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HOUSING, SOCIAL SECURITY,  
AND PUBLIC WORKS

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# HOUSING NEEDS AND THE HOUSING MARKET

by

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Different people look forward to a large volume of residential building in peacetime with different objectives in mind. Some see in it an avenue for the investment of savings; some see the employment of labor; some see markets for the products of the industrial system; and some see the provision of decent and wholesome living conditions for the families which make up the population of the United States.

To bring our housing up to decent levels for the middle and lower income groups, as well as to meet the demands of those who have always been able to afford good housing, will require a good deal of new building. It will thus provide a great amount of employment at the site, open a large market for industrial products, and engage the services of the various groups concerned with the transfer of real estate. To get this building done and the new houses occupied, credit will be needed—credit both to builders and contractors, and to the owners who occupy or rent out the structures built.

Housing is needed primarily, however, not to provide employment to workers, profits to businessmen, or fees to professional groups, but rather to supply a basic service. The primary purpose of a housing program should be to see to it that an adequate supply of housing that meets recognized standards of health and decency is available at charges commensurate with family incomes.

Such a housing program, directed chiefly at the conditions of housing, is perfectly consistent with programs looking to the maintenance of full use of resources in the economy. Indeed, a definition of consumption goals is necessary before full use of resources itself can be defined. The goal which we must set for housing, as one part of the consumption goal of the economy, is that, within a reasonable period of time, every American family shall have living space which meets accepted standards—standards not only for structures, but also for occupancy and environment. To achieve this we must build housing on a sustained scale such as we have never approached before. How this housing is to be provided depends on how much we want, what kind we want, how much we want

to pay for it, and the resources, techniques, institutions, and organizations which we have available, or can make available, to provide it.

The provision of new housing has varied widely in the past. In the period between the two world wars, the number of new nonfarm dwelling units built rose from 247,000 units in 1920 to 937,000 in 1925, fell to 93,000 in 1933, and then rose again to 515,000 in 1939. New nonfarm residential building has consequently represented a varying proportion of total economic activity; it averaged about 3 per cent of the gross national product in the interwar period, but varied from 1 per cent in 1920 to 5 per cent in 1925 and less than 1 per cent in 1933.

The relative importance of expenditures for the use of existing housing—which averaged close to 12 per cent of gross national product between the wars—is greater and has not been subject to such wide changes. Between 1929 and 1941, about one dollar out of every seven spent by consumers for goods and services was spent for house space, counting the use of owner-occupied houses at market rental value. This proportion has varied somewhat over the period, being about one dollar in six in the depths of the depression, and about one in eight in 1940. In 1944 the proportion was lower—only about one dollar in twelve of consumption expenditures went for house space—largely because rent controls were imposed before rents had risen markedly.

What particular families spend for housing depends largely on the size of their incomes. In general, families with smaller incomes spend less for housing than do families with larger incomes, but at the same time, devote a somewhat larger proportion of their expenditures for goods and services to housing. For example, in 1935–36, non-relief urban families with incomes between \$500 and \$1,000 spent on the average about \$182 for housing, while families with incomes between \$2,000 and \$3,000 spent about \$406, or somewhat more than twice as much. The \$182, however, represented 22 per cent of the entire expenditures of the lower income group for goods and services, while the \$406 represented only about 19 per cent of the expenditures of the higher income group. Because the more prosperous were able to add to savings while the lower income group had deficits, the \$182 spent for housing represented 24 per cent of income, and the \$406 only 17 per cent.

The quality of housing obtained by lower income families is much lower than that obtained by higher income families. In 1940, two-thirds of the houses occupied by nonfarm families whose incomes in 1939 were less than \$1,000 had gross defects—such as lack of sanitary facilities and need

for major repairs—which could be observed by Census enumerators, while only about one-eighth of the houses occupied by families with incomes between \$2,000 and \$3,000 had such defects. Of all the houses occupied by families with incomes below \$1,500 (somewhat more than half of all families) only about 40 per cent were free of gross defects. For families with incomes above \$1,500, almost 85 per cent of the houses were free of gross defects.

In a measure, therefore, the problem of assuring decent housing for every family, which is part of the general problem of maintaining adequate consumption, is one of assuring sufficient income to every family. There are special problems in the field of housing, however, which have to be considered and solved within the framework of a plan for a high level of employment and income and high living standards in the economy as a whole. These special problems arise from the nature of housing and of the housing market and from the way people react to their housing conditions and changes in their incomes. The significance of these elements can be better appreciated after we have examined housing conditions and needs and the way in which housing has customarily been provided.

#### HOUSING CONDITIONS AND THE HOUSING MARKET

The housing problem is often discussed mainly in terms of eliminating slums, but in reality it is much wider than this. So long as the bulk of the middle class is only indifferently housed, relatively little headway can be made in improving conditions for the lowest income groups. In other words, a large part of the problem is to devise ways of raising the quality of housing available to those in the middle income groups to a level consistent with the capacities of the modern American economy. If we can do this, slums and substandard housing will appear clearly as the anomaly they are; if we cannot do this, there is little likelihood that public opinion will support programs of the kind and scope needed for the elimination of archaic housing. This is not to say that slum-clearance and the provision of subsidized housing should be stopped until the housing of the middle classes is perfected—on the contrary, both goals must be sought together; but the success of programs to improve housing conditions for the lowest income groups will depend more on the improvement of housing conditions in general than on convincing the public that bad housing costs the community money or on devising techniques which make the financing of public housing easier.

Nevertheless, we can obtain an idea of the magnitude of the housing

problem if we look first at the amount of substandard housing in existence.

**Magnitude of the Problem.** The National Housing Agency, using Census data, has estimated that 7 million of our 30 million nonfarm houses, or close to one-fourth, were substandard in 1940.<sup>1</sup> If we apply somewhat lower standards to farm housing, we find that about 2.5 out of 7.6 million, or one-third, were substandard.<sup>2</sup> The number in both categories has no doubt increased since then.

Precisely what is adequate housing can be debated at great length, but most of the debate is over details of more and less. On the major elements essential to adequate housing there is little disagreement. Houses must be substantially built, safe against fire, tight against the weather and vermin, and provided with at least elementary equipment and facilities. They must be of a size, in both area and number of rooms, appropriate to the size and composition of the families which are to occupy them; they must be located on suitable land in neighborhoods and communities which offer the services and facilities needed in modern society; they must be available on a tenure adapted to the circumstances of the families which are to occupy them; and they must be available at costs which the occupants can calculate and pay. The criteria for essential sanitary equipment and other facilities in houses may vary from place to place, but they should always be sufficiently exacting to safeguard the health and decent comfort of the occupants.

Because the 1940 Census of Housing took account of only a few of these elements, the NHA estimate of the amount of inadequate nonfarm housing in the United States in 1940 must be regarded as a minimum. It seems likely that if we were to examine our nonfarm housing with the idea of eliminating all that cannot economically be made to conform to the community's sense of what is at least adequate, we should find the count of substandard units to be at least half again as high as was found by the National Housing Agency. In other words, substandard housing probably makes up more than one-third rather than one-fourth of the nonfarm supply.

There are several reasons for the existence of substandard housing. Much of the housing built in our great seaports for immigrants at the

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<sup>1</sup> National Housing Agency, *Housing Needs: A Preliminary Estimate (National Housing Bulletin 1)*, Washington, D. C., November 1944.

<sup>2</sup> This paper is concerned with nonfarm housing generally, and does not deal at all with farm housing, which presents quite different problems. In a more detailed treatment, distinctions would also be made between urban and other nonfarm housing problems and markets.

end of the nineteenth and beginning of the twentieth centuries was substandard, even in terms of the standards which existed then. This is true also of the housing built for miners in many areas. Houses that were substandard 50 or 25 years ago almost certainly violate municipal building, health, and housing codes today. One of the reasons the local governments have not removed such houses is that other housing has not been available.

Some substandard housing was good in its day, but age and neglect have worn it out; part of this housing can be brought up to our present standards of adequacy by repair and modernization. Still other housing is substandard, not because the structure itself has run down, but because the area in which it is located has run down. Industry has come in, commercial activities have grown up, or the area has become overcrowded. Generally, the occupants of such quarters should be housed somewhere else and the areas developed for other purposes.

The National Housing Agency has estimated that, if we want to eliminate substandard housing in 20 years, we will need to build 12,600,000 houses in the first 10 years after the war. About half of this number would be needed to take care of the normal growth in population, and of returned veterans, and to permit those families now sharing units in existing structures to have quarters of their own; the other half would be needed to replace half of the substandard housing standing in 1940 and all of the units becoming substandard currently, as well as the relatively small number of dwellings destroyed by fire, storm, and other disaster. But even at this rate of building, at the end of the first decade 3.5 million nonfarm families would still be living in substandard houses. If, on the basis of the discussion above, we raise the number of substandard units standing in 1940 to 11 million, we could build between 14.5 and 15 million nonfarm units in the next 10 years and still end the decade with 5.5 million families living in substandard houses.

Is the building of between 1.2 and 1.5 million new nonfarm units a year within the capacity of the economy and the construction industry? In the best year we ever had—1925—we produced only 937,000 units, and in the best five years—1923 to 1927—we averaged only 872,000. Today, however, the economy is much larger and more productive than it was 20 years ago, and the record of the past makes an inadequate goal for the future. We shall require time to overcome difficulties arising out of the war and to start new houses at an annual rate of even 900,000 units; but once these difficulties are met, there will be nothing—at least in

terms of available resources and organization—to prevent our building at the rate needed.

Lest it be argued that the low quality of our present housing is an indication that people do not want good housing, it may be noted that there is substantial evidence against such a thesis. We know that the kind of housing people have depends largely on what their incomes are—the higher a family's income, in general, the better the housing it has—and when there is a choice available, people move out of poorer housing into better housing. Part of the wartime shortage of housing is attributable to the fact that many families became financially able to obtain more suitable quarters. We need not fear that a program of raising the quality of housing in the United States would run counter to the wishes of the people whose living conditions would be improved. And we have ample resources for such an increase as well as for considerable increase in the consumption of many other goods and services.

**Prospect for Meeting the Need.** What is the likelihood that we shall build 1.2 or 1.5 million housing units each year for even a decade after the war? A number of influences will make for a large volume of building during the next four or five years: after the United States entered the war, there was very little residential building except in war production areas, and even there the amount of housing provided was the minimum necessary to house the increased population under more crowded conditions than would be acceptable in peacetime, even if family incomes were considerably smaller; many families have built up savings which can be spent rapidly when goods and services become available; special financing facilities have been made available to returning veterans for the acquisition of homes; and a relatively short time will suffice for house builders to get into operation.

These influences may be offset by several other factors. Rapid restoration of supplies of goods which consumers have gone without in recent years may result in a decline in prices, curtailment of production, and a substantial amount of unemployment; if this happens, many individuals will be forced to spend their savings for living expenses and many others will prefer to keep their savings rather than spend them on durable goods, and especially on houses, which require long-term commitments, and there will be some sharing of quarters by families whose incomes decline. If war workers migrate in force from war production areas, the shortage of housing which has developed may be reduced in these areas, though it may be increased in the areas to which families move. Values of existing

houses have risen substantially since the war began, and, if we have further marked price advances in the immediate future, costs may rise to a point where workers cannot afford to buy or rent new houses.

Even if these unfavorable elements do not turn out to be important, the prospect, for reasons that are developed in the following sections, is for a postwar residential building boom of perhaps four or five years duration, rather than for a sustained high level of residential building, unless basic conditions in the housing market are considerably improved.<sup>2a</sup>

**Experience of the 1920's.** Our experience in the 1920's offers some clues to what is likely to happen in the next few years. After the last war there was an acute shortage of housing, partly because there was relatively little residential building during the war, partly because the increase in the number of families and the migration of families from farms to cities were both great during the war, and partly because high incomes during the war accustomed many families to quarters of their own. Rents and prices increased rapidly after 1918 when most of the wartime controls were removed, and the building of houses got under way quickly. Twice as many nonfarm houses were built in 1919 as in 1918, and, after the depression of 1920-21, building increased until 1925 when it reached a peak of 937,000 units. Thereafter, building activity declined as rapidly as it had risen; by 1931 the number of units built was down to 250,000—about the same as in 1920. In 1933 only 93,000 were built—the smallest number since the turn of the century.

The boom of the early 1920's was a response to the high rents and prices brought about by the housing shortage, but it was helped along by other

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<sup>2a</sup> As this note is written (May 6, 1946), there is a strong likelihood that the residential building boom which is now under way will collapse within perhaps 15 or 18 months. Prices of existing houses advanced during the war, and the advance has continued, apparently at a more rapid rate, since the end of the war. The cost of building has risen in roughly the same proportion as the prices of existing houses.

There are probably enough families who have savings and borrowing capacity to form a market for new houses, as far as down payments are concerned, even at higher prices than now prevail; but the current payments required to carry the large mortgages with which houses are being bought are a serious charge on income. Every further increase in prices will reduce the number of families able to meet the current charges, and any decline in incomes, even if it is temporary, will leave many owning families unable to fulfil their mortgage contracts, and would-be buyers unable to assume mortgage obligations. In these circumstances, prices are likely to decline.

If prices turn down before costs have overtaken them, building may be sustained, but if, as seems more likely, costs are as high as prices when the decline comes, building will be curtailed.

Whether such a decline would be followed shortly by the boom referred to in the text would depend almost entirely on the measures taken between now and the decline, and on the steps taken to protect the victims of the collapse.

developments. The movement to the outskirts of cities, which had started before the war with the coming of the interurban streetcar, was greatly stimulated by the growing use of the private automobile and the motorbus. After the depression of 1920-21, as great new industries and markets developed, the United States looked forward with growing assurance to the "new era." By 1923 optimism was widespread, and people were eagerly buying the new houses that builders had to offer. Some bought to avoid high rents, some because housing could not be obtained otherwise, and some in the belief that real estate was a good investment.

Building and real estate transactions took on a speculative character. Houses were sold for what the market would stand, which, for a time at least, was far in excess of the cost of building. Thin equities were encouraged to "broaden the market," and were supported by appraisals which anticipated the "new era." Mortgages were written at interest rates which now would seem fantastic and, with the widespread use of un-amortized short-term first mortgages and junior liens, many buyers became committed to obligations they later found they could not meet.

In the later stages of the boom, apartment building was important. Here, new construction was financed in large part by speculative investment of a small and sometimes fictitious equity, and by the issue of mortgage bonds to a public which had already started to turn from real estate speculation as such to speculation in securities. The results were such as to discourage apartment construction for a long time.

The prosperity of the 1920's was not sufficient to maintain the high level of building for long. The whole rent, price, and cost structure for housing was so high, even in relation to the advanced income levels, that there were not enough families who could afford new houses. Although the prices of houses stayed up, the volume of sales of both old and new houses declined, and vacancies began to increase. By the time of the stock-market crash in 1929, residential building had declined 45 per cent from the peak of 1925, and over 40 per cent from the average of the five years 1923-27.

Further declines in volume after 1929 were accompanied by reductions in prices and rents. By 1933, in cities generally, rents had fallen by more than a third, all the way back to the 1919 level, and a fair number of the tenants were delinquent in their rent payments. Building costs, too, had dropped after considerable delay; but the depression forced families to double up to reduce expenses and there was little demand for new houses

at any price. New building was at a standstill and activity in the industry was limited mainly to repair and modernization work.

Later in the 1930's rents advanced gradually and markets revived, partly because of Government action in assuming distressed mortgages and introducing a system of mortgage insurance, and partly because of the business recovery. Government intervention helped to maintain the prices of houses and also made it easier for families to pay the prices; the business recovery raised incomes and put more families in a position to buy. Costs were at a lower level than in the 1920's, and, with prices stabilized and the market enlarged, building became more profitable. In the late 1930's there was a steady and substantial recovery of residential building, but even in 1939 only 515,000 units were started.

**The Market in Which Houses are Built.** Although the period of the 1920's was unique in some respects, it holds several lessons for us in showing why high building activity, once achieved, is not sustained.

Because the number of new houses available at any one time is very small compared with the existing supply, prices of new houses are determined to a very large extent by the prices of existing houses. New houses can be sold when they are more attractive to consumers than existing houses in that their prices are lower or they have more desirable features: that is, the upper limit to the prices of new houses is, as a rule, the prevailing prices of existing houses which buyers regard as equally desirable. The lower limit to the prices of new houses is the cost of building: new houses are built when there is an expectation that the prices they will bring will cover the costs of building, including a profit to the builder. If the prices of existing houses fall below the cost of building comparable new houses, or if the cost of building new houses rises above the price which comparable old houses command, building will stop. On the other hand, the prices of new houses cannot fall far below the prices of old houses, for, if new houses could be obtained for appreciably less than old, speculative buying for resale would develop. In practice, in such a case, the builder sets a price which is "in line" with the prices of competitive houses. Homer Hoyt tells us, for example, in his exhaustive study of real estate cycles in Chicago, that during the boom of the 1920's bungalows costing \$5,000 to build sold for \$7,500.<sup>3</sup>

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<sup>3</sup> A more recent example of this is furnished by Mr. Frank W. Cortright, Executive Vice-President of the National Association of Home Builders of the United States. During the war, priorities assistance was extended by the War Production Board to the builders of housing for

The cost of building houses, moreover, is not fixed. It is especially sensitive to the possibility of upward adjustments in periods of strong demand. As many observers have pointed out, no one element is an obviously large part of the cost of a house. When business is good, each supplier—either on his own initiative, or by accepting premiums offered by builders for prompt delivery, maintenance of grades, and similar factors—can raise his price a little without seeming unreasonable. Thus, when the price that can be obtained for the finished product exceeds the cost of building at the existing prices of the resources used, these prices tend to rise; in a relatively short time, total cost, including land, equals selling price, and then exceeds it. When the cost of building exceeds the price of existing houses which consumers regard as comparable, however, cost does not decline rapidly enough to prevent almost complete cessation of building. This is partly because even a large reduction in the price of one item has relatively little effect on the total cost, and such collusive arrangements as exist in the industry do not often extend to coordinating price reductions.

New houses are not built when prices are below the cost of building, but the levels of prices and costs are not the only factors which determine whether building will take place. Changes in incomes, vacancies, prices, and costs are also important; if costs are stable, for example, more building is likely to be done when prices are rising than when they are declining, even though prices stay above costs.

Changes in incomes, vacancies, prices, and costs are closely related. Old houses advance in price chiefly from two causes, which may act either independently or together, but almost always operate by producing a

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in-migrant war workers ("H-1 housing"), on condition that specified maximum prices would be observed. When controls were removed from building on Oct. 15, 1945, the price controls were also removed. Mr. Cortright reported in the *Washington Letter* of the Association for Nov. 3, 1945 that "Builders . . . have recently sold H-1 housing at the priority level and have seen this housing immediately resold at profits of \$1,000 to \$2,000. . . ." In the issue of Nov. 10 he said: "Disillusioned by the highly improper action of some home purchasers, members in a number of cities are seeking legal advice as to methods by which this practice can be prevented. . . . Restrictions being written into the agreements vary considerably. Some builders require that purchasers will not resell within a stipulated period of time without [giving the builders] the opportunity of buying back the property at cost plus legitimate charges. Others require that resale cannot be made within one year at a profit. Herein lies an opportunity for all sellers including builders, owners and banks to make an extremely important contribution in the fight against inflation in real estate."

The difficulty of this fight should be apparent. Sellers who forego profits of from \$1,000 to \$2,000 can be excused for becoming discouraged if they see other sellers accepting all that buyers will pay.

reduction in vacancies. First, an increase in the number of families in an area results in reduced vacancies and competition for existing quarters; in such a market, landlords and owners raise rents and prices. Second, a rise in family incomes causes families to cast about for better quarters, which results in reduced vacancies in the higher priced quarters, and a consequent rise in rents and selling prices. Both of these factors were in operation in the 1920's. Incomes were rising during most of the 1920's and by 1925 the number of families living in cities was much larger than before the war, both because many of those who moved to the cities during the war stayed, and because after 1921 the new employment opportunities in the cities attracted many more people from rural areas and small towns.

Thus, houses are built under a highly selected set of circumstances: building will not take place at all unless the prices of existing houses are above the cost of building comparable new houses; and it goes on most vigorously when the difference between prices and costs is large, prices are rising, and vacancies are declining. In addition to this, the markets for which building is done are limited, both in composition and in duration. Builders cannot supply houses for families in the lowest income groups, even though these families are being compelled to double up, because houses conforming to local codes cannot be built under certain minimum costs which vary from place to place and from time to time. People's incomes enable them to pay only so much for housing, and more and more families must drop out of the market as prices go up. Both rising prices and the new houses produced in response to rising prices tend to cause vacancies to increase, and, although the prices and rents of old houses may not drop immediately as a result of an increase in vacancies, building will stop if costs continue to rise or the margin between prices and costs is small, or if the number of families who can pay the prices declines. By 1928, vacancies had reached a "normal" level—partly because the building boom had added many houses to the supply, and partly because rising prices had forced many families to share quarters—costs had reached a high level which left little margin of profit to builders, and the families which could afford new houses at the going prices had, for the most part, been supplied.

**Need for a Housing Program.** In the next few years the housing market will be similar in several respects to that of the early 1920's. There will be a shortage of housing; many families will have ready money; and the production of goods which consumers and others, both here and abroad, have

been without during the war is likely to provide considerable economic activity for some time. There will also be some differences. Governments are more aware of problems in the housing field and better equipped to restrain unwise borrowing; cities are more aware of the tragic effects on their own finances of uncontrolled land development; and individuals may be less willing to believe that fortunes can be made over-night. We may therefore be able, by taking precautions, to avoid some of the speculative aspects of a residential building and real estate boom.

