BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date October 31, 1938.

To Miss Egbert

From Lauchlin Currie

Subject:

I left this with the Chairman Saturday night. I would like to have the charts returned, as I did not have an opportunity to make any copies of them.

COPY

October 29, 1938.

Fiscal Advisory Committee

Chairman Eccles

Lauchlin Currie

I am attaching some material for the next meeting of the Fiscal and Monetary Advisory Committee, along the lines you suggested.

1. The first is a one-page statement of the problem wherein I suggest that the title be changed from "Transition Problems" to "The Problem of Timing in Compensatory Fiscal Policy". You might want to secure this change as the present title restricts us unduly.

2. If time permits and there is sufficient interest you may want to present a slightly longer and more technical statement, which I am also attaching.

3. For illustrative purposes indicating some of the basic factors involved in compensatory fiscal policy, I am attaching some charts with brief comments.

4, In the list of investigations required I suggest that the title of (1) be changed from "Amount of national income to balance budget (a) at different price levels" to "Revenues that will be yielded by the present tax base at various national income levels, (a) currently, (b) after a year's lag".

An additional topic might be "The probable trend of main classifications of expenditures, (a) on the basis of past experiences and present plans, (b) at various employment and national income levels".

The National Resources Committee interprets the investigation entitled "Bottlenecks" to mean all the factors that prevent the attainment and maintenance of full employment. This entails considerable duplication with our problem of timing. I should like them to do more intensive work on probable labor and plant bottlenecks under the broad heading of "The Rate of Increase in Production and Consumption and Incomes that can be sustained without excessive price and inventory maladjustments."

An additional topic of a monetary nature might be "The Rate of Interest in Relation to Price Movements and the Attainment of Full Employment."

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THE TRANSITION PROBLEMS IN COMPENSATORY FISCAL POLICY

A more descriptive title would appear to be "The Problem of Timing in Compensatory Fiscal Policy". Any transition that may be made from deficit financing to debt retirement is merely one stage in the continuous problem of gearing fiscal operations to private business activity to the end of achieving and maintaining full employment.

The urgency of the problem need not be stressed here. The only question is how far the problem is subject to solution. This, in turn, boils down to the two-fold task of improving, on the one hand, both our analysis and the quantitative approach to the problem and, on the other hand, improving the technique necessary to carry through the policy which is indicated by our analysis.

A broad analytical and quantitative approach is very briefly summarized in the accompanying memorandum.

It is believed that with present knowledge and data more precise information than at present is available on which to base broad trends of fiscal policy can be obtained. With intensive study and the development of more and better relevant data, the basis for policy should be subject to continual improvement. It is emphasized, however, that whatever precision we can hope to obtain will still leave a wide possible margin of error, particularly in the short run, and that, therefore, efforts should be made to secure as much flexibility and appropriate automaticity in fiscal operations as possible.

October 29, 1938.

COMPENSATORY FISCAL POLICY

The Problem of Timing

A. Broad Statement of the Problem

1. A steady increase in consumption is the prime requisite of a progressive economy.

2. The desirable rate of increase in consumption is as rapid a rate as can be achieved without excessive price advances and inventory accumulations. This does not mean no advance in prices. It means no greater advance than is compatible with sustainable growth in investment, income and consumption.

3. The desirable rate of increase in consumption may be expected to vary with the degree of excess productive capacity, the number and nature of bottlenecks and shortages, the temper of the business community, etc., being higher when emerging from recessions than when approaching the limitations imposed by physical productive capacities.

4. Growth in consumption depends on growth of incomes of wage-earners, low-salaried persons, farmers and small business men, modified by the expansion and contraction of consumer saving and consumer debt. (See chart).

5. A growth in incomes is dependent upon whether the amount added to the spending stream through capital expenditures and public expenditures in excess of tax receipts is greater than the amount withdrawn from the spending stream through the failure of current income to be spent on current consumption.

6. Hence, the growth of consumption is dependent upon a growth in private capital and public expenditures in excess of current receipts, assuming no change in the relation of consumption to income, or on a rise in the proportion of the national income spent on consumption, assuming no change in private capital and public deficit expenditures.

7. Assuming the goal to be the attainment and maintenance of full employment, fiscal policy should be directed towards

(a) supplementing (or offsetting) the volume of private capital expenditures and/or

(b) modifying the relation of consumption to income.

8. The former type of action (a) is concerned with the relation of government expenditures to receipts; the latter (b) with the source of receipts in relation to the direction of expenditures.

B. Broad Quantitative Approach to the Problem

1. Calculate national income necessary for full employment.

2. Estimate maximum sustainable rate of increase in national income to achieve (1).

3. Ascertain ratio of capital investment plus government contribution to income in the past.

4. Consider how far developments of recent years may be expected to call for a different ratio.

5. From (1), (3) and (4) calculate amount of private capital formation plus contribution by non-federal public authorities necessary for full employment.

