BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

April 12, 1948

Miss Egbert:

Here are copies of the tax and housing letters of March 31 and April 5, respectively, for Chairman Eccles' folio -- in accordance with his request to Mr. Young.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

March 31, 1948.

Mr. Elmer B. Staats,
Assistant Director,
Legislative Reference,
Bureau of the Budget,
Washington 25, D. C.

Dear Mr. Staats:

This letter is in response to yours of March 25, 1948, asking for the comments of the Board of Governors on H. R. 4790, a bill to reduce individual income tax payments and for other purposes.

The Board of Governors feels that there should be no net reduction in tax revenues at this time. Total effective demand for goods and services is now greater than the supply which can be produced by the nation's productive capacity and labor force. That is the essence of inflation. A net reduction in tax revenue in this situation would either create a Government deficit or reduce the amount of funds that otherwise would be available for reduction in the Government debt. In either instance the result would be an increase in prices of consumer goods as well as capital goods. The resulting price rises would likely lead to additional borrowing by businesses from banks, and such expansion of bank credit would further add to inflationary pressures.

In view of the costs of carrying out the Governmental policies in the international field and, in addition, in view of the recent program calling for a large increase in military expenditures, it becomes more urgent than ever that tax revenue be maintained so as to avoid a Government deficit and, if possible, have some surplus to apply against the public debt. This is imperative under present conditions of full production and employment if further dangerous inflationary developments are to be avoided.

For the reasons stated above, the Board feels that the enactment of H. R. 4790 is undesirable at this time, especially the reduction in taxes provided in section 101 of the bill.

Nevertheless H.R. 4790 contains some provisions which the Board believes to be desirable because they recognize and correct certain gross inequities. One such provision is that for the splitting of incomes in order to bring about a more equitable situation as between taxpayers in a considerable number of States which have community property laws and those in States which at present do not have such laws. Since this provision gives benefits chiefly to persons in the middle and higher income brackets, it is necessary that the lower income groups, both because of need and for reasons of equity, have their personal exemptions increased along the lines provided in the bill. It would be desirable under the present economic conditions to limit the benefits of increased exemptions to the persons who would get little or no benefit from the split income provisions because of their low incomes.

It is believed, however, that if provisions such as those mentioned above were to be enacted, with a resulting reduction in revenue, there also should be such changes in the tax laws as would provide an offsetting increase in receipts. The Board would be glad, if called upon to do so, to make suggestions as to some of the changes it believes would be most desirable.

Very truly yours,

(Signed) Merritt Sherman

Merritt Sherman,
Assistant Secretary.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

FOR THE PRESS

April 8, 1948

Attached is the text of a letter from the Board of Governors to Senator Charles W. Tobey, Chairman of the Senate Committee on Banking and Currency, concerning general housing legislation, particularly S. 2317 and amendments to S. 866, for release in morning newspapers of Friday, April 9, 1948.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

April 5, 1948.

Senator Charles W. Tobey
Chairman, Committee on Banking
and Currency
Senate Office Building
Washington, D. C.

Dear Mr. Chairman:

The Board has been advised that your committee is considering general housing legislation, particularly S. 2317, introduced by Senator McCarthy, and amendments to S. 866 proposed by Senator Flanders.

The Board is in sympathy, of course, with the major objectives of such legislation, and is in accord with some of the provisions of these bills. We feel, however, that in view of the broad responsibilities of the Federal Reserve System in the field of credit, we should call attention to several undesirable features of the proposed legislation, some of which we have had occasion to comment on previously. In this connection I am enclosing a copy of our statement of November 25, 1947 on Housing Finance to the Joint Committee on the Economic Report.

The prospect for inflation is even greater now than it was last November. There is still a shortage of many goods in relation to the level of income, and, because of the imminent reduction in taxes, coupled with our commitments under the European Recovery Program and the recent program calling for a large increase in military expenditures, the Government must anticipate a deficit rather than a surplus. There is thus additional reason for the Government to take all steps possible to reduce inflationary pressures, particularly those generated by an excess of credit.

For these reasons the Board is opposed to some of the provisions of the bills before your committee which would intensify inflationary pressures by making additional credit available and thus increasing the demand for building labor and materials. In addition, some of their provisions would reduce the capacity of the fiscal and credit agencies of the Government to cope with either further inflation or future deflation.

The Board is particularly concerned about three proposals contained in these bills: first, creation of a Government-financed secondary market for mortgages already underwritten by the Government; second, continuation of the undesirable mortgage-insurance program under Title VI of the National Housing Act; and third, addition to Title II of the National Housing Act of a permanent program of excessively easy mortgage credit.

Creation of a Government-financed secondary market would be directly inflationary at this time, because, by making available $500,000,000 for the purchase of mortgages, it would represent added Government spending and increased demand for new housing which is already excessive, considering the available supply of labor and materials. Furthermore, one of the objectives at the time the Government mortgage insurance and guaranty programs were instituted was to eliminate the need for direct mortgage lending by the Government, partly by removing some of the risks to lenders and increasing the negotiability of mortgages. If private lenders are unwilling to hold or buy guaranteed and insured mortgages, perhaps the solution is to improve the quality of the mortgages or increase the return to levels which make mortgages attractive compared with other investments.

Title VI of the National Housing Act, by making credit available on excessively easy terms, has contributed to the large rise in house prices and building costs, and has encouraged buyers to go too deeply into debt. We believe that both builders and buyers should have larger equities in their properties in an inflationary period like the present, and that it is both feasible and desirable to return to the terms offered under Title II as far as mortgages on houses for owner-occupancy are concerned. The Board has no objection to the continuation of Title VI for rental housing, provided safeguards are maintained against excessive loans in relation to value.

Several of the proposed changes in Title II of the National Housing Act are subject to the same criticism as the present Title VI program. Mortgages on small houses for 95 per cent of value and running for 30 years are excessive and so also are 40-year mortgages of 90 and 95 per cent of value for rental housing.

Basically, these three proposals are of a type which would be appropriate for combating a serious deflation, and are the opposite of those appropriate in an inflationary situation such as we face today. Measures such as these should be reserved to cushion deflation should it later develop. Otherwise, the only measures available would be direct Government lending or subsidies, on a large enough scale to protect the real estate and housing market from a serious collapse such as developed in the early thirties.

Sincerely yours,

(Signed) M. S. Eccles.

M. S. Eccles,
Chairman pro tem.