A boom need not be speculative in character, however, to be undesirable, and even without the gambling in capital values which characterized the 1920's, we can have a boom and collapse in residential building. During the war, rent control kept rents from rising appreciably, but the prices of houses, which were not controlled, have risen substantially—in general, probably as much as 40 or 50 per cent over 1939. The cost of residential building has increased by at least a third. Even if rent controls are retained for some time, a substantial amount of building will be undertaken in many areas because housing will be scarce and the prices of existing houses high. There will be buyers as long as incomes are reasonably high for a large group of families and not so low for others that they have to give up their own quarters and share quarters with friends and relatives, or move very far down the rent scale. Veterans are likely to be an important part of the market because they will have their separation allowances and a certain amount of employment preference, and the Government has made special provision to guarantee or insure their mortgage loans.

From this boom we cannot expect that more than from 3.5 to 5 million new dwelling units will be built in the next five years, or that a high volume of building will be maintained much beyond 1950. If family incomes are maintained during this period, rents and prices will advance, and the boom may continue longer than five years even though costs also advance. If incomes decline substantially, the families able to afford new houses will be completely supplied sooner, and the boom will be cut off sooner. Whether incomes are maintained or not, it is very unlikely that we shall obtain sustained production of houses at the rate needed to bring our housing up to standard in a reasonable time unless the housing market can be made to respond better to long-term needs than it has heretofore.

There is no evidence today that the market will, of itself, respond more to long-term forces and less to a narrow and very unstable set of condi-

tions. If such a change is to come, it must come in large part from a housing program undertaken by the community.

#### THE SETTING FOR A HOUSING PROGRAM

In some recent discussions, the stimulation of economic activity has been confused with the improvement of housing conditions. The two things are not the same, though each is a valid object of social policy. Discussion of the connection between the two may be helpful in indicating the framework within which housing policy must be formulated and carried out.

**Improvement of Housing and the Stimulation of Activity.** There is a very direct and necessary relationship between achieving the goals of a program whose object is to raise the quality of the housing available in the market and the amount of economic activity carried on. It is not necessarily true in any such direct sense, however, that in carrying out a program of stimulating or maintaining economic activity we shall produce improvement in housing conditions. Indeed, if housing standards are sacrificed for objectives such as full employment or a high level of expenditures on construction, we may wind up with worse housing than we would have had without a program for maintaining activity. Incentives to build poor housing are fairly easy to create, but incentives to build good housing are somewhat more difficult.

In an economy as complex and as unstable as ours, the community must take action to see that resources are fully used; but full use of resources cannot be obtained directly, partly because the economy does not operate in comprehensive totals, but also—more important—because full use of resources cannot be defined except in terms of the values which people as individuals and in groups place on the end products of economic activity, and on the processes by which activity is carried on. Economic activity might be maintained at a high level for a long time if we undertook to fill in the North Pacific Ocean, but, though everyone in the labor force might be continuously employed, and all “savings” might easily be “invested” as a result of this project, there would not be full employment of resources if people preferred schools and rubber bands to a land link between North America and Asia.

The goals of a housing program, then, must be established, in large measure, independently of the goal of full use of resources. The amount by which goals exceed the prevailing state of affairs at any given time, the

period allotted for attaining the goals, and the techniques to be used in carrying out the program will all be influenced by the resources available to satisfy all wants. But fundamentally the goals must be a statement of the preferences people show for the satisfaction of various wants.

**Reasons Commonly Advanced for the Existence of Poor Housing.** A great many different courses of action have been advocated for raising the quality of housing available to families, and most of them are founded on the propositions, first, that what is needed is a large increase in the number of units available, and second, that the cost of housing—both new and existing—is too high in relation to incomes to permit the required supply to be built.

With this part of the diagnosis, however, general agreement stops. Many different reasons for high cost are advanced: monopolistic practices and obsolete techniques in building, the high cost of mortgage loans, the high costs of operation, and the inequitable taxation of real estate are some of the most common. Diverse courses of action are recommended by those who agree about the reasons for high cost. For example, some who attribute high cost to unduly high interest rates recommend that the Government take direct steps to reduce mortgage interest rates, or rates in general; others recommend that the Government guarantee certain classes of mortgage loans in one way or another and thus force selective reductions in the mortgage rate; others recommend that the Government itself make mortgage loans at attractively low rates; others recommend that housing be financed by bonds issued by large builders or real estate companies; and still others recommend that equity capital be substituted for borrowed capital. And the specific techniques which are to be used to carry out these recommendations vary from one observer to another.

It is not the purpose of this paper to review all the reasons advanced for high costs and other impediments to the provision of housing, or to appraise all the techniques suggested for correcting these conditions. Rather, this paper attempts to bring out some of the characteristics of housing and of the housing market, so as to distinguish, in a general way, those lines along which action will be worth while from those which hold little promise. To this end, some of the factors to which difficulties are attributed and some of the proposed remedies are discussed in the light of the physical and economic nature of housing, the organization of the building and real estate market, and the incentives to real estate transactions, all of which have been described in general terms in earlier sections.

Most of the proposals discussed here have been selected to represent important approaches offered in current discussions of solutions, and some have been selected to represent approaches which, though they receive relatively little attention, seem promising. No attempt has been made to cover all proposed solutions or all the variants of the general solutions dealt with.

**Nature of the Solutions Proposed.** In practically all discussions of “the housing problem,” the proposed solutions are aimed at increasing the supply or reducing the cost of one or another of the different kinds of housing. In general, various parts of the supply are distinguished by the tenure on which the housing is occupied, the areas in which it is located, and the prices at which it is available. A further distinction, which cuts across these lines, arises out of the way in which costs are paid—that is, whether the public subsidizes the housing.

Not all observers grant the need for specific action to make available each kind of housing. For example, some claim that there is no need—or even that it is undesirable—to encourage the building of new housing to be available at low prices, since higher priced housing, as it becomes older, will decline in value so that families of low income can afford it; and it is also maintained by some that the encouragement of rental housing is similarly unnecessary since those who wish to rent are generally in the lower income groups and that, as owner-occupied houses lose their value, they are turned into rental properties.

In the same way, action proposed to encourage the provision of one kind of housing is frequently held to encourage all kinds, as when the insurance of mortgages on new owner-occupied houses is regarded as reducing interest rates for mortgages on all types of housing.

Despite such cross-currents of objectives and analysis, we may separate proposals in a general way according to the part of the market which they are designed to help.

*General Solutions.* The broadest proposals, which are aimed at providing the setting in which the total supply of housing, of whatever type, can be increased most easily, are that we take steps to raise family incomes and to lower housing costs.

The proposal to raise incomes, of course, involves problems which, in the main, are beyond the scope of a housing program or policy as such. The approaches and techniques which may be advocated are many, ranging from a guarantee of “full employment” or of a minimum income to

each family, through unemployment insurance, the provision of dependency benefits, and minimum wage laws, to a flexible or progressive tax system.

The proposal that costs be reduced is usually made more specific in terms of particular costs and particular types of housing; but the general solutions that are commonly advocated for the general problem are the elimination of monopolistic and restrictive practices in the building business, the elimination of obsolete materials and techniques, and the reduction of mortgage interest rates.

Proposals for stimulating the provision of particular kinds of housing are many, sometimes contradictory, and often overlapping.

*Owner-Occupied and Rental Housing.* Different measures for stimulating the building of owner-occupied houses are advanced by different groups. Builders, their organizations, and their suppliers seem to favor modifying building and housing codes and reducing the periodic capital charges, the initial equity required of purchasers, local real estate taxes, and wage rates. Some large builders also advocate that local governments install utilities and community facilities, and assess the costs against the properties after they are sold rather than before. Observers outside the business are likely to advocate, in addition, that the cost of building be reduced by the adoption of more efficient techniques or new materials and that builders acquire more capital so that "construction money" can be obtained without mortgage credit. Mortgage lenders generally resist the suggestion that changes be made in the prevailing terms of mortgages, and tend to emphasize the revision of building codes, the adoption of more efficient techniques of building, the reduction of the cost of materials and labor, and the lowering of real estate taxes.

Suggestions for increasing the volume of rental housing include some of those advocated in connection with owner-occupied housing. To these are added reduction of the cost of land as well as encouragement of equity financing by the elimination or substantial reduction of the corporate income tax on rental housing enterprises and by a Government guarantee of a certain yield on invested capital.

*Housing in Suburbs and in Cities.* During the past 25 years, most residential building has been done outside the main built-up areas of cities—in small towns, metropolitan suburbs, or outlying districts within cities. Suggestions for stimulating the building of owner-occupied houses are generally made with the idea that building will continue to be done, in large measure, outside the built-up urban areas.

In recent years, increasing support has been given to the proposition, formerly voiced mainly by city planners, that the steady movement of population to the outskirts of cities should be reversed, and "urban redevelopment" is now an important subject in discussions of housing programs.

A great many different plans have been offered for bringing about the reconstruction of run-down sections of cities, from the voluntary pooling of property rights by the owners of the property concerned to outright purchase by the Federal Government of the areas to be redeveloped and the resale of these areas to private developers at substantially lower prices. Although many who advocate large-scale urban redevelopment insist that housing is not the only—or even the main—use to which redeveloped areas should be put, those who wish to see more residential building inside the cities look to reduced land cost and the provision of utilities and facilities by the local governments to provide the stimulus.

*Housing for Different Income Groups.* The great bulk of the housing which has been built in recent years has been built for owner-occupancy and has been available only to families with high incomes.

There is a substantial body of opinion which holds that this is the only way housing can be provided; lower income families and those who want to rent can be provided for only in housing which has "filtered down" through successive income groups as it wears out and loses value. Those who take this approach hold that if better housing is to be available to low-income families, more housing must be built for upper income families so that there will be enough housing to "filter"; and some hold that if there is not enough housing at the low end of the scale, poor families should be aided, by ordinary relief payments, to pay for their accommodations.

Another large body of opinion says that reliance on the "filtering" process has resulted in housing conditions as they are today—that is, that by the time housing filters down, even to income levels considerably above the bottom, it is no longer fit to live in, either because the houses themselves are in such bad condition, or because the neighborhood has deteriorated. In addition, this group points out, housing has frequently increased in value rather than declining, especially in cities, because the land is valued at what it might bring in commercial development, or because, as they grow older, the buildings are made to accommodate more families.

Among this group, several types of solution are to be found. Some hold

to a modified thesis of "filtering" and urge that steps be taken to build housing that will wear well, in communities that can be expected to last. Some urge that costs be reduced by the adoption of new techniques and materials, that financial charges be reduced, and that tax concessions be granted for low-priced housing. In the main, both these groups would also provide incentives for the rehabilitation of existing housing which can be made over into decent quarters available at low cost.

Others who reject "filtering" as an adequate process for housing low-income families hold that these families will not obtain decent housing unless the community itself builds housing and runs it at a loss. They therefore advocate a public housing program large enough to provide housing for all families who cannot find acceptable housing in the private market on terms within their means. By and large, this group also urges that steps be taken to lower the costs at which private housing can be made available.

**Analysis of Proposed Solutions.** Advocates of these various solutions seem to feel that, if their solutions are adopted, all conditions except those they aim to change will remain unaffected. It is pointed out, for example, that if, by means of new techniques and materials, the cost of building the "shell" of a house can be reduced by 50 per cent, the cost of the house will be reduced by 30 per cent since the cost of the shell is now about 60 per cent of the total; thus a contribution will have been made, it is believed, to the provision of low-cost housing.<sup>4</sup> The same sort of reasoning has been applied in the past 15 years to show that reductions in interest rates, labor costs, material costs, and the price of land would have similar effects.

*The Rôle of Capital Values.* Proposals to reduce cost to the occupant by reducing particular component costs overlook the important rôle played by capital values in regulating the amount and kind of new housing added to the supply. It has already been pointed out that new building takes place when the prices of existing houses are higher than the cost of building new houses which consumers regard as comparable, and also that, when building is under way, costs tend to rise to absorb the difference between the market value of existing houses and the sum of the prices of the component resources used in building comparable new houses. This behavior of the market, it has been shown, stops building fairly soon because, when

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<sup>4</sup> See, for example, National Housing Agency, *Housing Costs: Where the Housing Dollar Goes* (*National Housing Bulletin* 2), Washington, D. C., December 1944, p. 22.

values have risen as high as incomes will permit, and costs have caught up with values, builders cannot operate profitably.

This process goes on whether the techniques of building and the conditions on which houses are bought and paid for are changing or standing still. The introduction, at strategic times, of techniques and conditions which enable builders or landlords to make new housing available at lower prices than would otherwise be possible may give rise to building which would not have taken place under the earlier circumstances, but the very process of making use of these advantages tends to eliminate them. The market evaluates such advantages against the existing stock of housing and the incomes prevailing in the community; comparable houses command comparable prices; and the cost of building approaches market value. This process may be illustrated by a discussion of what happens when particular costs are reduced by one method or another.

*Reduction of the Cost of Building.* Houses which are judged by a substantial number of people in a community to be of comparable desirability take on comparable value. A house which costs \$5,000 to build but which is judged to be the equal of existing houses which bring \$7,500 will, in a very short time, command \$7,500 even if the builder, aware of the desirability of low prices, sells it originally for \$5,000. The influence of old houses in the market is so great that, even if costs are reduced substantially, there is an overwhelming pressure to price new houses only just so far below comparable old houses that all will be sold.

Intermittent reductions in cost, if they occur at the right times, can be passed on to consumers in the existing market. If a building boom is approaching its end, either because costs are overtaking prices or because the number of buyers at going prices is being exhausted, a builder who can reduce costs may be able to broaden his market by selling his houses for less than he has been charging, thus reaching a lower income group.

The influence of such a cost reduction on the market depends on how much it adds to the supply of housing relative to the whole market. If it should result in a large enough number of houses being built and sold, prices of existing houses would be brought down substantially, but this is not likely to occur. To have this effect, the cost reduction would have to appear at the proper time, and it would have to be large enough to make the resulting price attractive to a large number of people who had not been reached by the high-pressure salesmanship of the boom.

It is much more likely that the effect of a reduction in cost toward the

end of a building boom would be to enable the builder who enjoyed the reduction to offer a bargain, in terms of alternative houses, to people who were almost persuaded to buy but were reluctant at the going prices. The builder could thus continue building for a time after he would otherwise have stopped, but the additional houses built would probably be negligible in the market. The benefit of the low price would therefore be confined in the main to those who bought the bargain houses from the builder, because, by the time these buyers were ready to sell, prices, costs, and incomes would have gone through a period of adjustment and the bargain houses would reflect the market for generally comparable houses.

Similarly, if, when building is depressed, a builder can make savings in cost, he may be able to provide houses at prices which are attractive to consumers and thus add to supply, but he is likely to be confronted very soon with rising costs, either because other builders copy his innovation and bid up the prices of materials, land, and labor, or because his suppliers raise prices on their own initiative.

Intermittent cost reductions might conceivably be made from time to time in such a way that building would be continuous at declining costs. If we could have this situation we should be able to look forward to lower costs which would endure, and to the prospect that the upper limit of residential real estate values would be established primarily by minimum cost of reproduction. The organization and functioning of the real estate market, unfortunately, hold out little promise that such a state of affairs will come about.

*Reduction of the Cost of Maintenance and Operation.* The level of current costs, in relation to income, which a family must pay for housing and housing facilities is important in determining the quality of housing which it can enjoy, and attention has properly been given to finding ways in which these costs can be reduced. But just as high incomes and low construction costs of new houses tend to be translated into high market values, reductions in carrying and maintenance charges also tend to be taken up in higher capital values. A house is valued higher if it has a heating plant which is more economical—either in money cost of fuel or in personal attention required—than the general run of heating plants in the community. Insulation, brass or copper water pipe, hardwood floors, a generous supply of electrical outlets, and metal casement windows all add more to the value of a house than the additional cost of installing them, and thus the saving in operating expense or the addi-

tional convenience which can be expected over the life of the house from such items is capitalized so that the advantages of this house, compared with others in the market, disappear.

*Reduction of Interest Rates.* Federal intervention in mortgage financing, aimed at making home ownership easier, had a good deal to do with the revival of residential building after 1935. In the refinancing operations of the Home Owners' Loan Corporation and the insuring operations of the Federal Housing Administration, interest rates considerably below those prevailing generally were offered, and great emphasis was placed on regular amortization of the debt. Much of the effectiveness of these operations flowed from the fact that both programs supported the residential real estate market: the refinancing of existing mortgage debt under Government auspices through both HOLC and FHA reduced the need for foreclosures and forced sales, and the insurance of long-term, low-interest-rate, amortized mortgages on new houses increased substantially the number of people who could afford to buy new houses.

There is no clear evidence that this reduction of mortgage interest rates and general adoption of the direct-reduction loan has enabled families of a given income status to obtain appreciably better houses; nor is there convincing evidence, despite the reduction in interest rates, that current costs have declined. To be sure, the average price of houses bought with the aid of FHA-insured mortgages was declining before the war, but so too were the average size of the houses and the average income of the buyers. It is impossible, of course, to separate the effect of the rate reduction from the effect of the rising incomes of the late 1930's, and the changes in the equipment of the houses over the years, but it seems clear that the difference between the higher and the lower rates has not all been passed on to the consumer of housing. Builders themselves seem to have no illusions about the process. Many of them advocate further reductions in the interest rate and further lengthening of terms of mortgages, but they advocate these changes quite frankly not to reduce prices and costs, but to reduce the current charges per dollar of debt and thus to increase the size of the market at existing costs. Some of them do believe that, if the market can be increased sufficiently, costs can be reduced through sustained building. But easy terms are an advantage of the house that can be bought under them, and are consequently capitalized in the market to a large extent.

A seller expects a higher price for his house if he offers to take a mort-

gage from the buyer as part payment than if he demands all cash; and the house sold on a 25-year mortgage at 5 per cent tends to bring more than the same house sold on a 5-year mortgage at 6 per cent.

These examples are probably sufficient to show why manipulation of one element of cost alone is not enough to reduce the cost of housing substantially or to bring about the large, sustained volume of building for a long period of time which we must have if housing conditions are to be greatly improved. This is not to say that improved practices and materials, lower costs of upkeep, lower interest rates, and the like are of no value; on the contrary, they are essential. The point is that if we are to have better housing, we must find ways of modifying the operation of the housing market so that improved techniques and the like will show up in much more housing and much lower costs rather than in a little more housing and unchanged or higher costs.

*Monopolistic and Restrictive Practices.* Some observers may insist that monopolistic and restrictive practices in building are responsible for high costs and that they account for the dissipation of increased incomes and cost-reducing innovations into higher capital values. It seems likely that the cost of housing could be reduced—perhaps reduced substantially—even with our present state of technology if various restrictive practices did not prevail, and if the market operated in a different way; and there is some indication that technology could be improved rapidly in a more favorable setting. There are severe limitations, however, to what a frontal attack on restrictive practices can achieve.

The first, and perhaps most serious, limitation arises from the nature of the market in which residential building is done. As long as additions to the supply of housing are so small in relation to both the existing supply and the current need, cost reductions are likely to result initially in wind-fall gains to those who participate in the building, and, in the longer run, in the money costs of producing new housing rising to meet the prices which old houses command in the market.

The second limitation arises out of the fact that not every monopolistic or restrictive practice which raises or maintains costs and prices is illegal. Despite the seemingly broad, definite, and all-inclusive language in which the Sherman Act, before the addition of the Miller-Tydings Amendment, forbade combinations in restraint of trade, many practices with restrictive results are perfectly legal. The exclusive agency, for example, which insures that a buyer must obtain a given product from one dealer, chosen by the manufacturer, is perfectly legal and respectable (unless its effect

is, in the judgment of the court, "to substantially lessen competition"). There is an over-riding legal doctrine that a seller has the right to choose his customers.

The third limitation arises from the control of supplies by producers. Almost 75 per cent of the enameled iron bathtubs produced in the United States in 1937 were produced by four companies, and the other 25 per cent by nine companies. The four largest producers turned out 97 per cent of the asbestos shingles, and the remaining 3 per cent were produced by four small companies. The four largest companies produced 85 per cent of the window glass, and five other companies produced the remaining 15 per cent. Even more striking concentrations of sellers confront builders and consumers in given markets.<sup>5</sup>

Such concentration of production is not itself illegal, and not every practice on the part of producers which would result in such concentration would be condemned by the courts. Furthermore, practices which arise out of the fact that production is concentrated in a few companies cannot easily be reached by legal action, and, in some measure, the recent policy of the Anti-Trust Division of the Department of Justice has been directed to rationalizing such practices if business necessity can be shown for them. This approach was dubbed by Mr. Thurman Arnold, then Assistant Attorney General in charge of Anti-Trust, the "doctrine that you can't unscramble eggs."<sup>6</sup> A taste for scrambled eggs is thus assumed, and attention is focused on how they shall be seasoned. It is difficult to see how, given the framework of public policy toward private economic activities, the solution could be very much different.

Practices which are in fact restrictive must be expected to persist if the conditions under which economic groups operate make them feel that they cannot continue without such practices. Where two brick producers supply all of the brick used in an area, for example, it is futile to try to prohibit one from cutting his price when the other does so. Similarly, it is futile to expect that, when one feels that prices can be raised to advantage, he will not try—by devious means if direct means are effectively illegal—to be sure that his competitor is of like mind before he raises his prices. Neither is it realistic to expect that, when builders offer premiums for

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<sup>5</sup> See, for example, Temporary National Economic Committee, *The Structure of Industry*, (Monograph No. 27), Pt. V, "The Concentration of Production in Manufacturing," App. B, pp. 420-81; and *Hearings*, Pt. 11, "Construction Industry," testimony of Dr. Willard Thorp, particularly pp. 5220-27.

