

3/11/58

## IMMEDIATE REVIVAL OF THE CONSTRUCTION INDUSTRY

The purpose of this memorandum is to outline a means whereby the four billion dollars variously allocated in the Emergency Relief Appropriation Act of 1935 may be used to assure a total "priming" expenditure of two and one quarter times that sum, or nine billion dollars. This expenditure of an additional five billion dollars, augmenting the expenditure projected by the Administration in the relief act, would be accomplished without any additional appropriation by Congress and without any additional grant of authority to the Executive.

Adoption by the Administration of the means herewith proposed to bring about the expenditure of an additional five billion dollars would direct that sum, plus a substantial part of the relief allocations, into construction. The great bulk of the five-billion dollar expenditure would be for residential construction, privately undertaken and privately financed, and the remainder for municipal construction.

The reason for this emphasis on construction will be evident enough. It is that the construction industry and the building trades still constitute the largest area of business stagnation and unemployment. Construction is therefore the logical point of concentrated attack in the recovery effort. What is of greater importance, construction is the only point (for reasons that will be

presently explained) at which a concentrated attack can be immediately directed with the assurance of substantial and sustained recovery beyond the present level of business activity and employment. And it is also important that a vigorous beginning be made before the 1935 construction season, from March to November, is too far advanced.

Regarded in this connection, the advantages of the plan to be outlined in this memorandum may be summed up in the statement that, if the plan is put into effective operation, the resultant volume of construction will be some three and one half times greater than can be anticipated through the relief act alone. The benefits to collateral enterprises and occupations, directly or indirectly dependent on construction, would of course be similarly multiplied.

A construction program of this magnitude, initiated by the Administration but carried out largely through private enterprise--and financed largely by private capital--would not have been practicable in 1933 or 1934. The Administration first had to arrest a deflation that had been progressing at the rate of some ten billion dollars a year and that had reached a point where the national money income was some forty billion dollars below the level of 1929. The basis of recovery then had to be laid in the rehabilitation of the banking and credit structure.

These things accomplished, a great financial obstacle to new construction still remained. The banks, in which are now con-

centrated a large proportion of the available funds for financing builders and home-buyers, were in the main unwilling to make real estate loans. Their avowed willingness to help finance recovery did not extend to the field in which there is the greatest lag in recovery. Nor was their attitude in this respect unwarranted: it was the natural and logical result of their late experience with legal restrictions that denied to sound mortgage assets eligibility for borrowing at the Federal reserve banks. But even if this inhibiting factor had not existed--and if there had been, besides, no dearth of borrowers to undertake construction and home-buying--the national banks would still have been limited by law, where the amount of real estate loans they can make is concerned, in a manner in which they are not limited as to any other long-term investments authorized by law.

These handicaps to a resumption of construction and mortgage financing, it is earnestly to be hoped, are now about to be removed by Congress through the proposed Banking Act of 1935.

As a matter of practical economic policy, a vigorous resumption of construction is imperative. The reason for this is that the big contraction of expenditures--and hence of incomes--has from the outset of the depression been in the fields of equipment and construction. Consumer expenditures on perishable goods has never declined more than moderately, and the industries producing such

goods are now enjoying a state of relative prosperity. Annual expenditures for equipment and construction, on the other hand, have declined by nearly fifteen billion dollars. Residential construction, where the greatest decline has occurred, has now remained practically unchanged for three years at about one-tenth of the 1925-28 level.

The problem of recovery, therefore, is primarily that of bringing about a large expansion of expenditures by corporations, municipalities, and home builders--the buyers, that is, of equipment and construction. But what likelihood is there of a "natural" expansion of their expenditures for these purposes? The answer may best be arrived at by a process of elimination:

1. Industrial plant and equipment is already far in excess of current needs.
2. The public utility industry, which normally spends about \$1,000,000,000 annually in new construction, is at present undertaking practically no capital expenditures.
3. Railroad companies would like to spend more on maintenance and equipment, but are unable to do so because of their low current revenues.
4. Municipalities have decreased their construction expenditures from more than \$2,000,000,000 annually to \$600,000,000 or \$700,000,000, and there is little prospect of unaided expansion until the basis of taxation has been

broadened through an increase in property values.

5. Expenditures on residential construction have declined from over \$3,000,000,000 annually to \$250,000,000 in 1934. The costs of residential construction are now so high relative to rents and incomes that there is no prospect of increasing residential construction until either costs fall or rents and incomes rise.

