

For release on delivery

Statement of
William McChesney Martin, Jr.
Chairman, Board of Governors of the Federal Reserve System

before the
Subcommittee on Housing
of the
Senate Committee on Banking and Currency

May 13, 1958

The bills you have asked me to testify about today cover quite a bit of territory. They all deal with activities of the Federal Government relating to real estate, mortgage finance, or urban renewal programs. All of these activities, in their general aspects, are of interest to the Federal Reserve, since they make up part of the institutional framework of our economic system within which monetary policy must be formulated and carried out.

For the most part, however, the bills you have before you are either technical in the sense that they would make changes in authority or procedures that are thought desirable to facilitate carrying out policies already laid down, or make only incidental changes in established policies. I shall not comment on the bills that appear to be strictly technical, for I am not in a position to judge the desirability or suitability of the proposed amendments.

Several of the bills appear to make somewhat more than incidental changes in existing policy. One of these is S. 3064 which would make mortgages on 2-, 3-, and 4-unit residences eligible for insurance under section 221 of the National Housing Act. Another is S. 3398 which would permit the Federal National Mortgage Association to regard preferred stock dividends paid to the Treasury as deductible expenses in computing the amount to be paid in lieu of corporate income tax under the Secondary Market Operation. Three of the bills would extend the purposes for which educational institutions might borrow from the Federal Government: S. 3281 would make construction of science buildings eligible; S. 3351, construction of science buildings and libraries; and S. 3713, construction of any buildings

necessary or appropriate for instruction or administration. Perhaps S. 3484 is also in this group; it permits, and may require, the Secretary of Defense to acquire certain housing situated adjacent to military installations.

S. 3399 is the most voluminous of the bills before you. Like the bills I have just mentioned, it would make a good many technical changes in existing law and some relatively minor changes in policy. It would also make a few changes in policy that might be considered to be major. Among these last are the provisions in sections 305 and 509. As I understand it, the effect of these provisions would be to set up new Federal programs of guaranteeing loans--in the first case to guarantee certain loans for urban renewal projects by having the Government stand ready to make refunding loans, and in the second case to guarantee payment of principal and interest on bonds issued by private educational institutions.

Consideration of all these measures raises the question whether the laws relating to the Federal Government's activities in real estate, mortgage finance, housing, and urban renewal need to be so written as to require amendment so frequently as they have in recent years, or in as great detail as appears in S. 3399. It is possible that more general legislation, flexibly administered, might be more effective, not only in implementing established policy, but also in providing a framework within which the desirability of changes in policy could be judged.

Of all the bills under discussion today, S. 2791 appears to go furthest in writing new public policy. Under this bill, a Home Loan Guarantee Corporation would be established with authority to guarantee, within certain limits, first mortgages on homes designed for single-family occupancy.

We believe that the public interest might be better served if the Federal Government worked toward a single program of insurance of home mortgages--not several programs. To avoid the kind of policy conflicts that are inherent in the duplication of administering bodies operating in the same field, we think that all programs for insurance of home mortgages should be lodged with the Federal Housing Administration rather than with a potentially competitive agency.

The fact that, under the proposed program, only the top 20 per cent of a mortgage is insured rather than the full mortgage, as in the case of the present FHA programs, would not necessarily mean an appreciably smaller risk exposure to the insurer. Short of disaster of the sort that we went through in the 1930's, the bulk of defaulted loans is likely to show losses of less than 20 per cent. In other words, except in an extreme situation, there should be little difference in risk between the two programs, hence little difference between the premiums required to make them self-sustaining. Of course, if the standards for the acceptance of risks were markedly lower under the proposed program, the premiums required for successful operation would be correspondingly higher.

Another aspect of this comparison should be noted. The co-insurance element of the proposed program would increasingly limit the Government's liability as the severity of trouble increased. Sound public policy requires the reverse. Of course, a day-to-day reminder to lenders, by way of some sort of co-insurance feature, that unsound lending is costly is likely to have a good effect on lending practices, and thus minimize the chances of serious trouble. At the same time, however, if serious

trouble should come despite the use of sound lending practices, complete insurance would be much more helpful than partial insurance in keeping the trouble within manageable limits.

The bill as drafted raises other questions, also. Contrary to the Federal policy of some years' standing, the Home Loan Guarantee Corporation would be authorized to borrow by issuing obligations with exemptions from Federal, State and local taxes. The Board believes that as a matter of public policy tax exemption favoring particular types of obligations is undesirable. It appears also that the guarantee issued by the Corporation would be available only to mortgagees that had been examined and audited by the Corporation; it should be realized that many financial institutions prominent in mortgage financing, including both banks and insurance companies, are already subject to examination by other supervisory authorities, and might well be reluctant to submit to such additional examinations. While there is much to be said for re-emphasizing the principle of co-insurance in Federal mortgage programs the Board feels that, in view of these shortcomings, enactment of S. 2791 would be undesirable.