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June 6, 1938.

THE IMMEDIATE NEED FOR MORE SPENDING

I - The Emergency Situation

Business prospects are steadily deteriorating. Production, which flattened out for a few months, has again resumed a downward course, the index of production falling to an estimated 75 in May as contrasted with 80 in January and 117 last August. (In March 1933 it was 59). Retail sales and the national income have declined every month this year. We face a further contraction in income derived from the production of consumers' durable goods, new plant and equipment, exports, agricultural implements, mining, and general wage and dividend cuts. Agricultural income with benefits will be $1.1 billion lower this year.

The working off of inventories and consumer credit is an unending process, since liquidation in these fields results in a decline in sales and incomes, which in turn induces further liquidation, as in 1929-1932. Inventories of $20 billion with a national income of $56 billion would be relatively as high as inventories of $25 billion with a national income of $70 billion. The only way to arrest the decline in inventories is to arrest the decline in the national income.

In short, the danger of a prolonged worldwide depression is acute and can be averted only by the most energetic action.

II - The Inadequacy of the Spending-Lending Program

The negligible increase in spending in the next six months is completely inadequate to turn the tide:

1. The substantial increase in Government spending in the last quarter of 1933 to a new high level was not reflected in a rise in the

national income until the fall of 1934.

2. Inventories were low in 1933 in comparison with today.

3. Consumer debt was well-liquidated in 1933, whereas today it is not far short of the 1929 level.

4. By 1933 a lot of deferred maintenance and repairs had accumulated. This had been made up in mining and manufacturing by the time we entered this depression, expenditures on new plant and equipment last year approximating the 1928 level. Our physical plant is now geared to produce much more than in 1933 and consequently excess capacity, and the resulting lack of incentive to build or repair plant, is widespread.

5. In 1933 we were aided by increasing world production. Now world production is falling and this will be reflected in our sales abroad.

6. In 1933, 28% automobiles were under 3 years of age. At the beginning of this year, 42% were under 3 years of age.

7. With a higher level of prices and wage rates now, a given amount of Government spending will not create as much employment or production as it did in 1933.

III - Implications

1. If business does not stage a substantial revival before October there is a likelihood that the New Deal will lose ground at the polls, if well-established historical precedents in this and other countries are any guide. From the social and economic point of view, the real danger of a resulting fatal impasse between the Executive and Legislative branches of the Government cannot be ignored.

2. The only possibility of achieving a balanced budget within the life of this Administration rests on stopping deflation this year.

3. The thoroughly sound principle of a compensatory fiscal policy is being discredited through faulty execution. We are adding to purchasing power in a year of major depression far less than we did in 1936, a year of rapidly advancing production. We have ruled out the alternative of forcing a balanced deflation through securing reductions in certain prices and wage rates and yet have not adopted the only remaining alternative of maintaining sufficient buying power to justify those prices and wages. Under the present program, the peak of expenditures over taxes will probably not be attained until the second half of 1939, two years after the downturn in business.