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The differences among average finance rates charged new auto purchasers classified by type of credit agency, legal rate-ceiling categories, and by contract length as well as the wide differences in rates within these categories, suggest that the automobile credit market, although highly competitive, is also imperfectly competitive. Among the sales finance companies, only the four largest companies could be said to operate nationally in 1954–55. Among commercial banks, only in branch-banking states and where bank holding companies are important can bank policies be standardized through ownership control over appreciable market areas. Differences in state laws governing credit practices as well as the differences in creditworthiness of borrowers in different market areas also help to explain the diversity of the finance rate structure.

Further attention will be given to factors affecting finance rate levels on the basis of cross-section data in a monograph now in preparation. The question to be considered here is the movement of average finance rates before and after 1954–55. Because of data limitations, it is necessary to confine attention to the sales finance segment of new-auto financing, particularly to the four large sales finance companies whose operations are national in scope.

Sales Finance Company Rates, 1935–59

THE GENERAL COURSE OF FINANCE RATES

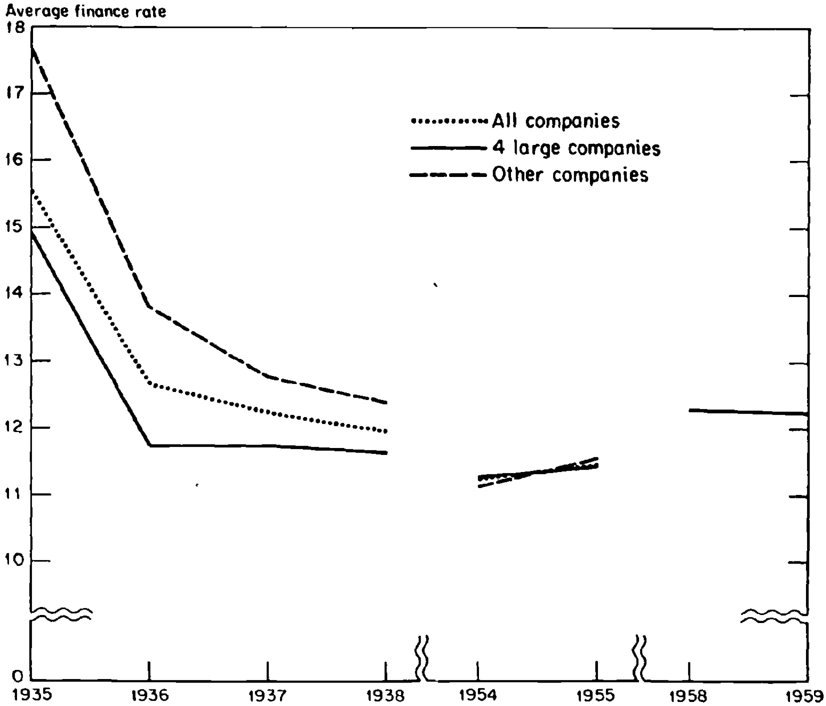
Average rates in the sales finance segment declined between 1935–38 and 1954–55, then rose to 1958–59 (Chart 1). After 1960 rates declined in subsequent years (Table 8). The characteristics of the samples from which the data come are summarized in Table 6. Average finance rates paid by customers of the four large sales finance companies declined from 14.92 per cent during the first nine months of 1935[14] to 11.74 per cent in 1936 and 1937, and to 11.63 per cent in 1938 (Table 7). The 1954 and 1955 finance rates were still lower, averaging 11.26 and 11.44 per cent, and the four large-company rate averages in 1958 and 1959 rose to 12.29 and 12.26 per cent, respectively. Other data show a subsequent decline after 1960 to 12.15 per cent in 1962 (Table 8).

The sharp decline in finance rates between 1935 and 1936 came about in response to a rate cut in November, 1935, by the General Motors Acceptance Corporation in connection with the introduction of a new "Six Per Cent Plan," designed to make customers aware

14. The first 9-month period is used instead of the year because of the sharp reduction of rates which took place late in 1935.

CHART 1

NEW-AUTO AVERAGE FINANCE RATES, SALES FINANCE COMPANY GROUPS, SELECTED PERIODS



Source: FTC, FR, and NBER samples (see Table 6).

TABLE 7*

FOUR LARGE SALES FINANCE COMPANIES, AVERAGE FINANCE RATES AND COMPONENTS, 1935–38 AND 1958–59

	Finance Rate (Per Cent)	Dealer Share (Per Cent)	Credit Agency Net Share (Per Cent)	Dealer Per Cent Share of Finance Rate
1935 (9 months)	14.92	2.46	12.46	17
1936	11.74	2.21	9.53	19
1937	11.74	2.40	9.34	20
1938	11.63	2.46	9.17	21
1958†	12.29	2.83	9.46	23
1959†	12.26	2.88	9.38	24

* Source: FTC and NBER samples.

† Contracts for the west region were excluded to improve comparability with 1935–38 sample.

of the lower costs of automobile financing being made available to them at that time.[15] Competing organizations quickly adopted the same method of advertising financing costs and made their rates competitive. Chart 1 reveals that the four large-company rates, including G.M.A.C.'s, declined rapidly. The other sales company finance rates also went down sharply, but more gradually, during the next three years.