<sup>6</sup> P. 5157 of *Hearings* cited in footnote 5.

prompt delivery, one producer will accept and the other reject them for long, or to expect that when a premium has been paid for a period, the sellers will not regard it as part of the basic price.

The product of the building industry is at best expensive, and its production requires a multitude of different components and skills. The market for construction work is highly irregular and segmented, and the intricacies of the process of assembling materials and skills at the proper place and time are such that conventions must be established and maintained subject to relatively little or very slow change if anyone is to operate at all. And the law, being adaptable to the felt needs of time and circumstance, makes its concessions in terms of the alternatives which are offered.

Like others in the building business, workers try to protect themselves against the hostile nature of the market, and, with a few notorious exceptions, the measures of protection they invoke have become recognized by the community as legitimate means of collective bargaining in an unstable world. Labor unions are criticized for refusing to handle certain materials, or materials in certain conditions, and in certain respects building practices could be improved if these restrictions were removed. But in general labor unions come in for a larger share of criticism than is warranted; manufacturers of materials are seldom criticized for following price and merchandising policies which may interfere quite as seriously with the adoption of new materials and techniques.

The restraints in building are reactions to the nature of the market—the market in which materials are sold as well as the market in which the final product is sold—and to the complexity of the process required to build a house. Unless we are willing to substitute, in the operation of the building business and its suppliers, some system of public judgments for private judgments based on desire for gain, there is little that can be done through direct attack on restraints. The development of a stable, adequate market for building would probably go far, not necessarily to eliminate all restraints, but to make those that remain less objectionable in their effects.

*Urban Redevelopment.* There can be little doubt that American cities, in the main, have been unable to adapt themselves rapidly enough to the changing and increasing demands made upon them, but it is unfortunate that the problem is discussed increasingly in terms of “blighted areas.” Those who advocate programs of “urban redevelopment”—and these are the only programs of assistance to cities which are being discussed widely—envisage the rebuilding of cities in their physical aspects. Yet in large

measure the present physical inadequacies of cities are attributable to the fact that cities do not have adequate legal and economic powers and resources with which to protect themselves and meet their problems as they arise. Some of the programs of urban redevelopment, if adopted, could add substantially to these difficulties if they were not accompanied by increased capacity of the cities to take care of themselves. In the next section a few suggestions will be made about the relation of these problems to housing.

**To Sum Up.** The conclusion to be drawn from this discussion is that, though total costs cannot be reduced except through the reduction of specific costs, the reduction of particular costs will be of only temporary and very limited value unless we can somehow prevent changes in capital values from cancelling advances made on other fronts. This merely emphasizes what has been recognized by some observers for a long time—that the solution of the housing problem can be found only in comprehensive and painstaking attacks along many fronts at once. All of the attacks must be coordinated, and they must be modified from time to time in the light of the results they produce. The problem can be solved, but only through a much more comprehensive approach than we have ever taken in the past.

#### ELEMENTS IN A HOUSING PROGRAM

It is clear that if housing conditions are to be improved substantially in the near future, the community, acting through its various governmental units, will have to take a hand all along the way. It is also clear that what is needed for the future is not a boom in the building of one or another type of housing, but a sustained high level of building, for a great many years, of a supply of housing which is balanced in terms of the needs, desires, and means of the families which will use the housing. It is also clear that measures of the type usually proposed will not, by themselves, produce a sustained volume of building of this balanced supply.

**Objectives of a Housing Program.** There are, in general, three goals for a comprehensive housing program: first, to assure that every family has, or can obtain, quarters which permit its members to live under acceptable conditions, as the community defines acceptable; second, to assure that as few families as possible have to live under merely acceptable conditions; and third, to assure that new supplies of housing come on the market on terms which make possible the improvement of housing for all, as well as a rising standard of what is acceptable to the community.

Such a program must be formulated and carried out within a framework which includes, on the one side, the resources we have available to meet all wants, and on the other side, the preferences people show for the satisfaction of various wants. This means that the standard of adequacy must not be fixed so high that it can be met only by diverting resources from uses which the individuals or communities concerned feel are more urgent, and that, in deciding to have progressively better housing above the minimum, families should have a reasonable opportunity to choose between purchasing housing and using their incomes in some other way.

These conditions do not imply any reduction of prevailing housing standards, which in a great many cases are not now met. The general nature of commonly accepted housing standards has already been indicated, but the precise content of the standards which each community is prepared to enforce must be determined locally. If consumers could constantly express their preferences freely, the exact content of these standards would vary in detail from time to time and place to place.

**The Kind of Market to be Achieved.** Attainment of these objectives implies a certain kind of market; and, unless the measures we adopt tend to produce this kind of market, they will be unsuccessful in improving our supply of housing materially.

In the ideal housing market there must be no houses occupied or offered for occupancy which are structurally inadequate by the standards of the community; and in this market there must be available to each family a unit of proper size, in a suitable location and environment, under a convenient tenure, and at a price which the family can pay.

Moreover, there must be enough vacant units of each size, environment, tenure, and price so that any family can move freely for its own good reasons. There must be enough vacancies in each type of housing so that the community can absorb normally predictable increases in population without discomfort and so that families can improve their housing conditions as their incomes rise. Incentives to build must be such that vacancies will always be maintained close to this level; there must be provision in the market for eliminating housing which has worn out or become obsolete; and it must be possible to remove housing when the development of the community requires that the land should be used for other purposes.

**Approaches to the Objectives.** It should be clear that, if we are to bring about a market of this character, we need a great deal of new building; it should also be clear that, in the market as we know it today, there are not

the incentives necessary to provide this volume of building or to maintain vacancies at the required level.

*The Rôle of Local Governments.* The housing market is exceedingly local, and for this reason local governments must take an important part in any housing program. What they can do varies with the powers they receive from the States, their financial resources, and the nature of their communities. If progress is to be made, local governments must have the authority and the money they need to direct the development of their own housing markets.

Local governments already have what appear to be substantial legal powers over housing. Municipalities have endeavored to establish certain types of housing standards through laws designed to safeguard health, prevent fire, and assure sound building. Most large cities, many smaller cities and towns, and some counties have zoning ordinances and land-use regulations which, though they may have been adopted originally to safeguard the values of the real property affected, operate in a measure to improve the conditions of housing. Probably the main shortcoming of these existing local laws is that they have been adopted to regulate particular conditions and activities related to housing but not to regulate housing conditions as a whole. A few cities—all too few—do have housing codes which prescribe the minimum conditions of housing under which people may live.

The actual power of municipalities over housing is generally much less extensive than it appears on the statute books, partly because the legal power to close illegal housing is hedged about with qualifications, partly because the power is exercised by many different departments of government without much coordination, partly because the expense of condemning property is greater than municipalities can meet, and partly because the municipalities have no authority to provide alternative housing if illegal property is closed.

Local governments must extend and strengthen their powers, both by exercising more fully those they now have and by obtaining further powers from the States. Perhaps the first step that each community should take is to work all its pertinent regulations for building, fire control, health conditions, public morals, land use, and the like into a code of housing standards for the community. Most communities now have many of the powers of prescription needed for the construction of an adequate housing code of this nature, but almost all of them will need additional powers from the States on some points.

Powers of prescription, however, are not sufficient. Practically all communities will need to obtain supplementary powers from their States in order to enforce a housing code. Most localities now have the power to condemn unsafe and insanitary buildings, for instance, but in many cases action is impeded by procedural difficulties. The standards for determining the compensation to be paid to the dispossessed owners are too high, or the power of the municipality to raise the money is restricted. If municipalities are to regulate the housing conditions in their jurisdictions, their powers of enforcement must be adequate for their powers of prescription; in other words, the consequences of violation must be obvious, and they must follow certainly.

While the adoption of sound housing codes, backed by adequate powers of enforcement, would place municipalities in a position to improve housing conditions substantially, strong powers of prescription and direct enforcement may become completely ineffective if municipalities have no power for constructive action. Any municipal government would be voted out of office promptly for enforcing ordinances which demolished even the worst slums if the displaced families had no alternative but to crowd into the somewhat better slums. Along with suitable powers to prescribe and enforce housing standards, the power to provide housing, either by their own enterprise or by their direction, is thus an important part of the whole group of powers which municipalities need if they are to do their part in any sound program for improving housing conditions.

But these are only part of the augmented powers which communities need over their own fortunes. The legal capacity for action by communities has not kept pace with the rapid expansion of the problems which communities are called upon to meet. Improper land use (and housing is a major user of land), especially in densely populated areas, gives rise to many problems which are of overwhelming importance to local governments. In the United States of the twentieth century, the most effective way to meet these problems is to control the use of land so that mistakes which can be foreseen may be avoided and those which are not foreseen may be remedied promptly.

Regulation of land use through zoning ordinances and land-use plans has not been outstandingly successful. Communities have found it difficult to establish the most desirable patterns of land use in the original plan because of the rights which property owners have in the existing uses. As time goes on and development takes place more or less in conformity with the compromise plan adopted, changes to meet changing conditions

become more and more difficult to make. At the present time, it is proposed in most urban redevelopment plans to counteract the past inability of communities to protect themselves against improper land use by buying up present rights, rubbing the slate clean of past errors, and returning the land to private development, subject only to regulations of the kind which have proved ineffective in the past, with the hope that slight extensions and more effective administration of the regulations will overcome the inherent weaknesses of this approach.

If local governments are to be able to regulate land use successfully and avoid the need to bail out periodically the owners of unsuccessful or obsolete developments, they must obtain a great many of the rights of ownership over large blocks of the land in their jurisdictions. The present state of legal doctrine does not promise that the most important of these rights will be upheld under the police power or the accepted interpretations of public welfare. It is hard to escape the conclusion, therefore, that communities need the power to own as much of the land within their boundaries (and, in some cases, outside their boundaries) as they feel necessary, and to use all the rights of disposition or development of such land which go with ownership.

With such powers, communities would be able to regulate the more important uses of land. They would be able, at the time a lease is written, to specify the uses to which the land may be put and to enforce the specifications under the laws of contract. At the same time, they would retain a large measure of control over the future by writing leases for periods during which events can reasonably be predicted, and errors of prediction could be erased fairly quickly. Furthermore, by exercising the power to develop land on their own initiative, communities would be able to insure that desirable land use is not hindered or distorted by the failure of private developers to provide one or another necessary service.

This interpretation of the rôle of the community in a housing program may seem too broad, and to imply a greater departure from tradition than is warranted. Part of the danger for the near future, however, is that we shall tackle problems which seem to be relatively easy to solve and find that our solutions only complicate broader and more difficult problems. Current urban redevelopment programs promise to be of this nature. What seems to be most needed at the present juncture is a thorough study of the land and housing problems of urban communities and a reasonable consensus of qualified opinion on the changes we must make in established ways of working.

*The Rôle of State Governments.* State governments are less intimately concerned with the problems of housing and land use than are local governments, but their importance is great. Communities derive all of their powers and privileges from the States, either in constitutional provisions or in legislation; and the States regulate the conditions of land tenure and the terms on which real estate may be financed by lending institutions within their boundaries. The sanction and support of State governments must therefore be obtained for a great many elements in a housing program.

The States have an interest in the problems of their communities, the housing of their citizens, and the solvency of their financial institutions, if for no other reason than that they find it necessary to foot many of the bills presented by distress; but in the main, the States are better equipped to lay down broad policies for communities and to supervise the activities of financial institutions than to administer detailed programs.

Perhaps State governments would make their greatest contribution to a sound housing program by sponsoring studies of the problems of their urban communities and working with the local governments to develop a set of powers with which the communities can take care of themselves, under the general supervision and with the active aid of competent State departments.

*The Rôle of the Federal Government.* In the decade and a half since the Federal Government seriously entered the housing field, the tendency has become increasingly strong to lay the responsibility for housing reform and progress on the shoulders of the National Government. To the extent that much that is valuable has been done, and attention has been focused on the problem, this has been good; but there is a danger that too heavy reliance on the Federal Government will result in neglect of aspects of the problem with which the Federal Government is unable to cope effectively.

High on the list of Federal housing activities should be continuous, active, and detailed cooperation with State and local governments with the object of defining more clearly the rôles to be played by each type of government and developing a consistent set of relationships for carrying out and modifying programs decided on cooperatively. The Federal Government should also help stimulate groups of citizens who have enduring common interests, such as trade-union members, to experiment with new or relatively untried methods of providing housing, along the lines of limited dividend housing corporations and mutual ownership associations.

There is need for a reappraisal of Federal policies now in effect and an examination of those proposed for the future in the light of the implications of these policies and the limitations on Federal action. Since the magnitude of the problem of doing anything significant about housing has become apparent among large groups of people in the past 10 years, and it is now proposed that the Federal Government do vastly more about the problem than it has ever done before, it is essential that any contradictions inherent in past and proposed programs be discovered and dealt with.

Three contradictions may be pointed out here as illustrative:

(1) The Federal Housing Administration has assumed large obligations through the insurance of mortgages, on the assumption that the mortgage debt bears a reasonable relation to "long-term stabilized values," and this program will continue. It is now proposed that the Federal Government take an active part in reducing the cost of housing, including the capital cost. But capital cost cannot be reduced and market value maintained at the same time on any scale that gives real meaning to the ideas as parts of a major policy.

(2) Along with the proposal to reduce capital cost goes a proposal to reduce interest rates on mortgage debt still further. Unless steps are taken to reduce the market rental value of mortgaged property, a reduction in the interest charge will increase the return on the equity, and thus—if alternative yields remain unchanged—the value of the property will be likely to rise because of an increase in the value of the equity.

(3) The proposal to reduce the capital cost of housing seems to be inconsistent with the proposal that a large volume of building be maintained for a decade or more, for reasons which have been set forth at some length earlier in this paper. Briefly, a large volume of building is done when market values are rising (or at least not falling), and when vacancies are low; but reduction of capital cost to the consumer, by definition, means a decline in market values, and this takes place most readily when there is at least a comfortable number of vacancies.

So long as the scale of intervention by Government is small, these contradictions are not serious, though they may offset a great deal of effort, but they may become very troublesome as the scope of Government intervention increases. Moreover, the pressing problem now is how to prevent both costs and values from increasing still further in response to the acute housing shortage. Although costs and values could be reduced substantially from present levels without endangering mortgages written during the 1930's, the mortgage transactions of the immediate past and the near future may exercise a powerful restraint on cost reductions. There is also a real danger that we shall try to overcome the housing shortage in part by inflationary measures such as easier credit terms and reduced standards of housing and construction.

To a degree, in the first two cases cited, the present programs do resolve the contradictions. The Federal Housing Administration pays practically all of the losses which the lender may suffer from all causes, including a decline in the value of houses because of a decline in costs. Investors' funds are attracted into low-rent housing at low rates because the income from local housing authority bonds is tax free. But the reconciliation is only partial: mortgage insurance does not compensate the borrower for his losses, and it is doubtful that mortgage insurance could be written economically if it were certain that values would decline continuously; tax exemption of income from housing authority bonds is a deviation from the general policy of reducing exemptions from taxation which the Treasury Department and Congress have indicated is desirable on other scores, and tax exemption probably cannot be justified for returns from investments in housing in general.

The Federal Government can avoid such inconsistencies, either by abandoning part of its program or by enlarging its program to prevent the inconsistencies from becoming effective. If it chooses to abandon enough to eliminate all inconsistencies, however, it will find itself with little more of an interest in the field than it had 15 years ago, and this is hardly a practical alternative. If it chooses, as it apparently must, to stay in the field, it will have to enlarge its rôle even beyond what is now contemplated. If its activities are not to become too unwieldy, however, it must formulate its policies with discrimination and enlist aid from many sources.

**Specific Steps toward the Objectives.** The general approaches discussed in the preceding pages imply a great many specific steps which must be taken if we are to evolve a comprehensive and consistent housing program. At many points it is not clear what these steps should be since we do not know enough about some of the problems involved. At some other points it is fairly clear what steps should be taken now, but it is also clear that the measures we adopt should be reappraised from time to time and modified or abandoned as experience improves our understanding.<sup>7</sup>

*National Housing Agency.* The first essential step is to establish a

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<sup>7</sup> On Nov. 14, 1945, Senator Wagner introduced in the Senate, for himself and Senators Ellender and Taft, the bill cited as the "General Housing Act of 1945." This bill is a revision of, and replaces, S. 1342, introduced by Senator Wagner on Aug. 1, 1945. The main outlines of this paper had been established before these bills were introduced, and, although several of the proposals discussed here are to be found in S. 1592, usually in slightly different form, no attempt is made here to analyze the bill.

Federal agency whose responsibility it would be to investigate continuously the nature of the problems which confront us, to formulate for the consideration of Congress consistent and comprehensive programs to deal with the problems, to coordinate the activities of Federal agencies established to carry out the programs, and to work with State and local governments and private groups to assure the success of the programs. The National Housing Agency, established as a temporary, wartime organization, has had some of these responsibilities during the war, and it might well be made permanent, with somewhat broader functions.

The housing activities which the Federal Government has engaged in during the past 15 years should, in the main, be continued, but serious consideration should be given to the contradictions and inconsistencies inherent in these activities at the present time.

*Federal Housing Administration.* The present home ownership program of the Federal Housing Administration should be continued. It would be improved substantially if it offered more protection to the home owner who is not now protected against loss except as he may be discouraged from making unwise commitments and as the FHA program has raised the quality of construction and land development. One desirable improvement over the present arrangement would be that the Administration insure the buyers of houses built under FHA inspection against any defective workmanship which comes to light within five years, perhaps by requiring builders to post bonds to guarantee their work.

A worth while supplement to the program of mortgage insurance would be a program for insuring to the buyer a minimum (but gradually declining) resale value for his house, whether it is mortgaged or not. Such minimum resale values, it may be noted, are implied in the present program of mortgage insurance, although they are lower than what would be required in the suggested program by the amount of the depreciated equity which the borrower risks. If this insurance carried with it the right of the insurer to the first chance to buy, at a price perhaps 10 or 15 per cent above the insured value, it could be a powerful influence in preventing both serious losses to owners and harmful rises in values. With such a protective device, the Federal Government could proceed with a clearer conscience to stimulate reductions in the cost of housing.

Two plans currently proposed for extension of the program of the Federal Housing Administration are worthy of adoption. Under the first plan, the Administration would issue to builders commitments to insure the mortgages on a specified number of houses of approved types

to be built and sold over a period of from one to three years. The object of this program would be to obtain sustained mass building of houses, at the lowest possible cost, for families in lower income groups than have been provided for traditionally by private builders. This plan seems sound, provided the houses covered by the plan and their costs are determined separately for each locality; and in such a program, a guarantee of workmanship would be particularly desirable.

Under the second plan, the Administration would insure a stipulated return on the equity invested in rental housing. This plan, too, seems sound, provided some standard of management policies is established so that a certain degree of occupancy must be maintained before the insured return will be paid; in other words, the insurance of returns must not be allowed to act as an incentive to the landlord to maintain rents in the face of a declining market. On the other hand, the degree of occupancy required must not be so high as to discourage new building, when vacancies have reached comfortable levels in the community. It would also be desirable for the insurance contract to stipulate that if the insured wants to sell his property, the Administration shall have the first chance to buy it, for the amount of the equity on which insurance is in force; this would protect against the speculative recapitalization of rental properties on a rising market which has had such an evil influence in this field.

*Federal Home Loan Bank System.* The operations of the Federal Home Loan Bank System should be continued substantially as they are. It would be desirable, particularly in view of the probability of a rising real estate market in early postwar years, to require that all members of the System use a uniform technique of appraisal. This technique should be consistent with standards approved by the National Housing Agency, and the valuation staff of the Federal Housing Administration might be made available to make appraisals for members of the Home Loan Bank System, whether the mortgages are to be insured or not. An alternative would be to have the Federal Savings and Loan Insurance Corporation or the System establish an adequate appraisal service for members.

*Federal Public Housing Authority.* The program of the United States Housing Authority (now the Federal Public Housing Authority) should be revived and extended so that much more low-rent housing may be built. Through this program there have been developed worth while techniques of cooperation between the Federal Government and local governments in the provision of housing for those who cannot obtain

decent private housing on terms which they can meet. The approximately 200,000 units built to date under all Federal and Federal-aid low-rent programs cannot be called more than a beginning, but it is at least a promising beginning.

Congress should consider the advisability of divorcing the program for provision of low-rent housing for low-income groups with Government assistance from the program of eliminating existing slums. It is desirable, of course, that slums be eliminated as a result of public low-rent building, but the present law insures that there will be no addition to the number of units in the market as a result of the public housing program. It would be much better if local governments were enabled to add to the supply of housing as part of their programs for eliminating sub-standard housing. A sufficiently large supply of decent housing is the only sound protection we can ever have against slums.

The financial program of the United States Housing Authority and the local housing authorities operating with its assistance is built on the assumption that the housing constructed under the program will have a useful life of 60 years. There is little doubt that the buildings will stand for 60 years, and it seems probable that some of the housing will be physically desirable and located in attractive environments 60 years hence. But social change has been rapid in the United States, and the likelihood is that it will continue to be rapid. It would be wise, therefore, to allow for a somewhat shorter useful life for these projects—say 40 years—but without reducing greatly the permanence of construction. Annual payments of debt under a 40-year schedule would be somewhat higher than under the 60-year schedule, but less of the total payment would go for interest. If we frankly recognize that housing costs money and that long amortization periods merely spread out the original cost, at interest, we may be willing to pay more per year for capital cost in the near future, when operating costs and occupancy are fairly predictable, and reduce our payments later, when these factors are very uncertain.

