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Some Fundamental Issues

In summary, this case study of selective credit policies suggests a number of instructive conclusions. It has often been said that governmental stabilization measures ideally should aim at flattening the top of a boom, with its attendant strain on resources, as well as at raising the floor of recession activity. The selective credit restraints of 1955 came too late to flatten the top of the housing boom, although they may have had a moderate part in helping to contain the expansion of aggregate demand and thereby lower the peak levels of general business activity. The considerable time lags in the process of financing and building houses delayed the detection of maladjustments in the housing and mortgage markets. Moreover, policy makers were reluctant to interfere in an economic sector endowed with special public interest. It appears that they were also hesitant to apply selective restraints before a full-fledged policy of general credit restriction was adopted. The effectiveness of the selective credit measures in the housing sector was also blunted by time lags. Nevertheless, these measures contributed moderately to speedy correction of maladjustments in the housing and mortgage markets and seem to have strengthened the policy of general credit restraint.

Policy makers were prompter in extending relief to the housing sector in 1956-1957 than in initiating restraints during 1955. The relaxations and positive aids offered in 1956-1957 helped to moderate the decline in residential construction and counteract the adverse impact on the housing sector of accidental credit control in the form of maximum interest rates on government-underwritten loans below competitive levels. Their effects on the over-all demand pressure on resources were probably slight.

Any kind of short-run economic stabilization policy must skirt the extremes of inflexibility on the one side and of over-manipulation on the other. The

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selective measures affecting housing credit in the period 1955-1957 showed a high degree of flexibility, but it is questionable whether regulations were not changed too frequently and sometimes for relatively minute effects. Stabilization policies should not increase uncertainty without strong reasons, especially in a sector where the usual market uncertainties faced by builders, lenders, and consumers are compounded by those resulting from the customary annual changes in housing legislation. From this point of view, sparing use of the tools provided by discretionary authority for administering the federal housing programs seems desirable even at the risk of less flexibility.

The record also serves to highlight the question of how private financial institutions can avoid more effectively lending policies that magnify instability in the housing sector. The headlong rush of major institutions into mortgage commitments on increasingly liberal credit terms and of commercial banks into highly profitable mortgage warehousing transactions from late 1953 to early 1955 are cases in point. The intense competition among lenders for new business, which was reflected in these developments, has on previous occasions threatened the soundness of financial investments as well as economic stability. Excessive expansion of mortgage lending and subsequent wholesale withdrawal from a saturated market can expose financial institutions to undesirable and avoidable risks as well as accentuate fluctuations in residential building. The growing practice of issuing forward commitments—a necessary and potentially very useful financial technique—has made it perhaps even more difficult for financial institutions to minimize excessive disruptions in the flow of funds into different sectors of the economy. This problem deserves intensive study.

The need for additional research to help improve the timing and execution of selective housing credit measures in the future has become apparent at various points of this essay. Because of the substantial time lags in the financing and building process, effective economic stabilization policies in this sector require adequate information on early decisions rather than on completed transactions: builders' programs as well as housing starts, local short-term projections of the effective demand for homes derived from careful market analysis, credit terms at the time loan commitments are made, and better reporting of the commitments of all major types of lending institutions, to name only a few. The time lapse between investment decisions and completed transactions under varying market conditions needs to be investigated more thoroughly. Also, more reliable data are required on current conditions in local housing markets, such as vacancies and especially the changes in the inventory of new, unsold homes. The relation between mortgage credit terms and the prices that consumers pay for homes, and the interaction of these variables in changing the effective demand for houses,

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bears further exploration,¹ and so does the subject of the different impacts of changing credit conditions on various economic sectors or groups of businesses.

Apart from the imperfections of the governmental or private actions affecting housing credit during the period under review, however, the experience of 1953-1957 revealed more fundamental issues. One of these is the great volatility of government-sponsored residential building compared to conventionally financed construction, which raises the question of whether the federal interest in this sector has had the ironical if not perverse effect of accentuating rather than moderating unstable performance. The second issue is the relation between social priorities and economic stabilization policy. The third concerns the role of residential construction in moderating general business fluctuations. Finally, the very purpose of adjusting the governmental housing credit aids to cyclical change needs clarification. Should the federal programs be administered so as to assist in maintaining stability and steady growth of residential building or of total construction activity or of the economy as a whole? And what are the implications of each of these alternative objectives?

The Volatility of Federally Assisted Construction

In the period 1951-1957, annual private housing starts under the government programs varied between 297,000 and 670,000 units while those financed without government aid fluctuated within the small range of 608,000 to 696,000 units (Chart 6 and Table 1). The relative variation between low and high volumes, measured from the former, was about 126 per cent for federally assisted construction and a little over 14 per cent, or about one-tenth that variation, for conventionally financed starts.² The expansion of 1953-1954 occurred entirely in government-underwritten starts, and nearly all of the contraction of 1955-1957 was in this segment of new housing construction. Within the government-assisted sector, starts under the V.A. program were still more volatile than FHA-financed activity. Similar differences in relative instability can be observed in financial data. New commitments on V.A. mortgages by life insurance companies, for example, at their

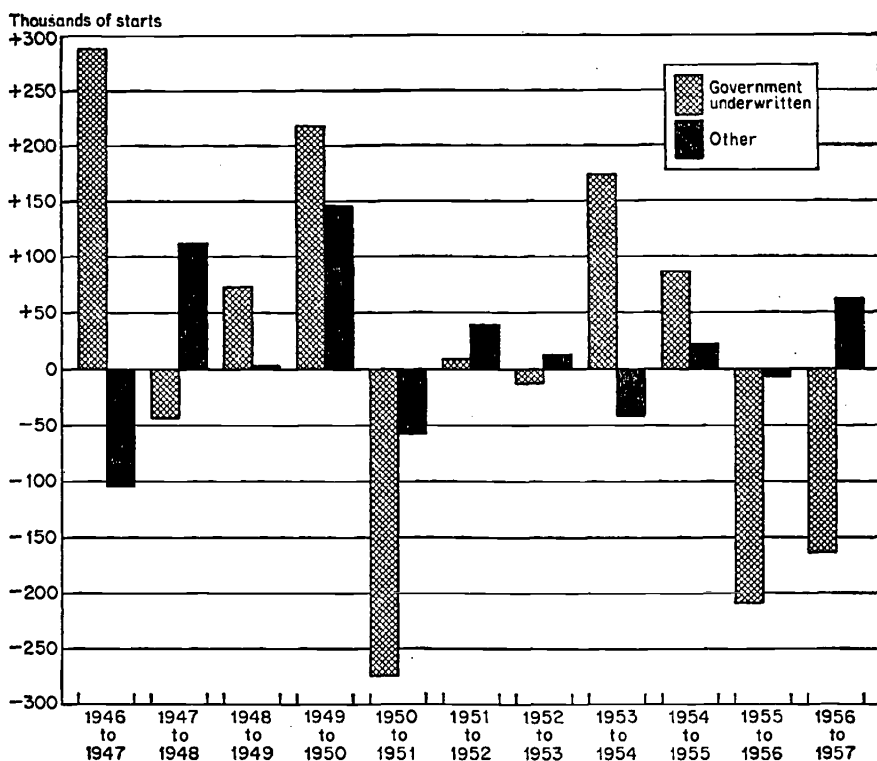
¹ For a discussion of this relationship and its bearing on housing credit policies, see *Mortgage Market Problems*, Hearings before a Subcommittee of the Senate Committee on Banking and Currency, 84th Congress, 1st session, November 1955, pp. 43, 56, 77, 79-80, and 155-156; and Ramsay Wood, "Credit Terms and Demand for Residential Construction," *Study of Mortgage Credit*, Subcommittee on Housing of the Senate Banking and Currency Committee, 85th Congress, 2nd Session, December 22, 1958.

