HARVARD UNIVERSITY

GRADUATE SCHOOL OF PUBLIC ADMINISTRATION

FISCAL POLICY SEMINAR

13 LITTLE HALL
CAMBRIDGE, MASSACHUSETTS

14 May 1938

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

Dear Mr. Eccles:

I have read with the greatest interest your address before the New Jersey Bankers' Association. This is just the sort of analysis which I think is extremely important to get before the business community and I am in substantial agreement with practically everything you said.

With respect to the building field it seems to me that it is not only necessary to get costs of materials and hourly wage rates down. I am not able to see why with the government guarantee we should not have a lower rate of interest. It seems to me that five per cent on a guaranteed basis is outrageously high, and indeed it is evident that there are vastly more funds that seek this market at five per cent than are wanted. If this situation were applied to the labor market, the conservative community would certainly agree that wage rates were so high that the supply enormously exceeded the demand. It seems to me that on a guaranteed basis the F.H.A. interest rate ought not to be above four per cent.

I have just been talking recently with Professor Myrdal of the University of Stockholm, who is a member of their Senate, and he says that building interest rates in Sweden are as low as three per cent and that for one hundred years both Denmark and Sweden have, through the use of state credit, provided extremely low rates of interest for farmers and for a program such as housing.

Very sincerely yours,

Alvin H. Hansen

AHH:C

Alvin H. Hansen

May 16, 1938.

Professor Alvin H. Hansen,
Graduate School of Public Administration,
Harvard University,
13 Little Hall,
Cambridge, Massachusetts.

Dear Professor Hansen:

I was glad to have your letter of May 14th and I am enclosing a copy of the full text of my discussion before the New Jersey Bankers Association, as only fragments appeared in the press, and knowing of your contributions to and interest in this subject, I felt that you might possibly wish to have the complete text.

While I agree with you in principle about the desirability of a low interest rate, as a practical matter it would be very difficult to bring about a four per cent rate, say, on F.H.A. mortgages except over a long period and by a gradual process, as I think has been the case in England as well as in Denmark and Sweden. Of course we have made considerable progress, especially in bringing down rates on real estate financing from the high levels prevailing before the depression.

I discussed this question at some length before the Senate Banking and Currency Committee in connection with the recent housing bill, endeavoring to point out to the Committee why, as a practical matter, the banks could not be induced to take hold of this thing at a rate under five per cent, and, in fact, many of the banks felt that that rate was too low in view of the servicing, foreclosure and other costs as well as the competitive situation with respect to other investments of a more liquid nature yielding fairly high returns. I felt you might be interested in some of this discussion and I am, accordingly, enclosing a verbatim extract from the printed testimony that bears just on this point.

Needless to add, I am always interested to hear from you and have the benefit of your views.

Sincerely yours,

M. S. Eccles,
Chairman.

enclosures
ET:b

Extract from hearings before the Committee on Banking and Currency, United States Senate, on S. 3055, a Bill to Amend the National Housing Act and For Other Purposes.

Mr. Eccles. I want to bring out, before I get through, this matter of the 5-percent rate that the bank or the lending institution is to get, and also the cost of absorbing foreclosure costs where the 90-percent loan is concerned; and I might do that right now in that connection.

Senator Townsend. All right.

Mr. Eccles. We hear considerable complaint about the 5¼ percent being too high; that the cost is too great. People say that a mortgage guaranteed by the Government should be not more than 3 or 3½ percent. In the first place, the mortgage is not guaranteed by the Government. The Government does not in any way guarantee the 5 percent. What the Government does is to guarantee debentures that the Housing Administration is authorized to issue in lieu of a transfer of the foreclosed property to it. Such a debenture at the present time is not tax-free and it bears interest of 3 percent and is due 3 years after the mortgage would mature. So it seems that it is a long-term debenture.

Senator Townsend. And the Government would have nothing to do with the foreclosure proceedings. The bank would proceed to foreclose and then collect on the debenture?

Mr. Eccles. It is a question today if 5 percent is high enough to induce private capital to invest.

Senator Townsend. That is also a question that I would like to have you discuss.

Mr. Eccles. In the first place, on a 20-year loan the money is being paid out for a 20-year period of time, with all the risks of a fluctuating value of money during that time. A long-term bond always bears a very much higher rate than a short-term bond. The cost of servicing the 20-year loan on the basis of monthly payments is at least three-quarters of 1 percent, and some claim it is as high as 1 percent. We will assume, then, that it is only three-quarters of 1 percent. I think it is nearer 1 percent on the homes valued at $4,000 or less. I think possibly on a $6,000 home it would be three-quarters of 1 percent. We will figure three-quarters of 1 percent. That makes a 4¼-percent yield. A 4¼-percent yield is taxable in the hands of the institution at a 15-percent income tax, approximately. A 15-percent income tax figures very close to three-quarters. That would leave a net of 3½ percent.

You can buy a 20-year bond, the longest-term Government bond, that will yield very close to 3 percent. Such bonds are free from the normal tax, the 15-percent corporation tax, and that puts it in a yield class of very close to 3½ percent.

So that you have here, if the loan does not default, a net income of about 3½ percent. If you buy a long-term Government bond, on a comparable basis, taking into account the tax-free feature, you have about the same.

