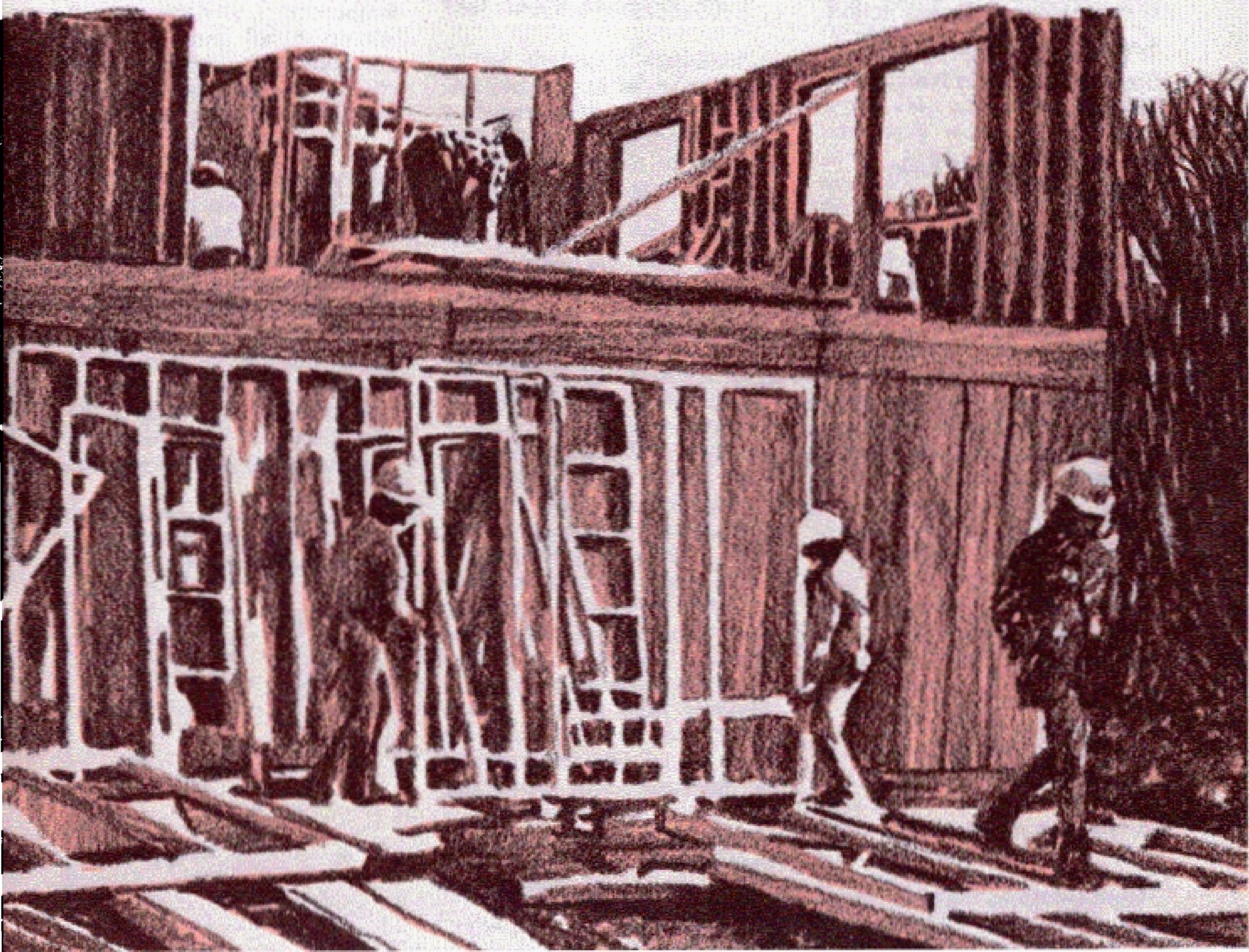
Ninth District Quarterly

Federal Reserve Bank of Minneapolis
April 1975

Minnesota's Usury Law: An Evaluation



District Conditions

How has Minnesota's 8 percent usury law affected new housing construction in Minnesota? How have borrowers' positions been affected as regards interest rates, credit availability, and the nonprice terms of a mortgage?

These questions are studied in an attempt to answer the largely disputed question: Is Minnesota's 8 percent usury law effective in protecting consumers from usurious rates of interest?

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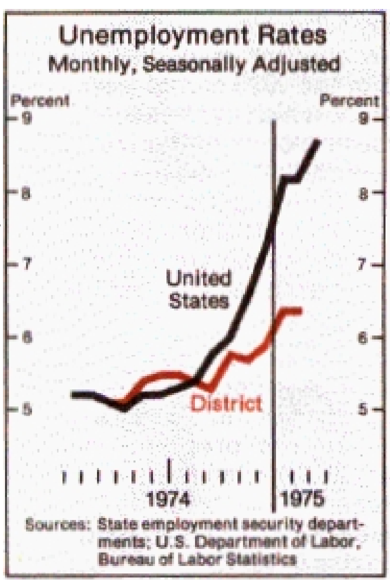
District Conditions

First Quarter '75 Review

Early 1975 brought a marked deterioration in district economic activity. Immediate prospects are for a further decline, but as in the past, the district's economic activity continues generally stronger than the nation's.

The district unemployment rate has neither risen as fast nor soared as high as the national unemployment rate. The district's seasonally adjusted unemployment rate went from 5.8 percent in the fourth quarter of 1974 to 6.4 percent in the first quarter of 1975, while the national rate advanced from 6.6 to 8.2 percent over the same period.



Other district indicators (initial claims and help wanted advertising) point toward further rises in unemployment.

The district's manufacturing sector has been hard hit by the recession—but still not as hard as the nation's. Manufacturing jobs in early 1975 fell from year-ago levels by 2.8 percent in the district and 8.5 percent in the nation. Slower growth in district manufacturing sales is expected over the first three quarters of 1975, with most of the growth still largely attributable to inflationary prices.

Construction spending fell sharply in early 1975. New housing unit authorizations were at record low levels, and nonresidential construction declined. District housing and construction may be aided by substantially increased savings inflows, which resulted in stronger liquidity positions and a rise in loan commitments at S&Ls in early 1975. Loans at district banks have paralleled the declines at commercial banks in the rest of the country, largely reflecting a reduction in business loan activity.

Counter to the declines experienced by most other district businesses, resort owners reported a phenomenal winter recreation business. Consumer spending in many other areas, however, is still being affected by the recession. Retail sales in Minnesota were down 2.3 percent from last year's record level, while retail sales nationally were up 6.5 percent. According to recent evidence, Minnesota sales continued slow in February and March.

Farm prices generally declined through the first quarter from the record levels of a year before. Several factors account for this decline. Farm prices typically fall during a recession. Expectations for a bumper harvest next fall as well as lower export sales have contributed to price weaknesses. Cutbacks in livestock feeding have reduced demand for grains. Finally, heavy cattle slaughter put strong downward pressure on livestock prices through the first quarter.

Effects of the recession are still being felt in most sectors of the Ninth Federal Reserve District's economy. But in most cases, as is evident in this first quarter review, the district continues to fare better than the nation. The following sections provide a closer look at three specific areas of the district's economy.

District Housing Construction

Residential construction is one of the major victims of the nation's current economic situation. The influences of past overbuilding, huge increases in input prices, high interest rates, and reduced savings inflows have combined to create the most extensive and protracted decline in homebuilding in postwar history. Housing units authorized in both the district and the nation declined in early 1975 to about one-third of the record 1972 pace and are currently at the lowest level since 1960—possibly since World War II.

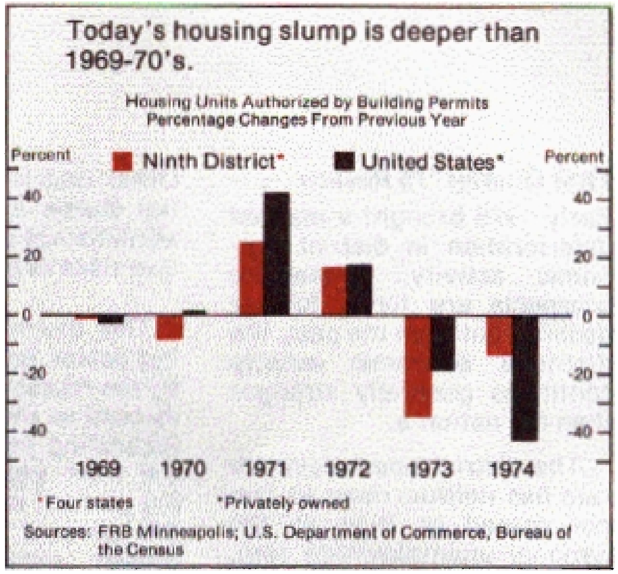
A marked rise in net savings inflows at savings and loan associations (S&Ls) in the first quarter, combined with a decline in mortgage interest rates, suggests that the decline in housing construction may have bottomed out. But the recovery is unlikely to be rapid with the influences that combined to create the decline still present and the absence of effective federal aid. Similar recovery rates in both the district and the nation may be expected since a more favorable inventory position in the district will be offset by somewhat higher shelter costs.

In order to determine the possibilities for recovery in district housing construction, the following questions will be discussed: How does the housing decline in 1973-74 compare to that of 1969-70? What are the prospects for recovery in the nation? What are some factors affecting recovery in the district relative to the nation?

Recent Housing Declines

In comparing the present contraction in housing construction with the one which occurred in 1969-70, the duration and scope of the current slump stand out most distinctly.

Housing units authorized in the United States during 1969 were only 2.3 percent lower than in 1968. Recovery was under way by 1970, with units for that year less than 1 percent below the 1968 level. The 1969 drop in units in the Ninth District, though less extensive than in the United States, continued and intensified throughout 1970, falling over 8 percent from 1968 levels.



Today's housing slump is deeper than 1969-70's.

Sources: FRB Minneapolis; U.S. Department of Commerce, Bureau of the Census

In both the United States and the district, a strong surge of activity in housing unit authorizations began in 1971 and extended throughout 1972. As in the period of decline, initial district changes in the period of recovery were smaller than national ones.

The record numbers of units authorized in 1972 paved the way for drastic declines in both 1973 and 1974. In contrast with the 1969-70 period, the effects of the 1973 slump were more evident in the district, which experienced a 34.4 percent drop in housing units authorized, compared to an 18.4 percent fall in the nation. However, while United States units continued to drop in 1974 an additional 42.4 percent, district declines moderated somewhat and units authorized fell 12.7 percent from the year before.

