

Tight money and housing.
Nov. 18-19 1959 Cont.

Summary of reasons to anticipate shortage of loanable funds:

1. Slower turnover of real capital as larger share of it gets frozen in fixed forms. Danger that some is lost for good, if not adequately complemented.
2. Reduced rate of ^{voluntary} saving, due to:
 - a. Capital gains, both as dynamic, & static end result; those who don't receive them emulate those who do in consumption standards.
 - b. Consumption standards catching up with incomes

3.

End of forced saving

Bes no more ΔM

Bes inflationary forces are out of power - at least ΔM forces, there are still plenty of ΔV forces, falling liq.

4. Reduction of certain forms of depreciation which were understated, hence tended to overstate saving. E.g. schools, city streets, water & sewer, ~~and~~ old houses.
Recognition of social costs of Δ popn: water pollution e.g.
5. Higher capital needs of builders

Higher land prices particularly harmful, bes builder must buy first & hold longest; & buyer must finance something he's not using, if ΔP based on remote future antici. rather than current income

- In aggregate, since dearer land calls for dearer house, Δ s $\geq$ all cap. needs very much
6. Pressing demands from gov't., for refunding and servicing & repaying, means higher taxes, & probly more compn from gov't. securities. (cf. brief period of falling net debt)
(On other side, probly reduced flow of capital into auto., releases funds)

Summary why antic. shortage funds, p. 2

7. Hi level of l.v. make it good collateral, so many are thus made very credit-worthy.

8. Hi level of l.v. stimulate projects to bring in new land, these compete for funds.

Has been lag in past crests, land dev't projects grow while building falls.

9. Many big mortgage lenders, e.g. ins. cos., have other, more risky loans, that might make them trouble & freeze up new mortgage funds.

10. We have started more than we can finish, by scattered land settlement. No one has looked at aggregate, computed how much captl. needed to complete all that has been started, in reasonable time. But is many times what are doing today.

11. ~~the big problem~~ A preference for equities - means less M available for loan. more goes into land spec-n.

Vital points for H & H conference:

1. Multistory building is increasing, despite abundant land. Latest Dodge Bldg. Rev., Oct '59, says housing slackening off.
2. Calif., outside money ceasing to flow in, trouble.
3. Is lag of response to higher i.r., bes line for a time on old commitments.

Moreso with land prices.

4. Possible crisis:

A. Surplus of land comes to light, prices begin to fall
Land substitution stops - which is what was feeding boom. (including autos)
But land-consuming not encouraged, until price shakedown is over.

B. Pressures to maintain boom, plus inertia, keep land substitution going, several years.

5. Need State authority to get metropolitan mergers. Now, ^{the} only areas, ^{which} ~~wanting~~ annexation are undeveloped, wanting something for nothing.

Suburbs will vote taxes, but resist joining city, fear unequal break, sometimes justly so. State law could withdraw this power of withdrawal.

6. Some towns tied up by a few giants.

Omaha by U.P.

Richmond, Calif., by Sta Fe & Milton Mayer

(Railroads, belatedly developing their choice sites, may pull rug from under truck-oriented industrial parks, etc. Burlington R.R. e.g. has many)

7. Increased liquidity of land in rising market, Δ velocity.

Also stocks. Today all assets are liquid - so who wants Treasury bills & bonds? Results: Δ i.r., Δ v. Manic-depressive nature of man, will undo it, react.

8. Shortage of liquid capital; ^{Slower turnover of supply of capital, in roads etc. STFR Bull, 9-59, p. 138} reduced saving, Δ urgent demands for real capital, to complement new hiways, power lines, iron canals, etc. Over emphasis on consumer spending as main spring of ec. activity, from underconsumptionists & Keynes.

Δ consumer credit is definite part of reduced saving. Neg. saving by some, using capital borrowed from others.

9. Wide belief, Fed. can lower i.r. at will. But have reached point where the antic. influ. resulting wd. reduce demand for Treas. securities, not help Treas. Also, now have large fn. holdings short term \$ liabilities, attracted by our high i.r., would be run on \$, lose much gold.

French precedent not applicable, bcs. they inflated to reduce taxes.

We haven't quite reached that yet, wd. inflate to promote prosperity, or / and help carry U.S. debt, help refund.

Sec'y Treasury's problem will get worse before gets better, due to hi i.r.s coming, due to real capital shortage, due to proliferation of works. Indiana canals of 1837 a precedent.

