



CAFRITZ

Realtors and Builders

14TH & K STS. -- DISTRICT 9080
WASHINGTON, D. C.



May 11, 1942

Mr. Marriner Eccles, Chairman
Federal Reserve Board
Washington, D. C.

Dear Mr. Eccles:

In view of your well-known advocacy of compulsory saving as one of the ways to finance the war, Mr. Cafritz has suggested that you might be interested in a new angle in this controversy.

First, I am enclosing herewith a memorandum written about a week ago, which discusses briefly the effects of heavily increased taxation upon people's ability to meet required payments on their debts, and the probability of wide-spread defaults. This memorandum is, of course, rather sketchy and I shall be glad at any time to discuss further with you the economic arguments underlying its thesis.

This problem came to our attention in a very direct manner recently. Several people who were paying off second trusts on their homes came to us in March with the statement that they could not meet their payments, their real estate taxes and their income taxes. We advanced their real estate taxes for them and, furthermore, deferred their second trust payments so that they could meet their income tax payments. Obviously, neither we nor any other firm could long continue this practice.

I think we can assume that the President is on economically sound ground in his contention that:

"TO KEEP THE COST OF LIVING FROM SPIRALING UPWARD, WE MUST DISCOURAGE CREDIT AND INSTALLMENT BUYING, AND ENCOURAGE THE PAYING OFF OF DEBTS, MORTGAGES AND OTHER OBLIGATIONS; FOR THIS PROMOTES SAVING, RETARDS EXCESSIVE BUYING AND ADDS TO THE AMOUNT AVAILABLE TO THE CREDITORS FOR THE PURCHASE OF WAR BONDS."

Mr. Eccles
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The discouragement of credit and installment buying has already taken place through recent regulations of the Federal Reserve Board. There still remains the problem of somehow implementing the rest of the President's recommendation.

My suggestion may not be a correct solution, but I do hope that it will at least serve the purpose of stimulating further discussion among you people with the hope that some practicable solution may be found.

The idea is briefly this:

I believe that enforced saving ought to be instituted for the duration of the war, this saving to be evidenced by certificates which cannot be cashed until the war is ended. This will be necessary in order to remove from people's hands the so called "hot money" which is pressing for expenditure in an inflationary manner. Then against the amount to be saved, which should be graduated according to incomes, there should be granted a tax credit to the amount of legally required minimum curtails on debts.

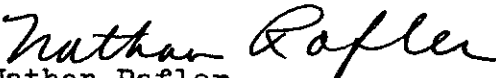
Such a plan would not favor the debtor class over the class of people who have somehow managed to pay cash for everything and remained out of debt. Those persons who are in debt will receive tax credits against enforced savings, which will enable them to pay up for things purchased in the past. Those persons who are not in debt will have their enforced savings as a nest egg, to be used for purchases after the war; a time when increased purchasing power will be very helpful during the transition period from a war economy to a peace economy.

The same approach could be employed for corporations, which in view of the proposed 94% excess profits tax and increased normal and sur taxes will also find it impossible to meet their obligations.

Unless some such device is worked out, it seems to me that we will precipitate wide-spread defaults, without in any way aiding the fight against inflation.

This letter is, of course, necessarily brief and I should be very happy to discuss this problem further at your convenience.

Very truly yours,


Nathan Rafler
Assistant to the President

NR:rl
Encl.

April 30, 1942

This morning, in the column conducted by Mary Haworth in the Washington Post, there appeared in a letter from a married woman whose husband had recently been called into the armed service, the following statement: "with a pay status much lower than his former civilian employment, our income is not now sufficient to meet certain obligations -- including purchase of a home -- which we had previously contracted".

This woman asked for advice as to what to do with respect to their debts on which regular payments had to be made. In reply, Miss Haworth pointed out that "Congress adopted legislation in 1940, described as the Soldiers' and Sailors' Relief Act, providing for reasonable deferment (or longer-term financing) of "time payment" debts, such as mortgages on real estate, installment purchase of home furnishings, cars, etc. -- in order to give selectees more peace of mind concerning the economic security of partial dependents. No doubt some provisions of this act can be invoked on your behalf by the Legal Aid Bureau, and explicit arrangements made to tide you safely through the worrisome emergency."

This is one of the first storm signals that has been raised concerning a situation which will undoubtedly snow-ball in a short time into a problem of alarming dimensions. Luckily, with respect to soldiers drafted into the armed service with a reduction in pay, Congress has foreseen the probability of defaults on installment debts of various kinds and has made some provision for working out the problem.

But, we are now face to face with a draft problem of another sort -- the drafting of incomes. In his message concerning the danger of inflation, the President called for extremely drastic taxation of incomes, in order to cut down the excess purchasing power resulting from arms expenditures to a level comparable to civilian goods available for sale. In this connection the President also calls for voluntary purchase of war bonds with earnings, instead of using those earnings to buy articles which are not essential.

Furthermore, in the President's own words: "TO KEEP THE COST OF LIVING FROM SPIRALING UPWARD, WE MUST DISCOURAGE CREDIT AND INSTALLMENT BUYING, AND ENCOURAGE THE PAYING OFF OF DEBTS, MORTGAGES AND OTHER OBLIGATIONS; FOR THIS PROMOTES SAVING, RETARDS EXCESSIVE BUYING AND ADDS TO THE AMOUNT AVAILABLE TO THE CREDITORS FOR THE PURCHASE OF WAR BONDS".