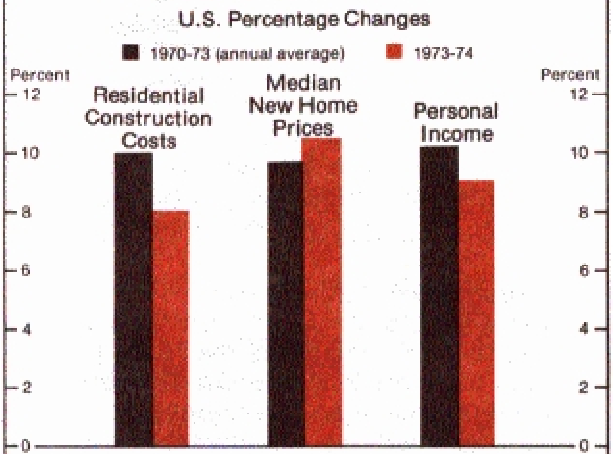
Several factors have contributed to the present homebuilding slump in the United States. The rapid growth in 1971 and 1972 ultimately resulted in upward pressure on input prices. Residential construction costs increased significantly between 1970 and 1973, and although pressure eased somewhat, most input prices continued to rise in 1974.

Increases in construction costs were soon reflected in home prices. Additions to the supply of available housing stemming from the 1971-72 boom apparently provided a moderating influence while construction cost rises slightly outpaced changes in home prices until 1974.

During 1974, home prices escalated not only more rapidly than residential construction costs but also faster than personal income. Average home prices in the Twin Cities rose even faster than nationally to a current level well above the national average.

Homebuilding in the United States was also adversely affected in 1973-74 by a rise in interest rates and a slowdown in savings inflows at S&Ls. After dropping from 9.03 percent in 1970 to 7.52 percent in 1972, the Federal Housing Administration (FHA) secondary market mortgage loan rate rebounded to 8.24 percent in 1973 and 9.50 percent in 1974. Savings deposits at S&Ls, after growing at an average of 19 percent in 1971-72, slowed to growth rates of 10 percent in 1973 and 7 percent in 1974.

New home prices rose more than construction costs and personal income in 1974.

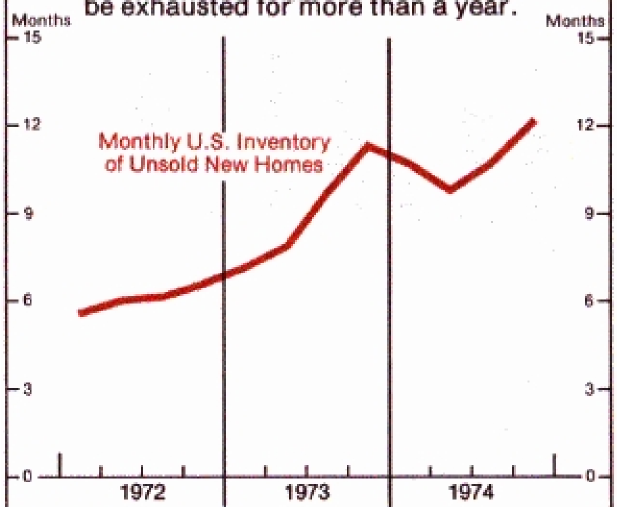


Sources: U.S. Department of Commerce, Bureau of Economic Analysis; FR Board of Governors

Prospects for Recovery

Chances are small that the national housing market will experience a recovery on the scale of that which occurred after the 1969-70 period. Probably the most significant deterrents are the current period's more serious declines in employment and output and the accompanying effects on consumer confidence.

If the sales rate doesn't speed up, the inventory of unsold homes won't be exhausted for more than a year.

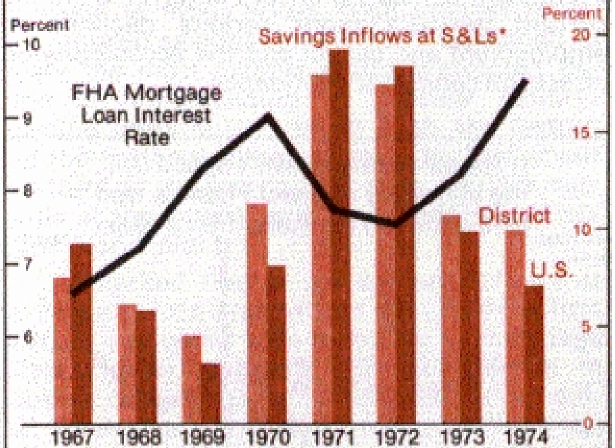


Seasonally adjusted

Source: U.S. Department of Commerce, Bureau of the Census

The extraordinarily large current inventory of unsold houses should create downward pressure on housing prices and may stimulate demand. That inventory must be substantially reduced, however, before any increases in new building can be generated. But since the decline in construction of rental units has been even more drastic than that of single-family homes, future upward pressures on rent costs may encourage home buying and *reduce* downward pressure on home prices. In addition, rapidly accelerating fuel costs will result in upward movements in both rental and homeownership costs.

The high level of mortgage interest rates, 1973-74 homebuilding was hurt by higher mortgage interest rates and scarcer mortgage money.



*Seasonally adjusted annual rate

Sources: Des Moines, Iowa, and Seattle, Washington, Federal Home Loan Banks; FR Board of Governors

if continued through 1975, is likely to provide an added constraint to the housing recovery. An analysis of the two preceding recoveries—in 1967 and in 1970—provides some evidence of the impact of mortgage rates. The recovery was more rapid in 1967 than in 1970, partly because mortgage interest rates were substantially lower in the earlier period. The FHA secondary market mortgage rate, for example, averaged 6.55 percent in 1967 compared to 9.03 percent in 1970.

The FHA rate has already declined substantially since reaching its peak in the third quarter of 1974, but was still a high 9.04 percent in January-February 1975. Further downward movement in this rate is being impeded by the currently large demands for long-term funds from the federal government and corporate sectors.

The recent, substantially stronger net savings inflows at S&Ls should benefit the housing recovery. The rate of net savings inflows at S&Ls in the United States nearly doubled in January-February from the 10 percent rate in 1974, and the heavy inflows seem to have continued in March. However, some of this inflow will likely be used to rebuild liquidity. Largely because of a substantial increase in borrowing to meet mortgage loan commitments, S&L liquidity declined to an unusually low level in 1974.

Federal aid to housing is currently at a low ebb. Two plans—one already enacted—may provide some stimulus to the housing industry, however. The first, part of the recently signed tax cut bill, provides a 5 percent tax credit on the price of a new principal residence purchased between March 12 and December 31 up to a maximum of $2,000. Eligible homes are those completed or under construction as of March 25 and include mobile homes, residential units in condominiums, and cooperative housing projects. The impact on new construction will be indirect because sales of eligible homes reduce existing inventory.

The second plan, which has passed the House, is intended to subsidize mortgages on 400,000 single-family homes of which up to 30 percent can be unsold or previously occupied homes. The subsidy, which applies to families with incomes not exceeding 120 percent of the area median-family income and, generally, to homes costing $38,000 or less, can be used in one of two ways: (1) the homeowner can pay a 6 percent rate of interest on the mortgage during the first three years and then an increasing rate until the seventh year when the market rate is paid; (2) the homeowner can pay a 7 percent rate of interest during the entire life of the mortgage.

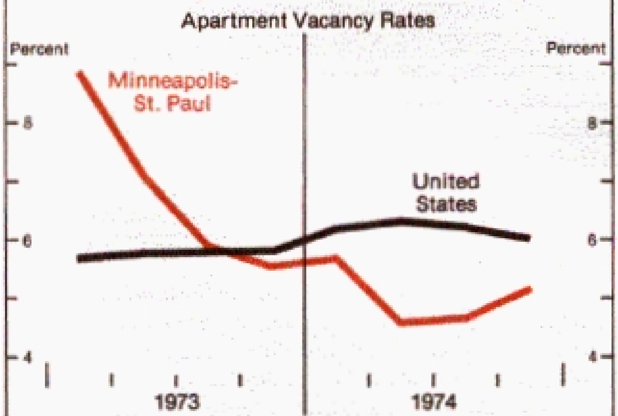
Ninth District vs. United States

The same factors which influence a nationwide housing recovery will affect the Ninth District, although probably to a different degree. To the extent that this area continues to be less severely affected by the current recession, expenditures for housing should remain relatively stronger.

However, housing prices relative to income have been rising more rapidly in the district since 1970. While inventory accumulation of single-family homes has not been as pronounced in the district, smaller current inventories imply less downward pressure on housing prices.

There are currently two very different influences being exerted on rental prices. District declines in rental unit construction, while greater than in single-family unit construction, have not been nearly as large as national declines. This implies less upward pressure on rent costs. However, apartment vacancy rates have been lower in the district than in the nation for over a year. This somewhat greater demand for rental units implies no downward pressure on rents in the district.

Excess supply in the rental market has been smaller here than nationally for over a year.



Sources: First National Bank of St. Paul, Minnesota; U.S. Department of Commerce, Bureau of the Census

The impact of rising fuel costs on home operating expenses and consequently on homeownership will also be felt more severely in district states.

On balance, there is no evidence which suggests that district housing recovery will differ from the rest of the United States. The greater demand which may be expected in the district from higher income and employment will be offset by higher costs of housing.

Stanley L. Graham
Diane D. Paxton

Family Budgets in 1974

A typical urban American family living at an intermediate-income level would have had to pay an additional $1,706 in 1974 to maintain its 1973 standard of living, according to recent United States government figures.[1] The same family living in Minneapolis-St. Paul would have had to spend $1,897 more in 1974 to support its 1973 level of expenditure.

The figures here are based on hypothetical intermediate family budgets constructed by the Bureau of Labor Statistics (BLS). The BLS has developed budgets for a family of four at low, intermediate, and high standards of living both for the national average and for 39 metropolitan and 4 nonmetropolitan areas. This hypothetical family of four consists of a husband aged 38, employed full time; his nonworking wife; a boy of 13; and a girl of 8. The BLS' fictional couple has been married 15 years, and the husband is an experienced worker. The family is described as well established with an average inventory of clothing, household furnishings, major appliances, and other equipment.

The budgets represent the BLS' estimate of typical expenditures at the three standards of living in 1973, rather than actual expenditures of any group of families. The comparisons for 1974 are for purchases of exactly the same goods and services that were purchased in 1973. No allowance was made for changes in the composition of a family's expenditures in response to higher prices or other economic factors.

