

# The Hire Purchase Problem in Australia

## 1. Introduction

This paper falls into three parts the first of which is concerned with description, the second (though only rather briefly) with analysis, and the third with prescription.

In the first (descriptive) part of this article we survey the structure of the Australian hire purchase industry, its record of development in recent years, its sources of finance, and the main classes of transaction which it undertakes (1).

In the second part of the paper we make use of our descriptive material to analyse the impact of the growth of hire purchase upon the Australian economy. The discussion in this section is, as we have already mentioned, brief. Moreover, it is confined to the field of macro-economics and concerned primarily with the short run. This does not mean that there are not important micro-economic problems connected with the development of hire purchase (2). Nor does it mean that the emergence of « consumer » finance does not bring long run changes in its train. What it does mean is that in the allocation of scarce space we have chosen to consider the questions which appear, at the moment, to be of greater urgency in Australia and greater interest to readers outside the Commonwealth.

Finally we turn to policy. Here the discussion is unavoidably rather technical since the question of the « control » of hire purchase, using the term « control » in its widest sense, necessarily involves the political, constitutional, and technical framework

(1) The reader who wishes to study the subject further is directed to:  
H. W. ARNDY and P. S. SHRAPNEL, "Consumer Credit in Australia, 1945-51", *Economic Record*, May, 1953.

P. S. SHRAPNEL and N. RUNCIE, "Hire Purchase in Australia", *Monograph No. 180 Economics Society of Australia and New Zealand* (N.S.W. Branch), July, 1955.

(2) Thus, for example, we do not consider the impact of hire purchase finance on the industries manufacturing durable consumer goods.

within which monetary policy in Australia is perforce conducted (3). Again, policy questions are examined only in relation to the short-run macro-economic objectives of the authorities, a restriction which follows logically upon the narrow scope of our earlier analysis but which, nevertheless, compels us to ignore a number of problems of varying importance.

## 2. The Development of Hire Purchase

Since the term « hire purchase » is not unambiguous we shall begin by defining a hire purchase transaction as one in which the ultimate purchaser, on undertaking the contract, obtains immediate delivery and use of the goods but does not become the owner of the goods until the final payment is made to the lender (4). In the intervening period the purchaser is the hirer of the goods: the lender is the owner. On this definition, hire purchase advances made for the acquisition of consumer goods are a part of what is usually termed « consumer credit ». The two terms, however, are not synonymous. Moreover, it is important to recall that hire purchase transactions may be and frequently are entered into to finance the purchase of « investment » goods (5).

Australia is a country with a relatively high real income per capita, which has, since the war, enjoyed a high rate of immigration. Again, in common with the greater part of the western world, Australia, since 1946, has experienced high levels of employment and more or less continuous increases in prices and money incomes. To speak in very general terms, during recent years Australian expectations have been almost uniformly optimistic while uncertainty has been small. Few persons either have expected or now expect the recent rate of development to undergo any substantial fall. Equally, few persons (6) have during this period expected

(3) For a review of some of these problems consult:

J. S. G. WILSON, "Banking in the British Commonwealth" (O.U.P., 1952).

D. C. ROWAN, "The Monetary Problems of a Dependent Economy", *Banca Nazionale del Lavoro, Quarterly Review*, December, 1954.

Dr. H. C. COOMBS, "The Development of Monetary Policy in Australia, E. S., & A. Bank Research Lecture, delivered at the University of Queensland, September, 1954.

(4) Usually a finance company but sometimes a retailer.

(5) This is partly a matter of definition. In the Australian National Income Estimates expenditure on motor-cars and cycles is included in gross private investment.

(6) Farmers and wool growers have, in some years, been exceptions to this generalisation.

their money incomes to decline other than marginally and temporarily. In consequence, Australia has provided a fertile field for the development of hire purchase finance. The favourable nature of the general economic background can be inferred from the series presented in Table I, which requires no comment.

SELECTED INDEXES

TABLE I

Year	National Income £A m.	Personal Disposable Income £A m.	Retail Sales (1) £A m.	Imports (f.o.b.) £A m.	Gross Private Investment £A m.	Wage Rates (2) (Index)	Average Earnings (3) (Index)	Net Immigration (4) 000's	Population (End Year) 000's	Unemployment (5)
1946-47	1384	1178	n. a.	208	279	1423	1035	- 1.6	7579	9438
1947-48	1752	1446	n. a.	338	423	1565	1159	7.3	7709	3888
1948-49	1945	1687	240.6	415	399	1757	1321	25.3	7908	1575
1949-50	2285	1992	276.4	538	544	1913	1451	40.4	8179	10247
1950-51	3101	2526	342.7	742	812	2298	1742	33.2	8422	763
1951-52	3255	2790	404.0	1051	1107	2806	2145	25.7	8636	2647
1952-53	3588	3086	425.8	510	477	3104	2350	14.5	8815	29984
1953-54	3836	3219	460.2	682	787	3207	2462	13.3	8986	13232
1954-55	4047	3433	505.1	847	1011	3249	2572	22.9	9201	3690
1955-56	4312	3657	540.4	819	987	3364	2743	24.7	9428	4013

(1) Quarterly average sales.

(2) Nominal weekly rates adult males: Average of 1937-39=1,000.

(3) Base: 1945-46=1,000.

(4) Quarterly Average.

(5) Average of monthly figures of persons on benefit.

Sources: Commonwealth Statistician.  
National Income and Expenditure.

In view of this favourable opportunity, the development of hire purchase in recent years has not been altogether surprising. The rate of expansion has, however, been rapid. This is shown by Table II.

The figures in this Table, though they make the broad pattern of development abundantly plain, demand a measure of comment.

In the first place, official estimates of total hire purchase debt held by finance companies do not begin until March, 1953 (7).

(7) Both our own and the official estimates of total outstandings include hiring and insurance charges.

In consequence, we cannot claim precision for the figures in Col. (1) prior to this date. The estimates for the earlier period (8), however, certainly suggest realistic orders of magnitude.

TABLE II

THE GROWTH OF HIRE PURCHASE DEBT (1)

As at 30th June	Total Debt Outstanding				Annual Increase	
	Finance Companies £A m.	Retailers £A m.	Total £A m.	Share of Retailers %	£A m.	%
	(1)	(2)	(3)	(4)	(5)	(6)
1947	13.1	6.0	19.1	31.4	—	—
1948	21.8	10.3	32.1	32.1	13.0	68.1
1949	33.7	14.4	48.1	29.9	16.0	49.8
1950	52.1	18.2	70.3	25.9	22.2	46.2
1951	69.7	22.9	92.6	24.7	22.3	31.7
1952	78.3	23.8	102.1	23.3	9.5	10.3
1953	88.5	24.2	112.7	21.5	10.6	10.4
1954	132.0	33.0 (2)	165.0	20.0	52.3	47.0
1955	181.3	42.5	223.8	19.0	58.8	35.6
1956	209.3	45.9	255.2	18.0	31.4	14.0

(1) In respect of goods sold by retail. Excludes wholesale credit.

(2) For March 31, 1954 the Commonwealth Statistician gave a figure of £A 30.7 m.

Sources: Col. (1) 1946-52: estimated. June 1953 onwards Commonwealth Statistician.  
Col. (2) Estimated.

In the second place, no official estimates of debt held by retailers are available other than the single observation for March 1954. The figures in Col. (2) are thus our estimates. These were derived upon the hypothesis that the share of retailers in total outstandings has been continuously declining. The reader is warned, therefore, that the Table provides no *confirmation* of the view that the share of retailers is declining. There is, however, little doubt that this is the case, though it would be tedious to recapitulate the evidence which has led us to adopt it as a basis for our statistical calculations.

(8) These are taken from SHRAFNEL and RUNCIE, *op. cit.*

Beyond these qualifications, the Table requires little comment. Hire purchase debt has grown extremely rapidly since the end of the second world war. Moreover, as the use of hire purchase has developed, the share of retailers has declined and that of finance companies grown; an instance of the familiar phenomenon of increasing specialisation accompanying the growth of the market.

