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Introduction

1

This paper is a product of a wider inquiry initiated by the National Bureau of Economic Research in mid-1950, at the request of the Life Insurance Association of America and with its generous assistance. The inquiry deals with long term trends in capital formation and financing in the United States — in the hope that establishing these trends and analyzing the relevant factors may contribute to a better understanding of current problems and to a more intelligent view of the future. Even if we find, as we well may, that the patterns of change revealed by the past are too complex and the factors at play too uncertain in their bearing to permit specific projections, whatever we learn should serve to enrich and revise current notions and theories, and thus provide a sounder basis upon which both research and policy may be planned.

The inquiry is organized primarily about the major capital-using and demanding sectors of the economy — agriculture, mining, manufacturing, public utilities, residential real estate, government, and the foreign sector. Each is the subject of a study designed to analyze the factors that have determined trends in capital formation and financing in the sector and to indicate, so far as possible, the significance of these factors for the future. In tracing trends in real capital formation we try to reach back to 1870; in dealing with trends in financing, we must, in most cases, stop at 1900 and have great difficulties extending the record even that far back.

In addition to the sector studies, the inquiry comprises two others, of somewhat wider scope. One deals with intermediate financial institutions, and attempts to establish trends in external financing channeled through these various institutions and to link them, so far as possible, with various groups of capital users. The other general study combines the results of all others and places them within the broader framework provided by countrywide estimates of national product and their relevant components, and of country-wide estimates of assets and debts. The whole inquiry gains much from a study of savings covering the period since 1897, recently completed by Dr. Raymond W. Goldsmith under the auspices of the Life Insurance Association of America.

The monographs which will present our results in detail will, it is hoped, be completed within a year or two. For earlier circulation, we shall present some of the findings as occasional papers, of which the present is the first.

2

Professor Grebler's paper deals with what, on the scale of the inquiry, is a brief period and a narrow facet — federal credit aids in their impact on the volume and financing of new nonfarm residential construction during the past seventeen years. But within this area, the conclusions are striking, and are of general interest not only because the magnitudes of the affected processes are so massive, but also because they reflect part of a wider trend with far-reaching ramifications.

Let me state the main factual conclusions of Professor Grebler's richly documented paper, quoting his text directly whenever convenient.

1. Of the 9.5 million new dwelling units constructed in this country during the seventeen years, 1935-51, some 3.8 million, or about 40 per cent, were financed with mortgage loans insured by the Federal Housing Administration or guaranteed by the Veterans' Administration. For the six postwar years, 1946-51, when 5.8 million dwelling units were built, 2.6 millions of these, or over 45 per cent, were so financed.

2. The federal credit aid program was most important in financing new, medium priced, one-family houses in the range from

$6,000 to $12,000. The proportion of new dwelling units financed by federally insured mortgages was higher for rental than for owner-occupied housing, after World War II, but rental units were relatively few in number.

3. From 1935 through 1951, the total of insured or guaranteed mortgage loans on new construction amounted to $22 billion; $17 billion of it originated during the six postwar years, 1946 through 1951. Over the entire period, government insured or guaranteed loans averaged about 45 per cent of the total estimated flow of mortgage funds into new construction, and about 50 per cent during the six postwar years. At the end of 1950, the estimated balance outstanding of FHA and VA loans on existing and new construction, over $22 billion, was roughly 40 per cent of the aggregate residential mortgage debt.

4. "The exclusion of individual lenders in the FHA program and their small share in the VA program have accentuated the tendency toward institutionalization of the residential mortgage debt. The government insurance programs, particularly FHA, have stimulated the participation of commercial banks in residential mortgage financing." (p. 36)

5. Largely through the Federal National Mortgage Association, a government owned facility, the government assisted in developing a secondary market for FHA and VA loans, which tended to widen the geographic scope of the market for mortgage loans. Even more important, the FNMA became a primary supplier of mortgage funds in some of its operations, e.g., through heavy purchases of VA loans in 1950 and 1951. This function is quite distinct from that of attracting private funds through insurance or guarantee.

6. "The federal credit aids since the middle thirties have probably accelerated the decline in residential mortgage interest rates and the liberalization of other contract terms. Lower interest rates and particularly longer contract terms on FHA and VA loans, compared to conventional mortgages, represent advantages to borrowers under these programs so far as periodic outlays are concerned. Because of the indirect influence of easy credit on prices paid for new as well as existing construction during the war and

postwar periods, however, these advantages were at least partially canceled by price effects." (p. 53)

The capsule summary above does bare justice to the findings of Professor Grebler's paper. It would hardly be possible to summarize here his illuminating comments on the effects of government credit aids on the volume of new residential construction; on its distribution between rental and owner-occupied housing, or among various price classes; on the channeling of mortgage funds through various types of financial intermediaries; or on the real costs of financing to the consumers. Nor can one condense his discussion of the changing philosophy behind this particular group of government policies — the shift from thinking largely in terms of "pump priming" under conditions of underemployment of resources to emphasis on facilitating supply, under conditions of full employment, to groups that, without special aid, would have difficulty in securing new housing. Finally, it would scarcely serve a useful purpose to try to summarize Professor Grebler's provocative discussion of the significance of this record of government credit aid for the future — particularly the possible extension of government activity beyond mere aid to private financing of new housing to measures that would stimulate new construction, not necessarily with private financing as this term is ordinarily understood. The reader, whose interest the preceding remarks are designed to stir, is urged to turn to Professor Grebler's discussion.

