

TO,.....**Mr. Eccles**.....

FROM.....**Miss Egbert**.....

REMARKS:

The attached is the copy of memorandum which Hon. Harold C. Ickes has sent you prepared by Mr. Paul Mazur, of Lehman Brothers of New York -- his views on the best way to bring about recovery.

GOVERNOR'S OFFICE



THE SECRETARY OF THE INTERIOR
WASHINGTON

February 2, 1935.

My dear Governor Eccles:

When I met you at Secretary Dern's recently, I spoke to you of Mr. Paul Mazur, of Lehman Brothers of New York, and his promise to send me a memorandum of his views on the best way to bring about recovery. You expressed an interest and I said I would send you a copy of his memorandum when it came to me. Two copies have just reached my desk, one of which I am sending to the President, and the other I am enclosing herewith. Will you be good enough to return this to me when it has served your purpose?

Sincerely yours,

Secretary of the Interior.

Hon. Marriner S. Eccles,
Governor of Federal Reserve Board,
Washington, D. C.

Enc.

February 7, 1935.

My dear Secretary:

I greatly appreciate your sending me the memorandum covering the views of Mr. Paul Mazur, of Lehman Brothers of New York.

In view of your desiring this memorandum returned to you and the fact that I am so busy with legislative and other matters right now. I have had a copy made of the memorandum so that I may not delay you and at the same time have it available when I can read it. I hope that this is satisfactory to you.

I am returning herewith the memorandum you enclosed in your letter of February 2nd.

Sincerely yours,

Governor.

Hon. Harold L. Ickes,
Secretary of the Interior,
Washington, D. C.

January 31, 1935

EXPENDITURES IN RELATION TO RECOVERY

PART I

PREMISES

- I. As a premise for this memorandum it is agreed that the Government in spending money in order to offset the lack of expenditures on the part of private enterprise is fulfilling a desirable function.
- II. It is, nevertheless, necessary to realize the reason for the failure of private enterprise to employ the total number of employable men and women during the past four years. The reasons are simple to state although it would appear that neither the Government, businessmen, bankers nor economists have indicated any of these reasons in their published statements.

It is doubtful whether manipulations of currency have been either helpful or harmful; it is equally doubtful if the so-called lack of confidence has been a substantial deterrent to the necessary recovery in business. Rather it would appear that business has failed to recover because of the following factors:

- A. The automobile industry has not been able to employ as many people as it did in 1929 because of the dis-

appearance of an important portion of its market. For the five years 1925 to 1929 the automobile industry produced over 4,000,000 cars annually. Since 1929 the average number of cars produced has been about 2,400,000 or a decrease in the market for automobiles of 1,600,000 cars per year.

- B. Foreign trade which amounted in 1929 to over \$5,000,000,000 declined to \$2,100,000,000 and even with the correction for the variations in price, the loss in employment inherent in the direct expenditures for the manufacture of such exports was over \$2,000,000,000.
- C. From 1922 to 1928 building increased at the rate of $6\frac{1}{2}\%$ cumulatively per year to a total annual expenditure in 1928 of \$6,600,000,000. Since 1929 this figure has amounted to an average of \$2,300,000,000 and today stands at about \$1,500,000,000.

From these three items alone the loss in capital goods has actually amounted to \$8,500,000,000 per year. If we assume that a primary expenditure of \$8,500,000,000 for automobiles, foreign trade and building multiplies itself by a minimum of two and one-half times in figuring the effect of such an expenditure upon the total national income, the loss through the diminution of these three markets alone in our national income would amount to \$21,250,000,000. This figure represents a loss of practically one-quarter of the total markets inherent in our national income figures for 1929.

- III. It should be clear, therefore, that until these markets are rehabilitated or until substitute markets are obtained, this

country cannot recover and cannot re-employ those people whose employment and whose purchasing power were dependent upon the industries which have suffered a diminution of such dramatic proportions.