*Housing Loans for Veterans.* An important element in the Federal housing program of the next few years will probably be the guarantee and insurance of veterans' mortgage loans under the Servicemen's Readjustment Act of 1944, commonly known as the G. I. Bill of Rights. Under this Act, as amended in 1945, the Government will guarantee the repayment of one-half of an eligible veteran's mortgage loan, but not more than \$4,000, provided the price paid for the mortgaged property does not exceed its "reasonable value." The interest rate on the loan may

not exceed 4 per cent and the veteran may take advantage of the Act at any time within 10 years after the end of the war. A loan which is supplementary to a loan made, insured, or guaranteed by a Federal agency may also be guaranteed provided the amount of the supplementary loan does not exceed 20 per cent of the purchase price of the property, and the total amount guaranteed does not exceed \$4,000. Instead of having particular loans guaranteed to the extent of 50 per cent or \$4,000, a lender may elect to have loans which are eligible for guarantee insured in a group. In this case, the Government will reimburse the lender for all losses suffered on these loans up to 15 per cent of the amount of loans made.

This program undoubtedly offers advantages to veterans, but at the same time it strengthens materially the sellers' market which would probably prevail in the next few years even without the program. The pressure on buyers was lessened somewhat by the amendment which extended from two years to ten years the period within which the veteran may make use of the program. At the same time, the substitution of "reasonable value" for "reasonable normal value" as the definition of the maximum price which the veteran may pay for the property mortgaged under the Act removed a protection which is sorely needed at the present time.

Perhaps the program would offer more protection to the veteran, the lender, and the Government, as well as to the housing market in general, if it were administered by the Federal Housing Administration under a new title to the National Housing Act. The FHA has experience in underwriting private mortgage loans and has, in its established appraisal procedures, the facilities for safe-guarding the interests of veterans in real estate transactions.

**Problems Remaining.** This paper has dealt with only a few of the questions surrounding housing needs and the housing market, and the suggested approach to a housing policy has probably raised more problems than it has solved. But in human affairs we seldom solve problems; at best, we find ways of living agreeably with them. An important step in reaching amicable relations is to recognize the problems as fully as we can and to remember that, as we find new ways of living with them, the problems themselves change, and we must make new adjustments.

Even so, it is apparent that the suggested approaches to the problems have not pointed very strongly to ways of achieving the kind of market which was set up as ideal. Two questions in particular have not been

answered: how to obtain sustained building in a market characterized by vacancies so plentiful and so well balanced that families have a free choice of their quarters; and how to reduce the costs of housing progressively. Some of the measures proposed, both in this paper and by others, may provide part of the answers, but they will not provide complete answers.

Curiously enough, the first question appears to be the more important for the long-run. So long as building goes on sporadically in response to scarcity as it is reflected in inflated values, our inventive energies—whether directed to improving the processes of assembling materials, to reducing current charges, or to any of the other traditional subjects of cost reduction—will be dissipated in attempts to prolong the duration of booms by keeping costs from rising as far as values. If we can devise a housing market in which new houses are built and old houses are retired fairly continuously in response to long-run developments, reductions in cost will be both easier to achieve and less important in their effects than they appear to be today. It is to the problem of devising this kind of housing market that the attention of citizens and students must be directed if we are to have a meaningful housing program.

High costs of housing may be regarded as unmitigated evils, to be attacked in their own right wherever and whenever they are encountered; or they may be regarded as a manifestation of interrelated evils which must be attacked in coordinated fashion, and not necessarily for their own sakes. If we take the second view, high costs represent an opportunity as well as an obstacle. In the immediate future, we can obtain a great deal of help from the fact that, as matters now stand, there are many costs which can be reduced. We have the conditions necessary for a residential building boom, but we do not have the kind of market which will transform this boom into the sustained provision, year after year, of the housing needed to raise our standard of living steadily. Not only can the coming boom be moderated and lengthened by reducing costs—it can be made the opportunity for developing the kind of housing market in which housing will be provided continuously in response to long-run needs, if a selective, consistent, and well-conceived program of cost reduction is followed. The most challenging problem of cost reduction is not to discover how to reduce particular costs; rather, it is to determine which reductions in costs can be made and maintained without producing serious conflicts in other parts of the economy, and how these reductions can be used most effectively in the development of a better

housing market. If we obtain a more suitable market, even if we must be content with moderate, but effective, cost reductions, we shall have done much; but if we lose the opportunity to reform market processes, high costs will continue to be an obstacle to the improvement of housing conditions, even though we adopt cost-reducing innovations on a substantial scale.

The kind of market we need is one in which the building of houses takes place to a greater extent in response to long-term needs and less in response to short-term lack of balance. In this context, "needs" is not to be contrasted with "demand," in the sense that "demand is need backed by ability to pay." Here, "long-term needs" is used in the sense that a public utility might use the term in forecasting the changes it will be called on to make in its plant over a period of time. Many of the changes that will be needed in our housing supply in the future are at least as predictable as the number of new telephone installations that will be required.

In the development of this more suitable market, the rôles of risk and incentive must be re-examined. Some of the risks now borne by those who participate in the buying and owning of real estate and the building of houses can be foreseen, and many of these could be eliminated with advantage to everyone; many of the losses which were suffered in the late twenties and early thirties in speculative subdivisions arose out of risks of this character. Other risks can be foreseen in a general way, but, because they are the consequences of the desirable or unpredictable adaptations people make in the process of living, cannot be eliminated or avoided, except at the expense of regimenting and stultifying our society. We may wish to minimize, but we should not try to avoid completely, for example, the possibility that, before new houses have worn out, the industry on which a community depends may become obsolete, or that people will prefer to live somewhere else. While such risks must be borne by someone, we must devise a more efficient system of apportioning necessary risks, and a more satisfactory system for rewarding those who control or minimize these risks.

Steps have been taken in recent decades to minimize and redistribute some of the risks in the real estate market. Municipalities have largely eliminated the possibility that buildings will collapse by adopting and enforcing building codes, and they have reduced some of the risks arising out of uncontrolled changes in land use by the application of zoning ordinances. Several different risks have been both reduced and reappor-

tioned by the Federal Government in its program of insuring mortgages. These measures are only partial, but they are a good beginning for a more comprehensive and consistent attack on the problems of risk and incentive. Until we have attacked these problems of risk and incentive, we shall not be able to develop the kind of housing market which is necessary if we are to have the kind of housing we deserve.

# ECONOMIC ASPECTS OF SOCIAL SECURITY

by

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The goal of social security is the universal maintenance of individual and family income at at least a socially acceptable minimum. In modern industrial society social security is unquestionably a matter of public concern and an accepted aim of public policy. The very forces which by raising the productivity of labor have accounted for the high standard of living of Western society have at the same time decreased the control of the family over its own fortunes.

In a broad sense, all public programs directed toward maintenance of adequate incomes are social security measures. This paper is primarily concerned with social insurance, that is, with protection in the form of cash payments, when earning power is interrupted or lost, provided as a matter of right to those in the plan. Eligibility for benefits usually, but not necessarily, includes contributions made by or for members of the system and no test of need is required. Although compulsory social insurance has come to be generally accepted as the principal instrument through which the problem of income loss can be dealt with, public assistance to those in need is a necessary supplement. The more comprehensive a social insurance program becomes, the less public assistance will be necessary, but some individuals and families will fall outside of the insurance system and special circumstances will prevent insurance benefits from being adequate for others.

To deal with the situation after the flow of income has been interrupted, however, will not achieve social security. A comprehensive program including other public measures related to the problem of adequate income is necessary. First, unemployment and disability must be prevented through positive action so far as possible. Cash benefits do not protect the individual from the destructive effects of continued idleness or sickness nor the economy from the waste represented by idle workers.

—income security which is all that can be given by social insurance is so inadequate a provision for human happiness that to put it forward by itself as a sole or principal measure of reconstruction hardly seems worth doing. It should be accompanied by an

announced determination to use the powers of the State to whatever extent may prove necessary to ensure for all, not indeed absolute continuity of work, but a reasonable chance of productive employment.<sup>1</sup>

Second, incomes actually being earned are not always adequate to maintain minimum standards. Such devices as minimum wage legislation and children's allowances provide an approach to this aspect of the problem.<sup>2</sup>

The basic purpose of social insurance is security for the individual and his family. In providing partial replacement when wage income is involuntarily interrupted or terminated, an adequate social insurance program alters the distribution of income among individuals and among income groups. Complete individual equity, in terms of premiums or contributions equated to the degree of risk and the amount of benefit, is inconsistent with adequate protection. The collection and disbursement of social insurance funds affects the size of the income flow as well as its distribution. A properly financed insurance program will help to maintain high levels of employment and income by raising and at least partially stabilizing consumption expenditure.

Any social insurance program, then, must be evaluated in two ways. First, what protection does it afford the individual; how completely does it express the responsibility of society toward its members? Second, what is its effect upon the economy; does its financing promote output and employment to the fullest extent?

In the following pages, existing protection for the individual is briefly described and proposals for more adequate coverage presented. This section is followed by a discussion of certain economic and fiscal aspects of social insurance. In this area considerable misunderstanding and consequently barriers to expansion are found. In brief, the thesis of this paper is that a comprehensive and unified plan of income maintenance through social insurance is desirable, and should be financed in large part from general revenues. The existence of such a program would itself encourage production and employment and, by increasing the national product, would lighten the burden upon the active working force of maintaining those who from causes beyond their control have become nonproducers, either temporarily or permanently.

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<sup>1</sup> Sir William Beveridge, *Social Insurance and Allied Services* (1942), p. 163.

<sup>2</sup> Insurance against the cost of medical care logically falls in this category of social security measures, but it is ordinarily considered in conjunction with social insurance.

## PRESENT AND PROPOSED SOCIAL INSURANCE PROTECTION

The major threats to income that should be provided against through social insurance are the unemployment, disability, old age, and death of the earning family members, and the cost of medical care. The loss of earnings from old age, permanent disability, and death are sufficiently recognizable for all members of the labor force and their dependents to be protected against them. Unemployment and temporary disability compensation should be available to all with the possible exception of the self-employed. For them, the fact of loss may be too difficult to establish. The cost of medical care may fall on anyone, whether employed or not, and universal coverage would be desirable.

Because of the wide variation among both occupations and regions in wages and living standards, benefits should probably continue within limits to be related to previous earnings. The emphasis belongs, however, upon the adequacy of minimum benefits, including dependents' allowances. At the same time, benefits should not be so generous as to discourage the search for employment.

Some distinction should be drawn between unemployment and temporary disability benefits on the one hand and those paid in the remainder of the system on the other. Unemployment and temporary disability interrupt, rather than destroy, earning power, and benefits could be so high, in relation to wages, that they could conflict with the willingness to work. In occupations where benefits that would provide for some sort of basic minimum would approach or exceed the wages paid to workers, there is a strong presumption, however, that correction of the wage level should be sought through minimum wage legislation.

Dependents' allowances also raise the danger of unemployment and temporary disability benefits in excess of earnings. In fact, the size of the family may itself make it impossible for adequate living standards to be maintained, apart from any interruptions in earnings. These factors, together with the extreme importance to the nation that children receive adequate care, suggest that a national system of children's allowances should also be given consideration.<sup>3</sup>

Although social insurance in the United States has advanced substantially during the past decade, it is far from complete. The Social Security Act, adopted in 1935, established unemployment and old age insurance for the industrial and commercial labor force and provided for Federal

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<sup>3</sup> Great Britain and Canada now provide children's allowances to all families.

financial participation in three types of public assistance administered by the States. All of these—old age assistance, aid to dependent children, and aid to the blind—are available only to those who can establish need on the basis of a means test. Major amendments in 1939 added dependents' and survivors' benefits to the Federal old age insurance plan. Even though this significant legislation provides the keystone, protection varies among occupations and localities, and there are separate systems at different levels of government.

**Unemployment Compensation.** Although the general conditions for unemployment compensation are outlined by Federal legislation, the industrial and commercial labor force is protected under the 51 separate systems of the States and territories. Federal plans cover railroad employees and veterans, regardless of occupation. The plan for veterans is temporary, however, in that benefits are available only within a given period after discharge from military service. The self-employed, agricultural and domestic workers, and seamen are excluded from all these unemployment compensation plans, as are employees of governments, nonprofit establishments, and small firms in covered industries in some States.<sup>4</sup> It is estimated that less than three-fifths of the nation's jobs are covered by State unemployment compensation plans.

Benefit provisions are far from uniform. Eligibility for benefits depends upon involuntary unemployment within the meaning of the law, which is much more restrictive in some States than in others,<sup>5</sup> and upon varying requirements as to previous earnings. Benefits nominally approximate 50 to 65 per cent of wages, and in four States they include allowances for dependents, but they are subject to minimum and maximum limits. The maximum limits, which range from \$15 in ten States to from \$24 to \$28 in six States,<sup>6</sup> keep weekly benefits of many recipients well below 50 per cent of their weekly wages. In 1945, the average weekly benefit paid under State programs for total unemployment was \$19, and ranged from \$11 to \$13 in seven States to from \$21 to \$23 in four. Under the Federal plan provided by the Servicemen's Readjustment Act of 1944, weekly unem-

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<sup>4</sup> The tax provisions of the Federal act apply to employers of eight or more, but many States have extended insurance coverage to those in firms employing less than eight persons.

<sup>5</sup> Involuntary unemployment implies that a worker did not quit without good cause, did not lose his job for misconduct, and did not refuse suitable work. These requirements are variously interpreted and carry penalties, in the form of postponement or disqualification of benefits, of varying severity.

<sup>6</sup> Including dependents' allowances in three States.

ployment benefits of \$20 are paid to veterans, irrespective of their past earnings.

In the State plans, the maximum duration of benefits in any one benefit year varies from 14 to 26 weeks, and in 37 States it may be reduced by insufficient amounts of previous earnings. In contrast, unemployed veterans may draw benefits for a maximum of 52 consecutive weeks within two years of their discharge or release from the service, or of the termination of the war, whichever is the later date, regardless of their previous employment experience.

It is evident that adequate protection against unemployment does not exist for many workers. Unemployment compensation should be available to all persons in the labor force, with the possible exception of the self-employed, for whom the fact of unemployment may be too difficult to establish. Benefits should not be expected to compensate wholly for loss of income, because of the adverse effect upon the willingness to work, but they could be increased before that point is reached. Dependents' allowances should be adopted. Benefits should be of uniform duration; if a worker has satisfied the test of attachment to the labor market, by having earned sufficient wages in the base period to qualify for benefits, the duration of his benefits should not be affected by the size of his past earnings.

Unwarranted variations in eligibility requirements and size of benefits should be eliminated by the establishment of national minimum standards—or better by Federalization of the entire system. Dollar benefits need not be uniform; regional differences in living costs and living standards are reflected in wage rates so that such differences would continue to be reflected in benefits. A national program would also eliminate the discrimination sometimes experienced by workers who have been employed in more than one State, although interstate cooperation has already solved many problems arising out of this situation.

Cash benefits do not meet the problem of unavoidable idleness as such, and unemployment compensation should attempt to deal only with relatively short-run unemployment. Benefits should not be unlimited in duration, but they could well be extended to at least 26 weeks. Continued unemployment beyond that point should be dealt with through public employment and occupational retraining programs. At present, a worker who exhausts his benefit rights before obtaining other employment has no recourse except his own resources or local relief.

It should be noted that a strong and efficient employment service, to

which most job openings are referred, is essential for satisfactory operation of an unemployment compensation system. Willingness to work cannot be tested unless job openings are at hand. Some employers who are most disturbed about the adverse effects of unemployment compensation upon the desire to work inconsistently fail to utilize the public employment exchanges.

**Old Age and Survivors Insurance.** Unlike unemployment compensation, old age and survivors insurance for industrial and commercial workers is established on a purely Federal basis by the Social Security Act. Eligibility requirements, benefit payments, *etc.* are uniform in all the States. Employment covered is the same as that covered by unemployment compensation, except that employees of small firms in covered industries are also included. Some 30 million of the 52 million persons employed in an average week in 1944 were in jobs subject to old age insurance, and some 40 million persons are now insured.<sup>7</sup> In addition, some 4 million railroad workers and Federal employees have their own Federal retirement systems and about half of 3 million State and local government employees are members of separate retirement systems. Other occupational groups are excluded from public plans and perhaps 8 million aged are not eligible for compensation, whether or not they formerly engaged in employment now covered.

Under the Social Security Act, old age benefits and dependents' allowances are paid to those insured upon retirement at age 65. Upon the death of an insured worker, benefits are paid to the surviving children under 18 and mothers, to aged parents if there is no widow or child, and to widows when they reach 65. Monthly benefits range from a minimum of \$10 to a maximum of \$85, based upon past earnings, length of employment, and number of dependents. Few families are eligible for maximum amounts, however. The average monthly benefit received by a retired male worker in 1943 was \$25; the average retired worker and his wife received \$39.

The principal gaps in old age and survivors insurance are lack of coverage for many persons and inadequate benefits. Protection should be extended to all the gainfully occupied and their dependents. Large numbers of persons least able to provide for their old age or for their survivors, including agricultural and domestic workers, are outside the system.

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<sup>7</sup> That is, they have had sufficient wages in covered employment for survivors insurance to be in force.

Many who worked in covered employment during the war will lose their insured status after they return to other peacetime occupations. Some persons previously insured who are in the armed forces or in Federal civilian employment may lose their insured status. The magnitude of the shift from covered employment to other employment or out of the labor force and back again is indicated by the fact that 74 million persons have some wage credits in covered employment, although only 40 million are insured.

Old age and survivors benefits purport to provide basic protection for their recipients.<sup>8</sup> If an adequate minimum is actually to be afforded, it would seem that a minimum benefit of at least \$20 to \$30 and a general increase in benefit scales through the lower levels are necessary. Present benefit schedules were hardly adequate when they were set up in 1939, and price increases in recent years have lessened their adequacy considerably. Higher wages have increased benefits only slightly during this period; they have had no effect upon payments to those previously receiving benefits and little effect upon new claims since benefits are related to past average earnings.

If past earnings within a specified period are a necessary condition for benefits, as in the existing plan, those already past working age pose a special problem. Complete coverage of the present labor force would afford them no protection other than public assistance.<sup>9</sup> Even though their numbers will ultimately diminish, compensation for all persons past working age comparable to that available to insured workers should be given serious consideration.<sup>10</sup>

**Disability and Medical Care Insurance.** Social insurance in the United States deals with disability and the cost of medical care to a very limited extent. All States save one require some insurance protection against occupational injuries or disease, but it is estimated that substantially less than one-tenth of all disabling illnesses of persons in the labor force fall

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<sup>8</sup> The age requirements attached to the receipt of both old age and survivors benefits eliminate the possible danger in unemployment compensation of benefits exceeding wages. Here a possible danger is rather that the system could be used to force withdrawal from employment, as a means of reducing unemployment. Old age compensation should be sufficient to enable the aged worker to retire if he wishes, but he should not be penalized by having future benefits reduced or denied if he wishes to work.

<sup>9</sup> Those permanently disabled at the time permanent disability insurance is adopted would be in a similar position.

<sup>10</sup> Benefits would obviously have to be paid at flat rates.

in this category. Railroad employees have some coverage against permanent disability along with old age insurance under the Railroad Retirement Act, and some protection is afforded Federal employees and veterans. Two States have adopted temporary disability insurance for those insured against unemployment. Otherwise, no public action has been taken except for war veterans.

In terms of risks, the most significant omission in the existing social insurance system is the lack of protection against the loss of income and the expense of medical care associated with sickness and disability. All members of the labor force face the risk of income loss through disability, and the risk of medical expense is universal. The loss of earning power because of disability and the inability to obtain sufficient medical care are serious causes of dependency. Illnesses are more prevalent and more severe the lower the family income. It is estimated that some 7 million persons, half of whom would normally be in the labor force, are disabled at any one time. Of the total, little more than half have been disabled less than six months.

Compulsory disability insurance is the only means through which loss of income from disability can be adequately offset. The permanently disabled worker and his dependents are in a position similar to that of a family in which the wage earner is incapacitated by age, and their need is likely to be greater. Similarly, the temporarily disabled worker is in a position analogous to that of the unemployed worker. Permanent disability insurance could readily be added to old age and survivors insurance and compensation for temporary disability incorporated into the unemployment compensation system.

Social insurance is well suited also to meet the expenses of medical care. The adequacy of medical care for many families is in part a matter of the distribution of medical and hospital facilities. Hospitals tend to be established and doctors to be located in relation to financial resources rather than in relation to need. However, a fundamental cause of inadequate care—and the major cause of the maldistribution of medical resources—is simply individual inability to pay for needed services. Families in low-income groups have a greater need for medical care but obtain much less than those in higher income brackets. The proportion of unattended illnesses varies directly with family income. To be sure, medical services for the poor are considered a public responsibility, but a means test deters many from seeking necessary attention and pre-

vents others who are not eligible from obtaining care that they need but cannot afford.

Voluntary prepayment plans for medical and hospital care have expanded in recent years, as the medical profession has shifted from opposition to support of such schemes, but they provide adequate coverage for only a small part of the population. Adequate medical care can best be assured through compulsory insurance against its cost. With such a plan in conjunction with disability insurance, families would be protected from the adverse economic effects of sickness and accident, doctors and hospitals would be assured of more secure incomes, and the nation would gain from a healthier and more efficient population.

