

Econ 113: April 2, 2015

- New Deal
 - Financial Innovation
- World War II

Response Paper #2 due Thursday April 2
Term Paper due Thursday April 16
Last Class is Thursday April 30

New Deal Mortgages World War II

New Deal Legislation

- FDR goals
 - Relief
 - Recovery
 - Reform
- Mostly legislative
 - limited fiscal stimulus

Table 1. Budget Surplus or Deficit
 (\$ billions)

	State & Local		TOTAL
	Federal		
1929	1.2	-0.2	1.0
1930	0.3	-0.6	-0.3
1931	-2.1	-0.8	-2.9
1932	-1.5	-0.3	-1.8
1933	-1.3	-0.1	-1.4
1934	-2.9	0.5	-2.4
1935	-2.6	0.6	-2.0
1936	-3.6	0.5	-3.1
1937	-0.4	0.7	0.3
1938	-2.1	0.4	-1.7
1939	-2.2	0.0	-2.2

New Deal Mortgages World War II

New Deal: Banking & Finance

- Bank Holiday, 3/6/1933
- Glass-Steagall Act (1933)
- Banking Act (1933)
- Bank Act (1935)
- Securities & Exchange Act (1934)

New Deal Mortgages World War II

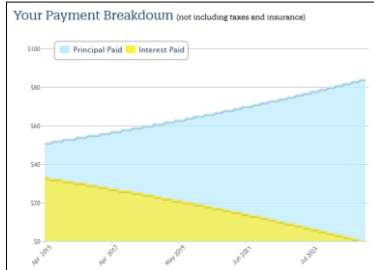
Mortgages: Direct Reduction Loan

- Direct Reduction Loan (Fully amortized mortgage)
 - Buy house for \$10,000
 - 20% down payment: Pay \$2,000 cash when buy house
 - Borrow remaining \$8,000
 - Fixed interest rate: let's use 5 percent
 - Fixed term: 10 years
 - Use a [mortgage calculator](#): Monthly payment = _____

New Deal Mortgages World War II

Mortgages: Direct Reduction Loan

- Fully amortized mortgage
 - Buy house for \$10,000
 - Borrow \$8,000
 - Fixed interest rate: 5 percent
 - Fixed term: 10 years
 - Use a mortgage calculator:
Monthly payment = \$84.85



- Benefit to borrower: building up equity in home (but at cost of higher payments)
- Benefit to lender: lowers lender's loss risk upon borrower default (but illiquid; ties up bank assets for many years)

New Deal Mortgages World War II

Mortgages: Balloon Mortgage

- Interest only, balloon mortgage
 - Buy house for \$10,000
 - Borrow \$8,000
 - Interest rate: 5%
 - Payment is interest only: \$33.33
 - At end of term, still owe lender full \$8,000
- Benefits
 - to borrower: lower monthly payment (but need to come up with \$8,000 at end of contract)
 - to lender: no need to compute principal/interest split in each payment & often will be asked to refinance when balloon due (but difficult to market because not popular with borrowers)

New Deal Mortgages World War II

Mortgages: Share Accumulation

- Buy house for \$10,000. Pay \$2,000 cash down payment
- Borrow remaining \$8,000 from B&L at 5% interest
- Each month
 - Make interest payments of \$33.33
 - "Purchase shares" for a fixed amount
 - Same as making a deposit into a savings account
 - To save \$8,000 over 10 years without interest = \$66.67 / month
 - Assume 3% interest (dividend): then it takes only 105 months
 - Total monthly payments: \$100.00
- Once accumulate \$8,000, cash out savings ("shares") and pay loan
- Benefits:
 - Borrower: Regular payments so no surprise balloon at end of term
 - Lender: Borrowers carry credit risk

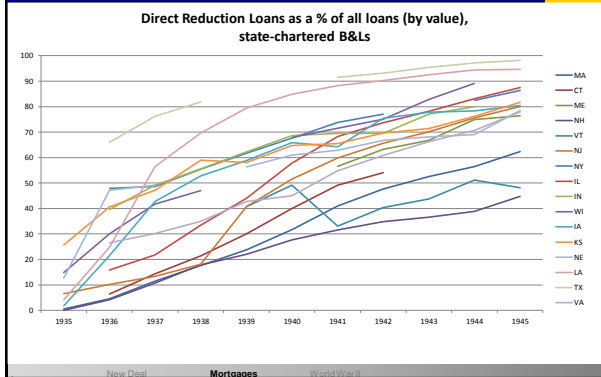
New Deal Mortgages World War II

Share Accumulation Loan: Credit Risk

- Risk of losses borne by "members" (customers)
- If other borrowers default, B&L decreases dividend paid
- Suppose B&L decreases dividend from 3% to 2%
 - You pay \$33.33 per month in interest
 - You pay \$66.67 per month to accumulate shares (save)
 - Assume 2% dividend, compounded monthly
 - Now takes 110 months to save \$8,000
- Alternative: B&L's accumulate "loss reserves" that they use to prevent loan defaults from triggering insolvency

New Deal Mortgages World War II

Move to New Mortgage Type over 1930s



Transitioning to New Mortgage Type

- But what about systemic risk due to widespread bank failure? Ack! Share accumulation borrowers lost lots!
- Jonathan Rose (yet another UCB PhD) & Ken Snowden
- B&Ls transitioning to direct reduction (Fully amortized) loans after addressing three issues
 1. solve credit risk by creating loss reserves
 2. solve income tax liability by requiring borrowers become B&L members (deposit at least \$1 into an acct)
 3. Solve accounting challenges with training & equipment

New Deal: Industry

- National Industrial Recovery Act (NIRA, 1933)
- National Recovery Administration (NRA, 1935)

New Deal: Agriculture

- Agricultural Adjustment Act, (AAA, 1933)
- Agricultural Adjustment Act, (AAA, 1938)

New Deal: Labor

■ Federal Emergency Relief Act (FERA, 1933), which included

- Civilian Conservation Corps (CCC)
- Works Progress (Projects) Administration (WPA)
- Public Works Administration (PWA)

	Total Grant to States	Amount Used as Work Relief Earnings
FERA	\$3,017	\$1,238
CCC	2,622	1,734
CWA	807	718
WPA	6,804	6,586
FSA	273	100
PWA	1,791	---
		\$10,376

New Deal

Minimums

Work/Wage I

New Deal: Labor, cont.