It is important for the Government and business to cooperate in planning the rehabilitation of old markets and the creation of new markets rather than to have the nation wait until accident or inventive genius creates such new markets.

PART II

FAILURE OF THE GOVERNMENT'S PROGRAM TO DATE

For two years a Government spending program of large proportions has been under way. It has failed to accomplish all of its purposes because some of the Federal activities have been a deterrent rather than a stimulus to private business and because most of the Federal expenditures have not been regenerative.

In order to induce recovery Government funds should be expended in such a manner as to encourage the simultaneous and collateral expenditures of private funds in amounts substantially larger than those actually advanced by the Government.

I. Government activities in some instances have deterred private enterprise.

A. While some Administration members have, on one hand, challenged private enterprise to promote recovery by

increasing volume and employing those now unemployed, other Administration members have, on the other hand, removed the chance of profit or have threatened to remove such chance of profit to private enterprise.

1. In the air mail investigation, in the munitions inquiry, in the Government's position on the entire public utility problem, in the two Acts regulating the issuance of and trading in securities, in the proposed Pure Food and Drug Act and in the F.E.R.A. self-help factories there are direct and potential threat to the profit of private enterprise.
2. Because of Government activity it has been increasingly difficult to arrange private financing of private industry.
3. Government activity has competed with private enterprise, particularly in housing, and has thereby discouraged such activity by private enterprise.
 - a. Private enterprise can neither be encouraged nor financed in private building construction if the Government using public funds builds housing units by:
 - (1) Providing money at lower rates than those obtainable in the open market.
 - (2) Granting subsidies of substantial amounts.
 - (3) Providing a maximum rental to be charged regardless of cost of operation.

(4) Eliminating profit.

As a result of such Government activities, the total new construction will be almost limited to such Government construction; private enterprise cannot afford to construct buildings.

4. Government activities have not been coordinated but rather have been conflicting and contradictory

a. P. W. A., C. W. A., F. E. R. A. and F. H. A. have been unintegrated; their relationship has been confusing.

B. Government expenditures have not been regenerative.

In large part Government funds have been used for self-limited activities - that is projects which, when completed, provided no stimulus for further activity by private enterprise.

1. Government measures looking toward stimulation have in some instances been abortive and in other instances been insufficient to serve the needs adequately.

a. It is impossible economically to construct low rent housing facilities without a Government subsidy. Even with a Government subsidy of a tremendous size housing facilities can be supplied for only a very small portion of the market.

b. The F.H.A. loans for renovation were limited to \$2,000 - an amount far too low. The terms

of repayment for these loans were too onerous.

- c. Mortgage paper should be subject to rediscount by the Federal Reserve. If this could be arranged thousands of member banks could be made agencies for the loaning of money on new homes. Credit control could also be established.

PART III

HOUSING AS A FIELD FOR GOVERNMENT EXPENDITURES

Unquestionably the best opportunity in terms of economic and social need lies in a major rebuilding program for the American population. Although the Government has directed some attention to this effort, results have been unsatisfactory because the devices used by the Government have in some instances been misdirected. It is questionable whether the funds used for slum clearance and low rent housing will be effective in reviving construction or in providing housing on a scale sufficiently large to be useful.

It is therefore suggested that \$1,000,000,000 of Government money be made available for a housing program upon a basis which through the expenditure of such funds will insure a total building program of \$5,000,000,000, and including collateral developments and the stimulation of private building outside of the program, will mean a primary expenditure of \$10,000,000,000. By using the same multiplier in calculating the effect of primary expenditures on national income, namely two and one-half times the expenditure - the direct, collateral, and derivative increase in national income would amount to \$25,000,000,000 for \$1,000,000,000 of Government expenditure.