[1]Bureau of Labor Statistics figures for 1974 were released in April 1975. The intermediate family budget figures for 1973 were published in: U.S., Department of Labor, Bureau of Labor Statistics, "Autumn 1973 Urban Family Budgets and Comparative Indexes for Selected Urban Areas," NEWS (June 16, 1974).

1973 and 1974 Intermediate-Income Family Budgets[1]

	Minneapolis-St. Paul				United States			
			1973-74 Change				1973-74 Change	
	1973	1974	Absolute	Percentage	1973	1974	Absolute	Percentage
Total Consumption Expenditures	$ 9,589	$10,700	$1,111	11.6%	$ 9,761	$10,880	$1,119	11.5%
Food	3,067	3,429	362	11.8	3,183	3,548	365	11.5
Housing	2,790	3,082	292	10.5	2,908	3,236	328	11.3
Transportation	1,026	1,168	142	13.8	1,014	1,171	157	15.5
Clothing	1,041	1,192	151	14.5	995	1,085	90	9.0
Personal Care	288	325	37	12.8	275	310	35	12.7
Medical Care	625	691	66	10.6	664	742	78	11.7
Other Consumption[2]	752	813	61	8.1	722	786	64	8.9
Total Nonconsumption Expenditures	$ 3,431	$ 4,217	$ 786	22.9%	$ 2,865	$ 3,452	$ 587	20.5%
Personal Income Taxes	2,194	2,788	594	27.1	1,607	2,010	403	25.1
Social Security Taxes	632	772	140	22.2	647	780	133	20.6
Other Nonconsumption[3]	605	657	52	8.6	611	662	51	8.3
Total Budget	$13,020	$14,917	$1,897	14.6%	$12,626	$14,333	$1,706	13.5%

[1]Based on the U.S. Bureau of Labor Statistics' hypothetical budget for an intermediate-income urban family of four: a 38-year-old husband employed full time, his nonworking wife, a boy of 13, and a girl of 8. Because of rounding, sums of individual items may not equal totals.

[2]Includes average costs for reading, recreation, tobacco products, alcoholic beverages, education, and miscellaneous expenditures.

[3]Includes allowances for gifts and contributions, life insurance, and occupational expenses.

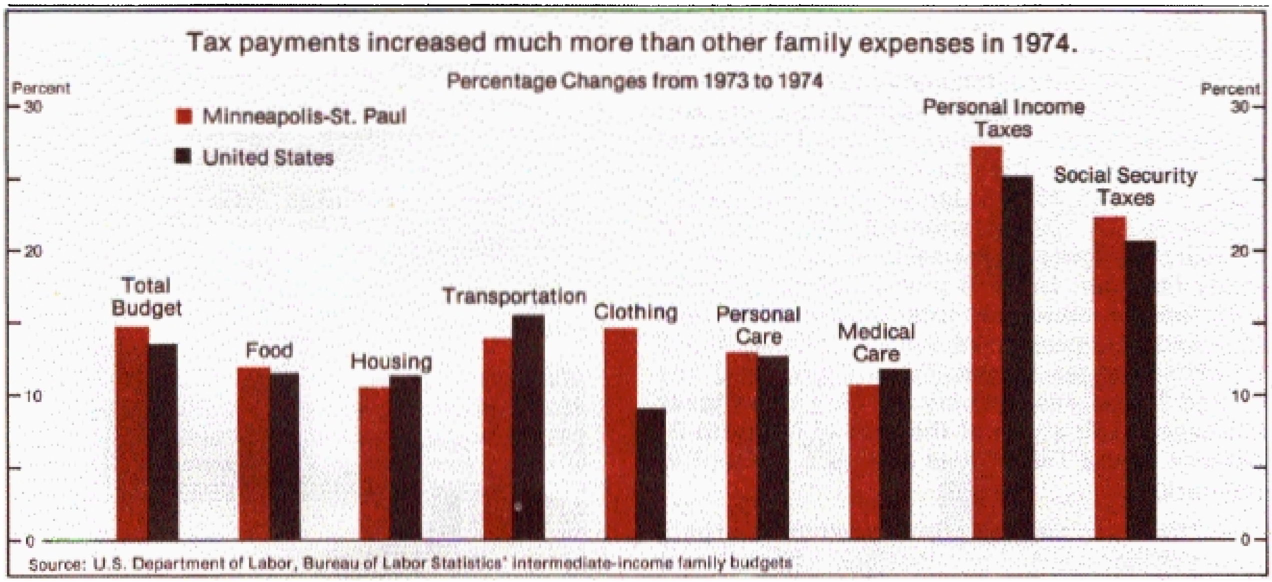
Source: U.S. Department of Labor, Bureau of Labor Statistics

Moreover, the BLS' budget studies do not imply that a family's actual income rose by these amounts. On the contrary, purchasing power for most families did not keep pace with inflation in 1974: all real income measures dropped last year. Although real weekly earnings in Minnesota declined 3 percent, less than the 4.6 percent fall experienced nationally, real spendable weekly earnings fell somewhat more in Minnesota than in the rest of the country.[2] Because withholding for increased income and social security taxes hit Minnesota residents harder, real spendable weekly earnings in the state declined 5.6 percent between October 1973 and October 1974, compared to the national decline of 5.3 percent.

A family living on an intermediate-level budget in the Twin Cities experienced a 14.6 percent increase in expenses between 1973 and 1974, while nationally the same family's expenditures rose 13.5 percent. These increases were substantially greater than the rise in the respective consumer price indexes (CPI) for the same period: The Twin Cities CPI rose 12 percent and the United States CPI rose 13 percent between autumn 1973 and autumn 1974.

The explanation lies in the difference between items covered by the consumer price

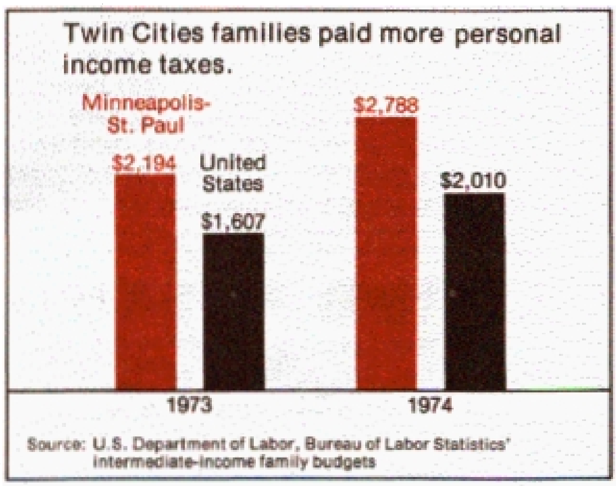
[2]Changes throughout this analysis are from October 1973 to October 1974 because the BLS' family budget studies are based on October data.



indexes and items covered by the family budget studies from which cost of living figures are derived. The consumer price indexes include only purchases of goods and services. Family budget studies also include expenditures on goods and services but in addition include non-consumption expenditures, such as personal income taxes, social security taxes, disability payments, allowances for gifts and contributions, and insurance and occupational expenditures.

Higher tax payments (based on standard deductions and exemptions for four people) outstripped all other price increases in the intermediate family's budget in 1974. For the Twin Cities family, not itemizing deductions, personal income tax payments jumped $594 or 27.1 percent in 1974. For the United States family, the tax increase was $403 or 25.1 percent.

A recent government study pointed out that this was the first recession during which the tax burden on individuals and families increased.[3] This is because progressive tax payments rise more rapidly than money incomes during periods of inflation. Price rises increase



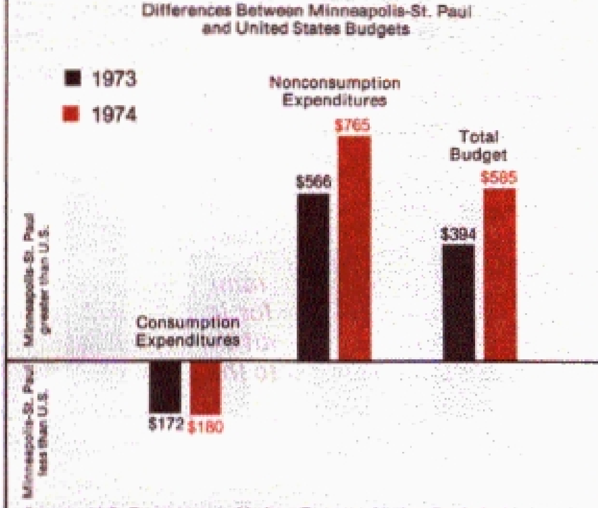
the tax burden more on low- and middle-income than on high-income families, however, because inflation reduces the value of both the standard deduction and the exemptions and because tax brackets are much narrower at low- and middle-income levels.

[3] U.S., Congress, INFLATION AND THE CONSUMER IN 1974, a staff study prepared for the use of the Subcommittee on Consumer Economics of the Joint Economic Committee, 95th Cong., 1st sess., 1975.

The dramatic hike of over one-fifth in social security tax payments intensified the strain on the middle-income family's budget in 1974. Although the social security tax rate was unchanged, higher levels of money income and the increase in the payroll tax base from $10,800 to $13,200 on January 1, 1974 (raised further to $14,100 on January 1, 1975) resulted in sharply higher social security payments for many families. In 1973 payroll taxes together with federal, state, and local income taxes took 21.7 and 17.9 percent of the intermediate-level family's budget in the Twin Cities and the United States, respectively. In 1974 these taxes increased their share of the cost of living to 24 percent in the Twin Cities and 19.5 percent in the nation.

There are also differences between expenditures on goods and services and expenditures on nonconsumption items for the average United States and Twin Cities middle-income family. Total expenditures on goods and services were less for the Twin Cities family, and this difference increased slightly ($8) between 1973 and 1974. Housing[4] and medical care were notably cheaper in the Twin Cities, and their costs rose less than in the nation. In contrast, clothing was much more expensive, and its cost

Living cost more here in 1973 and 1974 even though goods and services were cheaper.



Source: U.S. Department of Labor, Bureau of Labor Statistics' intermediate-income family budgets

[4]Housing costs are based on the homeownership component of the CPI which assumes ownership and maintenance of a six-year-old home and reflects increases in the purchase price of homes and mortgage interest rates only from 1967 to 1968. It does not reflect the differences in purchase prices and mortgage interest rates encountered by home buyers between 1973 and 1974.

