1940

General Statement

ECONOMY, DEBTS, AND BUSINESS

Aside from political maneuvering, the current economy drive in Congress is based upon two factors: (1) The belief that business is improving and will continue to improve under the stimulus of war orders. (2) The conviction that increased public debt is dangerous, coupled with an unwillingness to increase taxes in an election year.

These factors should change significantly in the near future. Business activity is already declining sharply, and the decline seems likely to continue to considerably lower levels. This will chill the recent optimistic expectations concerning business trends. Business recession in turn will change the attitude toward economy. Whatever the fear of expanding federal debt, the fear of depression is greater. A willingness to spend for recovery will develop as soon as this fear really takes hold.

It is vitally important that the administration be prepared to take aggressive measures to halt the decline. This will demonstrate to the country once more the administration's capacity for leadership and its readiness at all times to develop the type of policy which the situation demands.

The Business Outlook

It is now clear that the surge in activity since the outbreak of war was primarily production for inventory accumulation. Of the increase of $1100 millions of investment expenditures which occurred in the last quarter of 1939, inventory accumulation constituted $950 millions, or about 86%. While investment in inventories is still going on, it is sharply diminished. The other factors are not increasing rapidly enough to offset this decline and activity is therefore falling off. The only question at the present is the extent and duration of the decline.

The rosy views of business prospects were based on the fall upturn, which carried the Federal Reserve index from 102 in August to 128 in December. The New Year was followed by a slight hesitation, and now February has seen a distinct slackening to about 110 at the present time. Present export, investment, and inventory prospects lead to an expectation of further decline, with the bottom coming in mid-year or even later, and with the low point falling between 80 and 100. The higher figure would hold if there is no inventory liquidation and if exports exceed 1939 levels by 1½ to 2 billions. If two-thirds of the recent additions to inventories are liquidated, and if the export increase is only 1 to 1½ billions, the lower level of activity might be reached. At best, the decline would carry production and employment about back to where we were before the war was declared and at worst would plunge us far lower. Prompt action is called for if the present decline is to be checked before it reaches such dangerous proportions. 1/

1/ The analysis of investment and export prospects on which these business forecasts are based is given in Appendix 1.

Had December levels been maintained, national income would now be running at a 75 billion dollar level. Instead, it is now running at a 71 billion level, and may touch as low as a 65 billion level by mid-summer.

The recovery seems likely to be resumed at least by the fourth quarter, since inventory recessions, like inventory boomlets, are short-lived. That recovery, however, will probably be much slower in tempo than that of last fall, and with as much export stimulus as seems probable will hardly rise above 110 in 1940, even if the net contribution of the Government is not significantly reduced by budget slashing. 1/

War demands, thus, have little promise of producing substantial recovery. If the war should end suddenly, however, there would instead be a disastrous collapse.

The Immediate Program

The business outlook is, thus, a choice between an immediate substantial downturn, if present budgetary and Congressional intentions are followed, or only a moderate downturn, followed by quicker recovery, if prompt federal action is taken on an adequate scale.

The country is afraid of increasing debt, but it isn't afraid of federal spending, and it supports spending for particular projects. 2/ A new program of federal spending without increasing the debt can be developed by drawing on the several unspent reserves of the Treasury and by expanding some of the current activities on a self-financing basis outside the budget. In addition, several other forms of investment can be materially expanded with only negligible budgetary cost.

The only way to get expenditures increased quickly is through relief expenditures, the stamp plan, and F.S.A. In addition, though, we have to provide measures at once which are slower to take hold, if we are to satisfy the public insistence on an approach to budget balancing. To do this, we must show that the immediate program covers not only renewed direct spending, but also provides for an expanding volume of activity, which is not based directly on federal spending from the regular budget.

1/ The analysis of investment and export prospects on which these business forecasts are based is given in Appendix 1.

2/ See the opinion surveys in Appendix 2.

Elements providing prompt stimulus to consumption expenditures:

1. Develop out-of-the-budget financing for self-liquidating activities already under way.

(a) Restore the $40 million for R.E.A. back to R.F.C. financing as proposed in the budget.

(b) Authorize Farm Security Administration to put the best three-quarters of its rural rehabilitation loans and all of the tenant purchase loans on a self-financing basis, by the sale of debentures to R.F.C. or to the public. 1/ ($250 millions a year.)

2. Expand the W.P.A. rolls to three millions, and expand N.Y.A. and C.C.C. correspondingly, and from this level taper off gradually as employment develops as an outgrowth of the other measures.

3. Expand the stamp plan to enlarge food and textile consumption of low-income groups.

4. Cut the old-age payroll tax by 1/2, until such time as old-age outpayments become equal to tax receipts. (The old-age reserve is now adequate for contingencies. We can afford a lower tax rate until benefit payments increase materially.) 2/

5. The immediate increase in expenditures can be maintained without any additional borrowing by

(a) Drawing upon the cash balance of the Treasury.

(b) Making full use of the silver profit.

(c) Utilizing some of the gold in the stabilization fund.

Three billions could be drawn from these three sources without impairing the cash position or the operation of the stabilization fund.

1/ See Appendix 3, Section 1.

