



# House Building, the Business Cycle, and State Intervention: II<sup>1</sup>

by

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## THE EFFECTS OF HOUSING SUBSIDIES ON THE BUSINESS CYCLE

The British and German examples since the war show an elimination of the independence of house building with regard to the general business cycle. House building before the war was anticyclical. After the war, and so long as it was subject to the influence of State assistance, it was cyclical. This change in the position of house building in the business cycle is obviously connected with the granting of public funds. Both in Germany and in Great Britain (here, indeed, only up to 1927) the State subsidies for house building were greatest precisely in the period of the general prosperity, while they were rapidly reduced after the turning point of the cycle (in Great Britain, somewhat before). That this was so is to be ascribed primarily to the fact that the social problem of remedying the housing shortage was not seen in its relation to economic policy. The connection between the two was largely unrecognised.<sup>2</sup> Further, State assistance meant that house

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<sup>1</sup> For the first part of this article, cf. *International Labour Review*, Vol. XXXIII, No. 3, March 1936, pp. 337-355.

<sup>2</sup> It is indeed astonishing how little attention the extensive post-war literature on housing pays to the rôle—not unknown in the theory of the business cycle—of house building in that cycle. In addition to the work of K. PRIBRAM, already mentioned, the following may be indicated: E. WAGEMANN, in the collective work “*Deutsche Siedlungsprobleme*”, publication of the *Forschungsstelle für Siedlung und Wohnungswesen* of the University of Münster (Westphalia), 1929, pp. 265-278. Wagemann, however, makes only a brief reference to the problem. A detailed investigation of pre-war movements in Germany, not only of house building but of building as a whole, appears in the frequently cited Supplement, No. 17, of the *Institut für Konjunkturforschung*, Berlin. The English publications certainly deal extensively with the antagonism between Government and private enterprise in housing, but not in relation to the cyclical effects. Only H. BARNES, *op. cit.*,

building became highly dependent on the budget situation in the countries concerned. And since Governments have not used their financial policy to smooth the business cycle, budget movements have hitherto always been cyclical, that is to say, they have followed, with a slight time lag, the general course of the cycle. There is a similar problem here to that of financing schemes for providing employment out of public funds. The flow of money from this source tends to be smaller in periods of depression, just when the provision of employment is most necessary and this is why every measure for providing employment that is financed solely out of the normal budget has so far proved more or less ineffectual.

The dependence of house building on the State budget on the whole intensified the fluctuations of the business cycle, instead of moderating them. Building thus came to follow the same cyclical rhythm as economic activity in general. In the case of Germany, for example, it is arguable that it would have been better to have refrained from subsidising building in the years when the general level of such activity was high, from 1926 to 1929, and to have had recourse to public funds only from 1930 onwards, after the turning point of the cycle. Such a housing policy, determined by the course of business, if properly financed might have checked the slump, and made it unnecessary later to provide employment on so large a scale in other fields than house building. Instead of this, the sudden withdrawal of the subsidies which until then had been pouring into house building probably intensified the slump. In Great Britain it is true that housing subsidies were reduced already in 1927; but this was repeated in 1929, at a time when the reverse policy would have been more expedient from the point of view of cyclical equilibrium. The maintenance of the housing subsidies, say at the level of 1928-29, might have helped to moderate the slump of 1930-32. It would in no way have crippled the development of private house building, since this, as has been seen, depends primarily upon the rate of interest, besides which, especially in Great Britain, the building that is financed out of public funds serves quite other aims than the building undertaken by private

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makes a general statement concerning the opposite directions taken by building activity and economic prosperity as a whole, which, incidentally, he applies to the whole of the nineteenth century. For the American literature, see the first part of this article: footnote <sup>2</sup> p. 354.

enterprise. For example, energetic Government action to clear the slums need in no way have hampered private enterprise in the domain of ordinary house building. In the meantime the view has come to prevail in Great Britain that more must be done than hitherto for slum clearance (cf. the new Housing Act passed in August 1935), and increased efforts are to be expected in this direction. It is worthy of remark that this intensification of Government action has once more set in at a time when the building market is in any case in full swing and business activity has reached a high level.

Both in Great Britain and in Germany, as has been shown, subsidies were granted in a period of high general business activity, that is to say, of high interest rates, high prices, and high wages. They in turn forced the interest level higher still. The subsidies and loans granted free of interest or at low rates placed builders, whether public bodies, public utility organisations or private contractors, in a position to pay rates of interest higher by that much on the rest of the capital required.<sup>1</sup> The demand for mortgage credit was thus artificially made effective; it reinforced the demand for capital of other branches of industry in times of rising prosperity and boom; and since the subsidies enabled it to reckon with less narrow margins than the other users of capital, its competition was hard for them to meet. The natural consequence was a rise in the interest level on the whole capital market. Moreover, private capital was in this way attracted into building, although at such a stage of the business cycle more productive forms of investment were available. The supply of capital for the rest of industry suffered, with the result that one of the many factors which usually determine the turning point of the cycle was brought into being or strengthened.