How Minneapolis-St. Paul and U.S. Family Budgets Compare

	1973 Mpls.-St. Paul	1973 U.S.	1974 Mpls.-St. Paul	1974 U.S.	Difference (Mpls.-St. Paul minus U.S.) 1973	Difference (Mpls.-St. Paul minus U.S.) 1974	1973-74 Change in Difference	Mpls.-St. Paul as a Percent of U.S. 1973	Mpls.-St. Paul as a Percent of U.S. 1974
Consumption Expenditures[1]	$ 9,589	$ 9,761	$10,700	$10,880	$—172	$—180	$—8	98.2%	98.3%
Nonconsumption Expenditures[2]	$ 3,431	$ 2,865	$ 4,217	$ 3,452	$ 566	$ 765	$ 199	119.8%	122.2%
Total Budget	$13,020	$12,626	$14,917	$14,333	$ 394	$ 585	$ 191	103.1%	104.1%

[1]Purchases of goods and services

[2]Federal, state, and local personal income taxes, social security and disability payments, allowances for gifts and contributions, life insurance, and occupational expenses

Source: U.S. Department of Labor, Bureau of Labor Statistics' intermediate-income family budgets increased more sharply in Minneapolis-St. Paul in comparison to the United States average.

Overall, the premium paid by the Twin Cities family increased slightly between 1973 and 1974; that is, the additional expense paid by the Twin Cities resident increased $191 between the two years. All forms of taxes more than accounted for the added difference.

Kay J. Auerbach
Bruce W. Brinkmeier

***Note:** Data for the Minneapolis-St. Paul lower- and higher-level family budgets became available too late for inclusion in this article. Information about these budgets is available upon request to the authors.*

State Government Finances

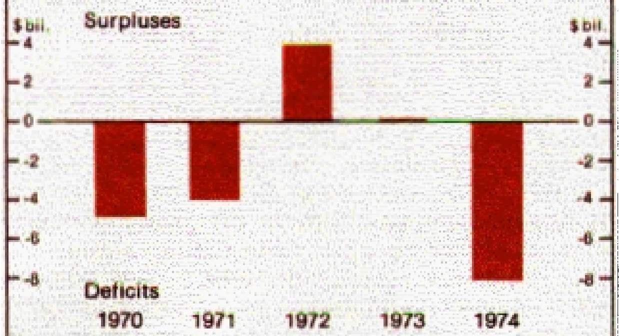
How has the outlook for state government finances in the Ninth Federal Reserve District been affected by weakening economic activity and rising prices? How can state governments be expected to influence district economic activity? A partial answer to these questions can be found by comparing the district state governments' revenue and spending plans for fiscal years (FY) 1976 and 1977 with their fiscal performance in the prior two years.

A review of nationwide state and local government finances will provide a perspective from which to view district fiscal developments. Then the fiscal situation in Minnesota, Montana, North Dakota, and South Dakota will be evaluated by looking at developments in both revenues and expenditures as they were projected in early 1975.[5] In conclusion, the overall fiscal situation will be evaluated and some observations made on the implications for the district's economy.

National Developments

After benefiting from the enactment of general revenue sharing in 1972 and the economy's rapid expansion in 1972 and 1973, state and local governments' fiscal positions shifted to the deficit in calendar year (CY) 1974.[6] Last year expenditures exceeded revenues by $8 billion, and prospects are for another sizable deficit in 1975. In 1974 about one-fifth of total state and local government revenues were attributable to personal and corporate taxes, while 50 percent of the federal government's revenues were from this source.

The nation's state and local governments shifted to a large deficit position in 1974.

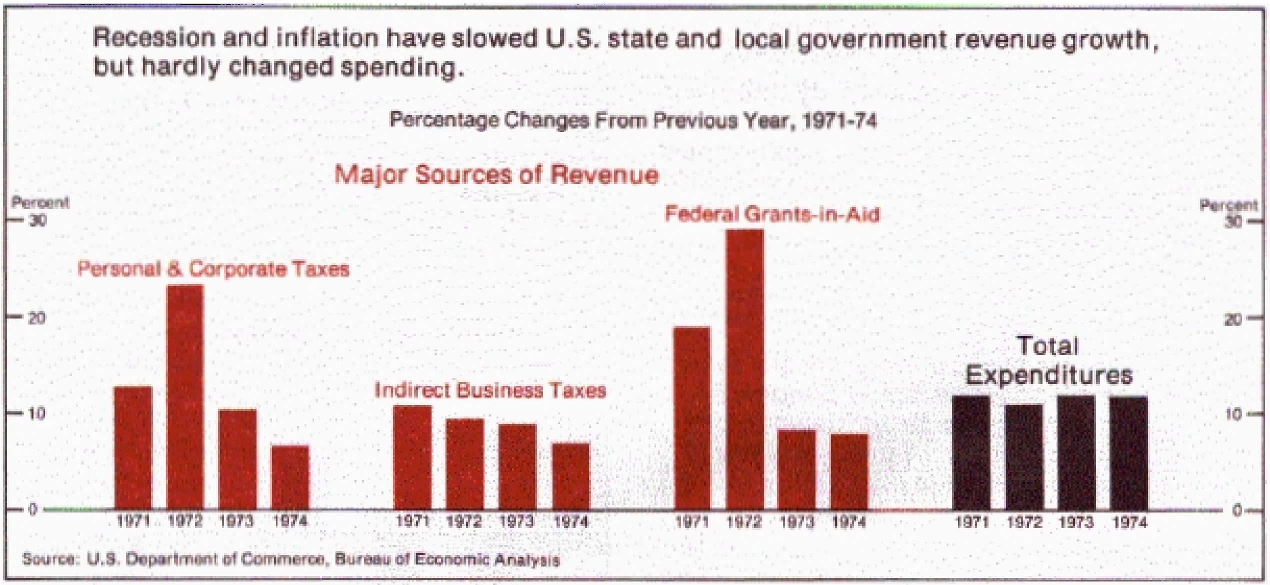


Excludes receipts and expenditures of social insurance funds as measured in national income and production accounts.
Source: U.S. Department of Commerce, Bureau of Economic Analysis

It is evident, after studying the changes in total state and local government expenditures and in major sources of funds over the past four years, that the recession has and will continue

[5]This report's estimates for FYs 1976 and 1977 reflect state executive officials' views of future fiscal developments. State legislatures may act contrary to the governors' wishes, and the revenues of state officials may be under or over actual receipts. Because the assumptions and methodology used in making the projections are not made available by any district state, it is not possible to evaluate the projections' realism nor to ensure that they are on a comparable basis. Also, as of early April the Minnesota and Montana legislatures were still in session and their actions could alter these projections.

[6]The difference between revenues and expenditures in measuring state and local governments' fiscal positions excludes the receipts and expenditures of social insurance funds. State-local social insurance funds generally record surpluses, but the surpluses, unlike their federal counterparts, generally are not available to finance capital spending projects or deficits of operating funds; as a result, they are usually excluded when assessing the aggregate fiscal health of these governments.



to have a slowing effect on the growth of state and local tax receipts. Federal grants-in-aid programs have stopped growing as well and are not expected to increase appreciably in 1975. On the expenditure side, price and wage increases have eroded state and local governments' purchasing power, while the recession has increased the demand for state and local government services.

Since these cost pressures are likely to remain strong, state and local governments will probably incur large deficits in 1975. As the Council of Economic Advisors stated in its 1975 annual report,

> *Budgetary reserves are now so tight that the rise in state and local expenditures will have to slow considerably to adjust to the reduced growth of receipts or taxes will have to be raised in a declining economy.*[7]

Stringent conditions, however, are not universal. Texas and Oklahoma, for example, have accumulated budget surpluses as a result of increased gas and oil revenues, and California also has excess funds. At the other extreme, New York, New Jersey, and Michigan are confronting serious fiscal problems.[8]

Ninth District Finances

Given the national view of state and local government finances, what is the outlook for the Ninth District states? In answering this question, each state's executive budget for the 1976-1977 biennium will be examined and compared to the preceding biennium's fiscal developments.

Revenues. The rates of growth in district states' revenues[9] slowed in FY 1975. With the exception of South Dakota, growth rates in FYs 1976 and 1977 are not expected to return to the highs attained in FY 1974. Indeed, North Dakota officials anticipate an actual fall in FYs

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[7] U.S., Council of Economic Advisors, THE ANNUAL REPORT OF THE COUNCIL OF ECONOMIC ADVISORS (Washington, D. C.: Government Printing Office, 1975), p. 65.

[8] The following articles discuss the fiscal plight of state and local governments: "The Crunch on City and State Budgets," BUSINESS WEEK, March 10, 1975, pp. 78-79; Philip Shabecoff, "States Retrench in Face of Slump," NEW YORK TIMES, March 17, 1975, pp. 1 and 39; and "Many States Spending Savings as Hard Times Reduce Incomes," NEW YORK TIMES, April 7, 1975, p. 24.

[9] Sources of state revenues are taxes; licenses, fees, and other charges; revenues from state-owned operations; and federal government grants-in-aid.

1976 and 1977 revenues. Montana and South Dakota estimated revenues indicate renewed strength by FY 1976, but a pickup in Minnesota revenues is not expected until FY 1977.

This slowing in receipts stems in large part from an anticipated slowing in the growth of state tax revenues. The changes that are expected in personal and corporate income tax as well as in general sales receipts through FY 1977 do not reflect any changes in the tax laws.[10] The changes reflect, rather, how state officials foresee economic conditions affecting tax revenues during the 1976-77 biennium.

During FY 1976 in Minnesota, the rate of growth in all three taxes is expected to slow and corporate income tax collections are expected to decline.[11] In Montana, however, personal income tax revenues are likely to accelerate over the next biennium while corporate income tax receipts are expected to slow. Due to inflation and the dramatic rise in farm income, North Dakota had large tax receipt gains in FY 1974 and anticipates the growth in tax receipts to slow markedly during the next biennium. The rate of increase in South Dakota's general sales tax is expected to continue to decline over the next fiscal year.

Energy developments have adversely affected motor fuel tax collections. Since motor fuel taxes are earmarked for highway programs, this falloff in receipts has hampered district highway building. Consequently, gasoline tax increases were enacted in Montana and South Dakota. On the other hand, no tax increase was requested in North Dakota, and the legislature rejected a request to hike Minnesota's gasoline tax.