2/ See Appendix 3, Section 2.

Elements providing follow-up expansion:

1. Intensify efforts to speed up private investment in housing. The field of low-cost housing is especially promising and the full force of Government encouragement should be placed behind the drive to promote it.

2. Expand public construction, with the budget assuming only the annual interest and amortization charge.

   (1) The U.S.H.A. has demonstrated how annual grants covering part or all of interest and amortization have enormous leverage on the volume of investment. Add an additional $500 million of construction to the U.S.H.A. authorization at an annual budget cost of only $15 million.

   (2) The proposed hospital building program might similarly be financed, on a greatly enlarged volume of construction, by a very small annual appropriation.

3. Authorize a renewal of public works construction of the P.W.A. type, but based on annual subsidy of the U.S.H.A. type, and with local or federal loans outside the federal budget. 1/

4. Urge the states to increase unemployment payments by shortening the waiting period, increasing the rate of benefits, and especially extending the duration of benefits. 2/ This would not produce an immediate large increase in benefit payments, but immediate pressure is needed to bring about eventual state action. (Favored both by A.F.of L. and C.I.O.) 2/

5. Correct the deflationary effects of the Social Security program (insofar as they cannot be eliminated by a decrease of payroll taxes and/or increase of benefits) by investing the reserves in securities that represent newly constructed works under the Government's investment program, which would not otherwise be constructed. This would meet the spurious but widely held view that there should be real assets to guarantee the Social Security funds.

1/ See Appendix 3, Sec. 4, for details.
2/ See Appendix 3, Sec. 3.

6. Broaden the eligibility to receive old-age pensions, by modifying the eligibility limitations, preferably by granting a small pension to all retired persons 65 or over. At present, half of those over 65 who paid old-age taxes are ineligible for benefits because of technical limitations. 1/

7. Reduce the annual budget charge for debt service by modifying Treasury policy to reduce interest costs on the debt.

   (a) Use more short-term maturities and less long-term bonds in refinancing maturing public obligations. (There is no justification for shifting to long-term obligations unless we believe the long-time trend of interest rates is upward.)

   (b) Reduce the present limit of $10,000 a year to one purchaser of Baby Bonds, to $1,000 a year. (The higher rate on these bonds constitutes an interest subsidy to savers. Savings of over $1,000 a year cannot be made by low-income families, and do not deserve a subsidy.)

The Longer-Term Program and Outlook

Unless measures such as those suggested above are taken, the longer-term outlook is not bright. With any expenditures the belligerents seem likely to make here, and any public action the budget now provides, 1941 at best will be no more prosperous than 1937. Unemployment will continue to grow almost as fast as the number of employables increases—600,000 a year.

Even with action along the lines suggested, a longer-term program is necessary to provide more fundamental techniques both to increase consumption and stimulate new investment. In general, such a program must place more emphasis on increasing taxation of income which would otherwise be hoarded, and on federal support of social expenditures which would otherwise be neglected. Such methods would make it possible to approach a balanced budget with safety. Possible elements of such a long-time program, and methods for popularizing it to the public, are presented in Appendix 4.

1/ See Appendix 3, Sec. 2.

APPENDIX I.

The Business Outlook

The decline of business activity that was forecast last September is already well under way. It is now clear that the surge in activity since the outbreak of war was based upon inventory accumulation. Of the increase of $1100 million of investment expenditures which occurred in the last quarter of 1939, inventory accumulation constituted $950 millions or about 86 percent. Investment in inventories is still going on, but the rate of accumulation is sharply diminished. Other investment is not increasing rapidly enough to offset this decline and activity is therefore falling off. The only question at the present time is the extent and duration of the decline.

On an optimistic estimate, assuming no inventory liquidation and an increase in exports of $1½ to $2 billion a year over 1939, the Federal Reserve adjusted index should decline from the December high of 128 to almost 100 in the third quarter; this decline will be a consequence of the cessation of inventory accumulation rather than any substantial down-turn in the less volatile investment factors. On a pessimistic estimate, assuming that approximately two-thirds of the inventories recently accumulated will be liquidated and that exports will increase by $1 to $1½ billion, the Federal Reserve index will fall to the neighborhood of 80 in the third quarter. At best, the decline would carry production and employment about back to where we were before the war was declared and at worst would plunge us far lower.

Had December levels been maintained, national income would now be running at a $75 billion level. Instead, it is running at a $71 billion level and may touch as low as a $65 billion level by mid-summer.

Chart I shows the range of investment trends on which these extreme estimates are based and the intermediate trend mid-way between the extremes of this range. The index of production through 1939 has also been drawn on this chart to show its close relationship to the investment total.

Inventories

At the outbreak of war, inventories were still at a high level. As the upper-left section of Chart II shows, the 1938 decline wiped out about 1/3 of the 1936-1937 advance. After the outbreak of war, inventories advanced sharply and by the end of 1939 were only 3 percent below the end of 1937 level.