6. Determine desirable rate of increase in capital expenditures to arrive at full employment.

7. Estimate the probable expenditures in each important field of capital expenditures.

8. If a deficiency appears likely, consider how far this could be made up (a) by a continuing federal contribution and/or (b) through a modification of the ratio of consumption to income; if an excess appears likely, consider how far this could be offset (a) by a negative federal contribution and/or (b) through slowing up the rate of increase in consumption relative to the growth in income.

C. The Handling of the Short-term Compensatory Problem

1. The type of approach outlined in B, while valid within broad limits, necessarily entails a possible margin of error large in relation to the magnitude of the federal contribution. Inventory movements, changes in consumer debt, housing and foreign developments are particularly difficult to forecast over the short term.

2. Therefore, the practical approach should be along two lines:

(a) Securing such longer-term modifications in the fiscal policy of the Government as appear

called for as a result of the broad, over-all type of statistical investigation outlined in B.

(b) Securing as large a measure of flexibility and appropriate automaticity in Government receipts and expenditures as possible, both within and outside the budget, so as to be in a position to secure the appropriate reaction to unforeseen short-term business developments.

October 29, 1938.

Chairman Eccles

Lauchlin Currie

Meeting of Fiscal Advisory Committee

As I have prepared quite a raft of material for your possible use in connection with the meeting of the Fiscal Advisory Committee, I thought you might like to look over it beforehand in order to decide what, if any, you would use and also to give you a chance to suggest any changes Monday morning.

Even if you do not propose to take along any material, I should like you to look over the charts as an indication of the type of work which, if carried on on a current basis, would reduce somewhat the element of guess work involved in the problem of timing. I have attached brief comments to each chart.

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LIST OF CHARTS

CONSUMER EXPENDITURES AND TOTAL INCOME PAYMENTS

This chart indicates:

(a) the close correspondence of consumers' expenditures with the income of wage earners, farmers, salaried workers and small business men.

(b) that the savings of this group vary with income. Despite the contraction of consumer debt from 1929 to 1932 and the expansion up to 1937, consumption fell less than incomes in the former period and rose less in the latter. In the early stages of a decline consumption appears to fall more rapidly than income (1930, 1938).

(c) that the rate of increase in consumption was exceptionally rapid in the latter part of 1936 when we were approaching plant capacity in various fields.

(d) that not only did incomes cease to expand in the spring of 1937 but that consumption actually declined. This was a fatal aggravation of an otherwise sufficiently critical inventory situation.

(e) the monthly average of national income produced, which includes interest, dividends and business savings, is superimposed in red on the chart to bring out the fact that total income shrank more than consumption in the depression, and rose more rapidly in the recovery. The rise in the monthly average in 1937 was, of course, held down by the bad last quarter.

PRODUCERS' DURABLE GOODS AND THEIR UTILIZATION, 1929 - 1937

This chart is designed to illustrate roughly the changes in the degree of plant utilization, relative to 1929. Although the composition of demand in relation to the composition of plant facilities would have to be intensively studied in any investigation of possible bottlenecks, use of the chart may be justified to bring out the broad facts.

(a) that as a result of the long depression the slack in the labor supply by 1937 was far greater than the slack in plant facilities, relative to 1929. This is a grave type of maladjustment and constitutes a sharp limitation on the rate at which the unemployed can be absorbed, after the bulk of excess plant capacity has been absorbed.

(b) that in late 1936 we were approaching the 1929 degree of utilization of our plant facilities. Since there is reason to believe that the production index did not adequately represent the increase in production from 1933 to 1937, it is quite possible that in December 1936 we actually attained the 1929 level of utilization.

(c) that when the degree of plant utilization, relative to 1929, passed 80 percent, the rate at which additions to the stock of producers' durable goods were being made, speeded up.

PHYSICAL PRODUCTION AND THE QUANTITY OF RETAIL SALES, 1929-1938.

This chart indicates:

(a) that the physical quantity of retail sales shrank far less than money incomes or physical production in the depression and that, in general, the amplitude of the fluctuations in the series is much less than that in others.

(b) that the volume of retail sales in late 1936 and early 1937 exceeded the volume in 1929.

(c) that the volume of retail sales shrank substantially from late 1936 to the middle of 1937.

(d) the divergence of production from retail sales is attributable to the wider variations in production of capital goods and of changes in the physical volume of inventories.

THE GROSS AND NET FEDERAL CONTRIBUTION TO BUYING POWER

This chart shows:

(a) the drastic nature of the reduction in the federal contribution in 1937, partly attributable to a reduction in expenditures but mainly to an increase in tax receipts. Social security taxes played an important role.