² 1951 is the first year for which reasonably dependable data on housing starts classified by type of financing are available. Ignoring the reconversion period of 1946-1947, the less reliable estimates for 1948 to 1950 also reveal a much greater volatility of government-sponsored starts (Table 1).

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CHART 6

Annual Changes in Private Housing Starts Financed with and without Government-Underwritten Loans, 1947-1957



Source: Table 1, columns 2 and 3.

lowest point in the 1953-1957 period were less than 1.3 per cent of their peak value, while those on conventional loans were 52 per cent of their peak value (Table 24). The annual amount of government-underwritten loans during the period 1948-1957 ranged from \$3.6 to \$10.2 billion as against \$7.9 to \$18.6 billion for the conventional loans which are captured in mortgage recordings (Table 2).

These figures seem to carry a severe indictment of the government programs for contributing substantially to instability in the housing and mortgage markets.³ Waiving the question of the influence of FHA and V.A.

³ The public housing programs, which are outside the purview of this essay, have also shown extremely wide year-to-year fluctuations in volume of activity. In the period 1948-1957, annual starts under these programs (including military housing) varied between 18,000 and 71,000 units, and even if the Korean War period is omitted there remains a range of 19,000 to 49,000 dwelling units. The forces producing this volatility, however, are quite different from those accounting for the fluctuations in private starts under the FHA and V.A. programs.

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on the *level* of residential construction and the growth of the housing sector, do not the more moderate fluctuations in activity outside the government programs suggest that a much greater degree of stability could be achieved if the housing sector were "left alone?"⁴

On analysis, the "feast and famine" in government-aided activity turns out to result from a mixture of conditions. One of the factors contributing to the volatility of housing starts and mortgage lending under the government programs is the source of the demand for FHA and V.A. loans. Much of this demand comes from groups of consumers who are in the market only when the most liberal terms permitted under the programs are available, and drop out when they are not. Another, and probably the most important, contributing factor has been the rigid ceiling on the maximum interest rate on V.A. loans, which has indirectly also led to inflexibility in the maximum rates on FHA loans. Because of this inflexibility of interest rates, lenders have usually withdrawn from the FHA and particularly the V.A. market during periods of rising interest rates when net yields on other investments were more attractive. Discounts on government-underwritten mortgages to provide yield flexibility have been at best highly inadequate substitutes for more freely adjustable interest rates, and even discounts have at times been regulated by legislative mandates (Appendix A).

The unstabilizing effects of rigid maximum interest rates have been reinforced by the fact that the lenders participating most actively in the FHA and V.A. programs—life insurance companies and banks—have a wide choice of investment outlets and are highly sensitive to yield differentials on alternative investments. In contrast, savings and loan associations, which are more or less confined to the mortgage market, are most active in conventional lending. Moreover, some lending institutions, during periods of ample supply of funds relative to demand, have concentrated their additional mortgage investment on acquisitions of FHA and V.A. loans outside their normal lending areas and, when the opposite market conditions prevail, have curtailed this activity sharply while maintaining a much steadier mortgage investment program in their own localities or states.

The geographic volatility of lending under the FHA and V.A. programs is clearly revealed in data for mutual savings banks (Tables 19 and 20). Between September 30, 1954 and the end of 1955, when net changes in mortgage holdings reflected the great eagerness of financial institutions to invest in mortgages, more than two-thirds of the increase in the mortgage portfolio of mutual savings banks was in out-of-state holdings, the bulk of which, in turn, was in government-underwritten loans. The banks added \$2.1 billion to their out-of-state holdings and increased these by 59 per cent,

⁴ Cf. "How Government Has Unstabilized the New House Market," *House and Home*, December 1956, p. 48.

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while the expansion of within-state holdings totaled less than \$1 billion, or little over 9 per cent. During 1956 and the first three quarters of 1957, on the other hand, when institutions became less eager to invest in mortgage loans, less than half of the increase in their mortgage portfolio was in out-of-state holdings. They added only \$1.5 billion to the latter and \$1.7 billion

TABLE 19

Amount of Mortgage Loans Held by Mutual Savings Banks within Own State
and out of State, 1954, 1955, and 1957 ^a
(million dollars)

Date and Location of Holdings	All Holdings	Conven- tional Loans	Government-Underwritten Loans		
			Total	FHA	V.A.
September 30, 1954					
Total	14,288	6,690	7,698	3,704	3,894
Within state	10,712	6,584	4,128	1,501	2,627
Out of state	3,576	106	3,470	2,203	1,267
December 31, 1955					
Total	17,396	7,501	9,895	4,142	5,753
Within state	11,710	7,171	4,540	1,398	3,142
Out of state	5,686	330	5,355	2,744	2,611
1957-III					
Total	20,647	8,502	12,145	4,561	7,584
Within state	13,455	8,061	5,394	1,682	3,712
Out of state	7,192	441	6,751	2,879	3,872

^a "Distribution of Mortgage Investments of Mutual Savings Banks," special tabulations of the National Association of Mutual Savings Banks representing 517 banks in 1954, 523 banks in 1955, and 520 banks in 1957. The coverage of reporting banks is nearly complete. The row "Within state" shows the amount of loans serviced within the state in which the bank is domiciled, and the row "Out of state" shows the amount of loans serviced in other states. Generally, only FHA and VA loans can be made by mutual savings banks outside their own states, except for a few jurisdictions in which banks can make conventional mortgages in adjoining states. This exception explains the relatively small amount of conventional out-of-state loans shown in the table.

