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Documentation

# Beryl Sprinkel talks to Congress

*The following exchange took place April 8 between Under-secretary of the Treasury Beryl Sprinkel and members of the Subcommittee on Monetary Policy of the Joint Econimic Committee:*

**Subcommittee Chairman Roger Jepsen (R-Iowa):** I take it from your testimony that your intent is to cut the monetary base rate of growth by one-half by 1984. That factors out to about 1 percent per year [growth rate reduction]. I don't think that is fast enough.
**Sprinkel:** I think that that would be a too drastic reduction of the money supply. There would be adverse effects on employment and production. I am more of a gradualist and I think that the adverse effects on the real sector can be made minimal.

**Rep. Jepsen:** Do you think that slowing the rate of growth of the money supply has contributed to high interest rates?
**Sprinkel:** Only in the short term. But that isn't the way markets work in the long term. Markets react in just the opposite way. If you slow the growth of the money supply in the very short run, you might see a slight increase in inflation. But in the longer run, such a policy will be income-creating and will result in less pressure on credit markets and lower interest rates.

**Rep. Henry Reuss (D.-Wisc.):** Are you satisfied with the Fed's activity to date?
**Sprinkel:** Yes.

**Rep. Reuss:** What is your view of the Fed's policy with respect to the federal funds rate?
**Sprinkel:** I think that there should be further relaxation of fed funds restraint. Let's say for example that credit demand is receding, interest rates are going down, and that you are at the low end of the band on federal funds [the Fed's intervention target for federal funds]. The only way for the Fed to buck that is by selling securities through open market operations. I think that what we have to do is concentrate more on controlling the quantity of money in the system and not so much trying to control the price of credit.

**Rep. Reuss:** The Fed's activities of late last week caused several billions of dollars worth of distress in the bond markets.
**Sprinkel:** I wouldn't blame that on the Fed. But I would say that trying to peg the fed funds rate interferes with achieving a steady growth in the money supply.

**Rep. Reuss:** But isn't it logical that if the central bank starts bidding up interest rates that the bond market will go down?
**Sprinkel:** No, not if we understand that in the long run, expansion of the money supply will mean higher interest rates.

**Rep. Reuss:** [I]n general what will your policy be [on foreign exchange intervention]?
**Sprinkel:** I believe that large competitive markets are highly efficient, and that the foreign exchange market is such a market. I find it difficult to believe that central banks or treasuries can consistently know better than the market what a particular exchange rate should be.

**Rep. Reuss:** Do you think that U.S. banks are overexposed with respect to the less developed countries?
**Sprinkel:** The regulators are better informed on that than I, but as a whole I think U.S. lending has been sensible and, barring a catastrophe, I see no serious jeopardies.

**Rep. Reuss:** The Congressional Export Caucus has stated that cuts in the Export-Import Bank are not in the national interest.
**Sprinkel:** I disagree. In my judgment, we have had a series of subsidies which have resulted in a misallocation of resources. It will be our policy to remove or reduce those subsidies in many areas including the Eximbank. But we are not talking about unilateral disarmament. We are not eliminating subsidies. This administration will work vigorously to reduce the export subsidies of other nations and then we will be able to continue to reduce ours accordingly.

**Rep. Reuss:** What do you think about the economic policies of Margaret Thatcher?
**Sprinkel:** Earlier, we had been examining the effects of British monetary policy in terms of sterling M3, the measure of money supply used by the Bank of England, and the results were incomprehensible. . . . But in examining the behavior of Britain's monetary base, we find a coherent picture of a nation in which there has been a massive improvement in inflation. Hopefully the recession associated with this monetary policy will soon be over.