PART IV

A SUGGESTED HOUSING PROGRAM

- I. The purposes of housing in the Administration's program are:
- A. To stimulate heavy industry and thereby promote recovery.
 - B. To increase employment in the heavy industries and particularly in the construction industry in the hope that construction will continue once started, thus absorbing substantial numbers from the lists of unemployed.
 - 1. Construction employment has suffered more than employment in almost any other field.
 - 2. It is estimated that 76% of the cost of a building represents funds going directly and indirectly to labor.
 - C. To re-establish the flow of capital into mortgages and housing.
 - 1. To reopen mortgage markets (particularly F.H.A. Title II).
 - 2. To revive capital markets as a means of reviving widespread construction which in turn would provide employment.
 - D. To provide an active demand for housing which, on an economic basis, offers the chance for re-establishing one of the major markets lost to this country in the depression.

II. The available demand for housing is tremendous.

A. There exists a great market for modern housing for families of middle class incomes. The market for low rent housing is restricted.

1. Table I below provides an analysis of families, incomes per year, and expenditures for housing as reported by the Brookings Institution in "America's Capacity to Consume".

Table I

1929

<u>Millions of Families</u>	<u>Family Income Class</u>	<u>Millions of Income</u>	<u>Millions for Home</u>
2 3/4	Under \$600	\$ 300	\$ 600
2 1/2	\$600 - 950	2100	600
2 1/2	950 - 1250	3000	800
2 1/2	1250 - 1450	3600	1000
2 1/2	1450 - 1700	4200	1200
2 1/2	1700 - 2000	4800	1200
2 1/2	2000 - 2450	6400	1600
2 1/2	2450 - 3100	7700	1900
2 1/2	3100 - 4600	10,300	2500
2 1/2	Over 4600	34,600	6600
27 1/2	All Classes	77,000	18,000

a. These figures indicate that as of 1929 there were 5,500,000 families with annual incomes of under \$950 per year whose total expenditures for housing amounted to \$1,200,000,000.

b. The same figures indicate that there were 16,500,000 families having incomes between \$950 and \$3,100 per year in 1929; these families spent \$7,700,000,000 annually for

housing. Obviously the latter group presents a much larger and a much more important market than does the former group.

- B. It is estimated that our country has today a potential market for 5,000,000 middle and upper class homes costing about \$25,000,000,000.

III. The failure of any natural revival of construction.

- A. In spite of the existing demand and market for housing, private industry has failed to reopen this available market for a number of reasons:

1. With the onset of the depression real estate values fell, individuals' incomes dwindled, families doubled up. Maintenance was discontinued while depreciation went on. Because of lack of funds the market for real estate disappeared while the income from real estate continued to decline.
2. While all of this went on building costs remained high. Today it is more expensive to build than to buy.
3. Construction activity has failed to revive because of the absence of a sufficient profit in such construction.
4. Recent conditions have shown some improvement. Rentals have shown a tendency to increase although present rentals show no profit on original capitalizations, such apparent losses discouraging new construction.
5. It is possible today for private capital to build

new housing at some profit but,

- a. The former builders and contractors are bankrupt.
- b. Existing structures are available at low prices.
- c. It is difficult to obtain mortgage money and equity capital.

6. The threat of a so-called low rent housing program financed by the Government discourages owners from constructing buildings which in effect will be competitive but which cannot be competitive in rental.

- a. The experience of Knickerbocker Village is an example. This project has attracted white collar and junior executive classes of people. It is ^{not} now low rent housing in any sense; it is merely bargain housing for shrewd purchasers.

7. Building has failed to revive naturally because it is cheaper to buy than to build since financial deflation has carried values down while construction costs have not declined.

IV. The Administration's low rent housing program has been, in a sense, unfortunate.

A. The standards of construction set for low rent housing are higher than are the standards of existing housing occupied by middle class groups.

B. Low rent housing is a sociological ideal but it does not advance a program of recovery for:

1. It cannot be built and operated profitably either by private capital or by the Government. The fact that the Government undertakes the burden and by subsidy constructs the buildings, does not

eliminate or minimize the social cost to the solvent and tax paying elements in our population.

2. The effect of Government subsidies for low rent housing serves to delay and even perhaps to eliminate the possibility for any natural recovery in real estate values or for any natural recovery of housing - as distinguished from low rent housing - construction.