to their holdings within their home states. Net investment in government-underwritten loans out of state declined from \$1.9 billion during the first period to \$1.4 billion during the (longer) second period. Net investment in such loans within the banks' home states increased from \$412 million during the first period to \$854 million during the second period, notwithstanding the reduced attractiveness of government-underwritten mortgages

TABLE 20

Increases in the Amount of Mortgage Loans Held by Mutual Savings Banks within Own State and out of State, 1954, 1955, and 1957

Periods and Location of Holdings	All Holdings		Conventional Loans		Government-Underwritten Loans									
	Million Dollars	Per Cent	Million Dollars	Per Cent	Total		FHA		V.A.					
					Million Dollars	Per Cent	Million Dollars	Per Cent	Million Dollars	Per Cent				
September 30, 1954														
to														
December 30, 1955														
Total	3,108	21.8	811	12.1	2,197	28.5	438	11.8	1,859	47.7				
Within state	998	9.3	587	8.9	412	10.0	-103	-6.9	515	19.6				
Out of state	2,110	59.0	224	211.3	1,885	54.3	541	24.6	1,344	106.1				
December 31, 1955														
to														
1957-III														
Total	3,251	18.7	1,001	13.3	2,250	22.7	419	10.1	1,831	31.8				
Within state	1,745	14.9	890	12.4	854	18.8	284	20.3	570	18.1				
Out of state	1,506	26.5	111	33.6	1,396	26.1	135	5.0	1,261	48.3				

SOURCE: Table 19.

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in 1956-1957. Since most of the out-of-state mortgage investments are made in "capital-deficit" areas,⁵ these areas have been subject to especially wide fluctuations in the supply of funds for government-underwritten loans. Thus, the inflexible interest rate ceilings have resulted in geographical discrimination.

The mortgage insurance feature itself may also contribute to unstable performance, to the extent that loan insurance tends to reduce the risk deterrent in periods of ample supply of funds and sharp competition for investment outlets. Finally, the volatility of housing starts under the federal programs is in small part a statistical illusion. The reports on starts under these programs are derived from the requirement that homes on which FHA or V.A. mortgages are to be made must be inspected by the agencies' technicians at various stages of construction. Compliance inspections by FHA or V.A., however, do not necessarily imply that the sale of inspected houses upon completion will be financed by FHA-insured or V.A.-guaranteed mortgages. A careful study has shown that attrition between starts and loan closings is greatest in a rising, and least in a declining, market. To some extent, this variation "reflects the practice of builders and lenders under favorable market conditions to arrange for government-assisted financing on a substantially larger share of the new housing they plan to start than at other times, and, correspondingly, at such times, to abandon the FHA and V.A. financing on a larger than usual proportion."⁶ Thus, the available data on housing starts tend to exaggerate the instability of government-aided construction. The year-to-year fluctuations in the amounts of FHA and V.A. mortgage loans closed (Table 2) are a more representative measure of volatility.

The great fluctuations in government-underwritten activity might suggest that a mortgage market comprising solely conventional loans would show the stability exhibited by the conventional sector during the postwar period. Such a conclusion would be unwarranted, for the stability of the conventional sector has been in part attributable to the concentration of marginal demands for loans in the government-underwritten sector. In the absence of government-underwritten mortgages, marginal lending would still occur in other forms, perhaps as a larger amount of junior financing, and would tend to produce more pronounced swings than those shown by the conventional sector in recent years. In any event, more flexible interest rates on govern-

⁵ At the end of 1955, Arizona, California, Florida, Georgia, Michigan, Oklahoma, Texas, and Virginia accounted for 75 per cent of the total mortgage portfolio of mutual savings banks in all "nonmutual" states. Holdings in each of these states exceeded \$100 million, with nearly \$700 million invested in California loans and almost \$440 million in Texas loans. Cf. source given in Table 19.

⁶ Marvin Wilkerson and Dorothy K. Newman, "FHA and VA Housing Statistics and the Housing Market," *Construction Review*, June 1957, p. 5.

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ment-underwritten loans would reduce instability in the housing sector and would at least remove the paradox by which governmental interference, intended to benefit this sector, at times operates *unintentionally* as a powerful restrictive force against housing. It may be argued that this type of control is desirable, or at least convenient, since it automatically restrains housing when other demands are high and interest rates rise, and thus acts as a built-in stabilizer for the economy as a whole. If it is desirable to restrain residential construction at certain times, however, the decision to do so could be a deliberate one instead of being left to the haphazard results of legal maximum interest rates which were not designed to perform such a function.

It is true that unemployment compensation and other social security benefits, which are now generally considered to be valuable built-in stabilizers, were also originally not intended for economic stabilization purposes. But this case provides no valid analogy to the effects of inflexible interest rates. When unemployment compensation and other transfer payments are stepped up during a recession they benefit the groups for whom they were designed, as well as the economy as a whole. In contrast, when interest rates on housing loans are held below competitive levels and the flow of funds into mortgages is reduced, the housing sector is affected adversely, even though the economy may benefit.

It suffices to say here that there are various ways of assuring greater flexibility of interest rates on government-underwritten loans. One is a legislative ceiling high enough to allow administrative discretion to alter the rates from time to time; this has been the case for FHA home loans since 1934 but never for V.A. loans. Under another method, the maximum rate would be adjusted to changes in average yields on certain well-defined federal obligations; this method is used in Canada, where the maximum on various kinds of government-underwritten mortgages cannot exceed the market yields on long-term government bonds plus 1.5 to 2.25 per cent, and was also proposed, but not adopted, in the administration-sponsored Housing Bill of 1954.⁷ Still another technique would give the local FHA and V.A. offices authority to establish maxima in the light of mortgage interest rates in their areas but subject to a legislative ceiling high enough to allow for regional variations and foreseeable changes in conditions of the capital markets. Or the rates could be left entirely to market forces, a radical

⁷ For Canada, see *National Housing Act of 1954*, as amended, Section 4. For the Housing Bill of 1954, see Chapter 2 of this paper. Whether such a formula would be practicable in view of shifts in yield differentials and whether the relevant competitive rates would be adequately reflected in average yields on federal obligations are open questions for further research in the light of the structure of the U.S. capital market.