#### ECONOMIC AND FISCAL ASPECTS OF SOCIAL INSURANCE

Social insurance financing is not simply a matter of making benefit payments out of a solvent fund built up and maintained by premiums collected from those participating, assessed according to the degree of risk and the amount of benefit payable if loss occurs. Because this is the essence of private insurance financing, and exists to a considerable degree in the present unemployment and old age insurance systems, it does not follow that social insurance should be financed in this fashion. In fact, individual equity in terms of premiums equated as nearly as possible to the degree of risk and the amount of benefit, comparable to the equity necessary in private insurance, is inconsistent with adequate social insurance. That lower income groups cannot afford to pay in full for the protection they receive is one of the principal reasons that voluntary social insurance is inadequate.

More important, it would be an undesirable and short-sighted policy not to consider the effects of social insurance financing upon employment and spending and not to finance the insurance system so that its operation would contribute to high and stable employment. Social insurance expenditures, properly financed, can be a significant part of a fiscal policy directed toward full employment. Benefits tend to be promptly and wholly spent by their recipients. Largely but not wholly on account of unemployment compensation, social insurance benefits in the aggregate vary directly with unemployment. Payment of benefits is a form of Government action that does not intrude significantly upon the province of private enterprise. Since the longer run problem of our economy appears to be to develop and maintain, within the framework of a free society,

sufficient demand for goods and services to utilize fully our productive capacity, social insurance is an apt governmental weapon. It should not be financed in such a way, however, that consumption expenditures will be simply shifted among individuals and left unchanged in the aggregate.

If the ultimate liability of the Government to provide benefits is admitted, separate insurance funds are no longer necessary. Benefits may be met in whole or in part out of general revenues. Contributions need not be directly related to benefits. The choice of sources of funds over and above those provided by contributions becomes a part of the problem of general fiscal policy and problems of insurance reserves do not exist.

If social insurance benefits are to be paid entirely from funds contributed by or for those insured,<sup>11</sup> however, a choice must be made between a pay-as-you-go plan, in which rates are adjusted to meet current expenditures, and a reserve plan, under which level rates provide reserves to meet the increased future liabilities of an old age and permanent disability plan and the potentially fluctuating liabilities of unemployment insurance.

**The Contributory Principle.** The use of earmarked funds from pay-roll taxes and some attempt to relate contributions and benefits were probably necessary to obtain public acceptance at the inception of unemployment and old age insurance in the United States. It was felt that separate funds fed from particular taxes would provide greater assurance that benefits would be available to claimants, on the one hand, and that excessive benefits would be checked, on the other, than if congressional appropriations were continually necessary. In addition, the fact that only certain groups were included made it difficult to justify the use of general revenues. Contributions meet the definite desire on the part of those insured to pay for their protection. They also provide a wage record against which claims can be checked and benefit amounts determined.

It would probably not be desirable to abandon the contributory principle entirely, but in a comprehensive system, benefits could be met in large part from general revenues. The wider the insurance coverage and the more general the understanding and acceptance of social insurance as a necessary public responsibility that, like public education, conveys indirect benefits to all members of the community, the more appropriate it becomes to draw upon general revenues. The right of individuals to

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<sup>11</sup> With or without a fixed Government contribution.

benefits and the guarantee that future obligations will be met do not rest on the fact that claimants have a previous contribution record nor on reserves built up from such contributions, but on the harmony of social insurance with the economic and social desires of the nation.

**The Reserve Problem.** There is a great deal of misunderstanding about Government insurance reserves. Regardless of the financial methods adopted, the output of the economy at the time social insurance benefits are paid must furnish the goods and services consumed by beneficiaries. The real burden of maintaining the aged in the future cannot be placed upon the present generation by currently accumulating dollar credits. The real, as opposed to the dollar, burden cannot be shifted over time.<sup>12</sup>

A private insurance company must provide in the present for future liabilities by building reserves which are invested in claims against others in the economy. Financial solvency is meaningful and necessary. The Federal Government, however, cannot practicably create a reserve in any form except its own obligations. The claim has been made that, in so doing and then spending the proceeds upon ordinary Government expenses, contributors' funds are being dissipated, rather than conserved, and the reserve is worthless. Although this position is meaningless in so far as it suggests insolvency of the insurance system, it illustrates the confusion arising from the existence of a large public reserve for which there is no alternative except investment in Government securities. There is no point in collecting pay-roll taxes and burying the receipts in a public vault. This would only necessitate higher taxes or more borrowing from other sources to meet general Treasury expenditures. A more efficient procedure is to make the cash receipts of the reserve fund available for general budget expenditures or for the redemption of public debt, and to credit the fund with Government bonds. But even then the fact remains that the existence of a reserve in Government bonds to meet future obligations does not alter the problem of meeting those obligations. When it is necessary for the insurance fund, in order to make cash outlays, to draw upon its reserve or even upon current income from interest, the Government must tax or borrow to obtain the money that is transferred to the insurance fund. The same amount could be raised in

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<sup>12</sup> Only if a reduction in consumption expenditures, caused by contributions in excess of benefits, should result in increased production of capital goods with resources that would otherwise have been used in consumption, might there be a greater future output of consumer goods than would have occurred had reserves not been created.

the same way and transferred to the insurance fund as a Treasury expenditure if the reserve did not exist.<sup>13</sup>

With only particular groups covered, a reserve gives some appearance of equity between those covered and those outside. The covered group exercises a claim against the remainder of the population when the reserve is drawn on, just as it would through a direct Government contribution to the fund. The justification for this, when a reserve exists, is the fact that the covered group has previously restricted its expenditure by providing more in contributions than it received in benefits. Whether the uncovered group has actually benefited from the previous decline in expenditures of the covered group or has been adversely affected by the deflationary effect is another matter. With comprehensive coverage, even this justification disappears. To meet increased liabilities can be a matter of choice between increased contributions by participants and general Treasury revenues.

**Government Financial Participation and Economic Policy.** The necessity of the use of general revenues depends upon the degree of income redistribution necessary to provide adequate benefits and upon the extent to which the nation wishes to integrate social insurance financing with general fiscal policy. It is often suggested that equal amounts of revenue be obtained from employers, employees, and the Treasury.<sup>14</sup> A superficial appearance of equity seems to be its only basis. The responsibility of the

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<sup>13</sup> Since the excess of contributions over benefits represented by a reserve account is "lent" to the Government for general use, it is sometimes argued that this process tends to reduce the privately held Government debt and its interest burden. It is said to be easier, therefore, for the Government at a later date to raise funds for insurance benefits than it would have been had the reserve not been created. Since at a future time a substantial part of the benefits will be financed from interest payments on the bonds held in the reserve fund, it will be possible later on to continue a relatively low rate of pay-roll taxation even though benefit payments have increased. This argument assumes that, in the absence of pay-roll tax revenues sufficient to create a reserve, total tax revenues over the period would have been lower. Certainly this does not necessarily follow; other taxes could have been higher. During the war, for example, the Victory tax rate and subsequently the normal income tax rate might very well have been higher had it not been for pay-roll taxes. In the late thirties, on the other hand, it is quite likely that Treasury borrowing from the public would have been utilized in lieu of pay-roll tax revenues, but this would have represented a fiscal policy decision to avoid the deflationary effects of additional taxation. The especially deflationary effects of pay-roll taxation could even have indirectly increased the necessity for Government borrowing during that period. At least, it is reasonable to assume that incomes and employment were reduced because of the restrictive effect of pay-roll taxes on consumption expenditure.

<sup>14</sup> This is the approximate ultimate division suggested by the Social Security Board and by Senator Wagner in their proposals. It has also been the nominal, but not the actual, division of the cost of unemployment insurance in Great Britain.

population as taxpayers rather than as covered workers would better be expressed in a fluctuating Treasury contribution based indirectly upon the level of employment.

For example, aggregate contributions might be equated to benefits at full employment, allowing for frictional unemployment. Under such employment conditions, the effect on consumption would be more or less neutral.<sup>15</sup> Contributions would exceed benefits with over-employment such as existed during the war and benefits would exceed contributions in periods of under-employment. This relationship would be in accord with a general fiscal policy which sought to restrict aggregate expenditure when inflationary pressures exist and to encourage it when deflationary forces threaten.

The stimulating effect of social insurance upon consumption could be increased by establishing contribution rates that would provide less than sufficient funds to meet benefits at reasonably full employment. The extent to which general revenues should be relied upon at such an employment level depends upon the longer run aspects of many factors: the distribution of income, savings habits, investment outlets, other sources of Treasury revenues and objects of Treasury expenditures, and the like. The important thing is that above a minimum which would provide recognition to the contributory principle, the sources of funds for social insurance benefits should be a matter of fiscal policy, not of social insurance. The greater the margin between contributions and benefits, the more effective social insurance can be in terms of economic policy.

Some attention should be given at this point to another proposal for increasing the effects of the social insurance program upon the level of monetary demand; namely, that of providing rates of contribution which would vary inversely with the level of employment.<sup>16</sup> This procedure might tend to increase consumption in depression and check it in prosperity more effectively than would constant rates, but it has several disadvantages. To vary frequently the rate of employees' contributions would obscure the contributory principle still more, and might well provoke confusion and uncertainty among both employees and employers. The fact that contributions would go down might tend to create unwarranted demands for further reductions, and increases in contributions

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<sup>15</sup> See pp. 54-55 for a brief discussion of the effects of pay-roll taxes on consumption.

<sup>16</sup> Among others, the British Government proposed this in its White Paper on Employment Policy.

might be effectively opposed, no matter how definite the previously agreed upon schedule of rates might have been. There would be political opposition to increases in employers' taxes as well. There is serious question in any case about changing rates of employers' contributions according to a criterion which cannot be anticipated very far in advance. Rate changes based on unemployment would tend to make business decisions as to future events more difficult, and not enough is known about the incidence of pay-roll taxes paid by employers to indicate at what levels of employment such taxes should rise or fall. A simple inverse relation between rates and employment might be inimical to the progress of business recovery in its early stages. On the other hand, a decline in contribution rates when unemployment is rising might result only in an increase in profits that, because of its source and presumably temporary character, would have little or no salutary effect upon business activity. On the whole there is much to be said for stability of pay-roll tax rates.

Even if frequent rate adjustments were not made, the proportion of expenditures to be met from other than pay-roll taxes at high employment, once determined, would not necessarily be permanent. It would be subject to revision when underlying changes in the factors listed above seem to be sufficient to require a reappraisal of general fiscal policy. In addition, the changing age distribution of the population over the next four decades would increase expenditures, even in a comprehensive system, quite apart from changes in employment. Periodic reconsideration of sources of funds would be necessary on this account alone.

This approach would retain the contributory principle to some degree, but benefits would not be limited by contributions and the collection of revenues would be directly related to other Government finances. This does not mean that contributors would have no other financial burden related to social insurance. Manifestly, Treasury expenditures would affect them as taxpayers. The extent to which this burden would differ from the added burden of higher pay-roll taxes would depend upon the other tax sources utilized. Other public measures dealing with unemployment would be encouraged, as their success would be directly reflected in a reduction in the Government contribution to the insurance fund.

The social insurance system should be designed to promote a generally high level of consumption expenditure and to increase such expenditure when employment declines. The role of unemployment compensation in maintaining consumer expenditure in depression is limited, however, by necessary restrictions upon the duration of benefits and by necessary

limits upon benefits as a proportion of wages. Fiscal aspects of social insurance should be consistent with general fiscal policy, something that has not been true under existing programs. No attempt has been made in this paper to deal with the general problem of Government fiscal policy,<sup>17</sup> however, except by implication.

#### FISCAL AND ECONOMIC EFFECTS OF THE EXISTING INSURANCE SYSTEM

Both unemployment and old age insurance are now financed in a manner more or less analogous to private insurance. The cost of benefits is met by pay-roll taxes paid by and for those in covered occupations. Contributions bear some relation to benefits, but no adjustment is made in contribution rates paid by those eligible for dependents' allowances or by those now in the older age groups, who receive considerably more generous old age benefits relative to their contributions than will younger contributors. On the whole, beneficiaries in lower income groups are treated more generously, in terms of their contributions, than those with larger incomes. An attempt has been made to meet the problem of fluctuation in costs over time by the creation of reserves, rather than by variations in the rates of contribution, although this continues to be a disturbing element in the old age insurance plan.

**Effects of Pay-Roll Taxes.** Pay-roll taxes on employees are restrictive in their effects upon consumption since they are borne by wage earners, most of whom have little margin for saving under ordinary conditions. The effects of pay-roll taxes paid by employers are less clear, but their burden probably also falls on wage earners in considerable part, whether it is shifted to them through higher prices or lower wages.<sup>18</sup> Consequently employers' taxes also restrict consumption over the longer run. In the short run at least, changes in employers' contributions probably affect profits as much as or more than wages or prices.

In the aggregate, the payment of insurance benefits out of pay-roll taxes tends merely to redistribute, not to increase, consumption expenditures.<sup>19</sup> If benefits equal pay-roll taxes, total consumption may be somewhat increased, however, since benefits are likely to be fully spent, while

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<sup>17</sup> See the various essays in *Public Finance and Full Employment*, No. 3 in this series of pamphlets.

<sup>18</sup> To the extent that employers' taxes are reflected in higher prices, those outside covered employment are also affected.

<sup>19</sup> The restrictive effects of existing pay-roll taxes on consumption are increased by the fact that they are levied only on the first \$3,000 of total annual wages.

contributions may not be provided entirely out of funds that would otherwise have been spent on consumption. This effect is offset to some extent by the fact that consumption expenditures made out of benefits probably do not wholly represent a net increase in spending. To some extent they replace spending by or for beneficiaries out of their savings or those of their relatives and out of public or private relief. We may conclude that, if the outflow of funds through benefit payments equals the inflow of contributions through pay-roll taxes, aggregate consumption expenditures tend to remain unchanged or to increase only slightly; if contributions exceed benefits, spending on consumption will be reduced; if benefits are larger than contributions, spending will be increased. The extent of the increase will depend, however, upon the alternative revenue sources that are drawn upon.

Pay-roll taxes are an accepted and productive source of revenue. Taxes on employees give them direct participation in the system, and provide useful administrative records. Contributions from employers in the form of pay-roll taxes do not appear to have as much justification, apart from their revenue producing ability, except in the case of occupational accident and disease. Over this risk, the employer has some control, and to tax him on the basis of rates adjusted to the degree of risk provides an incentive to the employer to eliminate this risk as far as possible.<sup>20</sup> Otherwise, there is serious question about the desirability of a business tax measured by employment. Nevertheless, the tax on employers would be difficult to eliminate, as long as the tax on employees is continued, especially if under an expanded program employees' taxes are raised above current rates.

**Unemployment Compensation.** Pay-roll taxes for unemployment compensation are levied almost entirely on employers.<sup>21</sup> Only four States add a tax on employees.<sup>22</sup> There is no attempt made to balance current contributions and benefits; balance is supposed to be attained over the period of the business cycle. Unemployment is so unpredictable, however, that

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<sup>20</sup> Experience rating in unemployment compensation is discussed on pp. 57-58.

<sup>21</sup> Employers are subject to a Federal pay-roll tax of 3 per cent, which may be offset up to 90 per cent by corresponding State taxes. In effect, the proceeds of a 2.7 per cent tax are credited to State accounts in the unemployment trust fund and the yield of 0.3 per cent tax accrues to the Treasury for expenses of administration of the plan. All but four States have taken advantage of Federal permission to reduce tax rates paid by individual employers, however, depending upon their loss experience. The actual average rate of employer taxes is currently about 2 rather than 3 per cent.

<sup>22</sup> In two of these States, Rhode Island and California, the existence of employee contributions is now related to temporary disability insurance programs.

such a balance, if it were attained, would be the result of fortuitous circumstances.

Benefits exceeded current contributions for brief periods in a few States in 1938 and 1940 and in a number of States in the latter part of 1945. Total collections consistently exceeded total benefits, however, until the last quarter of 1945, when benefits were about 125 per cent of collections. From the inception of the system through December 1945, less than 30 per cent of the contributions collected were paid out in benefits. No benefits were payable during the first two years of operation; benefit scales were more illiberal than at present; and, though many persons were unemployed prior to the war and after benefit payments had begun, a substantial proportion were outside the system or eligible only for brief periods. The effect of the war on unemployment, together with these factors, resulted in State unemployment funds that totaled 6.8 billion dollars at the end of 1945.

The incidence of unemployment in the near future is likely to differ markedly among States and not in accordance with the adequacy of their separate reserves. The Social Security Board states, however, that accumulated funds should be "sufficient for any foreseeable unemployment in the future, even if all States provide protection as great as that in the most liberal States."<sup>23</sup> States may also obtain interest-free Federal loans out of that portion of pay-roll taxes received by the Federal Treasury but not spent for administration of unemployment compensation.

Since its inception, the operation of the unemployment compensation plan has been deflationary. Most of the excess of contributions over benefits represents a reduction in consumption expenditure. To be sure, these accumulated funds have been exchanged for Government securities and the proceeds expended by the Treasury in its ordinary operations. But had they not been available, the Treasury would have obtained funds elsewhere, in all probability from less deflationary sources.

Nevertheless the system does have a degree of sensitivity to changes in the level of unemployment. Expenditures increase and collections fall as unemployment rises and pay rolls shrink. Experience rating provisions tend to make rates of contribution vary directly with unemployment, however, and consequently lessen the extent to which total collections vary inversely with unemployment. If the present system is to make a

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<sup>23</sup> Social Security Board, "Ten Years in Review," *Social Security Bulletin*, August 1945, p. 21.

significant contribution to consumer expenditure on the down-swing, however, excluded occupations should be covered promptly and benefits liberalized and extended.<sup>24</sup>

Also, pay-roll taxes should not be expected to balance benefits at some presumed average level of employment over the cycle. The two should come into balance at reasonably full employment with allowance for frictional unemployment, and less deflationary sources of benefit payments should be drawn upon during periods of severe unemployment. This would necessitate Federal participation in financing.

**Experience Rating.** One type of variation in employers' unemployment compensation tax rates is found in their relation to the loss experience of the individual employer. Individual employers' rates of contribution (or premiums) are directly related, within certain limits, to their losses under workmen's compensation and, in most State plans, under unemployment compensation. Reductions in rates for employers whose losses are small are supposed to provide incentives for preventive action by the employer that will diminish the causes of industrial accidents or unemployment. Experience rating has operated successfully in workmen's compensation. Industrial accidents and disease are controllable to a considerable degree by safety devices, inspection, education, and the like.

The major causes of unemployment, however, are not within the control of individual concerns to any significant degree. Some regularization of casual or seasonal employment might be possible in a relatively few concerns, but even in these instances, other and greater advantages than pay-roll tax reductions would probably attend the regularization of employment. Although unemployment cannot be appreciably reduced by experience rating, its widespread adoption attests to its popularity; the difference between the statutory rate of 2.7 per cent and the actual national average rate of employer contributions of about 2 per cent attests to its effectiveness in reducing tax bills. Most employers could qualify for tax reductions under wartime conditions, but the low level of unemployment had nothing to do with efforts of individual employers. Ten States have required additional so-called war-risk contributions from employers whose pay rolls have expanded markedly. Such employers are not the only ones, however, whose unemployment record was improved by the war. In addition, experience rating schemes do

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<sup>24</sup> To broaden coverage after widespread unemployment appears could even have restrictive effects, since those already unemployed would receive no benefits, and a net inflow of funds might result from the contributions of those still employed in the newly included occupations.

not differentiate among industries. An employer in an unstable industry who does his utmost to regularize employment within his plant may not obtain as great a rate reduction as one in a more stable industry who takes no steps whatever.

A serious objection to experience rating is the employer pressure it develops to obtain lower rates, not by lessening actual unemployment but by reducing the benefits charged against particular employer accounts. It is sometimes possible to spread work excessively to avoid layoffs and to lay off workers in relation to their eligibility for benefits. Legislative restrictions on qualification for benefits have been obtained, and increasingly severe disqualification for benefits appears to be directly associated with the spread of experience rating. Experience rating in the State programs has also led to competition among States in lowering employers' taxes, which has probably intensified benefit restrictions. The doctrine emerging in many States that unemployed workers should be denied benefits when their unemployment is not attributable to the specific action of their employers is a more limited concept than the basic one that workers should be denied benefits only when they are at fault. The employer has a similar financial incentive to oppose liberalization of benefits.

Finally, the effects upon aggregate contributions are exactly contrary to good fiscal policy. Rates tend to fall when employment is high and to rise when employment declines. Whether these short-run changes are reflected in corresponding changes in prices or in profits, they tend to discourage outlays when employment is low and to encourage them when employment is high. These considerations point to the conclusion that experience rating should be abolished in unemployment compensation taxes. The reduction of risk associated with the financial incentive is so slight that it is outweighed by the unfavorable developments associated with such provisions.

**Old Age and Survivors Insurance.** Pay-roll taxes for old age and survivors insurance are collected from both employer and employee in covered industries. Contributions tend to fluctuate with employment, since they are based upon wage payments, and benefits are affected to the extent that retirement is postponed when job opportunities are prevalent. Contributions have exceeded benefits by a wide margin, and the reserve fund now totals over 7 billion dollars. The reserve is invested in Government obligations; net receipts are borrowed by the Treasury and used for general expenditures, just as are net unemployment compensation tax receipts. Like unemployment compensation, old age insurance has been deflationary to date. Unlike unemployment compensation, the

growth in the fund may be expected to continue, although at a diminishing rate, well into the future under rates now in effect.