10. Outside money now pulling out of Calif.

11. Δ liquid assets is just obverse of Δ debt. No net gain in liquidity, just a higher ratio of debt to real assets, greater risk & leverage situation.
12. Bldg. union — to what extent encouraged by localities not caring to grow, to maintain existing values?
13. Some anomalies
- A. Δ ratio machinery to plant, vs one-story plants
 - B. Δ commercial & industrial bldg. ^{and lower residential} vs. lower savings. (Anderson & says rate of growth should depend on choice by individuals)
8. Need evidence on reduced saving — Mundock e.g. doubts
14. Mortgages were high & soaring when I wrote. Now even higher.
Is higher % of building now being mortgage-financed?
15. "Big institutional investors" holding public debt now regarded as very stable. But remember they hold this liquid asset in case they get into trouble with other investments — like mortgages. Low mortgages could mean a run on Treasury.
16. High vacancies in apts in L.A.

17. ^{Short term} I.I.R. has kept rising despite steel strike, which released funds, as steel inventories were worked off.

18. U.S. debt now nearly \$290b. - fluctuates regularly with collections.

19. Gold outflows reduce reserves of commercial banks. Fed can offset, buying U.S. bonds

20. Money flowing nationally from long to short term borrowers?
Bank "loans" (as vs. investments) have been increasing.

Banks have been dumping U.S. securities since late '58. a "sell-off."

This means U.S. secs. have become relatively more attractive to nonbankers, why? Banks are unique in they can't lose by inflation. So antie. of infln. is weakening?

21. Public construction is holding up much better than priv. But ambiguity: "public works" & "utilities" are down.

22. Bank loans to construction firms are declining. A decline of r.e. loans (to house buyers, is presumption) should follow.

Another indication of Δd demand for liquidity - borrowers want more short term credit, so funds are being pulled from long term to short term lending. This indicates a relative shortage

of things financed by ~~the~~ short term loans.

Industry: a higher % of new capital in '59 is for working cap. More bus. inv. has gone into inventory accumulation

23. July, stricter FHA mortgage insurance terms went into effect. Specified stricter construction standards. Requests plummeted.

24. Impact of higher l.v. on i.r.:

a. Δ demand for loans, to finance given volume of construction.

Thus raise i.r.

b. Reduce saving. These 2 will bring l.v. back down.

c. Reduce impact of given investment on N.I., but higher

% goes to buy land (except as hi land p $\rightarrow$ land devmt work)

i. Boom stage, Δ leverage of invmt on N.I., but booms land devmt.

ii. When land devmt no longer is affected by this factor, is depressant.

25. Businesses have been jamming more machinery in old plants.

Now need new plant - & such investment becomes sensitive to land prices. (But higher % new invmt now is in inventory accumulation)

Some firms have plenty land. But there are not nec. the

~~the~~ ones who want to expend. E.g. U.P. & C. rrs; old movie giants.

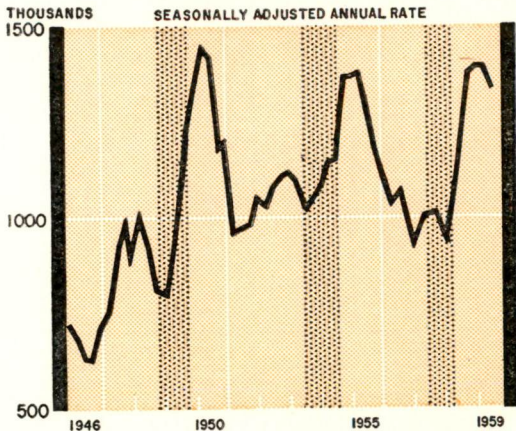
Now in R.E. business.

26. State & local issues, ~~still~~ '59 = '58 + thus far, but falling.

'58 > '57.

27. Life Ins. Cos. have been Δ g munic. ~~in~~ invmts, slowing Δ of mortgages.

NEW PRIVATE NONFARM DWELLING UNITS STARTED, QUARTERLY AVERAGES



Note: The shaded areas represent periods of economic recession, running from peak to trough according to dating by the National Bureau of Economic Research. The periods are November 1948 to October 1949, July 1953 to August 1954, and July 1957 to April 1958.

Source: *Construction Review*, July 1959, United States Departments of Commerce and Labor.