Changes in the physical volume of inventories show even more clearly the situation existing at the end of 1939. The upper-right section of Chart II indicates that most of the decline in inventories came in the last quarter of 1937 and the first half of 1938. Since a large proportion of the decline in value was due to the decline in prices, the decline in volume was even smaller than the decline in value. From the middle of 1938 to the middle of 1939, the increase in inventory volume was relatively small. After the outbreak of war, the rate of inventory accumulation was stepped up rapidly, and in December it was as great as at any time during the 1937 boomlet. By the end of the year, the volume of inventories had exceeded the 1937 peak.

Appendix 1

At the present time production still exceeds consumption, and inventories are still rising. As shown in Chart III, production was far above consumption in the last part of 1939. Since then, it has fallen more sharply than consumption and promises to close the gap within the next few months. The critical question is will inventory liquidation occur when accumulation stops?

Our optimistic assumption is based on the view, which is widely held, that business firms desire to hold larger inventories as a kind of war risk insurance and that there will be no liquidation of inventories despite the decline in activity.

On the basis of data represented in Chart III, a decline in the production index of about 12 points is required to bring accumulation to an end, even on the assumption that consumption will be sustained. This is equivalent to a 17 or 18 point decline in the Federal Reserve index. The decline will, of course, have to be larger if consumption also moves downward. A decline of this magnitude will probably affect consumption and other factors adversely so that the movement will have to be somewhat larger at best.

Our pessimistic assumption is based upon the view that a large part of the inventory accumulation derived from hope for, or fear of, price increases. Prices were driven up sharply in September by these very hopes and fears, but the upward movement has since been reversed. As is indicated in the lower section of Chart II, prices of foodstuffs and industrial raw materials have been falling steadily since the middle of December and have lost about half the previous advance. The downward trend of new orders indicates that the business community fears that this trend will continue. The losses that will be incurred with further price reductions, especially if finished-product prices are affected, create pressure for liquidation. In the past every inventory boomlet has been followed by a period of sharp liquidation.

It is probably true that not all the inventories accumulated since the outbreak of war will have to be liquidated. Our assumption that 2/3 of this increase will be liquidated may be somewhat pessimistic, but it is certainly within the bounds of reason. This would require a maximum fall of the production index on Chart III to a level perhaps 6 or 7 points under the index of consumption. This would be equivalent to a further decline of 9 or 10 points in the Federal Reserve index. This total decline is so large in magnitude that the other investment factors must be adversely affected. This will contribute further to decline in activity. This whole process is merely the pattern of the last part of 1939 in reverse.

Exports and the Net Foreign Balance

From the outbreak of war to the end of November, our export figures gave no clear indication of war stimulation. The significance of the sharp increase in December and the failure of the usual seasonal decline to appear in January, however, is unmistakable. The export total for January, with some documents still missing, is $350 million. Exports in December were $357 million and in January 1939 were $210 million. Some of the increase in the last two months represents goods which would have moved out earlier but for the embargo. While a strong stimulus is evident, therefore, it is not as powerful as the figures indicate.

If fighting becomes intensified in the spring, with perhaps extension of the war to other fronts, the volume of exports in 1940 may reach a level $1½ to $2 billion in excess of the total of about $3.2 billion in 1939. This is the most optimistic forecast that has come to our attention.

Even if the war continues on the present scale, with neither side feeling that the balance of power is definitely in its favor and willing to risk heavy losses in a large-scale offensive, the attempts of the belligerents to strengthen themselves and turn the balance in their favor may yield a level of exports $1 to $1½ billion higher than 1939. While more pessimistic views are held in some quarters, information concerning commitments by belligerents seems to justify the estimate of $1 billion as a minimum increase, if the war continues.

The increase in exports will not be reflected fully in the net foreign balance. In the past, increases in exports have only increased the net foreign balance by 1/4 to 1/3 of the increase in exports. Taking into account the decrease in export capacity of the belligerents and the decrease of tourist expenditures, however, it is reasonable to assume that the increase of exports will increase the foreign balance by something above 40 percent of the total increase in exports. The optimistic estimate for 1940, therefore, assumes that the net foreign balance which was $780 million in 1939, will increase to $1,500 million. The pessimistic estimate assumes an increase to only $1,250 million.

Producers Expenditures for Equipment

During the last quarter of 1939 orders for equipment reached a very high level. Owing to the lag of production behind orders, this large increase will carry over into the first quarter of 1940, which may reach a peak about as high as the peak reached in the second quarter of 1937. From this high level of output for the first quarter, however, some decline must occur. The decrease in industrial activity, by decreasing the proportion of present capacity utilized, is discouraging new equipment installation. Furthermore, the softening of prices is discouraging any tendency to anticipate future requirements.

New orders in this field have been falling off very rapidly. December new orders for iron and steel were 13 percent below November and were 20 percent below December, 1938; for electrical machinery they were 21 percent down; and for transportation equipment, down 36 percent. Backlogs of unfilled orders, which reached a peak in November, are being rapidly reduced despite the current decline in operation. The sharp bulge and decline in new orders since the outbreak of war is almost identical with the pattern established in early 1937. Only a reversal in the trend of new orders, therefore, a spurt such as might occur if the war reached a considerably larger scale, would justify our optimistic assumption with regard to the level of equipment expenditures.