(b) the sizeable increase in gross and net expenditures in the first half of 1938.

(c) tentative estimates of the gross and net contribution for the remainder of the fiscal year.

COMPENSATION OF EMPLOYEES, 1929-1938.

This chart indicates:

(a) the increase in importance of incomes derived from public authorities in relation to incomes derived from mining, manufacturing and construction. If the compensation of employees on public construction and farm benefit payments were included, the compensation of employees derived from public service would actually have surpassed the compensation derived from mining, manufacturing and private construction in the summer of 1938.

(b) the maintenance of consumer incomes derived from public authorities in the depression in contrast with the large shrinkage in compensation derived from mining, manufacturing and construction.

(c) the substantial expansion in the incomes derived from public service in the first half of 1938, which more than counter-balanced the decline in mining, manufacturing and construction. This is the main reason why consumer income has depicted on another chart shrank so little in the late recession in comparison with the drastic shrinkage in production.

	Gross National Product	Capital Formation Plus Government Contribution
1925-29	85.2	15.1
1929	90.6	16.7
1930	80.4	11.1
1931	64.5	8.3
1932	48.0	5
1933	46.8	5.7
1934	56.5	5.6
1935	62.1	8.8
1936	71.2	15.9
1937	78.0	14.4

GROSS CAPITAL FORMATION PLUS NET FEDERAL CONTRIBUTION.

This chart, presenting a breakdown of capital expenditures plus government contribution for the years 1925-1937, indicates:

(a) the various fields in which increased income-generating expenditures must take place if we are to achieve a national income requisite for full employment.

(b) the high level of expenditures for inventories in 1936 and 1937 and hence the extreme instability of the total income-generating expenditures in those years.

(c) the importance of the decline in the net government contribution in 1937 in slowing up the rate of increase in total income-generating expenditures.

(d) the importance of residential building in the years 1925-29 and the lag in this series in the recovery in comparison with the extent of the recovery in producers' durable goods expenditures relative to 1925-29.

GROSS NATIONAL PRODUCT

Kuznets' gross product series is used with the deduction of Government savings and imputed rents, both of which items are of doubtful validity. Gross product differs from net product, or national income, by the amount of depreciation charges on business and residential capital.

GROSS PRIVATE CAPITAL FORMATION PLUS NET GOVERNMENT CONTRIBUTION

Capital formation includes Terborgh's estimates covering producers' durable goods; Kuznets' series for net change in inventories carried, through 1937 by the use of Dun and Bradstreet material, and the net change in claims against foreign countries plus net purchases of gold and silver. The net Government contribution covers both the Federal and the State and local governments. For the latter the change in debt outstanding as estimated by the Treasury is used. The Federal net contribution has been carried back to 1930 by the method developed in this Section. For the period 1925 to 1930, the change in the outstanding debt is used as the best series available.

PRODUCERS' DURABLE GOODS CHART

This chart brings out:

(a) the divergence in the movement of capital expenditures in mining and manufacturing since 1933, as compared with capital expenditures in the utilities and railroad fields. Mining and manufacturing expenditures recovered their 1925-29 level, while both railroad and utilities lagged way behind.

(b) the relative importance of these different types of producers' durable goods in the total of business capital formation. A recovery in the railroad and utility fields to the late Twenties' level of capital expenditure would mean an increase over the actual 1937 outlays of about $1 billion. This would bring the 1937 total for producers' durable goods up to $8.3 billion, still somewhat short of the late Twenties' level. The rest of the deficiency is accounted for by commercial buildings, which fell from an annual average of $1.1 billion in the late Twenties to less than $400 million in 1937.

GROSS NATIONAL PRODUCT AND GROSS CAPITAL FORMATION PLUS NET GOVERNMENT CONTRIBUTION

This chart is designed to show:

(a) What the amount of private capital formation plus the contribution of public authorities will have to be to achieve various gross national income levels if the same relation between these series prevails in the future as prevailed in the average period 1925-1929 and again in 1937. (The comparison is between gross capital formation and gross national income. The relation between gross and net capital formation and net national income can be derived.)

(b) How investment increased relative to consumption from 1932 to 1937. Another way of saying this is that, due to the increasing desire and ability to save, a given amount of capital formation expenditures plus federal contribution generated proportionately less national income in 1937 than in earlier years.

(c) How very slight was the increase in the combined capital and net government expenditures in 1937 over 1936, compared with earlier years.

(d) That our problem in attaining the requisite national income is to secure higher capital expenditures plus Government contribution than prevailed in 1929, and/or to increase consumption relative to capital expenditures through tax legislation.