Further, this concentration of building activity often meant a loss, after that turning point had been passed, of the stimulus which provides a way out of the depression, for the demand for housing had already been met to a certain extent during the preceding period of prosperity. Many States therefore had recourse during the depression to other means of over-

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<sup>1</sup> In Germany, for example, from 10 to 12 per cent. was sometimes paid for first mortgages, whereas usually only from 1 to 2 per cent., including amortisation, was due for the so-called rent-tax mortgages, which ranked second or third. The resulting average of interest charges could thus be substantially higher than before the war, thereby stultifying the cheap State loans in their aim of keeping average interest charges down to what could be borne.

coming the crisis. It is remarkable how small a part house building has played in the manifold measures for providing employment which have been resorted to in the last few years. Yet, from the point of view of productivity, it does not fall behind numerous other schemes for providing employment, such as road and bridge building, river regulation, and land improvement. Its labour costs are high. Moreover the very important condition that the goods produced by the scheme shall not circulate, because they would otherwise ruin the market and so "create" a demand for new schemes, is fulfilled by house building, provided the State assistance is confined to dwellings for the poorest classes, in other words to tackling a problem which, according to all experience up to now, cannot be solved in any other way. Further, house building has the advantage over many other schemes for the provision of employment that the State subsidies usually form only a small part of the total capital employed, whereas in the case of other public works the whole amount must be found by the State.

#### STATE ASSISTANCE IN RELATION TO ECONOMIC POLICY

A German investigator of the theory of the business cycle<sup>1</sup>, who briefly touches on the subject of this study, has pointed to the almost grotesque circumstance that unregulated private enterprise apparently works more rationally than public authority in this matter. Without any desire to discuss the fundamental questions raised by this antithesis, the following observations should be made. Past experience, to judge from the available material, does not warrant the conclusion that State intervention in house building—whatever other effects it may have—must necessarily alter the place of housing in the business cycle and thus intensify cyclical fluctuations. On the other hand it affords certain indications as to what conditions must be satisfied by State intervention if it is to avoid the disturbances which have been described. Among these is the condition that it should be guided by the general policy adopted with regard to the business cycle and should take into account the special course followed by house building in relation to the cycle. Subsidies and other measures of assistance should therefore be initiated more particularly in periods of depression,

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<sup>1</sup> E. WAGEMANN, *loc. cit.*, p. 273.

when interest rates and building costs are low. In its financial policy the State must aim in this matter too at smoothing cyclical disturbances. In a word, both the timing of State action and the methods of financing raise all the problems that are already familiar in connection with the provision of employment.<sup>1</sup>

Many authorities have been content since the war with launching long-period housing programmes, without considering the question of the best date for carrying them out from the point of view of influencing the business cycle. It was only too obvious that both Governments and parliaments should in times of prosperity, with rising revenue receipts, be more inclined to provide State funds for housing, and it was equally natural to withdraw such funds from housing after the peak of the cycle had been passed. Yet exactly the opposite procedure is expedient from the point of view of influencing the business cycle. The desire that the State should subsidise house building is also frequently asserted when private initiative begins to fall off in the second stage of recovery. This is often due to the impression that if house building were to shrink at this stage, business in general must decline, and that therefore it would be advisable to maintain its volume by means of State assistance.<sup>2</sup> The idea of "stabilising" business also plays a part here. These arguments cannot be accepted as they stand. In times of prosperity house building is generally replaced by commercial and public building, so that its shrinkage does not necessarily involve a diminution of the total volume of building. Moreover, State assistance during such a period, as has been shown, usually only intensifies the cyclical fluctuations, without being able to prevent the change-over to depression, the causes of which are much more complex. Immediately after the war, when the housing shortage was most pressing, it was anyhow intelligible that all cyclical considerations should be outweighed by the desire to increase the supply of houses. Up to a certain point it was justifiable to build "many dwellings at high rents rather than few dwellings at low rents", as Pribram (*loc. cit.*) expresses it, regardless of the connection with the general movement of prices and interest rates. To-day, on the other hand, the

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<sup>1</sup> Cf. INTERNATIONAL LABOUR OFFICE: *Public Works Policy*; Studies and Reports, Series C, No. 19; Geneva, 1935.

