record unduly, about H.R. 11601.

The appearance here during the past two weeks of representatives of eight Government agencies and the Special Assistant to the President for Consumer Affairs attests the broad significance of this legislation and the full recognition of its importance.

So I shall be brief even to the point of risking misunderstanding.

The organic law of the Department identifies in the Secretary of Labor, however, a particular responsibility for "the interests of the wage earner," and few such interests are larger than that in protecting against abuse of his-or-her use of credit. For what is earned is useful principally for what it buys, and the effect of an unfair credit charge on a wage earner is indistinguishable from the effect of a wage reduction or a temporary layoff.

Wage earners are organized, to a considerable extent, in their capacity as producers; but not in their capacity as consumers. They bargain with employers collectively; but they buy alone, and at the disadvantage of unfamiliarity with the hazards of fine print. When they make purchase contracts, only the other party has the advantage of advice of counsel. They are entitled, at the very least, to have plainly stated truth as an ally when they go into the marketplace to buy the fruit of their own labor.

I make only the point that we try, in a variety of ways, to even up the odds between those who do business with each other and to prevent, so far as is practicable, undue advantage to either side in bargains that have to be made. The legislation under consideration contributes to this purpose in an area where it has been too little served.

Disclosure of the rates charged for consumer credit is an essential and important step toward more rational and fair consumer credit practices. Certainly, it is basic in deciding whether to borrow to buy. Without intelligible information on the cost of consumer credit, good management of family income is virtually impossible.

The buyer has every right to be told the price in words and figures he can understand—in terms which enable him to compare the rates offered by one seller or lender with those of another. And he should have the facts to permit him to decide whether he might not better wait and pay cash.

Both H.R. 11601 and H.R. 11602 contain workable disclosure provisions requiring the disclosure, in advance, of the terms of a consumer loan. They also require an itemized account of the cost of credit including all relevant charges, in dollars and cents, and the finance charges expressed as an annual percentage rate.

This means that the thoughtful buyer can gauge whether he will be able to meet the payments in dollars, and then—armed with an annual percentage rate—can make comparisons of charges between lenders or sellers. Without that calculated annual rate he is lost in a maze of confusing calculations.

I would prefer, frankly, to testify in support of the original provisions of S. 5, covering

—"open end" or "revolving credit,"

—transactions where finance charges are less than $10,

—first mortgages on homes.

Revolving credit—while still small in volume compared to automobile loans, for example—is the most rapidly growing type of consumer credit.

Department stores, mail order houses, furniture stores, jewelry stores, all advertise credit arrangements, many of them "revolving" or open-end. One has only to look at the advertisements in the Sunday paper to see how universal this has become. Accounts are invited, and indeed are urged on everyone strongly! Without a statement of the annual rate on such accounts, consumers will frequently not know what they are really paying for the credit they use.

The exemption of credit transactions involving a $10 annual credit charge or less, leaves out a great many credit purchases, especially those of the poor.

As a general rule, the rate of interest on most first mortgages is clearly stated and the various charges are itemized. But with the recent scarcity of first mortgage money and the prevailing practice of charging "points" for financing, some home buyers may not realize that they are in fact paying a higher rate on the total charge. Home buyers should be entitled to credit charge information, as are other borrowers.

There is a great deal to be said, too, for required disclosure of credit terms in advertising. If credit is offered this way, the offer is the place to apply the rule of whole truth—where less than that may mislead.

I note, too, the great service the Subcommittee has performed by bringing forward for public debate the other proposals contained in H.R. 11601, including

An 18% limitation on credit charges;
A prohibition against "confession of judgment" clauses;
Authority to regulate credit for commodity futures contracts;
Authority to restrict consumer credit during national emergencies;
Establishment of a National Commission on Consumer Finance; and
A prohibition against garnishment of wages.

It is no compromise of principle, however, to give reasonable recognition (which means no more than is practically necessary) to the part which time insists on playing wherever there is change to be made.

I accordingly urge the enactment now of the truth-in-lending provisions of H.R. 11601, with consideration of further safeguards given its separate timing.

A decent regard for a companion principle of truth-in-testifying prompts my saying a little more, however, about one of these further safeguards which has become the subject of particular attention in these hearings.

Perhaps my personal attitude about *garnishment* is influenced by having grown up in a family which was in the retail furniture business, but which was dead set against the idea of calling the law in to go after a customer's earnings. It seemed to the man who ran that store some way unfair to throw that much weight against anybody he did business with. Perhaps it was a small town morality—possibly even tinged with the realization that in that kind of community you count on doing business with the same person more than once. But I think it involved a more basic ethic, and a sense of the wrongness of ever letting institutions—and "the system"—get too large an advantage over individuals.

Perhaps, as Secretary of Labor, there is bias in the view that anything which results in the unemployment of people who are most in need of employment is wrong unless it is proven right on some more fundamental basis. When we surveyed the unemployment situation in ten slum areas last November, an astonishing number of people who were out of work listed their garnishment records as one of the reasons they couldn't get a job.

Whatever the explanation, I found basis for great satisfaction in President Johnson's saying, in his March 14 Poverty Message to the Congress:

> Hundreds of workers among the poor lose their jobs or most of their wages each year as a result of garnishment proceedings. In many cases, wages are garnished by unscrupulous merchants and lenders whose practices trap the unwitting workers.
>
> I am directing the Attorney General, in consultation with the Secretary of Labor and the Director of the Office of Economic Opportunity, to make a comprehensive study of the problems of wage garnishment and to recommend the steps that should be taken to protect the hard-earned wages and the jobs of those who need the income most.

This study is well along. It is not completed. It has to be, for whatever corrective action is taken in this area should be the right action; and some of the questions about dealing with garnishment are not easily answered:

Whether outright and unqualified abolition of garnishment is the right course; or
Whether tax debts and family relation obligations should be exceptions;
Whether only a minimum wage should be protected;
Whether the correction should be (although I think not) a prohibition not of garnishment but of discharge for having your wages garnished;
What, if anything, to do about wage assignments; and
Whether the commerce or the bankruptcy power can be more wisely used here.

Nor is it possible yet to be confident regarding what treatment of garnishment will prevent the development of some alternative procedure—just as garnishment developed as an alternative to imprisonment for debt.

The President has indicated his purpose to pursue "the steps that should be taken" to remedy the garnishment situation. The remaining question is how to do this. As strong as my own feeling about this practice is, I think it is constructive counsel that the garnishment issue be handled separately—after the truth-in-lending issue is disposed of, and after the garnishment study is completed—so that we can be certain that the corrective action is right and effective.

As President Johnson stated in his Consumer Message, "The American consumer today enjoys the highest standard of living ever experienced in the world.

And it has risen rapidly in recent years." But the President went on to point out that—

> . . . the march of technology that has brought unparalleled abundance and opportunity to the consumer has also exposed him to new complexities and hazards. It has made his choices more difficult. It has made many of our laws obsolete and has created the need for new legal remedies and safeguards.

This admonition is particularly pertinent to the need for consumer credit and wage garnishment legislation.

This concludes my statement. Assistant Secretary Peterson and I welcome the opportunity to repsond to any questions you may have.

Mrs. SULLIVAN. Thank you very much, Mr. Secretary.

I am delighted that you have brought Mrs. Peterson along. We are all very well acquainted with all of her talents and I am certain that either you or she can answer all of our questions.

I have just three short questions that I would like to ask and then as I said before, we will divide the time so that each member can have 3 minutes apiece to question the Secretary.

Mr. Secretary, we have had some very, very fine witnesses in these past 2 weeks on this garnishment problem.

Last Friday we had five gentlemen from the Federal court bankruptcy system, including four who are referees in bankruptcies. Their testimony was extremely enlightening and yesterday we had a Harvard professor of law who discussed some of the details that should be considered in writing this legislation. It was very helpful and they consulted with our counsel before they left.

Garnishment is a big problem, and I agree it is a problem that needs a lot of consideration, but it is a definite part of the overall picture of consumer credit because the misuse of credit so often results in garnishment and then, in turn, in personal bankruptcies.

Mr. Secretary, are you aware of a 1965 study done by the National Industrial Conference Board which showed that of the employees surveyed 43 percent had a policy of firing their employees in instances of repeated garnishment?

Given the fact, as one witness estimated for us the other day, that there are upwards of 4 million wage garnishments per year and in view of the clear policies of so many employers to fire workers who have been garnisheed, this would appear to have a serious impact on our economic stability, do you not agree?

Secretary WIRTZ. Yes, I would. There are a number of such studies which we have been looking into and surveying.

The NICB survey suggests figures that are in line with others. We are trying to arrive at a figure of the number of people who lose their jobs in this country as a result of garnishment. I can't tell you yet what that figure is, but I can give you the range. We think it is some place between 100,000 and 300,000.

That is the magnitude of this problem. It was reflected, too, in November 1966 when we went into the slum areas in 10 different cities to find out what unemployment looked like—not statistically but on a much more intensive basis. I think it was really the results of that study that brought this subject into such sharp attention. We found in those areas one of the significant factors is garnishment.

More people explained their unemployment on the basis of garnishment than their police records, which brought us up short.

Mrs. SULLIVAN. It is my understanding that in most States where an employer fires a worker because of garnishment the worker is

ineligible to receive unemployment benefits since such firing is considered to be a discharge for cause, is that correct?

Secretary WIRTZ. We are checking that. I don't have the complete report on the States. I cannot give you an up-to-date count but it is true that in a number of States that is the consequence.

Mrs. SULLIVAN. Can you tell us why the Department of Labor, in supervising unemployment insurance, accepts the policy that the discharge of a worker for wage garnishment is a discharge for cause, making him ineligible for unemployment insurance benefits? Could the Department change this policy without statutory amendments?

Secretary WIRTZ. The Congress has in its wisdom taken the position we should not go any further with State standards than we have so far gone. The particular point to which you refer has not been raised, but the effort last year to extend the standard concept, the Federal standard concept, was rejected and so the answer would have to be that we do not, in line with the last part of your question, now have authority to prescribe the standard.

Mrs. SULLIVAN. Mrs. Dwyer?

Mrs. DWYER. Thank you, Madam Chairman.

I, too, would like to say that it is wonderful to have Mrs. Peterson back on the Hill. It is always a joy to work with you here.

Mr. Secretary, is it my understanding that you prefer the garnishment provisions in this bill excluded?

Secretary WIRTZ. To answer that question one way or the other would be a little deceptive. I think quite sincerely we must find out more about what ought to be done with respect to it. I would—if the question is simply whether we go for straight abolition as provided in title II of H.R. 11601, I would have to say that I think that this is very possibly not the right answer, at least not in that form. We have to find what the right answer is with respect to these various points that I have mentioned.

I don't mean to evade your question. But I want our answer to be constructive. As the President has said in his poverty message, we must take steps to meet this problem.

If your question is whether I think we should take that step at this time, immediately at this time, I would think not.

Mrs. DWYER. Thank you very much. That would be all.

Mrs. SULLIVAN. Mr. Stephens?

Mr. STEPHENS. Thank you, Mr. Secretary, for coming before us.

As I gather from your statement on page 3, that you would prefer this bill as it came out of the Senate?

Secretary WIRTZ. I would argue for it as it went into the Senate. I don't think it was strengthened there. I recognize, of course, the practical considerations involved.

Mr. STEPHENS. What you mean, then, by the original provisions of S. 5, is not what came to us but what was originally introduced?

Secretary WIRTZ. I want to make clear that I do support many provisions of S. 5 as it came out of the Senate, but I made no bones, and Mrs. Peterson has made none, that there are some other things we think should be done that were in S. 5 as it was first reported.

Mr. STEPHENS. In respect to garnishment, we are all interested in it. But I think I would agree with you that we need to look into it more before we make a complete prohibition of it. Because as these areas

have developed I have learned a lot more about it than I thought I knew. I have been in the practice of law and have used it upon occasion when I was practicing law.

However, we have a provision in our State of Georgia about the amount that could be taken under garnishment proceedings from a wage earner. But there are some things that have been pointed out and you have pointed out some of them—the fact that it goes just beyond the fact that you are going to garnishee a man's wages. You might also prevent some wife from collecting alimony payments that are due to her.

Secretary WIRTZ. Or child care.

Mr. STEPHENS. And also a very important item: The Federal Government uses the garnishment procedure very much. In a complete review of garnishment it is true that the position of the Federal Government also may cause people to be discharged because of garnishment.

I have a tendency to feel that this committee, not composed of lawyers and people recognized in that field, might better wait and let the Judiciary Committee go into extensive hearings. They have more experts than we have on our committee in the field of judicial processes.

I would like to ask you to develop with me further if you would the differences between the original provision of S. 5 that we now have before us that would be preferable to what we have.

Secretary WIRTZ. My statement at the top of page 3 lists the three principal differences. As S. 5 started out it did cover the open end or revolving credit. It did cover first mortgages on homes and it covered transactions where the finance charges went down below the $10. The three changes made in the Senate were with respect to those points. Those are the ones that I have particularly in mind. I would add another one, that wasn't in the original S. 5, on which there has been considerable discussion. I think there is a considerable case to be made for extending these truth-in-lending requirements to advertising of credit.

That was not in the original S. 5, so I mentioned that in a separate category. It is in 11601 as are the other matters listed on page 4.

In specific answer to your question, it is the three points that were in the original S. 5 and were dropped out.

Mr. STEPHENS. Thank you very much.

Mrs. SULLIVAN. Mr. Fino?

Mr. FINO. Thank you, Madam Chairman.

Mr. Secretary, in view of the fact that you did not read your statement, I don't know whether you did cover in your statement two other points that have been the subject of some testimony and controversy before this subcommittee.

One of them is the garnishment which you have elaborated on. The other one is the standby controls on consumer credit. Some of the Government witnesses have testified.

Do you have the same position?

Secretary WIRTZ. I know there has been that discussion. I am afraid I can't answer on that. I have no sensitivity to testifying, I just don't know enough about it to know what standby controls might be necessary here.

Mr. FINO. The other point is on the question of the 18 percent national usury limits. There again, Government witnesses have indicated that they are not so sensitive on that phase of the bill.

Secretary WIRTZ. My position would be the same on that as on some other points—it is a pragmatic position. We need more information.

Mr. FINO. Mr. Secretary, you have expressed in connection with the garnishment ban a great concern about the evils of garnishment and yet the Federal Government, with the exception of Internal Revenue, does not permit garnishment.

Yet, although it does not permit garnishment of Federal employees' salaries it does fire employees if they have an accumulation of bills and get letters from creditors that the employee owes money.

Secretary WIRTZ. The Federal Government does?

Mr. FINO. We have seen that in the postal service. Some of these postal employees have come to me complaining their services had been terminated because they had an accumulation of bills. I was wondering about that.

Secretary WIRTZ. I would be opposed to it. I don't know on whose toes I am stepping but it is my greatly, deeply held conviction. It would not be my own sense of good management and it would not be the rule of the Department of Labor.

Mr. FINO. Getting back to garnishment, if we were to prohibit garnishment per se don't you think that would have a tremendous effect on our credit system in this country, in that retailers will not extend credit to anyone unless he pays for cash?

Secretary WIRTZ. I read the testimony of the witnesses last Friday before the committee and this is another area in which we are looking in connection with the study. Many have been assuming if we abolish garnishment, it would mean some reduction in the use of credit. This seems to me to follow almost automatically. Yet, I am frank to say that it is very hard to identify that effect when you look at the situation in Texas and Pennsylvania and Florida, which have abolished garnishment, and in several other States which have come so close to it that it has almost that effect.

You can't find the resultant effect on credit. It is a hard thing to measure. But I am willing to go along with the commonsense suggestion that if you tighten up on the use of this kind of practice it must have some effect on credit. It seems to me that plain.

I would be willing to accept that effect, but apparently it is less than I would have thought and perhaps by your question you seem to imply so. My answer—it could be a lot shorter—I think it must have some of that effect.

Mr. FINO. May I interrupt you, more particularly with the poor people? They will be the ones who will suffer the most because if you say retailer——

Secretary WIRTZ. Suffer the most?

Mr. FINO. Because they will not get the credit they are looking for.

Secretary WIRTZ. I don't think suffer. It seems to me they would be protected more. They really get themselves into a terrible situation.