It is interesting, and from the point of view of monetary policy important, to enquire whether the growth of the hire purchase industry has been accompanied by a growth (or decline) in the degree of concentration among the finance houses themselves. Since 1950 the share of what are now the three largest finance companies (excluding the Commonwealth Bank) (9), has risen slightly to about 37% (£A. 94.5 m.) of total debt or about 45% of all debt held by finance companies. On the other hand the share (£A. 15.7 m.) of the Commonwealth Bank's Industrial Finance Department has declined from 20% in 1950 to some 6% (10). «Concentration» has therefore declined or increased accordingly as one includes or excludes the Commonwealth Bank from the measure. From the point of view of monetary control, however, the more meaningful procedure is certainly to include it. Hence, if, as seems likely, concentration facilitates control, there has been some worsening of the position in recent years.

This view regarding the degree of concentration is, however, subject to an important qualification. This arises because one of the largest finance companies operating in Australia publishes no accounts (11). Its share of the market can thus only be guessed and the limits which can be imposed on the guess are not narrow. It is therefore unsafe to give any figure for its share of hire purchase business. It needs to be remembered, however, that if our measure of concentration was the share of the five largest lenders, inclusion of this company might, *if the facts were known*,

(9) The three principal holders of hire purchase debt were at 30th June, 1956: the Industrial Acceptance Corp., £A. 40.0 m.; the Australian Guarantee Corp., £A. 32.9 m.; the Custom Credit Corp., £A. 21.6 m. The Commonwealth Bank's Industrial Finance Department — the principal holder of hire purchase debt in 1950 (£A. 14.2 m.) — did not participate in the expansionary movement of the following period (£A. 15.7 m. in 1956).

(10) A change which reflects central banking policy *not* the competitive ability of the Department.

(11) The General Motors Acceptance Corporation which is a wholly owned subsidiary of General Motors.

modify the estimates of the degree of concentration and its direction of change given in the preceding paragraph.

None of the remaining finance companies is thought to hold total debt in excess of £A. 6 m. (some 2% of total debt outstanding). Moreover, apart from three companies which are closely linked with trading banks (12), none of them conduct business on a national (as opposed to regional) basis. The broad picture is therefore of a small number of relatively large lenders and a large number of relatively small lenders.

We emerge, therefore, from this brief general review with the following conclusions:

(a) the hire purchase industry (as defined) has expanded at a very rapid rate since 1945-6;

(b) during the expansion there has been a shift of business from retailers to finance houses, the latter now doing some 80% of the business;

(c) within the «finance house» group itself, the degree of concentration is high though there is no clear evidence of any tendency for concentration to increase.

In later sections of this article we shall consider the impact of these developments on the economy and their implications for (macro-economic) policy. Before doing so, however, it is necessary to complete our sketch of the present position by giving an outline of the types of business undertaken by the finance companies, their terms, their sources of finance, and the legal framework within which they conduct operations.

### 3. Types of Commodities Sold Under Hire Purchase

The commodities sold under hire purchase fall into two groups: producers' goods and consumers' goods. In the producer field typical purchases on hire purchase terms include tractors and trucks by farmers, semi-trailers by road transport operators, and machinery by jobbing engineers and by printers. In the consumer field motor cars, refrigerators, washing machines, radios and furniture, and more recently television sets, are the items frequently

(12) Four trading banks have interests in finance companies. This matter is discussed more fully below in Section 5.

purchased under hire purchase contract. However, the official figures analysing the direction of hire purchase lending distinguish only three broad commodity groups: motor vehicles, plant and machinery, and household goods. Based on this classification the direction of finance company lending in 1955-56 is shown in Table III.

TABLE III

## DIRECTION OF LENDING: FINANCE COMPANIES, 1955-56

Commodity Classification	No. of Agreements		Amounts Financed (a)		Average of Sale Financed (a) %	Average Amount per Agreement (a) £A.
	000's	%	£A. m.	%		
Motor Vehicles . . . . .	300	30.5	123.7	71.7	59	413
Plant and Machinery . . . . .	19	1.9	7.7	4.5	62	405
Household Goods . . . . .	665	67.6	41.1	23.8	81	62
Total . . . . .	984	100.0	172.5	100.0	63	175

(a) Excluding hiring charges and insurance.

Source: Commonwealth Statistician.

This pattern of lending has been fairly constant for the three years for which official figures are available. Of the 984,000 new agreements entered into by finance companies in 1955-56, 300,000 or 30% were for motor vehicles of all kinds. The 19,000 contracts for plant and machinery account for only 2% of the number of contracts while, by far the greatest number of contracts, 665,000 or 68% were written for household goods. However, this percentage composition completely changes when we examine the money advanced. Motor vehicles jump from 30% of the number of contracts to 72% of the amount financed, excluding hiring charges and insurance. The latter charges are much heavier for motor vehicles than for plant and machinery or household appliances. Hence the percentage of motor vehicles in the total amounts advanced (including charges) would be higher than the 72% shown. The average amount advanced per agreement (excluding charges) is nearly seven times greater for motor vehicles than for household goods which fall to 24% of the amounts financed.

An approximate indication of the (weighted) average terms of completed hire purchase contracts of the finance companies can be given. As the amounts financed (including charges) in a given period are provided by repayments from earlier contracts plus the increment in total outstandings, the first figure less the last, divided by the outstanding debt at the end of the previous period gives a crude estimate of the average life of a contract. On the assumptions made this is approximately 13-14 months for 1955-56.

Official figures for the average percentage of each sale financed are available. In 1955-56 this percentage averaged 59% for motor vehicles, 62% for plant and machinery and 81% for household goods; this suggests deposits as a percentage of the cash price of 41%, 38% and 19% respectively. These terms may be compared with the minimum deposits and maximum hiring periods shown in Table IV (13).

The only comparable figures for retailers (14) are for the March quarter of 1954 (15). These figures suggest that retailers are writing an additional 650,000 contracts per annum. The direction of retailers lending was revealed as 76.8% for household goods, 14.1% for motor vehicles and 9.1% plant and machinery. Machinery manufacturers and merchants who provide hire purchase terms for their customers are responsible for the latter figure.

No further dissection by commodity types is available from the official statistics; and no attempt has been made in the official figures to distinguish between producer and consumer elements. A better picture of the impact of this finance would be given if these distinctions could be drawn and a more detailed dissection, for example distinguishing between new and used vehicles (16), was sought on the questionnaires (17).

(13) The turnover period is considerably less. There are two explanations of this: (a) the companies customarily write contracts for less than the maximum period and (b) contracts are completed before the due date. This is particularly true of the motor vehicle trade.

(14) Including motor dealers and public utilities who carry their own paper.

(15) A sample survey has been conducted by the Commonwealth Statistician since this date but, as yet, no figures have been published.

(16) One trade authority suggests that 60-70% of used car sales and 20-30% of new car sales are sold under hire purchase contract.

(17) However see, SHRAPNEL and RUNCIE, *op. cit.*, pp. 2-3 and the statistical appendix. Moreover, in the absence of these details it is difficult to make effective international comparisons.

It is common experience in western countries that as incomes rise an increasing proportion is spent on consumer durables (18). Moreover the trends of industrialization, especially when stimulated by the incentives of a full employment economy, usually increase the capital equipment per worker; in Australia the farm labour shortage, as well as the extensive methods of agriculture and grazing, has encouraged mechanisation (19).

What factors have motivated people to buy these commodities on hire purchase terms? Firstly, from the consumer's viewpoint the main advantage is that he is able to obtain goods immediately and pay for them out of income. Hire purchase is regarded as a means of raising living standards immediately. The question usually asked is « Can I comfortably meet the payments from my income? », and not « Is it worthwhile incurring the cost of this credit? ». It therefore appeals to the less wealthy groups in the community and, in particular, to recently married couples who wish to acquire expensive household and personal goods.

Secondly, the producer might use hire purchase to acquire equipment because of the impact of credit restrictions. It is fairly clear that some of the hire purchase expansion of the post-war years would not have occurred under easier credit conditions because of the availability of bank finance. Despite the high cost of hire purchase finance some producers may have more profitable uses of their available funds than the 20% or more involved in using hire purchase accommodation. Again, from the point of view of the banking system, some small producers may have inadequate credit standing or collateral to obtain sufficient bank finance for their requirements; in effect, under hire purchase, the goods bought serve as collateral. Thus, hire purchase for producers supplements, as well as being an alternative to, bank finance; and it may serve from this point of view both as a safety valve and an impediment to the effective working of the Special Account machinery.