In addition to slowing tax receipts, the pace of federal grants-in-aid appears likely to decelerate. The federal budget for FY 1976 shows aid to state and local governments increasing 5.7 percent compared to the 14.4 percent advance of the preceding year. An increase in federal monies of this magnitude will probably not be sufficient to offset price increases.

Changes in District Tax Revenue

Percentage Changes From Previous Fiscal Year, 1974-77

	Minnesota	Montana[1]	North Dakota[2]	South Dakota[3]
Personal Income Tax				
1974	19.7	2.2[4]	68.3	n.a.
1975e	13.2	13.1	5.6	n.a.
1976e	7.9	17.6	2.1	n.a.
1977e	11.9	18.3	2.1	n.a.
Corporate Income Tax				
1974	12.2	25.5	43.7	n.a.
1975e	14.5	11.7	6.0	n.a.
1976e	−10.0	7.0	4.2	n.a.
1977e	11.1	6.6	4.2	n.a.
Sales Tax				
1974	16.3	n.a.	15.5	17.2
1975e	10.0	n.a.	10.0	11.9
1976e	7.8	n.a.	6.0	7.7
1977e	9.5	n.a.	6.0	n.a.
Motor Fuel Tax				
1974	−0.7	−0.9	−0.4	2.9
1975e	0.3	1.3	9.2	1.7
1976e	0.0	2.5[6]	3.9	4.5[7]
1977e	−1.3[5]	6.3	5.3	n.a.

e = estimated
n.a. = not available

[1]Montana does not have a state sales tax.

[2]Estimates do not reflect recent legislative changes in North Dakota tax laws.

[3]South Dakota has neither a personal nor a corporate income tax and budgets annually instead of biennially.

[4]Montana's 40 percent income tax surcharge was dropped to 10 percent in 1974.

[5]The 1976-77 decline is due to a $1.8 million increase in collection costs assessed every two years.

[6]Estimates do not reflect the 1.5 cents per gallon increase enacted by the legislature.

[7]Based on a 1 cent per gallon increase enacted by the legislature.

Sources: State budget documents and officials

Concern over the recession's impact on state and local government's fiscal position has led to a congressional proposal to increase state and local government grants-in-aid as unemployment rises. Under this proposal an 8.7 percent national unemployment rate (the level

[10]Personal and corporate income taxes and sales taxes are used for general fund expenditures while motor fuel receipts are dedicated to highway outlays.

[11]"Recession Aid Plan Tied to Jobs Rates," NEW YORK TIMES, April 8, 1975, p. 8.

District State General Fund Finances[1]

Fiscal Years 1973-77

	Millions of Dollars					Percentage Changes			
	1973	1974	1975e	1976e	1977e	1973-4	1974-5	1975-6	1976-7
Minnesota[2]									
Beginning Balance	−5.4	57.5	218.1	399.8	203.7				
Revenues	1,730.3	2,001.7	2,247.0	2,387.6	2,603.8	15.7	12.3	6.3	9.1
Expenditures	1,667.3	1,841.1	2,065.3	2,583.7	2,657.5	10.4	12.2	25.1	2.9
Annual Surplus or Deficit	63.0	160.6	181.7	−196.1	−53.7				
Ending Balance	57.5	218.1	399.8	203.7	150.0	279.3	83.3	−49.1	−26.4
Montana									
Beginning Balance	6.3	24.2	40.8	40.0	23.8				
Revenues	112.6	131.8	142.7	158.1	178.0	17.1	8.3	10.8	12.6
Expenditures	94.7	115.5	143.4	174.4	191.8	22.0	24.2	21.6	10.0
Annual Surplus or Deficit	17.9	16.3	−0.7	−16.3	−13.8				
Ending Balance	24.2	40.8	40.0	23.8	10.0	68.6	−2.0	−40.5	−58.0
North Dakota									
Beginning Balance	29.5	52.5	89.6	131.0	112.3				
Revenues	135.8	173.2	204.0	200.0	188.0	27.5	17.8	−2.0	−6.0
Expenditures	113.0	136.0	163.0	218.7	231.3	20.4	19.9	34.2	5.8
Annual Surplus or Deficit	22.8	37.2	41.0	−18.7	−43.3				
Ending Balance	52.5	89.6	131.0	112.3	69.0	70.7	46.2	−14.3	−38.6
South Dakota									
Beginning Balance	10.8	23.5	27.2	7.8	5.6				
Revenues	114.0	126.7	136.1	151.6	n.a.[3]	11.1	7.4	11.4	n.a.
Expenditures	101.3	123.0	155.5	153.8	n.a.	21.4	26.4	−1.1	n.a.
Annual Surplus or Deficit	12.7	3.7	−19.4	−2.2	n.a.				
Ending Balance	23.5	27.2	7.8	5.6	n.a.	15.7	−71.3	−28.2	n.a.

e = estimated n.a. = not available

[1]General funds are designated to defray the general costs of state government, not for specific purposes. Although they contain some education monies, highway funds are excluded. State governors' executive budget proposals primarily cover general fund revenues and expenditures. Figures above for Minnesota and Montana reflect January budget proposals which legislatures were considering in early April. Figures for North Dakota and South Dakota reflect legislative responses to governors' proposals.

[2]Minnesota's general fund balance is projected to increase from $399.9 million on June 30, 1975, to $660.2 million on June 30, 1977, if the legislature enacts no new spending initiatives. This report assumes that $150 million of the $660.2 million will be set aside for the governor's budget protection plan and $255.1 million spent on new or expanded programs in both fiscal years 1976 and 1977.

[3]South Dakota budgets annually rather than biennially.

Sources: State budget documents and officials

reached in March) would trigger authorization of $4 billion annually for state and local governments. These funds would help governmental units cope with declining revenues caused by the recession.[12]

[12]Some controversy surrounds these tax estimates for Minnesota, which were made by Francis Boddy, Professor of Economics, University of Minnesota. His estimates are $350 million higher than estimates prepared by the Commissioner of Revenue. Betty Wilson, "Governor Bets Bundle on Boddy Count," MINNEAPOLIS STAR, March 3, 1975, pp. 1 and 4.

Expenditures. Large general fund balances will allow Minnesota, Montana, and North Dakota to significantly increase expenditures in FY 1976. All three states, however, look for expenditure growth to slow in FY 1977. South Dakota plans no expenditure increase in FY 1976.

Wage increases will account for much of the anticipated rise in outlays by district governments, since state government employment is not expected to increase substantially over the next biennium. However, state governments will probably hire some additional workers under federal public service employment programs.

Additional analysis of expenditures is provided by the projections for education and highway outlays, which together account for around 60 percent of state expenditures. The largest area of growth in Minnesota's budget was state aid to elementary and secondary education, and Montana's budget called for increasing the level of support and fully funding the state school aid program for the second successive biennium. In North and South Dakota the legislatures raised state aids to local school districts.

Budget proposals indicate that wage increases will account for a large portion of increased outlays for higher education. In Minnesota, however, the Governor has asked for more funds for student financial aids and has proposed freezing tuitions at current levels for Minnesota residents attending state schools. In South Dakota, on the other hand, tuition increases were requested to defray rising costs.

Recent economic developments have appreciably affected district highway outlays. As previously noted, the energy crisis reduced motor fuel tax revenues, and federal highway aid has tapered off as the interstate highway system nears completion. Price increases have seriously eroded outlays; for example, the Federal Highway Administration's highway construction cost index increased 35 percent between the third quarters of 1973 and 1974. Cost increases of this magnitude are well above the increase in district highway outlays.

The impact of these declines in outlays on district highway construction is manifested by the decline in Minnesota's employment in highway and heavy building construction of 10.2 percent between 1973 and 1974. The projected declines in highway outlays, and therefore highway construction, may be partially mitigated by the release of $2 billion in previously impounded federal highway funds. By early April South Dakota and Montana had already taken advantage of the increased availability of federal highway funds. North Dakota is also expected to seek additional highway aid which is reflected in that state's highway expenditure projections.[13] Minnesota's highway department in early April did not have sufficient funds to match the federal funds and so will not be able to take advantage of the released monies.

Fiscal Position of Ninth District States

The preceding analysis attempts to answer the question: How has the outlook for state government finances in the Ninth Federal Reserve District been affected by weakening economic activity and rising prices? Revenue growth will be curbed by the recession. This will limit the expansion in discretionary spending at the same time that inflation is eroding real state government outlays. However, district states do not face severe fiscal problems, as do many other states across the nation.

District states, except South Dakota, are entering the 1976-1977 biennium with substantial cash balances. However, the rise in expenditures in dollar terms represents very little increase in real activity due to inflation. Current levels of planned expenditures reflect the determination to maintain essential services and commitments to tax and education reforms.

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[13] "Few States Claim Funds for Roads," NEW YORK TIMES, April 7, 1975, p. 48.

How can state governments be expected to influence district economic activity? The general conclusion is that the projections for revenues, expenditures, and surplus/deficit positions of district state budgets presented here imply a slightly stimulative fiscal posture. The extent to which states are using accumulated surpluses to bolster currently softening economies is worth noting. All district states plan to cut existing surpluses considerably to maintain real expenditure levels.

Moreover, state governments have refrained from requesting sales and income tax hikes during the current recession. Expenditure projections do not indicate any cutbacks in state programs or employment.

Although North Dakota plans to draw down its surplus funds over the next biennium, a sizable surplus will remain by the end of FY 1977. The fiscal situation is much tighter in Montana and South Dakota, where any appreciable shortfall in revenues could seriously strain those states' finances. It is interesting to note that Minnesota, Montana, and North Dakota, the states imposing income taxes, are all also proposing expenditure increases. These three states have more fiscal flexibility than South Dakota, which has no income taxes and which also has budgeted no increases in expenditures.

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Minnesota's Usury Law: An Evaluation

Arthur J. Rolnick
Stanley L. Graham
David S. Dahl

Is Minnesota's 8 percent usury law effective as a consumer protection law? Supporters of the law contend that it is. They argue that when borrowing money the uninformed consumer is protected from usurious rates of interest and that during periods of tight credit all consumers are protected from these rates.

In recent years, however, the law has come under attack. Opponents argue that the disclosures required by the federal truth-in-lending law are sufficient protection from exorbitant interest rates and that a usury law only eliminates high-risk borrowers from effectively competing in the market. In other words, it eliminates those borrowers who are willing to pay a higher rate. Opponents go on to argue that in periods of tight credit, when interest rates are higher than the 8 percent ceiling, either other, generally less efficient, rationing devices are used to allocate credit or the supply of credit is further diminished.