- Federal Emergency Relief Act (FERA, 1933)
- National Labor Relations Act (NLRA, Wagner Act, 1935)
- Fair Labor Standards Act (1938)

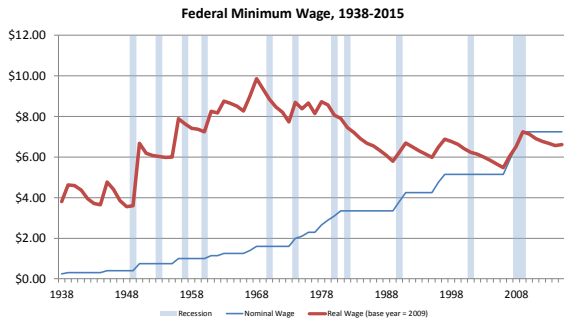
Year Increase Implemented	Nominal	Real (2009 dollars)
1938	0.25	3.80
1939	0.30	4.63
1945	0.40	4.77
1950	0.75	6.68
1956	1.00	7.89
1961	1.15	8.25
1963	1.25	8.76
1967	1.40	8.99
1968	1.60	9.86
1974	2.00	8.70
1975	2.10	8.87
1976	2.30	8.67
1978	2.65	8.72
1979	2.90	8.57
1980	3.10	8.07
1981	3.35	7.91
1990	3.80	6.24
1991	4.25	6.69
1996	4.75	6.49
1997	5.15	6.88
2007	5.85	6.05
2008	6.55	6.53
2009	7.25	7.25
2015	7.25	6.77

New Deal

Minimums

Work/Wage I

Minimum Wage



New Deal

Minimums

Work/Wage I

New Deal: Labor, continued

- Federal Emergency Relief Act (FERA, 1933)
- National Labor Relations Act (NLRA, Wagner Act, 1935)
- Fair Labor Standards Act (1938)
- Social Security Act (1935)

New Deal

Minimums

Work/Wage I

World War II Mobilization

Federal budget deficit increased . . . lots!

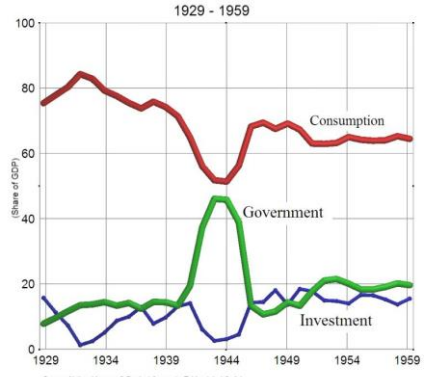
- From \$3 billion
 - < 3% of GDP
- To over \$50 billion
 - over 30% of GDP

Table 5. Federal Govt Spending, 1939-1947

	(Billions of \$)			
	Tax Revenue (TA)	Outlays (G + TR)	Budget Balance	BS (BD) / GNP
1939	6.6	9.4	-2.9	-3.3
1940	6.9	9.6	-2.7	-2.8
1941	9.2	14.0	-4.8	-4.3
1942	15.1	34.5	-19.4	-13.7
1943	25.1	78.9	-53.8	-30.8
1944	47.8	94.0	-46.7	-23.3
1945	50.2	95.2	-45.0	-10.7
1946	43.5	61.7	-18.2	-8.7
1947	43.5	36.9	6.6	3.0

Note: Budget balance is negative when there is a deficit and positive when there is a surplus.

Distribution of Aggregate Demand 1929 - 1959



Source: National Income & Product Accounts, Tables 1.1, 1.3, 4.1

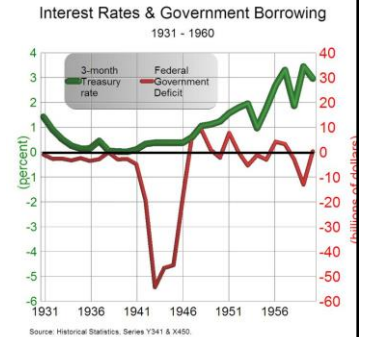
War Finance: Bonds

- WWII paid for with
 - Taxes 46%
 - Borrowing 54%
- Borrowed from
 - Households 23%
 - Banks 40%
 - Non bank institutions 37%



Interest Rates Kept Low

- In 1942, the Fed promised the Treasury:
 - "We will keep nominal rates low"
 - Promise ends in 1951 with "Accord"



Source: Historical Statistics, Series Y341 & X450

Labor Force Changes

- 1940
 - Labor Force = 32 million
- 1943
 - Labor Force = 42 million
 - Military = 9 million
- Where did all those people come from?

New Deal Progressives **World War II**

Rosie the Riveter

- Was Rosie a housewife drawn into the labor force by patriotic appeal?
 - No.
 - Rosie *the Riveter* was often a woman with previous manufacturing experience, not a housewife.



- Source: Sherrie A. Kossoudji, Laura J. Dresser, "Working Class Rosies: Women Industrial Workers during World War II," *Journal of Economic History* 52 (June 1992): 431-446

New Deal Progressives **World War II**