Currie 7/8/37

Implications for Governmental Policy

In view of the increasing shortage in housing, of the large amount of construction necessary in the next five years, and of the danger of a housing boom and collapse, it appears desirable for the Government to do what it can to stimulate construction now. In this way the danger of an excessive concentration of building activity and excessively high prices some years hence may be lessened. The longer it takes to attain an annual output of some 800,000 units, the greater will be the accumulated shortage, and the more difficult it will be to achieve stability in building and in general business activity.

The chief obstacles to a considerably higher rate of building activity in the next year or so are the rise in the price of building materials on the one hand, and a shortage of skilled labor on the other. Wholesale prices of building materials have risen 5.5 percent in the past few months to a level only 4 percent under 1929. A continuation of this rise would be a matter of grave concern.

The shortage of skilled labor is a consequence of the long-continued slump in building. The seriousness of the shortage is indicated by the numerous complaints on this score that arose last year when the output of new housing units was only between 250,000 and 300,000.

This shortage makes for higher prices, an inadequate volume of building, and less opportunity for the employment of unskilled building workers. The shortage might be lessened by governmental action in two ways. In the first place, the Government could lend its influence against any shortening of the work week in the building trades. The average hours worked per week in private building were 32 for the first ten months of 1936 while the highest average for a single month was 34. Secondly, the Government could in various ways provide for or encourage technical training in order to relieve the most pressing shortages.

When the output of housing units attains a volume of some 800,000 annually it may be desirable to attempt to restrain a further expansion. If this could be done building activity might be stretched over a longer period with beneficial effects on both building employment and general employment.

February 5, 1937

SUMMARY OF THE SECOND MEMORANDUM ON THE PROSPECTS FOR THE DURABLE GOODS INDUSTRIES

by

George Terborgh

HOUSING

Importance of housing

There can be no question that we have in housing one of the most important of all durable goods. Expenditures for new construction and repairs in this field averaged over 5 billion dollars annually during the residential building boom of 1923-1928, a figure which represents roughly 35 per cent of the total for consumers' durable goods, and 15 per cent of the total for all durable goods, in the same period.

The significance of residential construction from the standpoint of business fluctuations is greater than these relative magnitudes suggest, since it is subject to swings in activity more extreme than those which characterize the output of durable goods as a whole. During the low year of the depression, house building and repair operations were only 15 per cent of the previous high, as contrasted with 45 per cent for the output of all other durable goods.

Timing of movements

A review of housing construction since 1919 shows a movement with turning points differing quite widely from those recorded by most types of durable goods production, and by business activity in general. Thus residential building turned down in the middle of 1919, a year ahead of the break in business, and began rising early in 1921, several months ahead of the general recovery. Its next downturn came late in 1925, four years ahead of general recession, and the succeeding upturn appeared about the beginning of 1935, almost two years after the business revival set in. It is apparent that housing construction has been in an exceptional degree a law unto itself.

This is due not only to the fact that the demand for new housing moves in cycles differing from those which characterize most goods, but also to the fact that readjustments of supply to demand in this field proceed so slowly, and with such inertia, that they are likely to overcompensate, and to give rise to swings in production that are at times out of phase with the swings of business in general.

Housing during the depression.

The most important effect of the depression on housing was to suspend for several years the growth in occupancy on which, as we have seen, most of the demand for new construction depends. Because of the migration of population from urban communities to farms, the cessation of net immigration from abroad, the curtailment in the number of marriages, and the doubling up of families on account of reduced incomes, the total of nonfarm occupancy actually declined during the worst part of the depression and remained until 1934 below the 1929 figure. Even now it exceeds 1929 by only 1,500,000 to 1,600,000 dwelling units, as compared with a gain of at least 3,000,000 units to be expected except for the depression.