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departure from past Congressional practice on government-underwritten loans.⁸

Reflections on Social Priorities

The subject of this essay obviously involves judgments on social priorities. Thus, according to one view, the commitment of the federal government to aid housing and community development is almost tantamount to exempting this sector from the vicissitudes of economic fluctuations. The attainment of housing objectives is of such overriding importance that housing should be insulated from external disturbances. Let other sectors or industries, presumably of lower social priority, bear the burden of fluctuations if this is necessary for maintaining over-all stability or balanced economic growth. The idea of an ever-normal or ever-rising housing output, or at least a high-level floor below which the government will not permit residential building to fall, has found growing favor. Coupled with this view is often an unwillingness to let "the money market have complete power of decision as to the number of housing units we can build at any particular time."⁹

According to a somewhat modified version, selective restraint of housing credit is discriminatory unless other demands, such as those for automobiles or industrial plant or equipment, also receive similar treatment.¹⁰

An opposite view holds that the achievement of better housing is clearly subordinate to the larger objective of stable economic growth. Consequently, flexible use of the government housing programs as a part of policies to moderate business fluctuations is warranted if it is effective in strengthening these policies. Residential construction might have deserved an overriding priority in the early postwar years of shortage of residential accommodations. This shortage, however, has now been largely relieved although many families still occupy dwellings considered below par on physical standards of adequacy. Since the early fifties new construction has served the much less urgent though desirable purpose of improving the quality of housing.

⁸ Cf. the papers by Neal J. Hardy and Miles L. Colean in *Study of Mortgage Credit*; also Albert H. Schaaf, "Federal Mortgage Rate Policy and the Supply of FHA-V.A. Credit," *Review of Economics and Statistics*, November 1958. One of the implied reasons for maximum interest rates is consumer protection. This point has never received the thorough examination it deserves. Among the many questions to be analyzed is whether the additional supply of funds generated by free rates or higher maximum rates would be paid for by increased costs of borrowing not only by the home purchasers who would otherwise not have obtained financing, but also by those who would have obtained loans under the lower ceilings on rates. The answer would presumably depend mainly on the shape of the supply curve for funds.

⁹ Senator Sparkman, *Mortgage Market Problems*, p. 102.

¹⁰ Cf. Leon Keyserling's statements, *ibid.*, especially p. 65; also Sparkman, *ibid.*, p. 73.

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“ . . . Taking all economic goals into consideration, proper policy does not necessarily call for complete and unremitting stimulus to housing.”¹¹

Conflicting value judgments such as these cannot be wholly resolved in economic terms, but neither can they be reconciled without economic considerations. One of these is the time dimension of national housing objectives and of economic stabilization policies. Because the annual volume of residential construction is exceedingly small in relation to the total housing stock, at best 3 per cent, national housing objectives can only be attained over a very long time; as the failure of the veterans' emergency housing program of 1946-1947 demonstrated, there are no short cuts. The Declaration of National Housing Policy in the Housing Act of 1949 recognizes this condition by stating as one of its objectives “the realization *as soon as feasible* of the goal of a decent home and a suitable living environment for every American family. . . .” In view of the long period required for any marked improvement in the housing supply, temporary modifications of the government's support of housing need not seriously interfere with the attainment of housing goals. Economic stabilization policies, on the other hand, necessarily have a much shorter time horizon, and “unremitting” governmental support of housing at times of inflationary pressures *can* seriously interfere with the attainment of stabilization objectives. These differences in time dimensions themselves suggest that, in the long run, the gains in national welfare resulting from more effective stabilization policies probably exceed the gains that could be obtained from uninterrupted efforts to maximize housing objectives; short-run compromises in achieving a long-run objective are clearly less harmful than short-run compromises in accomplishing a goal which by its very nature must be attained in the short run or fail of accomplishment.¹²

A second, related economic criterion is the effect of temporary restraints of housing credit on the long-term demand for homes. In the case of goods or services with shorter consumption periods or acquired on impulse, the potential demand that is frustrated by tighter credit terms may be killed rather than deferred to a subsequent period of easier credit. Consequently, the demand cut off to flatten the top of a boom may not be available for “filling in” and helping sustain activity during the next recessionary phase. This effect of restraints is minimized in the case of housing. Here, the main result of short-run credit restrictions is deferral rather than permanent loss of demand. Few homes are bought on impulse. Consumers adjust the quality of their housing accommodations but slowly to changes in their income or

¹¹ Robert Turner, *ibid.*, p. 116.

¹² This reasoning obviously does not apply to a situation in which a prolonged decline in residential construction coincides with a prolonged general economic depression. The present essay does not address itself to such a situation.

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asset holdings. The time when a family first purchases a home is conditioned largely by the family life cycle in which a span of one or two years is negligible. Consequently, most of the demand eliminated by credit restraint is likely to be reactivated when financial conditions become more favorable to borrowers, provided that income and employment remain high.

Third, restricting housing by varying the intensity of government aid is not discriminatory, and does not necessarily call for accompanying selective restraints on other economic sectors or other purchases, when considered merely as a temporary modification of special benefits conferred on the housing sector. The federal assistance is designed to provide a permanent stimulus to residential construction and home purchase. If the stimulus is at times relaxed in the interest of economic stability, this can be considered a reasonable price to be paid for long-run benefits received by all those, including builders, who stand to gain from the preferred status accorded to housing. And when such action contributes to a decline in residential construction in the midst of general economic prosperity, one cannot ignore the very substantial stimulative influence of the government programs at other times.¹³ These observations hold also for another objection to using the federal housing programs to moderate general business fluctuations, that is, that such policies interfere with the market allocation of funds and therefore presumably with the most efficient use of resources. The governmental programs in any event constitute interference with market allocations, and economic stabilization policy must accept this as a given position. By the same token, the money market does not have complete power in determining the volume of construction, and the influence it does wield on residential building operates as both a stimulus and a restraint at different times.

Fourth, occasional restraint of activity in the housing sector can be considered good housing policy as well as a necessary or desirable tool of economic stabilization policy. Maximum output of new residential construction is not the only criterion of good housing policy, at least in the short run. Another valid objective of good housing policy is maintenance of reasonable stability in the housing market itself. Incessant stimulation of new building can seriously interfere with that objective if it results in excessive supply of new homes or sharp increases in their price or in credit extensions beyond consumers' ability to meet long-term obligations. In fact, a policy attempting to stimulate residential construction under all circumstances could at times meet with considerable practical problems in marketing the current output, unless the federal credit programs were to be converted into cash-subsidy programs.

Fifth, a policy of incessant stimulation of housing may adversely affect the flow of funds into other "high-priority" sectors of the economy instead

¹³ Cf. Turner, *Mortgage Market Problems*, p. 74.