1949	85	87	81	121	118
1950	91	80	108	137	141
1951	186	194	175	157	136
1952	171	200	129	199	137
1953	140	137	145	308	157
1954	132	139	123	260	163
1955	164	176	149	308	183
1956	199	258	117	449	197
1957	229	306	123	575	213
1958	174	210	123	537	213
1958					
August	181	222	121	513	180
September	178	212	130	607	195
October	174	207	127	712	221
November	178	201	145	545	235
December	170	218	101	762	231
1959					
January	237	243	228	504	263
February	153	181	144	694	210
March	209	204	217	652	378
April	168	190	138	600	273
May	158	178	131	576	272
June	...	...	...	...	...
July	...	...	...	...	...
August	...	...	...	...	...

¹ Adjusted for seasonal variation, except where indicated. Except for department follows: lumber, California Redwood Association and U.S. Bureau of the C Department of Commerce and American Iron and Steel Institute; electric employment, U.S. Bureau of Labor Statistics and cooperating state agencies railroads and railroad associations; and foreign trade, U.S. Bureau of the C ⁵ Commerce

⁴ Los Angeles, San Francisco, and Seattle indexes combined. ⁵ Commerce

⁶ Annual figures are as of end of year, monthly figures as of last Wednesday deposits, less cash items in process of collection. Monthly data partly estimated from end of previous month or year. ¹⁰ Minus sign indicates flow of

of receipts over disbursements in the case of Treasury operations. ¹¹ From interbank prior to 1942. Debits to demand deposits except U.S. Government

28. Mortgage yields have risen, but not 2 other kinds, so fewer funds going into mortgage mkt. This seems to suggest housing lacks drawing power of other outlets, is being out competed. Lower i.r. not answer, $\therefore$, except as special subsidy. Wd. lose more volume.

A l.v. have swallowed up return to invest. Lower l.v. is answer, bcs land has no alternatives.

Yields on Long-term Securities & Mortgages				
	May '58	Aug. '59	Δ	% Δ
U.S. long tm bonds	3.1	4.1	1.0	32% ⁹⁰
State & local bonds, Aaa	2.7	3.4	0.7	26
corp. bonds, Aaa	3.6	4.4	0.8	22
FHA mortgages	5.4	5.7	0.3	~~6%~~ 5.6% ⁹⁰
Conventional 1st Mortgages	5.6	5.9	0.3	5.4% ⁹⁰

29. Higher % monetary assets in forms of low turnover. Non-liquid.
Immobile. Sudden Δ demand for ~~short term~~ funds presses on narrow
mkt, i.e. shoot up.

Get supporting data

30. Understatement of % of land prices to house cost, because land
is bought before house sold.

On rising mkt this helps builders

On falling mkt will frighten them away. Builder is small fellow
who assumes large risk, are scary.

31. Sec'y Treas: can influence tax policy as well as debt policy

Cap. gains exemption, etc.

Land tax deductible, but p.u. rate is not (so don't say deductibility is
sacred cow)

Crisis of capital turnover situation is over commitment.

Picture elemental illustration of men, warehouse, & goods.

If they wish they can expand warehouse, simul. reducing inventory (w/o creating new capital). Smaller inventory could compensate by turning over faster — within limits. (The larger warehouse might facilitate its turning over faster).

This could occur smoothly, w/o reaction, if was originally desirable.

Problem comes when warehouse expands as our cities do. Groundwork is laid for much larger warehouse, (a) Than is needed, (b), Than economy has capital to complete. (resurgent need for more inventories is just one aspect of this larger picture).

When this comes to light, need is to regroup capital to cut down total need, & total completed facilities. But too late: it has been sunk, immobilized.

This aggravates problem because the capital thus sterilized by the shortage of complementary capital itself fails to turn over as expected. Some of it never does. Never again released for reuse. Never pays out. Lost.

Interest rates soar. Land prices should fall. But there is a lag. During lag, suffer from simul. hi i.r. & hi land prices. Building dies.

Now everyone wants capital. This should be very stimulating — but sources of capital dry up. --- saving & turnover. We have started more than we can finish.

(Make some quantitative stab at national capital)

As our magnificent capital equipment turns out not to be so productive because we lack the complements necessary to make it what it started out to be.

The new lands that we thought we were developing are not developed.

So builders shy off, because they lose confidence that simul. complementary building will occur. Thus after supply of loanable funds diminishes, demand does too. Market narrows on both sides. Thus develops seeming anomaly of lenders being unable to find investment outlets. Entire system was geared to, organized around a devmt that collapsed. After the crash, society has to reorganize, regain confidence.

Digest this & prepare to present it as historical fact, not just another hypothesis.

We see flood of new families coming on. They need houses. We assume they will borrow to build. But they do not come equipped with capital. We have grown used to assuming all the economy needed was customers. But are entering new era, short of revolving capital.

