

President
White House
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NEXT STEPS IN THE RECOVERY PROGRAM

The Outlook for the Next Six Months

1. On balance the probabilities favor no significant upturn in the next six months. Unemployment is still increasing and retail sales are declining. The index of production remains below 80 as contrasted with the 1937 average of 110. When the index was last around 80, in 1931 and 1934, the yearly volume of maintenance and new plant and equipment expenditures of mining and manufacturing amounted to \$3 billion, or \$2.7 billion less than in 1937. Utility and railroad expenditures are being curtailed.

Residential housing expenditures are increasing but the magnitude is small. F. W. Dodge residential building contracts awarded in the first half of April were 38 per cent below the first half of April, 1937. The volume of new residential building permits outside of New York in March was 28 per cent below March 1937.

No significant increase under the present program in Government expenditures can be reasonably expected. W. P. A. has about reached its peak; C. C. C. and public roads expenditures will be maintained; P. W. A., depending as it does upon local initiative, will be slow in getting under way; the same is true of U. S. H. A. On the other hand, revenues will continue to fall off so that net expenditures will increase moderately, though not to the levels of 1934-1935.

As against the mildly favorable factors of housing and government expenditures must be offset the strong deflationary effects of

the process of working off inventories, of the completion of orders for heavy durable goods carried over from last year, of the liquidation of consumer credit. The agricultural outlook is depressing.

The foreign economic situation is deteriorating.

Manufacturers, wholesalers and retailers entered the year with \$5 billion more inventory than they had two years previously. Then sales were increasing; now they are declining. It will be months before inventories are worked down to comfortable levels for industry as a whole. Witness the automobile industry with its still large bank of parts. The process of working off inventories involves losses, involves a failure to pass along money received from consumers, and involves a stoppage of production and new buying by producers. The working off of a billion dollars of inventories subtracts as much from the money stream as is added by a billion dollars of new construction, the most we can expect this year.

Under the stimulus of reduced down payments and longer terms there is evidence that consumer credit reached a high level in late 1937. The process of working this off will be a drag throughout the year.

Stock prices are high in relation to probable earnings in 1938, This is a potentially dangerous situation as a further fall in stocks would have depressing psychological repercussions.

A survey of various important elements in the current and immediately prospective situation yields, therefore, no basis for easy optimism for prospects in the next half year.

2. In the light of the above considerations every effort should be made to increase the total volume of public and private expenditures in the next six months to prevent a further deterioration in the business situation.

How Additional Expenditures May be Made

1. R. F. C. loans for railroad equipment. The R. F. C. has the power to purchase adequately-secured equipment trust certificates upon such terms and conditions as it may determine. Loans made for maintenance or purchase of equipment need the approval of the I. C. C. as regards maturity, but do not require a certification by the I. C. C. that the railroad in question, on the basis of present and prospective earnings, may reasonably be expected to meet its fixed charges, as do loans to railroads for other purposes.

It is suggested that for a limited period the R. F. C. announce itself prepared to purchase new equipment trust certificates:

- (a) covering 100 per cent of the cost of new equipment,
- (b) maturing in twenty years in the case of freight cars, fifteen years in the case of steam locomotives and passenger cars, and ten years in the case of complete streamlined trains and Diesel electric engines,
- (c) at a 2 per cent interest rate,
- (d) interest beginning one year after date of loan.

Arguments in Support of Proposal

(a) An offer on less favorable terms would not interest the better railroads that can now sell equipment trust certificates on a 4 per cent basis or better. On an offer such as outlined above, they could hardly afford not to anticipate part of their future requirements.

(b) In the present conditions of railroad finances, equipment trust certificates constitute the most secure type of loan that can be made to the roads.

(c) In no other way could the Government induce as much total expenditure and employment at as little cost to itself. It has been carefully estimated that to handle the volume of traffic consequent upon full recovery in three years' time would necessitate the purchase of $2\frac{1}{2}$ billion dollars worth of equipment.

(d) Any anticipation of these requirements would provide both employment and buying power now, and help mitigate the almost inevitable bottlenecks in the future.

(e) It is important to limit this offer to equipment purchased in the comparatively near future, as otherwise roads will hold back. The stipulation that the equipment must be contracted for in this calendar year to be delivered before June 30, 1939, in the case of freight cars, and September 30, 1939 in the case of locomotives and streamlined trains, appears to be reasonable. This type of work could be begun almost immediately, as contrasted with some other elements of the recovery program.

2. Further Stimulation of Residential Construction

The volume of private low-cost residential construction continues disappointingly low. If it is to grow to become a significant force

making for a sustained revival, additional stimulus appears necessary. This could be provided by an amendment to the Relief Appropriation empowering W. P. A. to supply W. P. A. common labor equal to 10 per cent of the appraised value of new low-cost residential building free to the builder. This offer should apply only to units appraised at \$5,000 or less, the contracts for which are awarded between, say, May 1st and December 31st of this year.

This proposal would

- (a) stimulate a socially desirable type of activity
- (b) give a substantial fillip to private residential building expenditures this year, when they are most needed
- (c) not involve any cost to the Government

The possibilities of aiding in railroad maintenance through the use of W. P. A. labor might be studied. A precedent exists in Canada.

3. R. F. C. Loans for New Utility Expenditures.

As in the case of the railroads, the R. F. C. could make loans for new expenditures for a limited period on very favorable terms. Although it is true that many operating companies are heavily bonded and that they are not now in need of new capacity, still an offer on favorable terms for a limited period should induce many companies to anticipate their future requirements and modernize or replace old equipment. Moreover, the offer by the R. F. C. to loan for such purposes at lower rates than now prevail should have the effect of bringing about a reduction in

the open market rates and hence permit private borrowing and refunding on more favorable terms. Refunding at lower rates reduces the burden of fixed costs, enhances the outlook for profits, and brightens the prospect for securing equity money, the greatest need of the utilities.

In addition to the considerations mentioned above an offer by the R. F. C. to loan money for new equipment for railroads and utilities on very favorable terms for a limited period would permit the replacement of obsolete and high cost equipment by modern low cost equipment. Psychologically, it should have the effect of strengthening the confidence of investors and of adding billions of dollars to the market valuation of the securities of railroads and utilities.

As a supplement to this program it would be helpful if it were announced that the P. W. A. would make no more loans for the construction of municipal power plants.

4. Speeding up of ordinary Government spending at the beginning of the new fiscal year.

Much can be done through the Director of the Budget, the Procurement Division of the Treasury, and the various Government departments to vary the rate of current expenditures and to anticipate the purchases of necessary supplies. Work on public buildings can be speeded up. There should be some possibility of concentrating a larger part of the armament program in the first half of the fiscal year.

Anything that could be done to throw ordinary expenditures into the first half of the fiscal year would be extremely worthwhile both because ^{the} business situation in the summer may be critical and because

the other elements of the program will result in a stepping up of expenditures in the second half of the fiscal year.