August 11, 1950.

Dear Bill:

In accordance with your telephone request yesterday I am enclosing herewith a memorandum which I hope you will find satisfactory and helpful.

If there is anything further I can do, please do not hesitate to call on me.

Warmest regards!

Sincerely yours,

M. S. Eccles.

Hon. William Fulbright,
United States Senate,
Washington, D. C.

Enc.-2

August 11, 1950.

The way to protect the eonomic system from inflation of prices is to prevent demand from becoming greater than supply. The sound way to carry on the present military effort is to have an amount of purchasing power big enough to buy all the civilian supplies available, but no bigger. Purchasing power in excess of supply inevitably leads to inflation.

In the battle against inflation, we may have to use direct measures such as price controls and rationing as well as the indirect, but most effective, measures of monetary credit and fiscal restraints. But price controls and rationing in the face of growing credit and monetary inflation can only lead to grayer and grayer markets, with evasive practices widespread. Furthermore, as we have discovered in the past few years, the direct controls do not prevent inflation if credit and monetary expansion is not prevented. Direct controls in these circumstances merely change the form of inflation and the time at which it occurs..

Limitation of inflation by monetary, credit, and fiscal means requires the combined and coordinated use of these instruments. It is not possible to rely on consumer credit regulation, on real estate credit regulation, on other credit restraints, or on fiscal measurers separately. They have to be vigorously used together.

Housing s tarts and extensions of housing credit are at far the greatest rates in the history of the nation. This construction, so laudable in a time of peace, cannot be continued in a time of rapidly mounting defense effort. It must be in considerable part postponed if we are to have the men and materials necessary for military production.

Even the starts which have already been made and those which inevitably will be made in the near future will provide a great inflationary factor for many months. Mortgage credit will continue to be extended to permit [provide] their completion. Immense amounts of labor and materials will be involved. Contractors are frantically scraping the bottom of the barrel to accumulate the materials to finish these houses. Until it is clear that the men and materials are available to complete these houses, the inflationary pressures should not be increased by starting further houses. Certainly the government should not postively sponsor the starting of new construction until such policy will not be conducive to inflation. Yet the F.H.A. & Veterans Administration by their policies are still stimulating housing construction.

The legislation under consideration would give the Federal Reserve Board authority to prescribe regulations with respect to real estate credit for new construction, in order to contain its inflationary expansion and reduce building during the emergency period, but this authority would apply only to real estate credit for new construction not made, insured, or guaranteed by the Federal Government. At the same time, the legislation would leave to Presidential discretion, after consultation with the Federal Reserve Board, the regulation of Government programs in the real estate mortgage field.

This approach is faulty because it divides administrative responsibility. The division of responsibility can seriously interfere with achieveing the objectives of this legislation. If the credit terms permitted under the Federal programs are not restricted sufficiently, the Federal Reserve Board has the choice of going along with the Federal programs, or of tightening the terms on private credit severely. If it takes the first course, the purpose of this legislation will be frustrated. If it takes the second, borrowers and lenders outside the Federal programs are penalized or the business is driven into the Federal programs. If there is to be effective credit regulation in the field of new real estate construction it must be a single regulation, regardless of what lenders extend the credit and whether the credit is insured, guaranteed, uninsured, or nonguaranteed.

That the Federal programs are important sources of funds for new construction is shown by the fact that over two-thirds of the rental units started in recent months have been financed with insured mortgages, and over two-fifths of the new houses sold have been financed with either F.H.A. or GI mortgages. The terms on these mortgages are considerably more liberal than the terms on unguaranteed mortgages, permitting down payments as low as 5, 10, or 15 per cent of the price, compared with 30, 35, or 40 per cent in the case of mortgages made by banks, insurance companies and other lenders. Maturities run as long as 20, 25, 30 and even, in a few cases, 40 years, compared with the more conventional 12, 15, 18, or 20 year terms.

This bill provides power to limit the terms of mortgage credit for new construction. But it would be futile and utterly mischievous to apply more stringent restrictions on uninsured than on insured credit. Such a procedure would simply cause the noninsured credit to dry up, and the insured credit to expand correspondingly. It would create arbitrary and unnecessary discriminations.

The essential point I am making is that there can be no effective anti-inflation regulation of real estage credit unless the terms prescribed cut across the board affecting Government-sponsored as well as other credit. Inflation control cannot be effective in one part of the field while forces of inflation are permitted to move forward unchecked, and indeed reinforced, in other parts.

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