- a. When the Government makes it possible to construct and rent a building on a basis such that a similar building could not be constructed and rented by private capital, further declines in real estate values must follow. The fear of Government competition will sterilize completely the flow of private capital into construction. Will not the net result be that the only housing activity that goes on will be that sponsored by the Government? Can the Federal budget stand amounts large enough to permit such Government activity to continue for long at a substantial rate?

3. There may be some justification for Government subsidized housing provided such housing be rented only to families actually in the poorest classes.

- a. The table above showing income distributions as of 1929 indicates that the lowest class income groups in 1929 had incomes of under \$950 per year. If we take as a rough guide

the fact that similar incomes have probably decreased by about 40% since 1929, these groups as of 1934 might be held to have incomes of about \$600. If the Government were to have a specific section written into a statute making it a criminal offense for any individual to misrepresent his income in an attempt to rent an apartment in a Government subsidized housing project and if further the rental of Government subsidized houses were to be restricted to families of incomes of under, let us say \$600 to \$750 per year, then such Government low rent housing would definitely be noncompetitive in the real estate market.

- b. The approach of the Government to date has been much less realistic. In the first place it lends money at low rates and a suggestion has now been made that these rates even be reduced still further to $1\frac{3}{4}\%$. The Government then proceeds to set limitations on family incomes as high as \$4,000, the figure set in Knickerbocker Village.

- (1) A number of Knickerbocker Village apartments have been rented to

individuals or families with incomes in excess of \$4,000. It is submitted that housing of such type is not low rent housing for the benefit of the under privileged classes of our population, but actually bargain housing for shrewd people.

4. It should be pointed out that even with very substantial funds only an inadequate job can be done by the Government on any low rent housing program. Even if the Government were to spend \$1,000,000,000 on low rent housing at present construction costs, accommodations for only about 800,000 to 1,000,000 people would result. This would mean that 200,000 to 250,000 families would obtain new low rent housing. As has already been indicated there are 5,500,000 families in the two lowest income groups in our population. It must be obvious then that only a very small proportion of the under privileged would benefit from a direct Government expenditure of as large as \$1,000,000,000.
5. To provide modern low rent housing for the 5,500,000 families in the two lowest income groups in our population would require the construction of 22,000,000 rooms. At an average over all cost of, let us say, \$1,200 per room, such construction would require \$26,400,000,000 of Government funds.
 - a. As against an outright expenditure by the Government of \$26,400,000,000 on which the

Government would show a loss, the program here suggested should provide stimulation to national income in an amount almost as large with the expenditure of only \$1,000,000,000 of Government funds.

6. The proper method of providing low rent housing for the lowest income groups is through a program which will provide competitive housing units at competitive prices. Such a program, if it provides funds to private owners, will force activity of the construction industry. Not only will there be new construction, but that new construction will force necessary rehabilitation of existing structures.
- C. Middle class housing is more inadequate relatively today than is the housing of the poorest classes. The real market is among those groups of middle class incomes. The Government is making a mistake by restricting its housing program to low rent projects.

PART V

SUGGESTED PLAN

I. Principles.

- A. Government funds should be made available to supplement private funds on a basis whereby:
 1. For each dollar spent by the Government a multiple of that sum would be spent by private capital.

2. The Government funds will be invested on a basis which will insure their repayment preferably with a profit to the Government.
 3. The stimulus to private industry would make such a program definitely regenerative.
- B. In order to provide the stimulating and regenerative effect which will promote recovery the Government should provide junior or equity money.

II. Practice.

- A. Establish a Federal Housing Authority with an appropriation of \$1,000,000,000 to be employed in the financing of approved housing developments - apartment buildings, groups of private houses and individual private houses.
- B. It is desirable that the functions of construction and operation of houses be decentralized, the Federal Housing Authority exercising the right to approve or disapprove, with supervision within wide limits.
 1. Decentralization of construction and operation of the buildings is desirable in order to promote efficiency. Decentralization is desirable in order to provide housing suitable for local needs. Decentralization is desirable in order to permit private interests to make a profit consistent with the existing real estate market on both construction and operation.
 2. Senior financing might very well be centralized or decentralized depending on a study of the relative advantages of each plan.

