CAPITAL REQUIREMENTS OF HOUSING INDUSTRY: PROPOSALS TO ENCOURAGE SAVINGS

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL MARKETS

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

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WITNESSES

CAPITAL REQUIREMENTS OF HOUSING INDUSTRY: PROPOSALS TO ENCOURAGE SAVINGS

THURSDAY, OCTOBER 2, 1975

U.S. SENATE,
SUBCOMMITTEE ON FINANCIAL MARKETS
OF THE COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:10 a.m. in room 2221, Dirksen Senate Office Building, Senator Lloyd Bentsen (chairman of the subcommittee) presiding.

Present: Senators Bentsen and Brock.

Senator BENTSEN. This morning, the Financial Markets Subcommittee is going to open its hearings on the question of capital requirements of the housing industry and the ability of our financial markets to satisfy those requirements.

OPENING STATEMENT OF SENATOR LLOYD BENTSEN

During the past 4 years, housing starts in the United States have plummeted from 2.5 million in 1972 to an annual rate of 1.26 million at the present time. It is clear that in its present condition, the industry is incapable of meeting a fundamental need of the American people—the need for shelter. A primary reason for the dismal performance of the housing sector has been high interest rates and the general unavailability of capital for financing home construction.

Recurring shortages of capital for home construction have put the industry on a stop-and-go, boom-or-bust cycle and greatly contributed to its inefficiency. The purpose of these hearings is to explore new ways for assuring an adequate supply of credit in the housing sector.

Recent statistics indicate that the housing recovery that had been anticipated may be in jeopardy.

—Building permits, a key indicator of future building activity, have not presented the clear upward trend that would normally be expected during a recovery and, in fact, fell 5.5 percent in August to an annual rate of 985,000 units.

—The interest rates on conventional home mortgages have failed to fall substantially from their 1974 highs, and rose from early July to early August.

—The inflow of funds into our Nation's thrift institutions also have shown signs of renewed disintermediation since June.

—The unemployment rate among construction workers remains at an unacceptably high level of about 20 percent.

I have introduced tax legislation, S. 666, with 16 cosponsors, to help provide a stable source of financing for home mortgages and construction loans to help alleviate these kinds of problems. By providing a stable source of mortgage money, my proposal will help ease the cyclical nature of the housing industry. There have been seven severe economic downturns in the housing industry since World War II, which have resulted in substantial inefficiencies.

Under my proposal, a parent could deposit $250 annually for each child into an educational savings plan and receive a tax credit equal to 20 percent of the amount deposited. These savings could only be used for postsecondary educational expenses. Thus, a family that saved $500 for two children would receive a $100 tax credit for the year. These plans could be managed by any financial institution that placed at least 50 percent of its assets into housing-related loans.

The Department of the Treasury estimates that as many as 15 million families would utilize these plans to save for the education of 33 million children. This would mean approximately $9 billion would be deposited in educational savings plans annually.

The $9 billion of annual deposits for educational savings plans provided by my legislation would not be subject to traditional market fluctuations and would provide a steady source of financing for as many as 300,000 new homes per year.

The benefits from these plans would be twofold: They would make postsecondary education more readily available to millions of young people in this country, and they would provide a stable source of private funds, at reasonable interest rates, for potential homeowners.

In the 10 years between 1962 and 1972, costs for tuition and room and board at public colleges and universities increased 50 percent, compared with an increase of only 38 percent in the Consumer Price Index, the traditional measure of inflation. During the same period, the costs of private higher education escalated 80 percent, or at more than twice the inflation rate. Equally important, the costs of vocational education programs have also increased substantially.

More and more, middle income students are being priced out of higher education. The children of the very poor frequently qualify for full scholarship aid. Those whose parents are very rich can afford high tuitions. But rising costs and limited funds for student financial aid make it increasingly difficult for those who are neither very rich nor very poor to finance college or vocational school. They don't qualify for Federal student assistance and, at the same time, the education cost squeeze keeps driving higher education further beyond their means.

The educational savings plan I am proposing should reassure many of these families that they will be helped in their struggle to meet the cost of their children's higher education.

In addition, these educational savings plans will help provide a larger, better trained, and more productive work force in our Nation. It is clear, that when the productivity of American youth is enhanced through greater education opportunities, both the individual and the national economy benefit. The educational savings plan should help bring this about by channeling an increasing number of students into career education, developing their skills, helping lower the unemployment rate, and in general, providing the Nation with a more effective work force.

When the long-term benefits of greater educational opportunity are considered, I am certain we will find—as we did with the veterans education programs—that the country stands to reap a healthy return on this investment.

[The Committee on Finance press release follows:]

[PRESS RELEASE]

BENTSEN FINANCIAL MARKETS SUBCOMMITTEE TO EXAMINE CAPITAL REQUIREMENTS OF HOUSING INDUSTRY, PROPOSALS TO ENCOURAGE SAVINGS

Senator Lloyd Bentsen (D., Tex.), Chairman, and Senator Bill Brock (R., Tenn.), Ranking Minority Member of the Finance Committee's Subcommittee on Financial Markets today announced that the Subcommittee will conduct public hearings on the condition of the financial markets and the capital requirements of the housing industry.

The hearings will be held at 10:00 a.m. on Thursday, October 2, in Room 2221 of the Dirksen Senate Office Building.

"These hearings will inquire into the capital requirements of the housing industry and the capability of our financial markets to satisfy those requirements," Senator Bentsen said.

"During the past four years, housing starts in the United States have plummeted from 2.5 million (in 1972) to an annual rate of 1.2 million at the present time. It is clear that in its present condition, the industry is incapable of meeting a fundamental need of the American people—the need for shelter," he said. "A primary reason for the dismal performance of the housing sector has been high interest rates and the general unavailability of capital for financing home construction."

"Recurring shortages of capital for home construction have put the industry on a stop and go, boom or bust cycle and greatly contributed to its inefficiency. The purpose of these hearings is to explore new and innovative ways for assuring an adequate supply of credit in the housing sector while meeting our national priorities," Senator Bentsen said.

Senator Brock added, "The housing market is one of the most vital to our overall economy. The availability of adequate capital should be fully explored and possible new programs investigated. It is my hope that these hearings can be fruitful in determining also if government interference is in any way contributing to the sporadic capital market."

The following witnesses have been scheduled to testify before the Subcommittee Thursday, October 2, 1975: Mr. J. S. "Mickey" Norman, President, National Association of Homebuilders, accompanied by Michael Sumichrast, Chief Economist; Prof. Roy Schotland, Georgetown University Law School; Professor Julian H. Levi, University of Chicago, representing the American Council on Education.

The Chairman stated that the Subcommittee would be pleased to receive written testimony from those persons or organizations who wish to submit statements for the Record. Statements submitted for inclusion in the Record should be typewritten, not more than 25 double spaced pages in length, and mailed with five (5) copies by October 30, 1975 to Michael Stern, Staff Director, Committee on Finance, Room 2227, Dirksen Senate Office Building, Washington, D.C.

Senator BENTSEN. We are pleased to have you gentlemen here this morning. Unfortunately, I am not going to be able to stay through this morning's hearings, because we are debating a gas regulation bill on the floor of the Senate that is of great importance to the Nation, and I have a major substitute piece of legislation for one that has been before us. But I would appreciate the members of the panel, if they would identify themselves for purposes of the record at this time.

STATEMENT OF J. S. "MICKEY" NORMAN, PRESIDENT, NATIONAL ASSOCIATION OF HOMEBUILDERS, ACCOMPANIED BY CARL COAN, JR., STAFF VICE PRESIDENT AND LEGISLATIVE COUNSEL, AND MICHAEL SUMICHRAST, STAFF VICE PRESIDENT AND CHIEF ECONOMIST

Mr. NORMAN. Thank you.

My name is J. S. Norman, Jr. I am a homebuilder from Houston, Tex., and am serving this year as president of the National Association of Home Builders, which represents some 74,000 member firms in some 603 State and local associations throughout the country.

With me today is Mr. Carl A. S. Coan, Jr., our staff vice president and legislative counsel, and Dr. Michael Sumichrast, staff vice president and chief economist.

Senator BENTSEN. If you will proceed, then, Mr. Norman.

Mr. NORMAN. Thank you.

I appreciate this opportunity to present to the subcommittee our views on S. 666, which would encourage the establishment of educational savings plans in financial institutions investing at least 50 percent of their assets in residential loans. This would be accomplished through the provision of a 20-percent tax credit on the first $250 invested in such accounts annually.

NAHB has long had policy in support of legislation which would encourage individuals and families to place their savings in institutions which support the residential mortgage market. The homebuilding industry relies on such thrift institutions as the single largest source of funds for residential mortgages.

When these institutions have had available adequate funds to meet the mortgage needs of American home buyers, the homebuilding industry has prospered and the housing needs of our people have been met. On the other hand, when funds have been in short supply or the stability of the funds held by thrift institutions has been uncertain, the industry has suffered and the housing needs of the Nation have not been met.

This has occurred when thrift institutions have experienced massive outflows of savings, generally known as disintermediation. We have had three periods of disintermediation during the past 10 years, with possibly a fourth coming up at the present time. Each time housing production has fallen sharply, with the resultant serious effects on the national economy through large layoffs of construction workers, as well as layoffs in the thousands of other businesses that depend on homebuilding. Tax revenues have fallen for the Federal as well as State and local governments, and the economy shortly thereafter has gone into a recession.

Having been buffeted by several of these cycles, the homebuilding industry is convinced that it is important for the Nation's economic health that a stable flow of savings into thrift institutions be encouraged. One preeminent way of doing this is to provide a tax incentive for the saver, especially the relatively small one. As a result, we have endorsed over the past 6 years several proposals which would provide an exemption from taxation for a portion of the interest earned on accounts in thrift institutions.

We have also supported the use of tax credits, separately or in conjunction with such a tax exclusion. This policy was most recently reaffirmed at our fall board of directors' meeting just last week. I have attached a copy of that resolution to this statement.

[The document referred to follows:]

ATTACHMENT "A"—NAHB RESOLUTION, HONOLULU, HAWAII, SEPTEMBER 23, 1975

TAX INCENTIVES TO SAVINGS AND INVESTMENT IN MORTGAGES

Whereas, a steady source of funds at reasonable rates for residential mortgages is the most important factor in providing badly needed housing which in turn furnishes much needed employment in the construction industry and all of the related trades and suppliers; and

Whereas, our saving institutions, the principal suppliers of mortgage funds, are subject periodically to being crowded out of the capital markets because of competition for funds from other sources; and

Whereas, NAHB has in the past called for the use of tax incentives to channel funds into residential mortgages and the construction of housing; now, therefore, be it

Resolved, That NAHB strongly reaffirms its support for tax credit and/or exclusions for both the saver and the saving institutions that invest funds in or for residential construction and residential mortgages.

(Approved by the board of directors.)

Mr. NORMAN. The concept of providing a tax incentive for savings is sound. It would encourage more people to become savers. It would encourage present savers to keep their money in a savings account rather than withdraw it for another investment which, while possibly offering a higher interest rate, would not be entitled to the same tax benefits.

The concept is also sound from the viewpoint of national policy. In 1968, the Congress called for an all-out effort to produce the housing needed to assure that every American family was afforded the opportunity to obtain a decent home. To date, we have fallen far short of the average annual production level of 2.6 million dwelling units deemed necessary by the Congress at that time.

One principal reason has been the lack of a stable source of funds to finance these units. This has been due to the disintermediation suffered by thrift institutions as funds have fled them for more attractive investments offered elsewhere. Even the Federal Government has been one of the principal causes of these outflows when it has issued low-denomination, short-term, high-interest rate obligations, as it is beginning to do again.

When other interest rates rise and funds begin to flow out of the thrift institutions toward these higher rates, the thrift institutions tend to be very cautious in their long-term mortgage lending activities. They are concerned that they will lose future funds and that they will not have funds to meet future commitments. This is why it is so crucial to establish stability in the savings that flow to thrift institutions.

We have also felt that it might be desirable, in helping to combat disintermediation, to provide for a variable tax incentive that would rise when the pressures for higher interest rates in other areas are the greatest and return to a normal level when these pressures subside. Our data indicates that there is a fairly direct relationship between the decline of housing starts and the rise of short-term interest rates. These rates are the ones which most often result in disintermediation in thrift institutions. Therefore, an increase in any tax incentive for savings which was keyed to a composite of lending short-term rates could be expected to help further in retaining funds in thrift institutions and, thus, in sustaining a reasonable level of housing production.

While we do not have specific policy on S. 666, it appears that it would be quite attractive to many potential savers, encouraging them to place their funds in relatively long-term accounts in institutions which are heavily invested in residential loans. It also has the advantage of serving another important national goal in that it would encourage the putting aside of funds for educational purposes. With the rising cost of education, the tax incentive provided under the bill should be quite attractive to many families.

We urge the subcommittee, in considering S. 666, to give it serious consideration as one definite means of encouraging greater stability in our thrift institutions and thereby assuring more stability in housing production. We also urge the subcommittee, however, to look at the many other proposals that have been made in this area and choose that one, or combination of ones, which will best deal with the serious cycles that have affected homebuilding over the past 10 years.

Thank you for this opportunity to appear today, and obviously we will try and answer any questions.

Senator BENTSEN. Thank you, Mr. Norman.

In addition, I would like to comment on the fact that I have known Mickey Norman for many years. I know him to be a man of great integrity and ability, a man who has been deeply concerned with civic affairs and has given of himself in participation in many worthy endeavors in his community. He is a forward-looking, progressive man, and I am pleased to see this kind of representation from the National Home Builders.

This particular piece of legislation that I have introduced with some 16 cosponsors is one that has really twin objectives dealing with homebuilding and education. Homebuilding is usually the first thing that leads us into recession or out of a recession because it permeates the entire economy because you have got the problem of supplying furniture and lumber, freight, real estate, jobs. But because of the cyclical nature of funds we have had a boom-and-bust approach to homebuilding in this country and it has added to the costs because you have not been able to have the stability in employment and work forces, in planning that there should be, and this inflow and outflow of money and disintermediation of funds has complicated the problem.

On the other side, you have got the situation if you are very poor in this country and have a very bright child, often you can get a full scholarship for that child. If you are very rich and have a bright child, it is no problem. But if you are in the vast group in the middle, if you have one, two, or three children and are trying to send them to college, it is tough. Working part time or what have you, it is very difficult to forward that child's college education. So we have tried with innovative legislation to work at both of these very important objectives for this country of ours. Stability in providing homes for young people, and the others who might want to improve their homes, to give them an adequate and stable mortgage supply, to keep rates reasonable on monthly payments, and in turn to encourage savings for the future education of the children.

Mr. Norman, we have been advised that the Chemical Bank of New York has predicted that 3-month Treasury bills will keep moving up from the 6.4 they are now to about 7 percent and by next year they may go as high as 8 percent.

Now, that is Treasury bills we are talking about. So if you are talking about mortgage money, and there is a correlation to a degree, would it not pinch off the recovery in housing construction if we see a further substantial escalation in rates?

Mr. NORMAN. Well, the short answer to that is yes, it would; and I would like to advise the committee that approximately 2 years ago our chief economist, Dr. Michael Sumichrast, began to develop an econometric model upon this very same issue and it is probably the most advanced model in the country. We discovered an amazing thing. While we knew that there was some type of relationship between short-term interest rates and housing starts, we have been now able to pretty well quantify it. When short-term interest rates such as the 90-day Treasury bills start having a yield just above the cost of money to the thrift institutions and that condition exists for something like 30 to 60 days, then disintermediation starts taking place within 30 to 60 days and then within 60 days after that housing starts begin to fall off.