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# OMB wrecks the housing dream

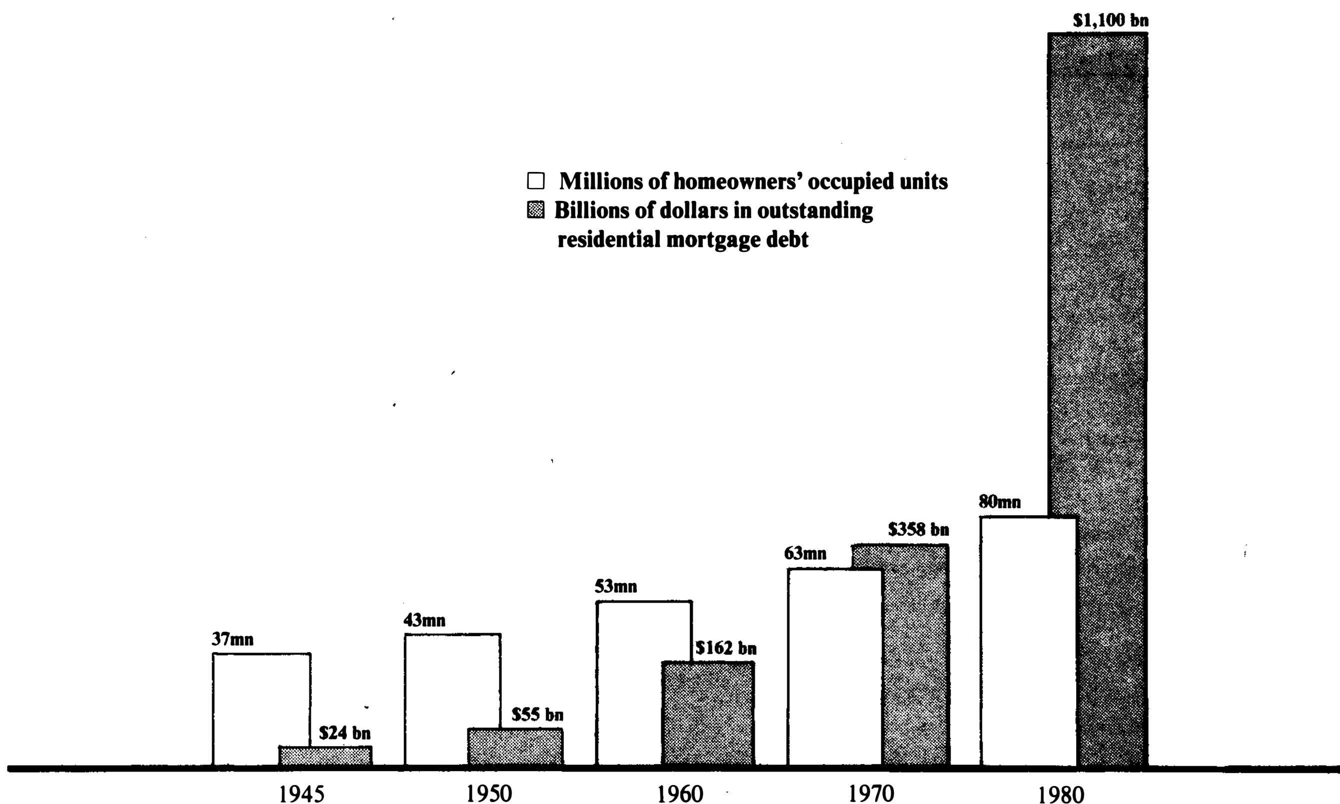
*Richard Freeman on the implications of the proposed new mortgage financing structure, and its purpose.*

With the U.S. housing industry in its worst downward spiral since the disastrous year 1966—when only 1,165,000 starts were made—Office of Management and Budget Director David Stockman has come up with a radical approach to the housing market. Stockman, the apostle of so-called supply-side economics, has proposed that, to "cut away the bloated bureaucracy" and stir up "free enterprise," the government role in the U.S. housing market should be greatly diminished. The U.S. government is hogging the credit markets with government-backed housing mortgage paper, so Stockman's argument goes, and therefore cutting back the government's housing financing will leave more money for important things like credit for industrial capital spending. But, if carried through, Stockman's strategy will permanently plunge annual housing starts to 1 million units.

His strategy has two parts. The first is to cut back the level of either direct housing lending or the purchase of mortgages in the secondary market by government agencies. This will open the door for both the government and the savings and loan institutions to be driven from the housing mortgage market in favor of the large life insurance companies like Prudential or Aetna, the private pension funds, and the Eurodollar market. The second is to drive the U.S. government out of the role of insuring mortgages and turn almost all of this market

Figure 1

**Relationship of homeowners to residential mortgage debt, 1945-80**



over to private insurers, led by the likes of the unsavory Mortgage Guarantee Insurance Corporation (MGIC).