In summary, it is clear that the demand for hire purchase credit is intimately connected with the demand for a number of durable goods. Firstly, in the consumer goods fields the potential

(18) Cf. National Income Supplements to Current Survey of Business Statistics for U.S. figures.

(19) The essential feature of durable goods for sale under hire purchase terms is a working life and a resale value extending beyond the duration of the contract.

demand for hire purchase credit depends, *ceteris paribus*, on the expansion of the market for consumer durables. Secondly, for producers the aggregate demand for hire purchase credit and the varieties of commodities purchased will be considerably influenced by the availability of other forms of finance. However for some small producers (20) it is probably the only institutional source of finance available.

#### 4. Hire Purchase Terms

The demand for hire purchase finance will also depend on the terms on which it is made available. From this point of view there are five main variables in a hire purchase contract: the size of the deposit, the number of instalments and the maximum period of repayment or hire, the financier's charge, insurance, and stamp duty and other charges if any. The terms being allowed or charged by the major finance companies in September, 1956 on a selected range of goods are shown in Table IV.

The size of the deposit and the repayment terms (number of instalments and period of repayment) vary according to the type of goods. The actual terms depend on the financier's appraisal of the rate of depreciation, whether the borrower is a good credit risk, and the guarantee given to the finance company by the retailer or dealer against bad debts. In general, the terms are fixed to preserve the financier's equity if a repossession sale is necessary (especially with motor vehicles).

The deposit and repayment terms are subject to some legislative provisions (21) and in the period from September, 1955 to July, 1956, were subject to a voluntary agreement for restraint between the finance companies and the Prime Minister (22). However, in general, these are the terms which have been current throughout most of the post-war years.

(20) Typically in working proprietor industries.

(21) Minimum deposits are prescribed in Tasmania (10%-20%), N.S.W. (10%), Queensland (10%-25%) and A.C.T. (10%). Maximum hiring periods are prescribed only in Tasmania and Queensland.

(22) The voluntary agreement with the Prime Minister provided, inter alia, for 33.1/3% deposit and 30 months to pay for motor vehicles and 15% deposit for household goods. The finance companies did not regard the latter condition as binding as a similar agreement from retailers was not obtained.

The financier's charge for making the loan is customarily quoted, except for agricultural machinery, as a flat rate per cent per annum on the total debt for the whole period. Hence the effective rates of interest, as shown in Table IV, are nearly double the quoted « flat rate ».

TABLE IV

TYPICAL HIRE PURCHASE TERMS  
(Major Finance Companies (a) - September, 1956)

Item	Minimum Deposit %	Maximum Length of Contract Months	Hiring Charge	
			Quoted Rates % p.a.	Effective Rates (b) % p.a.
<i>Motor Vehicles</i>				
Car - New . . . . .	25.0	36	6.0 - 6.5	11.5 - 12.5
Used (d) . . . . .	33.3-50	18-36	8.0	15.5
Truck - New . . . . .	33.3-40	30-36	6.5 - 7.0	12.5 - 13.5
Used (d) . . . . .	33.3-50	18-24	8.0 - 9.0	15.5 - 17.5
Tractor - New . . . . .	33.3	36	6.0 - 7.0	11.5 - 13.5
	40.0 (c)	24	12 % simple	12.0
<i>Plant &amp; Machinery</i>				
Lathe - New . . . . .	25.0	36	7.0	13.5
Agricultural Equipment - New . . . . .	33.3	36	12 % simple	12.0
	40 (c)	24		
- Used (d)	33.3-50	18-24	15 % simple	15.0
<i>Household Goods</i>				
Refrigerator (e) . . . . .	10.0-15.0	24-36	8.0 - 10.0	15.5 - 19.5
Washing Machine (e) . . . . .				
Furniture (e) . . . . .				

(a) Excluding the Commonwealth Bank.

(b) To nearest ½ per cent. Maximum range for terms quoted assuming monthly instalments.

(c) Quoted terms for other than monthly instalments (e.g. to coincide with crop payments).

(d) Terms quoted depend on age of equipment.

(e) Terms quoted vary with amount financed.

The Commonwealth Bank conducts hire purchase business through its Industrial Finance Department, and charges the lowest rate of  $4\frac{3}{4}\%$  flat (23). This credit is now restricted to producer

(23) For used motor vehicles the rate is 6% flat: for new equipment for farming purposes  $4\frac{1}{2}\%$  flat.

equipment and since February 1956 this no longer includes business cars. The medium sized finance companies offer rates one or two per cent higher than those shown in the table. Small financiers tend to charge what the market will bear and undertake the more risky contracts at flat rates of 10 to 15 per cent *i.e.* effective rates of 19.5% to 29.5%. The highest charges are for used motor vehicles.

Retailers' terms vary considerably and in many cases are highly competitive at flat rates of 5-6%. Most gas and electricity undertakings finance hire purchase sales of appliances as a means of promoting the use of their products and this finance is frequently carried at cost (a typical rate being 5% flat).

The insurance charge is a substantial outlay for a person buying a motor vehicle on terms and is an additional item included in the amount financed. In the case of household goods the hiring charge usually includes an insurance cover (for fire etc.) to the extent of the owner's equity (costing 0.25%-0.50%). This cost, included in the hiring charge, may be carried at the financier's own risk or under a group contract written with an insurance company.

Motor vehicle insurance is always written with a separate company although in the case of the major finance companies and many smaller ones, this is a wholly owned subsidiary conducting all classes of insurance business. The rates depend on whether the vehicle is used for private passenger purposes, for business purposes, for the use of commercial travellers or for goods carriage. Moreover, the rates vary between States and between metropolitan and country areas. However, for all these categories, insurance premiums for motor vehicles under a hire purchase contract are substantially higher than for owners. The premiums in one metropolitan area (Sydney) vary from 65% higher for private cars to 37% higher for goods-carrying vehicles (24).

The other charges are usually quite small when compared with the hiring charge, and in the case of motor vehicles when compared with either the hiring charge or the insurance premium. However, three State governments have decided to increase substantially stamp duty from a nominal amount to slightly in excess

(24) For a fuller discussion of hire purchase charges see N. RUNCIE, "Hire Purchase Charges", *Voice*, May, 1956.

of 1% of the amount financed (25). It is further provided that this stamp duty must not be collected from the customer; it is doubtful, however, whether this can be enforced. To meet cost rises (26) the major finance companies contemplate an increase of 1/2% to 1% in hiring charges early in 1957.

Irregular practices involving additional payments by hire purchase users are found mainly in the used car field and in contracts by small retailers. For example, some financiers in the used car field charge inspection fees and administration charges separately. These are in the nature of special loadings and there are some indications of a growth of loadings by dealers in recent times (27).

It is clear that many people who buy goods on instalment terms do not realise the high cost of this finance, or the availability of more reasonable terms from other sources. A person who buys a second hand car over thirty months, for example, pays from 25% to 40% more for the vehicle than the cash customer over the same period. Other people pay 18% for the finance of household appliances which might be purchased through a public utility undertaking at 10% (28). One State government bank (29) provides personal loans at 6% flat while the maximum overdraft rate for a personal loan from the trading banks is 6% on the outstanding balance.

##### 5. Sources of Hire Purchase Funds

There have been some significant changes in the sources of funds of the finance companies in recent years. These changes have been traced from 1949-50 to 1955-56 by an analysis of the balance sheets of sixteen finance companies from 1949-50 to 1953-54, and of thirty finance companies from 1953-54 to 1955-56. The main sources of funds which have been identified are (a) capital, consisting of ordinary and preference capital, (b) reserves, which

(25) The new stamp duty is effective from 3rd October, 1956 in N.S.W., from 3rd December, 1956 in Victoria and from 1st January, 1957 in Tasmania.

(26) Increased interest rates on borrowed money, company taxation, postal rates, wages and in the last six months of 1956 increased repossessions and a fall in the collection ratio.

(27) One consequence is that one State government (N.S.W.) has announced its intention of introducing legislation fixing maximum hiring charges and presumably prohibiting special loadings of all kinds.

(28) Small loan societies, similar to the American Credit Unions, have not developed to a significant extent in Australia.