In the case of the mortgage, if it is to be foreclosed, the institution foreclosing the mortgage has to absorb the foreclosure cost. The foreclosure costs in the State of New York, the State of Illinois, and the State of New Jersey, run all the way from $300 to $500 on these small loans.

Senator Frazier. Why should they be so high?

Mr. Eccles. I do not know why they are so high; but they are. In the State of Massachusetts the cost, I understand, averages $30. The property can be acquired within 2 months. In these other States it takes all the way from a year to a year and a half and, as I say, the cost is over 10 times what it is in Massachusetts. Certainly there is some enabling legislation needed in those States. In most of the States there are no such costs, but in all States the average cost would be possibly $100 or more. That cost must be absorbed by the lending institution.

I merely bring that out as an answer to those people who claim that this rate is too high. Possibly it is, so far as the borrower is concerned. Possibly the borrower should be able to get 3½-percent money. But merely fixing the rate at 3½ percent does not get private capital into the field. If you want private capital to come in, then the rate has to be fixed at a basis that will attract private capital; because, after all, this form of financing is in competition with baby bonds that yield 2.9 percent, and they are for only 10 years instead of 20 years, and they have a tax-free feature. So that it is in competition with all other types of financing.

Senator Townsend. Do you think that the present rate as fixed in the bill will bring in private capital?

Mr. Eccles. I was going to make two suggestions to show you why I think it will.

First, we have tried to get away from subsidies in connection with this, beyond the Government's guaranteeing the 3-percent debentures that the institutions would receive in case of foreclosures. To that extent the Government is in the picture, but only to that extent.

I would like to suggest that these 3-percent debentures that are issued in lieu of the mortgage in case of foreclosure be given the same tax-free feature that other Government obligations and obligations guaranteed by the Government have. Not that I am in favor of increasing the amount of tax-free securities on the market. I would personally like to see all tax-free securities of whatever nature entirely eliminated. But that seems to be a forlorn hope, so long as we have tax-free securities that are available today for investors.

On the land-bank bonds the farmer gets the benefit of the tax-free feature. In the home-loan bank debentures they have the benefit of the tax-free feature. It seems to me that in this type of financing if there is anyone entitled to get a benefit it is the home owner at this time.

Senator Byrnes. If it is an unwise policy, how can we get rid of that unwise policy if we continue to practice it?

Mr. Eccles. I cannot answer that. Of course, it involves the States, as you know. They issue an entirely tax-free security which is very much more objectionable, it seems to me, than the tax-free feature of the Government obligations, which are, of course, not free from surtaxes.

Senator Byrnes. What I mean is this. I have been making the same statement for years; I plead guilty to it. It is unwise; and yet at every session of Congress we add to it, and now we are told that the House Ways and Means Committee is trying to devise some way to reach it by taxation. While they are trying to tax them in some way, if we go ahead authorizing more tax-free securities, we do not get anywhere.

Mr. Eccles. It seems to me that if we do not have that, this rate will have to be increased, because it is not today where it seems to me it would be able to compete with other forms of Government financing.

Senator Bulkley. Do you mean to say that a 5-percent rate, inclusive of the service charge, is not high enough to attract private capital?

Mr. Eccles. No. This 5 percent is exclusive, in this program. It is a 5-percent rate without a service charge. That is an over-all charge.

Senator Bulkley. Do you think it is not sufficient to attract capital?

Mr. Eccles. I do, on these smaller homes.

Senator Bulkley. Most of our witnesses have thought that we ought to do better than that.

Mr. Eccles. I am just giving you my view and the reasons for it.

Senator Bulkley. Do you think we will have to pay as much as $5\frac{1}{2}$ percent, including the service charge?

Mr. Eccles. The $5\frac{1}{2}$ percent would include it. I am suggesting a tax-free feature as a means of attraction.

Senator Bulkley. And without the tax-free feature do you think we would have to go as high as $5\frac{1}{2}$ percent?

Mr. Eccles. I do, in today's market. You have got a 20-year obligation. If this were 10 years it would be very different. There is possibly a difference of one-half of 1 percent alone in the difference between the 10-year and the 20-year obligation.

The Chairman. We have had testimony before us that the English institutions loan at the rate of $4\frac{1}{2}$ percent upon this very same type of homes.

Mr. Eccles. That is right.

The Chairman. Why is it that we cannot do the same thing?

Mr. Eccles. In the first place, there are three or four great mutual building and loan associations, or what they call building and loan societies, that cover the entire British Isles, with offices in every community. Possibly the service charges would be substantially less there than here. I am sure that would be the case. They are strictly mutual associations.

Senator Frazier. Do you not think it is about time that we set up some of those organizations in the United States?

Mr. Eccles. The Government there did not set them up. They grew up.

Senator Frazier. It does not make any difference how they are set up; we should have them, in my opinion.

Mr. Eccles. I think that to start today and expect to cover the country with mutual associations that would provide the means of financing for this housing bill--I question very much that we would get very much result from it, either next year or possibly for some considerable time. We are trying to deal with the situation as we find it.

The Chairman. You are a realist.

Mr. Eccles (continuing). And not with the situation as we might like to have it.

As I stated, I do not like to recommend this tax-free feature, but it seems to me that it is possibly cheaper and better than some other form of subsidy.