More realistically considered, the decline should be much larger. The increase in exports cannot offset the decrease in production for inventories. With excess capacity increasing and prices falling, the decrease in equipment expenditures from the first quarter high is likely to be as rapid as the increase after the outbreak of war. This would still yield a level for 1940 about 4 percent higher than 1939, and would allow for continued high level in such lines as airplanes, shipbuilding, and machinery. The range established by these estimates is shown on Chart IV.

Producers Expenditures for Plant

In the case of plant expenditures even more definitely than in that of equipment expenditures there is a lag behind new orders. The level of new orders rose almost constantly through 1939 and expenditures in the first quarter of 1940 should be higher than in the last quarter of 1939. A continuation of this upward trend would reach a high by the last quarter of 1940 approximately as high as the 1937 peak levels.

On the other hand, activity will decline if the present trend in new orders continues. Private non-residential construction contract awards in January 1940 were reported to be about equal to January 1939. This represents a substantial decline from the level reached in the last quarter. With business volume falling off there would be little incentive for additional plant expenditures and a decline to the level of the first quarter of 1939 would not be unreasonable in the light of the foregoing analyses of the other investment factors. The year as a whole would in this case again be slightly higher than the corresponding total for 1939.

Net Government Contribution

The net government contribution will undoubtedly be lower in 1940 than it was in 1939. Unless there is a definite change in policy, the first quarter of 1940 will be perhaps $30 million lower than the last quarter of 1939 and the second quarter will be down about $150 million or approximately 17 percent. A still further decline is in prospect for the third quarter, even on the assumption that the budget will stand as originally recommended by the President. Thereafter, on this same assumption, the fourth quarter should show a recovery about to the level of the second quarter. If appropriations are slashed, however, both the third and fourth quarters should be somewhat lower. No attempt has been made to take this into account in projecting estimates into 1940. The current rate of expenditures and the budget recommended have been assumed to be the determining factors.

Residential Construction

The trend in residential construction has been almost continuously upward since 1934. 1939 was generally higher than 1938, but by the end of the year the margin over 1938 had been wiped out. This levelling off during 1939 appears highly significant in conjunction with other factors. The stimulus provided by the FHA program of low interest charges and more favorable amortization was largely absorbed in bringing construction to this level; the market has been nearly saturated with respect to houses in the $5000-$10,000 price range, which was the prevalent range under this program. According to the latest figures, applications for mortgage insurance have fallen off considerably, and on this basis a considerable decline in the volume of construction could occur during 1940. The ranges indicated on Chart IV assume that 1940 may be as much as 10 percent below 1939 or 10 percent above, the latter implying merely an extension of the upward trend of the last few years.

Consumers Durable Goods

With production falling as a result of the collapse of the inventory boom, prospects for 1940 cannot be considered favorable as compared with the level reached in the last quarter of 1939. Incomes will be impaired at least to the extent of any additional unemployment that occurs. Purchases of consumers' durable goods are usually more sensitive than incomes, and move with the level of activity. If the decline in activity corresponds to our pessimistic assumption as to the other investment factors, it is likely that 2/3 of the advance from the 1938 low will be lost.

Assuming, as is sometimes argued, that the long-term trend in consumers' equipment purchases is still upward and that a large backlog exists, the decline from the year-end peak might be somewhat less than the corresponding decline in activity. At best, however, a decline from the last quarter should be expected. An optimistic estimate might place this decline at only half the increase in the last quarter of 1939, which would leave the year as a whole 5 percent above 1939.

Total Investment and Productive Activity

The attached tables show the quarterly total for all the investment factors discussed above from 1935 to 1939 and estimates for 1940. There are three sets of estimates for 1940. The first of these is based upon the most optimistic assumptions concerning business trends, as discussed above. The third set of estimates is based upon the most pessimistic estimates concerning trends in these factors. Together these two sets of estimates establish the range within which the total is likely to fall. The second set of estimates is the mid-point between these two extremes.

As Chart I indicates, production at best is likely to reach a level in the neighborhood of 105 in the second and third quarters and to approach 100 closely for at least one month. It may on the other hand fall to the neighborhood of 80 in the third quarter and in that case is likely to get below 80 for at least one month. A decline of this magnitude would have very serious consequences and probably could be checked only as the decline of 1937-38 was checked; that is, by increased government outlays.