The President is on very sound economic ground when he makes such a recommendation for paying off installment debts and mortgages which are owing to finance companies and insurance companies, who would probably use the proceeds from such re-payments to purchase war bonds. This would be so because the usual fields of extension of loans are rapidly drying up due to the curtailment of installment buying and the almost complete cessation of private building. It is perfectly obvious that funds used for paying off debts and mortgages, which funds subsequently flow into the purchase of war bonds, are anti-inflationary. The funds are thus removed from the hands of prospective purchasers of civilian goods -- so far so good.

But, while the President makes an economically sound suggestion for the sterilization of buying power, he fails to implement his suggestion with the means for carrying it out. While it is true that many labor union workers in war plants are receiving a substantially higher weekly income than they received in the past, there does not seem to be any administration recognition of the fact that millions of citizens in this country have failed to share in this rise in weekly income. Among these may be included millions of middle-class white collar workers, millions of people existing on fixed pensions or annuities of one sort or another, as well as most if not all government employees, whether national, state or municipal. These people have, in fact, already suffered a reduction in income through a 15% increase in the cost of living since September 1939. They have also suffered a further decrease in income through the rise in income taxes which took place last year, the full import of which was painfully recognized for the first time when taxpayers made out their returns one month ago. Now, still further drastic increases in taxes are proposed as an anti-inflationary measure.

The President knows full well that union labor has achieved a percentage increase in wages much higher than the percentage increase in the cost of living. It would seem that he has forgotten the inarticulate, vast middle-class in this country whose income has remained stable but whose cost of living and taxes have both increased.

Just as surely as the government has drafted men for service in the armed forces at reduced pay, it has drafted the incomes of people for service in our national effort. But, while it has provided for the possible and probable defaults on debt payments by drafted men, it has failed to provide any relief for the large group of people who will now find it impossible to make payments on their debts, with consequent wide spread defaults and losses of various kinds of property which are debt encumbered.

It does not seem possible that such a result was intended, for it would work enormous hardships without adding one iota to the anti-inflationary fight. It is a known fact that interest paid on a debt is a deductible item in everyone's

income tax return while, under ordinary conditions, people pay their debts from the income remaining after taxes. But, people who incurred debts in the past did so on the basis of their income and tax liabilities at the time, and generally had little if any margin left over. Now, increased taxes will remove any margin of safety.

Most people who are making monthly payments on their homes are doing so by equal monthly payments which consist partly of interest and partly of principal. There are complicated tables which indicate how these monthly payments are split up, with the amounts for interest gradually decreasing as the amounts applied to curtail of the debt increase. These payments are indissoluble and no individual can pay one without the other. A default in either interest or curtail will result in loss of the property.

If the President is sincere in his recommendation that we should encourage the paying off of debts, mortgages and other obligations, it would seem that some provision must be made for allowing individuals to meet these obligatory curtails which would be endangered by increased taxation. This might be accomplished by means of a credit on the tax return for the minimum curtail which one is obligated to make. Furthermore, we could really encourage the accelerated curtail of debts by any additional credits that might be decided upon.

Before Congress rushes through any hasty tax program which might result in wholesale deflation, it would seem that careful study should be given to this debt problem. In connection with this, it should be kept in mind that the eventual size of the national debt resulting from our vast arms expenditures is not of great importance, so long as the national economy is kept operating fairly close to full blast. It will be easy to derive by taxation the few billion dollars which will be necessary for interest and carrying charges on our internal debt. A debt of two hundred billion dollars might require, roughly six billion dollars a year to carry. There is never any question that this debt needs to be repaid, for as fast as government obligations become due, they would be replaced by other obligations in the same amount. The holders of these bonds would not want them paid off because they would find it difficult to find other investments of equal caliber.

Since the President is on sound ground in believing that the purchase of war bonds out of current earnings is anti-inflationary, what difference does it make if people's earnings are first applied toward legally necessitous payments of debts, the recipients of whom themselves purchase the war bonds? The same end result is achieved, but additionally, there is the desirable effect of allowing people to retain their homes or other articles which were purchased in the past but which are being paid for out of current earnings.

By Nathan Rafler
Nathan Rafler

May 28, 1942.

Mr. Nathan Rafler,
Assistant to the President,
Gafrits,
14th and K Streets,
Washington, D. C.

Dear Mr. Rafler:

I have read your letter of May 11 and the enclosed memorandum with a great deal of interest and find myself in accord with your general analysis and conclusions.

As a practical matter, I am not clear as to how you could permit deductions for contractual obligations such as the paying off of mortgage debt. For a good many months I have given some thought to the predicament of the fixed income groups in the lower salary brackets, as well as those whose incomes have been sharply reduced. I wish some workable, practicable method could be devised affording some relief for these people.

I am taking the liberty of passing your memorandum along to people on our staff who make a study of tax problems, and I wanted you to know that I appreciated your courtesy in writing to me.

Sincerely yours,

(Signed) M. S. Eccles

M. S. Eccles,
Chairman.