Now, that has been true of every cycle we have been through.

As to the reverse—the recovery follows the exact reverse sequence but it takes twice as long, generally speaking.

More details on this could be provided by Dr. Sumichrast, but the short answer is that if Treasury bills increase at the rate that has been suggested, you can watch homebuilding take another nosedive.

Senator BENTSEN. Well, the interest rates on both conventional mortgages, FHA, VA mortgages, have risen in the last couple of months.

Mr. NORMAN. Yes.

Senator BENTSEN. Why do you think they are rising? What would you expect to be the average mortgage rate for the remainder of the year?

Mr. NORMAN. Well, sir, the typical mortgage rate is not going to be under 9 percent for the rest of the year and probably is going to be edging up closer to 9½, and therefore you are going to see fewer and fewer housing sales.

Senator BENTSEN. How many points involved?

Mr. NORMAN. I guess the average right now is somewhere around 3 to 4 points discount, if that was the question.

Senator BENTSEN. That is right.

Mr. NORMAN. Yes.

Senator BENTSEN. How many housing starts do you estimate for the balance of the year?

Mr. NORMAN. We projected figures back in February and March that our actual starts in 1973 would be on the order of 1.15 million units. That is actual starts. Now, we are going to say that we are not going to be very far off in that prediction which we made back in February and March, and unless something very dramatic happens it is probably going to be less than 1.1. Building permits have been falling off regardless of what the start figures have been.

Senator BENTSEN. What about multiple family starts? There has been a substantial drop in those. What do you attribute that to?

Mr. NORMAN. High interest rates. That is the only thing. As long as the mortgage rates for multifamily units is 10 percent or more, there will not be any multifamily housing starts to speak of, and that is the sector of housing that has really been hurt. Single family may have been hit, say, on the order of 30 or 35 percent. Multifamily has been hit on the order of 60 to 80 percent, depending on what part of the country you are from. So that is one sector of housing that really needs some special attention. Without a recovery in multifamily housing starts there is not going to be any substantial improvement in overall housing starts.

Senator BENTSEN. What is the position of the unsold inventory on houses as compared to past months?

Mr. NORMAN. It is—the inventory is improving. The tax credit provision that the Congress provided earlier in the year has helped move the inventory. Some of the special mortgage assistance funds have helped move the existing inventory. I do not believe at this time generally speaking that there is an excessive inventory. In spot areas, maybe in the condominium field, maybe in Florida or on the west coast, you may find some particular markets where there is a glut so-to-speak, but nationwide the inventory as far as numbers is concerned is pretty well——

Senator BENTSEN. In a statement to the Senate Banking Committee last July, the Federal Home Loan Bank Board made this statement, and I quote.

> Our own analysis leads us to stress that much of the housing problems of low- and moderate-income families in this country really represents a symptom of income deprivation. Housing policies need to be oriented at least as much to improving and using more effectively the existing housing stock as adding new units to the housing stock.

Now, what is your response to that, to those who advocate that our housing policy should be geared more toward preservation or improvement of the existing housing stock?

Mr. NORMAN. Well, it is obviously to the Nation's interest and the people's interest to preserve as much of the housing stock as they possibly can, and this should be done where it is overall feasible. Financing is just one of those problems, though. You know, you have to deal with the whole community and all of the elements that go into a community. The educational and recreational facilities and job opportunities are all part of that picture, and in many cases existing housing that is susceptible of reclamation, rehabilitation, has all of these elements around it, but in many others doesn't.

Our policy is to try and preserve as much of the existing housing as possible, recognizing that it is a very complex problem.

In relation to the income factor, the statement that you referred to by the Federal Home Loan Bank Board, about low- and moderate-income families, there certainly is an income problem.

We recently—our Economics Department headed up by Mike here, has also done another study in this area, and the proposition has often been made, well, the cost of housing has, you know, risen out of proportion to incomes; and then someone says, well, yes, it has gone up, but the family income has also gone up, and it has increased at a more rapid rate than the cost of housing.

Generally we have found that those two statements are true, but we also discovered one other thing. While family income has increased at a rate greater than the increase in the cost of housing, we have found that as a result of that increased income, the aftertax income of the family has actually risen at a slower rate than the increase in the cost of housing. Because family incomes have increased, they have gone into higher income tax brackets. And they have less money left in their pocket.

The September 1975 Economic News Notes, published by the Economics Department of the National Association of Home Builders, details the changing relationships between family income and housing costs that have occurred between 1955 and 1975.

[The following material was submitted by Mr. Norman:]

Economics Department
National Association
of Homebuilders
15th & M Streets NW
Washington, D.C. 20005

Subscription -
$78 a year

Michael Sumichrast, Chief Economist

Monthly Report

SEPTEMBER 1975

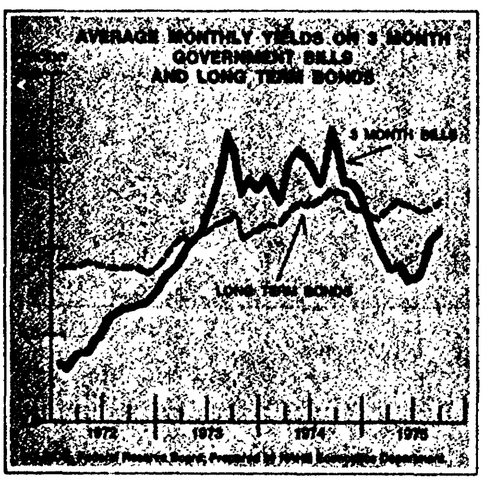
VOLUME XXI, NUMBER 9

CURRENT HOUSING SITUATION

The pattern of a consistently high level of savings flow into thrift institutions apparently was broken during the last two weeks in August. The change posed new problems for a housing recovery.

The first faint signs of savings leaving thrift institutions began in mid-July. This outflow, however, was centered largely in the New York area among mutual savings banks. Savings and loan associations had continued to register substantial increases throughout July, ending the month with a net of $2.867 billion, a new record for that month. The previous July record was in 1972 when net inflows amounted to $2.159 billion.

The large July inflow into S&Ls came on top of June's record $3.089 billion, as well as February to May record levels. In the



first part of August, inflows apparently started reasonably well; then the situation began to change. While August always is a low savings month, it seems that this August the level of savings will be about one-half the record 1972 level of $1.748 billion.

General tightening in the money markets–with sharply increasing interest rates since May–apparently influenced the slowdown. Short term rates are now at 6.5% (see chart, this page). This level is about at the point which triggers an outflow of funds from thrift institutions, since what S&Ls and mutuals offer in interest rates are not competitive with other investments.

(cont'd. p. 2, col. 1)

CHARACTERISTICS OF THE HOUSING STOCK 1973

More than 10% of the housing stock in the United States was less than three and one-half years old in October 1973.

The first report on the 1973 Annual Housing Survey recently released by the Census Bureau and the Department of Housing and Urban Development disclosed that 8 million housing units were added to the inventory by new construction in the three and one-half years following the 1970 housing census (see table 1, p. 4).

Newly constructed units added to the inventory in the early 1970s average 2.3 million a year, up 32% from the 1.7 million unit average during the 1960s. This large increase in new units during the early 1970s reflects the high rates of housing production during those years, and will decline as the effects of the current starts slump is seen in future surveys.

The housing inventory stood at 75.9 million units in October 1973, up 5.8 million units from 70.1 million existing at the time of the 1970 census.

It should be noted that components of change reported in the *1973 Annual Housing Survey* are not fully comparable to those in the *1970 Census of Housing*. The 1973 survey did not include data collection on units lost from the inventory through mergers, nor on units added to the housing stock through means such as change of structure from nonresidential to residential use. Newly built units were the only additions to the inventory accounted for in the survey.

Excluding both loss through mergers and additions through such means as changes from nonresidential to residential use, loss from the inventory totaled 2.2 million units during the 1970-73 period. The average annual loss was about 620,000 units, close to what it was during the 1960s, an indication that the rate of losses to the inventory may be declining.

Most long term forecasts of housing demand show an increasing proportion of demand to be for replacement of units lost from the inventory. Thus, the absolute number of losses in the 1970-73 period were expected to rise significantly–especially since 31% of housing units built in the 1960s replaced units lost through demolition, disasters, and other means (with the exception of mergers). The 1960s ratio was up markedly from 25% in the 1950s. However, the ratio was down to 27% in the early 1970s. A major factor in this decline is the drop in demolitions through Federal programs which were strong in the 1960s: Urban Renewal, Federally Assisted Code Enforcement, Demolition Grants, and Interstate Highway Programs. These programs have suffered severely reduced funding in the last few years.

(cont'd. p. 3, col. 1)

CURRENT HOUSING–FROM P. 1, COL. 1

The troubling money situation was reflected in the latest FNMA auctions. On August 25, 1975, yields on conventional commitments jumped sharply to 9.549% from the 9.380% on August 11. They increased again to 9.750% on September 8. FHA/VA yields on 8½% loans were up from 9.315 at the August 11 auction, to 9.501 on August 25. The FHA/VA rate had been increased to 9% by the September 8 auction, when the average yield was 9.695.

This bad money climate for housing comes on top of a period when sales have begun to decline, little help is evident from government sources, and uncertainties persist over price escalations.

Housing starts, although increasing 13.8% in July to 1,238,000 units at a seasonally adjusted annual rate, provide little comfort. A large portion of this increase was in the multifamily sector, which increased 48.3% in July to an annual rate of 311,000 units from 209,000 units in June. But since building rental units is not currently economically viable at such high interest rates, this increase cannot be expected to continue.

Single family starts, which have been increasing since the first of the year, were up 5.5% in July to 927,000 units at a seasonally adjusted annual rate from 879,000 units in June. However, the single family sector now is being threatened again by the upward turn in interest rates.

Building permits were up 6.1% in July, to a 1,007,000 unit rate from 949,000 units in June. Most of this increase was in the multifamily sector, which rose 17% to a 316,000 unit rate from 270,000 units in June.

Little other data are of any significance for review here. Therefore, it might be helpful to review the cost of new housing, housing expense, and income over the last two decades (see table, this page).

Put in perspective, this is the way buying a new home changed between 1955, 1965, and 1975.

Twenty years ago median family income was $4,418, and it increased 50% to $6,957 by 1965. Estimated 1975 median family income is $13,991, a jump of 101% over 1965.

In the 1955-65 period, the median price of new homes sold increased 49%, from $13,400 to $20,000. By second quarter 1975, the median price was $39,000, a 95% increase over 1965.

Gross median family income had a total increase of 217% in the twenty year period, and the price of new homes, a 191% increase. Thus, measured as a ratio of incomes to prices of new homes, gross income increased slightly faster than the price of new homes.

Not counting the effect of inflation, a median income family of four has less money to spend today than it did 20 years ago: 81 cents out of each dollar earned in 1975 compared to 91 cents twenty years ago.

Net income, or disposable income after payments of Federal, state, and social security taxes (for a family of four), increased substantially less: 53% between 1955 and 1965, and 85% in the 1965-75 period. Overall, disposable income increased 183% compared to the 217% increase in gross income. This difference is because of much steeper increases in all taxes and social security this family has to pay.

Of course, a family with a median income of $4,418 twenty years ago could not afford to buy a median priced $13,400 house. Nor can a median income family today qualify for a median priced home.

Based on a 2.031 ratio of income to housing price, a family needed $6,598 of annual income 20 years ago. Necessary income increased to $9,930 in 1965, and the ratio of income to price dropped to 2.014. In 1975, a family needs $21,161 of annual income to buy a $39,000 median priced home, and the ratio of income to price has dropped further to 1.843.

During the last 20 years, a family of four qualifying for a median priced home has had a 221% increase in gross income and a 189% increase in net, or disposable, income. However, these increases were offset by the following.

HOUSING EXPENSES AND INCOME REQUIRED TO BUY A NEW ONE FAMILY HOME, 1955, 1965, 1975

	1955	1965	1975	Percent Change 1955-75	1955-65	1965-75
Median Sales Price, New Homes Sold	13,400e	20,000	39,000	191.0%	49.3%	95.0%
Loan-to-Value Ratio	75.3	83.3	82.1	9.0	10.6	-1.4
Mortgage Amount	10,090	16,660	32,019	217.3	65.1	92.2
Length of Mortgage	23 Yrs	28 Yrs	28 Yrs	21.7	21.7	0.0
Interest Rate	4.875	5.750	9.000	84.6	17.9	56.5
Monthly Mortgage Payment, Total	77.34	128.35	333.41	331.1%	66.0%	159.8%
Principal and Interest	60.87	99.87	261.37	329.4	64.1	61.7
Interest (average for 1st year)	40.56	79.30	240.25	492.3	95.5	203.0
Real Estate Tax	13.27	23.34	58.58	341.4	75.9	151.0
Hazard Insurance	3.20	5.14	13.46	320.6	60.6	161.9
Other Monthly Housing Expense	24.32	34.74	77.82	220.0%	42.8%	124.0%
Maintenance and Repair	7.40	10.58	27.32	269.2	43.0	158.2
Heat and Utilities	16.92	24.16	50.50	198.5	42.8	109.0
Total Monthly Housing Expense	101.66	163.09	411.23	304.5	60.4	152.1
Annual Housing Expense, Total	1,219.92	1,957.08	4,934.76	304.5%	60.4%	152.1%
Mortgage Payment, Total	928.08	1,540.20	4,000.92	331.1	66.0	159.8
Principal and Interest	730.44	1,198.44	3,136.44	329.4	64.1	161.7
Interest (first year)	486.54	951.45	2,882.99	492.5	95.6	203.0
Real Estate Tax	159.24	280.08	702.96	341.4	75.9	151.0
Hazard Insurance	38.40	61.68	161.52	320.6	60.6	161.9
Other Housing Expense, Total	291.84	416.88	933.84	220.0	42.8	124.0
Maintenance and Repair	88.80	126.96	327.84	269.2	43.0	158.2
Heat and Utilities	203.04	289.92	606.00	198.5	42.8	109.0
Years of Income Needed to Qualify	2.031	2.014	1.843	-9.3%	-0.8%	-8.5%
Annual Income Needed to Qualify	6,597.74	9,930.49	21,161.15	220.7	50.5	113.1
Income Taxes Withheld for a Family of Four, Total	800.13	1,357.49	4,400.93	450.0	69.7	224.2
Federal Income Tax	687.59	1,102.10	3,195.60	364.8	60.3	190.0
Social Security	84.00	174.00	824.85	882.0	107.1	374.1
State Income Tax	28.54	81.39	380.48	1,233.1	185.2	367.5
Total Disposable Income	5,797.61	8,573.00	16,760.22	189.1	47.9	95.5
Annual Housing Expense as a Percent of Disposable Income	21.0	22.8	29.4	40.0	8.6	28.9
Percent of Families Eligible to Buy	22.9	25.8	22.4	-2.2	12.7	-13.2
Monthly Interest Payment as a Percent of:						
Payment to Principal and Interest	66.6	79.4	91.9	38.0	19.2	15.7
Monthly Housing Expense	39.9	48.6	58.4	46.4	21.8	20.2
Median Family Income	4,418	6,957	13,991e	216.7%	57.5%	101.1%
Income Taxes Withheld for a Family of Four, Total	420.12	821.02	2,661.16	533.4	95.4	224.1
Federal Income Tax	317.00	590.00	1,591.20	402.0	86.1	169.7
Social Security	84.00	174.00	818.40	874.3	107.1	370.3
State Income Tax	19.11	57.02	251.56	1,216.4	198.4	341.2
Total Disposable Income	3,997.89	6,135.99	11,329.84	183.4		84.7

e-estimate
Source: NAHB Economics Department, other sources available upon request

- *Federal taxes, up 365%
- *Social security, up 882%
- *State taxes, up 1,233%
- *Mortgage interest rates, up from 4.875% to 9%
- *Mortgage payments, up 331%
  - **Real estate taxes (341%)
  - **Hazard insurance (321%)
- *Maintenance and repairs, 269%
- *Heat and utilities, 199%–and most of this increase in the last two years
- *As a result, total monthly housing expense has increased 305%

Twenty years ago 67 cents of each dollar of monthly payment on the actual mortgage went to interest in the first year; in 1965, it had risen to 79 cents; and this year it was 92 cents. Putting it another way, in the first year the mortgage is held, today's family repays only 8 cents out of each dollar paid monthly to principal and interest, compared to 33 cents in 1955.