(29) The Rural Bank of New South Wales.

are part of shareholders' funds, (c) bank overdraft and (d) « other borrowing » including debentures, unsecured notes, fixed deposits and other deposits. « Other liabilities » include unearned hiring charges (30), creditors and insurance suspense accounts (which arise because consolidated balance sheets are the only ones available in a number of cases). Of the finance companies whose published balance sheets are analysed in Table V, the sixteen companies group accounted for 54% of the outstanding debts held by finance companies (excluding the Commonwealth Bank) in 1953-54 and at the end of 1955-56 the corresponding figure for the thirty finance companies was 69% (31).

The tendency for shareholders' funds to decline relatively as a source of finance was most marked in the early post-war years from 1944-45 to 1949-50. One survey shows a decline in shareholders' funds for a group of companies from 73.3% of total liabilities in 1944-45 to 24.4% in 1950-51 (32). The aggregated balance sheets of our sixteen finance companies suggest a further though slight tendency to fall. However, in 1954-55, this trend was reversed when the thirty finance companies raised their capital (by new issues) by no less than £ 10 m. or 75% in one year. To the extent that cash issues were floated at a premium these funds increased reserves; for the latter are not entirely surplus profits retained in the business. To the extent that bonus issues were made, issued capital as a source of finance is overstated. Subject to these qualifications, the figures suggest that some stability in capital gearing has now emerged and, secondly, that in periods of rapid expansion, the finance companies have raised considerable sums by share issues.

However, the outstanding feature of Table V is the decline in relative dependence of the finance companies upon bank over-

(30) "Unearned hiring charges" arise because the outstanding debt of customers includes a portion of hiring charges which is taken to account only as instalments are paid back. In a sources of funds analysis a portion of « unearned hiring charges » should strictly speaking be deducted from "Total Liabilities" as it is a book entry involving no outlay of funds by the company. In periods of little change in the length of hire purchase contracts and in the level of charges, unearned hiring charges should show some stability as a percentage of total liabilities.

(31) For the 30 finance companies outstanding debt accounted for 93% of total assets in 1955-56; unearned hiring charges are sometimes deducted from H.P. debt and some rearrangement of company balance sheets was undertaken in aggregating to obtain a uniform treatment. The other assets are cash, premises and other fixed assets, shares in subsidiaries and other investments, and in some cases stock.

(32) H. W. ARNDT and P. S. SHRAPNEL, *op. cit.*, p. 49.

## SOURCES OF FUNDS

TABLE V

Balance Sheets Ending in (1)	Shareholders' Funds			Bank Overdraft	Other Borrowing	Other Liabilities	Total Liabilities
	Capital	Reserves	Total				
<i>Sixteen Finance Companies</i>							
1949/50							
£A m.	5.6	1.5	6.1	11.0	1.1	4.3	22.5
%	20.3	6.7	27.0	49.1	4.7	19.2	100.0
1950/51							
£A m.	6.2	2.2	8.4	8.7	10.0	6.5	33.6
%	18.4	6.6	25.0	25.8	29.8	19.4	100.0
1951/52							
£A m.	6.8	3.4	10.2	9.3	13.2	7.6	40.3
%	16.8	8.5	25.3	23.0	32.8	18.9	100.0
1952/53							
£A m.	6.8	4.6	11.4	11.4	13.9	9.3	46.0
%	14.8	10.0	24.8	24.7	32.3	20.2	100.0
1953/54							
£A m.	8.8	6.6	15.4	18.1	17.7	13.4	64.6
%	13.7	10.2	23.9	27.9	27.5	20.7	100.0
<i>Thirty Finance Companies</i>							
1953/54							
£A m.	13.2	7.9	21.1	19.7	22.6	15.7	79.0
%	16.7	10.0	26.7	24.9	28.5	19.9	100.0
1954/55							
£A m.	23.0	11.2	34.2	18.3	39.5	27.5	119.5
%	19.3	9.3	28.6	15.3	33.1	23.0	100.0
1955/56							
£A m.	26.0	11.5	37.5	17.8	57.9	30.5	143.7
%	18.1	8.0	26.1	12.4	40.3	21.2	100.0

(1) The balance sheet of the Industrial Acceptance Corporation relates to the end of calendar years whereas most other companies balance on 30th June.

Source: Published Balance Sheets and Reports.

draft as a source of funds and the spectacular rise of « other borrowing » both in absolute and relative terms. In 1950 the Industrial Acceptance Corporation began substituting debentures for overdraft and was completely independent of bank overdraft by the end of 1952 (33). Both the Industrial Acceptance Corporation and the Custom Credit Corporation now operate completely without this form of bank support. In the period from 1949-50 to 1953-54 the relative dependence on bank overdraft for the sample of sixteen companies declined from 49% to 28% but the dependence on other borrowing increased from 4.7% to 27.5%. These trends have continued in the last three years and in 1955-56 « other borrowing » (40.3%) was more than three times as important as bank overdraft (12.4%). In absolute terms the comparative ease with which the finance companies have been able to obtain outside funds is even more marked. It is noteworthy that the periods of most rapid substitution are periods of credit restraint and inflationary pressure.

However, bank advances are not an entirely satisfactory index of changes in bank support in this period. The banks may have taken up parcels of some of the public flotations and, of even more importance for trading operations, have acquired share capital (34). Apart from the Commonwealth Bank the following share interests are known:

Custom Credit Corporation Ltd. (40% owned by National Bank);

Esanda Ltd. (100% owned by the E.S. & A. Bank);

General Credits Ltd. (45% owned by the Commercial Bank of Australia);

The Finance Corporation of Australia (40% owned by the Bank of Adelaide).

The banks' interest in this field has been dictated by the profitability of hire purchase operations and by the opportunity to direct their customers to an alternative source of finance.

(33) On 30th November, 1950 the Commonwealth Bank requested the trading banks to be selective in granting bank advances. The Bank directed that finance for capital expenditure and permanent non-fluctuating working requirements should be obtained from sources outside the banking system.

(34) "Investment Control" was deleted as a central bank power in the 1953 amendments of the Banking Act.



What have been the sources of the finance companies « other borrowings »? Firstly, some small investors have been attracted by the higher interest rates offered on deposits and debentures by finance companies. However, institutional sources of funds are probably the more important. Typical sources include:

- (i) Cash reserves of insurance companies, especially those associated with hire purchase businesses;
- (ii) portfolio investments of life assurance offices and pension funds (35);
- (iii) liquid reserves built up by companies for income tax and dividend payments;
- (iv) temporarily idle funds of firms, arising from trading (e.g. seasonal marketing in the wool trade);
- (v) capital received in advance of requirements by companies;
- (vi) funds earmarked for specific purposes by firms (e.g. building extensions, property purchase or plant modernisation);
- (vii) deposits from associated companies (e.g. retailers or manufacturers);
- (viii) deposits by individuals.

An innovation in the technique of borrowing has been the introduction of « Cumulative Debenture Stock » in the last twelve months (36). This stock enables investors to accumulate funds for 5 to 20 years at a comparatively high rate of compound interest. Superannuation, provident and similar funds may find it convenient to hold a portion of their portfolios in this form. Companies have been interested in cumulative stock for replacement of fixed assets and other sinking fund purposes. Moreover some private investors may find this stock attractive for the eventual payment of Probate, Estate and Succession Duties or on the grounds that it avoids the worries of re-investment and the risks of capital loss arising from stock market fluctuations. As yet no figures are available of the magnitude of borrowing by cumulative stock.

(35) In some cases trading banks may have purchased debentures; in one case (I.A.C.) this is known to have occurred.

(36) Introduced by I.A.C. and A.G.C. — now becoming a common technique with large and medium companies.

Typical interest rates on public borrowings by large and small finance companies in comparison with other interest rates are shown in Table VI.

