

January 7, 1934.

*Handwritten: Bond Financing*

MEMORANDUM OF REASONS WHY IT IS IMPORTANT THAT MUNICIPAL BONDS HELD  
BY THE UNITED STATES BE NOT SOLD:

Any attempt to sell municipal bonds now held by the Government would result in attracting to this source capital which it is desired to have available for Federal financing. In other words, a sale of these bonds would be in direct competition with the proposed Federal financing and it might also have a very pronounced depressing effect upon the municipal bond market if a substantial amount of these were sold. The selling of these securities would be considered deflationary in that they would absorb a portion of the funds which would normally go into the long term capital market, which funds would tend to stimulate the capital goods industry. It would be far better to finance the holding of these securities by Public Works through Treasury short term financing at low interest. As these securities are entirely tax-free, in placing them in the hands of the public the Government would lose the tax benefit which it would otherwise get if the same funds were invested in governments.

There are other reasons why it is probably desirable not to sell the bonds. It is the view of students of the problem that better results might be obtained through the Public Works program if municipal public works were financed, not by loans as heretofore, but by direct payments just as is done in the case of Federal and Civil Works Administration projects. This course is said to have numerous advantages.

In the first place it would be of material assistance in getting the money to work quickly. One of the slowest ways in the world to get money to work is to lend it to a municipality and experience under the present Public Works act has confirmed this impression. If the money were put out directly instead of through the medium of lending a great deal of time would be saved. The same result could not be attained by increasing

the percentage of the grant from 30 per cent to a given figure short of 100 per cent, because the elements of delay would still be present. Furthermore, the direct payment method would assure the extension of aid to municipalities which at the present time lack borrowing power or credit but where unemployment is particularly severe.

The force of the preceding arguments was back of the establishment of the C.W.Z. But the plan as outlined above would have several additional advantages since it would result in the substantial structures of permanent utility and would moreover stimulate the capital goods industries. These two features so essential to recovery are for the most part not present in the Civil Works program.

Moreover, a program based on direct payment would result in placing the burden on the Federal taxing system which is based upon ability to pay and would relieve the drain on the local taxing systems which are not so based and rest for the most part on the general property tax. The result of most local systems is to cut directly into purchasing power. This is not so with the Federal taxing system which affects only surplus income. Furthermore, local communities are very heavily burdened with debt which they are much less able to bear than the Federal Government is able to support the Federal tax burden. Then, too, a municipality, just like an individual, must balance its budget annually, whereas the Federal Government is free to balance the surplus of boom times against the deficit of depression.

At the present time it is estimated that one and a half billion municipal securities are in default, or nearly 10% of the total outstanding, and that many more are on the verge of defaulting. This has forced the

closing of the schools and the reduction of those on the public payrolls, thus increasing the necessity of C.W.A. and Emergency Relief expenditures to carry the unemployed. The Municipal Bankruptcy Bill now being strongly supported by many interests and the demand for Government to finance the current requirements of municipalities are results of the Government's pressure upon states and municipalities to use their credit to carry their relief burden, or to provide employment through Public Works. In my opinion it is, therefore, a wrong policy to further increase the obligations of municipalities, counties and states in order for them to expand their Public Works program to give employment, when it only brings them closer to bankruptcy, ultimately forcing the burden on to the Government to finally take care of the destitute and unemployed.

In case it should be decided to proceed with Public Works on the basis of the Government providing the funds as a grant it would, of course, be necessary as a matter of practical politics to make the grant retroactive. It would never do to continue to exact interest and repayment from the municipalities which were quick to respond to the call and to make direct payments to those that lagged behind. A new basis for Public Works would mean cancellation -- but this would involve not over \$400,000,000.

In case it is desired to cancel it would be much more difficult to do so if any of the bonds now in the hands of the Government have been sold to outsiders. In other words, if freedom of action in respect of future Public Works policies is to be maintained it is extremely important that municipal bonds now in the hands of the Government be not sold.