Mr. FINO. When I say "suffer," they will not be able to make purchases the way they are making purchases now.

Secretary WIRTZ. I think that would be a blessing. Because when they put themselves dangerously in hock for a television set I don't believe they have done themselves a good turn.

In this morning's paper, there were some references bearing on this in the news of the disturbances last night. Now, I know we are not going to find the answers to our questions in what a rioter does. I think that is wrong. But you can't help noticing that, in the troubles last night in Houston and in Syracuse, among the institutions the rioters hit in both cases were discount houses. Some discount houses, as you and I know, are a real advantage to the consumer. I don't suspect that was the kind of discount house that was burned last night.

I repeat again, to look at the riots is likely to give us more wrong answers than right answers. I don't respect the judgment of an arsonist or anyone of that kind, but I can't be unaware of the fact that in all of the trouble that has developed this summer there has been a very interesting concentration of bitterness on those institutions which apparently follow the most extreme practices of repossessing, high charges, and so forth, that you are talking about.

Mr. FINO. Thank you.

Mrs. SULLIVAN. Mr. Annunzio?

Mr. ANNUNZIO. Thank you, Madam Chairman.

I take this opportunity to commend Mr. Wirtz for his excellent statement and contribution to the committee. But I also would like to point out to you, Mr. Secretary, as one of the sponsors of H.R. 11601 and one of those who has long advocated the elimination of garnishment laws, you made reference to the President's message of March 14, and 5 or 6 months have gone by and this study has not been completed.

It is needless for me to tell you, as I have told all the other government people, how disappointed I am. We have been holding hearings for 2 weeks and in that 2-week period we have received information to substantiate the point of view that I have long held. With reference to your colloquy with Mr. Fino, I would like also to point out one of the most important factors about garnishment of wages is that before a furniture store or a retail store or any other store would give credit, they would give more careful consideration to the application before authorizing credit which, in turn, would be a protection to the consumer.

Also, we would avoid some of the situations that have been happening. As you know, there have been many, many suicides reported in this country because of the garnishment laws.

I have brought to the attention of this committee the laws of the various States dealing with garnishment showing the percentage of a man's pay or the dollar amount of his pay which would be exempted from garnishment, and these laws are usually quite harsh. I have also brought to the attention of this committee the situation in Los Angeles County and in my own county of Cook. The record shows that thousands—in fact, millions of dollars are being spent merely in the litigation of this garnishment law in our own courts—money that could well be spent for the poor.

So I am hoping, Mr. Wirtz, that this study can be completed as soon as possible, I know that you attack all the jobs that are assigned to you with vigor and I know the outstanding job that you are doing as Secretary of Labor in administering the labor laws of this country—and as former director of labor for the State of Illinois, I know something about administering labor laws.

Secretary WIRTZ. A praise from Caesar.

Mr. ANNUNZIO. Mr. Secretary, I hope you will use whatever influence you have with the Attorney General, the Office of Economic Opportunity, and your own Department, which is involved in this investigation, to complete this study as soon as possible because I sincerely feel that garnishment is one of the really important problems facing the American worker in this country.

Secretary WIRTZ. I am grateful for this comment.

Mrs. SULLIVAN. Mr. Wylie?

Mr. WYLIE. Thank you, Madam Chairman.

Mr. Secretary, Mrs. Peterson, I, too, express my appreciation for your taking the time to appear here this morning. I, too, think the hearings have been most educational, at least for me and part of the reason is that we have been able to hear witnesses of your high caliber. Thank you.

Apparently the area of major controversy, maybe the only area of controversy is in the area of revolving credit.

Have you formed an opinion regarding the revolving credit provisions of the two bills? One bill provides that an effort should be made to relate revolving credit to an annual rate and the other bill provides for disclosure of the monthly rate of interest.

Secretary WIRTZ. I know this is a difficulty. It was debated out on the Senate side quite fully with the conclusion reached contrary to the original bill we had supported. We had supported the original bill which did cover revolving credit and it would be a mistake to say that we have changed our mind about it. In my judgment, and in our collective judgment, it should be included.

My answer is, on the merits, I think there ought to be a requirement of truth in lending which extends to the revolving credit situation.

On the practical question of time, without seeming to be presumptuous or invading your province, my reaction would be that we have to wait on that.

Mr. WYLIE. I don't mean to be presumptuous on that, either, but there is some objection to S. 5 on the basis of what the revolving credit people have to disclose. It may be an advantage to them if the disclosure is based on a monthly rate of, say, 1½ percent, whereas the installment seller disclosure, say, 18 percent on annual basis, and disclosing interest may not be too meaningful to the person going in to make purchases, anyway.

I have two questions then. One, would it be more meaningful if we said that everybody, every seller, had to disclose their interest charges on a monthly basis?

Secretary WIRTZ. A monthly basis? It would be better on the annual basis straight across the board. I think they all ought to be on the same basis, Mr. Wylie.

Mr. WYLIE. That was my point. Maybe they should all be on the same basis so they could actually relate the charges. If you could do it so all interest charges could be on the same basis, an annual basis would be your preference?

Secretary WIRTZ. That is correct. We have grown up in terms of an annual figure. The only reason they say 1½ percent is that somebody is going to relate it with the low 4 percent they grew up on, and I think they have a point.

Mr. WYLIE. That may be true.

How about the possibility of disclosing the amount of interest or service charges in dollars and cents rather than on an interest-rate basis?

Secretary WIRTZ. May I invite Mrs. Peterson's reaction?

Mrs. PETERSON. I don't think it is a substitute for knowing that these service charges are really charges for the extension of credit. Therefore, I would prefer certainly that the annual rate be shown, too.

Secretary WIRTZ. On a percentage basis rather than in dollars.

Mrs. PETERSON. The bill requires that it be stated both ways. But in order to make a comparison, the annual percentage basis is necessary. I would prefer that.

Mr. FINO. Will the gentleman yield?

Mr. WYLIE. I would like to ask one other question.

Do you think there is any danger if we establish a ceiling as to the rate of interest which becomes a usurious rate, that this might, in fact, become the floor?

Secretary WIRTZ. I surely do. That is a real concern about that 18 percent. I think I would have great trouble bringing myself to the support of an 18-percent limit for the very reason that you just talked about. I am afraid it would become par for the course.

Mr. WYLIE. Do you think that same thing might occur on the annualizing of the percentage rate?

Secretary WIRTZ. No, I have no disagreement with annualizing the percentages.

As for putting in the 18 percent as a limit, that is one provision which on the merits would give me personally some pause because I am afraid it would attract all charges to that level as well as limit it.

Mr. WYLIE. I have been informed my time is up. I have a little fear about this, too. And I think maybe more and more people have become accustomed to the monthly charge system and I think more and more credit is being extended on a monthly charge basis than on an annual basis so that we might well face up to that and educate people to monthly interest rates.

Secretary WIRTZ. Maybe.

Mr. WYLIE. Thank you.

Mrs. SULLIVAN. I think we are talking about two different things: one, setting a top rate of 18 percent on all consumer credit; and the other, disclosing a rate of 18 percent on revolving credit.

Secretary WIRTZ. That is correct.

Mrs. SULLIVAN. Your idea is that you don't want to see a Federal usury law.

Secretary WIRTZ. That is correct.

Mr. WYLIE. I don't think you can separate the two. I think establishing a ceiling on interest rates bears a relationship to the establishment of a usury law.

Mrs. SULLIVAN. I don't agree that they are related. We are not setting a ceiling on revolving credit by requiring its disclosure on an annual basis. We are just making them show the charges. The 18-percent ceiling would apply to all credit.

Mr. FINO. Will the Chairlady yield?

In connection with what Mrs. Peterson said and what the Secretary said, I am trying to clarify in my own mind if Mrs. Peterson said that

she preferred to have a percentage-rate disclosure rather than the dollar disclosure?

Mrs. PETERSON. What I am saying is, they need to know the annual rate they are paying, if the monthly rate is 1½ percent.

Mr. FINO. Do you think the average person, I happen to be a lawyer—do you think I am concerned with how much the rate is rather than dollars and cents?

Mrs. PETERSON. I think you are completely right; people think in terms of what the dollars and cents charges are. But also that leaves something to be desired because you have to know the annual rates to make the comparison between credit costs of different lenders.

Mr. FINO. Mr. Secretary, did I understand you to say that you would rather see the dollar disclosure?

Secretary WIRTZ. I think we need both dollars and annual percentage rates.

We lucky college graduates think our lives through in terms of percentages. I am not sure how real the percentage rate may be in some other people's minds, although we are all used to it in our mortgages. I do think there is a communications advantage in letting people know how much their purchase is going to take out of their paycheck for the next year. So I can make a good argument for a statement in terms of dollars. But since other elements in the conditions of sales discounts, duration of payments, and so forth, differ so much, you can't easily compare one seller's costs with another unless you have the annual rate. A lot of our thinking has been channeled in percentages. I think it is a good thing that the bill provides for both.

Mr. FINO. I want to thank the Secretary for his frankness in this connection.

Mrs. SULLIVAN. When you are shopping for a loan, for instance, and find you pay back $108 for a $100 loan at one place and $100 for a $100 loan at another, but only get $92, the dollar amount of the cost is the same at both places—$8.

But if you know that you are paying 15 percent for one or 18 percent for another, or 36 or 42 percent on some other kind of loan—even if you don't know how to figure the percentages, you know which is higher.

Secretary WIRTZ. You and I do. But you would be surprised how many times in connection with the letters that we get, the mail that we get about the unemployment figures it is indicated to us, and it comes as a shock how many people think 0.4 is larger than 3.8—that decimal point is a sophisticated concept and so that makes you wonder how generally communicated percentages are.

I don't want to overpress the point because I agree it would only be disturbing to move this thing out of the percentage pattern.

Mrs. SULLIVAN. Our bill calls for disclosure of both the amount and the percentage. But the percentage rates are all expressed in the same way, on an annual basis.

Mr. BINGHAM. I wish we could continue under the 5-minute rule.

Mrs. SULLIVAN. Mr. Bingham?

Mr. BINGHAM. I hate to be the one to interrupt my colleagues.

Mr. STEPHENS. My question is pertinent to the one being discussed. Go ahead.

Mr. BINGHAM. Thank you. I, too, would like to welcome you, Mr. Secretary, and Mrs. Peterson. I have the greatest admiration for work you are doing.

I would just like to make a couple of quick comments and then ask one question. My comments are that I think in this matter of dollars and percentages, it is in the use of dollars that the great abuses occur.

On a small loan of $50, $5 does not sound like much, but it is actually 120 percent. But people with very little education will come up with a jolt if they are told they are going to pay 120 percent per annum.

As to the work of your committee, it's nothing new that garnishment does not affect the volume of credit transactions. That was pointed out effectively by our witnesses last Friday but we also discussed at some length the California Law Review article in December 1965 which quotes studies from the Associated Credit Bureau going back to 1963 pointing out there is no correlation visible in the amount of installment credit and consumer credit that is used and the toughness of the garnishment laws. I realize you hadn't had an opportunity apparently to study these matters.

Secretary WIRTZ. You are wrong, Mr. Bingham. I am familiar with the article.

I don't believe there is a difference between them and I don't believe the testimony springs from ignorance. I stated as clearly as I could the fact that the studies revealed no reduction in the use of credit when these things come in.

Mr. BINGHAM. I thought you said you were surprised by the testimony.

Secretary WIRTZ. I still would retain the feeling that when you remove a loose credit device there is going to be some reduction in the use of credit. But I would like to make the record clear that my information, limited as it may be, coincides with yours as stated previously in the record that there is no evidence in any State in which garnishment has been abolished of a reduction in the use of credit.

I repeat that statement.

Mr. BINGHAM. I would like to ask you what your position is on the enforcement provisions contained in the Sullivan bill, 11601, that is the proposal for administrative enforcement that is not present in the Senate bill?

Secretary WIRTZ. Well, it is in general, Mr. Bingham, that the provisions in the Senate bill are adequate but are going to have to be watched. I have some concern, which I assume your question reflects, about leaving the remedies up to the individual who is involved here. I think especially in this situation that is going to present some question.

As between the two bills I would personally take the stronger enforcement provisions of H.R. 11601, but as in the case of other additional features of the bill, practical considerations are involved. I think I view either proposal with enough confidence to go along with it, but with the understanding that there might need to be improvements in the future.

Mr. BINGHAM. Thank you, very much.

Mrs. SULLIVAN. Mr. Halpern?

Mr. HALPERN. Thank you, Madam Chairman.

First, I wish to commend the distinguished Secretary for his forthright testimony and for giving us the benefit of his views. I am cer-

tain they will prove most helpful to this committee in developing an effective and meaningful bill.

I am also delighted to see our dear friend, Esther Peterson, here. Few persons know the subject before us better than this great lady and these hearings would be incomplete without her. It is a pleasure to have you here and I welcome you to this committee.

Mr. Secretary, you stated that the original version of S. 5 is preferable to the bill finally passed in the Senate.

The bill in the other body excluded revolving credit, small transactions and first mortgages.

Could you possibly elaborate on the actual disadvantages that might occur in the final version of S. 5, if that were to be passed?

Secretary WIRTZ. Not helpfully, Mr. Halpern. I think the bill as it came out has many good features. As for elaborating the significance of the three changes which were made in it, I would have no specifics to spell out the significance further. I think the largest one, the one that bothers us most, is the elimination of the annual percentage rate on open end or revolving credit. That has come into very general usage. I would grade them this way: I would think that is significant. I doubt if the elimination of the provision of the coverage of the first mortgage has anything like equal significance.

Now, I can tell you that as far as the third one is concerned, where the disclosure provisions do not apply to transactions where finance charges are less than $10, that is going to cut pretty deep as far as poor people are concerned.

Mr. HALPERN. You feel that the bill should include all transactions where the finance charges are $10 or less.

Secretary WIRTZ. No question about it. But I have to couple that with just the practical reaction that right now—and I don't propose to intrude upon the province which is yours—we need to pass this very important truth-in-lending legislation.

If I seem a little timid about not wanting to risk that, it is because we have wanted it for so long. That's the only qualification.

Mr. HALPERN. I would like to clarify some of your earlier remarks.

First, you stated that you don't think it would matter whether you disclose rates on a monthly or annual basis—an annual rate—as long as all rates are comparable, yet as long as savings accounts, bank loans, and other financial instruments express their interest or service charges on an annual basis for purposes of competition, is it not necessary to express other credit charges on an annual percentage?

Secretary WIRTZ. I want to be clear, I think it should be on an annual basis.

Mr. HALPERN. Since H.R. 11601, the bill that we are deliberating on now requires expression of both dollar and percentage terms, does this not satisfy all your desires in this regard?

Secretary WIRTZ. Yes.

Mr. HALPERN. Thank you, Madam Chairman.

Mrs. SULLIVAN. Thank you very much, Mr. Secretary. You and Mrs. Peterson have been very helpful and generous with your time.

(See letter from Secretary Wirtz, p. 793.)

Secretary WIRTZ. Thank you very much.

Mrs. SULLIVAN. I now call Mr. I. W. Abel, president of the United Steelworkers of America. Mr. Abel heads one of the largest trade unions in the United States, and one of the best.

The late Philip Murray, who founded that union a little more than 30 years ago, was always ready to serve his country by sharing his knowledge and wisdom with Congress and the executive department, and he participated in numerous governmental programs directly.

Mr. Abel is carrying on that tradition of public service by serving now as a member of the President's Commission on Civil Disorders—a tremendously important assignment which is taking a great deal of the time and energy of those Americans selected to serve on it. Consequently, we appreciate even more, Mr. Abel, your courtesy and helpfulness in coming here today. You are the only president of an international union we shall be hearing on this legislation, and we are happy to have you here.

As I asked the Secretary to do also—because the House is going to meet at 11 o'clock and we want to get in as much of your testimony as possible and also have time for the members to do some questioning—will you please summarize your statement rather than read it in full. The entire statement will go into the record, of course. You can go through the various parts of it, as prepared, or highlight it, as you see fit.