Total Investment, Quarterly, 1935-1939

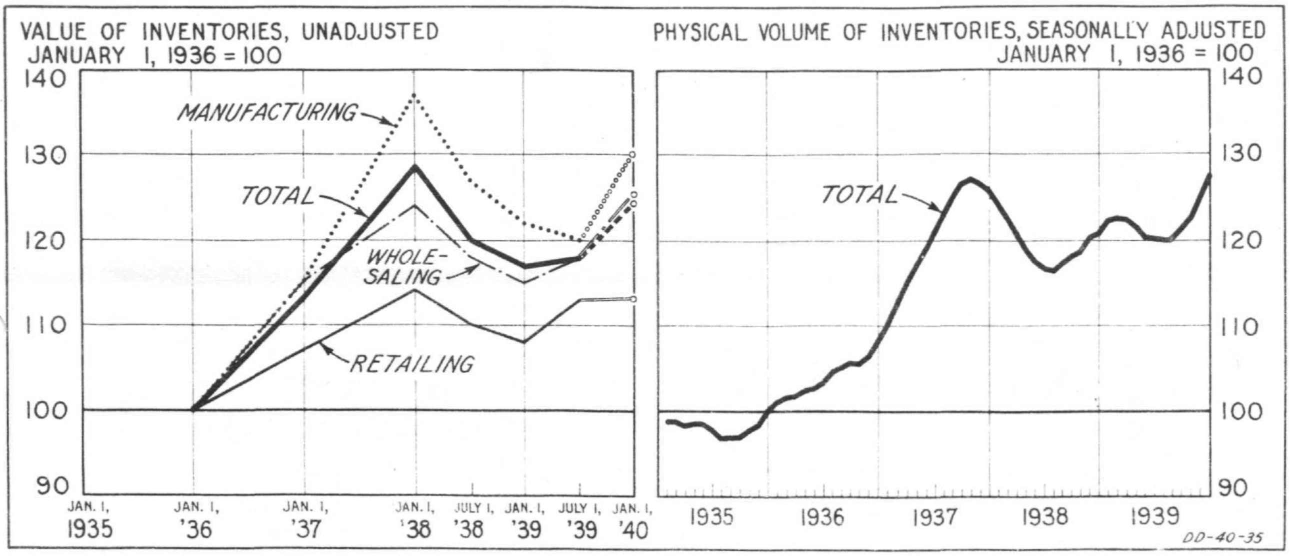
ar	Equipment	Plant	Housing	Consumers Durables	Net Foreign Balance	Inventories	Govt. Net. Contrib.	Total
1935	3090	1260	530	5545	185	272	3270	[illegible]
1Q	670	300	80	1310	80	+ 10	861	3311
2Q	750	295	110	1340	60	- 65	956	3446
3Q	780	320	160	1415	35	-145	989	3554
4Q	890	345	180	1480	10	+472	924	4301
1936	4135	1650	1100	7050	-155	1439	4337	
1Q	950	350	200	1565	- 10	+280	809	4144
2Q	975	385	240	1740	- 30	+241	1294	4845
3Q	1070	465	310	1830	- 50	+342	1220	5187
4Q	1140	450	350	1915	- 65	+576	1014	5380
1937	5275	2295	1390	7725	- 15	2743	1092	
1Q	1270	475	350	1980	- 85	+972	334	5296
2Q	1400	600	390	2010	- 25	+1014	281	5670
3Q	1355	590	350	1985	20	+896	227	5423
4Q	1250	630	300	1750	75	-139	250	4116
1938	3615	1775	1390	5815	1025	748	2374	
1Q	1045	520	300	1470	190	-795	221	2966
2Q	895	440	310	1290	310	-593	536	3128
3Q	810	410	360	1320	280	+221	756	4177
4Q	865	405	420	1735	245	+419	861	4975
1939	4285	1850	1900	7000	780	992	3644	
1Q	935	445	470	1750	210	+202	864	4891
2Q	1055	450	510	1640	170	-332	1010	4593
3Q	1090	460	460	1680	175	+168	870	4933
4Q	1205	495	460	1930	225	+954	900	6034