Old age insurance involves definite and growing future liabilities. For some time to come, an increasing proportion of those in covered employment will attain insured status. The average length of service of claimants will increase. The proportion of the population in the older age brackets is steadily rising. These factors will increase total benefit payments for half a century, without any change in wage levels or benefit provisions.

The extent to which this increasing future liability can and should be provided for currently has been the subject of much debate and confusion, and is directly related to the effects of the system upon levels of expenditure and employment. Proposals have ranged from pay-as-you-go plans, in which current revenues would be related to current benefits and rates of contribution would steadily increase, to level premium rates, which would result in the accumulation of a full actuarial reserve.

The plan originally adopted called for rapidly rising rates of contribution in the early years up to a level rate and the creation of a large reserve. It was hoped that no contribution from general revenues would be necessary. Opposition to the proposed reserve accumulation and to increases in pay-roll taxes soon developed. Adherents of deficit financing in depression pointed to the deflationary effects of contributions substantially in excess of benefits. Business interests objected to the increase in pay-roll taxes as such. This opposition, together with pressure for more liberal benefits, brought a revision of the system in 1939. Benefits for those near retirement age and for those with lower incomes were liberalized, and dependents' and survivors' payments were added. Scheduled increases in contribution rates were suspended. As a result of these changes, much smaller reserves were expected to accrue, and revenues from other sources will be necessary to supplement pay-roll taxes, assuming that present rates of contributions and benefits are unchanged. It has been estimated that, for the present system to be self-supporting, pay-roll taxes would have to be from 4 to 7 per cent. The current rate for employer and employee is 1 per cent each, with the rate scheduled to rise by 1949 to 3 per cent each.<sup>24a</sup>

Rate increases were suspended until 1943 in 1939 and have been suspended annually since that time. Many who opposed rate increases before the war because of their deflationary effects have favored increases in

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<sup>24a</sup> A bill introduced recently by the Ways and Means Committee but not as yet considered by the House proposes to increase the rate from 1 to 2½ per cent as of Jan. 1, 1948, and to continue that rate until Jan. 1, 1952, when it would be raised to 3 per cent.

recent years for the same reason, but opposition, largely from employers, has prevailed. Also, there is some indication that labor unions may be turning toward the position that general budget revenues rather than pay-roll taxes should be the main reliance for financing.

It would seem that, within the framework of the existing system, a pay-as-you-go plan with a small contingency reserve to take care of short-run fluctuations in receipts and benefits should be used. This would mean continuing the current rates of contribution until expenditures equal receipts. From that point on, a Government contribution from general revenues would probably be preferable to increases in pay-roll taxes.

#### THE COST OF SOCIAL SECURITY

No detailed estimates of the dollar outlays involved in a comprehensive social insurance plan have been attempted in this paper. Very rough indications of possible dollar amounts may be given, however. It has been estimated that a quite comprehensive system (the Wagner-Murray-Dingell Bill of 1943) could, with high employment, be financed in the immediate future with pay-roll taxes of 5 to 7 per cent.<sup>25</sup> This would amount to perhaps 8 billion dollars. Those already past retirement age would not have insurance coverage but would have to rely, as now, on old age assistance by the States. Over the next four or five decades, as an increasing proportion of the aged became eligible and as their numbers increased, costs would rise. The cost of a still more comprehensive plan which would include all of the present aged, as measured by an application of the Beveridge plan to the United States, has been estimated at 13 billion dollars in 1945 and 16 billion in 1965.<sup>26</sup>

Eight billion dollars is less than 5 per cent of total income payments at full employment, and 13 billion is about 8 per cent. Considered in relative terms, the cost does not loom quite so large as in dollars. But neither the dollar nor the percentage figure accurately describes the real cost of social insurance and related measures. The nature of social insurance expenditures and the effect of the system on the economy must be considered.

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<sup>25</sup> S. J. Mushkin and Anne de Scitovsky, "A Formula for Social Insurance Financing," *American Economic Review*, September 1945, pp. 650-51.

<sup>26</sup> L. R. Klein, "The Cost of a 'Beveridge Plan' in the United States," *Quarterly Journal of Economics*, May 1944, p. 423. These estimates, however, assume something less than full employment.

Almost all social security outlays are transfer payments; that is, they do not use up labor or other productive resources as do expenditures for goods and services. To build a dam involves a real expenditure in terms of labor and cement; less labor and cement is available for other uses in the economy. A similar money expenditure for old age benefits does not directly use up any resources; it is a transfer of resources from the working population to non-producers, but total resources of the economy are not directly affected. In these terms no real cost to the community is involved, but only a change in distribution.

The real cost of social security to the nation must be sought in its indirect effects upon resources and output. Social security may affect the level of production in two ways: (1) It may alter the willingness or ability of people to work (because of the tax liability incurred or the receipt of benefits), and (2) it may affect the level of total expenditures on consumption or investment in the economy.

Transfer payments are not accomplished without friction; taxes are not painless. If too high, taxes may diminish incentives to enterprise and effort by the working population and consequently lessen total available resources. The burden upon producers of additional taxes for social security purposes is lightened, however, by the reduction in direct demands upon them for dependents' support and for contributions to private and public relief. Some goods and services must be made available to non-producers, in whatever manner.

The effect of social security benefits upon recipients whose earning power is only temporarily interrupted or has not yet come into existence is also important. Too liberal benefits may diminish incentive and effort by weakening the willingness to work. Adequate benefits, on the other hand, will increase the present and future labor supply by maintaining incentive and protecting the health of those of working age and their children. Poverty may on occasion mother invention, but it more often breeds illness and dependency.

Unemployment is the great barrier to individual security, and it brings with it a smaller national output and an increased need for social security expenditures. An effective antidote for most—but not all—unemployment is increased outlays for goods and services. The transfer of funds to non-producers, whose consumption needs are great, will increase aggregate consumption expenditures, if funds are not wholly obtained from those who would otherwise have spent them—and they need not be. There may be some upward shift in consumption and a reduction in savings on the

part of the working population as well, by virtue of the insurance protection afforded them. Some believe that insurance against the cost of medical care is especially likely to have this effect. With a small margin for saving, old age may seem far away and other demands much more immediate, unemployment and permanent disability may appear to be hazards that confront the other fellow, but illness and medical expenses are an ever present threat to every individual.

Increased demand for consumption goods and services has a favorable effect upon investment expenditure, as does the increased social stability resulting from adequate income protection. Inadequate living standards and insecurity of earning power hardly create an atmosphere conducive to a stable and prosperous economy. Against these factors must be set the possible adverse effects upon investment decisions of the taxes and public borrowing necessary to make social security payments. On balance, it seems reasonable to conclude that adequate and properly financed social security can help to increase aggregate expenditure and, under most conditions, by so doing to increase employment and real output.

# PUBLIC WORKS AND SERVICES IN THE POSTWAR ECONOMY

by

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With the end of the war, full employment and production with rising standards of living has become our foremost economic goal. It should be achieved within the framework of a competitive private enterprise system, but this requires that public policy assume its share of responsibility. The development of a broad public works and service program will be an important factor in this task. This paper deals with the proper scope of public works and services in the postwar period and their contribution in attaining economic objectives.

## THE PLACE OF PUBLIC WORKS AND SERVICES IN THE ECONOMY

The economic importance of public works and services is twofold. They satisfy certain needs of the community which cannot be met as well in any other way and they may also be used at times to ameliorate fluctuations in the volume of employment. Until the thirties, the first of these aspects dominated public works planning.<sup>1</sup> During the depression the employment and income-creating aspects of public expenditures came to receive more prominent, if not always favorable, attention. Now, in the postwar economy, it will be necessary to set both the need and the employment aspects of public works in proper perspective if effective and beneficial planning is to be carried out.

**Public Works and Services—a Reflection of Changing Needs.** The conservation and development of our human and natural resources for the benefit of the community as a whole is an accepted goal of economic and social policy and establishes the framework and the limits within which a program of public works and services has to be developed.

At any particular time the content of a public works and service program depends on the economic and cultural progress of a nation. At an early stage of economic development when capital is scarce, only the most urgent economic needs can be satisfied. These are primarily the ones felt

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<sup>1</sup> Both in this country and in Europe the possibility of using public works as a stabilizing factor in the economy had been recognized by the early part of this century, but the lack of properly planned public works in sufficient amounts made it impossible to carry out this principle.

by the people as individuals and provided for by private enterprise. With an increase of wealth, the desire to satisfy community needs increases, and the allocation of a growing portion of the country's resources to community purposes becomes possible.

The steady rise in the general standard of living, for example, has been accompanied by a growing awareness of social responsibility for the assurance of minimum living standards. The need for expanded community facilities and services, such as health and education, is widely accepted. Sanitary housing and other needs which formerly had been thought to concern the individual only are becoming vested with public interest.

A rising national income, however, is no assurance that needed public projects will be undertaken. In this respect the relationship between the level of national income and the satisfaction of public needs differs from the relationship between individual incomes and the satisfaction of individual needs. Despite prosperous business conditions during the twenties, the nation emerged with serious deficiencies of such basic requirements as housing, schools, and medical facilities. In appraising economic well-being, it is not the position of the most fortunate members of the community which is decisive, but the kind of life which our economy affords to those who are least able to share in its wealth. Thus, the general level of health, education, and living conditions should weigh heavily in the final appraisal.

Other factors leading to an increase in public activity relate to the growing complexity of the economy. Heavy concentration of population in urban centers has created a host of new needs for public works and services. Technological changes such as the growing importance of electric power have created new responsibilities for resource development. Intensive exploitation of our best agricultural and forest lands has created a need for large-scale irrigation and flood-control projects. The increase in ability to pay for public works, therefore, has been accompanied by a closely related, though not always equivalent, growth in the need for them.

The term public works has been traditionally applied to public construction projects only. However, public construction projects frequently are only a part of broader public functions. To carry on education and public health functions, schools and hospitals are needed, but so are the services of teachers and doctors. Public services must thus be considered jointly with public works. A discussion of public works, furthermore, cannot be limited to public construction projects of the more traditional type,

such as highways and postoffice buildings, but must also include broad improvement projects, such as urban redevelopment or the development of river valleys. Actually, these are not new types of public activity, but the modern counterpart of Federal participation in canal and highway construction dating back to the early part of the last century. Individual projects, moreover, must be considered as parts of a comprehensive program and planned on a broad basis with the cooperation of public and private agencies and public bodies at the various government levels.

Notwithstanding the gradual expansion of public works and services, modern civilization has been characterized by a lag in the satisfaction of community needs.<sup>2</sup> While the general need for increased public activity is recognized by large parts of the community, different groups disagree on the relative urgency of particular projects. The projects finally undertaken usually reflect compromise on many issues, and thus often fall short of the community need.

Public inertia, lack of information, disagreement on financial issues, and legal or administrative obstacles also cause delay. These conditions account in part for the fact that public works and services undertaken in the past are not necessarily indicative of the extent of past needs or of what people at large would consider a desirable program. Extensive investigation of community needs and problems at various government levels will prove helpful in providing the necessary background for informed community discussion.

**Public Activity and Private Enterprise.** An objection frequently made to public works and services is that they represent a less efficient use of resources than would be achieved in alternative private uses. One reason for this may be the difficulty of obtaining full agreement on the desirable scope of a public program. The disparity of interests represented and the diversity of needs to be served in any community often lead to a compromise that is completely satisfactory to no one. Private action often leads to similar results, as the failure of many a business venture attests; but since the desires of the community are seldom consulted in advance the disappointment is less vocal and less evident.

There is also a difficulty in comparing the relative returns from public and private enterprise. Business calculations, for instance, are concerned with demand in money terms only. They cannot deal with needs which

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<sup>2</sup> Needless to say, the backlog of public works grew larger during the war when all public construction not immediately connected with the war effort was postponed for the duration.

may be supported by inadequate purchasing power but which are nevertheless economically and socially important. Moreover, they do not take account of many costs which are borne by the community as a whole, but do not show up as business expenses. Balance sheet profitability, therefore, does not always indicate whether the benefits of a private undertaking outweigh its cost to the community. The maintenance of urban slums, for instance, may be profitable to the landlord while most costly to society. The contention that public works and service outlays should be limited because they represent a less efficient use of resources is thus not a valid general principle. Alternative public and private uses of resources must be considered on their specific merits.

No clear-cut line of division can be drawn between exclusive spheres of public and private activity. Both are closely related and dependent upon each other. The important fact, historically, has been the growth of both private and public functions, which supplement each other in meeting new needs and providing more adequately for existing needs. Indeed, new public works are often a necessary condition for private expansion. The development of the automobile industry, for example, went hand in hand with the construction of a hard-surfaced highway system, and the provision of public airports may be expected to parallel the growth of the aircraft industry.

An expanded public works and service program to meet existing needs does not mean infringement upon private economic activity. On the contrary, it means that private enterprise is certain to benefit. It will benefit, for instance, from the increase in labor productivity resulting from adequate public health and hospital care, from the preservation of resources through flood-control measures, and from the supply of cheaper power through the development of river valleys.

Public initiative, moreover, often stimulates business enterprise by creating entirely new opportunities for private investment. Regional development programs, for example, make available for private exploitation land and power resources that formerly were undeveloped or inaccessible; roads, sewers, water works, schools are necessary to bring urban fringe areas within the orbit of expanding private business activity; and urban redevelopment revitalizes dead areas by removing obsolete structures which block new enterprise on potentially valuable land. Public works like these induce population shifts, open up new markets, and create new combinations of labor and natural resources to attract the enterprising manu-

facturer, retailer, and builder. More than is generally realized, private business follows the public dollar.

Compared with the large area of mutual support, the points of conflict between public and private activity are few. They are based largely upon misapprehensions. An expanded public works and service program, for instance, need not mean "more government in business." Most public works and development projects, though financed by the Government, are actually planned and carried out by private engineers and contractors.

Similarly, the goods and services provided by public programs are often of a kind for which there are no private suppliers. Even in those areas where public programs furnish goods similar to those traded in private markets—as in the field of housing—the public program will aim at sectors of the market, such as low-cost dwellings, which are unprofitable to private enterprise.

Some public works and services may, to be sure, be designed to compete with private enterprise. This may be the case where publicly owned institutions are established as competitive yardsticks to combat monopolistic practices and assure more effective services to the consumer. In such instances, they must be run according to the principles of private profitability and their cost accounting must provide a fair standard of competition. The problem of public enterprise or ownership is thus a separate issue, without direct relation to an expanded public works and service program.

**Public Works and Employment.** Public works and service programs contribute to employment and national income in several ways. Expenditures for goods and services in connection with the execution of the program, first of all, result in a direct addition to demand. If highways are constructed, jobs for highway workers are created and the products of the construction industry have a new market. The additional income paid out will raise the total income received by the community. Accordingly, the level of private expenditures will tend to rise and this in turn will result in increased demand, output, and employment. An over-all increase in income, however, will come about only if the projects are financed in a way which does not involve a corresponding reduction in the level of expenditures on the part of those who supply the funds. The way in which the programs are financed is, therefore, of vital importance for their employment effects.

There is a further and perhaps more important way in which public

works and services may affect the level of employment and output. A broad program of public works and services will, in the course of years, develop the nation's natural and human resources, add to its productive capacity, and create new opportunities for business enterprise. Whereas the income and employment effects mentioned in the preceding paragraph will continue only while the program is maintained, the latter type of contribution will be of a permanent nature. Once markets for new industries are developed, these industries will continue to operate and provide employment. Once the working efficiency of the population is raised, a permanently higher level of output can be expected. There is nothing transitory about these factors; they are designed to give a permanent lift to the economy.

**Public Works and Cyclical Fluctuations.** Neither of the two aspects of public works and services—satisfaction of community needs and creation of employment—provides by itself a sufficient guide to planning. Extensive public works and service programs are needed aside from their effect on employment. But program timing must allow for fluctuations in the general level of income and employment. With public works and services composing a substantial part of Federal and non-Federal government budgets, their role in a policy of cyclical stabilization cannot be overlooked.

Clearly, expenditures on public works and services should not be reduced when private investment falls and raised when private investment increases. A policy of this kind accentuates cyclical fluctuations and is altogether unsound. As a minimum requirement, public works and service programs should be maintained at a stable level over the cycle. The resulting stability in an important segment of total economic activity will place a floor under national income in times of depression. At the same time continuity in the development of an effective public works and service program will be possible.

Recently, however, this argument has been expanded into a rigid principle of counter-cyclical timing. According to this principle, public works and service expenditures should be increased when private investment falls off and decreased when private investment rises. The difficulty is that the rigid application of such a principle might involve a conflict between the need and the employment aspects of public programs. If the level of income and employment in the post-transition period should remain high, for instance, public works and services would not be a necessary part of employment policy. Yet a substantial volume of such expenditures will

still be required to meet continuing needs even though employment is at a high level. If the program were postponed until some future depression occurred, the development of essential community functions would be delayed.

It is true, of course, that during a period of depression the community is in a better position to afford extensive works and service programs than in times of prosperity when full employment of resources is assured with or without such programs. At such times, therefore, programs can well be expanded to include useful public works and services which could not be afforded during periods of full employment because of competitive demands upon our resources.

In either case it is well to remember that the level of public works and service programs is only one of the instruments of fiscal policy. If a high level of public works is necessary during a prosperity period, possible inflationary effects may be mitigated by a proper financing policy. Similarly, the problem of a depression cannot be solved by public works alone; full employment must also be approached through other channels such as tax reductions.

Some special considerations are relevant during the immediate period of reconversion from a war to a peacetime economy. The competition of public works and services for limited resources is likely to be small at this time since an extensive program cannot be started on short notice and plans and preparations at the present time are largely nonexistent or in a preliminary stage. A large number of public projects, furthermore, make only an insignificant demand upon the resources needed for private construction. To the extent, however, that public projects during this period would compete with urgent demands, such as for housing, their postponement is obviously justified.<sup>3</sup>

If after a few years unemployment should again assume considerable proportions and be of a less transitory character, the execution of public works and service programs could be speeded up. The current backlog of needed public works is so enormous that there is a considerable margin between the rate at which projects can be initiated and the rate at which

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<sup>3</sup> On Feb. 12, 1946 the Federal Works Administrator reported that the Interdepartmental Committee on Construction had agreed to defer those types of Federal construction which would compete for men and materials with the demands of the housing program for veterans. However, the Committee also recommended that the construction of highway projects, reclamation projects, river and harbor improvements, and flood-control projects should go forward. The Committee, furthermore, pointed out that the construction of certain community facilities such as streets, sewers, and water works was essential to the construction of housing.

they are needed. So long as this margin exists and projects are planned sufficiently in advance, their execution may be accelerated when conditions require, without reaching into projects of dubious social value or make-work character.

Once the most urgent needs for public works and services are met, the possibility of postponing certain parts of the program during business prosperity is likely to become greater.

**Paying for Public Works and Services.** In any one year the financing of public works and services will have to be planned in accordance with general fiscal policy considerations which apply equally to the other items of the budget. In this respect the financing of public works and services does not differ from other budget expenditures and depends altogether upon the requirements of the economic situation.<sup>4</sup>

To the extent that it is compatible with general budget considerations, however, the character of the public works and service expenditures itself may determine whether preference should be given to taxation or borrowing. Where recurrent expenditures on public services are involved, taxation would appear the more appropriate way of financing. In the case of larger capital outlays on construction and public improvement programs, on the other hand, preference may be given to borrowing, and the annual interest and amortization payments could be distributed over the period of the services rendered by these structures. Irrespective of general economic conditions this method would hold particularly for small government units whose financial resources are limited. During a budget period in which their expenditures reach a temporarily high level, due for instance to the construction of a schoolhouse in a small community, reliance on outside sources will be necessary. By repaying the debt in gradual instalments the cost to the local community may effectively be spread over time.

As distinct from matters of financing technique, a second issue dealing with the broad economic cost involved has to do with the question whether the community can afford an expanded public works and service program. Public works and service programs involve an economic cost because the resources thus applied cannot also be used for the satisfaction of other needs. By the same token, no direct cost to the community is

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<sup>4</sup> For further discussion of this point see Richard A. Musgrave, "Fiscal Policy, Stability, and Full Employment," in *Public Finance and Full Employment*, Pamphlet No. 3 of this series.

involved where the resources used would otherwise have been unemployed.<sup>5</sup> The public works programs of the thirties largely fall into this group.

Where a high level of employment is maintained independently of the public programs, the question is one of choosing between the satisfaction of alternative needs. To repeat, there is no *a priori* reason for assuming that one or another use of resources should be more or less desirable, merely on the grounds that it is aimed at the satisfaction of public or private wants. If the people feel that the construction of a public hospital is to be preferred to an expansion of private plant, additional public expenditures "can be afforded;" if the plant is preferred, they cannot. As will be shown in the subsequent discussion, the United States not only can "afford" an expanded public works and service program, but is urgently in need of it.

This presentation of the issue, however, tends to overstate the cost impact of a public program on the economy. It makes no allowance for the fact that the public works and improvement programs themselves will contribute to a permanent increase in the economy's output and hence in the level of national income. Outlays for public services furthermore will be reflected in greater health and efficiency of the population, and increase its ability to produce and to earn larger incomes. Thus the competition for resources even over a short period of time will be reduced. An increase in the public debt will involve no additional burden if it results in a corresponding expansion of the national income. The charges can then be financed from the increased yield of the existing taxes. Debt financing of public works and service programs therefore is sounder in the long run than debt financing of current outlays which induce no permanent rise in income.