Annual housing expenses increased by 303.4% in the twenty year period–from $1,219.92 in 1955 to $4,934.76 in 1975. Annual housing expenses account for 43.4% of the annual disposable income in 1975, as compared to 31.1% in 1965 and 30.5% in 1955.

The changes in the last ten years are particularly disturbing. While the percentage increase in the income of a family of four qualifying for a median priced home is more than double the rate between 1955-65, the rate of increase in social security payments is three and one-half times higher for the 1965-75 period than in the previous period, and the rate of increase in total income taxes withheld more than tripled.

The rate of increase in total monthly mortgage payments in the 1965-75 period is more than two times that in the previous period, and the rate for total monthly housing expenses is over two and one-half times higher.

Based on median family income, disposable income for a family of four also increased in the last ten years–but the rate of increase was only about one-half the rate of increase in mortgage payments or total monthly housing expenses.

* * *

HOUSING STOCK 1973–FROM P. 1, COL. 2

The ratio of units lost to units added through new construction varies significantly by geographic area. The ratio was highest (39.55%) in the Northeast–not surprising since a larger number of older structures is located there. The North Central had a 31.92% ratio, followed by the South with 29.09%. The West's low (12.79%) ratio can be attributed to the fact that its real growth in population is a post World War II phenomenon.

Growth in the suburbs can be seen by comparing the ratio of units lost to units added inside and outside the central cities of Standard Metropolitan Statistical Areas. The ratio was 12.88% outside central cities, and 39.03% within central cities.

Rural areas also had a high (37.53%) share of replacements.

Home ownership continues to be the most desirable preference. Owner occupants accounted for 64.4% of total occupied units in 1973, compared to 62.9% in 1970 and 61.9% in 1960. In the first third of this decade, the rate of increase in owner occupied units was more than double that of rentals–to some extent because of increasingly popular condominium units in multifamily structures (see table 2, p. 4).

In the 1970-73 period, one unit attached structures (row and townhouses) reversed their 1960s decline in popularity, and increased at annual rates of 11.7% for owner occupied units and 18.9% for renter occupied units. Their share of total occupied stock was up from 3.0% in 1970 to 4.5% (see table 3, p. 4).

The mobile home share of the total housing stock has continued to grow: 1.45% in 1960, to 3.27% in 1970, and to 4.73% by 1973. The share of single family detached rental units was 10.1% of total stock in 1973, down from 12.2% in 1960 and 14.9% in 1950. This sector was the only one which declined in absolute numbers in the 1970-73 period, dropping from 7.7 million in 1970 to 6.9 million units.

Households also continued to become smaller in the early 1970s. The median number of persons in owner occupied units was 2.8 in 1973 compared to 3.0 persons in 1970, and 3.1 in 1960. In rental units, the median number of persons was 2.1 in 1973, compared to 2.3 persons in 1970, and 2.6 in 1960 (see table 4, p. 4).

To a great extent, single persons living alone led to this decline, accounting for 13.9 million households in October 1973, or a 20.1% share of total households. In 1960, 7.1 million households were headed by single persons living alone, a 13.3% share of the total. In the 13 year period 1960-73, single person households grew sharply for several reasons.

Real income gains, coupled with post World War II baby boom children now in prime household formation age groups, and an increasing number of elderly persons have all contributed to this growth. Single person households are increasing in both owner and rental sectors. They constituted a 13.9% share of total owner occupied units in 1973, compared to 11.9% in 1970, and 8.8% in 1960. The single person household share in share of total rental units was 31.3% in 1973, up from 20.7% in 1960, and 27.1% in 1970.

The median value of owner occupied units was $24,000 in October 1973, up $7,000 or 40.4%, from the $17,100 of April 1970. This change represents an average annual increase of 10.3%–nearly triple the 3.7% annual rate of increase in the 1960s, when the median value rose to $17,100 in 1970 from $11,900 in 1960 (see table 5, p. 4).

Median gross rent did not rise as fast as the median value of owner occupied units. Median gross rent had a 6.1% average annual increase in the 1970-73 period, compared to 4.3% in the 1960s, when gross rents rose faster than the value of homes.

In the first part of this decade, increases in value and rents exceeded the rate of increase in incomes of both owners and renters–reversing the 1960s trend when real incomes rose faster than housing costs (see table). Rates of increase in value and rent also exceeded the rate of increase in the consumer price index which averaged 5.5% for the April 1970 to October 1973 period. This CPI increase nearly doubled its 2.7% average annual increase in the 1960s.

Data from the 1974 annual housing survey, which should be released in the next few months, are expected to reinforce the trends in the first survey.

The two most significant trends probably will be that losses to the inventory have continued to decline, and that the differential between price and rent increases has widened.

[redacted]

HOUSEHOLDS OWNING SECOND HOMES IN THE UNITED STATES, 1970, 1973
(In Thousands of Units)

	1970	1973	Percent Change
Total Households	63,445	69,337	9.3%
Owned Second Homes	2,890	3,011	4.2%
Percent of Total	4.6	4.3	-

Source: Table 2, p. 4.

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Note: Variations in the number of housing units shown in table 1 reflect Census Bureau revisions of previous housing census tabulations. In the 1973 *Annual Housing Survey*, the 1970 revisions are shown only in the statistical table on changes in inventory. All other tables in the *Survey* contain 1970 data as published in the final reports on that housing census.

1. NET CHANGES IN HOUSING STOCK
(In Thousands of Units)

	1960	1970	1973	Average Annual Change 1950-60	1960-70	1970-73
All Housing Units Present Period	58,468	70,207	75,969			
All Housing Units Previous Period	46,137	58,325	70,138			
Increase						
Units	12,331	11,882	5,831	1,233	1,188	1,666
Percent	26.7	20.4	8.3	2.7	2.0	2.4
Units Added, Total	16,861	18,598	NA[1]	1,686	186	—
Conversions	807	615	NA[1]	81	62	—
New Construction	15,003	17,240	8,000	1,500	1,724	2,286
Other Sources	1,050	743	NA[1]	105	74	—
Units Lost, Total	4,530	6,716	2,169	453	672	620
Merger	815	572	NA[2]	81	57	—
Demolition	1,933	3,797	838[3]	193	380	239
Other Means	1,783	2,346	1,330	178	235	380

1. No count was made on units added through conversions and other sources.
2. No count was made on units lost through mergers.
3. This figure represents units lost through demolitions and disaster. In 1960 and 1970 units lost through disaster are included in the "other means" category.

Source: Bureau of the Census, U.S. Department of Commerce, (1) 1960 Census of Housing, United States and Regions, Components of Inventory Change, Part 1A; (2) 1970 Census of Housing, Components of Inventory Change, United States and Regions, HC(4)-1; Current Housing Reports, Annual Housing Survey: 1973, United States and Regions, General Housing Characteristics, Part A, series H-150-73A; data compilation and analysis by NAHB Economics Department.

2. CHARACTERISTICS OF HOUSING INVENTORY, 1960, 1970, 1973
(In Thousands of Units)

	1960	1970	1973	Percent Change 1960-70	1970-73	1960-73
All Housing Units	58,326	68,672	75,969	17.7%	10.6%	30.2%
Vacant—Seasonal and Migratory	1,742	973	676	-44.1	-30.5	-61.2
All Year-Round Units	56,584	67,699	75,293	19.6	11.2	33.1
Occupied Units	53,024	63,445	69,337	19.7	9.3	30.8
Owner Occupied	32,797	39,886	44,653	21.6	12.0	36.1
Percent of Total	61.9	62.9	64.4	—	—	—
Renter Occupied	20,227	23,560	24,684	16.5	4.8	22.0
Percent of Total	38.1	37.1	35.6	—	—	—
Vacant Year-Round Units	3,560	4,254	5,956	19.5	40.0	67.3
Percent of Total	6.3	6.3	7.9	—	—	—
For Sale Only	522	501	502	-4.0	0.2	-3.8
Homeowner Vacancy Rate	1.6	1.2	1.1	—	—	—
For Rent	1,453	1,666	1,545	14.7	-7.3	6.3
Rental Vacancy Rate	6.7	6.6	5.8	—	—	—
Rented or Sold, Not Occupied	235	345	737	46.8	113.6	213.6
Held for Occasional Use	282	998	1,280	253.9	28.3	353.9
Other Vacant	1,068	744	1,893	-30.3	154.4	77.2

Source: Bureau of the Census, U.S. Department of Commerce, (1) 1960 Census of Housing, States and Small Areas, United States Summary, Volume I, Part 1; (2) 1970 Census of Housing, Metropolitan Housing Characteristics, United States and Regions, HC(2)-1; (3) Current Housing Reports, Annual Housing Survey: 1973, United States and Regions, General Housing Characteristics, Part A, series H-150-73A; data compilation and analysis by NAHB Economics Department.

3. CHARACTERISTICS OF OCCUPIED HOUSING UNITS, 1960, 1970, 1973
(In Thousands of Units)

	1960	1970	1973	Percent Change 1960-70	1970-73	1960-73
Units in Structure						
Owner Occupied	32,797	39,886	44,653	21.6%	12.0%	36.1%
Detached	28,436	34,397	37,516	21.0	9.1	31.9
Attached	1,526	1,113	1,637	-27.1	47.1	7.3
2 to 4	1,899	2,161	2,145	13.8	-0.7	13.0
5 or More	258	464	555	79.8	19.6	115.1
Mobile Home, Trailer	677	1,752	2,800	158.8	59.8	313.6
Renter Occupied	20,227	23,560	24,684	16.5	4.8	22.0
Detached	7,891	7,736	6,973	-2.0	-9.9	-11.6
Attached	1,860	794	1,456	-57.3	83.4	-21.7
2 to 4	5,027	6,218	6,591	23.7	6.0	31.1
5 or More	5,359	8,491	9,186	58.4	8.2	71.4
Mobile Home, Trailer	90	321	478	256.7	48.9	431.0

Source: See Table 2.

4. HOUSEHOLD COMPOSITION OF HOUSING UNITS, 1960, 1970, 1973
(In Thousands of Units)

	1960	1970	1973	Percent Change 1960-70	1970-73	1960-73
Total Occupied Units	53,024	63,445	69,337	19.7%	9.3%	30.8%
Two or More Person Households	45,949	52,294	55,428	13.8	6.0	20.6
Percent of Total	86.7	82.4	79.9	—	—	—
One Person Households	7,075	11,151	13,909	57.6	24.7	96.6
Percent of Total	13.3	17.6	20.1	—	—	—
Owner Occupied	32,797	39,886	44,653	21.6	12.0	36.1
Two or More Person Households	29,911	35,124	38,460	17.4	9.5	28.6
Percent of Total	91.2	88.1	86.1	—	—	—
One Person Households	2,886	4,763	6,193	65.0	30.0	114.6
Percent of Total	8.8	11.9	13.9	—	—	—
Renter Occupied	20,227	23,560	24,684	16.5	4.8	22.0
Two or More Person Households	16,038	17,170	16,968	7.1	-1.2	5.8
Percent of Total	79.3	72.9	68.7	—	—	—
One Person Households	4,189	6,388	7,716	52.5	20.8	84.2
Percent of Total	20.7	27.1	31.3	—	—	—

Source: See Table 2.

5. MEDIAN HOUSEHOLD INCOME, MEDIAN VALUE OF UNIT, AND MEDIAN GROSS RENT 1960, 1970, 1973
(In Thousands of Units)

	1960	1970	1973	Total Percent Change 1960-70	1970-73	Average Annual Percent Change 1960-70	1970-73*
Owner Occupied							
Median Value	$11,900	$17,100	$24,100	43.7%	40.9%	3.69%	10.30%
Median Income	5,900	10,400	11,500	76.3	10.6	5.83	2.91
Renter Occupied							
Median Gross Rent	$ 71	$ 108	$ 133	52.1%	23.1%	4.29%	6.12%
Median Income	4,100	6,400	7,200	56.1	12.5	4.55	3.42

*1970-73 Average Annual Percent Changes are based on data from April 1, 1970 and October, 1973.

Source: See Table 2.

Senator BENTSEN. Mr. Norman, we have with us this morning a Senator on this committee who has shared with me a great concern about capital formation for small business, for housing, and I defer ~~to him~~ now for such questions as he might have.

Senator BROCK. I thank you.

Mr. Norman, I have been interested in housing, as you know, for a long time. I served on the House Banking Committee for 8 years. I was on the Senate Banking Committee for four. And I must admit to an enormous amount of frustration. We have tried almost everything we know how to try to be helpful, and we have failed. We have not done an adequate job of developing housing for the average family in this country.

I recognize and accept your statement that interest costs are a major if not the most important factor in housing, but there are other factors; the cost of housing has gone up, new housing, at an incredible rate, and if you take aftertax net income, it is true that personal income has not risen at the same rate as housing costs and that means that, relatively speaking, the gap is widening, that less people are able to afford a home. An ever-increasing segment of our population, to wit, a good percent of our middle-income and all of our low-income people are unable to afford decent shelter, and that is a tragedy. You have got to compound that with land prices which perhaps have gone up even faster than anything else, particularly in areas such as your own.

I wish I had a good answer. I do think that one of the greatest failings of this Government of ours has been in the area of the existing housing starts. Just to draw an analogy, we are seriously considering changing the tax structure relating to the recycling of paper products.

Why? Because under the existing tax law, it is not profitable to recycle. It is more profitable to use existing raw timber, the forests. We have a finite limit to that, and it is not going to be too long before this country is very short of paper products, wood products, and that is causing problems for housing, too, as you well know.

But if we would recycle 35 percent instead of 20 percent of our paper products, we could take the pressure off of wood products which in turn hopefully would be of assistance to the building materials industry, and you can't recycle timber in a house. You can recycle a newspaper.

Mr. NORMAN. I might just interject that most building codes, and in particular the Federal Housing Administration minimum property standards, won't let us use used lumber.

Senator BROCK. That is right. And it is also interesting, as you probably are aware, the property standards published by HUD do not include any solar devices either, so we are making it more difficult for any innovation here, and I hope we will have some changes in that particular policy.

