Form F. R. 131

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date March 3, 1938.

To Chairman Eccles

Subject: The Railroad Equipment Proposal.

From Lauchlin Currie
LBC.

I had a long conference with Mr. Frank Wright and Mr. White on Wednesday. They raised certain objections to our proposal and proposed an alternative. The objections were as follows:

1. The railroads would overcharge the Corporation very badly on repairs. In order to prevent this, a corps of 500 inspectors would be required.

2. Unless traffic revived, or whenever traffic fell off, the Corporation would be left holding the bag. Problems would arise in connection with storage.

3. Their alternative proposal would accomplish the same results while avoiding these difficulties.

They propose that the Government

(a) buy non-cumulative preferred stock of railroads or notes to an amount equal to the difference between the amount spent on maintenance of way, structure and equipment in 1933 and 1936. The purpose of this proposal is to attempt to peg maintenance at the 1936 figure. If this is accomplished a maximum amount of loans to the roads of $365 million a year might be called for. Dividends and amortization would not begin for two years. Amortization payments would vary each year on the basis of a percentage of the operating revenues. Loans to roads in receivership would be secured by junior receivers' certificates.

(b) loan money to roads in the form of equipment trusts for equipment purchases. This loan would be contingent upon acceptances by the roads of proposal (a). These equipment trusts would be for 100 per cent of the cost of the equipment, would be amortized over a twenty-year period and bear interest of 2 per cent beginning in two years. They estimate expenditures of $300 million a year would result.

Mr. Wright has conferred with several railroad presidents on his proposal (b), (not ours) and has received assurances that make him confident that railroads would take advantage of the favorable terms of the proposed equipment trust certificates to buy 150,000 freight cars in the next three years (they bought 75,000 in 1937). He was not so sure about locomotives unless the proposed 90-car train bill is killed. He said the Pennsylvania Railroad would carry through a $100 million electrification program around Pittsburgh if favorable terms could be arranged.

I confess that I can't get up much enthusiasm for these counter proposals for the following reasons:

1. They call for the railroads assuming increased obligations.

2. They will encounter the usual objection to giving subsidies to the prosperous roads that do not need it. Many politicians will object to the Government acquiring a junior security of such roads as the Illinois Central and B. and O. On the other hand, if "adequate security" is required, the roads may not want or be able to go along. The usual experience is for Congress to insist on more stringent conditions in loans. Mr. White tells me that in the case of P. W. A. loans under the N. R. A. all that was required was "reasonable" security and the terms of interest and maturities were left to the determination of the President. He is going to let me know in a day or so how much new legislation and new appropriations would be necessary. The R. F. C. is limited to "adequate" security and the terms as well as the issue must be approved by the I. C. C.

3. They are simply another emergency device, similar to the 1934 loans, and have no particular favorable implications for greater stability in the future.

4. The outcome in dollars and cents of expenditures is uncertain. Of the estimated $665 million of additional annual expenditures, $365 million is on account of loans or purchases of preferred stock for maintenance purposes. The extent to which this part of the program can be passed in the desired form and availed of by the roads, particularly the more prosperous ones that are still earning something on their common, is highly problematical. Many roads will be loath to take on any more obligations so long as the whole railroad picture is in a state of flux and ferment. Of the $300 million annual equipment expenditures, $110 million is for locomotives, about which Mr. Wright expressed some misgivings.

5. The proposals tend to perpetuate and complicate the present involved railroad picture. I'm pessimistic enough at the moment to think that the roads will periodically get into difficulties and some drastic steps will eventually be necessary. Our proposal would tend gradually to simplify the problem as the Government Corporation acquired title to more and more of the rolling stock.

Of the objections raised to our proposal, neither of those relating to repair bills or to storage appear insuperable. After all, there are leasing companies today which are presumably meeting and overcoming these difficulties. I would still urge in favor of the proposal that it

(a) <u>makes certain</u> a definite expenditure

(b) paves the way for an eventual national car pool

(c) provides a compensatory mechanism that can be used in future recessions

(d) enables the roads to reduce their fixed charges as their present equipment is retired

(e) lessens the danger of the Government getting further tied in with the affairs of individual bankrupt roads.

I am going to see Mr. Eastman again and find out where he stands. I am told that Jones, Ickes and Delano all think highly of Wright. If they and Eastman all favor the other proposal, I'm afraid we would be licked on ours. In any case I will canvass the situation some more and let you know how I come out. Wright said something to me as he left about our reimbursing Mr. White for his time. Did he take this up with you? I have asked Mr. White whether he would look at our proposal from the point of view of administering it, and try to discover how many "bugs" there are in it from this point of view. He promised to give this some thought over the weekend.