FEDERAL EXPENDITURES FOR HOUSING AND URBAN REDEVELOPMENT

CONSTRUCTION COSTS AND GOVERNMENT POLICY

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As we all know, our economy is in one of those peculiar and infrequent periods in which physical output is stable or declining while prices keep rising. Gross national product (seasonally adjusted and in constant prices) has remained virtually unchanged since the last quarter of 1956. The labor force has continued to grow and we have been experiencing record levels of employment. But the increase in the labor force has been larger than the increase in employment, so that the rate of unemployment, although by no means high, has been running above last year. Manufacturing employment (seasonally adjusted) is actually below its level of December 1956; the increase in total employment is to be found elsewhere, particularly in trade and government.

Total industrial production (seasonally adjusted) has declined 2 percent since last December, while durable-goods production has declined 3 percent. And inventories continued to rise in the second quarter of this year.

Despite all these signs of hesitation and doubt in the general economy, consumer prices continued to rise. After almost complete stability from mid-1953 to mid-1956, consumer prices rose 1.5 percent in the last half of 1956 and 2.4 percent in the first 7 months of 1957. Wholesale prices, which started to climb in mid-1955, appeared to have leveled off in the first half of 1957 but seem to have resumed their rise in July and August.

In the face of this continued rise in prices, the Federal Reserve Board has continued to maintain that the immediate danger to the economy stems from inflation and has continued to restrict the growth in the money supply. The very strong measures taken by the Federal Reserve and the impact of these measures on various segments of the economy, via changes in interest rates and in availability of funds, has resulted in considerable outcry against the tight-money policy of the Federal Reserve Board.

The more serious of these criticisms reflect a view that the present upward swing in prices is different from those experienced in the past, that the present inflationary swing is not caused by excessive demand and therefore cannot be halted by monetary measures. Some of these critics place the blame on administered prices; others, on union pressure for higher wages.

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But more important than these criticisms of Federal Reserve policy is the possibility that the Federal Reserve Board may soon be faced with either of two kinds of situations that we do not quite know how to handle. One is a situation in which both prices and unemployment are rising. There is fairly wide agreement on monetary and fiscal remedies to be employed to offset either price increases or unemployment increases. But when both occur at once, there is no agreement, indeed little understanding of the underlying causes. The second type of situation is one in which a rise in prices could be halted by the Federal Reserve only by inducing substantial unemployment. Here, the problem is one of choosing between alternative but equally desirable objectives (price stability—full employment).

It may turn out in fact that the Federal Reserve is not actually faced with either of these difficulties. The economy has slowed down only slightly and the rise in prices, at least on the wholesale level, may be slowing down. Perhaps it will be possible for the Federal Reserve to terminate the rise in prices while still permitting constant or rising output and employment.

Increase in Residential Construction Costs

But this optimistic view is hardly possible in the field of housing, where prices continue to rise despite a substantial decline in output and employment. Since the middle of 1955 the annual rate of housing starts has fallen off by almost one-third, and the real volume of residential-construction work put in place has declined by almost 10 percent. Yet residential-construction costs[1] have risen almost 7 percent in the same period. At this rate it would only take about two decades for residential construction costs to double again.

Residential-construction costs, of course, have a long history of increasing more rapidly than other prices. In the six-decade period ending in 1945, the general price index rose only 160 percent, while the residential construction cost index rose about 340 percent, or more than twice as much.[2] Between the end of World War II (1945) and 1956, the general price level rose 54 percent, while the residential construction cost index rose 73 percent. Even in the last 2 years, when residential-construction activity fell off perceptibly, the consumer price index rose only 5.1 percent (June 1955 to June 1957) while residential-construction costs rose 6.4 percent. Indeed, there were only 2 years in the last decade when construction costs leveled off, and each was a recession year.

Residential-construction costs have risen relative to the general price level partly because building-wage rates and materials prices have increased faster than other wage rates and prices and partly because productivity in residential construction has probably increased less than elsewhere in the economy. Both of these factors have operated for many years.

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[1] E. H. Broeckh & Associates' residential-construction cost index.

[2] Based on price indexes implicit in 9-year moving averages of gross national product and residential construction, expenditures in current and constant prices. Leo Grebler, David M. Blank, and Louis Winnick, Capital Formation in Residential Construction; Trends and Prospects, Princeton University Press, 1956, p. 126.

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BUILDING WAGES AND MATERIALS PRICES

Average hourly earnings in the building trades have increased slightly more than in all manufacturing industry since 1950, 45 percent for building employees and 41 percent for manufacturing employees.[3] But, more importantly, the weight of wages in the total cost of construction is higher than for most other sectors of the economy. Therefore, the continuous increase in wage rates that we have been experiencing will tend to increase the costs and prices of construction by greater percentages than elsewhere. Thus, Leontieff, in his analysis of the effect of an increase in wages in each of 18 sectors of the economy (wages in all other sectors held constant), concluded that the construction industry would have the third largest increase in costs and prices.[4] Prices of building materials have risen 19 percent since 1950, while the overall wholesale price index has increased only 14 percent. During the preceding six decades, building materials prices rose almost twice as much as the average wholesale price of all commodities.[5]

Despite this wage and price behavior, residential-construction costs might not have advanced relative to other prices if productivity in the residential-construction industry had grown faster than elsewhere in the economy. In fact, however, the available data indicate that productivity in construction has grown little and certainly far less than we have come to expect elsewhere in the economy.

PRODUCTIVITY

The measurement of productivity changes in any industry is a difficult one, and particularly so for residential construction. But perhaps we can draw some tentative conclusions based on several studies that deal with trends in total construction.