<sup>2</sup> Cf., for the present situation in England, "The Housing Boom", in *The Economist*, 26 Oct. and 2 Nov. 1935.

State housing problem is no longer a general one of quantity, of securing the greatest possible increase in housing accommodation, but a limited one of quality : how to provide adequately for the poorest classes. The solution of this problem calls in any case for the long view, and not only permits of making full allowance for cyclical factors, but must be unsatisfactory without it. By concentrating house building in periods of rising prosperity and boom the subsidies have led to a heavy increase in costs. In consequence the new buildings have only to a comparatively small extent benefited the classes on whose behalf the State primarily intervened, the low-paid workers. Both in Great Britain and in Germany it is rather the middle class that has enjoyed the benefit of the State subsidies. Cheap building is therefore not only a question of technique and of rational forms of building, but also one of timing.

The last question is that of the form State intervention ought to take to be adequate from the point of view of influencing the business cycle. From what has been said above, the most suitable measures are those, of whatever kind, which reinforce the mechanism for bringing capital into house building after the peak of the cycle has been passed. These include in a general way the policy of cheaper money, which has been so much refined in recent years. For house building in particular there is, further, the system of public guarantees for second mortgages, which in many countries has taken the place of direct capital subsidies by the State and has been found very effective. The usual obstacle to the building of cheap working-class dwellings is the lack of a certain margin for obtaining the customary yield, and this is often connected with the high cost of second and subsequent mortgages, which certainly exceeds that of first mortgages by fifty per cent. on the average. Even before the war there were difficulties in the way of obtaining these later mortgages in many countries. After the war the difficulties were at first overcome because State subsidies or loans, granted either free of interest or at very low rates, took the place of the mortgages. But the problem of second mortgages again became very acute when State financial assistance was withdrawn ; and it was therefore only logical that in several countries the ending of house-building subsidies was accompanied by the creation or extension of State and municipal guarantee institutes for second mortgages. A State guarantee has the great advantage of making

house production cheaper, for it reduces the risk on second mortgages, and therefore lowers their cost, without affecting the special position of house building in the business cycle—provided that the principles on which it is granted are fixed for the long run. During a period of depression it facilitates the flow of capital to house building, but in periods of prosperity it is not a sufficient incentive to lead to an uneconomic absorption of private capital in house building. Thus it does not interfere with the mechanism of interest as a whole, as do subsidies, whether towards capital or interest charges. From the point of view of the business cycle tax exemption, if spread over sufficiently long periods, is also a neutral measure. Such measures, however, are suitable only for the general promotion of house building for the poorest classes, and cannot serve other important aims of housing policy which the State will have to set itself in the immediate future. Slum clearance, in particular, calls for the direct contribution of State funds, and here it becomes necessary to pay special attention to cyclical considerations.

#### IS HOUSE BUILDING AS A DYNAMIC FORCE BECOMING PARALYSED ?

In conclusion it is necessary to examine a theory which was often put forward immediately after the war, when the revival of house building usual in a period of depression failed to make its appearance. This is the theory that the important function of stimulating a business revival which was patently performed by house building in the nineteenth century and up to the world war depended on certain very definite structural conditions in the movement of population. It has already been shown that the progress of house building during periods of depression was due to particularly favourable conditions, not only on the side of supply, but also on that of demand : the great and steady increase in population which set in with the industrialisation of Europe, and in addition the marked growth of urban population due to the rural exodus. These factors intensified the natural inelasticity of the demand for housing, and thus made possible the revival of house building during periods of depression.

These conditions have now changed. The increase in population in the older industrial countries has become paralysed.

The rural exodus, although large also after the war, has been held up in many States, whether for political reasons, or owing to a certain falling-off in the demand for industrial workers, or because of the return to an agrarian policy that appears to be in progress in industrialised Europe. The question therefore arises whether in any case the importance of house building as a factor in the business cycle has not declined, and whether, if only because of the changes in so many of the necessary conditions, some other force will not have to be used to initiate a business revival.

To a certain extent the experience of the last few years goes against this theory. In many countries house building has continued to act as a motive force and pillar of economic revival—on the whole, even without public assistance. That it has done so provides further evidence of the relation here described between general economic fluctuations and the fluctuations in house building. The following table <sup>1</sup>, which shows the movement of house building in England, Denmark, Sweden, Norway and Switzerland, indicates that in these States a revival set in as early as 1930 (in England 1931), that is, one or two years after the change-over to depression.