TABLE VI  
INTEREST RATES ON PUBLIC BORROWING: NOVEMBER-DECEMBER, 1956

Institution	Term in Months										5-20 yrs	Cumulative 5-20 yrs.	
	On Call	3	6	9	12	18	24	36	48	60			
<i>Savings Banks</i> (1)	2 <sup>3</sup> / <sub>4</sub>	—	—	—	—	—	—	—	—	—	—	—	—
<i>Trading Banks</i>													
Fixed Deposits	—	2 <sup>1</sup> / <sub>4</sub>	2 <sup>1</sup> / <sub>2</sub>	—	2 <sup>3</sup> / <sub>4</sub>	—	3 <sup>1</sup> / <sub>2</sub>	—	—	—	—	—	—
<i>Finance Companies - Large</i>													
Debentures	—	3 <sup>1</sup> / <sub>2</sub>	4	4 <sup>1</sup> / <sub>2</sub>	5	—	5 <sup>1</sup> / <sub>2</sub>	6	6 <sup>1</sup> / <sub>2</sub>	7	7	6 <sup>1</sup> / <sub>2</sub>	
Deposits	3	3 <sup>3</sup> / <sub>4</sub>	4 <sup>1</sup> / <sub>4</sub>	4 <sup>3</sup> / <sub>4</sub>	5 <sup>1</sup> / <sub>4</sub>	—	6	6	—	—	—	—	
<i>Finance Companies - Other</i>													
Typical Low Rates	3 <sup>1</sup> / <sub>4</sub>	3 <sup>1</sup> / <sub>2</sub>	4 <sup>1</sup> / <sub>4</sub>	4 <sup>1</sup> / <sub>2</sub>	5	5 <sup>1</sup> / <sub>2</sub>	5 <sup>1</sup> / <sub>2</sub>	6	6 <sup>1</sup> / <sub>2</sub>	7	7	8	
Typical High Rates	3 <sup>1</sup> / <sub>2</sub>	4	4 <sup>1</sup> / <sub>2</sub>	5	6	6 <sup>1</sup> / <sub>2</sub>	7	7	7	8	8	8	
<i>Commonwealth Bonds</i> (2)	—	—	—	—	—	4	—	—	—	—	—	5	
<i>Semi-Government Bonds</i>	—	—	—	—	—	—	—	—	—	—	—	5 <sup>1</sup> / <sub>4</sub>	

(1) Maximum savings bank interest rate of 2<sup>3</sup>/<sub>4</sub>% applies up to £1,000; 1<sup>1</sup>/<sub>2</sub>% from £1,000 to £1,500 and thereafter nil.

(2) Short dated section of government loan (18 months) issued at a discount (£99.10.0. for £100) giving a redemption yield of £4.7.0%; long dated bonds (8<sup>1</sup>/<sub>2</sub> years and 20 years) issued at par. Bond interest carries an income tax rebate of 2/- in £.

Source: Published borrowing rates of 14 finance companies.

Since June, 1955 there has been an increase in all interest rates shown in this table (37). Partly because of competition for funds and partly because of increases in the long dated bond rate (38) (1<sup>1</sup>/<sub>2</sub>%) and fixed deposit rates (1-1<sup>1</sup>/<sub>2</sub>%), the borrowing rates of finance companies have increased by 1/4 to 3/4% in the short-dated section and by 1 to 2% in the long-dated section. There has probably been a trend to longer terms in finance company bor-

(37) For comparison see P. S. SHRAPNEL and N. RUNCIE, *op. cit.*, p. 5 (Table V).

(38) The taxation rebate of 2/- in £ of bond interest raises the equivalent fully taxable yield on bonds by over 1/2% for most classes of investor. For a discussion of the working of this rebate see N. RUNCIE, "The Calculation of Bond Yields", *Economic Monograph No. 1*, N.S.W. University of Technology.

rowing in the last two years. However, the most recently published balance sheets of the three largest companies show that 45% of the debentures issued to the public (39) were « short » in the sense of a borrowing period of twelve months or coming up for redemption in the next twelve months. The larger companies, with their established reputation as borrowers, are undoubtedly more successful than the smaller companies in raising short-term money. Moreover, the large finance companies have been able to borrow from the public on more attractive terms than the small ones. However a « cat and mouse » levering up of the former's rates has been occurring and the relative margin has decreased (40).

Public borrowing on the terms outlined above would be more or less expensive than bank overdraft (41), depending on the proportions of short and long term borrowing and the expense rate associated with the public borrowings. The underwriting commissions vary, for example, with the status of the company, the size of the issue, the time the issue remains open and the interest rates. These associated costs, including the costs of advertising, may be fairly high for small companies but are likely to be considerably less for the larger companies.

Only fragmentary data on finance company costs are available. However, the following cost analysis of a typical two year contract has been provided by a public utility undertaking (42).

	Costs as % of H. P. Debt.
1. Interest . . . . .	5.025
2. 90 day sales . . . . .	.492
3. Clerical costs . . . . .	1.982
4. Overhead costs . . . . .	.832
5. Printing, Stationery . . . . .	.931
6. Bad Debts. . . . .	.250
	9.512
Charge . . . . .	10% (5% flat)

(39) A high proportion of Fixed Deposits would also be short.

(40) The Custom Credit Corporation announced a reduction in interest rates for long term debentures on 1st December, 1956 as follows: 5-20 years, from 7% to 6%; 4 years, from 6½% to 6%.

(41) Current maximum interest rate is 6% per annum on daily outstanding balance.

(42) January, 1956.

Some explanatory comments on this table are necessary as the cost experience of finance companies would be different in many respects. Firstly, the interest charge has been calculated at the old public utility borrowing rate of 4¾% (now 5¼%) whereas a major finance company's interest bill may be several percent higher. Secondly, the « 90 day sales » item is the proportionate cost of carrying hire purchase sales which are completed in the interest free period of 90 days; there is no corresponding item in the accounts of finance companies. Thirdly, the other expenses for finance companies, other than bad debts (43), would probably be lower, especially for those firms engaged in motor vehicle finance. This study suggests that the major finance companies probably aim at a gross profit margin of 3% to 6% of the debt on the existing level of charges.

We suggest that the following conclusions emerge from this survey:

Firstly, it is clear that the finance companies have been responsible for some development of the short-term money market in Australia. By offering attractive interest rates and a wide range of short-term investment opportunities, and by extensively advertising their borrowing terms, it has been possible for the finance companies to mobilise considerable funds and avoid the more severe effects of restricted bank credit.

Secondly, taking all finance companies and retailers together it seems likely that some £ 100 m. has been raised in this way for hire purchase purposes.

Thirdly, the finance companies, in the absence of ceiling interest rates on borrowing and lending, appear to retain a competitive margin in competing for funds on the open market.

## 6. The Legal Framework

The division of powers between the Commonwealth and State Governments in Australia has complicated the devising of a uniform legal framework for the conduct of hire purchase transactions. Moreover, the federal system has inhibited the development of the overall controls which might otherwise be expected under a unitary system of government. It is true that the central government may,

(43) Including losses on repossession.

under the « defence power » contained in the constitution, exercise overall controls in wartime. However, in normal peace-time situations, the only overall controls possessed by the Commonwealth which may be used to control hire purchase are those relating to taxation (direct and indirect) and other fiscal measures, banking (other than State banking) and insurance. Except in wartime, or under the threat of war, the Commonwealth is unable to exercise direct controls over capital issues or other borrowing (44). Thus the legal framework under which hire purchase transactions are conducted is the product of state legislatures.

All Australian States have legislation affecting the terms of hire purchase transactions (45). In part, this legislation springs from a desire to regularise the growing volume of commercial transactions conducted under hire purchase terms, and, secondly, it arises from social discontent in the twenties and especially the thirties with the lack of equity between the parties and the stringent powers possessed by the vendor especially in cases of default. For these reasons the legislation has been concerned mainly with the rights of the parties and only in a minor degree with regulating the volume of business.

As indicated in our definition in Section 2 the fundamental feature of a hire purchase contract is that ownership of the goods does not pass to the purchaser until payment for the good is complete. Although the ultimate purchaser obtains immediate delivery of the goods his payments are regarded as « rentals » until the final instalment. An essential feature is that the hirer has the right to complete the hiring at any time by returning the goods without incurring any further liability.

This outline distinguishes hire purchase from (i) a hiring contract, where there is no option to purchase, (ii) « lay-by », where possession, use, and ownership do not pass until the good is finally paid off, (iii) cash orders, which are money lending devices conferring no rights of repossession by the lender of the goods

(44) The temporary or permanent transfer of powers relating to capital issues and borrowing has been unsuccessfully sought by the Commonwealth at successive meetings of Premiers in post-war years. The latter have had their financial independence reduced by a uniform taxation system introduced during the war by the Commonwealth and have been unwilling to increase still further the financial control of Canberra.