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of activities which the proponents of ever-normal or ever-rising residential building would consider less urgent than housing (such as automobiles or other consumer durables or additions to industrial capacity). Since neither business investment nor consumer credit is highly sensitive to the usual moderate changes in the cost of borrowing, increased financing for housing in tightening capital markets would probably draw funds away from the capital improvement programs of state and local governments. These may be as sensitive to credit changes as housing. Moreover, many local capital improvements are necessary for increasing the public services associated with additional housing construction.

All of these considerations must be balanced against the impact of selective credit restraints and relaxations on residential construction activity itself. Long-term business planning, continuity of production at an optimum scale, and efforts to reduce cost can be frustrated if builders must adjust their operations to selective credit measures as well as to changes in general credit availability and monetary policy, in addition to the vagaries of housing demand. This point argues in favor of sparing use of selective controls.

Also, the application of selective controls places an increased burden on the equitable conduct of the fiscal affairs of the federal government so as to avoid or minimize expansionary actions on other fronts when residential construction is being restrained. The record of the fiscal policies of 1955-1956 on this score is not without blemish. Federal expenditures increased for several civilian programs as well as for national defense.¹⁴ More specifically, federal aid to construction by state and local governments was stepped up in 1956 and more markedly in 1957 when direct federal construction also expanded.¹⁵ The sharp rise in certifications under the accelerated tax amortization program for plant and equipment for defense purposes in late 1955 and the first half of 1956 could not but add to the inflationary tendencies that were especially noticeable in the market for investment goods.¹⁶ It also probably contributed to excess capacity of certain industries relative to current or near-future sales and therefore to unbalanced resource allocation. Further, a liberalized program of federal insurance of ship mortgages, with

¹⁴ For an appraisal of fiscal policies during this period, cf. Arthur F. Burns, *Prosperity without Inflation*, Fordham, 1957, pp. 37-39.

¹⁵ *Economic Report of the President*, January 1958, Table F-32.

¹⁶ During the fourth quarter of 1955 and the first half of 1956, the amount certified for accelerated write-off totaled \$3,419 million, as against \$976 million in the first three quarters of 1955 and \$1,061 million in the entire year 1954. The certifications of nearly \$3.5 billion equaled about 10 per cent of total business expenditures on plant and equipment in 1956, but the actual expenditures associated with the certifications were, of course, spread over a longer period. The amounts certified after mid-1956 dropped sharply. *Defense Production Act Progress Report No. 38*, Hearings before the Joint Committee on Defense Production, 85th Congress, First Session, May 21, 1957, p. 58.

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an interest rate ceiling of 6 per cent, and an expanded military housing program drawing on private capital had a directly competitive impact on the funds or financing commitments available for home building, although actual production under these programs in 1956 and 1957 was relatively small.¹⁷

Whatever the merits of the increased federal spending or aid programs in comparison to housing, the case illustrates the rapidly growing problems of equity and social priorities in the conduct of short-run stabilization policies as federal programs affecting the economy proliferate. The problems are, of course, accentuated by the fact that Congressional and administrative actions impinging on economic stability are quite imperfectly attuned or synchronized.

Residential Building—Balance Wheel of the Economy?

It is sometimes alleged that selective housing credit regulations have been employed deliberately so as to use residential building as a beneficent balance wheel of the economy. Quite apart from the question of intent, what has been the relation between short-term swings in residential construction and general business fluctuations during the postwar years?

The most straightforward comparison of fluctuations relates changes in the amount spent on residential building to changes in gross national product (Table 21). It would be an exaggeration to say that these figures reveal a systematic counter-cyclical behavior of residential construction. In some critical periods, changes in the volume of residential building have given powerful support to the initial recovery from a business contraction. Thus, in the general economic recovery during the first half of 1950, before the Korean War had had any sizeable impact on the economy, continued expansion of residential construction contributed \$2.9 billion to the \$17 billion increase in GNP (annual rates), a much larger percentage than the normal share of this sector in total output. In the second half of 1954, the housing sector contributed more than \$2 billion to the \$12 billion advance in GNP.

¹⁷ An amendment of August 7, 1956 (*Public Law 1017*, 84th Congress, 2nd Session) to the Merchant Marine Act of 1936 raised the maximum amount of ship mortgage loans that can be insured by the Secretary of Commerce from 90 per cent of the cost of vessels to 100 per cent. As of March 1957, mortgages totaling \$19 million had been insured subsequent to the amendment and another \$4.1 million had been committed, but applications were pending for a much larger amount. Cf. *Housing Act of 1957*, Hearings before the Subcommittee on Housing of the House Banking and Currency Committee, 85th Congress, 1st Session, March 4-15, 1957, pp. 142-144. For military housing, see Title IV of *Housing Amendments of 1955* (*Public Law 345*, 84th Congress, First Session, approved August 11, 1955), and Title V of the *Housing Act of 1956* (*Public Law 1020*, 84th Congress, 2nd Session, approved August 7, 1956). The number of dwelling units started under these provisions with FHA-insured financing rose from 2,837 in 1956 to 16,539 in 1957 (*11th Annual Report, Housing and Home Finance Agency, 1957*, p. 57).

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TABLE 21

Quarterly Changes in Gross National Product and Residential
Construction Expenditures, 1948-1958
(annual rates in billion dollars, seasonally adjusted)

Year	Quarter	GNP	Residential Construction ^a	Stage of Busi- ness Cycle ^b
1948	I	4.4	0.1	E
	II	8.2	1.8	E
	III	6.3	-0.1	E
	IV	1.9	-0.7	P
1949	I	-6.1	-0.7	C
	II	-3.4	-0.1	C
	III	2.4	0.7	C
	IV	-1.8	1.3	T
1950	I	8.8	1.3	E
	II	8.6	1.6	E
	III	18.8	1.6	E
	IV	11.1	-1.0	E
1951	I	13.5	-0.3	E
	II	8.6	-1.6	E
	III	6.4	-0.7	E
	IV	4.3	0.3	E
1952	I	2.9	0.3	E
	II	0.3	0.3	E
	III	3.7	0.1	E
	IV	11.6	0.6	E
1953	I	5.9	0.3	E
	II	4.3	0.3	P
	III	-1.7	-0.2	C
	IV	-6.1	-0.1	C
1954	I	-1.0	0.0	C
	II	-1.1	1.0	C
	III	3.1	1.1	T
	IV	8.8	1.2	E
1955	I	13.5	1.5	E
	II	8.7	0.4	E
	III	10.4	0.0	E
	IV	5.5	-0.5	E

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TABLE 21 (Continued)

Quarterly Changes in Gross National Product and Residential
Construction Expenditures, 1948-1958

(annual rates in billion dollars, seasonally adjusted)

Year	Quarter	GNP	Residential Construction ^a	Stage of Busi- ness Cycle ^b
1956	I	1.9	-0.6	E
	II	4.1	-0.1	E
	III	5.6	-0.1	E
	IV	10.0	0.1	E
1957	I	5.8	-0.5	E
	II	4.9	-0.7	E
	III	4.4	0.4	P
	IV	-6.7	0.7	C
1958	I	-11.8	-0.5	C
	II	3.3	-0.9	T
	III	9.4	1.7	E
	IV	13.2	2.2	E

SOURCE: U.S. Department of Commerce.