The principal purpose of this introduction is to indicate the relation of the findings in the paper to the main concern of the broader inquiry into capital formation and financing. In one sense this relation is obvious, for the quantities speak for themselves. From 1946 through 1950, in one quinquennium, nonfarm residential building amounted to $40 billion, out of a total of private domestic capital formation (gross) of over $180 billion, or somewhat less than a quarter. It may safely be asserted that the ratio of external financing to gross capital formation is much higher for nonfarm residential construction than for other types of business capital formation. It follows that the governmental activities with which Professor Grebler deals directly affected a quarter of all private domestic capital accumulation, and a much higher proportion of the total external capital funds used for this purpose.

Rather than stress the obvious, it may be of more interest to touch briefly upon a more difficult problem raised by Professor Grebler's paper. What does this historical incident, this rapid change during a period just a bit more than a decade and a half, mean with respect to our capacity to extract from the past results both tangible and stable enough to provide a firm basis for analyzing current problems and future prospects? This question, which haunts all research into complex and variable phenomena, is perhaps most appropriate here — when we deal with a case of rapid change, the acting agent being that apparently most unpredictable institution, the government.

3

As Professor Grebler observes, each step taken by the government in providing aids in financing new residential construction might be explained by the specific circumstances of the time. If one asks why each phase of this unprecedented program of insurance and guarantees was undertaken when it was, one can find many apparent reasons in the immediate antecedents. The drastic decline in values and the resulting threat to the whole ownership and debt structure of the country that occurred after 1929 produced conditions under which an adequate flow of funds to new construction, without aid by government, was thought by many to be far from likely. One should also note that, at least as far as the historical record back to the Civil War reveals, the decade of the 1930's was the first since the 1870's in which the drastic contraction of the long cycle in residential construction and values coincided with a severe and prolonged depression in general business conditions. Finally, it occurred when the structure of real estate debt was more fully encased than ever before in a complex network of intermediate financial institutions acting as custodians of the savings of a vast majority of the population. Under such conditions, many thought that the drastic process of deflation could only be checked by government aid, and that a satisfactory revival would not otherwise take place. Likewise, the coming of World War II and the accompanying restriction on construction; the accumulated shortage of housing facilities; the expected pressures upon limited productive resources in the postwar reconstruction; the restrictive effects of rent control; and many other facets of the economic and political scene provided a setting without which the governmental aid programs might not have been undertaken.

It is patent that other specific explanations could be added to or substituted for those mentioned. Less apparent is the implication of this wealth of specific explanations. That each step in governmental activity in this, as in many other fields, can be traced to a variety of antecedents — some immediate and others with roots in the longer past — makes all the more difficult reduction to a few determining factors. We are faced here with the familiar problem of generalizing from specific interpretations of concrete historical events. One is always struck by the multiplicity of "causes" that can be adduced for any specific historical event, or a specific chain of them. Were these "causes" reducible to one or few dominant factors, of the kind that can be observed and empirically studied — not merely glib references to "trends" and "waves of the future" — the task of deriving a tenable theory for analysis of current problems or predicting future prospects would be much simpler. Yet, however difficult the task, the first prerequisite is a clear realization of the difficulty — a full recognition of the historical setting within which the events occurred, the kind of recognition that is provided by Professor Grebler's account.

This account of the development of a new pattern of governmental aid also suggests the great capacity of society, particularly when organized with adequate room for individual and group initiative, for social invention. The record of the human mind in the fields of scientific discovery and technical invention has become so familiar that reference to it is a commonplace. Anyone who has ever observed how society deals with the succession of problems into which it seems to blunder cannot fail to be impressed by the ingenuity and inventiveness that goes into evolving new measures, new institutions, new practices. Professor Grebler's account is a story of one of these social inventions. But if our economic and social past has been materially affected by the series of social (as well as technical) inventions, an orderly pattern is bound to be all the more elusive. Discoveries and inventions, by definition, include an element of the unusual and accidental; would not this element be sufficiently strong to render the past a succession of events, each specifically explicable, but not falling easily into recognizable and simple patterns?