III. Plan of financing - general outline.

A. It is suggested that the following general basis be employed:

1. A 70% mortgage to be sold to the public in the form of an insured mortgage bond following the issuance of mortgage insurance under Title II of the National Housing Act. The entire mortgage issue should carry with it one-sixth of the equity. By permitting the mortgage bonds to carry a small portion of the equity there will be a speculative attractiveness in the bonds. Purchasers will be given what appears to them a hedge against inflation.

It is interesting to point out that if the program here suggested is successful there will be no reason for any inflation. On the other hand, people with capital fear an inflation. The equity interest which accompanies these bonds will make them attractive to such people.

2. A 20% preferred stock issue to be purchased by the Federal Housing Authority. Such preferred stock issue to carry with it one-third of the equity. The equity interest obtained by the Government will provide a reasonable opportunity for a profit on some funds to provide insurance against loss on others. On the other hand, since a recapture provision is to be given to the equity owner there will be no difficulty from having the Government active in private business through

the operation of real estate.

3. 10% of the total construction costs to be advanced by the owner or builder for which such owner or builder will receive 50% of the equity. Arrangements to be made for owner to repurchase from the Government the portion of the equity owned by the Government on a basis such that in the event of repurchase, the Government will show an actual profit on its purchase of preferred stock.
- B. It will be important to have legislation so set up as to permit local sponsoring groups, whether such groups be housing authorities or other instrumentalities already established to continue operations in the housing field. The encouragement of such operations so long as the operations are kept on a competitive basis is desirable. The right of condemnation held by such Governmental units is of great aid in assembling land on a fair and reasonable basis through avoiding speculative and hold-up tactics by present owners.

IV. Advantages.

- A. The mortgage bonds to be sold to the public will be sound securities with a definite attractiveness because of the equity interest which they carry.
- B. A builder requires but 10% of the total cost of land and building - in most instances less than the cost of the land alone.
- C. This plan will make Title II of the National Housing Act - potentially a very constructive piece of legislation - both practical and effective.

- D. Arrangements can be made for the amortization of the preferred stock purchased by the Government so that there will be no drain on the Federal budget. The possible resale of the Government's equity interest to the owner will yield a profit in many instances on individual projects and will definitely yield a profit on a total housing program. The return flow of funds to the Federal Housing Authority resulting from the amortization payments on the preferred stock will supply funds for a continuing housing program.
- E. A program such as is here suggested would be regenerative; it would stimulate the construction industry by encouraging expenditures of private funds greatly in excess of the amount of Federal funds employed.

PART VI

AIR CONDITIONING

The general principle can be applied to the purchase of air conditioning apparatus for office buildings, factories, and transportation facilities. The market would be substantial.

PART VII

RAILROAD EQUIPMENT

The same plan or a modification thereof could be used for the construction of new streamlined facilities for the railroads. The need

for modernization of our railroads is great and Government funds for this purpose can be made regenerative by one of several plans.

Plan I.

Grant junior money to the railroads so that private funds can be raised upon a reasonable basis.

Plan II.

Grant a subsidy (free of cost) to railroads if used in eighteen months for the construction of new equipment.

Plan III.

Government could organize an equipment corporation financed to build two or three streamlined trains for each railroad system. This equipment would be built at Government expense and rented to the railroad at a low interest rate on the principal invested with an option upon the part of the railroad to purchase either at cost or a small profit to the Government.

If new type of equipment has a service to render, the introduction of individual units would prove their competitive value and should force the rapid extension of other similar new types to replace the old obsolete equipment.

EXPENDITURES IN RELATION TO RECOVERY

It is suggested that \$1,000,000,000 be made available by the Government for a housing program - not low rent housing - upon a basis which will insure expenditure by private capital of sums greatly in excess of such Government expenditure.