In many cases the original money cost of a public works and service program results in corresponding savings to the community, without increasing total outlays. Highway construction expenditures, for instance, reduce transportation costs to individuals and business. Flood control projects reduce the annual losses of life and property. Improved health of workers lowers labor costs at any given level of wage rates.

Finally, public works and service programs have direct repercussions on the public budget itself. Soil irrigation programs may greatly increase

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<sup>5</sup> This, of course, provides no excuse for inefficient program planning.

agriculture's productivity in certain regions and reduce the need for subsidies. A vigorous program of slum clearance will raise budget expenditures temporarily, but as a result other cost items, such as fire and police protection, health and hospital care, may be greatly reduced in the longer run.

The merits of public works and service programs and the magnitude of the projects which the community can afford, therefore, must be appraised not on the narrow basis of direct cash outlays or profitability, but in the broader framework of economic welfare and development. In cases where an immediate increase in national income and tax revenue cannot be expected, longer range programs may still be eminently desirable in the interest of economic and social development. Only the Government is in a position to take account of these longer range needs and does not have to be limited by the prospects of immediate monetary return. However, until the full results of the program become effective, existing taxation may have to be increased. The question therefore arises how this affects the income of the individual.

The increased tax payments of the individual will not necessarily affect his real income. If in return for additional taxes he receives from the Government goods and services which were not otherwise available, his real income will be roughly unchanged. If he is in a lower income group which is exempted from the additional tax payments, any benefits he enjoys from the public outlays will increase his real income. If he is in a higher income group where he pays more in additional taxes than he receives in direct benefits from the public expenditures, his real income will decrease; nevertheless, even in this case, he is likely to benefit from the increase in social stability and opportunity for private investment brought about by the public projects.

A more specific question of financing technique arises with regard to *self-liquidating projects*, that is, projects financed not out of general revenue but from fees paid by the users of the services. While fee finance is useful in some cases, it is clearly no criterion for the desirability of specific public works projects. The contribution which public works and services may render to economic welfare and development, as has been pointed out, cannot be judged on these grounds. For a large number of highly useful improvement projects, specific allocation of benefits is quite impossible and fee finance therefore not feasible. Even where financing on a self-liquidating basis is technically possible, its application may frequently be undesirable because it would interfere with the purpose of the project. Outlays for child welfare, for instance, might conceivably be financed on a

fee basis, but this would undermine their objective which is in part to provide free services to people not in a position to pay on a cost basis. In other cases some fee financing may be called for, but it may be undesirable to defray the entire cost in this manner.

The case for fee finance, on the whole, is stronger for State and local governments than it is at the Federal level. State and local governments are more limited in their taxing and borrowing capacity, and often can finance needed services only through the issue of bonds to which the project receipts are pledged as collateral. Parking lots or swimming pools are examples. The possibility of paying for such projects without having to increase tax loads furthermore gives an incentive to States and localities to provide the needed services.

#### AN INVENTORY OF NEEDS

The importance of a comprehensive program of public works and services to the economy and its role in achieving high levels of employment and rising standards of living will be brought out more fully by surveying briefly the more important areas where public action is urgently needed. The estimates given are rough approximations only and do not purport to be all-inclusive estimates of the total cost of a complete program. The purpose is to convey an idea of the order of magnitude of the need in important areas. All cost estimates are at 1940 prices. As is indicated in the table on page 84, they would be appreciably higher at 1945 prices.

**Transportation.** The urban and rural highway transportation system was greatly improved during the two decades before the war, but it is still far behind the requirements of modern traffic. Since all road work not directly connected with the defense and war effort has been suspended for several years, the war has added a heavy backlog of repair and maintenance work to prewar deficiencies.

In the rural sections, deficiencies consist primarily of too narrow roads, excessive curvature and grade, poor surfacing, and too many crossings at grade level. These shortcomings are reflected in high operating costs and wear and tear on vehicles, delays in transportation, and accidents resulting in a heavy annual toll of lives and property. A considerable part of the rural road mileage, including farm-to-market routes, needs to be improved for year-round service. A program to provide a satisfactory system of rural roads would improve the economic condition of many rural areas and provide farm families with better access to schools, hospitals, and

medical care. As has been indicated before, these social and economic gains must be considered in appraising the total cost of road improvement. More tangible and direct savings would also result. There would be a saving of about 2.5 billion dollars annually in operating costs, which are more than twice as high on earth roads as they are on paved roads.

In many respects the urban transportation system is in worse condition than the rural, for several reasons. Urban rights-of-way are often costly and difficult to obtain, and improvements are relatively more expensive on urban streets than on country roads. More extensive and coordinated planning is required for urban than for rural areas. Furthermore, until recently, the Federal-aid program has favored rural highways and roads.

The chief urban transportation problem is traffic congestion. In many big cities the time needed for traveling in certain sections has actually increased since the horse and buggy era. The transportation system has not kept pace with the development of our cities and the inclusion of suburban residential areas in the metropolitan system. One of the main problems is to facilitate the traffic flow between the central business district and the outlying areas during the daily peaks.

In improving urban transportation, account has to be taken of the fact that the heaviest traffic is to and from the center of cities. Express highways with limited access provide the best answer to this problem. They relieve city streets from through traffic and preserve the residential character of many neighborhoods. Separation of transit routes for public and private conveyances also adds to the speed and efficiency of the transportation system. Radial thoroughfares and circumferential highways feed traffic to express highways and distribute it between the residential and outlying areas. Used in conjunction with by-pass routes, they enable through traffic to avoid city streets. Several studies of the traffic situation and the needs for improvement were made during the war, both by private organizations and government agencies. The estimates presented here are based mainly on these studies.

The cost of merely correcting the accumulated deficiencies of our rural and urban transportation system has been estimated at between 25-30 billion dollars. Somewhat more than half of this amount would be spent for the improvement of the main State highway systems and other rural roads. Approximately 1.2 million miles of the latter would have to be improved for year-round traffic. Somewhat less than half of the 3.3 million miles of highways (including city and town streets) are still unsurfaced, and most of them should be surfaced over a reasonable period of time.

In addition to these outlays the National Interregional Highway Committee, appointed by President Roosevelt in 1941, recommended in 1944 the establishment of a limited system of approximately 34,000 miles of greatly improved interregional highways connecting the principal geographic regions of the country. The cost of this improvement (probably between 7 and 10 billion dollars) would be divided approximately equally between the urban and the rural sections of the system. In the Federal-Aid Highway Act of 1944 legal endorsement is given to this recommendation, and a national system of interstate highways is included in the Federal-aid highway system.

On an annual basis the average outlay for construction, replacement, and maintenance of city streets and thoroughfares and of rural highways and roads over the next 20 years is here estimated at 3 billion dollars. Expenditures in 1941 for the same purpose amounted to about 1.7 billion dollars. The American Road Builders' Association has recommended new highway construction in the amount of 3 billion dollars a year. This amount includes about 1 billion dollars each for State highway systems and metropolitan area highways, and about half a billion each for city streets and county and local roads.

Improvement of highways and streets is only part of the urban transportation problem. Better parking facilities for private vehicles and a consolidated terminal for different types of public transportation are urgently needed in most cities. The cost of both passenger and freight transportation is greatly increased by the time and effort consumed in movement between terminals. This in turn adds considerably to traffic congestion on city streets. Discharge of passengers and freight at a central terminal having facilities for efficient transfer from one line to another would be a major improvement in urban transportation systems.

Air routes and terminals are an important and expanding part of modern transportation. If air lines are to give maximum service to the public, their terminals must be located within easy access to supplementary rail, water, and highway transportation. Otherwise much of the time saved in rapid transit over long distances will be dissipated in making local connections.

**Urban Redevelopment.** Blighted areas and slums are the result of many factors, including the haphazard way in which our cities have grown. Other factors have been the rapid economic changes of recent decades, the great movement of population to industrial centers, and the consequent high density of population in many residential areas. Added to this is the

difficulty of devising and enforcing police and zoning regulations and housing and sanitation codes that will protect the health and morals of city families.

Comparatively recent investigations have revealed that slums and blighted areas are heavy economic liabilities to municipalities as well as social hazards and human wastes. One Middle Western city has found that the per capita cost of police protection is three times higher in its slum area than in the city as a whole, and that fire protection is seven times as costly. The social findings are also appalling. Juvenile delinquency is approximately three times as frequent in these areas as elsewhere, murder eight times as frequent, and deaths from tuberculosis five times as frequent.

A Southern city has found that the cost of supporting certain slum areas is over five times the tax revenue they yield. These decadent sections are of course a financial burden on the commercial and industrial districts and better residential areas. Furthermore, their existence is a threat to the economic health of neighboring commercial and residential districts and lowers the real estate values in the adjacent areas.

Two major difficulties have interfered with urban redevelopment on a large scale.<sup>6</sup> One is that the cost of acquiring and improving slum areas is very high in relation to the monetary returns to be expected from the investment. Land tends to be overvalued in slums because of the relatively high income that can be obtained by overcrowding poorly maintained and congested buildings. With redevelopment in accordance with decent standards, however, this source of profit disappears. Limitations imposed upon population density and the higher percentage of acreage devoted to public purposes, although of advantage to the community, result in lower revenues from the redeveloped property unless the area is no longer expected to house lower income families.

A second difficulty in the way of urban redevelopment has been the lack of suitable housing into which displaced slum dwellers could move. In the past the housing market has provided an ample supply of new dwellings for the upper income groups only. Thus, because of the pressure of demand for lower income dwellings, there has been overcrowding in buildings that have been occupied long beyond their useful life. According to the Housing Census of 1940, about one-third of all dwellings in urban areas were substandard and almost half were over 30 years old.<sup>7</sup>

<sup>6</sup> For an illustration of the factors involved in urban redevelopment, see pp. 88-89.

<sup>7</sup> For further discussion of the housing problem, see "Housing Needs and the Housing Market" by Ramsay Wood, pp. 1-39 of this pamphlet.

Private enterprise alone cannot be expected to clear away urban slums and blighted areas. The process involves temporary financial losses that will result in social and economic gains for the community, and the shouldering of these losses is a function of Government. The cost of a nationwide urban redevelopment program commensurate with existing needs has been tentatively put at 20–25 billion dollars at 1940 prices. This includes the cost of site acquisition and improvement, and of nonresidential facilities, but it does not include the cost of housing for the lower income groups which cannot afford to pay commercial rents at present levels.

A frequent estimate puts the need of our population for additional housing at a million and a quarter dwelling units a year for the next two decades. Over a third of the total demand is for houses costing less than \$30 a month, which is a lower figure than the private housing market can meet. Consequently there is need for public action to provide from 300,000 to 500,000 low-cost housing units a year. A housing program of this magnitude would require an annual outlay of about 1.5 billion dollars. By comparison, the number of publicly financed dwelling units constructed in 1940 was about 73,000.

**Agricultural Needs, Forests, and Recreation.**<sup>8</sup> Even before the war the long-range productivity of land, our most valuable natural resource, was badly impaired, and vigorous public measures to conserve and improve the soil were urgently needed. Erosion due to soil washing and blowing had damaged and impoverished over half our agricultural acreage. Lack of rainfall interfered with the development of some 40 per cent of the land, and only about 3 per cent of the acreage affected was being irrigated. For want of maintenance and improvement, the grazing capacity of range lands and the productivity of cultivated fields had been depleted. The war aggravated these difficulties by emphasizing the necessity of immediate large yields.

The National Resources Planning Board estimated in 1943 that approximately 40 million additional acres of cropland were needed by 1960 to provide the prewar diet for the expected increase in population. This estimate was based on the 311 million acres devoted to domestic food production shortly before the war, and on a yield per acre equal to the 1936–40 average. In view of the known deficiency of this diet for a considerable part of the population, the estimate appeared conservative.

The wartime expansion of acreage and especially the great increase in

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<sup>8</sup> For a full discussion of postwar agricultural problems, see Arthur C. Bunce, "Our Agricultural Policies," in *Agricultural Adjustment and Income*, the second pamphlet of this series.

yield per acre would seem to justify a downward revision of this estimate. Exceptional weather, mechanization, improved seed, and better feeding methods and farm practices have produced record crops. However, about 45 million acres at present devoted to crops should be retired eventually to grass or forest because of destructive erosion. Also, the National Resources Planning Board estimate should be raised by approximately 5 million acres to provide for an adequate diet for our population.

There is no doubt that the long-run economic use of our land requires the conversion of considerable marginal crop land to more suitable uses, and the improvement and reclamation of other land that can be worked effectively by modern methods. In view of this fact, a rough estimate of the cost of making necessary improvements and adjustments in our agricultural resources, based primarily on the study made by the National Resources Planning Board, is still relevant. The estimate of 13 billion dollars includes approximately 6 billion for soil erosion control, 3 billion for drainage and clearing projects, 3 billion for irrigation and 1 billion for the conservation and improvement of range land.

Our forest lands have also been impaired by uneconomic use. While a growing need for timber products is anticipated for building and the manufacture of plastics, paper, textile fibers, and other industrial products, the yield of our timberlands has long been decreasing. Too rapid and wasteful use of mature timber, together with large-scale neglect of reforestation, has left large areas of denuded forest lands. Not only are these tracts unproductive in themselves but through their effect on rainfall and erosion they threaten the productivity of large surrounding areas. The cost of a forest conservation program which would achieve balance between yields and requirements has been put at about 4.5 billion dollars. It would include planting, stand improvements, additional forest roads and trails, and control of fire, destructive insects, and water shed.

Forest areas within relatively easy reach from urban centers might well be developed as part of a recreational program which would also provide for greater public use of lake and sea shores. The social and economic value of recreation areas is well recognized, and the preservation of natural beauty and historic sites has long been considered a function of public authorities. From either the recreational or cultural point of view, much remains to be done. According to recent estimates approximately 5 billion dollars would be required to make the necessary additions to our State and national parks, scenic highways, and other rural recreation areas.<sup>9</sup>

<sup>9</sup> Based on preliminary and confidential estimates prepared by the Twentieth Century Fund in connection with its forthcoming study entitled *America's Needs and Resources*.

**Regional Resource Development.** The economic progress achieved in a decade by the Tennessee Valley Authority illustrates the possibilities of regional development.<sup>10</sup> Throughout the United States, many river valleys are in need of development, including those of such major arteries as the St. Lawrence, the Ohio, the Missouri, the Mississippi, the Columbia, and the Colorado. The major purpose of regional development is to raise the income and standard of living of people within the region. This result is achieved in many ways. Flood control reclaims fertile lands for agriculture by preventing periodic inundation of some areas and relieving drought in others. It helps farmers to increase yields even while they retire land of marginal productivity. In many instances it makes possible a better diversification of crops. At the same time it prevents the heavy loss of life and property which uncontrolled rivers too frequently exact.

The erection of dams and reservoirs for flood control offers the opportunity to develop power for rural electrification and industrial expansion. The possibilities of rural electrification can be seen from the fact that over a third of the rural dwellings in this country are still without electricity. The availability of power at reasonable rates combined with easier river navigability improves the competitive position of industries within river valleys and stimulates new industries that can process local raw materials to advantage. River development programs thus contribute to economic diversification within regions and greater economic equality between various regions.

While traditional public construction projects are part of a river valley development, they must be so coordinated and integrated that they will reconcile divergent needs within the region and serve the best interest of the area as a whole. Irrigation needs of upstream areas must be dovetailed with the need for flood control and improved water transportation of the lower regions. Dams and reservoirs must be so planned as to prevent floods and also to store and supply water for irrigation. Power plants at the site of these dams should be capable of serving the area as a whole and of expanding as needs increase.

Development of the economic potentialities of our river valleys is a long-range project, and programs must be adjusted continuously to growing needs and changing conditions. It is therefore hard to estimate

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<sup>10</sup> See, for instance, David E. Lilienthal, *TVA-Democracy on the March* (Harper & Brothers, 1944).

eventual costs. With these limitations, a recent estimate believed to be conservative puts the total at 25 billion dollars.<sup>11</sup>

**Public Health and Medical Care.** Since the turn of the century the death rate in the United States has been steadily declining—from 17.2 deaths per 1,000 persons in 1900 to 10.5 per 1,000 in 1941. The leading causes of death in 1900—influenza, pneumonia, and tuberculosis—have been cut down by more than two-thirds. Typhoid fever and diphtheria now account for a negligible fraction of deaths. Yet the Interdepartmental Committee to Coordinate Health and Welfare Activities reported in 1939 that with more adequate medical care the pneumonia death rate could be further reduced by more than 25 per cent and tuberculosis could be made a negligible hazard to life and health. The Committee also reported that a more aggressive application of present knowledge to cancer—the second leading cause of death in 1941—would save a considerable proportion of the patients.

The national health survey undertaken by the United States Public Health Service in 1935 revealed that over 23 million people in this country—nearly one-sixth of the population—had some chronic disease or physical impairment. The findings were further supported by experience under the Selective Service Act. According to Selective Service records about 40 per cent of the men who reported for physical examination, or between 8 and 9 million men, were physically unfit for general military duty, and well over half of this number were not acceptable for rehabilitation and had to be rejected entirely.

An additional fact brought out by the national health survey is the deficiency in medical care among the poor and low-income families. The death rate from tuberculosis was seven times higher among unskilled workers than it was among professional workers. The close relation between low income and inadequate health care results in a vicious circle which it is beyond the power of the individual to break. In 1942 the average amount spent for medical care by families with incomes under \$2,000 was less than half of that spent by families with incomes over \$3,000, but it was almost twice as large a proportion of the family income. In 1935 wage earners in families with incomes under \$1,000 suffered about twice as many days of disabling illness as did workers in families with incomes over \$3,000.

Another striking fact is the wide disparity in the health record of

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<sup>11</sup> For source, see footnote 9 on p. 78.

various parts of the country. According to Census figures for 1941, for instance, the maternal death rate is about twice as high in the South as it is in the North, and is considerably lower in urban than in rural communities. In 1941 the infant mortality rate was 97.5 per 1,000 in one State and 29.7 in another, while it was about 45 for the United States as a whole. It is clear that all parts of the country have not benefited equally from the medical progress which reduced the infant mortality rate from 100 to 45 within 25 years.

The distribution of public health and medical care facilities is very uneven. In 1935, little more than a fifth of the counties had full-time public health agencies and two-fifths of the counties, having a combined population of 15 million, had no registered hospital. Since the proximity of a hospital strongly influences the location of physicians, areas far from hospitals are usually also greatly deficient in physicians. Counties with hospitals are known to have two and one-half times as many physicians as have counties without hospitals.

Two hospital beds per annual tuberculosis death and 4.5 general hospital beds per 1,000 of population are considered reasonable minimum standards. Yet before the war the number of beds per tuberculosis death was less than one in 27 States and as high as two or more in only 8 States. Ten States had less than two general hospital beds per 1,000 of population. Furthermore, lack of funds on the part of patients or potential patients interfered with the optimum utilization of existing facilities in many areas where hospitals were inadequate in terms of minimum standards.

A public program of health improvement involves several important steps. Effective public health service can be provided by establishing district health centers to serve each 50,000 of the population. The important functions would be the control and possible eradication of contagious diseases, and the development of more effective programs for mental and industrial hygiene. Hospital facilities for about 500,000 additional beds are needed to assure adequate hospital care and to replace obsolete facilities. This number pertains to both general hospitals and tuberculosis and mental hospitals. Special programs of maternal and child care are needed to reduce the incidence of infant mortality. According to the Interdepartmental Committee the lives of more than 70,000 mothers and children could thereby be saved annually. Until a nation-wide health insurance system is established, more public funds are needed to provide adequate medical care. These programs have to be supplemented by

continuous and expanded research in health and medical science and the training of medical personnel. Since defective diets are one of the main causes of ill health, for some time a nutritional program may have to supplement the health program.

Another important but preventable health hazard is the pollution of our rivers. It also threatens the destruction of aquatic life, and makes many streams unsafe for recreational purposes. Municipal sewage and industrial and mining wastes are known to be the major sources of contamination, and yet approximately 10,000 communities have deficient sewage systems or none at all. About 20 million people are consequently exposed to a special and preventable health hazard. Equally great is the need for new and improved systems to furnish safe water. Over 10,000 communities need new water supply systems or extensions and improvements of existing systems. In addition, 5 million of our rural homes lack sanitary privies and an equal number lack proper water supplies.

On an annual basis, needed public expenditures for health and medical care are estimated at 2.5 billion dollars. They include capital outlays and current expenditures for increased public health services and maternal and child care, as well as expenditures for hospital construction and replacement, more adequate medical care for the lower income groups, and adequate sanitation facilities. Comparable expenditures in 1941 amounted to slightly less than one billion.

**Education.** During the last 50 years educational opportunities and standards have been greatly improved in this country. Eighty-five per cent of the population between the ages of 5 and 14 attended school in 1940 as compared to 64 per cent in 1890. Nevertheless, the 1940 Census revealed that 2 million children between the ages of 6 and 15 had never been in school. At the same time there were 3 million adults who had never been to school and almost 11 million who had not gone beyond the fourth grade. Serious educational deficiencies are also revealed by Selective Service records. Up to December 1944, the combination of illiteracy and failure to meet minimum intelligence standards caused the rejection of 620,000 registrants. In addition there were 150,000 illiterates whom the Army accepted between 1943 and 1944 and gave instruction in reading and writing before assignment to regular duty.

Deficiencies in our provision for education are also reflected in low salaries for teachers and inadequate school plant and equipment. In 1942 the average annual salary of teachers, principals, and supervisors of public schools was about \$1,500 and of rural teachers only about \$900.