STATEMENT OF I. W. ABEL, PRESIDENT, UNITED STEELWORKERS OF AMERICA; ACCOMPANIED BY JOHN J. SHEEHAN, LEGISLATIVE DIRECTOR

Mr. ABEL. I would prefer to go through the statement as prepared. I will try to accommodate your wishes.

Mrs. SULLIVAN. All right.

Mr. ABEL. My name is I. W. Abel, I am president of the United Steelworkers of America which is an organization comprising over a million and a quarter working people. I appear before you to support the principle, incorporated in H.R. 11601, that all finance charges, involved in consumer credit, be converted to the common denominator of an annual percentage rate and be disclosed to the consumer.

At long last the issue of truth in lending is before a House committee. For more than 7 years, this legislation was trapped in the Senate Banking and Currency Committee without any glimmer of hope that it would reach the floor of the Senate for a vote.

It was during those years that the heroic efforts of Senator Paul Douglas kept the legislation alive. The American consumer owes a great debt of gratitude to this man for his crusading spirit to protect the average working man from misleading and, at times, unscrupulous credit practices in the marketplace.

The hard work and persistence of this committee will, I hope, be instrumental in correcting some unneeded compromises made in the Senate-passed bill and in contributing some new concepts of its own to the original bill.

During the last few years there has been a growing grassroots concern about and awareness of the plight of the consumer.

As a matter of public policy, the old adage, "Let the buyer beware," has been rejected by the American people. Congress, for the most part, has reacted favorably to this demand for legislative action. A consumer-oriented Congress has gradually expanded the areas of its scrutiny where the safety of the consumer was at stake.

It has also taken some steps when his economic interests were involved. Consumer credit vitally affects the economic well-being of every American family. Statistics presented to your committee indicate the phenomenal growth of consumer credit from $56 billion, just 6 years ago, to a current rate in 1966 of $95 billion. The interest charges are over $12½ billion.

Proper use of credit is, of course, an important factor contributing to the economic growth of the economy. However, the consumer cannot make a wise decision in the use of credit unless he has sufficient knowledge about the credit transaction. The consumer has the right to know the true cost of borrowing, just as he had the right to know the price of any other commodity he purchases.

Furthermore, as was pointed out to this committee by Sargent Shriver, Director of the Office of Economic Opportunity:

> It is the low-income consumer who is most likely to fall prey to the unscrupulous merchant or lender, because it is the low-income consumer who is undereducated, who needs the credit, and who must hunt for the bargain with the low downpayment.

It is little wonder, then, that pent-up resentment in the ghettos can become the fertile ground for the violent militant.

Just yesterday some of the members of our commission toured the ghettos of Harlem and certainly there is evidence at hand of every place you turn in areas like that of the impact and the need for this kind of action.

The truth-in-lending legislation, therefore, would provide both information and protection. The key tool is the provision which requires that there be a full disclosure both in dollar terms and in annual percentage rates of the cost of credit which is extended in making a purchase or obtaining a loan.

When credit transactions are reduced to a common denominator in terms of an annual percentage rate, then there can be an adequate comparison between the various forms of credit which are offered.

Furthermore, the consumer will be in a position to determine whether he can afford the credit. This, I think, is very important. The consumer should, at least, be given the information so that he can make that choice for himself.

I emphasize this factor of "ability to pay" because it has been the experience of saving and loan associations in Pittsburgh, Pa., that the primary cause of default for many homeowners has been the overburdening monthly payment obligations on other consumer debts and loans. These borrowers admit getting into financial difficulty without knowing it. When they came to a realization that they could not keep up their payments, they lost not only the articles which they purchased on time, but their homes as well.

The unwary consumer is too often misled by the sale with the low downpayment and the low monthly rate. He is usually not aware that the final price of his purchase may well be beyond his means.

The small loan companies, by failing to disclose the annual interest charge, or by misrepresenting the charges to be only 6 percent, are able to extract from the consumer rates which vary from 35 percent up to 100 or 200 percent.

Four years ago this month, the Senate Subcommittee on Banking and Currency went to Pittsburgh, Pa. A number of steelworkers testified before that committee. One of them, a president of a local union

with many years of seniority in a United States Steel plant, was a good credit risk. Yet on a loan of $152 he paid an interest rate of over 71 percent. He was completely unaware of the charge and could have obtained the same amount at the local bank for much less interest.

There is no need for me to enumerate the various methods of subterfuge used by small loan companies and finance institutions to hide the true annual rate of interest. This committee is by now fully aware of them. As a matter of fact, nearly every member of this committee has introduced a rate disclosure bill. Let me, however, address myself to some areas of controversy.

(1) REVOLVING CREDIT PLANS

There is absolutely no reason why the open end or revolving credit plans should be exempt from coverage of the annual disclosure requirement. Claims have been made by retail associations that the rate cannot be translated into annual percentage terms. These claims have been refuted by reliable experts.

Most department stores charge 1½ percent per month on the unpaid balance. This equals 18 percent a year and the stores should be required to make such a disclosure. The family which is counting its pennies can ill afford to have its income sifted away at rates of 18 percent a year.

Despite arguments to the contrary, the so-called "free ride" period does not really represent free use of credit. During those periods, the lack of credit charge is reflected in a higher price of the article. Hence, the credit should not be measured from the date of the purchase, but from the date the service charge actually begins. H.R. 11601 rejects the spurious argument of the retailers that revolving credit charges cannot be calculated on an annual basis. We agree.

The bill introduced by Congresswoman Sullivan rectifies the compromise which the Senate made on this issue by requiring annual percentage disclosure of all charges incurred in these plans. I can concur, surprisingly enough, in the statement of the American Bankers Association that this category of credit should not be exempt from the same requirements which apply to other creditors. According to the ABA, a single, nondiscriminatory system of time disclosure should be uniformly applied to all creditors and all types of credit.

The competition which the banks are offering through bank credit cards could be beneficial to the consumer.

I would like to insert for the record an article pertaining to this that appeared in the Wall Street Journal.

Mrs. SULLIVAN. Without objection it will be made a part of the record. (See p. 762.)

Mr. ABEL. If we are interested in giving the consumer a real opportunity, then there's every reason why we should encourage wholesome competition among these creditors.

Furthermore, the Senate's version could become an escape hatch whereby installment or closed-end credit plans could be converted into revolving credit plans and thereby escape annual disclosure.

The "installment open-end credit plan" wherein the creditor retains a security interest in the property purchased and the borrower does not pay more than 60 percent of the unpaid balance within 1 year is

arbitrarily designed to exempt other open-end or revolving credit plans. We oppose such exemptions and, hence, the need for the above-mentioned definition.

(2) FINANCE CHARGES

We strongly urge that H.R. 11601, which includes credit health and/or life insurance premiums within the definition of a finance charge, be approved. The Senate bill excludes these premiums even though, in most cases, they are incident to the extension of credit.

The use of this insurance, in many cases, is a subterfuge for raising the true cost of the loan to the borrower. By quoting a lower interest charge and then requiring the borrower, as a condition for receipt of the loan, to purchase a credit life insurance, the creditor, in reality, may be charging a very high rate of interest.

Moreover, there is growing evidence of a tie-in between the small loan companies and credit life insurance. In testimony before the Senate Antitrust Subcommittee evidence was given that banks, finance companies, and other consumer-loan institutions require their borrowers to take out certain insurance policies for which they are getting kickbacks from the insurers. In such cases, the creditor accepts the highest bid rather than the lowest for this type of insurance because he can receive the difference in a kickback.

In many cases credit companies set up their own insurance companies. In an article which appeared in the New Republic, James Ridgeway discloses that the CIT Finance Corp. through a wholly owned subsidiary, the North American Co., insures its credit life insurance policies wherein there was a gross profit of 50 percent in premiums or $6.8 million in 1965. And this profit is on top of the rate that is already being charged for the loan.

I should like to submit two articles for the record dealing with this subject. (See p. 758.)

(3) SMALL INSTALLMENT TRANSACTIONS

Unfortunately, the Senate bill exempts from coverage installment sales and loan transactions in which the finance charge is less than $10. The reason for this exclusion defies explanation.

In a bill which is admittedly designed to afford the consumer protection, the proponents for this dropout from coverage claim that the interest rate is so high that, and I quote from the testimony of the Federal Reserve Board:

> The creditors may be understandably reluctant to disclose a high annual percentage rate, and might instead simply discontinue this type of credit.

Well, all I can say is that the consumer himself might well decide to discontinue this type of purchase if he knew what the true charges were. It is that right which we are trying to provide by this legislation.

We are also concerned that a single unit of purchase might be subdivided into parts in order to come under the $10 finance charge loophole. The purchase, for instance, of a $50 chair with a $5 finance charge at the end of the month amounts to a 120-percent annual rate.

The exclusion of these transactions would, of course, have a real adverse impact upon the low-income wage earner who needs the protection of this bill the most.

(4) GARNISHMENT

Madam Chairman, a Federal antigarnishment law is long overdue. You are well aware of the vicious repercussions of garnishments. Many employers, rather than undertake the costly procedure to garnishee wages, will discharge the worker. Or the worker, driven by the threat of discharge or loss of reputation, will seek out other loan companies to pay off the original loan. Eventually, many of them end up in the hands of the "loan sharks."

Garnishment increases the security of the creditor thereby making them willing to extend credit to borrowers that they otherwise might not accommodate. The protection, which the creditor thus obtains, makes him most eager to entice the wage earner into his tender trap.

Stripped of this privilege the lenders will be more cautious in their extension of credit. The labor movement has consistently opposed the garnishment of wages. It is reminiscent of the days when workers were thrown in jail until such time as they would pay their debts. Now, instead of seizing his person, they seize his wages and, in many cases his job.

Last year the Wall Street Journal carried an article indicating that at the Inland Steel plant in East Chicago, Ind., each pay period the company makes deductions from about 2,000 production employees—all of whom are members of our union. Inland annually pays out more than $500,000 in withheld wages to creditors.

Even the editorial page of the Journal remarks that:

> In their own interest lenders could stand a stronger dash of self-restraint. By paying a little less attention to boosting their business and a little more to a borrower's actual ability to repay, they not only would protect their own solvency but possibly head off new restrictive legislation.

Inland Steel has written to Congressman Annunzio expressing their concern that these garnishments not only are a heavy financial burden to the company but that "this repayment device may well lead to the extension of credit to wage earners in situations where credit more reasonably might be withheld."

Mrs. SULLIVAN. Your attachments will be made part of the record.

We previously had a letter from Inland Steel that Congressman Annunzio inserted in the hearings.

Mr. ABEL. I, too, have a copy of Inland's letter and I would like to attach that to my statement.

Mrs. SULLIVAN. That will be done.

Mr. ABEL. A recent study conducted by the Labor Department "How Garnisheed Workers Fare Under Arbitration," which appeared in the May issue of the Monthly Labor Review, mentions that a worker's going into debt, like any other off-duty conduct, generally should be of no concern to the employer. However, if defaulted debts are subject to garnishment, then arbitrators tend to treat this the same as off-duty misconduct and uphold the right of the employer to discharge the worker.

Mrs. SULLIVAN. That, too, without objection will be made part of the record.

Before you continue, Mr. Abel, I want to announce that we will recess for a few minutes in a little while but if any of the members

wish to go over to the House floor now and have their names recorded and then come back, they may be excused.

We are going to continue here until we get through with the witnesses.

Mr. ABEL. In many States the labor movement is trying to get the State legislatures to pass laws to prevent discharge due to garnishment. Where there is an organized plant the discharge is subject to the grievance procedure and arbitrary discharge is prevented. But what about the many unorganized low-income workers who are most subject to the blandishments of easy-money advertisement. What recourse do they have where there is no union to protect them. At the very least, there should be a Federal law prohibiting the discharge of employees because of garnishment.

In some cases the tenacious lender pursues the employee into another State jurisdiction where there may be more liberal garnishment laws. One steel corporation has actively pushed a bill in Congress to prevent the courts of the District of Columbia from issuing a garnishment decree which is not consistent with the State law in which the worker resides and draws his income. For instance, the State of Pennsylvania prevents garnishment but it is of no avail to the worker if the District of Columbia courts can attach his wages.

Strong testimony was given to you by a group of referees in bankruptcy wherein they attest to the fact that in those States where there is no garnishment there is a drastic reduction in the number of personal bankruptcy cases.

According to Mr. Elmore Whitehurst, Texas:

It is my considered judgment that it is the result of these prohibitions and not a mere coincidence that the bankruptcy courts in Texas have a far less number of wage earner cases than states of lesser population which have severe garnishment statutes.

Furthermore, there is no evidence that a prohibition of garnishment of current wages has by any means put loan companies out of business. It has not happened in Pennsylvania. We are confident it will not happen elsewhere.

The experience of many of our State labor federations at the State legislatures indicates that a Federal law is necessary. In some States there is absolutely no protection.

In others, there are various degrees of protection. Only three States—Texas, Florida, and Pennsylvania—have a total prohibition. It is now time to have a uniform Federal prohibition. I, therefore, urge that this committee retain the antigarnishment provision of H.R. 11601.

I would like to conclude right here and have in the record the remainder of the statement. I did want to touch on our position with respect to garnishment provisions of the bill.

Mrs. SULLIVAN. We are very happy that you did, Mr. Abel.

Your full statement will be placed in the record at this point.

(The statement and additional material referred to follow:)

STATEMENT OF I. W. ABEL, PRESIDENT, UNITED STEELWORKERS OF AMERICA

My name is I. W. Abel, I am President of the United Steelworkers of America which is an organization comprising over a million and a quarter working people. I appear before you to support the principle, incorporated in H.R. 11601, that all finance charges, involved in consumer credit, be converted to

the common denominator of an annual percentage rate and be disclosed to the consumer.

At long last the issue of truth-in-lending is before a House committee. For more than seven years, this legislation was trapped in the Senate Banking and Currency Committee without any glimmer of hope that it would reach the floor of the Senate for a vote. It was during those years that the heroic efforts of Senator Paul Douglas kept the legislation alive. The American consumer owes a great debt of gratitude to this man for his crusading spirit to protect the average working man from misleading and, at times, unscrupulous credit practices in the market place.

The hard work and persistence of this committee will, I hope, be instrumental in correcting some unneeded compromises made in the Senate-passed bill and in contributing some new concepts of its own to the original bill.

During the last few years there has been a growing grassroots concern about and awareness of the plight of the consumer. As a matter of public policy, the old adage "Let the buyer beware" has been rejected by the American people. Congress, for the most part, has reacted favorably to this demand for legislative action. A consumer-oriented Congress has gradually expanded the areas of its scrutiny where the safety of the consumer was at stake. It has also taken some steps when his economic interests were involved. Consumer credit vitally affects the economic well-being of every American family. Statistics presented to your committee indicate the phenomenal growth of consumer credit from $56 billion, just six years ago, to a current rate in 1966 of $95 billion. The interest charges are over $12½ billion.

Proper use of credit is, of course, an important factor contributing to the economic growth of the economy. However, the consumer cannot make a wise decision in the use of credit unless he has sufficient knowledge about the credit transaction. The consumer has the right to know the true cost of borrowing, just as he has the right to know the price of any other commodity he purchases. Furthermore, as was pointed out to this committee by Sargent Shriver, Director of the Office of Economic Opportunity, "It is the low-income consumer who is most likely to fall prey to the unscrupulous merchant or lender, because it is the low-income consumer who is undereducated, who need the credit, and who must hunt for the bargin with the low down-payment". It is little wonder, then, that pent-up resentment in the ghettos can become the fertile ground for the violent militant. (See attachment 1.)

The truth-in-lending legislation, therefore, would provide both information and protection. The key tool is the provision which requires that there be a full disclosure both in *dollar terms* and in *annual percentage rates* of the cost of credit which is extended in making a purchase or obtaining a loan. When credit transactions are reduced to a common denominator in terms of an annual percentage rate, then there can be an adequate comparison between the various forms of credit which are offered. Furthermore, the consumer will be in a position to determine whether he can afford the credit. This, I think, is very important. The consumer should, at least, be given the information so that he can make that choice for himself.

I emphasize this factor of "ability to pay" because it has been the experience of saving and loan associations in Pittsburgh, Pennsylavnia, that the primary cause of default for many homeowners has been the overburden monthly payment obligations on other consumer debts and loans. These borrowers admit getting into financial difficulty without knowing it. When they came to a realization that they could not keep up their payments, they lost not only the articles which they purchased on time, but their homes as well.