^a Includes expenditures on new dwelling units, nondwelling residential facilities such as hotels and motels, and additions and alterations.

^b E = expansion; C = contraction; P = peak; T = trough. Peaks and troughs from standard reference dates for business cycles. National Bureau of Economic Research.

In the second half of 1958, the increase in residential outlays accounted for \$3.9 billion or 17 per cent of a \$22.6 billion rise in GNP.

In certain periods, stable or expanding expenditures for residential construction have tended to moderate the downward pull of recessionary forces in other sectors of the economy. In the last half of 1949, for example, when the gross national product just about held its own, residential building increased at an annual rate of \$2 billion, enough to offset declines in other sectors. During the second half of 1953, following a general business peak, the relative stability of residential construction helped materially to keep the decline in GNP within narrow limits, and the beginning expansion of this sector in the first half of 1954 equaled half the drop in GNP.

At other times, reduced expenditures for new housing have tended to moderate the pace of general economic expansion. This was the case between late 1950 and the fall of 1951, partly under the influence of the restrictions during the Korean episode, and again between late 1955 and mid-1957. But between the fall of 1952 and mid-1953, the rising volume of residential con-

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struction paralleled the general economic expansion in its late phase, and in the first half of 1949 the declining residential output paralleled the general contraction.

On the whole, the evidence indicates that residential construction expenditures usually conformed positively to business fluctuations with a lead, cushioned recession, gave strong support to initial recovery from a business contraction, and tapered off in advanced phases of general business expansion. A more nearly counter-cyclical behavior of residential construction is shown by other measures of housing output such as building permits, housing starts, and construction contracts. These series, however, really indicate future output or initial phases of activity rather than the volume of activity itself.

The market forces mainly responsible for short-term residential building cycles during the postwar period need only be sketched here. The line of analysis is quite familiar and was already indicated in previous sections. Given long-run demand and supply forces favorable to residential building, short-run cycles in housing construction were associated for the most part with changes in the supply of mortgage funds and credit terms, which in turn were greatly influenced by the level of total economic activity. When that level was rising and high, the expanded demand for funds by business, which is relatively insensitive to increased cost of borrowing, tended to reduce the availability of funds for housing, which is highly sensitive to changes in the cost of borrowing. When there was slack in the economy at large and the supply of funds was ample relative to demand, credit became more readily available for home building and home purchase, which are highly responsive to easing as well as tightening financial markets.¹⁸ As was shown before, inflexible interest ceilings on government-underwritten loans have reinforced these market influences. Thus, it may be said that the strategic factors in short-term fluctuations of residential building have indeed been counter-cyclical in character but, because of time lags in the process of initiating, financing, and building residential projects, they have produced less than counter-cyclical results.

There remains the question of whether the 1953-1958 cycle of residential construction, in which selective housing credit policies were used, showed characteristics markedly different from those of earlier postwar cycles. Two tests are possible on this point. One is a comparison of the duration and severity of successive short-term swings in residential construction, and the other is a comparison of cycle averages of total housing output during successive short-term cycles. Obviously, these tests can give no conclusive evi-

¹⁸ Cf. also Chapter 2, footnote 17. Here, as on earlier occasions, cost of borrowing is defined broadly to include noninterest costs and especially credit terms such as loan maturity and down-payment requirement as well as the interest rate.

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dence on the effects of governmental credit policies. The cyclical behavior of home building and its average volume in the 1953-1958 period were influenced by a multitude of forces which defy neat segregation and any combination of which may have caused variations from past performance. Nevertheless, an examination of cycle characteristics will be illuminating.

For this purpose, the period after World War II is divided into four cycles for both housing starts and residential construction expenditures (Chart 7 and Table 22).¹⁹ The 1953-1958 cycle of residential construction, whether measured by housing starts or expenditures, was substantially longer than any of the three preceding postwar cycles, mainly because its contraction phase was more extended. The amplitude of the 1953-1958 cycle, on the other hand, was quite in line with previous postwar experience. For housing starts, it was about the same as in the first postwar cycle and smaller than in the second cycle of 1949-1951. For expenditures, the amplitude was smaller than in any other postwar cycle except that of 1951-1953.²⁰

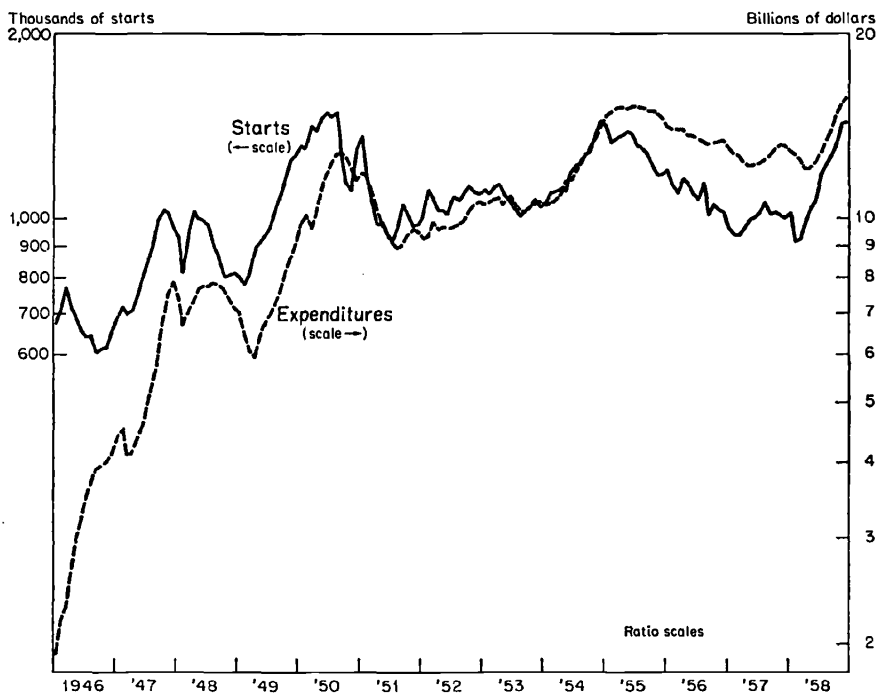
On the whole, then, instability as measured by the crucial test of amplitude of fluctuations was not any greater in the 1953-1958 cycle than in earlier postwar cycles, but the contraction was unusually long in view of the fact that the decline was not associated with a severe general depression. The long duration of the downward movement does not seem attributable to any single cause. The business investment boom of two years, the general credit restraints extending over a similar period, the increasingly adverse impact on the housing sector of the noncompetitive interest rate ceiling for V.A. loans, the time required for the governmental relief to housing in 1956 and 1957 to take hold, and possibly a weakening of the basic demand