With these opposing views in mind, this study examines periods of tight credit and assesses the impact of Minnesota's usury law. After a review of the usury related legislation, the focus turns to these questions: Has the usury law affected new housing construction in Minnesota? To what extent are borrowers' positions affected as regards interest rates, credit availability, and the nonprice terms of a mortgage? This, then, is not a comprehensive study, since it examines only the impact of the law on new housing construction and on mortgage lending. One obstacle to a more comprehensive study is the data limitations; a second, as discussed below, is that the law itself is not as comprehensive as it might appear.

What Is the Usury Law?

Usury laws in Minnesota can be traced back to 1858, but they were not formalized until 1877. Then all previous laws were revised to prohibit rates above 12 percent; the new law read:

> *No person, company, or corporation shall, directly or indirectly, take or receive in money, goods, or things in action, or in any other way, any greater sum, or any greater value, for the loan or forbearance of money, goods, or things in action, than twelve dollars ($12) on one hundred dollars ($100) for one (1) year.*
>
> *Laws 1877, c. 15*

Since 1877 the law has been revised several times. The ceiling was lowered in 1899 to 10 percent and in 1923 to 8 percent where it remains today.[1]

Until quite recently, general long-term market interest rates have been well below the usury ceiling (see Chart 1). For example, the corporate unadjusted index number of yields of American railroad bonds averaged 6.5 percent in 1877, 4 percent in 1899, and 5 percent in 1923.[2] Since 1970, however, the index has exceeded 8 percent, and as recently as January 1975, it reached 9.5 percent.

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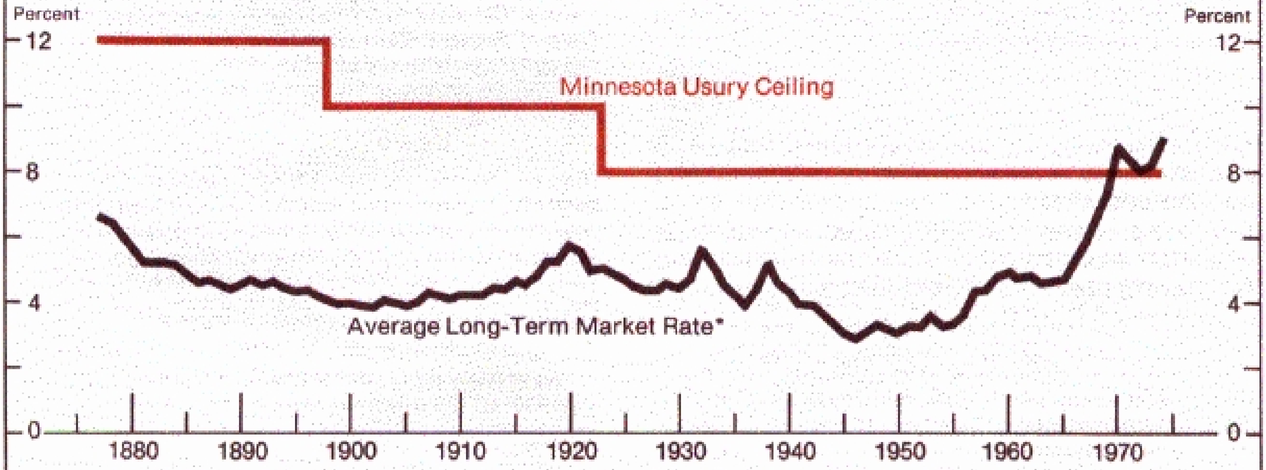
[1]The history of Minnesota's usury law can be found in MINNESOTA STATUTES ANNOTATED, Sec. 322 to 335 (St. Paul: West Publishing Co., 1966), Vol. 21, C. 334.

[2]The series is a chain index number based on the arithmetic average of yields on long-term high-grade railroad bonds. Yields for individual bonds are based on arithmetic averages of monthly high and low sale prices. With a few exceptions the index includes no bonds with maturities under 10 years, and since 1909 the minimum has been 14 years.

Chart 1

Market Rates and the Usury Ceiling

1877-1974



*Corporate unadjusted index number of yields of American railroad bonds

Sources: FR Board of Governors; U.S. Department of Commerce, Bureau of the Census

The legal specification of an exorbitant or usurious rate, therefore, has fallen not only in absolute terms but also, and more importantly, in relation to market rates. Legislation in 1877 and 1899 considered rates roughly 6 percentage points above long-term market rates exorbitant. In 1923 the relative excess dropped to 3 points, while today it is less than 1 point—possibly negative.

As the relative definition of usurious has fallen, the number of exemptions has increased. (See "How has the scope of the usury law diminished?" p. 18.) The only areas Minnesota's usury law currently affects are conventional mortgage loans and loans to individual and unincorporated businesses and farmers.

There has been no recent estimate of the percent of credit subject to Minnesota's usury law. In 1966 it was estimated that the total private debt in Minnesota subject to the law was 34 percent, but in light of recent legislation, this estimate must be lowered.[3] Nevertheless, important areas of the state's economy are still subject to the 8 percent ceiling. The question is: With long-term market rates well above the 8 percent ceiling, do uninformed borrowers need this protection? Although one might argue that the uninformed need protection from rates significantly above market rates, 8 percent in the present financial environment can no longer be considered exorbitant.

Today, therefore, it seems the purpose served by the usury ceiling is to keep those interest rates which are subject to the ceiling at or below 8 percent. In this way, the informed as well as the uninformed are protected from paying higher rates of interest.

[3]The 1966 estimate was taken from Henry J. Bailey, 3d, "Analysis of Existing Debt in the United States and State by State on Basis of Existing Law Affecting Interest Rates and Finance Charges" (unpublished study for Willamette University, College of Law, 1966).

How has the scope of the usury law diminished?

Minnesota's usury law no longer has the same scope it had when it was first developed. What kinds of exemptions now exist, and under what authority were they enacted?

The Minnesota Legislature has enacted a number of statutory exemptions. A large part of business lending was exempted from the law when legislation was enacted in 1947 stating, "No corporation shall hereafter interpose the defense of usury in any action."

Exceptions have been enacted that have made the usury ceiling no longer binding on a wide range of consumer loans as well. These began in 1925 when credit union loans were exempted from the usury law. Under current legislation the following approximate annual percentage rates can be charged on these types of consumer loans: 12 percent on credit union loans; from 12 to 23 percent on automobile installment loans; 12 percent on revolving charge accounts; from 9 to 11 percent on bank installment loans; and from 26 to 35 percent on consumer finance company loans.

Judicial rulings in Minnesota have upheld the common law which permits the time/price differential as an exception to usury ceilings. This law states that a person may charge a higher price for items sold on time than if sold for cash without the difference being regarded as interest for purpose of the usury law. This exception, however, no longer applies to the time sales of autos.

In many instances loans made under various federal government programs are exempt from state usury ceilings, sometimes by federal law and sometimes by state law. In Minnesota, for example, state law exempts government-underwritten (FHA/VA) mortgages from the 8 percent ceiling. Minnesota law also exempts mutual building associations and cooperatives created or operating under the Federal Farm Credit Act of 1933 from the state's usury law.

Federal legislation has been interpreted to give national banks the power to charge interest on all loans at the state usury rate or 1 percent over the Federal Reserve discount rate on 90-day commercial paper, whichever is higher. Also, if state banks are allowed certain exceptions to the usury law, the exceptions apply to national banks as well.

Moreover, last October the U.S. Congress enacted legislation permitting national banks, federally insured state banks, savings and loan associations, and small business investment companies to charge interest on business and agricultural loans that are in excess of $25,000 at a rate of 5 percent over the Federal Reserve discount rate on 90-day commercial paper.

As of early April, the following proposals which would affect the usury law were being considered in the Minnesota Legislature:

- SF 160 and HF 102 would allow state banks to charge 1 percent over the Federal Reserve discount rate for 90-day commercial paper.
- HF 172 would place maximum finance charges of 1 percent per month on consumer credit sales (making the rate the same as for open-end credit).
- HF 578 would permit corporations to interpose the defense of usury.
- HF 629 would expand the loan-making powers of industrial loan and thrift companies.
- HF 511 would make all loans for amounts over $100,000 written prior to July 1, 1978, exempt from the usury law.
- SF 733 would permit state and national banks to charge interest of 5 percent over the Federal Reserve discount rate for 90-day commercial paper on all business and agricultural loans.

Some, however, say that this protection is an illusion and that, rather than keeping interest rates down, the impact of the ceiling is to encourage a flow of credit from markets subject to the law to exempt markets so that little, if any, credit is available at 8 percent. Furthermore, the argument goes, it encourages both lenders and borrowers to find ways around the ceiling, so that the actual rate is greater than 8 percent in any case.

Does the Usury Ceiling Affect New Housing?
Despite the numerous statutory exceptions to the 8 percent ceiling, casual observation suggests that the usury law may have had a significant impact on the housing industry. In two

recent periods when market rates rose above 8 percent, there was a dramatic decline in new housing starts. According to opponents of the usury law, this decline was caused by the usury ceiling. The argument is that, as market rates on other financial assets which can easily be substituted for Minnesota mortgages rose above 8 percent, Minnesota as well as out-of-state lenders found it more profitable to do business elsewhere.

But declining housing starts are generally observed in all states when interest rates are high and credit is tight. As mortgage rates rise, the cost of financing a home increases and the demand for new housing decreases.[4] A housing decline in Minnesota, therefore, may simply be part of a more general downturn occurring throughout the country.

One way to isolate the effect of the usury law in Minnesota is to compare Minnesota to those states that either have no usury law or have a rate ceiling well above market rates. If opponents of the law are correct, it should be found that during periods of tight credit either new housing construction in Minnesota declines significantly more than in nonusury states or that mortgage-financing terms (for example, down payments and lengths of maturity) in Minnesota are significantly more restrictive.