This increase in the present occupancy over 1929 has been accommodated in part by a growth in the housing supply in the interval, which, despite the drastic curtailment of building, has amounted to 800,000 to 900,000 dwelling units. In part it has been accommodated by an absorption of some of the large supply of vacancies existing at the beginning of the period. Although the number of vacant units increased from 1929 to 1933 by something like 700,000, the reduction since then has been approximately twice as great. At the present time the supply is about 400,000 to 500,000 dwelling units below the level indicated by a long-term average vacancy ratio.

The decrease in vacancies which began in 1933 was followed early in 1934 by an upturn in rental rates on new leases. It was at least a year later, however, before there was any significant advance in the average of rents on outstanding leases or in property values. New construction did not begin to revive before 1935. The tendency for building to give a delayed reaction to vacancy situations has been evidenced again in this movement. The housing shortage, as measured by the suppby of vacancies, was more acute in 1936 than in 1925, when 900,000 dwelling units were produced, yet the 1936 output has been less than a third of that amount. Realignments in rents and values have clearly not proceeded fast enough to keep building in step with the growth of occupancy. Just as in the Twenties we passed from a shortage to a surplus of housing because of the delayed response of building to the underlying supply and demand situation, we have already passed in the Thirties from a surplus to a shortage, and for the same reason.

Building prospects during the next five years.

Without going here into questions of method and procedure (which are discussed in the full memorandum) I shall merely summarize the results of an analysis of the probable housing market during the next five years. The estimates are based on the assumption that the period will be prosperous:

Components of the Five-Year Housing Market

1. Increase in households	[illegible]
(a) From currently accruing natural increase	2,400,000
(b) From reduction of the depression marriage backlog	300,000
(c) From undoubling of families	300,000
(d) From net reduction in farm households	200,000
Total increase in households	3,200,000
2. Replacement of dwelling units demolished during the period	400,000
3. Elimination of present housing shortage	500,000
Total housing market in dwelling units	4,100,000
Average market per year	820,000

The prospect may be summarized a little more fully in three propositions. (1) If building averages 800,000 units a year for the next five years, the period should close with a reasonably comfortable housing situation. (2) If construction averages 700,000 units annually the period should close with a shortage comparable in magnitude with the present shortage. (3) If the average is 600,000 units, the shortage at the end of the period promises to be very acute, comparable, let us say, with the worst period after the World War.

In view of the fact that the five years start at a relatively low level of construction (250,000-300,000 units in 1936) the attainment of a rate of 800,000 units a year cannot be expected until we are well into the period, and the achievement of that rate as an average for the period as a whole would call, therefore, for an output of at least a million units a year in its later stages. While this is not impossible (it is only 10 per cent higher than the 1925 peak) it seems to me doubtful that it will come soon enough, if it comes at all, to produce an average of 800,000 for the five years. The inference is, therefore, that there will be some housing shortage remaining at the end of the period.

One reason for this doubt is the danger that as construction activity increases there will develop shortages of skilled labor, and of certain classes of building materials, that will retard further expansion. Such a limitation of the output of new housing, if it becomes effective, will be reflected partly in higher labor and material costs and partly in higher unit profit margins for contractors and developers, but in any event the final cost of the product to buyers will tend to rise sufficiently to equate demand with the limited supply being produced. It seems likely that it will require prices for new housing materially higher than those now prevailing to mobilize enough productive activity to offset demolitions and occupancy expansion during the next few years, to say nothing of eliminating the shortage now existing. I am inclined to believe that barring unexpected developments in pre-fabrication, government subsidies, or other alleviatives of the situation, supply and demand will be equated during the next five years by a volume of construction which averages between 600,000 and 800,000 dwelling units a year, with 700,000 as likely a guess as any. This would represent an average expenditure at pre-depression building cost levels (including repair activity) of 4.5 to 5 billions of dollars annually. Higher cost levels would of course increase this figure.