INDEX OF ACTIVITY IN THE BUILDING INDUSTRY :  
HOUSES AND DWELLINGS COMPLETED  
(Average 1925-1929 = 100)

Year	England and Wales	Denmark	Sweden	Norway	Switzerland
1928	84	98	109	101	107
1929	101	113	110	134	115
1930	86	136	148	141	129
1931	101	159	150	146	154
1932	101	128	136	208	155
1933	121	157	99 <sup>1</sup>	142	119
1934	155	226	127	195	132

<sup>1</sup> Dispute in the building industry.

Obviously this revival of house building was temporarily checked in some countries in 1932 by the effects of the Central European credit crisis (e.g. in Denmark and Sweden). But except in Switzerland it continued in 1933 and 1934. In all these

<sup>1</sup> Cf. LEAGUE OF NATIONS : *World Production and Prices 1925-1934*, p. 145. Geneva, 1935.

countries there is a clear agreement between the fall in the rate of interest and the growth of house building during the period under consideration.<sup>1</sup> In Switzerland, however, a setback began in 1933 which, after a temporary improvement, became even more marked in 1935. It was presumably due to a certain saturation of the demand for dwellings in this country, resulting from a deterioration of the general economic situation and the rigidity of the whole machinery of prices. Since 1933 the rate of interest has risen again, not owing to a greater demand for capital, however, but in connection with the increased lack of confidence created by the difficult position of the gold bloc countries.

The United States is in a special situation. Here, as in Germany, the policy of creating work turned primarily to other fields than house building. It is true that on several occasions the plans for combating the depression (e.g. the foundation of federal home loan banks, the National Housing Act) meant to begin with house building, but so far there cannot be said to have been any considerable State promotion of the industry. At the same time, in spite of the low rate of interest prevailing for years, there has been no development of private building enterprise, as will be seen from the following table<sup>2</sup>:

INDEX OF ACTIVITY IN THE UNITED STATES BUILDING INDUSTRY<sup>1</sup>  
(Average 1925-1929 = 100)

Year	Index
1928	112
1929	77
1930	45
1931	38
1932	15
1933	14
1934	13

<sup>1</sup> Residential buildings; number of contracts awarded.

Some writers ascribe this to a certain saturation during the previous boom period which led in its last few years to a very heavy fall in rents and a very high proportion of vacant

<sup>1</sup> For detailed figures, cf. LEAGUE OF NATIONS : *World Economic Survey 1934-35*, pp. 64-65. Geneva, 1935.

<sup>2</sup> Cf. LEAGUE OF NATIONS : *World Production and Prices 1925-1934*, p. 145.

dwellings. Further, the banking crisis delayed the necessary relief of the capital market. When it took place, building costs rose under the influence of the National Industrial Recovery Act, which thus offset to some extent the favourable effects of the fall in the rate of interest.<sup>1</sup> Consequently, private enterprise lacked the incentive to engage more actively in house building. It was not until the spring of 1935 that private house building showed a more favourable movement. For the months of the building season the index was about twice as high as the corresponding figure for the previous year.

Taken as a whole, no falling-off in the dynamic force of house building can be discerned. Even if the quantitative factor of the increase in population may have lost strength, there are still a number of qualitative factors which may acquire equal importance for house building in the next few decades. These include in particular changes and improvements in housing standards, slum clearance, the reconstruction of old quarters of towns, reduced housing density, and the demolition of obsolete buildings. Especially this last factor can play an important part. Since the war demolition has been much neglected, for it has been regarded as inefficient and unprofitable in view of the continued housing shortage. There is no doubt that much leeway must be made up in this respect. Moreover, in the industrial countries of Europe houses dating from the period of industrialisation during the middle and second half of last century, that is to say, from a period which was characterised by great activity in the building industry, will become ripe for demolition in the next few decades. There are further the changes in the structure of the population connected with the fall in the birth rate (more adults, fewer children), which will lead to considerable alterations in the demand for housing. Finally, the changes in the localisation of industry, which are a constant source of new housing demand, must not be forgotten. It appears that since 1932 house building in Great Britain, which shows perhaps the most marked tendencies in the period under review, has been considerably affected by some of these factors: the development of new industries in the south of England, the increasing preference for flats as against the former one-family houses, and replacement. It is very difficult to assess the strength of all these individual

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<sup>1</sup> Cf. *World Economic Survey*, p. 65.

factors and balance them against each other. But at least it can be said that, in view of the small increase in population during the last ten years in Great Britain, the quantitative factor cannot have played any great part. All these facts are surely sufficient to show that the slowing down or even stagnation of the increase in population need by no means result in a paralysis of the dynamic force of the house-building industry.