The unwary consumer is too often misled by the sale with the low down-payment and the low monthly rate. He is usually not aware that the final price of his purchase may well be beyond his means.

The small loan companies, by failing to disclose the annual interest charge, or by misrepresenting the charges to be only six percent, are able to extract from the consumer rates which vary from thirty-five percent up to one hundred or two hundred percent.

Four years ago this month, the Senate Subcommittee on Banking and Currency went to Pittsburgh, Pennsylvania. A number of steelworkers testified before that committee. One of them, a president of a local union with many years of seniority in a U.S. Steel plant, was a good credit risk. Yet on a loan of $152 he paid an interest rate of over seventy one percent. He was completely unaware of the charge and could have obtained the same amount at a local bank for much less interest.

There is no need for me to enumerate the various methods of subterfuge used by small loan companies and finance institutions to hide the true annual rate of interest. This committee is by now fully aware of them. As a matter of fact, nearly every member of this committee has introduced a rate disclosure bill. Let me, however, address myself to some areas of controversy.

(1) *Revolving credit plans.*—There is absolutely no reason why the open-end or revolving credit plans should be exempt from coverage of the annual disclosure requirement. Claims have been made by retail associations that the rate can not be translated into annual percentage terms. These claims have been refuted by reliable experts.

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Despite arguments to the contrary, the so-called "free ride" period does not really represent free use of credit. During those periods, the lack of credit charge is reflected in a higher price of the article. Hence, the credit should not be measured from the date of the purchase, but from the date the service charge actually begins. H.R. 11601 rejected the spurious argument of the retailers that revolving credit charges cannot be calculated on an annual basis. We agree.

The bill introduced by Congresswoman Sullivan rectifies the compromise which the Senate (S–5) made on this issue by requiring *annual percentage* disclosure of all charges incurred in these plans. I can concur, surprisingly enough, in the statement of the American Bankers Association that this category of credit should not be exempt from the same requirements which apply to other creditors. According to the A.B.A., a single, nondiscriminatory system of time disclosure should be uniformly applied to all creditors and all types of credit.

The competition which the banks are offering through bank credit cards could be beneficial to the consumer. (See attachment 2). If we are interested in giving the consumer a real opportunity, then there is every reason why we should encourage wholesome competition among these creditors.

Furthermore, the Senate's version could become an escape hatch whereby installment or closed-end credit plans could be converted into revolving credit plans and thereby escape annual disclosure.

The "installment open-end credit plan" wherein the creditor retains a security interest in the property purchased and the borrower does not pay more than sixty percent of the unpaid balance within one year is arbitrarily designed to exempt other open-end or revolving credit plans. We oppose such exemptions and, hence, the need for the above mentioned definition.

(2) *Finance charges.*—We strongly urge that H.R. 11601, which includes credit health and/or life insurance premiums within the definition of a finance charge, be approved. The Senate bill excludes these premiums even though, in most cases, they are incident to the extension of credit. The use of this insurance, in many cases, is a subterfuge for raising the true cost of the loan to the borrower. By quoting a lower interest charge and then requiring the borrower, as a condition for receipt of the loan, to purchase a credit life insurance, the creditor, in reality, may be charging a very high rate of interest.

Moreover, there is growing evidence of a tie-in between the small loan companies and credit life insurance. In testimony before the Senate Antitrust Subcommittee evidence was given that banks, finance companies, and other consumer-loan institutions require their borrowers to take out certain insurance policies for which they are getting kickbacks from the insurers. In such cases, the creditor accepts the highest bid rather than the lowest for this type of insurance because he can receive the difference in a kickback.

In many cases credit companies set up their own insurance companies. In an article which appeared in the *New Republic*, James Ridgeway discloses that the CIT Finance Corporation through a wholly-owned subsidiary, the North American Company, insures its credit life insurance policies wherein there was a gross profit of fifty percent in premiums or $6.8 million in 1965. And this profit is on top of the rate that is already being charged for the loan. (I should like at this point in my testimony to submit two articles for the record dealing with this subject). (See attachment 3.)

(3) *Small installment transactions.*—Unfortunately, the Senate bill exempts from coverage installment sales and loan transactions in which the finance charge is less than $10. The reason for this exclusion defies explanation. In a bill which is admittedly designed to afford the consumer protection, the proponents for this drop-out from coverage claim that the interest rate is so high that, and I quote

from the testimony of the Federal Reserve Board, "[The creditors] may be understandably reluctant to disclose a high annual percentage rate, and might instead simply discontinue this type of credit." Well, all I can say is that the consumer himself might well decide to discontinue this type of purchase if he knew what the true charges were. It is that right which we are trying to provide by this legislation.

We are also concerned that a single unit of purchase might be subdivided into parts in order to come under the $10 finance charge loophole. The purchase, for instance, of a $50 chair with a $5 finance charge at the end of the month amounts to a 120 percent annual rate.

The exclusion of these transactions would, of course, have a real adverse impact upon the low-income wage earner who needs the protection of this bill the most.

(4) *Garnishment.*—Madam Chairman, a federal anti-garnishment law is long overdue. You are well aware of the vicious repercussions of garnishments. Many employers, rather than undertake the costly procedure to garnishee wages, will discharge the worker. Or the worker, driven by the threat of discharge or loss of reputation, will seek out other loan companies to pay off the original loan. Eventually, many of them end up in the hands of the "loan sharks."

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I understand that Inland Steel has written to Congressman Annunzio expressing their concern that these garnishments not only are a heavy financial burden to the company but that "this repayment device may well lead to the extension of credit to wage earners in situations where credit more reasonably might be withheld." (See attachment 4.)

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Strong testimony was given to you by a group of referees in bankruptcy wherein they attest to the fact that in those states where there is no garnish-

ment there is a drastic reduction in the number of personal bankruptcy cases. According to Mr. Elmore Whitehurst, Texas, "It is my considered judgment that it is the result of these prohibitions and not a mere coincidence that the bankruptcy courts in Texas have a far less number of wage earner cases than states of lesser population which have severe garnishment statutes."

Furthermore, there is no evidence that a prohibition of garnishment of current wages has by any means put loan companies out of business. It has not happened in Pennsylvania. We are confident it will not happen elsewhere.

The experience of many of our state labor federations at the state legislatures indicate that a federal law is necessary. In some states there is absolutely no protection. In others, there are various degrees of protection. Only three states (Texas, Florida and Pennsylvania) have a total prohibition. It is now time to have a uniform federal prohibition. I, therefore, urge that this committee retain the anti-garnishment provision of H.R. 11601. (See attachment 6.)

Enforcement.—H.R. 11601 is stronger than the Senate bill in that it provides more than "self-enforcement." Administrative enforcement of the Act by the Federal Reserve Board through cease and desist orders are a necessary complement to the right of an aggrieved individual to bring civil suit where information has not been properly provided. We note that the Board is reluctant to assume this responsibility, although it recognizes that "self-enforcement is probably less effective, however, in the field of advertising."

Usury.—The question as to what should be the maximum ceiling for interest charges is quite a different one from whether there should be a ceiling. We agree that usurious rates should be proscribed. We are not in a position, however, to advise this committee what that rate should be. The various types of credit situations should be reviewed by this committee. The relationship of an interest rate to the all-inconclusive finance charge must be made. But we support the idea that all charges which are incident to the loan should also be included in any calculation of a ceiling. Otherwise, we are fearful that a low-interest ceiling will be compensated by high finance charges. Certainly, the question of the rate could be an area of investigation by the proposed National Commission on Consumer Finance. Te salutary effect of a disclosure bill will, we hope, create an atmosphere of competition among creditors which would help to drive down interest charges.

Conclusion.—Madam Chairman, we know that effective lobbying by financial institutions has prevented an earlier enactment of a truth-in-lending bill. However, in the process the American people have been educated about the issue. There is now both a need and a demand for this legislation. A national consensus has evolved. Your committee, we hope, will give legislative expression to that consensus. The United Steelworkers of America appreciates the opportunity to appear before you in order to add its voice to that consensus.

Senate Unit Investigates Charges That Credit Insurance Is "Tied In" to Consumer Loans

According to several witnesses who testified before the Senate Antitrust Subcommittee last week, consumer-lending companies are forcing small borrowers to buy credit insurance at excessive rates. Subcommittee Chairman Philip A. Hart (D-Mich) estimated that 85 percent of all consumer installment credit is "tied in" with insurance that guarantees repayment of a loan in case a borrower dies or becomes ill.

Allegedly, banks, finance companies, and other consumer-loan makers who require their borrowers to take out these insurance policies are getting kickbacks from the insurers.

Although insurance regulation is now left almost entirely to the states, the Antitrust Subcommittee believes it may have jurisdiction over these credit-insurance arrangements because of the tie-in feature. Even some state insurance commissioners, the hearings revealed, reluctantly admit that federal regulation may be needed to protect small borrowers against exorbitant credit-insurance charges.

Senator Hart announced that he is going to send the transcript of his Subcommittee's credit insurance hearings to the Justice Department and the Federal Trade Commission. He will ask the agencies to see if the testimony uncovered any violations of law and to explore the possible avenues of federal intervention in this field, including use of the antitrust laws.

On May 16, James H. Hunt, Vermont's Commissioner of Banking and Insurance, said he doubted that the states, "as a group, are dealing affirmatively and effectively with this problem" 13 years after a previous investigation of abuses by the Senate subcommittee. While he shies away from recommending federal action in a field which Congress has reserved for the states, he said there "would be many advantages to federal regulation" and he would not "worry much" if there were "dual regulation."

"In *most* states," Mr. Hunt testified, "the debtor is paying excessive premiums and needs help . . . Credit insurance is subject to widespread abuse." He claimed that "fantastic profits are being made from the incidental sale of insurance in connection with loans and other transactions."

The real culprits and beneficiaries in this insurance tie-in system are the creditors, not the insurance companies, Mr. Hunt asserted. Since the lenders typically sell the insurance on a commission basis, they push the policies with the highest rates in order to receive the highest rebates. As Mr. Hunt put it, "The creditor accepts the highest bid rather than the lowest because he gets the differences in kickbacks in one form or another." He called this "reverse competition"—competition that pushes rates up rather than down. "The debtors form a captive market for the insurance and have no ability to evaluate the reasonableness of the insurance charge," Mr. Hunt added.

ABUSES

Vermont's commissioner pointed out that in many cases the credit extenders set up their own credit-insurance companies. He said the insurance abuses include failure to refund the unearned insurance premium on refinancing or repayment of the debt, pyramiding of policies when debts are refinanced, excessive coverage, the addition of finance charges to the insurance premium, and failure to refund finance charges on prepayment of a debt due to the death of an insured debtor.

Many of the best insurance companies, Mr. Hunt indicated, are discouraged by the abuses from seeking new business in the credit-insurance field. He said the largest companies "are only modest participants in credit insurance" and "this is a serious indictment of the credit-insurance industry for it tends to breed a myriad of inefficient companies whose administrative and other expenses would choke them if they had to compete on a price basis."

Many of the Vermont commissioner's views were echoed by South Carolina's Chief Insurance Commissioner, Charles W. Gambrell. He described consumer-credit insurance as a "camouflage to obscure from the borrower the actual cost to him of the loan" and as "a devious and costly rigmarole" intended to increase the lender's income.

He related the difficulties his state has been having in coping with this problem. "To urge that this solemn farce which is called consumer-credit insurance be ended or curbed through denying the privileged sanctuary represented by McCarran-Ferguson [the federal law] to these tie-in transactions which pose as 'insurance,' is not to espouse federal regulation of insurance. Indeed, freeing state regulation from the impossible burdens of attempting to reach the real parties in interest, the lenders, through regulating the insurers, who are held in thralldom by the lenders, would enable state regulation to address itself to its true functions of regulating for solvency and protecting the insuring public."

VERTICAL MONOPOLY

Specific federal legislation was proposed by Edward C. Fritz, a Dallas attorney, at the May 17 hearing. He said that credit-insurance sales by lenders is "a type of vertical monopoly whereby the lender prevents the borrower from shopping for insurance of his choice, prevents competition, and restrains trade * * * in violation of the Sherman Antitrust Act." But, he added, under existing law "it is difficult to enforce a prohibition against tied-in sales of credit insurance." The best solution would be a new law that would "separate the creditor from the insurance company and from the insurance income. This can be done by prohibiting the creditor from obtaining any compensation, directly or indirectly, from the insurance except the insurance security for the loan or for the pledged property." Mr. Fritz maintained that a federal law is "the only likely hope for protection to the consumer from the evils of tied-in insurance."

Another state insurance commissioner, testifying before the Subcommittee on May 18, said the consumer-credit insurance field has "become a racket." Massa-

chusetts' Deputy Banking Commissioner, John P. Clair, urged action by both the states and the Subcommittee to stop overcharges and other abuses that he described as "mighty close to larceny."

Mr. Clair recommended that the Subcommittee look into the field of educational loans. Many colleges have been embarrassed to find they've been referring parents to loan plans that charge "outrageous" insurance rates and are "misleading" as to credit costs.

"It's time that we call a halt in this country to lenders making more money selling insurance than lending money," Mr. Clair declared. He said the situation has reached the point where insurance companies are getting into the lending business to share in the profits creditors are making on the sale of consumer credit life, health, and accident insurance.

MODEL STATE LAW

Two Maryland witnesses testified about similar abuses in their state. Attorney General Francis B. Burch and former Insurance Commissioner Norman Polovoy predicted that, in 1968, their state would pass the model law of the National Association of Insurance Commissioners designed to curb consumer-credit-insurance abuses and overcharges.

But Subcommittee Chairman Philip A. Hart (D-Mich) expressed doubt that the model law would be the solution. More than half the states have adopted it, and many still have high credit insurance rates.

Mr. Burch and Mr. Polovoy both stressed the importance of state rate regulation and of adequate enforcement as other needed factors in controlling credit insurance. Mr. Polovoy estimated that more than $2 million of the $9,638,000 Marylanders paid for credit insurance last year was excessive. He said that, in his opinion, lenders should pay the entire cost of the insurance for small loans since it provides them with "additional security and protection."

The senators also heard Cecil G. Huskey, a Charlotte, North Carolina, homebuilder relate his personal experience with abusive credit insurance.

Mr. Huskey claimed that North Carolina's fourth largest bank, First-Citizens Bank & Trust Co., pushed the cost of his business loans as high as 36 percent by making him buy credit insurance from an affiliate. The first time he went to the bank for a loan, no credit insurance was required. But the next time, he testified, a bank official insisted that he buy credit insurance through the bank at a very high rate. When he asked the bank official why he couldn't buy a cheaper policy elsewhere, Mr. Huskey said the official replied, "We want to make money, too."

At the May 19 hearing, Leonard J. Harmatz, a Baltimore attorney charged that "Maryland is an open field for the practice of loan sharks and racket lending."

Two specific Maryland loan firms were named by Charles W. Grambrell, the South Carolina Insurance Commissioner. Attorney General Burch told Senator Hart that he will investigate the Atlantic Management Co. of Silver Spring, which trades as Maryland Cash Loans, and Investor Loan of Frederick.

[From the New Republic magazine]

DIRTY DEAL IN SMALL LOANS

(By James Ridgeway)

Finance companies are making a killing on insurance. Tacked on to their high interest rates is an exorbitant charge for insurance, used to repay the loan in case the borrower dies. It takes the risk out of lending.

But what the customers probably don't know is that relatively few borrowers die before loans are repaid. Much of the premiums are pure profit, and a good bit of it is funneled back to the finance company either in the form of commission or because the loan company owns the insurance company.

In a speech in Chicago last week, Dean Sharp, an assistant counsel of the Senate antitrust and monopoly subcommittee, said an unpublished committee report on credit life insurance indicates that borrowers have been overcharged $700 million since 1959.

About 80 percent of the $72 billion in outstanding consumer debt is covered by credit life insurance. This is financing for automobile and household appliances as well as personal loans.