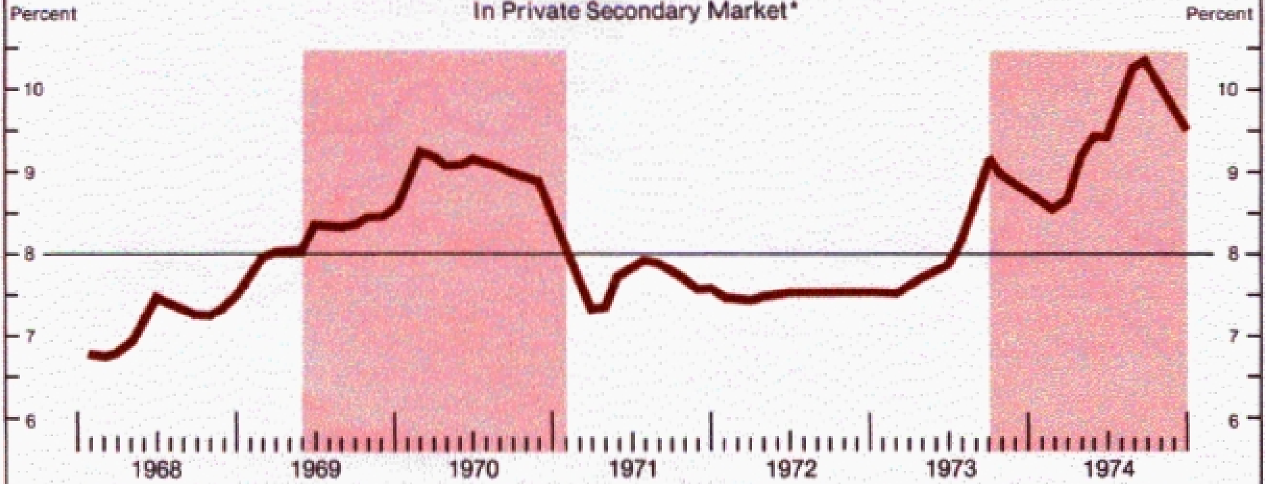
To begin the analysis, periods of tight credit (that is, when market rates are above the 8 percent ceiling) must be identified. To do this a market-determined interest rate on an investment instrument that lenders consider a reasonable alternative to mortgages made in Minnesota is needed. The average private

[4]In fact, the impact of high market interest rates on housing seems to be greater than other markets. Financial intermediaries, who supply most of the credit for housing, are prevented from competing for funds because their deposit liabilities are subject to maximum rates of interest. As market rates rise above these maximum rates, depositors shift their funds to investments on which interest rates are not regulated, causing mortgage rates to rise even further.

Chart 2

Interest Rate on FHA-Insured Loans

In Private Secondary Market*



*Based on opinion reports submitted by HUD (FHA) field offices of prevailing local conditions as of the first of the succeeding month. Yields are derived from weighted averages of private secondary market prices for Section 203, 30-year mortgages with minimum down payment and assumed prepayment after 15 years.

Source: FR Board of Governors

secondary market yield on mortgages insured by the Federal Housing Administration (FHA) seems to be the best candidate, since there exists a national market where FHA-insured mortgages are bought and sold and where Minnesota lenders are active participants.

Chart 2 plots the FHA secondary market rate since 1968; the shaded areas represent a best guess at periods when the effects of the 8 percent ceiling might be observed. These periods are assumed to begin three months after the FHA rate reached 8 percent, partly because lenders had prior commitments to make mortgages at interest rates below 8 percent and partly because there tended to be some lag before participants reacted.

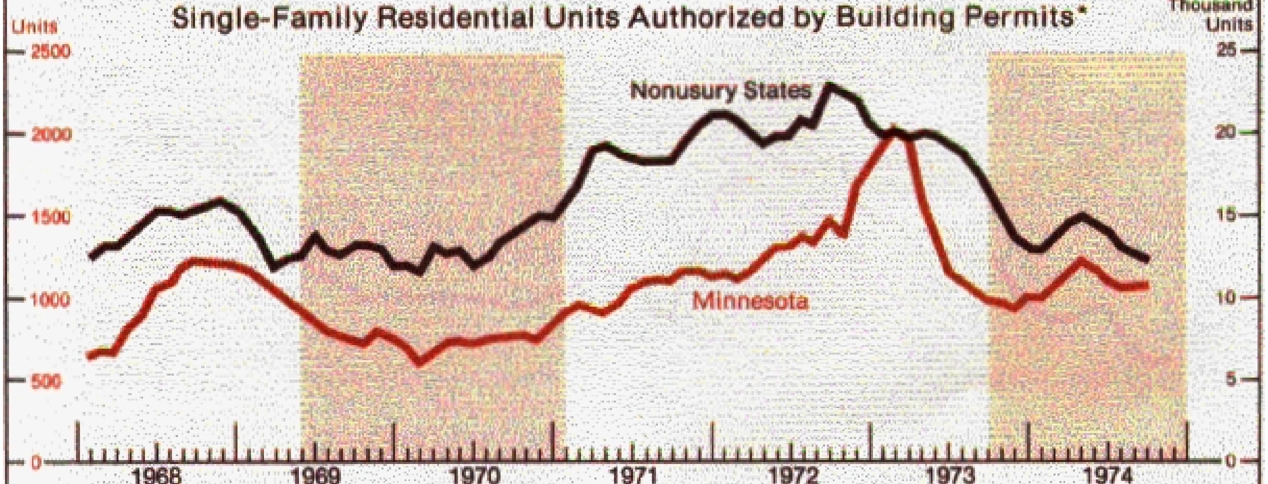
The usury ceiling is believed to have had an impact in only two periods. The first starts in June 1969 and ends in January 1971; the second begins in October 1973 and continues through October 1974 (the latest date when most data were available). In the first period the secondary rate reaches the 9 percent level for only a few months, while in the second period it rises well above 9 percent, reaching 10.38 in September 1974. The ceiling should prove to have its greatest impact during these months.

Chart 3 compares the number of single-family residential units authorized in Minnesota with the number authorized in nonusury states. Notice that both series begin to decline well before they reach the shaded areas. This suggests that rising interest rates are a major reason for the general housing slowdown. More importantly, notice that the two building permit series are closely synchronized and that, although the difference between them varies, the variation does not depend on the ceiling periods. That is, during periods of tight credit there does not appear to be a significant difference in the behavior of the two series.[5]

[5]These observations were confirmed by a statistical analysis which tested for correlation between tight credit periods and the difference between the series. Although there was a positive correlation—specifically, in periods of tight credit the difference tended to be slightly larger—the results were statistically insignificant.

Chart 3

Single-Family Residential Units Authorized by Building Permits*



*Seasonally adjusted number of new, privately owned, single-family housing units authorized. Nonusury states include California, Colorado, Connecticut, Hawaii, Maine, Massachusetts, Nevada, New Hampshire, Rhode Island, Washington, and Wisconsin.

Source: U.S. Department of Commerce, Bureau of the Census

This suggests that the usury law has not had an impact on housing construction in Minnesota. Either lenders are making mortgages at the ceiling rate and ignoring more profitable alternatives, or they are able to work around the ceiling and obtain a higher effective yield or better nonprice terms than is apparent.

Supporters of the usury law argue it is the former, contending that the ceiling has helped the average borrower obtain a mortgage at a *reasonable* rate of interest. But there is further evidence which seems to be more consistent with the alternative hypothesis that during periods of tight credit and high interest rates lenders and borrowers find ways around the ceiling. Outlined below are some of the tactics that have been used and a rough measure of their importance.

Can the Usury Ceiling Be Avoided?

The most obvious way for borrowers and lenders to avoid the 8 percent ceiling is to switch from conventional to FHA/VA mortgages. Presumably when conventional mortgages are constrained by the ceiling rate, FHA/VA mortgages are an attractive alternative. Another advantage to the lender, of course, is that they are government insured. From the borrower's point of view, they usually permit a smaller down payment and a somewhat longer maturity than a conventional loan. The disadvantages are that the building codes are more restrictive and that the administrative costs (for example, paper work and processing time) are generally higher.

Another way around the ceiling is for lenders to raise the fee to builders for commitments to make conventional mortgages earmarked for specific projects. These charges seem to be exempt from the usury law, and builders attempt to pass them along by raising the base price of their homes. Although borrowers may still be able to get 8 percent conventional financing, at least part of the builder's finance charge is transferred to the home price.

Finally, there are some instances (usually when market rates are not substantially above the ceiling) when lenders do not avoid the ceiling but simply change their product by offering less attractive nonrate terms. Common examples include shortening maturity and increasing the down payment on the conventional mortgage. While this may not increase profits directly, it reduces risk.

The consumer, however, is generally not benefited by these changes. In periods when market rates are below the ceiling, a variety of financing terms are available, including standard conventional mortgages; mortgages with higher interest rates, longer maturities, and smaller down payments; and mortgages with lower interest rates, shorter maturities, and larger down payments. In periods when market rates are above the ceiling, however, there is at most one type of conventional mortgage (with a shorter maturity and larger down payment), and as discussed below, even these may not be available.

According to Chart 4, during the 1969-70 period of tight credit, there was a significant fall in the length of maturity on conventional mortgages in the Minneapolis-St. Paul Standard Metropolitan Statistical Area (SMSA) but not in the nonusury SMSAs.[6] Before 1969 Minneapolis-St. Paul mortgages had an average maturity that was three to four years shorter than other SMSAs; by late 1969 the length of maturity was seven years shorter.

On the other hand, in the 1973-74 period of tight credit, there was no significant fall in maturity length. It had been increasing in the Minneapolis-St. Paul SMSA since 1970 and with minor fluctuations continued this trend through 1973-74, reaching a 28-year maturity—less than a year short of the average maturity in the nonusury states.

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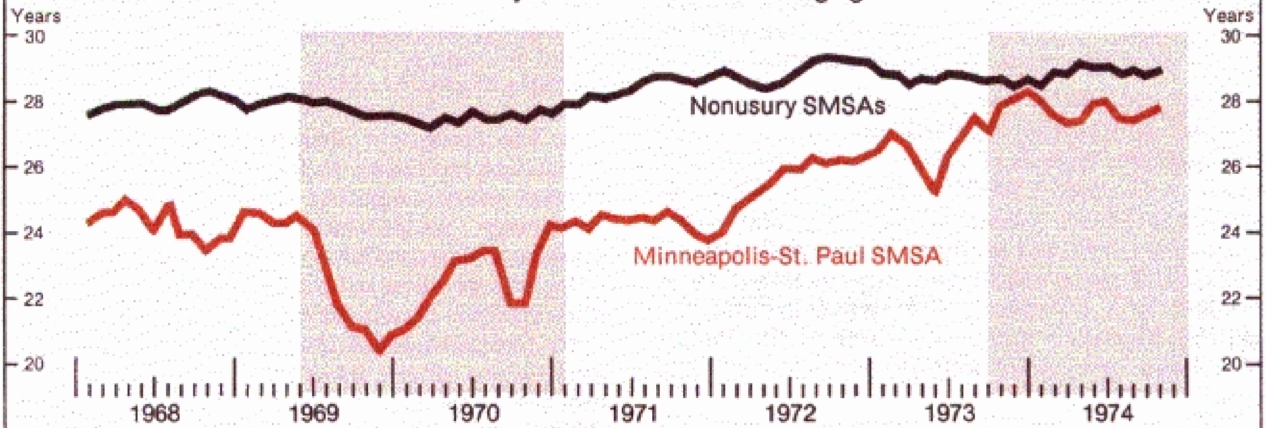
[6] Chart 4 compares length of maturity, and Chart 5 compares the ratio of down payment to new-home purchase price. Since data were only available by standard metropolitan statistical area (SMSA), the comparisons are made between the Minneapolis-St. Paul SMSA and a set of SMSAs located in the nonusury states.