I think you know I have had an interest, as Senator Bentsen has, in motivating additional capital formation. This bill reflects one effort to do that. There are others. I don't know really which is the best. The appeal of Senator Bentsen's bill is that it does carry with it an educational impact as well as on housing, savings, and capital formation. But my question to you really is whether or not you think that relieving the earnings on $250 per year is adequate. I know Senator

Bentsen is a realist, and we are not going to get much more than that to start with, but let us just talk about what we would like to have rather than what is possible at the moment.

If you really want to enhance capital formation, why shouldn't we give people who place their savings in a financial institution the same opportunity that we give to holders of stock? There is a $100 dividend exclusion. What about a $100 interest exclusion for savings in fiduciary institutions, long-term savings?

Wouldn't that be equitable? Wouldn't it treat both parties the same way, and wouldn't it afford a really significant increase in the deposit accounts?

Mr. NORMAN. Well, the answer obviously is yes, that it would, and certainly we would encourage it. You will recall in the last session of Congress there were several proposals moving through the various committees which I thought would be the greatest incentive for saving. And that was the first $750 or the $1,000 of interest earned on savings accounts would be tax exempt or work out some tax credit formula on that. I personally would like to see a tax credit provision. Lower income families get a little better benefit than high-income families do with the tax credit. So that is our position.

As far as this particular bill, S. 666, is concerned, it is a step in the right direction, and we, too, think we are pragmatic about what possibly can be accomplished. It is moving in the right direction, and I don't think anybody would be kidding themselves if they understood this as not being the answer, the final answer, to the housing capital needs of the country.

Senator BROCK. Well, we are not going to come up with one final answer.

Mr. NORMAN. I know. It is going to take many.

Senator BROCK. I don't think any of us are.

Mr. NORMAN. Right.

Senator BENTSEN. I might say, Senator Brock, that Treasury estimates of that, estimates that as many as 15 million families would take advantage of this, and it would provide for the education of as many as 33 million children and as much as $9 billion in savings a year if those estimates are valid. And I quite agree with you, Senator Brock, that I would like to see it more, but frankly, I think that this is as much at this stage as we could probably get.

Senator BROCK. We have both been on the committee long enough to know that there are differences between what we can do and what we would like to do.

Mr. COAN. Senator, can I bring out one comment? Mr. Norman and I discussed last night as we were reviewing his testimony something that concerns me.

I have two children in college, one more going next year, and I said the bill wouldn't help me. Yet that is where all my savings are going now, to meet that tuition bill that comes up every quarter or every semester.

I just throw that out as something at present that struck me as an individual who would personally like to see something enacted, and who has two other children, headed for college later.

Senator BROCK. I don't think this bill reflects a response to that but you know we have been trying at least for 10 years in the Congress, some of us, at least, to provide a tax credit for the education of children, period. We had a proposal that failed by one vote in the Senate to give up to a $375 tax credit. That is quite different from the tax deduction. That is equivalent to a rather sizable deduction for education. And our problem again is one of revenues. You know, we always keep coming back to the bottom line and that is our difficulty.

Back to the question of interest rates, Mr. Norman. I think you would have to accept the fact that when we have a $70 or $80 billion deficit it has an adverse effect on interest rates.

Mr. NORMAN. Yes. We understand that.

Senator BROCK. Perhaps you could show us where we could make some cuts and resolve that problem. I have been unsuccessful in my endeavors.

Mr. NORMAN. Well, I am a builder and I am also an attorney and I am also an engineer, but one thing I am not is an economist. So I really—while I have some strong viewpoints on that, I am afraid it might take the rest of the day to explain them.

Senator BROCK. I obviously don't want to put you into a box.

Mr. NORMAN. I know.

Senator BROCK. You know my prejudices. I will assume yours.

Mr. NORMAN. Right.

Senator BROCK. The fact is that when we are trying to refinance the magnitude of debt we have in Washington at this particular point in time, short-term interest rates are going to go up if the economy is in other than totally desperate circumstances because we are competing for the same dollars that you are.

Mr. NORMAN. I understand, Senator Brock, and we are going to pay. As Bill Simon says, you know, the Treasury goes to the front of the line when we borrow money. And that is exactly what is happening. I am afraid that we are going to put housing back into the box next year.

Senator BENTSEN. If you will excuse me, that means that that legislation is coming up and I have to go. If you will preside, Senator Brock.

Mr. NORMAN. Thank you, Senator.

Without getting too far out into the blue sky, we recognize the deficit proposition. We obviously recognize the Federal Government has to finance its debt and all of that. But if housing can get moving again, it can help cut that deficit.

Senator BROCK [presiding]. That is right.

Mr. NORMAN. That has been our contention for more than 2 years that we have been in the recession that the housing industry has been in. There is nothing any more inflationary than 500,000 unemployed construction workers. That is construction workers. You go out to the building materials manufacturing plants—well, you just pull out any of them you want to and you talk to them about what their unemployment record is in their plant and it has that whole rippling effect through the economy.

Our contention is get housing moving, and how do you do it? We want housing to be built and financed through the private sector as much as we can and the only way that that can be done is for the Government not to put obstacles in front of the private sector, but rather provide incentives for the private sector so as to accomplish that goal of getting housing moving. And this bill is one of the incentives that you are placing in front of the private sector, for savings, to encourage that capital formation. We applaud the effort and we know it is not the final answer. You do. Everybody does. But it is moving in the right direction and this is the type of policy that the Government has to follow.

I have very little patience with the Treasury's position, that, well, it is a tax credit and therefore it is going to cost so much money. When you total up the final line as was observed just a moment ago, the cost of unemployment, the cost of unused plant capacity in this country, the loss of resources, you know, it is just staggering.

In my opinion and in the opinion of our economists they more than offset one another. Whatever incentives you place in front of housing.

Senator BROCK. You don't have your own savings and loan but you have to deal with those people and know how they operate. It is your impression—I sort of gathered from something you said in your statement—I don't remember where it was but something that indicated part of the problem is that when the markets are as fluid as they are and as variable as they are, that the instability itself creates a disincentive to make loans. That is a fair statement.

Mr. NORMAN. Yes.

Senator BROCK. I think that is almost a market assumption that you make.

If we were allowed to have some form of variable rate mortgages, would that be helpful?

Mr. NORMAN. The variable rate mortgage obviously is a very controversial subject and whether you are for or against it separates you into the class of lender or borrower. In general the borrower is not much in favor of the variable rate. In general the lenders are.

Every study that we have seen on the subject of variable rate mortgage, and I guess we have seen at least a dozen of them and we have read much on it, indicates that the variable rate mortgage is really to the advantage of the lender, the thrift institution. It increases their yield, period.

One of the propositions often made by the thrift institutions is that with the variable rate mortgage we would be able to have more funds for lending to housing because we would be able to pay the saver a higher dividend, you know, on their savings. But no study that I have seen ever ties that back and says, well, if the mortgage interest rates go up to a certain level, then the dividend that will be paid to the saver will also go up. They don't tie that to a little index.

Now, if that could be accomplished, you would do two things there. You would increase the yield in general to the thrift institution. At the same time you would increase the yield to the saver, another incentive for saving, you see. But unfortunately none of the studies have really recommended establishing an indicator on the dividend to be paid the saver. They have been worried about what interest rate was going to be paid, the interest rate on the mortgage.

Senator BROCK. Well, I think the premise was that there are literally billions of dollars in pension trusts, and so forth, that are not available to housing because it is not a good investment. If you start off lending at 6 percent and your rate goes to 12, you have made a poor choice. It is a good buy for the borrower. But it is not a good buy for the lender.

Mr. NORMAN. Well, I am not a trust fund manager but I do know something about residential mortgages. I do know something about the yield on mortgages. And I would challenge any trust fund—any pension trust fund manager in the country to match his record in equities, in stocks and bonds over, say, a 10-year period with mortgages, the return he could have made if it had been invested in long-term mortgages. His record blows him out of the water every time. Even the thrift institutions, you know, which are in mortgages have a better record than the pension funds do. And the pension funds, bringing them up, you know, they have done nothing, done nothing, in residential mortgages, you know. They have invested only something on the order of 2 or 3 percent of their assets in residential mortages.

Senator BROCK. But the question is why? If there were all that return there, why don't they put their money into it? They haven't. They won't. And the answer is from them, at least, whether it is valid or not, that they would not accept your statement. They do not agree that they can get an adequate return, that they are disadvantaged in a loan circumstance when inflation is taking 10, 12 percent of their value every year.

Mr. NORMAN. I understand that, but I would also suggest that the pension fund managers are commercial bankers, not mortgage bankers, and in all due respect to them, commercial bankers just don't know too much about mortgages.

Now, we have heard that they——

Senator BROCK. They know a lot about money.

Mr. NORMAN. Oh, they know about money. Short-term money. But the point is we have heard the objections, well, they don't like the servicing that is involved in it, and a few other things like that, so we have assisted and the Congress has permitted and many organizations have put together things such as GNMA. FNMA is trying to develop something along this line. The thrift institutions are doing the same thing, for instance, the $50 million issue just sold in California this past week. These are all things that are available to the pension funds and the life insurance companies. By clipping the coupons, so to speak, they don't have to worry about the servicing. Usually they have more security than what their investments provide.

And so we are trying to—the industry is trying to overcome the so-called objections that some of the pension funds have.

Senator BROCK. But you are dealing with the peripheral objections. You know, servicing is really not a major objection. I don't think that is a valid argument on their part. I don't believe you do either. That is a little problem that if they really wanted to get into it, they could get into it.

Mr. NORMAN. I am trying to answer their objections.

Mr. COAN. Senator, I don't have the full figures with me but I do know it is a fact and I can supply the figures to the committee for the record, that the assets of private pension funds declined substantially from 1972 to 1973 to 1974, the total value of their assets.

Senator BROCK. Sure they did.

Mr. COAN. At the same time while they were taking funds in. Now, it is our feeling that, if they had been invested in mortgages, this asset decline would not have occurred. In effect, there would have been a substantial growth in the assets of the pension funds. As I say, I was looking through this file which I have on another matter and all I have is 1 year's figures, but we can supply them for the record if you desire.

Set out below is a copy of a statement submitted in May 1975 to the House Subcommittee on Labor Standards detailing the investment patterns of pension fund assets for the years 1969 through 1974. It illustrates the point that the heavy investment by pension funds in corporate equities has resulted in recent years in an actual decline in the total value of their assets.

[The following material was submitted by Mr. Coan:]

STATEMENT ON THE INVESTMENT OF PENSION FUNDS IN RESIDENTIAL REAL ESTATE MORTGAGES

During the last ten years the assets of this nation's pension funds have more than doubled and are now at a level almost equal to the total assets of the savings and loans. Pension funds for the small saver have to a great extent replaced the traditional savings account which the smaller saver used for retirement and protection in his later years. Thus, thrift institutions, who by law and custom have put the great bulk of their funds into residential mortgages are no longer receiving the same proportion of the savings of the people who at the same time look to these institutions for a mortgage loan when they buy a home.

Pension funds, however, since the early '60s have taken an investment course away from residential mortgages and into corporate equities. It is the opinion of NAHB that the very heavy investment of pension fund assets in corporate securities is not in the best interests of the beneficiaries of the pension funds, nor does it serve the social purposes for which the pension funds were created. Evidence of this is borne out each time Wall Street takes a turn for the worse and the stock market falls. Neither corporate equities nor corporate bonds provide the protection of principle that residential mortgages provide. However, the investment of pension fund assets into these corporate issues continues to increase.

Attached are three tables detailing the investment patterns of pension fund assets for the years 1969 through 1974. The tables detail in both amount and percentages the distribution of pension fund investment for private non-insured pension funds, state and local government employee funds and a total of the private and government employee funds. You will note the drastic reduction in mortgage investment by the private pension funds from 4.12% in 1969 to 2.03% in 1974. Equally significant is the reduction of state and local government employee fund mortgage investment from 11.55% to 7.55% for the same period while the increase in total assets was over 80%. The investment of these funds in corporate shares is almost four times the 1969 level.

It is the belief of NAHB that the reduction in private pension fund assets during the past two years is a direct result of the losses these funds have suffered in the equity market.

A number of residential mortgage investments yielding higher overall returns than corporate equities are and have been available for pension fund investment.

Examples are the Government National Mortgage Association's Mortgage-Backed Pass Through Securities and the Federal Home Loan Mortgage Corporation's Guaranteed Mortgage Certificates. These instruments are guaranteed to return both principle and interest, are freely traded in the open market and represent funds for housing in America.

NAHB believes the pension funds, which enjoy a very favorable tax position should own up to their social responsibilities to both the pension fund beneficiary by protecting his assets, and to the nation as a whole as a repository of the people's savings. It is for these reasons that we have urged that pension funds be required to invest a percentage of their assets in residential mortgages. One way this can be accomplished is by conditioning their continued eligibility for favored Federal tax treatment on such investment.

ASSETS OF PRIVATE NONINSURED PENSION FUNDS, 1969–74[1]

Year	Total assets	Demand deposits and currency	Corporate shares	U.S. Government securities	Corporate bonds	Residential mortgages	Miscellaneous assets
Millions of dollars:							
1969	102,360	1,620	61,400	2,790	27,610	4,220	4,720
1970	110,630	1,800	67,100	3,030	29,670	4,170	4,860
1971	130,470	1,640	88,600	2,730	29,010	3,660	4,830
1972	156,770	1,860	115,300	3,690	28,210	2,730	4,980
1973	135,190	2,340	90,500	4,400	30,330	2,380	5,240
1974	116,620	4,290	63,300	5,530	35,030	2,370	6,100
Percent distribution:							
1969	100	1.58	59.98	2.73	26.97	4.12	4.61
1970	100	1.63	60.65	2.74	26.82	3.77	4.39
1971	100	1.26	67.91	2.09	22.23	2.81	3.70
1972	100	1.19	73.55	2.35	17.99	1.74	3.18
1973	100	1.73	66.94	3.25	22.44	1.76	3.88
1974	100	3.68	54.28	4.74	30.04	2.03	5.23

[1] Corporate shares reflect market value, all other categories reflect book value.

Source: Securities and Exchange Commission, "Statistical Bulletin," April 1975; data compilation and analysis by NAHB Economics Department.

ASSETS OF STATE AND LOCAL GOVERNMENT EMPLOYEE RETIREMENT FUNDS, 1969–74[1]

Year	Total assets	Demand deposits and currency	Corporate shares	U.S. Government securities	Corporate bonds	Residential mortgages	Miscellaneous assets
Millions of dollars:							
1969	51,824	479	5,877	7,003	30,150	5,984	2,331
1970	58,089	601	8,014	6,698	33,935	6,809	2,032
1971	64,374	700	11,199	5,143	38,120	7,085	2,127
1972	72,232	799	14,661	4,530	43,445	6,764	2,033
1973	81,647	967	18,583	4,643	49,381	6,658	1,415
1974[2]	93,900	900	22,100	5,200	57,800	7,000	900
Percent distribution:							
1969	100	.92	11.34	13.51	58.18	11.55	4.50
1970	100	1.03	13.80	11.53	58.42	11.72	3.50
1971	100	1.09	17.40	7.99	59.22	11.00	3.30
1972	100	1.11	20.30	6.27	60.15	9.36	2.81
1973	100	1.18	22.76	5.69	60.48	8.15	1.73
1974	100	.96	23.54	5.45	61.55	7.45	.96

[1] Corporate Shares reflect market value, all other categories reflect book value.
[2] Preliminary.