It is suggested that this objective may be attained if the Government will provide junior capital. One possible plan would be as follows:

- I. 70% of construction cost to be raised through mortgage bonds insured under Title II of the National Housing Act; mortgage bonds to carry one-sixth of the equity in the building.
- II. 20% of the cost to be supplied by the Government through the purchase of preferred stock carrying with it one-third of the equity.
- III. 10% of the cost to be supplied by the owner or builder in return for which he will receive 50% of the equity and the right of purchasing from the Government the portion of the equity owned by the Government.

These suggestions are submitted as a result of an analysis substantially as follows:

- I. Government expenditures are necessary in order to stimulate recovery. Unless substitute markets are found to replace the markets for automobiles, export trade, and the building construction of 1929, the present low level of activity in this country represents the only recovery that can be expected.
- II. The Government's program of pump priming has not met with substantial success because Government funds have been poured into dry pumps; the only resulting employment and spending created was the expenditure of those Government funds.

Some Government activities have exerted a deterring rather than a stimulating influence on private enterprise. Government funds should be spent in such a manner as to encourage the simultaneous and collateral expenditure of private funds in amounts substantially larger than those actually advanced by the Government.

III. A substantial housing program would promote recovery because:

- A. It would fulfill the purposes of the Administration through the stimulation of employment in the construction and allied heavy industries.
- B. The available demand for modern middle class housing is tremendous.
- C. Housing construction can be undertaken at a small profit today but outside stimulus is needed since it is still cheaper to buy existing structures than to build new structures at present construction costs.
- D. It would eliminate the objection to the Administration's present low rent housing program which does not stimulate private enterprise and is bound to be unsuccessful both socially and from the standpoint of stimulating recovery.

M E M O R A N D U M

31
Jan 1935

TO: Governor Eccles
FROM: Mr. Edmiston

Subject: Suggested Housing Program Forwarded to you by Secretary Ickes.

Comments on General Contents of Memorandum

The general objectives outlined in this memorandum are admirable. With limited funds available for public spending it is essential that they be spent in ways that will encourage and promote private expenditure. Moreover, the methods of public expenditure which tend to disturb confidence and discourage private capital investment should be avoided. This memorandum points out clearly the dangers when funds are used on low-cost housing projects which appear as a potential threat to private ownership of housing accommodations.

Comments on the Specific Plan to Promote Building

The main question at issue is whether or not the specific proposal will actually lead to the objectives claimed for it. As a practical proposition I doubt if it would be successful, particularly in the field of residential housing. Several objections are listed below:

1. There is nothing in the plan that will cut down interest rates or provide a method by which the discrepancy between building costs and rents is narrowed sufficiently to make new building operations profitable. The inducement to draw private capital into housing is a 20% purchase of preferred stock by the Government. However, this is not a gift and as the stock would have to be repaid in the future, it would not provide a great incentive to builders.

2. The red tape that would be involved in the purchase of preferred stock by the Government in the case of small homes throughout the country would be tremendous. The immense amount of work involved in checking up on each project would make for a slow rate of spending and would destroy the effectiveness of the program as a pump-priming operation. Preferred stock on a \$5,000 house seems slightly ridiculous.

3. The schedule of dividing the equity between the mortgage-holder, the preferred stock-holder and the owner is an unnecessary complication. Why the mortgage-holder or the Government is entitled to any equity in a property is more than I can see. They already have prior liens against the property in case of default of interest or dividend payments and they are entitled to nothing more.

4. Another difficulty is that the prospective builder must finance his operation through the Federal Housing Administration. This is a restriction that would delay the program. The owners should be left free to obtain capital from any source available to them.

On every count a direct subsidy scheme is preferable to this plan. The money would be taken up rapidly and a large volume of private expenditure would result. Moreover, the administration of the subsidy would be more efficient.

February 23, 1935.

N.K.