Estimated Total Investment in 1940

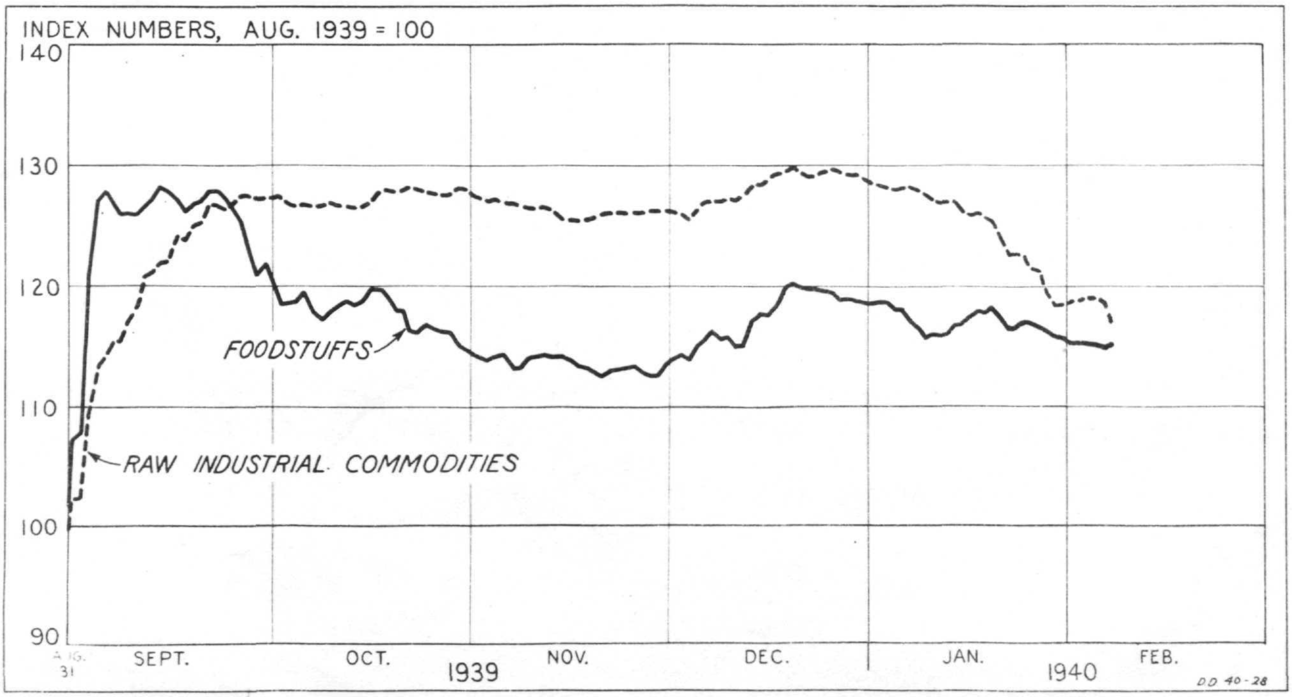
	Equipment	Plant	Housing	Consumers Durables	Net Foreign Balance	Inventories	Govt. Net Contrib.	Total
I.	**Optimistic Estimate**							
	5180	2230	2080	7360	1500	350	2980	21,680
1Q	1340	520	490	1910	300	350	870	5,780
2Q	1280	540	510	1830	350	0	730	5,240
3Q	1260	570	530	1790	400	0	630	5,180
4Q	1300	600	550	1830	450	0	750	5,480
II.	**Intermediate Estimate**							
	4835	2035	1910	7010	1375	-100	2980	20,045
1Q	1325	510	475	1885	290	350	870	5,705
2Q	1230	510	480	1765	325	-100	730	4,940
3Q	1150	505	480	1645	360	-300	630	4,470
4Q	1130	510	475	1715	400	- 50	750	4,930
III.	**Pessimistic Estimate**							
	4430	1840	1740	6660	1250	-550	2980	18,410
1Q	1310	500	460	1860	275	350	870	5,625
2Q	1180	480	450	1700	300	-200	730	4,640
3Q	1040	440	430	1500	325	-600	630	3,765
4Q	960	420	400	1600	350	-100	750	4,380

Inventory Values and Trends, 1935-39 (Dun & Bradstreets and U. S. Department of Commerce).

Note.--Value of inventories (Dun & Bradstreets series), for January 1, 1940 was estimated by the Department of Commerce upon the basis of changes in sample data during the last half of 1939. The monthly index of total inventories in terms of January 1, 1936 dollars is based upon the Dun & Bradstreets series; adjustments for wholesale price trends, and interpolations for monthly figures have been made by the Department of Commerce. This index also has been adjusted for seasonal variations.



Indexes of Spot Market Daily Prices of 12 Foodstuffs and 16 Raw Industrial Commodities, August 31, 1939 - February 7, 1940 (U. S. Department of Labor)



Appendix 2

Educational efforts in the light of city and farm attitudes toward spending.

Recent opinion tests among farmers and city people throw some light on their present attitude toward debt and spending. (These tests, made by a unit of the Bureau of Agricultural Economics, are summarized in Appendix A to this memorandum.) The tests covered a representative sample of farmers and of city people in northeastern cities.

Both among farmers and city people, there was general approval of the use of funds for specific purposes. They approved of New Deal efforts to help them make a living, and of New Deal expenditures to raise farmers' incomes, to aid tenant farmers, and to relieve unemployment through W.P.A., C.C.C., etc. Both city and country had practically unanimous approval of conservation. When the matter was posed as to whether the Government was spending too much in general, one-quarter of the city people thought it was, whereas three-fifths thought it was not. Among farmers, however, 30% opposed spending in general, and 6% favored, while approximately two-thirds expressed no opinion.

It appears, therefore, that public opinion against "spending" is by no means so strong as the newspapers and Congress have been asserting. It also appears, though, that public opinion is most ready to back spending when it takes specific concrete forms, and most ready to oppose when it is stated as spending in general. Publicity on fiscal policy, therefore, if it is to be most effective speedily, should center upon the needs and justifications of particular expenditures.

Since a majority of the public apparently have no fixed opinion against spending in general, however, efforts at education with respect to general spending and debt increase should be continued, but should be expected to produce results only as a long-time educational program.

Appendix 2

Some of the most significant of the opinion facts are as follows:

	Per cent of those interviewed	
	Farmers	Northeastern City People 1/
Is the Government spending too much?		
Yes	29%	26%
Don't know	65%	5%
No	6%	60%
Is it spending too much on farm programs?		
Yes	5%	19% 2/
Don't know	60%	5%
No	35%	74%
Attitude on spending on unemployment relief programs:		
Undesirable feature of New Deal	10%	13%
Desirable feature of New Deal	(not asked)	33%

1/ The percentages do not add to 100, since some interviews did not obtain any indication on the question.
2/ The question to city people was stated in terms of whether Government should spend money at all on farm programs, not whether it was "too much."