Source: Federal Reserve Board (1) "Flow of Funds Accounts 1965–73," September 1974, p. 35, (2) unpublished data or 1974; data compilation and analysis by NAHB Economics Department.

TOTAL ASSETS OF PRIVATE NONINSURED PENSION FUNDS AND STATE AND LOCAL GOVERNMENT EMPLOYEE RETIREMENT FUNDS, 1969–74[1]

Year	Total assets	Demand deposits and currency	Corporate shares	U.S. Government securities	Corporate bonds	Residential mortgages	Miscellaneous assets
Millions of dollars:							
1969	154,184	2,099	67,277	9,793	57,760	10,204	7,051
1970	168,719	2,401	75,114	9,728	63,605	10,979	6,892
1971	194,844	2,340	99,799	7,873	67,130	10,745	6,957
1972	229,002	2,659	129,961	8,220	71,655	9,494	7,013
1973	216,837	3,307	109,083	9,043	79,711	9,038	6,655
1974p[2]	210,520	5,190	85,400	10,730	92,830	9,370	7,000
Percent distribution:							
1969	100	1.36	43.63	6.35	37.46	6.62	4.57
1970	100	1.42	44.52	5.77	37.70	6.51	4.08
1971	100	1.20	51.22	4.04	34.45	5.51	3.57
1972	100	1.16	56.75	3.59	31.29	4.15	3.06
1973	100	1.52	50.31	4.17	36.76	4.17	3.07
1974	100	2.46	40.57	5.10	44.10	4.45	3.32

[1] Corporate Shares reflect market value, all other categories reflect book value.
[2] Preliminary.

Source: Federal Reserve Board (1) "Flow of Funds Accounts, 1965–73," September 1974, p. 35, (2) unpublished data for 1974; Securities and Exchange Commission, Statistical Bulletin, April 1975; data compilation and analysis by NAHD Economics Department.

Mr. NORMAN. Might I add one thing, Senator. I have made a number of statements that seem to cast me in the position of being negative as far as the pension funds are concerned and on the yield question. As far back as 1969, we, our association, developed a program, studies, et cetera, to try and attempt to sell mortgage-backed securities and the like, to pension funds. We weren't very successful. But just this year we have renewed this effort with new ideas and the like. Before the year is out we expect to have a very effective presentation put together to again appeal to the pension fund managers on the very issues you are talking about—yield. When I speak about the yield on mortgages, mortgage investment yields have been better than equities, particularly over the past 10 years, I say that with some authority. Here is my authority, Dr. Sumichrast, our chief economist. And there are other sources, because we believe that the actual facts will demonstrate that the statements that I have alluded to are true.

I would also like to advise the subcommittee that we are not content with just sitting around and wringing our hands and talking to the Congress and, you know, appealing to the Government. On July 9 I called for a meeting of the private sector that does the financing of housing. The American Bankers Association were represented. The two savings and loan groups, the mutual savings banks, the realtors and the builders. And we—and the mortgage bankers. We also included the AFL-CIO, top people in each of those organizations.

One simple premise. The average American family cannot acquire a decent home today. They represent the private sector. It seems reasonable that if we wanted to preserve the private delivery system of housing that we have in this country, it is incumbant upon us to come forward with a financing system that will permit at least a majority of the American families to acquire a home of their own through the private sector.

July 9 I think was a very historic day. And so we laid that objective in front of those institutions, those associations, and said—and they agreed to accept that challenge—and we said, we don't have time to go out and hire 50 consultants to go through the studies. You have been telling us—I am talking to the associations now—that you have great staffs, that you have the real pros, guys like Dr. Sumichrast. You come up with a system. And so the chief executive officers of those associations have agreed to meet as a task force and to meet at least monthly until they have solved this problem, come up with a system. And I am hoping that by January they will have a system developed that we can lay before the American people.

It is the first time that all of these diverse elements, lenders and borrowers, conflicting interests, management and labor, have gotten together and tried to accept this type of challenge and are trying to solve the problem themselves, and I am very pleased to report this to you. I am looking forward to great things in that regard.

Senator BROCK. Well, I wish I had been a fly on the wall because I would like to hear the comments of those people. I have talked to most of them individually and there is not one of them that doesn't share my conviction, and I know yours, that that is one of the most important objectives we have as a nation, to provide adequate shelter to the people of this country. We are not doing anything like an adequate job today and whether it is the fault of the Federal Government or any other particular institutional group, I am not prepared to say. I just know that we have failed and it is time to get off this dead end track and start doing something more constructive. There is nothing more important to our free society than the feeling of participation that comes from homeownership. It is important psychologically, it is important socially, it is important economically. Every advantage lies at this door and we are not taking the opportunity and running with it.

So I would like to be of help. I do think that one of the fundamental answers we have to arrive at as a society is how to encourage greater savings. We are not doing anything like a good job in that particular area and until we do, housing will not be able to compete with the more exotic areas of opportunities for investment.

Mr. NORMAN. Might I address that issue? I have heard that statement, you know, that housing just cannot compete with more exotic investments, and all of that, and I will say under the present rules that is true.

Senator BROCK. That is what I am talking about.

Mr. NORMAN. Under the present rules that is true.

Senator BROCK. But our rules are set in a way so as to disadvantage housing and that is the point I am getting at.

Mr. NORMAN. And we want to change those rules.

Senator BROCK. All right. I will help.

You wanted to say something?

Dr. SUMICHRAST. Yes. I would like to comment on Senator Bentsen's bill, if I may. Essentially we have two types of savings. One is the voluntary savings and the others are forced savings. The voluntary savings are typically associated with time deposits. They trickle into the savings institutions, commercial banks, and the like. The others are in a very broad category, the pension funds and retirement funds, and the like, life insurance companies.

A look over the history of these funds presents a fairly dismal picture in terms of their investment of assets into mortgages. I could never understand the policy of pension funds in the United States, because when you look over other countries in the world, you see the picture as being entirely different. The contribution of the forced savings segment of the economy, as a general rule in the Western democracies, has been much higher into housing investments. In the order of 40 to 60 percent of the assets are directly or indirectly invested in mortgages. We have only about 4 percent. A fundamental problem, a difference between some of the European countries and the United States, has been that the pension fund philosophy is different. In these countries the pension fund money is looked upon as the worker's money and as such provides a high visibility by being put into housing. It is a community, a factory, which provides housing for its own people or for its own community. It is not the money which goes from Detroit to New York. It is the money which stays pretty much in a community and it is a social goal as well as an economic goal.

We have not done that in the United States. We have no such goal or such understanding of the function of pension funds and as a result, as Mr. Norman said, the book value really dropped very sharply because their total investment is 80 to 85 percent in the securities market rather than in housing.

Now, we have done some—we have made some progress and, as Mr. Norman suggested, this has been directly traceable to GNMA mortgage-backed securities. This is a very exciting tool when you look over the numbers. I don't know whether you are familiar with them, but they are really encouraging. When you take out the drudgery of the servicing and you take the small denomination out of the picture, a pension fund will put money into mortgages. As of July 31, 1971, out of $70.9 billion in GNMA mortgage-backed securities, the pension funds and retirement funds directly or indirectly do have close to 20 percent of the total $70.9 billion.

So we have done something, but obviously this is not enough. What we really need is a moderate shift of the assets of the pension funds and retirement funds into mortgages. This would be very helpful in assuming a stable supply of mortgage funds.

We are not really talking, Senator, about large changes in the total portfolio. We are talking about moderate changes in portfolio which would be terribly helpful to us.

Senator BROCK. Well, we have some other witnesses who have to go on. May I ask, Mr. Norman, if you will submit for the record the report you mentioned earlier. And I think you mentioned one as well that was different.

Mr. COAN. Yes.

Senator BROCK. If you will just submit those, we would like to have them as part of the record.[1]

Mr. NORMAN. Thank you very much. They will be submitted.

Senator BROCK. Thank you so much.

Professor Schotland is next.

STATEMENT OF PROF. ROY A. SCHOTLAND, PROFESSOR OF LAW, GEORGETOWN UNIVERSITY, WASHINGTON, D.C.

Mr. SCHOTLAND. Thank you, Senator. I am sorry I was not able to be here to hear all of Mr. Norman's testimony but I was late for a purpose I believe he'd applaud. I was closing on the purchase of a house. In light of that he may forgive some of the disagreements with his statement that I will express.

Senator BROCK. I thought there might be some. I appreciate your being here today. We have met before and I have great respect for you and look forward to your testimony.

Mr. SCHOTLAND. You are very kind, Senator.

I have to perhaps in disagreeing with him wrap myself in the points you were making. It is quite astonishing that all of the institutional investment managers, and we are really talking about virtually all, would overlook what are alleged to be the facts which differentiate mortgage investment from equity and other forms of investment. I just can't accept the facts and I certainly can't accept statements like "look at 10 years." It depends on which 10 years. If you look at anything up to December 1974 you have one picture. If you look at up to June 1975 you have like a 30-percent rise in a great many of the equity oriented vehicles.

[1] The material referred to appears on pp. 10 and 19.

I am not saying that we don't have unfortunate fads, foolishness and other things among institutional investment managers, but if they had been buying mortgages in the days when rates were much lower than recently, I hate to think what those portfolios would be like now.

Senator BROCK. They wouldn't have much of a portfolio.

Mr. SCHOTLAND. I am afraid not. Indeed we had experience back in the 1950's before the bank trust departments became as truly admirable as they have been in the last decade or so, when they just sat on long-term bond investments and the yields and the values just went to pot.

I think much of our problem in the housing sector has been that the basic financing institutions, the S. & L.'s, are invented by somebody from Mars, with short-term liabilities and long-term assets and it just can't fly. You are bound to have disintermediation.

I think what the Senate Banking Committee did yesterday, as I understand it, is a splendid step in the direction of rationalizing along many of the lines of the Hunt Commission's, the administration's, the financial institutions bill recommendations.

Senator BROCK. I am not familiar with that.

Mr. SCHOTLAND. They are proposing to broaden the powers of the S. & L.'s so as to write checks and credit cards, et cetera. I think these kinds of steps are necessary to make the basic financing institutions able to have more stability, for one thing.

For another thing, housing is a highly leveraged operation. If you are highly leveraged, there are times when you are going to go down and there are times that you will make high profits. You can't get the reward without the risk.

Senator, I will only excerpt from portions of my statement. And submit the full statement for the record.

People save for only a few reasons. Home purchase is one, which we encourage as I believe certainly we should, particularly this morning, with favorable tax treatment. Retirement is another, which we also encourage with favorable tax treatment. Only the fortunate are able to save much for passing on to the next generation, but all except the very rich and the unfortunately poor save for their children's education. The rise in education costs is rivaled only by hospital costs—and I guess I should insert oil. At the same time, lower middle income and middle income groups are being squeezed by "slumpflation," are the major source of the consumers of higher education, but are expected to pay their own way with no aid to bridge over this worsening problem.

Senator, I would like to tell a startling tale. I have been asked not to name the firms.

In 1972 an imaginative effort to encourage parents to save for postsecondary education was undertaken by a major regional bank in the Northeast, a major insurance company and a multinational nonfinancial company with diverse holdings. The effort was serious enough to have startup costs of several hundred thousand dollars and a marketing test involving 300,000 potential customers.

The essence of the idea was that parents who will not be able to save enough to cover the cost of postsecondary education would have to undertake some borrowing when those costs arise. If instead of borrowing, say, $4,000 when my daughter is starting postsecondary studies, the parents would borrow several years earlier, they would be able to borrow less—some $2,800 total instead of about $4,000—then put the borrowed sum into a savings account, and in short reduce the total cost of the borrowing.

In spite of the impressive names of the joint venturers, their unquestionable skills and unusual access to the relevant families, the plan was a complete flop. Subsequent nationwide tests, to find out what caused the widespread uninterest—this is 3 years ago—showed clearly that the reduction in total costs offered by the plan was too little to induce increased savings for postsecondary burdens—a larger incentive, somehow, had to be found. The three firms involved, I am assured, have not given up their hope or their joint venture agreements, expecting that such an incentive will emerge, and I believe you have before you this morning the kind of incentive that is needed.

New personal savings in the past few years seemingly held up quite well. That is consistent with the historical pattern of increased savings when economic instability seems ominous. There are several reasons to draw little solace from such data. First of all, the data include not only true personal savings, but nonprofit organizations. Thus if, for example, a major corporation gave a large gift to a nonprofit organization, that would show up in the relevant data as an increase in what is called personal savings.

Second, even if truly personal new saving has held up, this is out of fear of future economic problems rather than a shift in habit pattern; again, so the historical record suggests. For most people, saving must be getting far tougher in the past 2 years at the very least. Disposable real income is down, from 1973 to June 1975, by about 6 percent on a per capita basis, even more on a per household basis.

Since the costs of shelter, transportation, food and medical care have seen particularly sharp rises, the decline in discretionary income—what is left after savings—which is the source most people would draw upon for increased saving—must be horrendous.

Third, even if what data we have show new "personal" saving holding up, it is clear that "personal" liquidity has been declining. According to a recent Solomon Brothers study (Financial Well-Being: The Slow Road Back, September 3, 1975), per capita household financial assets, adjusted for inflation, were down, as of June 1975, 26 percent below their 1968 high. This somber erosion has received almost no notice, whereas a fair bit of attention has been directed to a reduction in consumer debt, although that reduction has been minuscule, and, again, I suspect, out of fear.

In short, personal savings are in trouble. As of this past June, per capita household financial assets had slid back to the level of 11 years ago, 1964. Since education costs have done quite some moving since 11 years ago, how do we expect people to meet these costs?

Are we really satisfied to load students with work for survival, or to load young people with debt, or to force parents to expand their own mortgage or other debt—or else, to see shrinkage in the opportunity for higher education?

Senator, I will go right down to page 14, since Senator Bentsen and Senator Brock are among the leaders in the efforts to both draw recognition to and secure action about the capital shortage. And I do not think I should burden you with reciting this, but with your permission, if I may include the entire statement in the hearing record——

Senator BROCK. It will be included.

Mr. SCHOTLAND. All the administration and business fanfare recently for further tax breaks for large corporations cannot override the enormous role of personal savings.

In 1947, business saving was over 70 percent of total private saving, about three times as large as personal savings. Last year business saving was less than two times as large as personal savings.

I do not mean to say we should not encourage further business saving. I do mean to say that, especially in light of the erosion since 1973, we must act to assure at least continued vitality of personal saving.

I see no need to reiterate Senator Bentsen's excellent reasons supporting S. 666, which he first put forward in the last Congress. I am delighted to see such numerous and leading Senators now cosponsors. I hope the list will expand, and I much hope that today' shearing is only the beginning and tip of the iceberg of support that will build for this bill.

I hope Senator Bentsen and persons who share my support for this bill will not object to my view that the bill is too modest. I strenuously urge two expansions of the bill, and one restriction.