Premiums for credit life vary around the country, and run from a low of 37.5 cents per $100 borrowed per year charged by General Motors Acceptance Corp., the biggest finance company, to $2 per $100 asked by the small loan companies located near military bases. A usual premium is $1 per $100. The insurance usually

is calculated on the whole loan and must be paid at the outset. This can add up: A Washington finance company recently quoted a price of $30 for insurance on a three-year, $3,000 loan.

Credit life is a relatively small part of the insurance industry, but it is the fastest growing. The business is lucrative because costs are low, and borrowers seldom howl. Once in the hands of a finance company they are too beaten down to figure out the different charges which frequently are hidden. Last year 63 million borrowers paid insurance companies $590 million in premiums for credit life. The major costs to the insurer are death payments, but they only came to $280 million. James H. Hunt, Vermont's insurance commissioner, and one of the people concerned about the high cost of this insurance, said recently that actuarial studies showed the cost of a claim to be only 30 cents per $100 borrowed. The insurance companies themselves have said that administrative expenses run a bit under 5 cents per $100. This brings total cost to 35 cents. So, if a company charges the usual $1 per $100 rate, it comes out with a profit of 65 cents.

This system can result in rosy profits. For example, Old Republic Life Insurance Co. of Chicago is one of the biggest firms specializing in credit life and writes little else. In 1965 Old Republic reported premiums of $62.6 million and paid out death benefits of $23.3 million. This suggests a gross profit of 63 percent.

The interests of the finance and insurance companies frequently coincide. The insurance company pays the finance firm a commission on the credit life sold and, of course, the more made in premiums, the higher the commission. At the end of a good year, it is common practice for the insurance company to kick back profits to the finance company. This is known in the trade as the retrospective rate credit. Thus, competition works in reverse. Instead of looking around for the cheapest insurance for its borrowers, it is very much in the interest of the finance company to work the rates as high as possible.

Moreover, some of the biggest finance companies own the insurance companies that write policies on their loans. Under this double-headed arrangement, the parent finance company makes money on interest as well as from premiums, and it can charge the insurance subsidiary management fees for handling the records.

There are even more subtle renderings. "In examining the statement of a very large and well-regarded stock insurance company," Commissioner Hunt has said, "I noticed that most of their credit life business was being reinsured. There was no actuarial reason for this, so I made some inquiries. It turned out that this company wrote credit insurance for a large finance company. The deal was that the insurance company reinsured over 95 percent of the incoming credit business with an insurance company controlled by the finance company. About 45 percent of the premium was profit, and, of course, all but a prenegotiated part of this went to the wholly-owned subsidiary of the finance company. For a price, then, the finance company bought the good name of the insurance company and, to boot, avoided the appearance of controlling the business, whereas, in fact, they did."

Mr. Hunt makes this seem all rather conspiratorial. But there are no laws prohibiting finance companies from owning insurance companies; nor in most places are there any restrictions on their dealings with insurance companies. These transactions are in the open and apparently regarded as a common business practice, as the following examples suggest:

CIT Finance Corp., second biggest finance company in the country, buys credit life from Connecticut General which then reinsures these policies with a wholly-owned subsidiary of CIT called North American Co. (Figures for North American were not readily available. But Connecticut General says that it took in $13.5 million in credit life premiums in 1965 and paid out $6.7 million in death benefits for a gross profit of 50 percent. As a reinsurer North American shared in the risks and the profits.)

Associates Investment Co., another of the largest finance companies, also owns an insurance subsidiary which writes some of the credit life on its loans. The way it got into the business is interesting. In 1953, Associates wanted to move into the insurance field. At the time, Old Republic was issing credit life policies for the finance company. Associates then set up an insurance subsidiary called Alinco. Old Republic reinsured Associates' business with Alinco and handled the administrative details. Alinco had no office or any salaried employees. An accountant employed by another of Associates' subsidiaries spent one day a month taking care of the books. Despite the simplicity of its operation between 1953 and 1959. Alinco's financial success was striking. Its net gain from operations during that period, before federal income taxes but after paying its expenses and share of death benefits, was in excess of $28.5 million. In 1957 Associates

acquired Capitol Life Insurance Co. of Denver, an old line insurance company, and subsequently shut down Alinco.

An Associates' official recently said insurance rates range from 50 to 75 cents per $100 borrowed. In 1965 Capitol Life, which writes half of Associates policies, reported premiums of $4.3 million and death payments of $1.6 million (gross gain of 63 percent).

Other companies have insurance subsidiaries. Commercial Credit Co. owns American Health & Life Insurance Co. which writes policies on the parent's loans. An American official said an insurance rate is $1 per $100. American showed premiums of $10.6 million last year against death payments of $5.8 million for a gross gain of 45 percent.

Financial General controls Bankers Security Life Insurance Society. The Transamerica Corp. owns Pacific Finance Corp. which, in turn, controls Pacific Fidelity Life Insurance Co.

In general, the profits for insurance companies in this business range from about 36 percent to 60 percent. Commenting on this situation, Commissioner Hunt said, "If normal competition, rather than reverse competition, could exist there would be a tremendous reduction in costs of credit insurance passed on to borrowers. I would estimate that, based on current premium income, the savings would exceed a hundred million dollars nationwide annually."

Payment of death benefits probably has risen during the past year because of the war. Many finance companies thrive on army camps. One congressional investigator reports helicopter pilots at Fort Rucker, Ala., about to leave for Vietnam, are buying automobiles and household appliances. They borrow the money and it is insured against their death at rates up to $2 per $100. The Defense Department has approved 93 life insurance companies to solicit business on military posts. One-third of these write credit life, and include companies charging high rates.

As in the case of all insurance, regulation of credit life is left in the hands of the states. Thirty-one states have no effective regulation over rates charged. Massachusetts recently sought to bring down rates by limiting the premium to 50 cents per $100 per year. Both Vermont and Connecticut have passed laws prohibiting lenders from making a profit on credit insurance in the small loan field.

In his Chicago speech, Dean Sharp called for federal regulation. As a step in this direction, the antitrust and monopoly subcommittee will surely want to release its study of credit life insurance, and hold a full-scale investigation. This would come under Senator Dodd's insurance subcommittee. Dodd comes from Connecticut, the insurance capital, which means that when he proceeds, if ever, it is at a snail's pace. (The committee has been involved in an alleged study of the insurance industry since 1958.) At any rate in this matter, the large life insurance companies may want to protect themselves before the finance companies get them into a mess which Dodd can't cover up. Credit life insurance on any loans under $1,000 should be banned outright. The risks to the finance companies are too slight to bother with. And the congress should make it illegal for a finance company to profit on insurance.

JAMES RIDGEWAY.

BANK IN THE BILLFOLD—MORE CONSUMERS PAY LOCAL SHOPPING BILLS WITH BANK CREDIT CARDS—LENDERS DON'T SET MINIMUM INCOME REQUIREMENT; PLANS CHEERED BY SMALL RETAILERS—"JUST LIKE THE RICH PEOPLE"

(By George Nickolaieff, Staff Reporter of The Wall Street Journal)

PITTSBURGH.—"How about this," says a grocery clerk here as he brandishes a new credit card. "Just like the rich people."

The clerk's prized possession represents a relatively recent development in the world of on-the-cuff living—the bank credit card. Such cards, issued by a rising number of banks around the country, permit their holders to charge everything from doctor bills to candlelight dinners for two. Their growing use—and easy availability—may well signal that the day of credit-card existence has dawned for the plumber and factory hand as well as for the executive and professional man.

The bank credit cards overlap to some extent with national credit card plans like those offered by American Express Co. or Diners' Club, Inc. Both can be used to charge restaurant tabs, for example, and some banks have copied the

national cards and persuaded airlines to accept their cards. But, for the most part, banks are carving out new areas of operation for their credit cards.

STRETCHING OUT PAYMENTS

Whereas applicants for national credit cards met specified income standards—American Express sets $7,500 as the floor—banks have no minimum income requirements for their card holders. Also, whereas national credit cards are designed mainly for use in travel and entertainment, bank cards are intended principally for local shopping or for paying repair and other service bills. Another significant difference between the two types of cards is that national cards must usually be paid in full each month, except in the case of airline ticket purchases, while banks allow holders of their credit cards to extend payments over a period of time if they choose.

Within the past year, a half dozen banks, including Mellon National Bank & Trust Co. and Pittsburgh National Bank here and Valley National Bank of Arizona in Phoenix, have launched their own credit card plans. California's giant Bank of America and Buffalo-based Marine Midland Trust of Western New York have issued their own credit cards for several years. A score of other banks across the nation currently are studying the possibility of starting credit card programs.

From the banks' point of view, credit cards offer a way to put their ample funds (commercial bank deposits total about $310 billion now, up from $223 billion at the end of 1960) to work at a high rate of return. Evidence that banks see the credit-card field as increasingly attractive is found in recent moves by First National City Bank of New York to acquire Hilton Credit Corp.'s Carte Blanche national card plan and by Chase Manhattan Bank to buy Diners' Club as well as in the rise of local bank credit-card operations.

BOON FOR SMALL BUSINESSMAN

But the impact of the new bank credit cards is not limited to the profits of the banks, who collect for their services from both participating businesses and credit-card holders, nor to the new class of card users being created. A prime beneficiary is the small businesman who lacks the cash or accounting facilities to provide credit on his own but who, with the aid of bank credit cards, can offer his customers the same credit services as larger competitors.

Says E. H. Gugliotta, manager of a small Buffalo shoe store that participates in the credit card plan of Marine Midland Trust of Western New York: "This store went into the black this year and it's all because of the credit card. People used to look into the window and then keep walking to the big department stores. Now they see the credit card decal and come in." Mr. Gugliotta adds that bank credit cards have increased multiple sales 100%—"now they buy two or three pairs of shoes and let the old man worry about paying."

Some department stores, on the other hand, are not at all happy about bank credit cards. Many department stores permit customers to stretch out payments over several months, charging a monthly fee on the unpaid balance and thereby adding substantially to earnings. This same type of credit service is available to shoppers under bank credit-card plans, and as a result, says R. B. Adam, president of Adam, Meldrum & Anderson, Buffalo's second largest department store, "there's no question these cards are a threat to us. The bank is in competition with us, and we don't like it."

IRRESPONSIBLE HOLDERS

Some early attempts to set up local bank credit-card plans encountered rough going. Chase Manhattan started a bank credit program in 1958 and then dropped it in 1962 when, according to the bank, the plan "did not develop as projected." Other bankers, however, blame the failure on inadequate screening of card applicants, which left hundreds of cards in irresponsible hands. The credit manager of one New York store says Chase's list of holders of credit cards that were not to be honored reached 10 to 15 pages.

The Bank of America, which started issuing credit cards in 1958 and Marine Midland Trust of Western New York, which set up its plan in 1959, both had large losses at first because of high promotional costs and a high proportion of bad debts. Industry sources estimate the Bank of America lost about $15 million to $20 million in the first two years or so its credit-card plan was in operation: Bank of America calls this estimate high but refuses to disclose any figures itself.

However, the Bank of America started making a profit on its credit cards in 1961; in 1962, its first full year of in-the-black operations, it's believed the bank earned about $8 million from credit-card business. In 1963 Marine Midland Trust of Western New York got its credit-card plan into the profit column.

When the Bank of America's credit-card plan began to pay off, it was the signal for a number of other banks to enter the field. "I think we all waited to see how the Bank of America would turn out," says a Mellon Bank spokesman here. "When it turned the corner we could see what a well-run program could do." Mellon started its credit-card plan this past summer.

The key to a successful credit card operation appears to be a happy balance that excludes dubious risks but still gets the maximum number of card holders, and most banks make their cards available to any applicant who can pass a credit check, regardless of his income level. In contrast to most national credit cards there is no initial fee.

"We look at the man's credit record and then we make a decision," says P. M. Welch, vice president in charge of consumer credit at Atlanta's Citizens & Southern National Bank, which has issued cards since 1959. "This means we're dipping pretty well into the middle and even some low-income groups."

Holders of bank credit cards are billed once a month. They have the option of paying the whole amount at one time or dividing it into installments.

Besides using bank credit cards to pay bills, holders can use their cards to borrow money up to a specified limit—Pittsburgh's Mellon bank, for example, will automatically lend holders of its cards up to $350. "It wouldn't pay to lend $100 or $200 as a conventional instalment loan, but it works real well with a card," says one bank official.

ATTRACTING NEW ACCOUNTS

Banks charge merchants and others who honor their credit cards discounts ranging from 2% or less to as much as 5%, on each sale. They pay participating businesses over-night for charged sales by crediting an account the business must keep with them; a side benefit of credit-card plans for banks, note bank officials, is that they draw new accounts from businesses, some of whom eventually begin to make use of the banks' other services.

Instalment charges to card holders on unpaid balances average about 1.5% a month, or 18% a year. Bankers estimate that total net earnings on a successful credit-card program work out to over 5% a year on investment; by way of comparison, instalment loans generally net about 3.5% annually on investment.

Banks that issue their own credit cards and the firms that issue national cards maintain they don't seriously compete with each other. But as bank cards catch on it seems inevitable that they will cause trouble for the national cards. United Air Lines now accepts the cards of Mellon National Bank, the Bank of America, Citizens & Southern and Bank of Hawaii, a development that puts the banks' cards into direct competition with national cards for travel business. Moreover, bank and national cards are likely to compete increasingly in restaurant and specialty shop fields.

CUTTING DISCOUNTS

In some areas where banks have aggressively promoted their credit-card plans, national cards already have been forced by the competition to cut their discounts. In California, where the Bank of America has over 1,250,000 cards holders, the national cards were charging discounts of 7% to 10% before the bank's plan started going strong. But they had to drop their discounts to 4% and 5% in order to bring them more in line with the Bank of America's rates. In Phoenix, national cards reduced their discount to 4% from 6% at one large restaurant shortly before Valley National started its credit-card program this year, according to T. L. Larsen, manager of the operation.

Despite the absence of minimum income requirements for holders of their credit cards, most banks say they now have little difficulty with customers' failing to pay up. Banks with credit-card plans usually allow for bad debts equal to 1% of volume on charge cards, but some are hitting well below this figure. Citizens & Southern of Atlanta, for example, says its bad debts on credit cards are running at 0.35% of volume.

For many of the new credit-card holders, the big attraction is convenience. R. J. Klein, a 28-year-old airline clerk in Buffalo, recently bought rubber boots and shotgun shells for a hunting trip, a purchase totaling only $7.50. "I had the

money in my pocket, but if I spent it I might be caught short at work, so I used my card," he says.

Some users of bank credit cards concede, however, that at least initially the new purchasing power went to their heads. That was the experience of a Buffalo cab driver who, together with his wife, has an annual income of "about $7,000." Shortly after he got his card, he relates, "I bought $300 worth of junk for my car in one month. My wife got so mad she took my card away for a while."

SEIZING PAY—UNIONS, FIRMS, LAWYERS SEEK TO CURB GARNISHING AS ITS INCIDENCE RISES—IT LEADS TO BANKRUPTCY, FIRING AND RELIEF ROLLS, THEY SAY; AUTO WORKER KILLS HIMSELF—DEDUCTING $500,000 AT INLAND

(By James P. Gannon, Staff Reporter of The Wall Street Journal)

CHICAGO.—One payday in January, auto worker Carl W. Clark discovered his entire week's take-home pay of $112.39 had been turned over to the state of Indiana for delinquent state income taxes. Beset by debts, he asked officials at Ford Motor Co.'s plant in suburban Chicago Heights, Ill., for his accrued vacation pay to tide him over.

Next payday, he learned Indiana—the state where he used to live—had received $208.84 out of his $363.93 in wages and vacation pay. The 24-year-old father of a young boy, not knowing how much he owed Indiana tax collectors, (the two deductions actually satisfied the claim) became despondent over the pay loss. Two days later, Carl Clark placed a .22 calibre rifle under his chin and shot a bullet into his brain.

This suicide has spurred anew wide-ranging inquiries into the consequences of consumer debt problems. Under special scrutiny is the rising number of wage garnishments and other forms of pay seizure by creditors, including state and Federal tax collectors. The spotlight on pay attachment also has illuminated a misery-multiplying debtor's course that runs from garnishment and loss of job to bankruptcy and going on relief.