Several thousand teachers were receiving less than \$300 a year. Of the 240,000 elementary and secondary school buildings in 1940 almost half were one-teacher schools, and the same proportion of the total were substandard and poorly located. About 5 per cent, which accommodated 1.4 million children, were unsafe for use. One million children attended school in temporary structures and 600,000 children attended school only part time because of a shortage of school buildings.

In general, children in urban areas and in the wealthier States have the best chance of obtaining adequate schooling. Although the lower income States spend on the average a much higher proportion of the income received by the people for educational purposes than do the more prosperous States, they are unable to finance the necessary educational improvements. In 1941-42 the annual expenditure per pupil in one State was more than five times as high as in another, yet outlays of the latter State in relation to its income were one-third higher than in the former. This is in part due to the fact that the birth rate is much higher in rural areas and in some of the poorer States. The attendance rate of children of school age is furthermore much higher in urban areas and in the wealthier States. A higher attendance rate in the poorer States would further increase the cost of education to them.

Achieving adequate minimum standards of education involves the relief of overcrowded buildings, replacement of outworn buildings, and the consolidation of small schools. It means increasing the school equipment per pupil, lengthening the school term in many areas, and raising the salaries of teachers. In many areas the teaching staff is heavily overburdened; to equalize their pupil load would mean an increase of at least 50 per cent in teaching staff.

To attain a desirable minimum level of education of 10 years of schooling for each child, the enrollment in elementary and secondary schools in 1950 will have to be about 20 per cent greater than it was in 1940. An adequate outlay for plant and equipment would mean an annual capital expenditure of \$400 per pupil. Total annual public outlays needed for education have consequently been estimated at 5.5 billion dollars in the postwar period, including approximately 200 million dollars for public libraries. This compares with an expenditure of less than 3 billion dollars in 1940.

**Recapitulation in Terms of Annual Outlays.** The preceding inventory was intended to give a general idea of the kind and volume of public works and services needed to achieve goals generally recognized as desirable and

attainable. In the table below the various items are estimated on an annual basis. This facilitates comparison with similar outlays in past years and also with other budget items.

AN ANNUAL PROGRAM OF NEEDED PUBLIC WORKS AND SERVICES  
(In billions of dollars)

Type of outlay	At 1940 prices	At 1945 prices
Transportation (highways and streets) . . . . .	13.0	4.0
Airports, waterways, and ports . . . . .	0.3	0.4
Housing and urban redevelopment . . . . .	2.0	2.5
Conservation, reclamation, recreation, and regional resource development . . . . .	1.5	1.8
Public health and medical care . . . . .	2.5	3.0
Nutrition . . . . .	1.0	1.3
Education . . . . .	5.5	6.8
Public buildings . . . . .	0.2	0.2
Total . . . . .	16.0	20.0

<sup>1</sup> Includes maintenance.

<sup>2</sup> Includes site acquisition.

<sup>3</sup> Owing to rounding, the increase is not shown.

Both current needs and accumulated deficiencies are included in the estimates, with the assumption that the deficiencies will be met within approximately 20 years. Some arbitrariness is unavoidable in deciding on any particular span of years and trying to reconcile the urgency of the need with the magnitude of the program. To take care of accumulated deficiencies and develop projects fully is likely to require different amounts of time for various component parts of the program. The expenditure estimates should therefore be interpreted as averages of the annual outlays during the next two decades. It seems likely that the outlays will be unevenly distributed throughout the years because of the initial delays in planning and getting programs under way and because parts of the program must be held in abeyance until other parts have been completed. The figures are based on present estimates of needs and make no allowance for additional needs which may develop during the 20-year period. Slightly less than half of the total, or about 7.5 billion dollars at 1940 prices, are outlays for new construction and replacement, while the remainder represents service programs and the acquisition of necessary sites and rights-of-way.

It is difficult to evaluate these outlays on the basis of relative urgency. They are all intended to satisfy basic needs and, so far as possible, they

should be initiated without delay and carried out simultaneously. From the point of view of government economy this would be particularly desirable in the case of related needs, since it probably would reduce total costs.

Actually, at the present time the preparation and planning is in a more advanced stage for some projects than others and their execution is likely to be pushed. Also, the inauguration of some programs may be delayed by the necessity of recasting financial arrangements. Unfortunately, it is exactly in those areas in which the need is most urgent from a welfare point of view that the greatest obstacles will have to be overcome. Plans and preparations for enlarged health and educational programs, for instance, are lagging far behind those for highway or airport programs. In the immediate future, therefore, the state of present preparations will largely determine the speed with which various parts of the program can be carried out. While these projects are getting under way, however, it will be important to concentrate on the preparation and planning of those public works and services which are relatively new or which require a considerable additional outlay as compared to the prewar period.

In appraising the contribution of the program to cyclical stability, short-run and long-run considerations must be distinguished. For the near future, the most important feature will be gradual growth with the increase centering mainly on construction projects, partly because they are the ones whose plans are in a relatively more advanced stage and because they are, in part, prerequisites to more extensive service programs. Once the foundations for the latter and for development and improvement programs have been laid, a larger part of the program could be made responsive to changing economic conditions.

#### PREREQUISITES OF AN EFFECTIVE PROGRAM

The effectiveness with which a public works and service program will meet the needs of the people and of the economy in the postwar period will depend to a considerable extent upon the care with which the program as a whole is prepared and carried out and the extent to which its various parts can be coordinated. Close cooperation between the various government levels will further contribute to smooth execution.

No rule-of-thumb methods can be expected to insure the success of all types of public projects. In order to be most useful, each project must be adjusted to the special needs of the region and population it is to serve, and to the inevitable changes in requirements that are introduced by

economic, social, and in some instances physical developments. All this must be accomplished within the limits set by financial arrangements, multiple jurisdictional participation and control, and available professional knowledge and skill. A few indispensable prerequisites are common to all successful public programs, however, and meticulous care in meeting them will smooth the way to effective and economical execution of individual projects.

**Advance Planning.** A considerable amount of time necessarily elapses between the time a project is decided upon and its actual execution. Even after the necessary funds have become available, the project has to pass through several stages of planning and blueprinting before contracts can be let. Even then, some time may elapse before the project is well under way and exerts its full impact on employment. One important function of all planning is, therefore, the elimination of delay in making a thorough appraisal of the needs to be met and the best means of meeting them. This will include investigation of ways to avoid possible legal and financial obstructions and other impediments to prompt action when the blueprints have been completed.

In a broad national program, advance planning will include coordination and integration of related projects as well as determination of the proper sequence in which to undertake complementary parts of single projects. It will also include decisions concerning the relative urgency of many different projects and the possibility of dovetailing the program as a whole with other economic activity. These decisions are indispensable, not only to efficiency in providing necessary public works and services but also to the usefulness of the program in strengthening other efforts to maintain a high level of production and employment.

**Adjustability to Changing Needs.** Estimates of future requirements as well as knowledge of past deficiencies should serve as the basis of blueprints, and even then the way must be left open to change during execution of the project. It may be necessary to prepare several alternative or successive blueprints before the work is completed. Considerable flexibility in planning is particularly important in the case of State and local projects, since the public works and services they provide must be closely geared to private residential construction and the location of industrial activity.

**Functional Balance.** Judicious appraisal of the relative importance of physical plant and operating personnel to the functioning of the completed

project is the third prerequisite of effective planning. In the field of education, for instance, the construction of schools would be of little advantage to pupils unless good teachers and equipment were made available. Similarly, hospitals and clinics can contribute little to the health of the nation unless they are competently staffed. Past emphasis on public construction enhances the danger that the growing importance of public services will not be fully reflected in public projects.

**Effective Intergovernmental Relations.** Recent emphasis on public works and services as an instrument of national policy has somewhat obscured the fact that the greater part of most programs will be carried out by State and local governments. The resulting wide dispersion of responsibility and points of view is a challenge to ingenuity and diplomacy. A regional development project, for instance, enters the jurisdiction of many local political units, and urban redevelopment may affect a metropolitan area which includes several municipalities and lies within more than one county and State. The problem is to devise a harmonious working arrangement that will reinforce the strengths of all units and overcome their weaknesses.

Local governments are intimately acquainted with the special requirements and resources of their communities and are thus better qualified than is the Federal Government to execute programs within their jurisdictions. They seldom have the legal powers and financial resources to undertake advance planning, however, and they are in no position to carry out the intensive research required to formulate satisfactory standards. Moreover, local governments are not in a position to coordinate and synchronize all parts of a regional or national program or to adjust them to general economic conditions.

With regard to all these aspects, the Federal Government can make an important contribution to the execution and ultimate usefulness of the project as well as to the economic health of the nation. Surveys of need on a national level, establishment of minimum standards, expansion of research, and collection of pertinent data provide helpful information and guidance for State and local governments in the preparation of their own plans. The need for nation-wide minimum standards in health and educational services requires Federal participation in their financing. Federal grants for advance planning can overcome local difficulties as well as contribute toward cyclical timing of public works on a nation-wide scale. The effectiveness of this aspect could be increased if congressional

authorizations of national public works and services allowed for greater flexibility in the initiation and timing of projects and in the use of the funds made available.

The possibilities of intergovernmental cooperation in the execution of a public works program are illustrated by a recent proposal made by the Canadian Government to the Provinces.<sup>12</sup> It is part of a comprehensive proposal to adjust the financial relations between the Dominion and the Provinces to peacetime conditions. Its purpose is to influence the timing of local projects so that they will supplement other efforts to achieve economic stability. The Dominion Government proposes to grant financial assistance to the Provinces for the planning and execution of useful but postponable public projects, provided that the projects have been fully planned prior to the time of execution and that they are executed in a period designated by the Dominion Government.

**An Illustration—Urban Redevelopment.** Most of the important general considerations in planning and executing a program of public works and services are illustrated by urban redevelopment. It requires coordination of many related needs, integration of several individual projects into a master plan, and attention to relative timing. It involves the cooperation of various government units at the same and at different levels, and depends to a considerable extent upon Federal financial participation. Both the Government and private enterprise are participants in its execution, and the benefits accrue not only to the community at large, but also to commercial, industrial, and real estate interests.

The first step in a program of urban redevelopment is a survey of existing conditions and preparation of a master plan which takes account of present needs and foreseeable developments. Residential sections and commercial and industrial districts are clearly separated and provision is made for adequate community facilities. Housing projects to supply standard dwellings for low-income groups are laid out so as to prevent the recurrence of overcrowded and insanitary conditions. Plans are made to improve the transportation system by eliminating bottlenecks, reducing hazards, and assuring rapid transit between different districts.

Execution of the master plan involves careful timing and dovetailing of many projects. The improvement of the transportation system will involve the enlargement and relocation of certain arteries. This cannot be done without tearing down some buildings and demolition cannot begin before provision is made for rehousing the displaced occupants.

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<sup>12</sup> *Proposals of the Government of Canada, Dominion-Provincial Conference on Reconstruction, August 1945.*

This may involve the construction of low-cost housing units to avoid overcrowding of existing facilities and to offer suitable living quarters at prices which the former slum dwellers can afford.

Although the city has to be considered as one redevelopment unit, several local jurisdictions are often involved. The preparation of the master plan therefore involves agreement among the participating units and reconciliation of divergent interests. This becomes particularly important in deciding on financial arrangements. Large expenditures of public funds are involved in the initial acquisition of land. A considerable part of these outlays may be recouped later in selling or leasing the land to private builders. However, a net loss may be unavoidable because in the process densities will have to be reduced, existing inflated land values will have to be written down, and a larger proportion of the area will be converted to streets, parks, and other public purposes. Provision will also have to be made for the financing of low-income housing. In most cases the local community alone will not be able to shoulder the losses involved and make the necessary financial arrangements. The Federal Government will have to participate through low-interest loans, loan guarantees, and annual subsidies. Until the exact form of participation by the Federal Government has been decided through appropriate legislation, action on urban redevelopment is likely to be delayed.

#### PROSPECTS FOR EXPANSION

The right of every family to a decent home and the right of every individual to adequate medical care and a good education were among the principles of the Economic Bill of Rights enunciated by President Roosevelt in his message to Congress on January 11, 1944. They were emphasized by President Truman in his message of September 6, 1945, in which he also asked for early action to check the depletion of our natural resources by reclaiming and rebuilding land, harnessing our waters, and initiating regional development programs. President Truman suggested that an agency be set up to make an inventory of our national wealth and basic resources and to formulate a consistent public works and development program. Later, he recommended early congressional approval of the Agreement of 1941 between the United States and Canada for the development of the St. Lawrence Basin. A further recommendation for congressional action was contained in President Truman's message outlining a comprehensive national health program.

Establishment of separate authorities to deal with the comprehensive

development of the economic resources of our river valleys has been an accepted goal of national policy ever since the launching of the TVA experiment. By September 1944, President Roosevelt had recommended to Congress the creation of additional authorities for the Arkansas, Columbia, and Missouri Rivers.

**Congressional Reports.** A report of the Subcommittee on Wartime Health and Education of the Senate last year discussed the urgent need for medical care of our population and recommended Federal grants-in-aid to the States to assist them in postwar construction of hospitals, medical centers, and health centers. It also recommended Federal scholarships or loans for medical and dental education to overcome the acute shortages of doctors and personnel with training in psychology and psychiatry.

On August 1, 1945, the Special Committee on Postwar Economic Policy and Planning of the Senate issued a report on postwar housing in which it accepted the principle that "the Federal Government has an interest in seeing that minimum standards of housing, food, and health service are available for all members of the community." In recommending a program of urban redevelopment and public housing construction, the Committee recognized the need for Federal participation, but stressed the importance of assigning to the Federal Government a role "subordinate and supplementary" to the part played by the States, localities, and private institutions.

In a recent report the Special Committee on Postwar Economic Policy and Planning of the House of Representatives considered the role of postwar public works in maintaining a high level of construction activity. It stressed the need for advance planning of a reserve shelf of useful public works, and of timing the execution of both Federal and non-Federal projects. It recommended the establishment of a Construction Policy Board to guide the public works program and work closely with the construction industry as a whole. For the longer run, the Committee recommended Federal advances to State and local governments to encourage their planning of a shelf of public works sufficiently large to have at any time a 5 billion dollar backlog of construction projects.

**Federal Legislation.** Congressional action does not as yet measure up to the needs of the situation and their reflection in official recommendations. The only important laws enacted in the field of postwar public works and services are the Federal-Aid Highway Act of 1944, the Flood Control Act of December 1944, and the Rivers and Harbors Act of

March 1945. To these has been recently added the Federal Airport Act passed by the Congress in April 1946.<sup>13</sup>

The Highway Act provides for a three-year highway construction program of 3 billion dollars to be financed through equal contributions by the Federal Government and the States. The Federal grant is to be allocated between the Federal-aid highway system, principal secondary and feeder roads, and highways in urban areas. The Flood Control Act authorizes public works projects amounting to one billion dollars and the Rivers and Harbors Act authorizes an additional 500 million dollars. The Airport Act provides for Federal aid to States and localities for the development, construction, improvement, and repair of public airports. The Act authorizes the expenditure of 500 million dollars over a period of seven years, beginning July 1, 1946, as grants for the construction of airports in conformity with a national airport plan. In most cases the Federal grants are to be matched by States and localities on a 50-50 basis.

Only a small proportion of the contemplated projects is ready to be initiated promptly, however, and many of them will take years to complete. It is expected that not more than 25 per cent of the highway program provided for the first year can be carried out. In a recent statement before Congress, the Federal Works Administrator testified that Federal public works construction is unlikely to amount to more than 500 million dollars during the current year.<sup>14</sup> Federal expenditures on general public works based on existing legislation are estimated in the latest budget at 585 million dollars for fiscal 1946 and 860 million dollars for fiscal 1947. This amount includes outlays for highways and airports, river and harbor work, flood control and reclamation, but does not include expenditures for the construction of veterans' hospitals and housing. Almost one-third of the outlay for fiscal 1947 is for the Federal-aid highway program.

Important legislation for a broad public works and service program is now pending in Congress. In December 1945, the Senate passed a Hospital Survey and Construction Act providing 75 million dollars annually for the next five years to assist States in the construction of public and non-profit hospitals. In April 1946, the Senate passed the comprehensive General Housing Act of 1946 which contains provisions for Federal aid to urban redevelopment, low-cost public housing, and farm housing. A bill authorizing the establishment of a Missouri Valley Authority is before the Committee on Agriculture and Forestry of the Senate after

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<sup>13</sup> This paper does not cover events later than May 1, 1946.

<sup>14</sup> *Full Employment Act of 1945: Hearings before a Subcommittee of the Senate Committee on Banking and Currency on S. 380* (79 Cong. 1 sess.), p. 866.

having been reported adversely by the Senate Committees on Commerce and on Irrigation and Reclamation. Other bills dealing with Federal grants for health services and medical education, the construction of educational facilities, the control of water pollution, the provision of recreational facilities, and with the stabilization of construction are pending before various committees of the Senate and the House. Should these bills be passed in the near future, it would still take considerable time for the programs to become effective.

**State and Local Preparations.** State and local governments likewise have no extensive completed plans for public works and services. Two surveys recently undertaken by the Federal Works Agency give a good picture of the present status of State and local planning of public works.<sup>15</sup> Both surveys indicate that the public works for which plans are completed, without Federal assistance, amount to less than one billion dollars. This figure excludes Federal-aid highway and State highway programs. About 80 per cent of this amount is the estimated cost of construction, the remainder being divided between the cost of land acquisition and rights-of-way, equipment, and other cost. Less than half of the programs in the completed stage could be constructed within one year.

The estimated cost of State and local public works in the design stage more than doubled between July 1944 and January 1946, and amounts to 4.4 billion dollars. Many of these plans, however, have not progressed far and cannot be completed without Federal aid. Sewer, water, and sanitation projects comprise more than one-fourth of the plans in the completed and design stage. Next in importance are schools and other educational facilities. Over 10 per cent of the plans are for highways, roads, and streets.

Considerable inequality exists with regard to the geographical distribution of such projects as have been prepared. Two-thirds of the completed plans are concentrated in four States: New York, California, Pennsylvania, and Ohio. New York State alone accounts for nearly half of all completed planning in terms of estimated construction costs. The same four States, together with Illinois, account for two-thirds of the plans in the design stage.

Similar inequality exists in the distribution of plans among cities of

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<sup>15</sup> The first survey was made in collaboration with the Bureau of the Census on the request of the Special Committee on Postwar Economic Policy and Planning of the House of Representatives, and includes projects planned up to July 1, 1944. The second survey includes plans up to Jan. 1, 1946.

various sizes and between rural and urban areas. Almost 50 per cent of the completed plans are for cities having populations of over 500,000. Of these, New York, Philadelphia, San Francisco, Los Angeles, and Detroit account for over 45 per cent of the total.

Even among the larger population centers, however, 12 cities of over 100,000 and 20 cities between 50,000 and 100,000 reported having no plans in either the completed or the design stage. Plans are lagging even more among the smaller government units. Over one-third of all the counties reported no plans in either the completed or the design stage, and the same situation prevailed among two-thirds of the reporting cities and towns with populations of less than 10,000.

Less than half of the funds needed by the States and localities to carry out the completed plans are available at the present time or obtainable through authorized bond issues and anticipated tax revenues. For most of the remainder, reliance is placed on Federal subsidies. While the financial position of States and localities improved during the war, the main result has been a reduction of their indebtedness. Their financial problems are by no means solved. Many non-Federal government units are still unable to finance needed public works programs and are furthermore hampered by legal restrictions forbidding the accumulation of surplus funds or the appropriation of money in advance of construction. Many are waiting for the establishment of a clear Federal policy on public works before embarking upon their own programs.

Title V of the War Mobilization and Reconversion Act of 1944 authorized the Federal Works Administrator to make loans and advances to the States and their political subdivisions for the purpose of planning the construction of public works. Congress thus far has appropriated 30 million dollars for this purpose. At least 150 million dollars would be required to build up and maintain a 5 billion dollar reserve of planned public works construction projects on the non-Federal level. By December 31, 1945, the Federal Works Agency had approved applications for advances amounting to slightly over 13 million dollars. These plans represent public works with an estimated total cost of 565 million dollars. This amount is in addition to the estimate of public works planned without Federal assistance.

In his recent testimony, the Federal Works Administrator stated that execution of completed plans by Federal, State, and local governments would result in a public works program amounting to not more than 2.5 billion dollars in the first postwar year. This is only half of the annual

amount allocated to public construction by most programs for full employment in the post-transition years. If the prewar relation between construction and national income prevails in the postwar economy, full employment will mean that construction work, excluding maintenance, will total about 15 billion dollars annually. One-third of this volume, or 5 billion dollars, would be devoted to public works, in line with past relations. In planning a flexible program of public construction, however, this figure should be considered the lower level of annual activity. Whenever private activity slackens, a larger volume of public works would be needed to offset the decline in private construction. Advance planning for a larger shelf of public works is essential to the prompt introduction of such projects as can be timed to offset declines in private construction. This point was again brought out in the latest Budget Message of the President, transmitting the budget for fiscal 1947.

#### CONCLUSION

Public works, public services, and development projects are important to the economy because of their immediate usefulness. They are not primarily an instrument of fiscal policy and are no substitute for other government economic policies for full employment. However, a comprehensive program is likely to make an important contribution toward economic stability and social progress.

A review of present plans for public works and services indicates that, although a beginning has been made, preparations on a much broader scale are urgently necessary to meet the deficiencies existing at the present time. Such a program is fully compatible with, and indeed very important to, the maintenance of the private enterprise system.