While Stockman professes to be "privatizing" the housing market to make the overall economy more productive, his motives point in a different direction. This can be adduced from the fact that in March 1979, Stockman cochaired the congressional subcommittee Task Force on Domestic Consequences of U.S. Population Change of the Committee on Population. In the report, Stockman asserted that the need for housing would diminish—provided the U.S. population shrank. Although "he keeps the issue of population at arm's length now," Stockman's slashing of government expenditures is "only putting into practice the work that he did on U.S. population patterns" during the 1970s, said Michael Teitelbaum, director of the Ford Foundation population office, on March 31.

Stockman is adding the second blow to a one-two punch first delivered by Federal Reserve Board Chairman Paul Volcker. Housing starts, with their dependence on credit on two levels—both the construction and the purchase of the home—cannot withstand home mortgage rates, now above 15¼ percent.

Housing starts averaged nearly 2 million per year in 1977 and 1978. In late 1979, Volcker's usurious interest-rate policy was administered; by May 1980, the annualized rate of home starts was down to 0.9 million, more than 50 percent down from the peak. Housing starts finished the year at a rate of 1.29 million. According to the National Association of Homebuilders, if housing starts average 1.4 million this year, homebuilders will be lucky.

The traditional standard 30-year home mortgage at 5 to 7 percent interest also went out the window, along with the balance sheets of the savings and loan associations and the savings banks. In 1976, nearly 100 percent of all thrifts' new mortgages were fixed-interest, long-term mortgages. This figure has dwindled to just 60 percent as of 1980. The savings and loan institutions, nearly 35 percent of which lost money last year, were locked into portfolios of low-interest mortgages, while Volcker pushed their cost of money through the roof.

As Volcker's policy fed inflation—along with the $1.3 trillion unregulated Eurodollar market and the highly speculative U.S. real-estate bubble—the mean price of a house and therefore the total growth of mortgage commitments grew far faster than the rate of growth of construction in the U.S. housing stock (see Figure 1). The credit crunch forced the thrifts to withdraw heavily from making home mortgage loans and the government-owned or sponsored agencies, ranging from the Government National Mortgage Association to the Federal Housing Administration stepped in, as they were conceived to do, to avert even greater disaster. It was the U.S. government housing programs that saved the U.S. home market from falling to pre-1945 levels! The percentage of U.S. government-owned or sponsored agencies' share of the gross acquisition of home mortgages for one-to-four family homes—either through issuance of new mortgage loans or purchase of mortgage pools on the secondary market—went from an average 17.9 percent for the last three quarters of 1979, to an average 22.8 percent for 1980 (see Figure 2).

Now Stockman is out to stop that help. For the fiscal year 1982 budget, Stockman has already proposed reducing the planned number of subsidized housing

**Figure 2**

## Gross acquisition of long-term mortgage loans for one- to four-family homes

(in billions of dollars)

| | Lending institutions | | | |
|---|---|---|---|---|
| Quarter | S&Ls | Government* agencies | Total | Govt. agencies as % of total |
| **1979** | | | | |
| 1 | $18.8 | $11.5 | $52.0 | 22.1 |
| 2 | 27.4 | 11.3 | 66.6 | 16.9 |
| 3 | 26.4 | 12.5 | 72.2 | 17.4 |
| 4 | 21.9 | 12.9 | 66.0 | 19.5 |
| **1980** | | | | |
| 1 | 14.4 | 12.6 | 48.4 | 26.2 |
| 2 | 13.0 | 8.9 | 39.5 | 22.5 |
| 3 | 23.5 | 12.0 | 58.0 | 20.7 |
| 4 | 22.6 | 11.9 | 54.7 | 21.8 |

Source: Financial Analysis Division, U.S. Department of Housing and Urban Development.
*Government-owned or sponsored agencies.

units from 260,000 to 175,000 units. He has floated the idea of disbanding the FHA, Ginnie Mae, and their sister agencies or reducing their lending to "socially necessary and beneficial" areas—home loans or insurance to lower-income people to whom private home lenders and insurers would not lend.

By the same "free enterprise" logic, Stockman also plans to privatize the insurance of mortgage loans and to take this area out of the hands of government agencies. Not only will it saddle home purchasers with higher per unit mortgage loan insurance rates, but also ensures the deterioration of housing. Whoever insures the loan has greater say-so over the type of housing that insurance will go for. And some private home-insurers intend to put an end to the well-built standard single-family homes, in favor of something more akin to cave dwellings.