Thus in each of the above cases it is seen that increased private expenditures on equipment and construction wait upon increased demands for the products of industry. But increased demands depend upon increased incomes; and increased incomes wait upon increased expenditures on construction and equipment. The impasse can be broken only by vigorous Government action.

The national money income can be increased with certainty at the present time by only two ways--namely, by Federal expenditure of funds which otherwise would not have been spent, or private expenditure of this same nature stimulated by Government action. An increase of incomes, by increasing the demand for goods, absorbs unutilized plant and equipment, means more traffic for railroads, increases property values in cities, and leads to higher rents--factors all of which stimulate private expenditures on equipment and construction. Moreover, increased incomes mean a greater yield from Federal taxes.

It would appear that the expenditures by the Federal Government that in 1934 increased incomes on balance, and hence were inflationary, amounted to approximately \$3,000,000,000. This was less than 7% of the depressed national income of that year, and less than the national income for but two weeks in a normal year.

The moderate degree of business recovery experienced in 1934 can be attributed in large part directly to this factor. The amount of expenditure, however, was small relative to the amount normally spent by the community on equipment and construction and its effect was in part offset by continued liquidation and by increased saving, both of which reduce spending. The amount which it is intended to spend in the fiscal year 1935-36, \$4,000,000,000 (it is assumed that the \$800,000,000 will be spent in large part before July), is very little in excess of that spent in the calendar year 1934. There is no reason, therefore, to expect any substantial improvement with the expenditure of such a small amount. It may look large absolutely, but in relation to our normal income and the income which we hope to restore, eighty-five to ninety-five billion dollars, it is totally inadequate. Most of our problems have resulted from the shrinkage in income; they will not be solved until incomes are restored.

The case is one in which the boldest and most courageous course is also the safest, surest, and least costly course. For if

the Government spends something every year, but not sufficient to give the required stimulus to provide expenditures, we can build up a huge debt and still not be out of the depression. This has been the history of the deficits of 1931-34.

The reasons for believing that \$4,000,000,000 will not in itself be sufficient to "prime the pump" have now been stated. However, it is evident that both the Administration and Congress are now finally committed to this figure as a maximum. The gist of the proposal here offered, therefore, is to adopt the subsidy principle in order to make certain that, although the Government spends but \$4,000,000,000, nevertheless, by the use of this sum as leverage, it is possible to bring about a total of new expenditures, public and private combined, in the amount of \$9,000,000,000.

Manifestly, the most important use that can be made of the subsidy principle is in the field of residential construction. The revival of residential construction would (a) relieve unemployment in the most depressed field, (b) provide expenditures and hence employment in localities roughly in proportion to population, (c) provide a substantial increase of freight to railroads, (d) be decentralized and thus carried out rapidly, and (e) satisfy urgent needs of our people for better housing accommodations.

Because of the present ratio of costs to rents, however, a revival cannot come about unaided. Efforts of the Federal Gov-

ernment thus far in this field have proceeded on the assumption that it is the reluctance of lenders that is preventing new construction, whereas it is really the unwillingness of people to build that is causing the trouble. Loans insured by the Federal Housing Administration have amounted to only \$40,000,000, a negligible figure. If new houses are to be built and alterations and repairs are to be made on existing homes, it is essential that an inducement in the form of a subsidy be offered.

It is proposed that the Administration grant a subsidy of not less than 20% of the cost of new housing communities, the total amount of the subsidy not to exceed \$2,500 per unit. It is likewise proposed that a subsidy of 20% be granted for alterations and repairs on existing homes, the total subsidy not to exceed \$500. It might be desirable to decrease the amount of the subsidy as rents approach costs.

The subsidy could be administered through the local offices of the Federal Housing Administration, or through the Home Owners' Loan state offices. A certification of expenditure could be obtained by requiring the receiver of a subsidy to file an affidavit of performance, with recourse provided under the Criminal Code for attempts to defraud the Government.

Construction should begin within three months after application is approved, and should be completed not later than December 31, 1936.



In an effort to promote the low cost housing and slum clearance program, the Government might agree to pay the costs of demolition of existing properties and in addition to provide a subsidy to cities or corporations which agree to complete such projects within a stated period of time and according to approved minimum standards. There should be no restrictions as to rentals or financing. The administration could be carried out by the Housing Division of PWA.