¹⁹ The delineation of the first two of these cycles raises few problems. The period from about mid-1951 to the spring of 1958, however, can perhaps be treated as one or two cycles, depending on the purpose of the analysis. Because the fluctuations between mid-1951 and the fall of 1953 were moderate and somewhat irregular, there may be reasons for considering this period part of a longer expansion starting in 1951 and extending to the statistically clearly defined peaks of December 1954 for housing starts and June 1955 for construction expenditures. On the other hand, the forces affecting residential building during the 1951-1953 and 1953-1958 periods were so dissimilar that a division into two cycles is clearly indicated for the present purpose. In 1951-1953, construction was first subject to the restrictions imposed during the Korean War and later to successive relaxations of the restrictions. As was shown in Chapter 2, the housing expansion of 1953-1954 was mainly associated with easy credit, and its merger with the preceding movements during the Korean episode would only blur the analysis. Moreover, the fluctuations between mid-1951 and the fall of 1953, while moderate and irregular, are still sufficiently distinct in duration and amplitude to warrant their treatment as a separate cycle.

²⁰ Comparison of the characteristics of the short postwar cycles in residential construction with those of the period before World War II is made difficult if not impossible by the absence of consistent, seasonally adjusted monthly or quarterly data, especially for the period before the thirties.

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CHART 7
Annual Rate of Private Housing Starts and of Construction Expenditures for
New Dwelling Units, Monthly, 1946-1958
 (seasonally adjusted)



Source: Bureau of Labor Statistics.

for new construction compared to earlier postwar years may have all contributed to lengthening the decline.

The cycle average of housing starts during the 1953-1958 period came close to the highest of the four postwar cycles (Table 23). Moreover, the average annual rate of new dwelling units per 1,000 incremental nonfarm households was at a peak level. Each of the postwar cycles, in fact, shows an increase in the rate of housing starts over the preceding cycle when starts are related to the growth of nonfarm households. In the 1946-1949 period, new building could not keep pace with the unusually high net household formation, but the rate of building per 1,000 additional households improved steadily in each successive cycle as net household formation decreased and construction remained at a high average level. The 1953-1958 cycle average of expenditures on new dwellings was also substantially greater than the average for any preceding postwar cycle, both in current and constant prices. The share of these expenditures in the gross national product during the

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TABLE 22

Characteristics of Short Cycles in Residential Construction, 1946-1958

Turning Points			Duration in Months			Amplitude		
Trough	Peak	Trough	Ex- pan- sion	Con- trac- tion	Total	Rise	Fall	Total
<i>A. New Private Permanent Dwelling Units Started^a</i>								
Sept. 1946 ^b	Oct. 1947	Feb. 1949	13	16	29	+48.9	-27.5	76.4
Feb. 1949	Aug. 1950	July 1951	18	11	29	+52.8	-40.2	93.0
July 1951	Apr. 1953	Aug. 1953	21	4	25	+16.6	-8.7	25.2
Aug. 1953	Dec. 1954	Feb. 1958	16	38	54	+34.0	-40.4	74.4
<i>B. Expenditures on New Dwelling Units^a</i>								
Apr. 1947 ^c	Aug. 1948	Apr. 1949	16	8	24	+53.3	-24.3	77.6
Apr. 1949	Sept. 1950	Aug. 1951	17	11	28	+66.2	-37.6	103.8
Aug. 1951	June 1953	Sept. 1953	22	5	25	+16.3	-3.0	19.3
Sept. 1953	June 1955	May 1958	21	35	56	+36.8	-23.7	60.5

^a Bureau of Labor Statistics.

^b This dating is somewhat uncertain inasmuch as housing production during the entire year 1946 was influenced by reconversion and the confused impact of the veterans' emergency housing program. Under these circumstances, the seasonal adjustment of the series by the Bureau of Labor Statistics is probably less adequate for 1946 than for other years. The decline in the annual rate of starts from 774,000 in March 1946 to 605,000 in September 1946 most likely reflects difficulties in material supplies following the initial spurt of starts immediately after the termination of the war.

^c The difficulties described in the preceding footnote also apply here. The trough of expenditures in April 1947 followed an apparent peak only two months earlier. It seems to be associated with the trough in housing starts of the fall of 1946, the construction period being longer than usual due to materials shortages.

1953-1958 cycle was higher than in any previous postwar cycle except that of 1949-1951.

Thus, the average performance of the housing sector during the 1953-1958 cycle gives no evidence of a deterioration in the sector's position. It is, of course, true that residential building might have done better than it actually did; so could many other activities. But the fact remains that there is no indication of a change in the composition of national output to the detriment of housing over the cycle as a whole; on the contrary, home building

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TABLE 23

Cycle Averages of Residential Construction, 1946-1958

Initial and Terminal Cycle Dates	Number of Dwelling Units Started		
	Annual Rate ^a	Per 1,000 Increase in Nonfarm Households ^b	
<i>A. Private Housing Starts</i>			
September 1946—February 1949	811,130	538	
February 1949—July 1951	1,163,330	802	
July 1951—August 1953	1,056,700	878	
August 1953—February 1958	1,132,145	1,199	
Initial and Terminal Cycle Dates	Monthly Data (million dollars)		
	Current Prices	1947-1949 Prices ^c	
<i>B. Expenditures on New Dwelling Units ^c</i>			
April 1947—April 1949	561.9	551.4	
April 1949—August 1951	828.2	765.7	
August 1951—September 1953	834.2	698.7	
September 1953—May 1958	1,087.3	860.3	
Initial and Terminal Cycle Dates (quarters)	GNP (billion dollars)	Dwelling Unit Expenditures (million dollars)	Dwelling Unit Expenditures as Per Cent of GNP
<i>C. Expenditures on New Dwelling Units as a Percentage of GNP ^d</i> (annual rates in current prices)			
II 1947—II 1949	252.6	6,830	2.70
II 1949—III 1951	288.1	9,855	3.42
III 1951—III 1953	351.2	9,994	2.85
III 1953—II 1958	403.4	12,907	3.20

^a Starts and expenditures as reported by the Bureau of Labor Statistics. For cycle delineations, see Table 22. The figures are cycle totals of seasonally adjusted monthly data, divided by the number of months in each cycle.