Chart 4

Years to Maturity on New Home Mortgage Loans*

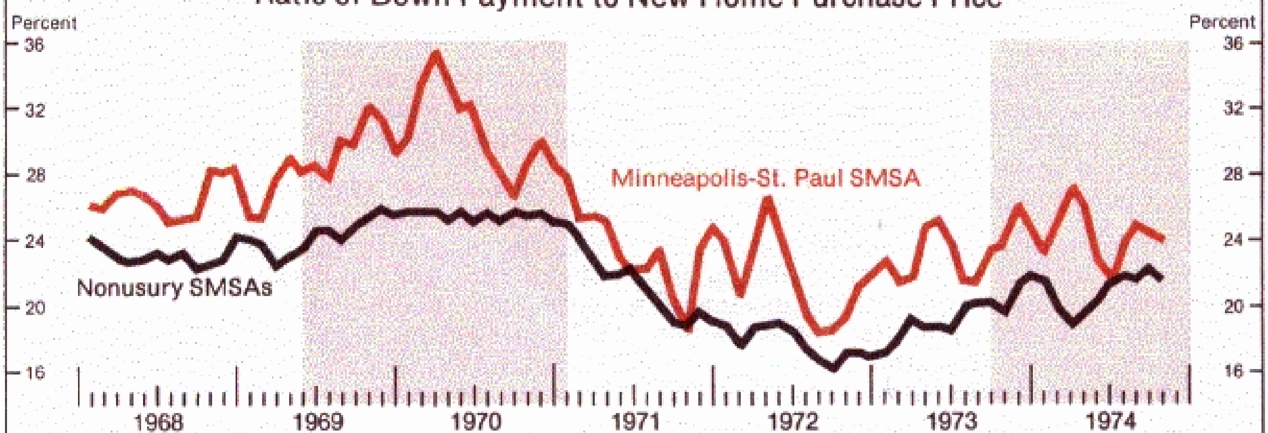


*Seasonally adjusted weighted averages compiled from individual loan data reported by a sample of savings and loan associations, commercial banks, mutual savings banks, and mortgage bankers. Data cover fully amortized conventional first mortgage loans secured by newly built, single-family residential property and exclude federally underwritten loans. Nonusury standard metropolitan statistical areas include Denver, Los Angeles-Long Beach, San Francisco-Oakland, and Seattle.

Source: Federal Home Loan Bank Board

Chart 5

Ratio of Down Payment to New Home Purchase Price*



*Seasonally adjusted weighted averages compiled from individual loan data reported by a sample of savings and loan associations, commercial banks, mutual savings banks, and mortgage bankers. Data cover fully amortized conventional first mortgage loans secured by newly built, single-family residential property and exclude federally underwritten loans. Nonusury standard metropolitan statistical areas include Denver, Los Angeles-Long Beach, San Francisco-Oakland, and Seattle.

Source: Federal Home Loan Bank Board

In Chart 5 a similar picture for down payments emerges. In the Minneapolis-St. Paul SMSA, down payments increased during 1969-70 to a peak of 35 percent of the home price, while before 1969 they had never been significantly higher than 28 percent. In the nonusury states they were also rising but reached only 26 percent from an average of 23 percent before 1969. During 1973-74 the results are more difficult to interpret. Although in the Minneapolis-St. Paul SMSA down payments tended to rise, they did not rise significantly more than they had in the most recent period when market rates were below the ceiling. Moreover, during 1973-74, down payments were also rising in the nonusury SMSAs.

So the impact of Minnesota's usury law on the nonprice terms of conventional mortgage loans was clearly evident in the 1969-70 period. How extensive was the impact on FHA/VA mortgages? Chart 6 depicts for both Minnesota and the nonusury states the value of FHA/VA mortgage loans as a percent of the total outstanding value of all mortgages.

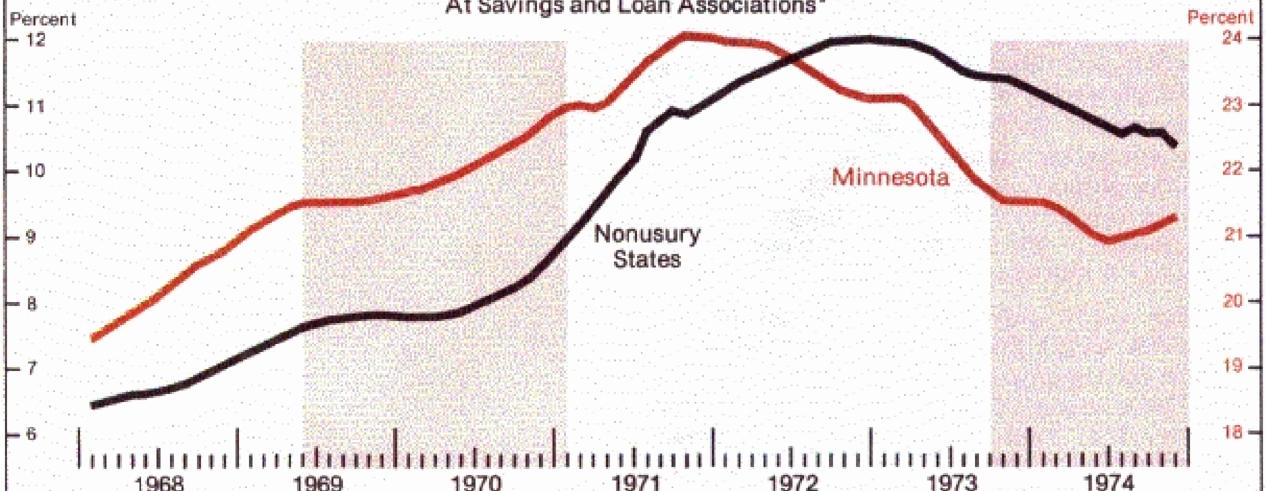
This time the effects of the 8 percent ceiling are found in the 1973-74 period, especially in the last months of 1974 when the FHA rate exceeded 10 percent. Before 1969 there developed a trend toward FHA/VA financing that peaked in 1971 for Minnesota and in 1972 for the nonusury states. This trend was unaffected by the 1969-70 ceiling period. From these peaks, both series consistently declined until June 1974, when the trend leveled off in the nonusury states but turned rather sharply upward in Minnesota.

By November 1974 the percentage in Minnesota had increased to 21.3 percent from 21 percent in June. Although this change may not appear to be large, recall that it is nearly one-third of a percent of all outstanding mortgages. During the last four months of the period July to November 1974, 40 percent of all

Chart 6

Value of FHA/VA Mortgage Loans Outstanding as a Percent of Total

At Savings and Loan Associations*



*Seasonally adjusted. Nonusury states include California, Colorado, Connecticut, Hawaii, Maine, Massachusetts, Nevada, New Hampshire, Rhode Island, Washington, and Wisconsin.

Source: Federal Home Loan Bank Board

new loans were FHA insured—about double the usual share.

Even this may be understating the case. In a more recent survey of the larger thrift institutions in the Minneapolis-St. Paul area, it was found that new conventional mortgages were simply not available. The institutions claimed that the only conventional mortgages being made were those due to prior commitments, older mortgages that were being refinanced, and out-of-state mortgages. Virtually all new mortgages made in Minnesota were FHA/VA.

Conclusion

The evidence gathered in this study on the impact of Minnesota's 8 percent usury law during periods of tight credit suggests that it has not been able to protect consumers from usurious rates of interest. Moreover, there have been unintended side effects which have generally made borrowers worse off.

Although it seems to have had little impact on housing construction, the usury law has had a significant effect on mortgage financing. For those conventional mortgages made in Minnesota during the 1969-70 tight credit period, maturity lengths were relatively shorter and down payments relatively larger than they were in nonusury states. Furthermore, when market rates exceeded 10 percent (as in the 1973-74 tight credit period) and lenders no longer found conventional mortgages made in Minnesota an attractive investment, these mortgages virtually disappeared—the borrower's only option was the FHA/VA mortgage.

This study examined the impact of the Minnesota usury law on mortgage financing for, and the volume of, new housing construction. There are a number of other areas (for example, the used-home market and small unincorporated business loans) where the costs and benefits of the law could be examined. It seems reasonable, however, that the findings expressed in this study would hold for most, if not all, transactions covered by the 8 percent ceiling; that is, lenders and borrowers would seek similar means to avoid the ceiling.

What are the policy implications? Supporters of the law might conclude that there are too many exemptions. They might argue that if FHA/VA loans were covered by the 8 percent ceiling, mortgage lenders would be forced to make 8 percent loans. But this conclusion does not necessarily follow. The evidence here is that lenders seek the most profitable investment. The most likely outcome of extending the coverage of the law to all mortgage loans would be a shift of funds out of Minnesota mortgages. There have been a number of studies in states which have had more inclusive usury laws that confirm this hypothesis.[7]

The burden of proof, therefore, seems to be on the supporters of an 8 percent ceiling. This analysis suggests that Minnesota's usury law does not provide the type of interest rate protection which some claim it does. Its effect, rather, is to severely limit the financial options available to borrowers. If a usury law is deemed necessary, these results suggest that the rate ceiling should be significantly above market rates, which was the original intent of the law.

[7]See Norman N. Bowsher, "Usury Laws: Harmful When Effective," FEDERAL RESERVE BANK OF ST. LOUIS REVIEW, Vol. 56, No. 8 (August 1974), pp. 16-23, and Philip K. Robins "The Effects of State Usury Ceilings on Single Family Homebuilding," JOURNAL OF FINANCE, Vol. 29, No. 1 (March 1974), pp. 227-235.

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