The narrowing of the differential between the rates of the four large companies and the other companies (from 18 to 6 per cent of their combined average finance rate between 1935 and 1938) was followed by the virtual elimination of any differential in 1954 and 1955 (Chart 1). The added fact that rate levels in 1954 were below those in 1938 suggests that the eventual elimination of the rate differential occurred in connection with competitive pressures forcing additional rate reduction. The behavior of finance rates between 1935 and 1955 strongly implies an increased competitiveness in the automobile financing market. As the 1958–59 rate data are drawn only from four large sales finance companies, it is not known whether the reversal of the trend of declining rates to rising rates caused any reappearance of a differential between rates charged by the four large companies and their smaller sales finance competitors.

DEALER SHARE OF FINANCE RATES 1935–38 AND 1958–59

As mentioned earlier, when the credit agency purchases credit contracts from automobile dealers, the finance rate charged the customer in the credit contract is usually higher than that received by the credit agency which purchases the contract from the dealer. Originally, the differential was intended to be held by the credit agency as a reserve against the dealer indorsement of the contract and returned to the dealer when the credit was repaid. However, competition became sufficiently intense in the mid-1920's to enlarge the dealer's share of the finance income above that required for reserve purposes on recourse contracts, and non-recourse contracts began to be made in which the dealer retained a portion of the finance income.

It is possible to measure the dealer share of the average finance rate from data collected in the 1935–38 and 1958–59 samples of credit contracts. Table 7 breaks down average finance rates into two

15. For a detailed description of the introduction of this plan, see Plummer and Young, *Sales Finance Companies*, pp. 201–3.

components: the dealer share and the credit agency's net share, both in percentage points. Also shown is the percentage share of the finance rate accruing to the dealer.

The table supports two conclusions. First, when rates were cut sharply in late 1935, the dealer percentage-point share of the finance rate declined slightly in 1936 and returned gradually to its 1935 level by 1938. The bulk of the finance rate decline was borne by the sales finance companies. Because of the reduced finance rate level, the percentage share of the rate which accrued to the dealer rose in each year following the rate cut. Second, some twenty years later the four large sales finance companies' net rate was still within the range of 1936–38 rates, revealing that most of the increase in the average finance rate charged customers was attributable to a higher average dealer share of the rate. The implication that the credit agency net finance rate changes were either minor or offsetting between 1938 and 1958 is striking, since short-term interest rates rose appreciably. Because of the paucity of data collected to measure dealer participation in finance charges, the relation between the dealer and credit agency components of the finance rate cannot be traced within the twenty years separating the two bodies of sample data.

CHANGES IN THE TERM STRUCTURE OF FINANCE RATES, 1935, 1936–38, 1958–59

There was a fundamental change in the term structure of average finance rates for the sales finance group at the time of adoption of the Six Per Cent Plan in 1935. Chart 2 indicates that, prior to introduction of the plan, mean finance rates declined sharply as maturity lengthened. The vastly different 1936–38 average term structure suggests that a new system of quoting charges replaced the earlier system. The shape of the 1935 term structure implies the predominance of charges computed on a basis unrelated to the length of term of credit contracts. Before 1935, Otto C. Lorenz and H. Mott-Smith stated that sales finance companies quoted finance charges or discount rates in two ways:

1. The "flat rate" is the one most commonly quoted by the finance company when purchasing instalment paper. The flat rate is a percentage which, when multiplied by the amount of paper presented for discount or by the amount of advance, gives the amount of charge for the advance.

2. The "rate per annum" which may be expressed as an interest

rate (an added-to or mark-up charge on the amount of the advance), or as a discount rate on the amount of the advance.[16]

The first of these methods, if used to establish the customer rate, would result in a term structure similar to the 1935 structure. The second would more closely approximate the term structure shown in the years after 1935.

Other writers have commented on the existence of varied methods of charge in instalment credit, but none have identified those used predominantly in automobile financing.[17] E. R. A. Seligman commented on the variety of systems of charge that existed during the 1920's, but the 1935 term structure of finance rates shown in Chart 2 provides the only empirical evidence to support the idea that a predominance of charges were computed in a manner unrelated to length of maturity in new-automobile financing. The 1936–38 term structure resulted from the rate per annum method, noted above, which was required by the Six Per Cent Plan method of computation.

As shown in Chart 2, a relatively flat term structure of finance rates in 1936–38 contrasts sharply with the declining structure in 1935. The lengthening of maturities from 24 to 36 months between 1936–38 and 1954–55 did not sharply alter the term structure. A tendency for rates to increase with length of maturity could be observed for all companies, although not for the four large companies. However, by 1958–59, mean rates for the four large companies rose with longer maturities. Thus it can be concluded that important shifts in the term structure of mean finance rates have occurred since 1935 but that changes since 1936–38 have been moderately in the direction of average rates which rise as contract maturities lengthen.

NEW-AUTO FINANCE RATES AND COMMERCIAL BORROWING RATES, 1924–62

With sample data discussed above as bench marks for further investigation of rate movement, Table 8 presents annual estimates of

16. *Financial Problems of Instalment Selling* (New York: McGraw-Hill Book Co., 1931), p. 93.

17. E. R. A. Seligman, *The Economics of Installment Selling* (New York: Harper & Bros., 1927), I, 288 ff.; William Trufant Foster and H. LeBaron R. Foster, "Rate Aspects of Instalment Legislation," *Law and Contemporary Problems*, April, 1935, pp. 189 f.