First, I believe the dollar amounts, as I believe Senator Brock was himself addressing earlier, are too low to stimulate a significant contribution toward the total dimension of savings which, I hope I have persuasively shown, is essential for family financial soundness and for our overall economic growth. Of course, the argument against higher dollar amounts is revenue loss, but I submit that argument is both shortsighted and unfair. It is shortsighted because increased savings are a direct contribution to sound and permanent improvement of our economy's level and stability with enormous benefit to fiscal policy. It is unfair because the revenue lost through the full $15,000 Keogh plan yearly shelter for even high-income lawyers and others, or the revenue lost through the lack of a limit on deduction for so-called business-related wining and dining, or the revenue that would be lost from proposals liberalizing capital gains but preserving as a "sacred cow" the stepped-up basis of capital assets dwarf the loss, if there really would be one, in expansion of the S. 666 plan.

The second expansion I urge is that when the dollar amounts are raised, the limitation on forms of investment should be less restrictive. However, I entirely share the concept of the bill, that this is an admirable vehicle for aiding sectors which are critically short of investment. My own view would be to allocate Bentsen plan funds not only to housing, but rather in perhaps three ways: for example, 25 percent to housing mortgage investment; 25 percent to small- and medium-sized business investment, both as equity and debt; and the balance free to move pursuant to responsible investment judgment. I believe such diversification is sounder economically as well as in other ways. May I also say it will increase support for the bill. I urge study of somewhat similar statutes in Brazil, and append to my statement information about the Brazilian situation.

The restriction I propose is that these incentives are not needed for truly upper income people—whether one draws the line for these purposes at levels like the child-care deduction or, I would hope, somewhat higher. For such people, the proposal would not be an actual incentive, but a mere tax shelter, and the revenue loss in that instance would be unjustifiable.

Secretary Simon's recent proposal on July 31 before the Ways and Means Committee, his proposal for an individual savings account program, has received a little attention, but too little comment on how questionable is his concept and how totally undeveloped is his proposal. He equates savings for a car with savings such as we are focusing on today, but I submit it is preposterous to propose tax incentives for very short-term consumption saving.

We need to assist people in the large savings burdens, not the routine ones. And we need to encourage more long-range savings, or we will do little—or nothing—for investment and economic growth and stability. It is troublesome that the Treasury Department, with its great expertise, comes forward with a proposal showing so little thought, let alone work, on ways to promote personal savings.

In July 1974, responding to an inquiry by your committee staff about other nations' tax incentives for savings, Treasury answered with one item about Germany, another about Japan, all in about one paragraph, and then washed their hands of the matter by acknowledging that they have not looked any further. It is truly astonishing that they don't know about the unique, unprecedented savings incentives in Brazil, which have been so successful that they have even had the side effect of increasing willingness to pay taxes. I deeply hope Treasury's extraordinarily able economists and lawyers are much advanced, or advancing, on these questions.

D. Need for background research on personal savings, under aegis of this committee and Treasury.

We seem lamentably behind not only on the potential of tax incentives to encourage personal saving, but on surprisingly many aspects of savings. Governor Holland of the Federal Reserve Board spoke last year on savings, "an old-fashioned virtue in a newfangled world." I think we need a little attention back on that old-fashioned virtue. May I take this opportunity to urge your committee, perhaps working with Joint Economic and calling upon Treasury and the Federal Reserve Board for aid, to take steps to heighten our focus on, and knowledge of, personal savings. For example, we need better data. At least, careful approximations toward that end seem much needed. For another example, how much do tax incentives actually increase total personal saving, whether we are talking about Keogh or IRA or the proposal here? Is anyone at work on this? How can we make sound tax policy without not merely some, but substantial, work on that question?

For a last example, what is the relationship between personal saving and discretionary income. It must be critical, but for all the difficulty in getting firm information about discretionary income itself, we seem to be virtually ignoring it. As I understand it, the only sources of informatoin about it are the FRB—which, I am happy to say, is hard at work on this matter—and the Conference Board. But both these sources treat discretionary income without distinction among income levels. How can one possibly make significant statements about discretionary income without distinguishing between a family earning a total of $12,000 and another earning $50,000 or $112,000?

I hope the concern for personal savings evidenced by the sponsors of this bill will not stop with that bill, but with such strong representation among the sponsors on the Finance Committee and on Joint Economic, will advance our awareness so as to give a sounder basis for tax and other policy on savings and investments.

Senator Brock, I would like simply to put in as the last part of my statement without recital here two or three technical questions going to the drafting of the bill. I have to express reservation about the idea that distributions should be tax exempt. I think that is a degree of incentive which is a little hard to justify, and I think favorable treatment and exemption are two different things, and I think it goes too far. By removing exemption, of coures, we will vastly reduce revenue loss, enabling us to expand dollar amount of the credit, or whatever form it takes, so as to increase the incentive to get this saved.

Senator, if I may, I would like to close on a very closely related matter, but a wholly separate one. Whatever conditions or requirements the Federal Government imposes out of deep wisdom or simple politics, whatever costs must be borne, New York City must not be allowed to default. I am not saying that if it defaults we will have a series of defaults elsewhere. I am saying that all interest rates will be pushed up, sharply temporarily, but up somewhat for a long time for probably all long-term debt, certainly most of it, certainly including mortgages. People will be less confident about buying such debt and that means higher interest rates. Of course, State and local finance itself, which is already in crisis, if New York City defaults would be a disaster area with taxpayers throughout the Nation carrying yet greater debt service burdens than they are now, and with local budgets yet more stringent, and yet more strife between local communities and public employees there.

Senator Brock, whatever must be done should be done to New York City but we have to keep them from defaulting or public employees and taxpayers in every part of this Nation will suffer severe costs.

Thank you, Senator, for the opportunity to be here.

Senator BROCK. I appreciate it. I didn't know you were going to raise a new issue.

Mr. SCHOTLAND. I appreciate the opportunity to do so.

Senator BROCK. I appreciate it very much.

I understand your concern and I have the same concern. I just don't have the answers to how you resolve that problem. I really don't.

Mr. SCHOTLAND. Well, Senator, I felt, contrary to many people who share my position on the political spectrum, that the steps which were taken by the Congress in behalf of Lockheed, the steps which allegedly have been taken by the Federal Reserve Board in behalf of W. T. Grant, and the REIT's, and perhaps at an earlier date, Chrysler, probably were sound. I think it is very important to keep large entities from going out. It is important not only because of the direct ripple effect, but the financial markets are all about confidence in a very large degree. They are about intangibles, and when major firms go out, that makes people a little shaky, and if they are shaky, the debt service costs are higher and that is something I don't see anybody wanting.

If as large an entity as New York City goes out, I just don't understand what Secretary Simon, as a bond trader of all things, is talking about.

Senator BROCK. Well, not to argue because I am not sure that I do, but the problem is in finding a way to provide the least expensive guarantee and avert that tragedy and yet create a circumstance in which it is not repeated.

Mr. SCHOTLAND. Well, I think we may have to put New York City through a wringer, so there isn't very much incentive for others to do it, but the wringer has got to stop short of default.

Senator BROCK. Well, that is what a receivership is.

Mr. SCHOTLAND. I am afraid that is a wringer which is going to impose costs on everybody.

Senator BROCK. I agree. We will talk some more about that.

Let me ask you how the Brazilian plan works. Can you describe it?

Mr. SCHOTLAND. I can somewhat, Senator. I appended two charts and references to two articles.

Senator BROCK. I have got your charts here.

Mr. SCHOTLAND. There are essentially two different vehicles, as I understand it. One is called the Open Capital Company which has certain tax incentives in return for making certain kinds of investments. For example, a certain amount of its activity has to be aimed at development of the Brazilian Northeast, which is a particularly economic and social problem in Brazil. Then there are also what are called these tax incentive mutual funds. As I understand it, the taxpayer has an option. He can send his tax dollars—that is, some of them—I think it is up to 30 percent of the tax burden—I am not sure of the precise figure but he can send a certain portion of his tax burden to the tax collector or quite literally he can invest it in a qualifying fund. And that qualifying fund, of course, has to make certain kinds of "socially necessary" investments, again such as the Brazilian Northeast or such as certain kinds of emerging industries or emerging-size companies. In this way there has been an extraordinary increase, obviously. Who wouldn't rather send to an investment, however later it might be taxed, instead of to the tax collector?

Senator BROCK. What is the difference between that and $1,000 tax credit, just to pick a figure out of the air, which is granted only on the basis that the income is earned through a depository institution or a long-term savings plan?

Mr. SCHOTLAND. Well, if it is a depository institution, it might or might not go into mortgages. It might just be a bank. And if it is a thrift, or limited to thrift, then it will go into mortgages, and that certainly is an appropriate capital short sector which I think needs incentives.

I am troubled about—in two ways about changing tax laws to aid or to encourage people to put money into savings accounts. First, the equities are such that only certain kinds of people are going to be using the savings account. You have to be really way above even upper middle income to have a significant amount in a savings account, at least at present rates, even with the $1,000 credit. It just isn't going to make sense.

Now here again we have really an excellent instance of the way the market can work to bring in new investments, the money market funds that have emerged in the last 2 years or so. Before that an ordinary individual could not get access to commercial paper with its high rates. Now he can. Well, if today you can get over 7 percent in a money market fund, how many people with sophistication would leave it in the savings account? So I think it probably is going to be a real benefit only to people with so very much money that it doesn't matter to them to have about $20,000 in savings accounts, which would be the amount to take advantage of the $1,000 credit.

The other thing that concerns me is I think we need to change our financial institutions, not reinforce the status quo. I think we need to get away from the bank/thrift split as the Senate Banking Committee is now proposing, going forward with the Nixon and Ford administration proposals on financial institutions. If we put more tax incentives in, we build up more vested interest in just keeping these things as they are.

In the new structure, I think there are going to be some small S. & L.'s maybe some small banks, that maybe won't be able to perhaps swing it. That is not a good thing, but on balance I think we are going to be much advanced if we start going perhaps even to a financial institutions universe of, shall we say, retail or consumer banks and wholesale banks rather than the present S. & L. commercial bank split.

Senator BROCK. Well, it is an unnatural split as it is.

Mr. SCHOTLAND. Exactly, Senator, and I am afraid it is proving a very inefficient one with unjustifiable impact on housing.

Senator BROCK. If you provided a $1,000 maximum on your tax credit which—or maybe $500—you would maintain your limit at the middle income and below group. That is what you are reaching for, I think.

Are you suggesting that in effect they could make a deposit in an S. & L. or take that $500 and put it in an S. & L. and that would be exempt or they would buy stock in General Motors, or would it be a qualified investment in certain areas?

Mr. SCHOTLAND. Well, I think something like S. 666 is a good idea. We might say an S. 666 fund can go only, let us say, a quarter to housing or maybe a half to housing. I am not married to any of these proportions.

Senator BROCK. Who makes the investment, the individual or the S. & L.?

Mr. SCHOTLAND. I think it ought to work about the way the Keogh and IRA's do work, where there is a variety of competing money managers or depository institutions offering programs and people are free to choose among them according to whether they want a fixed income investment or equity or a miss.

Senator BROCK. Then we would in effect certify certain institutions.

Mr. SCHOTLAND. Yes. I am not happy with the extent of the tax shelter of Keogh, but I think Keogh and IRA are absolutely splendid. I just would happen to phase Keogh out at a certain income level. Not IRA, it doesn't amount to that much, at least not yet. And I think these offer us an excellent model to copy for this situation.

Senator BROCK. You mentioned that you felt that the levels in S. 666 were inadequate. That is a comment I think you understand I agree with. Do you have any figures? I didn't hear you mention them, as to what you——

Mr. SCHOTLAND. I certainly haven't been able to work them out, but I would think something like a $500 deferral per child.

Senator BROCK. Per child?

Mr. SCHOTLAND. Per child.

Senator BROCK. Deferral of——

Mr. SCHOTLAND. Of the taxes.

Senator BROCK. The tax?

Mr. SCHOTLAND. And then tax it as it is distributed, probably taxing it at an arbitrary rate. In Keogh we are able to tax it simply when it comes out, when it is distributed, because almost without fail at that time the recipient is in a lower income level and that works just fine.

Here you have the parents, let us say, in their late twenties perhaps and through their thirties putting the money aside and avoiding taxes as they are, relatively speaking, not in particularly high brackets. Then as the child or children go to college, when the parents are moving into their highest tax brackets, you have the distribution occurring, so you can't tax it to the parents at that time or you are actually, I think, being plain unfair. If you tax it to the beneficiary, the child, you really are going to have a miniscule tax take in most instances.

Senator BROCK. Why don't you tax at the capital gains rate?

Mr. SCHOTLAND. That would be an arbitrary level which I think would work excellently—not arbitrary and capricious, but just fixed. I think that would be an excellent way to treat it. It would be administratively hard to go back to the original tax level because they are paying it every year. I hadn't thought of the capital gains rate, but that would do exactly what I am talking about and I think it furnishes the incentive. I think bills such as I believe Senator Ribicoff has had in, simply to give a deduction when tuition is being paid, are exactly the wrong kind of treatment. They reduce the revenue. They don't encourage any saving or investment. That isn't the kind of thing we need. I think the fact that it has been in for quite a few years and hasn't gone anywhere says my own view is shared.

Senator BROCK. Of course, the point that one of our previous witnesses made, and he has already got a child in school and he is not in a position to save retroactively—how do you——

Mr. SCHOTLAND. Well, Senator, if my judgment were accepted about phasing this out at certain income levels, I might, though I have young children, also be unable to use it, but we are really talking here about something which is going to benefit the segment of society which is sending people to post-secondary training of one type or another, who can't get scholarships, who don't have wealth, and this is a terrible situation.

Senator BROCK. OK. If you have some additional thoughts I personally would appreciate them because this is an area of enormous concern. As we were talking earlier about housing, we are not even beginning to deal with the capital formation problem, the savings problem in society, and until we do, we are going to stay in a stagnant position. I don't think this country will survive if we do that too long.

Mr. SCHOTLAND. I appreciate the invitation. If I may take the opportunity to work with some of the committee staff to try to get some of this information I have been talking about developing so we have a little better sense of where we are——

Senator BROCK. We would be most appreciative of your help and will talk to you about it later on.

I take it that Mr. Levi is not here.

Our next witness was unable to come, so we will recess the hearing subject to the call of the Chair.

Thank you so much.

[The prepared statement of Mr. Schotland follows:]

STATEMENT BY ROY A. SCHOTLAND, PROFESSOR OF LAW, GEORGETOWN UNIVERSITY, WASHINGTON, D.C.

Summary

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Statement

I. THE KNOWN PROBLEMS NEEDING NO ELABORATION

A. High costs for consumers of post-secondary education.
B. Financial squeeze on producers of post-secondary education.

II. PERSONAL SAVINGS

A. Historical setting

Federal Reserve Board Governor Robert Holland spoke last year about "saving: An Old-Fashioned Virtue in a New-Fangled World." He noted the historical work by economists which shows that how much people save is a constant depending on how much they earn. He noted also the theoretical work suggesting that changes in interest rates will not affect the amount of savings. Still, he said that despite those studies, he believes that the aggregate amount of savings can be raised by high interest rates. I am confident that he is right and the studies are wrong. I am even more confident that we need more economists at work on this.

The historical studies have serious data vulnerabilities. The theoretical studies are also seriously vulnerable in that they have examined only savings like long-term bonds, which have not been used by individuals other than the most sophisticated. Also, they did not examine periods with sharp increases in interest rates.