The activity on pay-seizure problems is intensifying on several fronts. Labor unions are campaigning to restrict wage garnishment laws in many states. Legal experts are drafting a uniform consumer credit code that they hope will be enacted in each state. An Illinois Congressman is seeking legislation limiting the amount of wages that can be taken at one time to pay back taxes. And business and financial interests, anxious to avoid any image-blackening, are accelerating joint efforts to aid over-burdened debtors.

BUY NOW, PAY LATER

The cause of the wage-attachment problem is overuse of credit, easy to find in America's debt-fueled economy. Consumer debt outstanding rose to $86 billion in 1965, up 12% from 1964 and 50% from 1961. A convenience to most people, readily available credit is a curse to many others, who can't or won't use it wisely. They're the ones facing garnishment troubles.

Because wage garnishments are issued by thousands of local courts, there aren't any national statistics on their volume. But checks of big courts in some metropolitan areas indicate more and more workers are finding part of their wages confiscated to pay overdue debts.

In Chicago, the Cook County Circuit Court issued 84,513 garnishments last year, 15% more than in 1964 and 72% more than in 1961. The marshal of the municipal courts of Los Angeles County served 114,972 wage garnishments in the fiscal year ended last June 30, up 6% from the prior year, and garnishments there this year are running at an annual rate of 122,000. Court officials in New York, Cleveland and other big cities also cite rising garnishment totals.

The figures don't disclose the full extent of pay impounding. They don't include the huge volume of wage "assignments," which are legally distinct but similar in effect to garnishments. Under a wage assignment, a debtor pledges his future wages to repay the debt if he defaults; execution of the wage assignment doesn't normally require a court judgment, as a garnishment usually does. The garnishment figures also don't include tax levies, such as that in the Carl Clark case.

MR. REED'S PLIGHT

The records of Inland Steel Co. indicate how widespread wage attachment can be. Each payday the company makes such deductions from the paychecks of

about 2,000 of its 22,000 production employes in the Chicago area, says Dorothy A. Lascoe, who handles this chore. Inland annually pays out more than $500,000 of withheld wages to creditors, she adds.

Who are the people behind the statistics? Most often, they are working men like Franchot Tone Reed, a 29-year-old tire mounter for a Chicago-area truck manufacturer, who learned of garnishment the hard way.

In 1964 Mr. Reed traded his 1956 Plymouth in on a 1950 Cadillac and signed an installment sales contract to pay $1,200 for the aging car in 48 weekly payments of $25. After he defaulted, the dealer repossessed the car and had Mr. Reed's wages attached to pay off the contract. The deduction took 15% of his pay, the legal limit on garnishments in Illinois.

To "get cut loose" from his debts and the garnishment, Mr. Reed filed bankruptcy late in 1964. Last year, Federal bankruptcy court in Chicago discharged Mr. Reed of $2,195 in debts, including bills for jewelry and clothing as well as the costly old Cadillac.

TRIGGERING BANKRUPTCY

As this case suggests, there is a connection between mounting garnishments and the steady rise in the number of personal bankruptcies in recent years. "Garnishment frequently triggers bankruptcy," says Linn K. Twinem, chairman of the American Bar Association's committee on consumer bankruptcy.

A record 180,323 bankruptcy cases were filed in Federal courts in the fiscal year ended last June 30, up from 171,719 in the prior year and 110,034 five years earlier. Bankruptcy filings this year are expected to top 200,000. Personal bankruptcy filings accounts for 91% of the total.

Mr. Twinem says there is a "close relationship" between the severity of a state's garnishment law and its bankruptcies. California, which has a relatively tough garnishment law, led in bankruptcy filings in fiscal 1965 with 33,656. At the other extreme, three populous states that don't allow garnishments have dramatically lower bankruptcy-filing totals; Pennsylvania had 1,133, Florida 958 and Texas 661.

Garnishment often causes workers to lose their jobs. Many employers fire employes whose debt problems lead to excessive wage attachments, arguing that company handling of garnishment paperwork and court appearances by employes are costly and time-consuming. The Cook County Credit Bureau in Chicago surveyed 1,100 employers in 1964 and found that processing a single garnishment costs a company from $15 to $35; the estimated costs of garnishments to the surveyed employers totaled $12 million annually.

Few companies will discuss the firing of workers for garnishments. A personnel official at one General Motors Corp. plant near Chicago confirms union reports that 45 men were discharged at the plant for that reason last year. Another Chicago manufacturer admits firing "25 or 30" men for garnishments.

Union officials liken the practice of firing debt-burdened workers to the medieval custom of locking debtors in prison. "Under both practices, the debtor has a harder time paying his bills," says one. Most companies say they try to keep a man as long as he is making sincere efforts to straighten out his debts.

Employes fired for debt problems often wind up on relief rolls, social workers say. In a study of 827 persons applying for general assistance relief, the Cook County Department of Public Aid found that about 9% of the applicants had been fired from their jobs due to garnishments.

REFORM MOVEMENTS

Organized labor campaigns annually to ease the impact of garnishment laws on debtors, and this year the drive is picking up steam. Unions are pushing legislators in many states to increase the amount of wages exempt from garnishment. These exemptions vary widely at present, from 50% in California to 90% in New York; in some states, the exemption is a flat amount, such as $100 a month for a family-head in Mississippi.

In Illinois, where Gov. Otto Kerner is considering calling a special legislative session this year, the state AFL–CIO wants the wage exemption raised from 85% to 90%, with the minimum amount safe from attachment set at $65 weekly rather than the present $45. Unions in Illinois also want abolition of wage assignments.

Unions in Ohio, Connecticut, Colorado and other states also are seeking legislation to increase the amount of pay shielded from attachment. Recent

efforts seem to be showing results. Seven states amended their garnishment laws last year, generally lifting the exemption; this was considerably more activity than in other recent years, says the ABA's Mr. Twinem, because "more and more attention is being focused on garnishment." And last week Kentucky's house of representatives passed a measure backed by both labor and business groups raising the exemption from garnishment to 75% of wages from the 55-year-old limit of $16.87 a week. The bill is before the state senate, where backers predict early passage.

PAYING THE BACK TAXES

Another union goal in several states is a ban on firing an employee for garnishments. New York's legislature passed such a measure last year, but Gov. Nelson Rockefeller vetoed it on the ground it was unenforceable. A bill modified to overcome this objection has been introduced this year. In New Jersey, antifiring bills have failed in past years but a recently introduced measure is given a better chance this year because control has passed from Republicans to Democrats in the state senate, where earlier bills died.

The Clark suicide also has touched off efforts to protect delinquent taxpayers from total wage seizure.

The AFL–CIO's community services department is surveying the attorneys general of all 50 states to determine which ones permit 100% pay withholding for delinquent state taxes. "Depending on what we find, if the situation looks bad our department of legislation will communicate with the central labor bodies in the states to seek changes in the laws," says an AFL–CIO spokesman.

On the Federal level, Rep. Sidney Yates (D., Ill.) plans to introduce a bill next week limiting the amount Federal tax collectors could take from the paycheck of a delinquent taxpayer. His draft bill calls for limiting Federal tax levies on wages to 10% of the first $200 in monthly earnings, 20% of earnings from $200 to $500 and 50% of earnings over $500. "This would protect against the total taking of the paycheck, which is presently the pattern," he says.

A much broader effort to modernize and unify all state laws regulating consumer credit is under way. The National Conference of Commissioners on Uniform State Laws, comprised of representatives of each state, currently is drafting a uniform consumer credit code.

The model law is expected to cover all aspects of consumer credit from "advertising and sales solicitation through the sales contract to collection and default problems, including garnishment," says Allison Dunham, executive director of the organization. When completed and approved by the conference, the code will be presented to each state legislature. Numerous other uniform codes have been enacted by most states.

Present state laws regulating consumer credit are "very much a hodgepodge" with an unusual amount of state-to-state variation because most were developed piecemeal in response to specific problems, says Mr. Dunham. A uniform code would benefit businesses dealing in consumer credit in numerous states, he contends. Because of the lengthy conference procedure, however, the credit code couldn't be ready for state legislatures before 1968, he says.

THE ROLE OF BUSINESS

Businessmen, meanwhile, are accelerating a debtor-aid program of their own. Consumer credit counseling services designed to aid overburdened debtors were set up in 15 cities last year under a program sponsored by the National Foundation for Consumer Credit, a trade association. Since 1962, more than 30 such counseling centers have been established, largely supported by contributions from merchants, banks, loan companies and others. The foundation plans to set up "one or two a month" in 1966.

The centers offer two services: Financial counseling for debtors who are overextended but can meet obligations by careful budgeting, and "proration" services, or debt-pooling, for more serious cases. Under the latter, the center works out a repayment-stretchout plan with creditors, regularly collects a portion of the debtor's income and parcels it out among creditors as agreed.

In Salt Lake City, for example, the Consumer Credit Counseling Service of Utah, Inc., last year aided 433 families, collecting and paying to creditors

$426,000. "It would have been necessary for at least 75% of the 433 families we were servicing to have taken bankruptcy had our service not been available," says Charles E. Williams, president. Generally, the business-supported counseling services don't charge fees.

[From the Wall Street Journal, Mar. 29, 1966]

REVIEW AND OUTLOOK—THE VIRTUE OF PROFLIGACY

Among Inland Steel Co.'s 22,000 production employes in the Chicago area, nearly 10% have a portion of their wages withheld every payday to pay off delinquent debts. While the Inland workers probably aren't typical of the whole population, their dreary credit record helps point up a growing national problem.

Consumer credit outstanding has nearly doubled in the past seven years, rising to nearly $90 billion. Though most Americans use credit responsibly, an increasing number are submerging themselves in overdue obligations; the result, as a recent story in this newspaper reported, can be personal tragedy, even suicide.

Obviously, then, a cause for serious concern, and yet some of the approaches to the problem seem incapable of offering anything like a full solution.

Labor unions and other groups are urging new laws to defend beleaguered debtors, and perhaps certain changes are needed. It seems excessive, for instance, to allow Federal and state tax collectors to seize a man's entire paycheck or to permit Kentucky businessmen to take all but $16.87 a week.

There's more than a chance, however, that the process of legal change will go too far. As a number of businessmen and other creditors are arguing, the nation has come a long way since the days of debtors' prisons; personal bankruptcy laws and other statutes now often make it possible for debtors to avoid paying most or all of their legitimate obligations.

Any further legal revisions surely should be fair to creditors as well as debtors, and not only for reasons of equity. Credit is essential to the present-day economy, and many businessmen simply may not extend it if laws are passed to unduly weaken their ability to collect from customers.

Even-handed debt-collection laws, in any case, clearly can't make all Americans use credit rationally. Nor will it help much to require, as the Administration proposes, that all lenders state credit costs in the same way. If a consumer is foolish enough to overburden himself with debt, it won't matter greatly whether his credit costs are high, low or in between.

More productive might be an extension of credit education through the nation's school, a process that is already under way. Something can be said, too, for stricter enforcement of present laws to curb deceptive and dishonest lenders; they may be a small minority, but there's no question that they exist.

Beyond that, a lot of quite reputable businessmen can't escape a share of the responsibility for the troubles in consumer credit. High-powered advertising and promotion has helped produce vast changes in public attitudes toward debt over the past three or four decades. Maybe it was overly puritanical to consider borrowing almost a sin, as many of our fathers did, but the pendulum now perhaps has swung too far in the other direction. In not a few business establishments today a customer who wants to pay cash finds himself regarded as a bit peculiar.

In their own interest, lenders could stand a stronger dash of self-restraint. By paying a little less attention to boosting their business and a little more to a borrower's actual ability to repay, they not only would protect their own solvency but possibly head off new restrictive legislation.

It's more than slightly ironical that the source of some of that legislation probably would be the same Federal Government whose own carefree fiscal and monetary policies have done so much to foster an easy-come-easy-go philosophy among the public. The way Washington has been living it up, it may be surprising that a large proportion of the population still remains free of credit woes.

Many of these fortunate ones, of course, are sustained mainly by the present high level of prosperity. If more widespread trouble is to be averted in some perhaps not distant future creditors, debtors and the Government all had better get over any notion that profligacy now is a positive virtue.

Hon. FRANK ANNUNZIO,
House of Representatives,
Subcommittee on Consumer Affairs,
Committee on Banking and Currency,
House Office Building,
Washington, D.C.

INLAND STEEL CO.,
August 3, 1967.

DEAR CONGRESSMAN ANNUNZIO: Mr. Joseph L. Block, Chairman of Inland Steel Company, has asked me to reply to your letter of July 29, 1967 concerned with H.R. 11601, the proposed Consumer Credit Protection Act, of which you are a cosponsor in the House of Representatives. You were good enough to enclose a copy of the proposed legislation along with a summary of it.

The provisions of the proposed bill which have a direct relationship to our operation are those requiring full disclosure of credit terms and prohibiting the garnishment of wages. We are in favor of both of these provisions in the bill.

While we are aware that it may be contended that full disclosure of credit terms may often fall on deaf ears, we believe that many wage earners for the first time will learn the full extent of the cost to them of credit extended and consequently may be less inclined to assume additional credit obligations that they cannot reasonably carry. Certainly full disclosure of credit terms can do no harm to the buying public. Probably we cannot assess the full advantage of disclosure until we have experienced it in practice.

Wage garnishments constitute a heavy and costly administrative burden for this Company. In fact in your above-mentioned letter you referred to certain statistics about Inland that appeared in a *Wall Street Journal* article of last year. For your information we do not pursue a policy of discharging employees on account of garnishment actions or even in the case of repeated or excessive garnishments. Quite apart from the administrative burden that garnishments impose on any large-size company, we believe that this repayment device may well lead to the extension of credit to wage earners in situations where credit more reasonably might be withheld and in fact serves to enhance the credit problems to which many employees find themselves subject.

Perhaps also should be added the observation that garnishment actions constitute an undue burden for our courts which are already severely taxed by other kinds of litigation.

We hope the foregoing comments may be helpful to you in your consideration of the proposed legislation.

Needless to say we are grateful to you for your thoughtful letter in soliciting such observations as we might care to make.

Sincerely yours,

GEORGE A. RANNEY,
Vice President and General Counsel.

SPECIAL REPORT: DISCHARGE FOR GARNISHMENT

A worker's going into debt, like other off-duty conduct, generally is no business of the employer. But if bad debts result in garnishments, arbiters tend to treat this the same as on-duty misconduct and uphold a management policy requiring discipline for garnishment.

This is one of the findings of a survey of published arbitration awards undertaken by Robert W. Fisher of the Labor Department's Bureau of Labor Statistics. His report, "How Garnisheed Workers Fare Under Arbitration," appears in the May issue of the *Monthly Labor Review.*

In all of the cases examined, the arbiters found that management had the right to discipline garnisheed workers, even in the absence of a formal rule, Fisher finds. But in about half the cases, the arbiters nevertheless refused to go along with discharge decisions.

In treating garnishment as in-plant misconduct, the arbiters note that employers naturally want to avoid the inconvenience and expense of extra bookkeeping, the necessity of filing written returns to the attaching office, and the need for company representatives to appear in court.

Thus, each case of discipline for garnishment is tested against the usual yardsticks for determining just cause: (1) Was the rule reasonable and well-

known to the workers; (2) was the application of the rule nondiscriminatory; and (3) were there extenuating circumstances?

Reasonableness of Rules.—A rule that provides for automatic discharge after a single garnishment is not regarded as reasonable by arbiters, Fisher finds. While rules specifying "two times and out" have been okayed, many arbiters seem to favor withholding the discharge penalty until the third garnishment. One arbitrator gave this explanation:

"Many companies have established the practice of terminating employees after their third wage or salary deduction. This may seem harsh to those who are perpetually in financial difficulties; but at least the employees are put on notice; they are counseled and . . . warned that future financial involvement of this kind will result in discharge." (44 LA 87).

Arbiters invariably insisted that employees be amply warned of a garnishment rule, Fisher notes. Thus, discharges were invalidated where (1) the company had not posted or otherwise disseminated its garnishment rule (14 LA 787); (2) no preliminary warning was given prior to a "final" warning (46 LA 822); or (3) the contract, which contained a new and stiffer rule, had not yet been printed (43 LA 1268).