^b To compute these rates, the averages of the annual census estimates of the increase in the number of nonfarm households between the following periods were used: April 1947 to April 1949, April 1949 to April 1951, April 1951 to April 1953, April 1953 to March 1958 (*Current Population Reports*, Bureau of the Census, Series P-20, No. 59 and No. 86).

^c Seasonally adjusted monthly figures adjusted by the Boeckh index of construction costs for residences, 1947-1949 = 100.

^d Because GNP estimates are only available for quarters, the cycles of expenditures on new dwelling units are delineated on a quarterly basis.

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continued to grow relative to net increases in household formation and in terms of spending on new dwellings.²¹

What to Stabilize

Finally, the record of the 1953-1957 period has sharpened the question of the proper aims of selective credit policies in the housing sector. What is it that such policies should help stabilize and grow with minimum disruption—residential building itself, or total construction, or the economy as a whole? The consequences of adopting any of these three goals for short-run stabilization policies may be quite different, although the objectives are not necessarily mutually exclusive; nor is the distinction between the three purposes merely theoretical. As was mentioned earlier, something approximating an “ever-normal” or “ever-growing” output of new homes has become a notion widely accepted among legislators, builders, and civic groups interested in the improvement of housing standards. Consequently, even a short-run decline in residential construction has come to be considered in many quarters as a national calamity no matter what the circumstances are, and one that calls for intensified government assistance to housing no matter what other results such action may produce.

If greater stability of residential building itself were the objective, federal policies might be aimed at maintaining residential construction at a maximum sustainable level regardless of general business conditions. Liberalizations and restraints of the government’s housing credit programs would be adjusted solely to this purpose, without consideration of the effects of these actions on general economic stability. Given the influence of federal credit programs on the housing sector, policies geared solely to the objective of a sustainable level of home building would appear to be both fair and feasible, although the determination of sustainable levels at any given juncture would be beset with difficulties. In addition, the goal of a sustainable volume of residential construction would avoid some of the problems created by long lead times which complicate the use of federal housing programs for purposes of general economic stabilization.

Maintaining a sustainable level of output, however, is not equivalent to

²¹ The foregoing analysis, as well as other parts of the paper, use available standard series on housing starts, residential construction expenditures, and similar items. All of these series suffer from weaknesses and are subject to errors which cannot be examined here. On the whole, it is believed that the data provide a fair portrayal of movements over time, which are of principal concern here, while they are less reliable as to levels. The absolute volume of housing starts, for example, is probably understated in the available estimates of the Bureau of Labor Statistics, and such understatement affects directly the cycle average shown in Table 23. There is no evidence, however, that the degree of understatement has varied over time; for this reason, the movements indicated in Table 23 are believed to be sufficiently reliable for the general analysis presented in the text.

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supporting a given volume regardless of effective demand. The latter policy would at times encounter serious practical difficulty. This difficulty is illustrated by conditions in early 1955 when the market for new homes was beginning to show clearly the signs of threatening oversupply. Given current consumer incomes and income expectations and current house prices, it would have been impossible to sustain the going rate of residential construction even on the very liberal mortgage loan terms available at that time. To maintain the current level of home building, even more generous credit arrangements would have been necessary. If new legislation was required, this would have meant delay and, for this reason alone, the rate of construction would have declined. More important, an attempt to maintain the current level of construction would have increased the upward pressures on building costs, land values, and house prices. Higher prices, in turn, would have canceled much if not all of the reduction in financing costs and would have defeated the purpose of the credit liberalization in addition to kindling the fires of inflation. Eventually, final prices to consumers might have been cut as a result of oversupply, but this consequence would have been greatly delayed and would then have led to a sharp decline in new construction rather than sustained output.

Thus, stability of residential construction in a literal sense is a highly impractical objective. Credit policies to help achieve it are unlikely to succeed or, if they did, might merely delay and perhaps increase market maladjustments. In many ways, the total construction sector would seem to be a more sharply defined as well as a more useful unit to be considered in economic stabilization policies. Residential building and many types of non-residential construction use a large amount of common resources which can shift to various types of construction in response to changing demands, while resource transfers from construction to nonconstruction activities or vice versa are much more difficult. The main demand forces influencing the volume of total construction are divided among business, consumers, and governments, with the result that stabilization policies need not concentrate on any single source of demand. The varying responsiveness of these three sectors to changes in the ease of borrowing tends to moderate the severity of short-term fluctuations in the volume of total construction. Also, other things being equal, reasonably stable performance of a larger economic sector is more beneficial to the economy as a whole than similar performance of a smaller sector. For these reasons, selective housing credit policies will probably always and quite properly take into account the current and anticipated volume of aggregate construction. Whether by design or accident, spending on total new construction in the 1955-1957 period was in fact highly stable, although its main components showed substantial fluctuations.

As for the third possible objective of selective regulation of housing credit,

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i.e. to help maintain general economic stability, the record of 1953-1957 has demonstrated that monetary and fiscal measures and the management of the government's housing programs are necessarily so interwoven that it would seem unwise as well as impractical to neglect this tool of economic stabilization policy. Stabilization policies, whether they operate through general or selective credit controls or through fiscal devices, necessarily take a panoramic view of economic life, although they must be concerned with balanced composition of the national output as well as with aggregate stability and progress. Also, as was pointed out earlier, the inclusion of selective housing credit controls in the armory of stabilization tools need not create inequities. But the principle of modifying the execution of federal housing programs in the interest of general economic stability will have to be extended to all major federal credit programs if the government's potentials for counteracting economic fluctuations are to be more effectively and more equitably realized.

In the conduct of economy stabilization policies, the real question is not whether the influence of the federal government on the housing sector is to be used for a purpose predetermined for all times or circumstances. No individual business cycles are really alike, nor is the role of the housing sector in specific cycles ever the same. Under some circumstances, selective housing credit policies can effectively aid general stability. In others, there is no reasonable prospect that they can perform such a function. The question is rather whether, under given conditions, the general interest is most effectively served by employing flexible housing credit policies for accomplishing one or the other of the three objectives that were outlined previously, or for a proper admixture of these several realizable goals. A rigid definition of the purpose of any means of moderating the severity of business fluctuations would only inhibit the government's capacity to help maintain steady economic growth.