Now to meet this demand for loans we would like to pull back some capital sunk in extensive networks. But too late!

Started more than we can finish? Yes, started by proliferating roads & c. nets that include more land than the economy has capital to finish improving — ^{esp. after so much cap. has gone into networks} with houses, most of all, but also with supplementary networks. And then building more houses even beyond the nets. Started something we can't finish — not for 50 years anyway.

Result is rising i.r.

Who gets stuck & can't pull money out?

Public agencies largely, as they are the ones who build ahead of need. E.g. Richmond-San Rafael Bridge, expecting toll income

U.S. Highways, expecting gas tax income

Municipalities expecting Δ prop. taxes

Priv. developers who finance utility extensions & expect payoff in Δ l.v.

Some utilities (altho they are more likely to lag behind, still the ponderous nature of their reactions, the lag, probly means they will be expanding for 2-3 years after they want to ~~stop~~ stop

Public works, too, will take some time to turn off.

Supplemental needs will become more apparent — e.g. water, sewers, schools, parks, perhaps even sidewalks — things overlooked in first bloom of enthusiasm.

In desperate competition to come for limited capital, most determined bidders will probably be those who are pretty well begun, but need vital supplements — e.g. water, sanitation.

They will have added advantage over new couples of owning land already, not penalized by hi land prices. Less risk for lenders.

So capital will go into more nets, rather than housing: extensive, bcs govt can't turn off programs; intensive, bcs established communities needing finishing can out compete new ones.

Also, net-builders, being larger, acquire land & its of way farther ahead of schedule, aren't so quickly hurt by higher land prices.

So housing takes the brunt.

So now is time to lower land prices.

Where has the capital been coming from for our new housing, last ¹³ ~~10~~ years?
New ~~on~~ saving. But N.I. accounts have overstated this — failed to deduct
several items of social deprec-n. E.g. deprecn of munic. streets, water nets;
of schools, colleges; of capital stored up in profit ~~trng~~. Since these are not real
saving + they are temporary. Current decline of "saving" is result, as have reached limits.
Amortizn of old buildings

Expansion of commercial bank deposits — also spurious, was point Hayek stressed.

1 m housing units a year, @ \$12,000, makes \$12b per year.
Whence the capital? Much of this is compensated by deprecn of
older buildings, & is no net Δ to nation's housing capital.

Yet with Δ g popn there must be net new capital - & besides
that there is more per capita.

Lots of funds came from businesses paying off their debts.
Thus corps were saving, creating new cap.

Why do munic. govts pay for extensions? Bcs they are controlled by owners of
land to be up-valued, - or people who control them own the land.

Just as U.S. Fed. govt took over western lands, protected them, built Nat.
Road, bcs western spec & governing class were one group. Also L.A. bringing

Owens wtr for San Fernando Valley

Also is belief new areas will pay for selves, & more. New areas may not like
this - unless cns of scale are obvious, like Owens Ag.

Nowadays, unbalanced road program. State & Fed. are building
trunks, but who is building local nets? Subdividers

2 anomalies:

1. Rising land prices amid rising C.R.
2. Proliferation of new projects among signs of capital shortage

Higher l.v. mean higher captl. requirements for builders. Requires more funds, even if not more real capital. Increases liq. pref, slows V

Who wants strong \$? Who fears gold outflow? Banks with foreign deposits! They want hi i.r. — also of course hi i.r. increases their earnings, more than their payments out.

So here is a powerful interest behind deflation.

Also Life Ins. Cos. — they want to avoid flight from \$, have played policy-holders for suckers long enough.

→ Does higher land price differ from any other kind in effect on

Ag cap. reqs?

a, Comes earlier — builder must buy land first

b, Other costs are income & employment creating, & real capital creating.

(But not if just higher cost for same thing)

c. Seller of land at stable price doesn't regard receipt as income. But if price rises 10%, the 10% is all income. But if wages rise 10%, is just a 10% of income.

— d. Higher % of investment is now deferred inc. — cf. auto. or trailer

Effect of Δ l.v. on conen — true, not everyone or a majority get in on the joyride, but those who do set higher consumption standards for others to emulate.

One new source of capital (& materials) is automobiles.

Net cap. fmtn in them was maybe ^{8-10b} ~~\$4-5b~~ a year, & they took 30-40% U.S. steel production.

U.S. steel production.

Dept. Commerce data probly didn't call it captl fmtn, but consn.?

Anomaly: I foresee capital shortage, but also dearth of inv. outlets.

Is qn. of timing.