(45) The initial acts (subsequently amended in most cases) were passed in the following years: South Australia (1931), Western Australia (1931), Queensland (1933), Victoria (1936), New South Wales (1941), Tasmania (1943) and A.C.T. (1955).

purchased, and (iv) time payment and other credit transactions involving the payment of instalments (e.g. instalments charge accounts), where ownership passes with possession (46). All these instalment sales devices are used to enable consumers to acquire durables and (i) and (ii) are used by producers. However, the volume of hire purchase transactions would be by far the more important.

In order to eliminate harsh conduct by vendors (as far as possible) State legislation has enacted provisions which apply despite any clause in the hire purchase agreement to the contrary. So « contracting out » is impossible. A radical alteration in the existing law was provided by giving the purchaser an equity in the goods hired. In cases of repossession, or return of the goods, the hirer is entitled to a refund if the second-hand value of the goods exceeds the difference between the purchase price and the instalments already paid. Where goods are repossessed the vendor must keep them for a specified period and give the hirer the chance of recovery by formal notification of the outstanding amount. Hire purchase agreements must be in writing, set out specified details and a copy, including a summary of the hirer's rights under the Act, must be provided by the vendor. If the hirer makes payment in advance he is entitled to a refund of part of the financier's charge. However only one State has proposed a maximum hiring charge although there is frequently a provision for a court re-opening the contract where the terms are harsh. These are some of the forms which « hirer protection » has taken.

It has been claimed that some of the hirer protection devices increase the instability of what is already a « fair-weather system » (47).

No statistical evidence is available for Australia (or for any Australian State) either of the volume of repossessions, or whether they are effected voluntarily or on the initiative of the finance company. Likewise, although most finance companies calculate their delinquencies (defined as one or more instalments in arrears) no official figures are available. Consequently, up to the present

(46) Where loans are made by Bill of Sale (giving the right to the lender to seize and take possession of goods) it is usually necessary for the bill of sale to be registered and for details to be published in an official gazette. Many people do not like the attendant publicity and loans of this kind are restricted accordingly.

(47) See R. RANDERSON, "Hire Purchase Raises Acute National Problems", *Australian Quarterly*, September, 1955.

time, no reliable evidence on the relationship between repossessions, delinquencies, and economic conditions in Australia has emerged. However, we make three comments on this controversy concerning the provision of hirer protection and the stability of the hire purchase system.

Firstly, consumers probably exercise considerable care in the selection of durable goods to ensure close correspondence between the characteristics of the article purchased and their needs. They do not, therefore, lightly allow the goods to be repossessed. Again, the conspicuous nature of the demand for durables is a strong characteristic and provides an additional incentive to complete payments and become the legal owner. Moreover, hire purchase transactions may, if necessary, be financed by cutting down on other forms of expenditure, increasing the work performed within the family unit (e.g. by the wife seeking employment), or the running down of liquid assets. It seems wrong to assume that people who buy goods on hire purchase terms are completely lacking in liquid assets for they may buy goods on terms simply to preserve their contingencies reserve. Equally it seems wrong to assume that there is no room for reducing other expenditure to meet hire purchase commitments. Further, protection against irresponsibility is contained in the legislation itself, which provides that both husband and wife must sign a hire purchase contract for household goods and in the provision of minimum deposits. Even where legislation specifying these requirements does not exist, the practice of the major companies at least, is to insist on both signatures for household goods and on minimum deposits as shown in Table V. For these reasons repossessions experience in Australia in the post-war years has apparently been favourable; as confirmed by U.S. evidence, most hire purchase buyers have a strong determination to complete their contracts. So long as near-full employment conditions are maintained repossessions are usually small.

Secondly, in our judgment, «hirer protection» in its various forms is socially desirable. For example, the prohibition on minimum hiring periods and legal provision for repayment of portion of hiring charges for early payment, encourage consumers to complete their contracts as soon as possible and eliminate a possible form of exploitation. We do not, moreover, feel that this protection has increased consumer irresponsibility.

Thirdly, the potential liquidity of the finance companies and their actual reserve position are both quite high. Cash reserves

may be built up by cutting down on new lending or by borrowing; moreover, in the face of a general slump, bank support could be expected for the purpose of preserving liquidity. Thus, the hire purchase concerns probably possess a greater degree of financial stability than might be inferred either from their balance sheets or their obligation to accept goods returned by hirers who do not wish, or are not able, to complete the contract.

The States either individually or in concert, have not attempted to control the volume of hire purchase business. Minimum deposits and maximum repayment periods have been specified in some of the State legislation but no attempt has been made to vary these with economic conditions. In general the provisions are more liberal than current trade practices. The single exception is the attempt to eliminate «no-deposit» trading (48) apparently on social rather than economic grounds. State governments seem to be sensitive to the view that hire purchase is the «poor man's overdraft», and that restrictive action in one State may divert the expansion of durable goods industries to other States.

#### 7. The Impact of Hire Purchase on the Australian Economy

From the point of view of short run macro-economic policy the principal question which arises out of the expansion of hire purchase since 1947 is whether this expansion has added to the instability of domestic demand. If it has, there is a *prima facie* case for ensuring that the monetary authority is able to exercise restraint wherever restraint seems essential in the public interest.

In its simplest form, contemporary income analysis assigns the leading role in the generation of income fluctuations to certain variables which it is customary to classify formally as independent of incomes. These are usually indentified as exports, government expenditure, and private investment. Where hire purchase exists on any scale, it seems reasonable to add a fourth to this list, namely expenditure on consumer durables. In Australia, partly by virtue of the definitions employed in the national income accounts (49), hire purchase concerns are a source of finance for both investment

(48) No deposit trading has been widely practised by retailers, but most finance companies insist on deposits.

(49) Cf. above footnote 5, Section 2.

expenditures and expenditure on consumer durables. They are thus, in principle, a potential source of instability (50) on both counts.

Though the willingness of any individual to engage in a hire purchase transaction is not unaffected by his (or her) income and expectations regarding future income, the ability to do so depends upon the availability of finance. In Australia, at least in the more recent years (51), it seems safe to say that it is the availability of hire purchase finance which has determined the amount of business undertaken. The growth of hire purchase debt has thus been largely supply determined. Thus, looked at from the point of view of income determination, expenditure financed by hire purchase lending bears a strong resemblance to private investment as a whole in that it is at once largely independent of income and strongly influenced, if not determined by, the availability of institutional finance. Thus where, as is undeniably the case in Australia, the capital and money markets display considerable short run elasticity, changes in the availability of hire purchase finance, as one aspect of this elasticity, may be a significant « cause » of fluctuations in the individual components of private expenditure.

Subject to certain qualifications, the marginal contribution of hire purchase finance to the change in total institutional finance made available, in any period, can be assessed statistically.

To do this we define the « institutional » sources of finance as banks, hire purchase concerns (including retailers) and the new issue market. The « net new money » provided by the banks for households and productive enterprises, is then defined as the increment in advances to the private sector less the increment in advances to hire purchase concerns. For « net new money » provided by hire purchase concerns we take, as an approximation, the increment in total outstandings; for the new issue market, « new money » issues less issues by banks and hire purchase companies. This procedure enables us to determine the relative importance of hire purchase concerns as intermediaries at the margin. The relevant figures are set out in Table VII.

(50) The estimates of expenditure on durable consumer goods in Australia are not very detailed. Research in the U.S.A., however, has shown that variation in expenditure on durable consumer goods is a significant factor in explaining instability in the consumption-income relation.

(51) More particularly since 1952-3.

Three points need to be made about this Table before commenting on it. In the first place the three sources of finance listed in it are not independent but interdependent. In the second, since no industrial breakdown of new issues is available, the adjustment which has been applied to the published figures is a rather crude estimate.

In the third, the absence of statistics for bank advances to hire purchase companies makes necessary a second crude adjustment.

TABLE VII

INSTITUTIONAL SOURCES OF « NEW MONEY » FOR THE PRIVATE SECTOR (1)  
(in £A m.)