One such study was undertaken recently by Colean and Newcomb.[6] In attempting to analyze changes in productivity in the building industry (including nonresidential building), they compared the movement of two indexes of building cost. One index was simply a weighted average of wage rates and materials prices, calculated by the Engineering News-Record; the other was an average of cost indexes of four well-known building contractors. The contractor indexes according to Colean and Newcomb, attempt to measure changes in building costs based on "actual estimates for building comparable structures." The authors state:

> Since the Enginering News-Record index is a combination of wages and materials prices according to a fixed relationship, while the combined contractor index is based on estimates of the actual cost for erecting comparable structures, a comparison of the two should at least suggest the changes in cost that result from changes in efficiency.[7]

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[3] In the six decades ending in 1950, average hourly earnings in the building trades increased 851 percent; in manufacturing, earnings increased 769 percent. Grebler, Blank, and Winnick, op. cit., p. 127.

[4] Wassily Leontieff, Wages, Profits, and Prices, Quarterly Journal of Economics, November 1946, p. 33.

[5] Grebler, Blank, and Winnick, op. cit., p. 127.

[6] Miles L. Colean and Robinson Newcomb, Stabilizing Construction: The Record and Potential, McGraw-Hill, 1952, pp. 69–74 and 247–248.

[7] Ibid., p. 71.

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While there was some short-term difference in movement between the two series, the striking fact is that there was no pronounced long-term difference over the four decades being studied. With both indexes on a 1913 base, the ratio between the indexes was 101 in 1950 and 103 in 1951. At no time did the ratio fall below 90 and at no time in the 30 years prior to 1951 did it rise above 113.

To the extent that productivity increases in building construction were reflected in the contractor indexes, such increases cannot have been very great in total building construction.

Chawner made a similar analysis for all construction (including nonbuilding construction) for the two decades prior to the great depression.[8] He found that heavy construction, railroad construction, and highway construction had experienced significant increases in productivity, but that building construction had not.

Clearly this is inadequate evidence from which to draw any firm conclusions but one might reasonably draw the inference that residential building, particularly the construction of single-family houses, has shared little in the rise in productivity so characteristic of other sectors of the economy. Indeed, Colean and Newcomb state that—

> it now probably requires more man-years of work for the average worker to pay for the labor going into a house than it required in 1925 or 1915.

Role of the Government

In general, it is not the responsibility of the Federal Government to intervene in markets for particular commodities or services. It is widely held that the Federal Government should confine its influence on the economy to general measures of monetary or fiscal policy, to create the proper environment in which industries and individuals work out their individual problems. But housing, for better or worse, is not a commodity to be so treated. It has apparently been accepted by both political parties and by the last three administrations that the Federal Government has an obligation to help the public achieve higher housing standards than would have been possible without government aid. This commitment runs through numerous Federal programs—public housing, mortgage insurance or guaranty, direct-mortgage lending, purchase of FHA or VA mortgages, etc., and is found in legislation enacted over the last two decades.

The Federal Government has, in fact, played an important, perhaps dominant, role in the housing market in recent years and presumably will continue to do so. In view of this it is impossible for the Government to avoid facing at some time the question of what impact the various Federal-aid programs have upon the cost of building homes. In particular, the Joint Economic Committee, interested as it is in questions of stability and growth, cannot help but be concerned about this question.

The future is, of course, unclear, but we do not have long to wait before the pressure on the residential construction industry begins

[8] Lowell J. Chawner, Construction Cost Indexes as Influenced by Technological Change and Other Factors, Journal of the American Statistical Association, September 1935, pp. 561–576.

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to get much heavier. Indeed, the evidence is that increases in the demand for housing are already probably outstripping the rate of housing starts of roughly 1 million or less that we have been experiencing for the last year. Net nonfarm household formation, which fell from 1,046,000 per year in 1950–53 to 878,000 per year in 1953–56, rose to 1,189,000 in the year ending in March 1957. National vacancy rates, according to the Census Bureau declined from their "peak" of 2.8 percent in the third quarter of 1956 to 2.5 percent in the fourth quarter and to 2.3 percent in the first quarter of 1957. Similarly, vacancies in apartments with FHA-insured mortgages have fallen to their lowest level since such data were first gathered in 1950.

But the really serious problem will arise a few years from now when the babies born during and after the war will be reaching marriageable age and when houses will need to be built at annual rates that will probably be 50 percent or more higher than currently. At that time, the pressure on land, labor, and materials is likely to be greater than we have experienced since the early postwar years.[9]

The tasks facing the Federal Government then are twofold. First, efforts must be made to increase the rate at which productivity rises in the housing industry. In view of the very large sums spent on or invested in housing by the Federal Government, the cost of such a program, to be supported by the Federal Government, would not appear to be very great.

However, if such a program is not undertaken or if it is not sufficiently effective, the Government must then begin to take into account the effect upon housing prices of any action it undertakes in the credit field. That is, any attempt to ease downpayments or carrying costs that successfully results in a considerably larger number of houses being built is likely to have substantial adverse effects in the form of higher prices. As a result, the gains offered to the house buyer by this easing of credit terms may be partly offset by the increased price that he will have to amortize and pay interest on over the length of the mortgage. Indeed, it is not hard to visualize a situation in which the benefits to the additional families enabled to purchase new homes are considerably more than offset by the harm done to the remaining families who would have purchased new homes in any case.

At any rate, it will be necessary at times to make a conscious and perhaps unpleasant choice between an expansion in housing production, with its associated prices increases, and an avoidance of increasing housing production, with its associated retardation in the rise in housing standards in this country.

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[9] The influence of land prices on the rise in new house prices has not been discussed in this paper but is readily apparent.

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