Also is qn. of effect of l.v. on inv. opps. Rising l.v., good collateral; falling l.v., no collateral. Here is another snowballing element, up & down. One that carries seeds of its own destruction, less Δ l.v. $\rightarrow$ Δ inv. opp. $\rightarrow$ higher i.v. $\rightarrow$ lower l.v.

1956. Total net. spending on highways & streets, incl. capital, was \$8.2b of this, \$5.6b was for "State Highways". So there is bulk of new building - State-financed.

Blank & Winnick.

Real ^{net cap. fmtn in} residential r.e. was higher in mid-twenties than late '40s. So per capita, we still haven't approached the '20s.

While land prices are rising, & simul ΔM , the ΔT necessitated by higher land, is same as $-\Delta V$. lets people keep higher M w/o $\rightarrow \Delta P$. Hence eases cap. frtn.

Who pushes highways? In L.A., "civic groups" pushed, even had city pay for some, for 2. until State began to c. 1947.

Cal. Hiway Mag. justifies freeways on basis of Δd l.v., so I suppose that is in minds of promoters.

Is hard to generalize: sometime land promoter pays for utility extensions himself, or at least one promoter does, and others benefit; sometimes they get city to pay; or p.u., which by extending to one, goes by others; or the State or Fed. govts. But whoever pays, the drive is supplied by landholders wanting to get lands improved, tied closer into urban economy.

Secular trend, cap. fntn in resid. v.e., ~~of~~ net becomes smaller & smaller % of gross, as housing stock Δ s.

Furthermore, much analysis understates deprecn of old housing bcs based on mkt value, which is inflated by Δ g land prices. Thus studies report more net Δ cap. in housing than there really has been, ~~underestimate~~ in effect are thus treating Δ l.v. as cap. fntn, underest. % of funds that have come from deprecn of old houses.

The "forced saving" was not only thru infln, but ΔT ---- ec. needed more M, which came via loans, largely for cap. fmtn. Holders of new M contributed capital by building up their real liquid assets.

Was also for a time some liquidation of nat. debt, cap. fmtn via taxes, now reversed.

Life Insurance policy holders contributed vast sums thru inflation. The recipients - (debtors) Needed: A incentive to form capital, to save, didn't nec. use funds for cap. fmtn.

Now I can add these several factors & make strong case that supply of loan capital was temporarily expanded, but cannot maintain itself.

Why can't housing compete for funds?

1. Houses we already built are inadequately served with streets, water, sewer, etc.
2. Hi land prices direct ec. forces to build fewer houses, more streets, highways, etc.
3. Housing is new debt, less urgent than refinancing old - e.g. U.S. Treas.
4. Local govt have tax advantages

Many lenders could get in trouble, begin calling loans, or stiffening. Because long prosperity has lowered their standards. E.g. Ins. Cos., with vast Δ of 90% of assets in indl ~~the~~ bonds since '45. And even common stock, now \$46 or so. \$3.46 v.e.

N.I. as rptd by Dept. Commerce includes allowance for imputed value of owner-occupied residences. 4% of N.I., or c. \$11b, 1954.

That is a large share of all "saving", except no doubt it is counted as part of consumption.

May be overstated, bcs what a person would pay for quarters covers deprecn as well as income.

7/ nat. accts understate deprecn, thus, they overstate net cap. form.

During infln, much cap. came from deprecn of money. There was limited voluntary saving, but builders could borrow from banks, use M to compete for resources.

People were used to lower living standards, would accept harder life. Now have adjusted.

I had thought when people shifted from rented to owned residences N.I. data for their consn went down. But now realize consn stays same, & income rises. (I assume the consn is either the finance charges or imputed value, but not both)

Now it is right to ΔC by full rental value. But not right to ΔY by same, bcs of deprecn. Perhaps accounts thus overstate Y , & i. saving.

to \$376.

1953-58, Life Ins. Cos. Δ d mortgage holdings by \$14b.¹ Also Δ d

P.U. bonds \$4b ^{to \$6b.} State & local bonds \$2b, to \$3.5b.

Reduced U.S. secs \$3b.

On balance Δ d their assets.

Capital shortage also to come bcs Δ d taxes at all levels will be necessary. All levels of govt. have over committed selves, lived on past surpluses, postponed taxes by Δ g debt, and neglecting maintna

1958 Ins. Co. Assets

Type	\$b	%
U.S. Secs	7.2	6.7
State & Local	3.5	3.3
P.U. bonds	16	15
Intl bonds	23	22
Stocks	4.1	3.8
Mortgages	31	34
R.E.	3.4	3.1

Σ \$1086