Clearly, a broad inquiry such as the present study of capital formation and financing must assume some discoverable order in the past, some basic and persistent forces, some recognizable pattern in the motley succession of specific events. To quote Professor Grebler: "Here, as in the interpretation of other events, it is necessary to distinguish sharply between the incidents that give rise to political actions and the more deep-seated forces that underlie the actions" (p. 56). It does not require much digging or imagination to identify the more deep-seated and persistent forces that give continuity to social life and impose some order on its course. The members of society transmit their continuing heritage from one generation to another and, expecting to do so, plan their actions accordingly. New social inventions, geared to the needs of the moment, are added to a series of other past events and thus absorbed into a common stock of experience. The past so determines the present that the choice is constrained, and the new and unusual elements, the inventive aspect of history, are to some extent kept within limits. In the particular story told by Professor Grebler, is it not clear that the whole cast of our society made some other alternatives that might have been imagined highly unlikely, e.g., complete substitution of public for private financing or a drastic reorganization of the residential construction industry under government control? If large-scale government aid to financing of new housing was novel in our history, it also had elements of the old — in that it was aid to *private* financing and attempted to preserve the organizational fabric of the industry and of the network of private finance built around it. And again, after the program was initiated under the impact of the specific conditions of the mid-1930's, did not this series of steps prove to be cumulative, so that in turn it became part of the heritage and will affect what is likely to happen in the future? It is this combination: the limitations on any new steps by the continuing past and the cumulation of new changes into a persisting contribution of the past that lends historical continuity to the whole course of economic and social change. To find this continuous pattern is the goal of empirical research.

Three brief comments in conclusion may be in order. First, one of the ways to find intellectual order, that is, to distinguish persistent from transient factors, is to lengthen the historical perspective. Such extension of the perspective permits one to study a greater variety of events and should inhibit mechanical extrapolations from short series of events. For this reason, the present inquiry into capital formation and financing attempts to cover a relatively long stretch of our economic past — although for several problems our stretch is not long enough.

Second, one may ask as to the proper definition of the term "government." As it is used, the term leads one to think of a narrowly defined institution, an industry — in which meaning it is often employed in industrial distributions of the labor force or of national income. But the same term is also applied to the *state,* the society as a whole acting under a different name from that which is used when it acts as a collection of living and consuming units, or as a group of producers organized in business firms. The extreme multiplicity and variety of governmental functions, and the claims made upon the government in a free society (rather than claims made *by* it, which are prominent in an authoritarian society) clearly suggest such interpretation. In many contexts governmental activity and policy must be viewed not as a set of decisions by a group of bureaucrats, but rather by society — whether or not under pressure of special groups. In these cases, government activity must be studied for its functional implications — examined, as Professor Grebler does, for the underlying forces, the social and economic values which drive society, through its government, to take certain actions under certain circumstances.

Third, it may seem that broad reflections of this kind have no practical bearing. Now, it is true that they are of little use in dealing with detailed and specific questions — such quandaries as whether to use index A or index B for adjustment for price changes, how to frame or whether to introduce regulation X or W, whether to count upon lower interest rates during the next year or two and arrange investments accordingly. But these fundamental notions have bearing upon the direction and standards of economic and related research, and upon the effectiveness of such research in influencing the course of economic education — in the first place of scholars in the field and eventually of society itself. Basic social decisions are made within a framework and against the background of some implicit theory or theories as to how economy and society operate; of some knowledge, no matter how crude, of the basic magnitudes; of some hypotheses about how individuals and groups will respond to changes to be imposed by the decisions. Such theory, knowledge, hypotheses are the results, in part, of thinking and research by scholars in the field, in part, of direct experience by individual members of society. The basic notions that govern the directions of research and channel the thinking are, therefore, important because they affect the framework within which far-reaching social decisions are made. Hence one may urge that in the long run, the run that affects ourselves and future members of society, a set of basic notions that forces one to consider not only the full diversity of economic experience, but also the testable distinctions between the more lasting and the more ephemeral factors in operation is of great practical importance.

The whole cast of the inquiry of which the present paper is the first instalment is colored by such notions. They cannot be stated here in precise detail, nor is their precise formulation indispensable for determining the specific course of our study. But their general import is decisive to it: decisive for an understanding of the aim of the inquiry and of what each piece contributes to that aim.

SIMON KUZNETS

Director's Comment: I do not share Dr. Kuznets' apparent faith in "our capacity to extract from the past results both tangible and stable enough to provide a firm basis for analyzing current problems and future prospects." Although the present is, of course, limited by the past, the limits would appear to be broad enough to permit an infinite variety of future courses of action. If the term "cumulative" as used by Dr. Kuznets refers to the future rather than to the past, it surely cannot be maintained that all social innovations are cumulative. History affords examples of discontinuities as well as continuities.

The above observations are not intended to detract from the value of the excellent study made by Dr. Grebler, nor from the value of the companion studies in the present series. Although we may never be able to predict the course of future social development, we do know from experience that social change generally takes place slowly. There is, accordingly, a fair degree of probability that the relationships which have obtained in the not-too-distant past will persist with slight modification into the not-too-distant future. The assumption of a certain measure of inertia in social institutions and in the social values which support them is a far cry, however, from Dr. Kuznets' assumption that there is "some discoverable order in the past, some basic and persistent forces, some recognizable pattern in the motley succession of specific events."

CLARENCE HEER