There are further reasons to doubt the economists' dogma about savings being a constant depending on income. First, today's financial scene containes so much which is fundamentally new, as I will expand in a moment. Second, higher interest rates are only one of the ways to induce more saving; changes in tax treatment have caused innumerable other changes in economic behavior, and could change savings habits too. Third, to the extent that we promote savings by individuals. we reduce unnecessary consumption and inflationary pressures, which simple down-cycles clearly don't adequately reduce. Since we have begun a period of capital shortage—as I will also consider in a moment—doesn't it follow that we must be working on ways to marshall more savings, wholly apart from the difficult problems of how those savings are invested?

Are people aware enough of just how poor is the American record for saving, in terms of total savings as a proportion of after-tax income? Since 1960, our rate is below Britain's, is only ⅔ of the rate in France, just over half of the rate in Germany and would you believe, only about 40% of the rate in Japan? Of course there are many reasons for differences in propensity to save, from the economy's relative level of maturity, to pension arrangements, to social psychology, but isn't it clear from these relative figures alone just how much we are a consumption economy, spending today on gadgets and tinsel rather than investing for stability and security tomorrow?

We all know well how much new money is expected to flow into Keogh and IRA accounts because of the new pension law. Of course much of that money will not be new savings, but merely a shift from other vehicles. Some believe that such tax changes even reduce the total amount saved, but we don't know, and unless your Committee gets to work on matters like this (as I expand on below), it'll be five or ten years before the question is examined.

B. Why people save

People save for only a few reasons. Home purchase is one, which we encourage with favorable tax treatment. Retirement is another, which we also encourage with favorable tax treatment. Only the fortunate are able to save much for passing on to the next generation. But all except the very rich and the poor save for their children's education. The rise in education costs is rivaled only by hospital costs, but at the same time, the lower middle income and the middle-income groups which are being squeezed by slump-flation and are the source of the bulk of the consumers of higher education, are expected to pay their own way.

C. A startling tale

In 1972 an imaginative effort to encourage parents to save for post-secondary education was undertaken by a major regional bank in the Northeast, a major insurance company and a multinational nonfinancial company with diverse holdings. The effort was serious enough to have start-up costs of several hundred thousand dollars and a marketing test involving 300,000 potential customers.

The essence of the idea was that parents who will not be able to save enough to cover the cost of post-secondary education, would have to undertake some borrowing when those costs arise. If instead of borrowing, say, $4,000 when my Daughter is starting post-secondary studies, the parents would borrow several years earlier, they would be able to borrow less, put the borrowed sum into a savings account, and in short reduce the total cost of the borrowing.

In spite of the impressive names of the joint venturers, their unquestionable skills and unusual access to the relevant families, the plan was a complete flop. Subsequent nationwide tests, to find out what caused the widespread uninterest—this is 3 years ago—showed clearly that the reduction in total costs offered by the plan was too little to induce increased savings for post-secondary burdens—a larger incentive, somehow, had to be necessary. The three firms involved, I am assured, have not given up their hope or their joint venture agreements that such an incentive will emerge, and their plan will be made to work.

D. Recent events affecting personal saving

While new personal saving have seemingly held up quite well in the past few difficult years, this is consistent with a historical pattern of increased savings when economic instability seems ominous. There are several reasons to draw little solace from such data. First of all, the data include not only true personal savings, but non-profit organizations. Thus, if e.g. a major corporation gave a large gift to a non-profit organization, that would show up in the relevant data as an increase in what is called personal saving.

Second, even if truly personal new saving has held up, this is out of fear of future economic problems rather than a shift in habit pattern; again, so the historical record suggests. For most people, saving must be getting far tougher in the past two years at the very least: disposable real income is down, from 1973 to June 1975, by about 6% on a per capita basis, even more on a per household basis.

Since the costs of shelter, transportation, food and medical care, have seen particularly sharp rises, the decline in discretionary income—what is left after savings—which is the source most people would draw upon for increased saving—must be horrendous.

Third, even if what data we have show new "personal" saving holding up, it is clear that "personal" liquidity has been declining. According to a recent Solomon Brothers study ("Financial Well-Being: The Slow Road Bade, Sept. 3, 1975), per capita household financial assets (adjusted for inflation) were down, as of June 1975, 26% below their 1968 high! This somber erosion has received almost no notice, whereas a fair bit of attention has been directed to a reduction in consumer debt although that reduction has been minuscle.

In short, personal savings are in trouble. As of this past June, per capita household financial assets had slid back to the level of 11 years ago, 1964. Since education costs have done quite some moving since 11 years ago, how do we expect people to meet these costs? Are we really satisfied to load students with work for survival, or to load young people with debt, or to force parents to expand their own mortgage or other debt—or else, to see shrinkage in the opportunity for higher education?

III. THE ECONOMY'S NEED FOR SAVINGS, PERSONAL AS WELL AS BUSINESS

A. *Is there a capital shortage—and does it matter to small business?*

"Capital shortage" is simply short-hand for saying that we have a smaller supply of capital—relative to the demand for it—than we have experienced in recent history, a period in the United States which goes back to before 1900. Three kinds of answers have been expressed by persons denying we have any such shortage. One kind of answer is utopian, a second kind comes from the blind believers in what they call the free market, and the third is Panglossian.

The utopian answer.—The utopian answer (to use Business Week's word), exemplified by the Bosworth-Duesenberry-Carron study for Brookings, and the Brinner-Sinai study for Data Resources, admits that we are close to a severe problem, but tell us we have nothing to worry about if only the Federal budget is brought into balance in a year or two, and kept there. It is always resssuring to know of intelligent people who believe in utopia, but especially reassuring to learn that utopia is just around the corner. Unless you believe that our economic and political picture will change about $75 billion worth in about the next year, you can forget about those utopian studies.

The blind believers' answer.—The second group denying we face a capital shortage, people like Professor Eisner of Northwestern and Walter Wriston, believe so blindly in what they think is a free market, that they think, to quote Eisner, "it doesn't make sense to talk of such a shortage". That is, there cannot be a shortage of capital, there can only be higher prices for it, and that cannot be undesirable because market prices merely reflect what people want. If people just don't want to save enough to keep interest rates low enough for the survival of such sectors as housing and small business, then, in Professor Eisner's carefully measured terms, "that's just tough" (Business Week, Sept. 22, 1975, p. 44). Whatever is, is right. Walter Wriston makes a more persuasive statement of similar arguments. But if you had the best access to capital and were best situated to pay high rates, any capital shortage wouldn't hurt you or your customers, whatever such rates might do to your competition and small firms.

The Panglossian answer.—The most interesting denial that any capital shortage exists is the Panglossian, exemplified by Walter Heller's August Wall Street Journal article (Aug. 19, p. 12). He shares the utopians' admitted reliance on a Federal surplus, though for one thing he seems to push back its due date, and for another he counts on such a change in attitudes toward spending held by Members of Congress, that it would be a change in the character of our political system. Consider just some of the economic realities the Panglossians are ignoring.

First, they think that if aggregate manufacturing capacity is now underutilized, it must follow that there are no significant new investment needs. Focusing on aggregate manufacturing capacity, they simply ignore known facts as to needs in such sectors as energy or steel, let alone the truly revolutionary dimension of capital needs for agriculture and the trauma in construction.

Second, the Panglossian notion that we've been doing rather well, and so will continue well enough, ignores major changes over the last few years. For one, the more affluent 1960's brought forth increased concern for quality of life, and so we are making unprecedented investment in areas like pollution control and in safety, making it wrong to look at past years' investment figures without major adjustments. But instead of an increased ability to meet these increased costs, our investment capacity has been steadily shrinking. Gross business savings, as a percent of GNP, declined in all but two years since 1965, as did total return on assets of nonfinancial firms. Gross business fixed investment, which Walter Heller apparently thinks the premier measurement, has held steady, but steadily more reliant upon borrowed funds: internal corporate funding has declined (as a percentage of business investment) in all but two years since 1965, and the equity-debt ratio (of manufacturers) has weakened in all but *one* year since 1965. Also, nonfinancial firms this year are more dependent on short-term debt, relative to long-term, than at any time since World War II, except for the December 1974 bottom. [For thorough analysis and figures showing just how much more fragile are our financial structure and the large majority of balance sheets, see Professor Hyman Minsky's articles in the Senate Banking Committee's 1975 Compendium of Papers on Bank Regulation, and in the latest issue of *Challenge*.] Not only have public offerings suffered a well-known drying up, but the percentage of offerings by smaller firms has declined in all but two years since 1965.

The shrinkage of savings and of firms which marshall savings.—Parallel to this decline of business savings has occurred a weakening of both personal savings, as noted above, and of our main mechanisms for marshalling savings, the banks, investment bankers and broker-dealers. The flight of firms and capital from the securities industry has been so bad that the parochial Alan Greenspan thought them the worst sufferers of all in these troubled times. And banks and insurance companies have run out of room to let us fall back on them. Bank regulators are not alone in believing banks must themselves add new capital or else shrink their lending, but for banking just to *preserve* the *present* ratios if lending grows with the economy—and if it doesn't, how will the economy grow; and if *it* doesn't . . .—well, banks need an average of about $15 billion per year until 1985, in new capital.

Secretary Simon's abuse of a real problem.—The capital shortage is something of a fad at the moment, but that doesn't mean it isn't a real problem. I have been pointing to this as one of our major problems first in early 1973, before the oil shock (Conference of State Bank Supervisors, April), again at this Subcommittee's February 1974 Hearings on increasing capital availability and financial competitiveness, and again a year ago to the American Bankers Ass'n. Trust Division. Of course saying the same thing early and often doesn't mean it's the right thing. But neither is it the wrong thing just because it is being used by Secretary Simon and others who believe that Government should help the rich since, as Simon actually said to Ways & Means on July 31, helping big savers will "in the end" help all savers. For example, I consider the Secretary's proposed tax umbrella over corporate dividends to be hollow politics and horrid economics, as the disagreements with it expressed by Governor Henry Wallich and by Fortune Magazine (editorial, Sept. 1975, p. 94), show well. [Capital shortage and deteriorating balance sheets mean we should encourage retention of earnings and reinvestment of dividends, not tax breaks for the well-to-do in the false hope that enough will trickle down to raise equity prices, and maybe someday something will trickle beyond the wealthy and the major corporations. If Simon weren't simply using the capital shortage problem, he would expand the proposed dividend treatment he has suggested only for electric utilities (July 8, Ways & Means testimony), *deferring* stockholders' tax on *reinvested* dividends, the reinvestment to be taxed later at *ordinary* income rates. Such treatment would involve only a deferral, not a loss, of Federal revenues, and would be *the easiest* way to increase equity investment. Why not spread such treatment, at least to publicly held small companies?]

The NYSE study.—Perhaps the most frequently criticised statement pointing to the capital shortage has been the New York Stock Exchange's. I don't often defend the NYSE, but three points must be made.

First: While some have attacked the NYSE projections of investment needs as being a mere shopping list more like a child's letter to Santa than realitic needs, it is striking that the Brookings Study's need projections are only about 5% lower, so the real difference is not in the need projections but in the utopian assumptions.

Second: Let's compare some recent capital needs projections with earlier ones. Just two years ago, McGraw-Hill estimated the steel industry would need $4.5 billion a year by 1985 (Business Week, Sept. 22, 1973). Last week U.S. Steel's

President said his industry needs $5 to $6 billion a year between now and 1980 (Washington Post, Sept. 19, 1975, p. *D11*). McGraw-Hill estimated electric utilities would need $41 billion a year by 1985, but this month Continental Illinois estimated about a $50 billion annual need by 1985 (Business Week, Sept. 22, 1975). Last, McGraw-Hill estimated petroleum would need $12.6 billion a year by 1985, ConIll's study says domestic petroleum investment alone will have to be about $38 billion a year, three times the estimate of only two years ago.

Third: The NYSE, in addition to being an interested party, has made bad goofs before, and their capital needs projections may be only the latest goof. But I'm reminded of some goofy projections they put out just 10 years ago, estimating the growth of their own stock trading volume. They set a figure for ten years ahead, 1975, which many attacked as widly high. That figure was hit not in 10 years, but in just 3, 1968 ,and the too modest projections were a large part of the reason for the terrible back-office crisis of 1969–70. We'd better get very serious about figures on projected capital needs, and of course on action to meet those needs, or the back-office crisis will be seen, somewhat rightly, as a teapot tempest.

Recent bulletins from the capital shortage front.—Just three last indications that there is a capital shortage. First, don't high interest rates say a great deal, or are there some serious people who believe Arthur Burns is entirely responsible? Second, remember last Spring's fad in finance, the fuss over "crowding out"? In light of the extraordinary recent rash of cancelled public offerings, the near-record rates Federal offerings are paying and the impossible burdens confronting state and local units, is there any longer doubt about crowding out? I would like to insert here a statement by Henry Kaufman of Solomon Brothers, in the Wall Street Journal, Sept. 15, 1975, p. 15:

Even wider consequences are foreseen by Henry Kaufman of Salomon Brothers, who recalled that "a very vociferous debate occurred earlier this year concerning the possibility that the huge budget deficit would force the Treasury to crowd out other prospective borrowers and thus hinder rather than encourage economic recovery. Crowding out didn't materialize to a significant extent in the first half of the year when the economy was contracting and the inflation rate was decelerating, but it is surfacing with the emergence of some real economic growth, an acceleration in inflation and the huge Treasury financing demands," he said.

"Many medium-rated corporations have postponed or canceled attempts to market their new securities during the past two months, and savings flows to deposit institutions are slowing appreciably," Mr. Kaufman said. "Commerical banks have relaxed their efforts to enlarge their capitalization base through external financing," he added.

His assertion about "crowding out" appears reasonable considering that only about $1.36 billion of new corporate bonds have been scheduled for public sale this month, down sharply from an average of $3.18 billion in the first eight months of this year. A mere $830 million have been listed for sale in October thus far.

Third, just consider this past Sunday's New York Times Business section: AT&T is offering shares at below book value, because its balance sheet is 50% weaker than 10 years ago. Crocker National, merely a $10-billion bank holding company, sold shares at 25% below book value—no major American bank had ever before sold shares below book at all. And Bankers Trust, merely a $20-billion bank holding company, offered preferred shares at a 10% yield.

B. Personal savings and business savings

All the Administration and business fanfare recently for further tax breaks for large corporations cannot override the enormous role of personal savings.

In 1947, business saving was over 70% of total private saving, and personal saving was over 25%. That is business saving was just under three times as large as personal.

In 1974, business saving was less than two times as large as personal saving; business saved over 60% of total private saving, and personal saving was just under 40%.

I do not mean to say we should not encourage further business saving. I do mean to say that, especially in light of the erosion since 1973, we must act to assure at least continued vitality of personal saving.

IV. THE BENTSEN PLAN FUND'S PROMISE VS. SECRETARY SIMON'S IRRESPONSIBLE CRUMB-TOSSING

A. November 7, 1974 introduction of Bentsen educational savings plan

I see no need to reiterate Senator Bentsen's excellent reasons supporting S. 666, which he first put forward in the last Congress. I am delighted to see such numerous and leading Senators now co-sponsors, and much hope that today's Hearing is only the beginning and tip of the iceberg of support that will build for this bill.

B. Unduly modest scope of Bentsen educational savings plan, S. 666

I hope Senator Bentsen and persons who share my support for this bill will not object to my view that the bill is too modest. I strenuously urge two expansions of the bill, and one restriction.