Source of Finance	1951/52	1952/53	1953/54	1954/55	1955/56
1. Increase in Bank Advances to private sector . . . . .	+ 161.7	- 83.4	+ 126.1	+ 123.4	- 36.9
less					
2. Advances to H.P. Companies . . . . .	- 1.2	- 4.2	- 13.4	+ 2.0	+ 0.7
3. Sub-Total . . . . .	+ 160.5	- 87.6	+ 112.7	+ 125.4	- 36.2
4. " New Money " New Issues (2) . . . . .	+ 57.2	+ 26.5	+ 42.6	+ 87.2	+ 108.8
less					
5. New Issues by H.P. Companies (2)	- 1.2	Nil	- 4.0	- 14.0	- 4.3
6. Sub-Total . . . . .	+ 56.0	+ 26.5	+ 38.6	+ 73.2	+ 104.5
7. Increase in H.P. Debt . . . . .	+ 9.5	+ 10.6	+ 52.3	+ 58.8	+ 31.4
8. Total of Sub-Totals 3+6+7 . . . . .	+ 226.0	- 50.5	+ 203.6	+ 255.4	+ 99.7
9. Share of 7 in 8 . . . . .	4.2 %	-	25.7 %	+ 23.6	31.5 %

(1) Defined as: households *plus* trading enterprises.

(2) " Listed companies only ". For years 1951-54 excludes new money raised by deposits, debentures, and registered notes.

Sources: Items 1 and 4: Commonwealth Statistician.  
Items 2, 5, 7: Our estimates.

Despite these qualifications, it seems clear from Table VII that, at least since 1952-3, increments in hire purchase outstandings have been a relatively important source of « new money » for the household and trading sectors. In the domestic boom of 1954-5, for example, the increased availability of hire purchase finance was

certainly not an unimportant influence in the growth of expenditures by the private sector which, in the main, characterised the boom (52).

A similar conclusion can be reached by another route. In 1954-5 expenditure on cars, cycles, and trucks was £A 50m. (some 24%) above that of 1953-4, while expenditure on consumer durables was £A 34m. (11-12%) above 1953-4. Expenditure on cars, cycles, and trucks, by accounting convention, form part of gross private investment in fixed capital. The change in them accounted for nearly 50% of the change in this aggregate. Over the same period hire purchase outstandings rose by £A 59m. (53). This suggests that the latter was a factor bringing about the former — a suggestion strongly supported by evidence given elsewhere in this paper and the fact that a very similar relationship existed between 1952-3 and 1953-4, while the slowing down of hire purchase expansion in 1955-6 has been accompanied by a sharp decline in the rate of growth of expenditures on cars, trucks, and consumer durables. For simplicity, the relevant figures are set out in Table VIII.

TABLE VIII

EXPENDITURE ON CARS, TRUCKS, AND DURABLE CONSUMER GOODS (1)  
(in £A m.)

Expenditure on:	1952/ 53	1953/ 54	1954/ 55	1955/ 56	Changes		
					1953-4 over 1952-3	1954-5 over 1953-4	1955-6 over 1954-5
1. Cars and cycles . . . . .	111	145	183	186	+ 34	+ 38	+ 3
2. Trucks and Utilities . . . . .	58	65	77	82	+ 7	+ 12	+ 5
3. Sub-Total . . . . .	169	210	260	268	+ 41	+ 50	+ 8
4. Durable Consumer Goods . . . . .	263	298	332	360	+ 35	+ 34	+ 28
5. Total of 3 and 4 . . . . .	432	508	592	628	+ 76	+ 84	+ 36
6. 3 as % of Private Investment in Fixed Capital . . . . .	26.1	28.6	29.4	29.2	45.6	45.8	11.3

(1) Defined as: Expenditure on "Hardware, Electrical Goods, Furniture, etc."

Source: National Income and Expenditure.

(52) It is noteworthy that, in his Budget Speech for 1955, the Commonwealth Treasurer (Rt. Hon. Sir Arthur Fadden) pointed specifically to the growth of hire purchase as a factor helping to bring about the resurgence of inflation.

(53) Gross private investment in 1954-55 was £A 229 m. above the figure for 1953-54.

From this and other evidence (54) it seems difficult to deny that hire purchase in Australia has now reached a stage of development which makes it desirable for the authorities to be in a position to enforce restraint.

## 8. The Problems of Control

Since it is still a matter of public controversy in Australia whether or not control over expenditure financed by hire purchase is necessary, it seems advisable to preface our discussion of possible methods of control by a brief statement of our position on this control question. Put as concisely as possible our position is this.

In a dependent economy (55), subject to impulses towards fluctuations originating abroad as well as at home and, at the same time, bent upon maintaining a high level of employment and a rapid rate of development, the authorities must, if they are to be charged with the responsibility for keeping inflation within bearable bounds, be endowed with effective means of influencing aggregate demands in the form of fiscal and monetary devices. At present, as the experience of 1954-6 so amply demonstrates, these means are not properly effective. Since full employment economies are economies with very little room for manoeuvre, it is a matter of some urgency to improve the available means of conducting economic policy. In our judgment, control over expenditures financed by hire purchase should form part of any additional devices developed by (or granted to) the monetary authorities. This does not, of course, mean that it is the *only* additional power we should like to see in the possession of the Commonwealth authorities. To discuss other possible (and possibly desirable) powers would, however, make necessary a lengthy discussion of the technical and other limitations at present suffered by the Australian

(54) For other evidence cf.:

R. I. DOWNING, "The Australian Economy, March 1956", *Economic Record*, May, 1956 and D. C. ROWAN, "The Future of Monetary Policy in Australia", *The Bankers' Magazine*, February, 1956.

(55) Cf. D. C. ROWAN, "The Monetary Problems of a Dependent Economy: the Australian Experience 1948-52", *Banca Nazionale del Lavoro Quarterly Review*, December 1954.

monetary authorities (56). This would take us too far from our main theme.

Any discussion of the control (57) of hire purchase in Australia necessarily falls into two parts: first a description and analysis of the present position and recent developments; second, proposals regarding reform. We begin, then, with an outline of the present position.

Under law, primary responsibility for conducting the monetary and banking policy of Australia is laid upon the Commonwealth Bank, the powers of which are laid down in the Acts of 1945 and 1953. These Acts give the Bank no direct powers over hire purchase. Nor do they give it authority over capital issues (58). They do, however, give it an extensive array of powers in relation to the banking system (59). It follows, therefore, that any impact which the Commonwealth Bank makes upon the supply of hire purchase finance can only come through its banking and open market policies.

In theory, if not always in practice (60), the Commonwealth Bank is in a technical position to control lending by the trading banks and, in particular, their lending to hire purchase concerns. In practice, however, denied access to banking funds, it is always open to the finance companies to borrow directly in the (uncontrolled) new issues market. Since 1953-4, the finance companies have in fact done this on a considerable, and probably increasing scale (61). They thus substitute short term debt to the public (including some other financial institutions) for short term debt to the banking system. On average, it seems that their costs of borrowing are slightly raised while their liquidity may or may not be impaired according to the maturity pattern of public subscrip-

(56) For a discussion of some of these consult:

Dr. H. C. COOMBS, *op. cit.*

D. C. ROWAN, "The Future of Monetary Policy in Australia", *The Bankers' Magazine*, February, 1956.

(57) « Control » is discussed here only in its macro-economic aspects.

(58) This power resides with the States, who do not choose to exercise it.

(59) Cf. J. S. G. WILSON, *op. cit.*, and *ibidem* "The Operation of Australian Central Bank Controls", *Banca Nazionale del Lavoro Quarterly Review*, January-March, 1952.

(60) Cf. the references cited in footnote (56) above. In July 1955, the Commonwealth Bank asked the trading banks to limit advances to finance companies.

(61) Cf. above Section 5.

tions to their issues (62). It follows, therefore, that the principal results of reducing the availability of bank finance to hire purchase concerns are to raise slightly the cost of their funds and aid the development of a short term money market. In the absence of any means of checking the new issue market and in the presence of an active demand for hire purchase finance by consumer, the fruits of a restrictive banking policy in the orchard of hire purchase finance are certain to be unimpressive.

On the other hand, and once again in theory, it should be possible for the Commonwealth Bank to use its open market policy in such a way as to check new issues in general including new issues by hire purchase companies. There are three qualifications to this view, which, in practice, are so important as to remove most of its validity. The first of these concerns the structure of the Australian capital market which, being as yet relatively undeveloped, does not display that close connection between changing bond prices (and uncertainty regarding future bond prices) and the readiness to take up new issues which is apparently to be found in New York (63). The second is that there is good reason to believe that, in practice, the Commonwealth Treasurer is unlikely to give the Commonwealth Bank sufficient freedom to vary bond rates so as to permit such a policy to be operated in good time (64). The third is that much borrowing by finance companies is not likely to be much affected by a policy of bond price manipulation.