More than one-fourth of the houses built in England from 1930 to 1933 were built with State assistance. The German experience with housing subsidies indicates that the public reception to such schemes is extremely favorable and that it is a highly successful method of getting money out rapidly. The German subsidy consisted of two parts, one of 20% of the costs for alterations to homes, and the second of 50% of the costs of sub-dividing large buildings. Successive allotments were taken up with striking rapidity. In the year from March 1933 to March 1934 unemployment in the building trades fell from 810,000 to 235,000, while employment in the building material industries increased by 91%.

In this country we have given subsidies to farmers, veterans, ship builders, air and ocean mail carriers, and others. Although our present proposal appears to be a subsidy to home builders, it should more properly be regarded as a subsidy to

labor in the building, the building material trades, the railroads, and all the collateral employment that follows upon construction activities, and the consequent rise in money incomes of such a large proportion of the working population. The subsidy in this case is designed to bridge the gap between costs and rents—a gap that has resulted in very large part from the operations of NRA. The subsidy leaves the home builder in the same position he would have occupied if there had been no NRA or rising costs. It would be desirable to present the subsidy as a subsidy to labor and to attempt to secure assurances that there will be no increase in wage rates as long as the program is in operation. It would also be desirable to remove all price and production controls from the building codes.

It is suggested that \$1,000,000,000 of the funds appropriated in the Emergency Relief Appropriation Act of 1935 be allocated to subsidies for residential construction and alterations. This should result in total expenditures of four to five billion dollars.

It is suggested that another \$1,000,000,000 be allocated to municipal construction, but that in this case the subsidy shall be 50% of the cost of new construction rather than 20% as in the case of residential construction. If fully utilized, the subsidy thus granted to municipalities would result in a total expenditure of \$2,000,000,000.

It is also suggested that \$100,000,000 be set aside to be used as a subsidy for the purpose of providing electric facilities in rural areas.

In making allocations for specific projects it is suggested that speed be the primary consideration and only projects that can be completed within a year be approved. In this connection, expenditures on highways, grade-crossing elimination, and the C. C. C. are particularly worthy of attention. Expenditures on highways should be undertaken through the Bureau of Public Roads, grade-crossing elimination by the Bureau of Public Roads and the engineering department of railroads. It is urged that Federal aid be in the form of grants and not loans. It is highly desirable that the R. F. C. should make loans on a liberal basis to railroads for equipment and maintenance purposes. Liquidation on balance of the outstanding loans of the R. F. C. would be deflationary in effect and would tend to defeat the other parts of our program.

In so far as it is possible, it is desirable that the program be carried out mainly by private contractors, who have the equipment and organizations already available. The primary objective should be to increase employment and incomes rather than simply to remove people from relief.

The program outlined above is designed to provide the maximum possible amount of employment. It would be unduly optimistic, however, to expect that it will result in a complete cessation of relief expenditures in the fiscal year 1936. It is proposed, therefore, that \$1,000,000,000 be kept in reserve for relief or work relief payments.

The vigorous prosecution of this program would result in total expenditures of some \$9,000,000,000 with a cost to the Federal Government, and a consequent increase in the public debt of only \$4,000,000,000. The initial or "priming" expenditure of \$9,000,000,000 would mean an increase in the national income of some 16% to 18%—not a huge increase, but certainly far more to be desired than the lesser percentage that would result from the Government expenditure of \$4,000,000,000 alone. Furthermore, by increasing the national income in this manner we will have made a substantial contribution toward the solution of a number of pressing problems. Some of these that the program here proposed would deal with may be mentioned in concluding this memorandum:

1. Our unemployment problem.
2. Our debt problem.
3. Our railroad problem.
4. Our real estate problem.
5. Our international trade problem.
6. Our relief-wage problem.
7. Our inflationist problem.
8. Our problem of social and political unrest, as reflected in the Long-Coughlin-Townsend phenomena.
9. Our problem of avoiding Government competition.
10. Our problem of avoiding work relief that is non-competitive in relation to private enterprise.

11. Our problem of raising housing standards and improving living conditions.

Most of these problems, and others related to them, can be reduced to one problem--namely, that of increasing incomes. This problem is one that the Administration, by making use of the leverage principle to multiply the volume of new construction, will go a long way toward solving.

March 11, 1935.