First, I believe the dollar amounts in the bill are too low to stimulate a significant contribution toward the total dimension of savings which, I hope I have persuasively shown, is essential for family financial soundness and for our overall economic growth. Of course, the argument against higher dollar amounts is revenue loss, but I submit that argument is both short-sighted and unfair. It is short-sighted because increased savings is a direct contribution to sound and permanent improvement of our economy's level and stability with enormous benefit to fiscal policy. It is unfair because the revenue lost through the full $15,000 Keogh Plan yearly shelter for even *high*-income lawyers and others, or the revenue lost through the lack of a limit on deductions for so-called business-related wining and dining, or the revenue that would be lost from proposals liberalizing capital gains but preserving as a "sacred cow" the stepped-up basis of capital assets.

The second expansion I urge is that when the dollar amounts are raised, the limitations on forms of investment should be less restrictive. However, I entirely share the concept of the bill, that this is an admirable vehicle for aiding sectors which are critically short of investment. My own view would be to allocate Bentsen Plan funds not only to housing, but rather in perhaps three ways: for example, 25% to housing mortgage investment, 25% to small and medium-sized business investment (both as equity and debt), and the balance free to move pursuant to responsible investment judgment. I believe such diversification is sounder economically as well as in other ways. I urge study of somewhat similar statutes in Brazil, and append to my statement information about the Brazilian situation.

The restriction I propose is that these incentives are not needed for truly upper-income people (whether one draws the line for these purposes at levels like the child care deduction or, I would hope, somewhat higher). For such people, the proposal would not be an actual incentive, but a mere tax shelter, and the revenue loss in that instance would be unjustifiable.

*C. Secretary Simon's unduly undeveloped individual savings account program—"Typically, individuals save to purchase a home or a car * * * [T]he goal seems very desirable." (Testimony before Ways and Means, July 31, 1975.)*

Secretary Simon's recent proposal for an "Individual Savings Account" Program has received a little attention, but too little comment on how questionable is his concept and how totally undeveloped is his proposal. He equates savings for a car with savings such as we are focusing on today, but I submit it is preposterous to propose tax incentives for very short-term consumption saving. We need to assist people in the large savings burdens, not the routine ones. And we need to encourage more long-range savings, or we will do little—or nothing—for investment and economic growth and stability. It is troublesome that the Treasury Department, with its great expertise, comes forward with a proposal showing so little thought, let alone work, on ways to promote personal savings.

In July 1974, responding to an inquiry by your Committee Staff about other nations' tax incentives for savings, Treasury answered with one item about Germany, another about Japan, all in about one paragraph, and then washed their hands of the matter by acknowledging that they have not looked any further. It is truly astonishing that they don't know about the unique, unprecedented savings incentives in Brazil, which have been so successful that they have even had the side effect on increasing willingness to pay taxes. I deeply hope Treasury's extraordinarily able economists and lawyers are much advanced, or advancing, on these questions.

D. Need for background research on personal savings, under aegis of this committee and Treasury

We seem lamentably behind not only on the potential of tax incentives to encourage personal saving, but on surprisingly many aspects of savings. May I take this opportunity to urge your Committee, perhaps working with Joint Economic and calling upon Treasury and the Federal Reserve Board for aid, to take steps to heighten our focus on, and knowledge of, personal savings. For example, we need better data. At least careful approximations toward that end seem much needed. For another example, how much do tax incentives actually increase total personal saving? Is anyone at work on this? How can we make sound tax policy without not merely some, but substantial work, on that question. For a last example, what is the relationship between personal saving and discretionary income. It must be critical, but for all the difficulty in getting firm information about discretionary income itself, we seem to be virtually ignoring it. As I understand it, the only sources of information about it are the FRB—which, I am happy to say, is hard at work on this matter—and the Conference Board. But both these sources treat discretionary income without distinction among income levels. How can one possibly make significant statements about discretionary income without distinguishing between a family earning a total of $12,000, and another earning $50,000 or $112,000?

I hope the concern for personal savings evidenced by the sponsors of this bill, will stop with that bill but, with such strong representation among the sponsors on the Finance Committee and on Joint Economic, will advance our awareness so as to give a sounder basis for tax and other policy on savings and investments.

V. Technical Questions About S. 666

I close noting three problems needing work before the bill becomes law.

What would be the method of distributions from Bentsen Plan funds? Wouldn't some verification of enrollment in post-secondary studies be a necessity?

Second, what will happen if premature distributions are needed, unrelated to post-secondary expenses? I believe treatment somewhat similar to the Keogh and IRA funds would be needed.

Last, isn't there an unjustifiable revenue loss if the distributors are tax exempt, unlike Keogh or any pension benefits? Wouldn't it be wise to adopt an arbitrary tax percentage, in light of the difficulties or inequities of any other course?

BRAZIL'S FINANCIAL SAVINGS, 1964–74

[In millions of current Cr$]

	Savings accounts	Time deposits [1]	Acceptances	Housing bonds	Government securities [2]
1964			230		73
1975			695	9	463
1966	18	141	906	47	1,434
1967	86	469	2,105	290	2,520
1968	330	1,055	4,558	644	3,535
1969	893	1,938	6,172	1,195	5,881
1970	2,080	4,283	9,756	2,007	10,111
1971	3,761	9,319	14,390	3,128	15,465
1972	7,713	16,803	22,305	5,015	26,175
1973	14,122	25,568	37,129	6,517	38,344
1974 [3]	29,077	31,151	46,304	8,393	47,433

[1] Excludes small amount of unindexed time deposits.
[2] Federal government securities only.
[3] Preliminary.

Source: Central Bank of Brazil.

TAX INCENTIVE MUTUAL FUNDS AND ORDINARY MUTUAL FUNDS, 1968–74

[In millions of current Cr$]

	Tax incentive mutual funds, net worth	Ordinary mutual funds, net worth
1968		
1969	221	615
1970	380	810
1971	774	3,555
1972	788	2,109
1973	1,414	1,851
1974	1,391	1,530

Note: For background see (1) David Trubek: "Law, Planning, and the Development of the Brazilian Capital Market," N.Y.U. Graduate School of Business Bulletin, April 1971; (2) Walter Ness: "Financial Markets Innovation as a Development Strategy: Initial Results from the Brazilian Experience," 22 Economic Development and Cultural Change 453 (Apr. 1974).

Source: Central Bank of Brazil.

[Whereupon, at 11:30 a.m., the subcommittee recessed to reconvene subject to the call of the Chair.]

[By direction of the chairman, the following communication was made a part of the printed record:]

U.S. LEAGUE OF SAVINGS ASSOCIATIONS,
Washington, D.C., October 22, 1975.

Hon. LLOYD BENTSEN,
Chairman, Subcommittee on Financial Markets, Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR BENTSEN: On October 2, 1975, the Senate Financial Markets Subcommittee held hearings concerning the capital requirements of the housing industry and the ability of financial markets in this country to satisfy those requirements. In particular, the Subcommittee considered your bill, S. 666, to encourage the establishment of educational savings plans in financial institutions investing at least 50% of their assets in residential loans. This would be accomplished by providing a 20% tax credit on the first $250 invested in such accounts annually.

Clearly, the savings and loan institutions which we represent are vitally interested in this kind of legislation and would appreciate very much if you would place in the hearing record our views (as stated hereafter) with regard to your bill.

The savings and loan business for many years has been the principal support for the home mortgage lending industry in the United States. Over 85% of the assets of our institutions are devoted to residential mortgage lending. Current aggregate statistics show that we hold in our investment portfolios at least 48% of all home mortgages (1–4 family dwellings) in America. Together with the mutual savings banks, we hold nearly 60% of all home mortgages. Even in "tight money periods," we continue to stay in the mortgage market—indeed, our percentage of total loan originations increases, to 75% of all activity in such periods—and today we are making at least 60% of the permanent home mortgage loans being made in the United States day-in, day-out.

Particularly, since 1966, there have been three or four periods of "tight-money" which have put a severe crimp in the availability of long-term mortgage money. A sensible and fair tax incentive to benefit our savers directly has been a long-sought goal of our business. A tax incentive for savings will have a positive effect on maintaining sufficient flows of home mortgage money. It is a tax device which we think will particularly benefit savers who have in recent years seen the interest paid to them on their deposits severely discounted because of the ravages of inflation. It would help correct the bias against savings implicit in our tax laws.

Our institutions are particularly intrigued by the dual purpose of your bill to foster the financing of education as well as stimulate a steadier flow of mortgage funds. S. 666 will, we believe, help typical Americans finance the purchase and/or construction of homes at reasonable interest rate levels while encouraging savers to maintain high levels of savings because of the tax incentive for doing so. Families will thereby be encouraged to save not only for a rainy day but for a specific purpose; namely, educating their children. Tying the long-term home financing need to the long-term savings requirement for educational purposes is an ideal combination which we fully support.

There have been some other recent Congressional efforts to develop a tax incentive for savings program through the exclusion of income on any type of savings account in any financial institution up to $500 or $750 per person ($1000 or $1500 per joint account). This kind of legislation was reported out by the House Ways and Means Committee last year but never reached a vote on the floor of the House in the waning days of the 93rd Congress. At that time a question was raised as to whether the encouragement of savings for depositors in all types of financial institutions would necessarily assure that savings deposits would continue to go into home financing. Further, there was a question whether a tax exclusion or deduction was really equitable for the small saver and, of course, certain revenue loss issues were raised.

It seems to us that your bill certainly answers any question concerning whether the money will be used for home financing purposes since a basic requirement of S. 666 is that this type of tax incentive savings account must be placed in private lending institutions with 50 percent or more of their assets in home loans. The tax credit, of course, would benefit all savers equally in terms of tax treatment. Economists differ on the issue of projected revenue loss, since added stability for the depressed housing sector might offset any direct loss to the Treasury; but assuming there might be some revenue loss, the question then arises as to whether that revenue loss, as a matter of public policy, would not be justified in view of the twin objectives of your bill to stimulate through savings the financing of education and home borrowing. We, of course, believe that S. 666 is moving in the right direction and its economic and social advantages far outweigh in significance the possible revenue loss.

In fact, during the consideration of last year's bill, we demonstrated that through the "multiplier effect," there would be no real revenue loss. A tax incentive plan which stimulates home building and decreases unemployment in the home building industry would produce large amounts of additional revenue thereby making up for any "first blush" cost to the Treasury because of the tax incentive device.

Your bill, of course, is just another but very useful and well-thought out tax incentive device to stimulate home financing at reasonable rates. The bill, in addition, benefits savers and families seeking to educate their children. In a sense, this is a unique coupling of responsible public policy objectives.

There are various tax incentive methods to stimulate savings for home building which have been used in other countries. Attached hereto for your information is a list of savings incentive programs used elsewhere, but not in the United States (Addendum A). It is not an exhaustive study but it is helpful in demonstrating that there are other tax incentive methods which might be used to maintain a steady flow of mortgage funds. Interestingly enough, nowhere have we found, however, the linking of the twin objectives of savings for educational purposes while at the same time stimulating home mortgage lending. This makes your bill unique.

If we can be of further assistance to you in this matter, please let me know. Again, we would appreciate very much if you could put this letter in the hearing record in connection with your bill, S. 666.

Sincerely,

ARTHUR B. EDGEWORTH,
Director, Washington Operations.

Enclosure.

ADDENDUM A

FRANCE

A home savings bonus account is the approach used in France, and in one of its former colonies, Tunisia. The would-be homeowner commits to a systematic monthly savings program upon which he receives interest at the regular rate. When the funds are withdrawn for a closing, the government pays a bonus of two or three percent. This bonus is viewed as a method of stimulating savings, and the bonus is considered a direct payment that avoids some of the problems associated with the tax exemption.

GREAT BRITAIN

The British have developed a "save-as-you-earn" program. Under this program, which was initiated in 1969, any individual over 16 years of age could save from one to a maximum of 20 pounds per month (about $46 a month). The required term of the program is five years and in that time an individual may save a maximum of roughly $2,800; and as a reward for this, he would be given a bonus of 240 pounds, or roughly $550, free from all tax. If this combined amount is left intact for a further period of two years, another bonus of 240 pounds is added. The participant in the "save-as-you-earn" program earns from 4 to 4.4% *above regular passbook rate.* These payments are, of course, in addition to the regular interest earned on the savings. All interest in the "save-as-you-earn" plan is tax free.

In Britain another scheme stems from an Employees Savings Plan offered by the Trustee Savings Banks of Great Britain. Under this, an employer automatically deducts from wages a fixed amount for credit to a personal savings account earning four percent interest. Interest on the first 1,000 pounds deposited (about $2,300) is tax free, or the first 2,000 pounds ($4,600) for married couples. Employees can also participate in the "save-as-you-earn" program mentioned above.

AUSTRIA

Austria has a "savings with a bonus" plan. Savings banks offer six percent interest on deposits made for four years. In addition, the saver gets a government bonus of 3¼ percent per year. The minimum quarterly deposit in Austrian Shillings (AS) 150 and the maximum is AS 1,500 (about $275). In addition, after the four years expire, any depositor under the age of 35 can borrow an amount equal to his savings at a favorable rate up to a maximum of AS 40,000 ($2,250) to buy consumer goods or AS 70,000 $(3,900) for a home loan.

WEST GERMANY

West Germany has a number of complicated and versatile plans.

Home building premiums

The government gives a premium of 25 percent on contributions to savings-for-building schemes, up to a maximum of DM 400 (about $160) per year. This premium rate rises with the number of children to as much as 35 percent. A 30 percent premium is granted to lower-income groups, to a maximum of DM 520 ($206).

Contributions to the building society can be used to build a dwelling at any time without loss of the premium. The owner of the scheme applies for the savings premium through the society. The premium is actually paid by fiscal authorities to the society, which then credits it to the saver's account.

The savings premium law

Under Germany's Savings Premium Law, you cannot get a premium if you already have a building-savings contract. The two types of savings premium contracts are: General, in which savers deposit a lump sum for six years; and Installment, in which they pay so much per month or quarter for six years. After that, they make no more deposits, but the total is frozen for another year before being released.

Maximum annual deposits are DM 600 (about $240) for a single person, DM 1,200 ($427) for couples, with a supplement for each child up to a maximum of DM 1,600 ($630). Under this program, the government pays a savings premium of 20 percent for single persons and married couples, with the premium rising to 30 percent according to the number of children. The Savings Premium Law also allows people to buy securities and to loan funds to employees rather than opening a savings account. Contract terms are the same as for savings.

It should be noted that higher premiums are received from savings-for-building plans than from savings accounts. Thus, a single person can receive a premium of DM 400 (about $160) from a savings-for-building contract, but only DM 120 (about $48) from a premium savings contract. It should also be noted that an amendment under discussion in the German Parliament in 1974 would have restricted premiums to single persons with an annual income of less than DM 24,000 ($9,600) or DM 48,000 ($19,200) for couples.

Capital Formation Act

Germany also has a Capital Formation Act which provides especially for employees. An amount up to DM 624 (about $250) can be invested. The state will pay a supplement of 30 percent on the amount invested rising to 40 percent for couples with three or more children. This supplement is paid out with the wage or salary. However, the only persons eligible for this program are those with annual taxable income of less than DM 24,000 ($9,600) for single persons and DM 48,000 ($19,200) for couples.

The capital must be invested in a wide range of options. If the employee wishes to invest it according to the Premium Savings Act, he can then get the government savings premiums in addition to the supplement for employees. This would give him bonuses totaling more that 50 percent of the amount saved from the government, not counting the interest paid by the savings banks.

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