Appendix 3, Section 1

If the Farm Security Administration were authorized to make self-liquidating loans up to $250,000,000, the money could be used approximately as follows:

A. $150,000,000 for Rehabilitation Loans.

These loans, averaging about $500 each and bearing 5 per cent interest, would be made to approximately 300,000 needy farm families, who are unable to obtain adequate credit elsewhere. Loans would be used for the purchase of seed, fertilizer, livestock, tools, and other equipment needed to enable these people to make a living from the land. FSA now has on hand more than 400,000 applications from families eligible and in need of rehabilitation loans.

Such loans, now made from relief funds, are proving about 80 per cent collectible; and losses are largely concentrated in the Great Plains states which have suffered repeated and severe droughts.

Under the proposed program, only those loans which are 100 per cent recoverable would be made from self-liquidating funds; while the poorer risks would be handled with emergency relief funds. If any loan made from self-liquidating funds should become seriously delinquent, it could be transferred to the emergency relief account. It is estimated that at least 75 per cent of all rehabilitation loans could be classed as entirely self-liquidating.

B. $100,000,000 for Tenant Purchase Loans

These loans, averaging about $5,000 each, would be made to approximately 20,000 tenants, sharecroppers, and farm laborers, to enable them to buy farms. FSA now has on hand 148,000 applications, although requests for loans have been accepted in less than half of the nation's agricultural counties. Current collections indicate that these loans would be 100 per cent repayable, at three per cent interest over a 40-year period.

It is estimated that at least a third of the money advanced for rehabilitation loans would be spent for construction or durable goods, such as farm machinery and canning equipment; and that about 25 per cent of the Tenant Purchase loans would be used for construction and repair of buildings, fencing, terracing, and land improvement.

Appendix 3

Appendix 3, Section 2

Old-Age Insurance

It is estimated that during the fiscal year 1941 the excess of receipts over outpayments from the old-age and survivors trust fund will amount to nearly $600,000,000, increasing the accumulated reserve from $1,750,000,000 at the beginning of the fiscal year to $2,330,000,000 on June 30, 1941. Old-age benefit payments are estimated at only $100,000,000 in fiscal 1941. The excess of payroll tax receipts over benefit payments involves a corresponding draft upon incomes and particularly upon the buying power of the lower and middle income groups. Since the groups chiefly affected consume currently all or nearly all of their income, this draft upon incomes directly produces a nearly equivalent contraction in the volume of consumer purchasing; when account is taken of the indirect, cumulative effects of the primary curtailment in consumer demand, the total curtailment in national income attributable to the piling up of idle reserve funds substantially exceeds in amount the current additions to these funds.

The restrictive effect upon national income exerted by our present old-age insurance system can be relieved through a liberalization of the present stringent provisions regarding eligibility for benefits of persons reaching age 65, preferably by granting a small pension to all retired persons of 65 or over. Many persons reaching age 65, even though they have suffered payroll deductions under the old-age pension system, are ineligible for any benefits whatever under that system, because their earnings in covered employment have been either too low or too intermittent to meet the present eligibility requirements.

Alternatively, this drain on consumer buying power would be reduced through a lowering from 2 per cent to 1 per cent of the present tax on payrolls, with the provision that the lowered tax rate should remain in effect until outpayments from the trust fund become equal to receipts. This reduction would reduce consumption taxes by over $300,000,000 in fiscal 1941. It would still permit a gradual growth in the old-age and survivors insurance trust fund, which is already more than adequate as a contingency reserve.

Appendix 3, Section 3

Unemployment Insurance

It is estimated that the balances of States in the unemployment insurance trust fund, which totaled $1,510,000,000 on December 31, 1939, will rise from $1,800,000,000 to $2,380,000,000 during fiscal 1941. The experience of the State employment insurance system has already clearly shown that in the relationship between taxes and benefits the system is, for most states, needlessly unliberal. Employers' groups are urging legislatures to reduce taxes, and labor organizations, both A.F. of L. and C.I.O., are advocating more adequate benefits. It is urgently desirable that the Social Security Board should exert all influence which can appropriately be brought to bear to secure the amending of State laws regarding unemployment insurance benefits. Since legislative action is required in each State separately, results cannot be swiftly achieved, but a vigorous start ought, nevertheless, to be made at once, for both economic and political reasons. Liberalization of benefits might best take the form of a lengthening of the maximum period during which benefits can be drawn, now 16 weeks in most States. Such liberalization might well be accompanied by an approach to nationalizing the unemployment compensation system, the present structure of which involves the possibility of serious inequities between States. Difficulties may arise when regional variations in business conditions substantially deplete unemployment funds in a few States while reserves continue to accumulate in others, unless benefits are held down in those States where employment fluctuates most widely.

Appendix 3, Section 4

Extension of U.S.H.A. type of financing

In an effort to obtain the stimulating effects of substantial non-Federal public works expenditures and at the same time avoid the heavy charge on the Federal budget that is involved under the P.W.A. system of 45 per cent cash grants, it is proposed that special inducement to local governments to continue public construction projects be furnished by giving a subsidy in the form of Federal annual contributions to servicing the debts incurred by municipalities in the financing of such projects. The Federal Government's contribution to municipalities might be given in an annual amount equal to 50 percent of the annual debt service on municipal borrowings incurred to finance the cost of the projects. These annual Federal payments would be made both on loans made to the municipalities by the Public Works Authority of the United States and on loans obtained elsewhere, provided that the rate of interest on the latter loans would not exceed 3 per cent. The interest rate charged by the U. S. Public Works Authority would also be 3 per cent. The Public Works Authority would be authorized to obtain capital funds for the making of such loans through the sale of its own obligations, carrying a Government guarantee. The main reason for annual contributions is that this method spreads the cost over the life of the project instead of treating the whole capital outlay as a charge against the current year's budget.