Equal Treatment.—Application of a policy against garnishments must be regular and predictable, with the same corrective escalations of discipline applied to all employees if arbiters are to sustain a discharge, Fisher says. Thus, a discharge for a third garnishment was set aside where it was shown that in six similar cases, only three had been discharged. (27 LA 160).

But a too mechanical observance of a disciplinary schedule also may be rejected by an arbiter. Where the policy called for a warning for a third garnishment and discharge for a fourth, a company should not have discharged an employee when the third and fourth garnishments arrived on the same day, an arbiter said. (37 LA 85).

Extenuating Circumstances.—In garnishment cases, arbitrators reinstate more workers because of extenuating circumstances than for all other reasons combined, Fisher notes. Extenuating circumstances include discharging the debt through bankruptcy, speedily lifting it prior to discharge, lack of knowledge of the debt, a good work record, or loss of income due to chronic layoffs.

One arbiter, Benjamin Roberts, noted in a recent address that discharges for garnishment are being given a closer look by arbiters these days.

A discharge may be set aside, Roberts said, if it appears that the employee had found himself in unusual and difficult circumstances not necessarily of his own making. If extenuating circumstances are found, reinstatement may be directed on the condition that there be no further garnishments and that the existing liabilities be liquidated as soon as possible.

State legislatures currently are showing an interest in this subject and are considering restricting management's right to discharge for garnishment. Hawaii, for example, has adopted such a law.

Garnishment Still Big Threat to Workers in Debt

Despite the determined fight of unions to prevent the firing of workers whose wages are garnisheed, the worker in debt whose wages are garnisheed more than once or twice is in grim danger of losing his job.

A study of widespread arbitration cases published in the current Monthly Labor Review by the U.S. Department of Labor comes to the conclusion that garnishment—although an off-the-job "offense"—has come to be regarded as having equal status with such on-the-job offenses as fighting, drunkenness or theft.

Author of the study, Robert W. Fisher, notes that unions "do not accept discharge of workers for garnishment with equanimity primarily because such discharges smack of employer control of the employee's private life—the philosophical root of the questioning if discharged for garnishment."

He further notes, however, that in the absence of protective legislative or a specific clause in the collective bargaining agreement, most arbitrators accept too frequent wage garnishment as a legitimate "just cause" for discharging a worker.

As a rule, Fisher found, arbitrators took the position that garnishment represented a burden on employers who are subject to harassment by creditors, the necessity for keeping special accounts as well as being called into court under certain conditions.

Having accepted garnishment as a "just case" for discharge in principle, most arbitrators seek to lay down mitigating conditions. One arbitrator stated that

"discharge should be used only when employee behavior affected the employer-employee relationship," and that "pay attachments were definitely in the twilight zone."

He was critical of civil law that permitted creditors, many of whom knowingly permitted workers to overbuy, to "wipe out the pay envelope" and even have a man discharged. Nevertheless, he and other arbitrators accepted the "just cause" principle, but have worked out a number of "reasonable rules" surrounding job loss.

One is the number of garnishments. Fisher reported that most arbitrators would not permit the firing of a worker for the first garnishment; many would permit two garnishments within a stipulated time. Three garnishments, however, appeared to be enough to warrant firing in most of the arbitration cases studied.

Another factor taken into account by arbitrators was whether a company had amply warned its workers of definite garnishment rules that may lead to discharge.

A third factor was whether a company was consistent in its policy toward garnisheed workers—that is it can't discriminate in the application of its rules.

Finally, other "extenuating circumstances" which resulted in the reinstatement of discharged workers were lack of knowledge of the debt; prompt payment of the debt; going into bankruptcy which extinguished the garnishment or a good working record.

Mr. HALPERN. I would like to welcome a very able, and no pun intended, and distinguished witness. He has been a credit to the labor movement and, in the short time since he succeeded an admired and outstanding predecessor, he has proved his ability as a respected leader of organized labor and is a potent and highly respected part of the American industrial and economic scene, and I welcome you to this committee and wish to commend you for your most superior and most helpful testimony.

Mr. ABEL. Thank you.

Mrs. SULLIVAN. We will take a few minutes recess at this time.

(Short recess.)

Mrs. SULLIVAN. The subcommittee will come to order.

Mr. Abel, I want to say that you have given a very clear and precise statement of your position on our consumer credit protection proposals.

You have made your position so clear that I don't have too many questions to ask of you.

Mr. Abel, Congressman Annunzio has introduced into our hearing record a letter from the board chairman of Inland Steel Corp. supporting the provision of H.R. 11601 to abolish wage garnishment, as a terrible annoyance and expense to the employer and a cruel thing for the employee.

From your knowledge of the steel industry and others with which you have contracts, would you say this is the prevailing sentiment of the employers you deal with?

Mr. ABEL. Very definitely I would.

As a matter of fact, perhaps Inland is more lenient with their views toward this problem than are most companies. Inland is one company that doesn't discharge their employees because of garnishments but many companies do.

Mrs. SULLIVAN. Do you know whether any of these companies have debt counsellors who help employees who get themselves into financial trouble?

Mr. ABEL. There is some of that in the personnel departments, but it isn't a large practice.

Again, the companies take the position that this is a cost and something they can't afford. It is bad enough the burden is placed upon them to make the collections and do the paperwork and take care of the creditors. So, there isn't too much of that.

As I say, in a number of cases they just discharge them, sometimes on one garnishment, and other companies have a policy of perhaps three garnishments and then the employee loses his job.

Mrs. SULLIVAN. There is another subject that I want to bring up, but first I will yield to Mr. Annunzio.

Mr. ANNUNZIO. Thank you, Madam Chairman.

I take this opportunity to welcome the distinguished president of the United Steelworkers of America to our committee hearings and also to commend him for his very forthright position with reference to H.R. 11601.

As a former legislative representative of the United Steelworkers for the State of Illinois, I am naturally tremendously delighted to welcome you, Mr. Abel, to our committee, and I would like to state for the record that Mr. Abel, as the leader of 1,250,000 steelworkers, represents the American dream.

Mr. Abel is a steelworker—he started to work in a steel plant, and through the processes of industrial democracy, he now has risen to the position of the head of one of the largest industrial unions in America.

We know in today's union structure an industrial union does more than protect the rights of the workers as far as wages and hours are concerned. The union also contributes to American industrial society by educating and protecting the workers regarding the rights they have under our Constitution.

Mr. Abel, I am tremendously pleased with the position you took with reference to the garnishment section of H.R. 11601, and I know that my other colleagues on the subcommittee who cosponsored the bill with our distinguished and charming chairman, Mrs. Sullivan from Missouri, also appreciate your forthright position.

As I stated to Mr. Wirtz, the Secretary of Labor, who is on the Committee which the President ordered to conduct a study some 5 months ago for garnishment of wages, I know that you are a vice president of the AFL–CIO, you are a member of that executive board, and you are truly a representative of labor appearing before this committee. The legislative director of the AFL–CIO, who appeared before this committee recently, stated that the national labor movement of America had no official labor policy with reference to garnishment, but I know that every State labor federation in the country has formulated a position and that we are against garnishment.

I know that my colleagues who sponsored this bill would be grateful for an official statement from the national AFL–CIO and we are tremendously grateful for your very forthright position on the garnishment provisions.

Mr. Abel, for the benefit of the committee can you tell us if the steelworkers union has an education program?

Mr. ABEL. Yes, Mr. Annunzio, we do have a very good one, I think, I would like to say that the steelworkers—one of the first things that Philip Murray did in establishing the steelworkers union was to set up an educational department and employ an educational director. We have since that time expanded our efforts, both in an attempt to bring

about better understanding, qualify our representatives better to render a greater service to the membership.

As a result, we have programs, resident programs in the city of Pittsburgh for staff people, a staff that numbers some 1,260, so that they are kept current and better qualified.

We have going on at the present time throughout the country on the campuses of universities and colleges throughout the country some 27 of them, summer institutes and we will have at these institutes roughly 25,000 local union officers, committeemen, and members where we attempt to acquaint them, better acquaint them with the problems of the day and even getting into problems such as we are discussing here today—truth in lending, credit charges and that sort of thing, hoping that through this process we make them not only trade unionists but better citizens.

Since you have given me the opportunity, I might report to the committee that since 1947 we have sponsored quite a scholarship program in our union and between our local unions and our districts we have since that time granted 1,160 scholarships to youngsters who otherwise would not have an opportunity to go to college, and these 1,160 scholarships represent an investment of better than $1,500,000 in this kind of effort.

So, we are very much interested in educational programs.

Mr. ANNUNZIO. As the president of 1,250,000 steelworkers—for the benefit of the committee and the record—would you tell us the States in which the steelworker union are located?

Would that be too difficult a job for you or could you answer that for the record when you get the transcript?

Mr. ABEL. We could give very definite coverage, but I would say briefly we have membership in practically every State in the union, including some membership in Hawaii, membership in Puerto Rico. Unfortunately, we don't have any in Alaska, but States where you wouldn't maybe expect—in Utah and out in the Western States—wherever membership in the hard rock lines in fabricating operations.

So, it is practically every State in the Union we find United Steelworkers of America.

Mr. ANNUNZIO. One more question. If an employee of a plant where the steelworkers have organized is fired for garnishment, I know that that worker can go to the grievance committee of the union, and the grievance committee will protest the firing.

Could you enlighten the committee as to the cost that is involved, because this is another hidden cost in the enforcement of this law, that is ultimately passed onto the people?

Mr. ABEL. We have that experience constantly, Congressman, as you have made the point. Most any problem that a member encounters, whether it be discipline or discharge, does make him by reason of his membership entitled to protection and every effort to rectify it. So, we do find ourselves going to arbitration in many cases where an employee has been discharged. In some cases we are successful in reversing the discharge and reinstating the individual, in some cases the arbiter upholds the discharge so we lose.

With respect to the costs of such action, it is difficult to put an exact dollar and cents cost because of the service required on the part of local union officers as well as staff representatives and occasionally some of our experts.

But with respect to arbiter's charges, I don't think it is any secret that they, too, have been doing quite well in our society and the average charge of an arbiter now runs about $500 per case.

So, it would be safe in saying that each one costs at least $500 to the arbiter, to say nothing of the costs of the union's services. It is a costly factor.

Mr. ANNUNZIO. In trying to establish the exact cost of these garnishments, we find it is costly to the counties involved and it is costly also to the international unions. The money they are spending to arbitrate these cases could easily be spent for more worthy purposes than representing a man who is losing his job.

My time is up, Mr. Abel, and we appreciate your coming.

Mr. ABEL. I might add further to what you have said that in many instances we probably would be ahead to pay the bill that the individual had rather than having the arbitration charges.

But then again, I think you must keep in mind, always, that while we have this problem—and it is a burden to us in our industry—it is almost unbelievable the impact of this on the lower earning workers that are unorganized and have no protection such as the union.

Mrs. SULLIVAN. Mr. Wylie?

Mr. WYLIE. Thank you, Madam Chairman, I, too, would like to thank you, Mr. Abel, and Mr. Sheehan for being here this morning and for giving us the benefit of your testimony during our deliberations. Were you here, Mr. Abel, when I was asking questions of Mr. Wirtz?

Mr. ABEL. Yes; I was.

Mr. WYLIE. I have been pursuing a line of questioning all during the hearings in an effort to gain information. You stated you are for full disclosure both of an annual interest percentage rate and in dollar-and-cent terms. I have taken the position that a disclosure in dollars and cents, in cash amounts, would be more meaningful to the customer than a disclosure in interest rate terms alone, would you agree with that?

Mr. ABEL. It has an impact both ways. I think you must realize, while dollars and cents may be more understandable in many instances, I think a real understanding is to understand—to wake up one day to find that maybe you have been paying 147 percent as a usury charge and this in itself pretty much scares you.

As I pointed out also, one of our own local presidents found he was charged 71 percent. Maybe the actual dollars didn't concern him too much and evidently they didn't. But when he got it translated into 71 percent and learned that he was paying almost double that shook him up.

So, we think it should be in both methods. Percentagewise as well as dollars and cents wise.

Mr. WYLIE. The people who have a revolving charge account, as I understand it, may represent about 40 or 50 percent of the credit extended in this country.

Now the revolving credit people maintain that to disclose an annual interest rate of 18 percent based on a 1½ percent per month revolving charge is not truth in lending but untruth in lending, in that their annual rate may be something less than 18 percent. I am wondering if you think it would be just as meaningful if we could amend this bill so that the interest rate would be disclosed on a monthly basis for

all credit, if that would be more nearly the approach we are trying to get at in this legislation and in this bill?

Mr. ABEL. Mr. Congressman, there I would have to agree with the Secretary's view that this in itself is misleading. Because setting forth the 1½ percent a month certainly can lead people to believe that they are getting a break, and actually it is not the true fact. An 18 percent would certainly cause them some pause.

Mr. WYLIE. Except for the fact that we are trying to disclose an interest rate so that customers can compare or make comparison before making purchases. If one store says we use a 1½-percent interest rate and another says we have three-quarters of 1 percent interest rate per month, that would give a customer more of an opportunity to make a comparison of purchases than having one say we charge interest at a rate of 1½ percent per month and another at 9 percent per year.

Mr. ABEL. You can make comparisons, that is true. But certainly in our way of thinking, as we have looked at both banking, financing, and that sort of thing down through the years, the terms are on an annual basis. We talk about 6 percent per annum. We talk about returns on investment on the basis of per annum, not on the basis per month.

Certainly we feel that this should be kept on an annual basis.

Mr. WYLIE. Thank you, Mr. Abel.

Thank you, Madam Chairman.

Mrs. SULLIVAN. Mrs. Dwyer?

Mrs. DWYER. Thank you, Madam Chairman. Just one question.

First of all, I want to congratulate you for a very fine constructive statement, Mr. Abel.

Mr. Abel, as a union president what do you think is more meaningful to your steelworkers during contract negotiations, the annual percentage increase in salary in benefits or the dollars and cents increase in their weekly pay envelope? Which do they understand best?

Mr. ABEL. Well, that I am afraid would be difficult to give a truthful answer. Certainly everybody looks at the dollars and cents in the pay envelope.

But again, we have become accustomed to translating improvements in advancement on a percentage basis—there is a lot of comparison and a lot of thinking on the percentage part. A year or two ago there was much talk of trying to limit the improvement to 3.2 percent, you know, and now we hear talk of 5 percent. In some cases even 8 and 10 percent. So it is translated pretty much on a percentage basis. At the same time we are looking at the dollars, too.

Mrs. DWYER. Did the 3.2 carry much weight with the worker himself?

Mr. ABEL. I think so, more than a flat 5 cents an hour or 6 cents an hour or 10 cents an hour.

Mrs. DWYER. Do you think the wife who is interested in the pay envelope thinks in terms of percentage or does she think in terms of dollars and cents in the pay envelope?

Mr. ABEL. You always get down to the dollars and cents. Mr. Sidney Hillman said some years ago about organizing reports when they were reporting on increase in membership. He said, "Don't give me the percentages, give me the facts." So, no doubt, that is the case with the housewife—she is concerned naturally with the dollar because it is the dollars she is spending.

Mrs. DWYER. She has to budget. She is thinking in terms of dollars and cents, is she not?

Mr. ABEL. That is right.

Mrs. DWYER. That will be all, Madam Chairman.

Mrs. SULLIVAN. Apropos of Mr. Wylie's comment, he may be right that dollars and cents are what most people think of when they use credit. However, that is one of the main reasons why we need truth in lending—to educate people to understand that the cost of credit or the price of credit is more meaningful for comparison purposes when stated as an annual rate.

Mr. Bingham?

Mr. BINGHAM. Madam Chairman, thank you.

I just want to join in welcoming Mr. Abel here today, I think we are all very grateful to him, not only for the work he is doing as president of the Steelworkers, but more particularly for taking the time and trouble to come here today and present this splendid statement.

I particularly welcome your statement on garnishment, Mr. Abel. I think it is very helpful, particularly in light of the fact that AFL–CIO did not take a firm position on this matter. Since you work directly with the rank and file, I think it is most important that we have your statement and views. Since I yielded the time previously I won't ask any questions.

Thank you, very much.

