

5/15/39
May 15, 1939.

ACTION RECOMMENDED AT THIS TIME

To insure a continued recovery throughout 1940 it is imperative that action be taken now to prevent a decline in the Government's contribution to buying power next year.

Political considerations that must be taken into account in working out a program include (a) the demand for progress toward a balanced bookkeeping budget in the estimates to be presented next January, (b) the demand for more adequate old age security, (c) the demand for increased farm benefits, (d) the waning popularity of work relief.

The following suggestions are designed to (a) maintain the Government's contribution, (b) meet the demands for old age security and farm benefits and (c) reduce the bookkeeping deficit:

I - Old Age Security

It is essential that the old age security program be converted from a deflationary to an economically sound one, - from a political liability to a political asset. The real demand in the country is for old age pensions rather than old age insurance. By the end of this year we will have accumulated a fund, and decreased buying power, by \$1.7 billion. Even under the proposed amendments there will be an additional \$500 million accruing to the reserve fund in the calendar year 1940. An incoming Administration will be in a position to inaugurate a national old age pension plan financed out of payroll tax collections and the accumulated fund, which will be more than \$2 billion at the end of 1940. It will be able to reduce the bookkeeping deficit without decreasing Government cash expenditures.

This seems to me to be a distinct possibility since recent polls have indicated that of all types of expenditures old age

pensions are the most popular and that a national old age pension program will be one of the most vital issues of the coming election.

Obviously, here is a case where the Administration should assume the initiative. In the next calendar year the Federal Government will make appropriations of over \$800 million for old age security. Yet only \$300 million will actually be expended in old age assistance and insurance payments. Federal appropriations of \$800 million, plus \$250 million of state contributions, could finance an adequate national old age pension program.

A plan has been worked out along this line that will preserve the contributory principle, and is available.

II - Farm Benefits

Additional agricultural parity payments, going out in the spring of 1940, would be particularly well-timed from the point of view of other changes in the budget and of the requirements of recovery at that period. Additional payments which Congress is likely to appropriate could be coupled with increased taxes on individual incomes in the middle brackets, and on estates. This would tend to reduce savings and result in a net addition to consumption.

III - Railroad Equipment.

Additional railroad equipment would be urgently needed in the event of further recovery or in the event of war. The supply of freight cars, for example, is nearly 700,000 below 1928. The potential demand could be made actual if:

(a) the loan authorization of the RFC for equipment loans were increased,

(b) the RFC would announce that, for a period ending June 30, 1940, on equipment to be delivered before June 30, 1941, it was prepared to make loans covering the full cost of equipment for long maturities and at a low rate of interest. For this offer, interest payments could commence on June 30, 1941.

Such loans would be financed out of the proceeds of RFC guaranteed obligations and hence would not be a charge on the budget. To the extent that increased expenditures were secured in this way, budgetary appropriations (e.g., for WPA) could be reduced without entailing a decline in the net contribution to buying power.

IV - Housing

Upon the passage of the pending FHA amendments, reduce the maximum rate of interest on FHA mortgages from five percent to four and a half percent. This would mean an effective rate to the borrower of five percent, allowing for the insurance premium. Make this change effective by having the Federal National Mortgage Association purchase FHA mortgages to yield three and a half percent instead of the present four and a quarter percent. This would entail no additional charge on the budget.

V - Public Works

Provide for the continuation of non-federal public works through loans and interest subsidies, rather than outright grants of principal. In this manner \$1 billion of additional expenditures could be secured at an annual charge on the budget of \$20 million, if the loans were secured from the RFC, or slightly more if the loans were raised in the open market.

VI - Public Self-Liquidating Investments

Capitalize various existing revenue-yielding assets of the Government and substitute guaranteed for direct debt. Finance current expenditures on self-liquidating projects through the issue of guaranteed obligations.

Conclusion

The above program is believed to be politically feasible and economically desirable. It would obviate the danger of a downturn in 1940; it would permit various popular demands to be met; and it would permit an approach to a balanced budget for the fiscal year 1941.