Appendix 4.

II. Long-time fiscal program.

Paralleling this program of immediate action should be a longer time program of continuing policy, to be followed in succeeding Congresses.

The country is alarmed about the steadily rising debt, and wants an approach towards a balanced budget. This can be accomplished safely by a long-time program which includes:

1. Tax reorganization to produce more taxes, with less pressure on consumption and more encouragement for investment. The tax program of the Federal Government should be modified as rapidly as possible to diminish taxes now pressing on consumption and to increase taxes on incomes now going into idle hoards. This shift in the tax program should make it possible to decrease the net contribution and approach a balanced budget with safety.

   (a) Close the loopholes in the present income tax laws.

   (b) Tax rates on the middle-income brackets should be increased.

   (c) Impose a tax on war profits as soon as the recovery begins to take hold; under present conditions large excess profits in the limited fields receiving war orders merely go into idle surpluses and make no further contribution to recovery.

   (d) Taxes which bear on consumption should be diminished as additional revenue from the above taxes begins to accrue.

   (e) Cease the issuance of tax-exempt securities.

2. Expand the range of continuing federal grants to provide annual grants to states in aid of social programs.

   (a) At first, these might cover grants for new fields for which well-matured programs and widespread support have already been developed, including education, public health, and child welfare.

   (b) Subsequently other areas of expanded social service might be developed, such as broad recreational and juvenile welfare programs.

3. As national income rises past 80 billions, and federal revenues rise and relief needs decline, make a start in paying off past debts, but be careful not to contract federal expenditures to the point where business activity is checked and income might again fall.

Appendix 4

4. No program of fiscal policy alone can provide a solution to all our ills. Fiscal policy is the most effective recovery weapon that the New Deal has yet devised. It cannot, however, provide an answer to the problems of concentration of financial power and to the price and production policies of monopolistic corporations, with which the T.N.E.C. has been grappling. An effective fiscal policy, aggressively and broadly followed, can hold the fort while we work out solutions to these larger problems. Fiscal operations alone could raise our national income to 80 to 90 billions a year, and hold it there for a ten or fifteen year breathing spell, in which we might learn how to deal with the larger industrial problem.

III. Long-time educational effort necessary.

Current surveys of opinion indicate that spending is not nearly so unpopular among the general public, as the newspapers have led Congress to believe. Both on farms and in cities, a large majority of the public approves spending for particular purposes, and only a minority oppose even spending in general. (Note Appendix 2.) Yet it still remains true that most persons would probably answer "Yes" to the question, "Should we balance the budget?"

An educational program should lay major emphasis where the resistance is least—on the human value of relief, C.C.C., N.Y.A., and farm programs, on the general welfare in soil and natural resource conservation, and on the social value of public works and services. At the same time, continuing education on the general problem is needed.

As the program outlined above goes into effect and we most toward full recovery, popular support can be expected to expand, regardless of any propaganda measures that the opposition may resort to. In the shorter term, however, it is important that the public be educated on the nature of Government debt and sold on the immediate necessity for further deficits. The temporary nature of the deficits under the new program can be emphasized. Among the points to be used in selling the program may be listed the following:

1. The cost of <u>stopping</u> deflation is negligible in contrast with the cost of deflation. The country is obviously better off when its citizens are employed in producing useful goods than when they are idle and in want.

2. The program is designed to further the expansion of markets. The benefits of Government expenditures are felt, therefore, by every stratum of the community. Every dollar of Government expenditures represents at least a dollar of receipts by some business

firm; it is ordinarily multiplied several times. On the average, each dollar added to Government expenditure has increased national income by three to five dollars.

3. The budget comes into balance as the national income increases. It can be kept in balance only if the economy can be kept in balance. This is assured by the program outlined.

4. Debt represents only one side of the ledger and the assets on the other side also ought to be taken into account. Offsetting the increase in debt are tremendously valuable assets, such as schools, roads, and utilities. Many people know little or nothing about many recent public improvements, such as sewer projects. Publicize these assets and their values to specific sections of the country and specific communities.

5. Emphasize that there is no danger of bankrupting the Federal Government. The present debt could be increased tremendously without endangering the Government's credit. On the other hand, insist that the Government will not have to resort to this credit under the new program and that its credit will therefore remain good indefinitely.

6. Emphasize that rising debt does not mean inflation. A dollar today will buy much more than a dollar would in 1929. So long as many men are without jobs, heavy expenditures mean more goods and more employment, and not higher prices.

X ~~7. Increases in federal debt have been offset by decreases in local and private debt. It is not federal debt alone, but total debt, that requires a debt service.~~

7. ~~8.~~ Our national debt is very low compared with France's and England's and taxes also are low compared with those other countries.