Mrs. SULLIVAN. Mr. Abel, as a member of the President's Commission on Civil Disorders, do you see, as did Secretary Wirtz, a connection between these disorders and predatory credit policies?

Mr. ABEL. I don't think there can be much question there. As I said during the course of my statement, several of us on the Commission spent all day yesterday in Harlem and in the ghettos of Brooklyn, and I don't think there can be much question in your mind that this is a contributing factor. Here is a sizable portion of our people who are exploited in every degree.

I am sure the loan shark, the easy-credit man, has left his mark and made his contribution to bring about our ghettos in this country.

Mrs. SULLIVAN. Thank you. I felt sure that you would have a basis for judgment on that as a member of that Commission.

Mr. Abel, if we can't get through the committee a complete prohibition of garnishment at this time, do you think that a 90-percent exemption on wages, such as they have in Washington, D.C., and in New York State, would be helpful?

Mr. ABEL. I think any step in this direction would be better than where we are at the present time. There is no question in my mind the extent of confiscation of the paycheck in many of these garnishees forces the individual to go out and seek credit to tide them over through this period and it is one of these things that feeds on itself.

Eventually, the individual is beyond his means. I think this is one of the great problems we find even in our reputable banking institutions who are constantly urging people, if they have 10 or 12 payments to make in a month, consolidate them—get one big loan and pay. This just compounds this problem.

Mrs. SULLIVAN. I know that putting this provision in H.R. 11601 made many people gasp. The first reaction among lawyers and businessmen to the idea of prohibiting any garnishment of wages seems

to be one of shock. But I wanted to do a little shocking on this issue because I think the issue needs to be brought out into the light and explored. We have received a liberal education on this subject in the past 2 weeks. I am just sorry that the study ordered by the President last March has not yet been completed by the Department of Justice, and by Labor and OEO.

But, I think we have made great progress, and I am still going to push as hard as I can to get something accomplished on this issue.

One other thing: You did not mention anything about our provision on credit advertising. You have touched so thoroughly on the other provisions in the bill that I would appreciate your comment on whether or not you feel the advertising of credit as it is done today helps to mislead those who want to use credit.

Mr. ABEL. I don't think there is any question—I just mentioned, as you recall, the reputable banks now advertising consolidation of payments, and this is just one example. The issuance of credit cards by a lot of our banks today to again move into this lucrative field, in my opinion, of easy credit certainly contributes—at least in the Pittsburgh area there is constant advertising and enticement offered to get people to get credit cards.

Mrs. SULLIVAN. We would not, in our bill, stop the advertising of credit—only the misleading type of advertising where they might advertise 4 or 3 percent and then you come in and find it is several times that much.

Mr. ABEL. That is right. I think there is no question, there is a lot of this that has built this thing up to proportions and it is in a dangerous area in my opinion—in our opinion.

Mrs. SULLIVAN. Again, I say thank you very much for giving us your time, your thoughts, and your help on this legislation.

Mr. ABEL. We thank you and your committee for this opportunity to express our appreciation of the fine work you are doing in pointing up this problem and paving the way, we hope, for some remedial action that is going to help alleviate this condition.

Mr. ANNUNZIO. Madam Chairman, I also wanted to express my appreciation to Mr. Jack Sheehan, legislative director of the steelworkers union, for the very constructive help he gives to this committee.

Mrs. SULLIVAN. Thank you very much.

Our next witness this morning is the Director of the Office of Emergency Planning in the Executive Office of the President, former Gov. C. Farris Bryant, of Florida, whose job it is to prepare the plans for the day we hope will never come—when the United States would again be fighting for its survival in a world war.

The legislative authority for most of the planning work done by Governor Bryant's office is the Defense Production Act of 1950—or what is left of it. This legislation comes within the jurisdiction of our committee so we have had the pleasure of having Governor Bryant testify on previous occasions.

Our reason for asking you to appear this morning is to discuss with us the position of the administration on the question of adding to our arsenal of economic defenses, in time of national emergency, the authority to establish limits on the use or extension of credit. War or the threat of war always sets off an inflationary spiral, particularly in civilian goods which would undoubtedly become scarce in time of

war, and this affects the entire economy. We had credit controls during World War II, and for part of the Korean war. This committee tried last year to reestablish—not the controls—but the authority for them during a national emergency. However, we were badly beaten on the House floor. One of the reasons we were badly beaten was the charge that we had not held hearings on this issue—that it was added to the bill as an amendment after the hearings ended.

We have provided such standby authority in section 208 of this bill, and now Governor Bryant, we want to go into that with you.

STATEMENT OF HON. FARRIS BRYANT, DIRECTOR, OFFICE OF EMERGENCY PLANNING; ACCOMPANIED BY MORDECAI M. MERKER, GENERAL COUNSEL; AND LEONARD SKUBAL, CHIEF, ECONOMIC STABILIZATION DIVISION

Mr. BRYANT. Madam Chairman and members of the Subcommittee on Consumer Affairs, I am pleased to have this opportunity to discuss with you H.R. 11601.

The Office of Emergency Planning is involved in the development of preparedness plans and programs which are intended for use in the event of an extraordinary national emergency situation. Included in such plans is legislation specifically covering consumer credit controls. If such controls become necessary, we would submit draft legislation to the Congress.

We have taken this approach in our planning for two reasons:

(1) If consumer credit controls become necessary, a program administered by the President should have the support of the Congress, and

(2) If consumer credit controls become necessary, legislative support for such a program would have the best chance of enactment at that time.

There appears to be general legislative authority for consumer credit controls in section 5(b) of the Trading with the Enemy Act (50 U.S.C. App. 5(b) and 12 U.S.C. 95a). I have discussed that law in some detail in my report to the chairman of the House Committee on Banking and Currency. By citing this authority I do not mean to imply that we would plan to rely upon it without further congressional action. In a most extraordinary emergency situation, however, it could be used.

Accordingly, we do not feel that more standby authority, such as section 208, is needed at this time. If, however, the Congress decides to enact such additional authority at this time, we strongly recommend that no restriction, such as the restriction contained in the last sentence of section 208 with respect to real estate credit, be included in such legislation.

The other provisions of H.R. 11601 which would require full disclosure of credit charges would be in accord with the President's program. Those provisions, however, are not within the responsibility of the Office of Emergency Planning, and I defer to the departments and agencies having a direct interest in the subject matter.

Mrs. SULLIVAN. Thank you, Governor.

I want to make a comment before we begin the questioning. Incidentally if we don't have time to complete the questioning, I have a series of questions I will read into the record for you to answer when you correct your transcript.

Mr. BRYANT. Thank you very much.

Mrs. SULLIVAN. Governor, this committee of the House, more than any other, recognizes the problems of your agency in preparing for eventualities we hope will never occur.

I personally think—and have expressed this on numerous occasions—that we should have on the books all of the necessary authority—standby authority—we would need in a war situation. That includes price, wage, salary, and rent stabilization powers, credit control authority, rationing—nobody mentions that word and yet in a war situation it would become instantly essential to have such powers.

Why don't we write these things into law when there is no emergency—when we can look at the problems calmly and with reason without trying to translate national policy during a war emergency into a question of whether controls should help the retailer to get a refund from the wholesaler or the wholesaler from the manufacturer.

The Korean war started on a June day and it was September before the Defense Production Act was enacted. Even then it couldn't be put into operation in major particulars until the following January.

In the meantime, the Consumer Price Index went up 1 percent a month. We are trying to help you do your job for the American people. But there is too much timidity in facing up to these issues until an emergency is actually upon us and then I think it is far too late. This is my speech. But it is something I have believed should be done ever since 1953 when we voted to take the standby economic powers out of the Defense Production Act. That act was passed in 1953 over my nay vote. I have been trying to do something about this issue ever since. I feel very much concerned about it.

With that I will turn the questioning over to the other members until they have exhausted their time.

Mrs. Dwyer?

Mrs. DWYER. I have just one question.

I am happy to welcome you, Governor, to this committee. I might say to the chairman that he is doing an outstanding job as a chairman of the Advisory Commission on Intergovernmental Relations.

My question is, Do you believe, and I don't think you do from your testimony, that consumer credit controls should be in a truth-in-lending bill at this time?

Mr. BRYANT. Really, I would have to say that I do not think that they ought to be in any bill at this time. I would not particularly relate it to truth in lending. It is our position that the development of emergency credit controls is related to the total problem of economic and other emergency controls and ought not to be considered until the shape of the emergency is more easily and completely discernible than it is now.

Mrs. DWYER. Thank you.

Mrs. SULLIVAN. Mr. Bingham?

Mr. BINGHAM. Thank you, Madam Chairman.

I, too, would like to welcome Governor Bryant.

I want to compliment him on the work that he is doing. I would just like to ask one question, Governor.

Would you develop a little further the thought contained in your statement that if there is a restriction—that if Congress does decide to enact this emergency authority at this time that you recommend

there be no restriction with respect to real estate credit as is now contained in the last sentence of section 208?

Mr. BRYANT. Yes, sir. The problem of credit control is not really a separable problem, and if it is attempted, it ought to be attempted in its broadest aspects, and, therefore, in our planning, we do prepare to submit control measures which would control the entire spectrum of credit including real estate credit.

Mr. BINGHAM. Was real estate credit included in the regular uses during the Korean war, for example?

Mr. BRYANT. Yes, sir.

Mr. BINGHAM. Thank you very much.

Mrs. SULLIVAN. I have a few questions that I would like you to answer now; and then, Governor, if there are others, I will submit them for the record for you to answer in writing.

First, as I understand your position in your recent letter to Chairman Patman, you are claiming that since President Roosevelt on August 9, 1941, 26 years ago, issued Executive Order 8843 establishing regulations over consumer credit on the authority of section 5(b) of the Trading With the Enemy Act, originally enacted in 1917, that the President could still adopt emergency consumer credit controls by Executive order pursuant to section 5(b) of the Trading With the Enemy Act. Is that correct?

Mr. BRYANT. Yes, madam.

Mrs. SULLIVAN. Could you tell me specifically what provisions of section 5(b) of the Trading With the Enemy Act could be relied on to support consumer credit regulations by Executive order?

I ask this question because the title of section 5 of the Trading With the Enemy Act is "Suspension of Provisions Relating to Ally of Enemy; Regulation of Transaction in Foreign Exchange of Gold and Silver." The annotated code indicates that practically all executive actions taken under this provision have related to foreign trade and exchange matters and not to control of domestic consumer credit.

Mr. BRYANT. May I refer you, Madam Chairman, to title 12 in the U.S. Code Annotated, section 95(a), subsection (1)(A), in which the President is given authority, "to investigate, regulate, or prohibit transfers of credit or payments between, by, or through, or to any banking institution."

I have not given you a total quotation, but that is the essence of the language upon which the authority is predicated.

Mrs. SULLIVAN. I am not a lawyer, so I don't know whether the legal meaning of that section can be stretched to apply it to standby controls or the requiring of a minimum amount to be put down on any item that is to be purchased with credit by the ordinary consumer.

Mr. BRYANT. Madam Chairman, I have with me today, two persons that I would like to present at this time, one, Mr. Skubal, Chief of the Economic Stabilization Division and Mr. M. M. Merker, who is General Counsel for OEP.

May I ask him to respond more fully to your legal question?

Mr. MERKER. Madam Chairman, the Executive order which was issued on August 9, 1941, by President Roosevelt specifically relied upon section 5(b) of the act of October 6, 1917, which is the Trading With the Enemy Act.

So, we feel that the precedent of reliance upon that statute at that time would still be available to us today, even though our planning does not contemplate it. We would seek legislation at the appropriate time.

Mrs. SULLIVAN. Of course, at the time President Roosevelt adopted this device in the summer of 1941 we did not have on the books a whole pattern of congressional legislation pertaining to various aspects of emergency regulation of our economy. Since that time Congress has spoken on this subject by enacting several laws including the Defense Production Act, containing legislative authority for consumer credit controls. It seems to me that the administration is on very thin ground in relying on a 1917 law for such executive authority when Congress as recently as 1950 provided such authority in the Defense Production Act and in 1953 deliberately and consciously allowed such authority to lapse.

Don't you think that there was a clear intention here by Congress, at least in a limited emergency situation, that the President should not exercise any such authority without coming to Congress first, as President Truman did in 1950?

Mr. MERKER. That is why our planning contemplates we would come to Congress. We mentioned it only in connection with the most extraordinary situation which might arise which would be more than a normal limited situation where we could appear before Congress. This authority is still on the books and is still available, but is certainly not the approach that we are taking, as we have indicated.

Mrs. SULLIVAN. As I have said, this is the whole reason why I have been trying to have this issue brought up in a calm situation, when we are not in an emergency.

Certainly, the President, or the Federal Reserve Board, would not use such authority under any except the most urgent circumstances. So the whole problem should be reviewed by Congress now, not when it is necessary, or when we are in a hot war, or in a situation where something legislatively would have to be done quickly, and perhaps too hastily.

As I stated before, the Korean war started in June, but we didn't get this act passed until fall, and most of it couldn't be put into effect until the following January. I can remember very, very clearly what happened to prices at that time. People rushed out to buy things they were afraid would be scarce. There was no regulation as to how much of a downpayment they had to make on these things. And we did go into an inflationary spiral.

Mr. MERKER. The approach we have taken has been the agency's position for about 10 or 12 years, and the reason for that is that at the time we developed this approach, it was felt that if we proceeded for legislation without the relatively immediate need for legislation, that we might have restrictions written into the law, such as the restriction that is in here at the moment concerning real estate credit, and other restrictions which might not give us the generally broad authority which the President ought to have if he is to institute a program of consumer credit controls.

Mrs. SULLIVAN. What would prevent you from sending up a bill and letting us explore it? As I say, things are calm right now. There would be no fear that this power was about to be exercised.

Mr. MERKER. As I indicated, we felt that was not appropriate because we would not get the kind of bill we would like to submit and like to see enacted.

Mrs. SULLIVAN. Our staff advises me that you have recognized this problem in your own documents that you have prepared. One of the most important documents your agency publishes, called "The National Plan for Emergency Preparedness" states in chapter 13:

> Economic Stabilization: In a limited war mobilization, without attack on the United States, emergency measures would probably be required to stabilize the economy. Fundamental problem would be restraining or controlling the inflation which accelerated mobilization could set in motion, even though inflationary pressures might not be generated by immediate shortages of food and services in the early stages of a limited war the psychological reaction in such a situation could produce inflationary pressures requiring forceful national action.

We could be approaching such a situation in the next few months, for all we know. We don't know. Under what authority would the administration provide forceful, national action in the consumer credit area if it did not have standby authority already on the books and did not wish to risk the psychological reaction which would certainly result from a request to Congress for legislative authority under such circumstances?

Mr. BRYANT. The approach would have to be a much broader economic approach that one relating only to consumer credit. As I indicated a moment ago when the question was whether or not this should be included in truth in lending, I said, in my opinion, it should not be included in any bill until it was approached in its broadest aspects, that is, until you encompass the entire spectrum of inflationary or economic controls. However, we would have no objection to section 208 if the restriction on real estate credit is removed.

Mrs. SULLIVAN. We weren't getting anywhere with this on any other proposed bill, including the Defense Production Act, where it had been before, so we put it in with this bill on consumer credit, where we really think it does belong.

Mr. BRYANT. I understand that.

Mrs. SULLIVAN. I also notice that "The National Plan for Emergency Preparedness" has a section entitled "Index of Authorities" which is said to be the "principal Federal statutes and Executive orders concerned with emergency preparedness." Under the heading, "Principal Statutes" you list the following laws: The National Security Act of 1947, the Federal Civil Defense Act of 1950, the Defense Production Act of 1950, the Strategic and Critical Materials Stock Piling Act, the Federal Property and Administrative Services Act of 1949, and Reorganization Plan No. 1 of 1958. There is no mention anywhere in that listing of the Trading With the Enemy Act as an authority for the exercise of emergency consumer credit controls or of any other domestic emergency preparedness measure.

If the Trading With the Enemy Act is the authority that the executive branch is relying on to institute emergency consumer credit controls, how can you explain that this is not cited in your list of principal statutory authorities for emergency action?

Mr. BRYANT. I think even worse than that, I wrote Chairman Patman a letter March 30, 1966, really in response to your inquiries,