There seems no doubt, in any event, that the current housing shortage will become considerably worse before it begins to be generally alleviated. Even with the most rapid pick-up in construction for which we have any reason to hope, the prospect is for a worsening of the situation for at least a year, and the probabilities appear to favor a period nearer two years than one. The shortage seems destined to become decidely acute in many places during this stage. The attainment of reasonably comfortable housing conditions is, of course, much more remote than the beginning of improvement, since progress will at first be slow.

<u>More remote prospects.</u>

For the next few years the housing market will experience an exceptional concentration of demand. Superimposed on the regular demand arising from the currently accruing natural increase in households and the replacement of structures currently demolished will be a special and temporary demand attributable to the after-effects of the depression. This special demand appears to total something like 1,300,000 dwelling units, as follows:

Accumulated housing shortage at the end of 1936	500,000
Delayed marriages likely to be contracted in the future	300,000
Probable undoubling of families still doubled because of the depression	300,000
Probable net decrease in farm families 1/	200,000

1/ There is no satisfactory way of estimating this item. The assumption here is that the net decrease in farm families during the next few years will be half of the increase attributable to the depression. This seems a conservative supposition.

If, as seems probable, these special demands will become effective during the first few years of prosperity, the building of housing will be stimulated to a level that cannot be maintained once they have been satisfied. The regular demand thereafter, barring an unprecedented increase in demolitions and replacements, will probably be around 600,000 dwelling units a year. If during the period when general and special demand operate concurrently construction activity is stepped up to say a million units a year, a subsequent let-down will be inevitable.

Historical analogies are seldom close, and no one can rightly be very confident of inferences drawn from earlier situations, but it seems to me nevertheless that there is enough similarity between conditions prevailing at the beginning of the last building boom and those obtaining today to justify a tentative expectation that the forthcoming boom will repeat, in a general way, the pattern of the preceding one.

If this expectation is justified, we may look forward to a protracted housing shortage, accompanied by rising rents and values, with the latter culminating at very high levels when building activity at last overtakes the current growth in occupancy (plus demolitions). By that time construction costs will be high, along with land values and contractor-developer profit margins, and the momentum of the building boom will carry it forward despite a decline in the growth of occupancy and the accumulation of vacancies. By that time also, lenders will be full of confidence. The most liberal loans will be made at the top of the market, or even during the early stages of the recession in values. The sale of new housing will be supported against the growing competition of existing structures by a narrowing of the wide profit margins previously obtained by contractors and developers, and by excessive credit. In the end the process will enter its critical stage when new housing can be sold only at prices which severely restrict output and when lenders become disturbed by the adverse trend of developments. A fairly abrupt contraction of activity will then ensue.

This pattern of developments is not presented as a definite forecast, but merely as a basis for orienting our expectations at the moment. Constant rechecking and revision of these expectations will be necessary as time goes on. It is quite possible that some of the incipient developments of the current housing situation, such as pre-fabrication and mass production, or government leadership in the mortgage market, may later become sufficiently controlling to alter the pattern, or that the course of business activity in general may provide a background for housing construction so different from that of the Twenties that a radically modified pattern results. Just now, however, I see no reason to reject the pattern of the preceding housing boom as a tentative guide to the future.

If governmental authority is to be invoked to prevent the accumulation of a housing surplus and a subsequent reaction some years from now, it seems to me that control over the supply of mortege funds for new construction is the most promising approach. This would have to be much more intimate and direct than the blanket and general control over money rates now within the power of the Reserve Board.

It is one thing to prevent the development of housing surpluses, and quite another to stabilize the volume of residential construction. Even if it were possible to tie construction activity closely to the current growth in occupancy (plus current replacements) we would still have building booms and depressions. The growth of occupancy, as we have seen, is extremely irregular, and promises to remain so as long as the economy is subject to periodic business depressions. The prevention of a housing surplus several years hence - which is about the most that we can even hope for from regulatory control - will not prevent a boom and recession in the meantime. It can only make the recession prompt, gradual, and orderly.

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