The private insurers' market is run by the Mortgage Guarantee Insurance Corporation, better known by its initials MGIC (pronounced magic) which has one-third of the private home mortgage insurance market.

In 1957, Max Karl, now MGIC's chairman, founded MGIC by dishing out free shares of stock in his company to gain the legalization of private insurance of home mortgages. This practice had been outlawed in the 1930s because of private insurers' reputation for fly-by-night pillaging. Karl gave free shares of stock to Bobby Baker, the personal aide to Senate Majority Leader Lyndon Johnson. While Baker went to the slammer for this offense, Karl turned song-bird and stayed out of jail.

Now Karl's home loan insurance empire stands at more than $50 billion in insurance. To build it he leaned heavily on his close acquaintances Detroit real estate speculator Max Fisher and Sen. Henry Jackson of Washington state. Karl's idea was simple. Instead of offering to insure home mortgages for 100 percent of their value, as FHA does, he would insure only the top "20 percent" of the home mortgage, leaving the remaining 80 percent uninsured. Karl's monthly premium charges, on an 100 percent equivalent basis, are much higher than the government's.

What Stockman's privatization of the home mortgage insurance market will mean was spelled out by one of MGIC's chief financial officers, John O'Chotnecky, in an interview with *EIR* last week.

"The family that wants four bedrooms in a two-story colonial home is dreaming. That home won't exist much more," he explained. "The average house will soon cost $100,000 because of the rising costs struction and financing. We will need 2 million new housing units over the decade of the eighties. But there is no way 2.2 million people will afford $100,000 each for a home, so there will have to be alternatives."

So MGIC's O'Chotnecky proposes that "we have to develop more efficient land and materials use. This means the existing housing zoning restrictions that say only a certain minimum number of homes can be built on an acre of land have to be scrapped. We have to use land better and, in the case of cluster development, houses can share front and back yards."

O'Chotnecky went on, "You don't need struts every 13 to 17 inches apart in the support for a house; they can be spaced 18 or 24 inches away. We can also use wood instead of concrete foundations for houses." Then, "We can build a lot of earth-shelter housing. That's where you build a house into the side of a hill or mountain." To conserve energy, he said, "Houses and rooms can be smaller, and we can use insulation, solar energy, or passive heating to provide energy for the houses." And, he added, "More people will live in condominiums." The commitment of such agencies as FNMA to finance condominiums, though still on a small scale, is indicative of this trend (see Figure 3).

As for financing, O'Chotnecky predicted that "the S&Ls will play less and less of a role. The insurance companies will play a big role. So will the pension funds and the Eurodollar market."

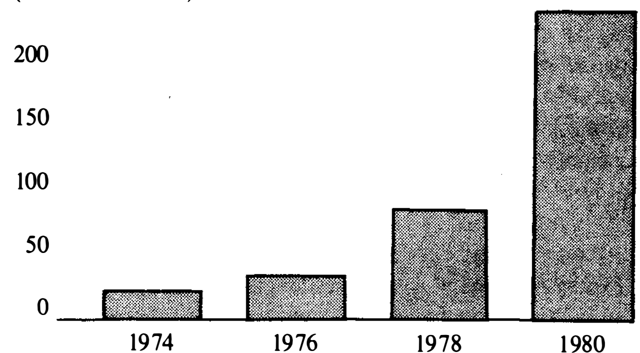
According to O'Chotnecky, "someone in the U.S. will put together a group of mortgages and sell them on the Eurodollar market where the money is. This is a huge source of funds. Perhaps some Saudis will buy the mortgages."

Does this mean a Saudi would have to earn on a U.S. mortgage a return on funds comparable to what he could earn by investing in certificates of deposit or other high-yielding money market instruments in the Eurodollar market? "Yes," confirmed O'Chotnecky. "That just means that mortgages will have to pay a lot more and that will cost homeowners a lot more. The era of the 30 year, 9¾ percent mortgage is dead." And that means the end of the family home.

**Figure 3**

## FNMA condominium loan purchases

(in millions of dollars)




Source: Federal National Mortgage Association