At present, the Commonwealth Bank has only one additional device at its disposal — the raising of the rates of interest offered upon time and savings bank deposits (65). Presumably such a procedure would force finance companies to pay higher rates in order to protect their existing funds and attract new ones. The interest cost to the companies is, however, only about 60% of their

(62) Advances are technically repayable « on demand ». In practice, of course, they are nothing of the sort. It is a nice point, therefore, to say precisely how « liquidity » would be affected by "switching" of this type.

(63) Cf. R. V. ROSA, *Money, Trade, and Economic Growth*, Macmillan 1951, pp. 279-293.

(64) This can be inferred from events during 1954-56. Until March, 1956, despite its general policy of restraint during 1954-55, the Commonwealth Bank was supporting the bond market. It is difficult to believe that this was not due to government policy. Thus the Bank was only allowed to raise rates in the market nineteen months after its own conditional forecast of inflation (August, 1954).

(65) Savings bank deposits are less directly competitive with the short term obligations of finance companies than time deposits.

total costs. A 1% rise in short rates would if passed on, therefore, add only about 2/3% to the charge made to the customer. Since many users of hire purchase finance are unaware of the true rate they are paying, it seems clear that few undertake the nice weighing of marginal choices which would be required if changes of this magnitude were to have an appreciable result on the demand for hire purchase credit. On the other hand, to raise hire purchase interest costs by say 1½% per annum might require a substantial increase in deposit rates; perhaps even doubling them. Even if this were done, it is doubtful how far the rise in hire purchase interest charges would discourage borrowers even assuming that the whole of the increase was passed on to the consumer.

We may thus conclude that, at present, none of the methods open to the Commonwealth Bank of Australia seem likely to provide effective means (jointly or severally) of restraining expenditures financed by hire purchase. The fact that, in September 1955, the Commonwealth Government made, through the agency of the Prime Minister (66), a direct approach to the hire purchase concerns designed to obtain *by agreement* a reduced rate of growth in such expenditures, provides official confirmation of this view. Further confirmation is to be found in the expansion of hire purchase in 1954-5, a year for which the Commonwealth Bank had already made a conditional forecast of inflation (67) and in which it followed a policy aimed at securing restraint (68).

Accepting our judgment that control over hire purchase is necessary and our argument that, at present, the monetary authority is unable to provide it, what type of action is to be recommended?

Control of hire purchase may be applied either on the demand for hire purchase or the availability of funds to finance hire purchase transactions. There is, of course, no reason why it cannot be applied on both sides of the market simultaneously. Let us consider the supply side first.

(66) On 4th October, 1955 a majority of finance companies agreed to the Prime Minister's request to limit the increase in their business in accordance with a formula so that outstanding balances would not exceed a figure slightly in excess of 10% of outstanding balances on 30th September, 1955. Also, as part of the same agreement, the minimum deposits and maximum repayments period for motor vehicles were also tightened.

(67) *Annual Report* (1953-54), pp. 23-34.

(68) *Annual Report* (1954-55), pp. 21-23. The policy of restraint was actually begun in the second half of 1953-54.

At the moment it seems clear that there are three fundamental reasons for the inability of the monetary authority to control the supply of funds from finance companies. In order of importance they are:

- (a) the absence of any means of denying finance companies access to the capital and money markets;
- (b) the technical difficulties facing the Commonwealth Bank in its conduct of banking policy;
- (c) the structure of the Australian capital market.

To modify the third, at least in the short run, is not possible.

Discussion of the second is outside the purview of this paper and, in any case, even were the technical difficulties in the sphere of banking policy to be wholly removed, this itself would certainly not give an adequate degree of control. We are therefore led to the provisional conclusion that the re-introduction of capital issues control is a necessary step in any serious attempt to control the availability of hire purchase finance (69).

It might, however, be unwise to be over sanguine regarding the results in the hire purchase field of the re-introduction of capital issues control, even supposing the constitutional and political difficulties in the path of such re-introduction were overcome. There are two main reasons for retaining a measure of scepticism. The first arises because in recent years finance companies have raised considerable sums by the attraction of deposits. This form of borrowing is not so simple to control as those forms which involve the issue of marketable securities. It is possible, therefore, and in fact probable that some deposit raisings, particularly by the smaller companies, would escape official regulation. On the other hand, there seems little doubt that control over capital issues could be operated in such a way as to check the expansion of the larger companies.

The second reason for thinking that the re-introduction of capital issues control might not be wholly effective arises because in practice such controls can be avoided by borrowing amounts below the minimum requiring approval or borrowing privately. If, therefore, control was effective in preventing the acquisition of funds by large companies, one consequence might be the emergence

(69) Cf. N. RUNCIE, "Methods of Hire Purchase Control in Australia", *Economics Society of Australia and New Zealand (N.S.W. Branch) Paper*, July, 1955.



of a large number of small concerns (70). Many of these would be less well managed, less scrupulous in their dealings with the public, and more preoccupied with earning large profits in the short run than the existing concerns. Moreover, by reason of the small scale of their operations they would be less able to obtain a wide spread of risks and thus a greater (potential) source of instability. If such an expansion did follow the imposition of capital issues control, there would plainly be some social costs to be offset against the social gain obtained from reducing hire purchase lending.

On balance, however, despite these qualifications, it appears that the re-introduction of capital issues control in an appropriate form would succeed in giving the authorities power to check the rate of expansion in total debt. In any case, unless finance companies can be brought within the scope of existing banking legislation (71), and thus the authorities given direct powers over hire purchase lending, it is difficult to see any alternative means of limiting the availability of hire purchase finance. In our judgment, therefore, capital issues control, which in any case is desirable on other grounds, is a necessary condition for the effective control of hire purchase. It may not, however, be a sufficient condition since all controls are in some measure subject to evasion and the control can only prevent or diminish expansion. It cannot reduce lending from a given portfolio. We therefore feel that capital issues control in its operations on the supply of hire purchase finance should be strengthened by powers designed to make an impact upon the demand for such finance.

On the demand side there are two lines of approach. The first is to take action which leads to an increase in the costs of hire purchase. The second is to give the monetary authority power to vary the minimum deposit and maximum repayments period of hire purchase transactions along the lines of the famous Regulation « W ». We have already given reasons for being sceptical about the former. Hence the only reasonable course to propose is the latter.

(70) Cf. the experience of the United Kingdom.

(71) It has sometimes been suggested that finance companies which accept deposits and lend to the public could be defined as banks and thus brought within the scope of the Special Account technique and other banking controls. It is, however, very doubtful whether the courts would accept such a definition.

The general nature of the powers formerly available to the Federal Reserve System are sufficiently well known to require no elaboration. The aim of these powers is quite simply by raising (lowering) the minimum compulsory deposit and reducing (increasing) the maximum repayments period to make hire purchase less (more) attractive to the borrower. Generally speaking these powers seem to have worked well (72) though in some cases legal ingenuity has been able to find ways of circumventing them.

Unfortunately, however, though an Australian variant of Regulation « W » and the re-introduction of capital issues control are probably both necessary for the better conduct of macro-economic policy, their introduction does not seem probable. At present, as we have pointed out in Section 6, both powers reside not with the Commonwealth but the States. For these powers to be granted to the Commonwealth Bank, either the States would first have to refer their powers to the Commonwealth or a successful referendum would need to be undertaken. This second possibility may be neglected entirely, while the first seems unlikely to eventuate in the near future. Whatever may be desirable, it seems that the Commonwealth Bank will be compelled to continue its attempts to discharge its duty to conduct a monetary and banking policy « in the best interests of the people of Australia » with no control over either capital issues or the terms on which funds may be borrowed from finance companies: in short with only a very restricted technical ability to conduct monetary policy (as opposed to banking policy) at all.

D. C. ROWAN, N. RUNCIE

(72) Admittedly experience in the U.K. has been less encouraging, but in this case the minimum deposit enjoined by the authorities was not always a deterrent since it was, in some important cases, below that *already* demanded by the finance companies.