

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

# Office Correspondence

Date August 13, 1940

To Chairman Eccles

Subject: Secretary Morgenthau's testi-

From Henry Edmiston

mony on August 9

I thought you might be interested in certain aspects of Secretary Morgenthau's testimony before the House Ways and Means Committee in which he gave a revised Budget summary for fiscal year 1941.

The statutory debt limitation and national defense obligations

It was my impression that the Secretary was concerned about the fact that the Revenue Act of 1940 did not increase the regular statutory debt limitation of \$45,000,000,000 but merely authorized the issuance of \$4,000,000,000 special short-term defense obligations outside the regular limitation and he was planning to take up the question with Congress during this session. The Secretary in his testimony last week, however, made no suggestion for a change in the law at this time. Of course, he made the obvious observation that the present combined debt limit of \$49,000,000,000 will sooner or later need to be increased, but did not even urge that action on this general proposition be taken immediately. He indicated that he contemplates issuing \$1,540,000,000 of the new defense obligations between now and the end of this calendar year, which is about \$1,000,000,000 more than Mr. Bell had tentatively scheduled at the time of our meeting with them in July.

The Secretary's figures also imply that the Treasury intends to pay off in cash nearly \$700,000,000 of the present outstanding open-market direct obligations between now and the end of December. The only maturities in this period are \$100,000,000 weekly of Treasury bills and \$750,000,000 of Treasury notes on December 15. I do not know what the Secretary has in mind, but I think he is planning to refund the December notes at the September financing, so apparently some Treasury bills will be paid off. The Secretary gave a hint this summer that he might do this and there is no reason why the Treasury could not replace maturing bills every week with an issue of "defense" bills which could be retired later from the taxes that must be earmarked for redemption of defense obligations under the Revenue Act of 1940.

The Secretary also indicated that he would issue the entire \$4,000,000,000 of national defense obligations during this fiscal year. He stated that this program would leave the Treasury with a working balance of \$1,275,000,000 and unused borrowing authority under the general statutory debt limitation of only \$300,000,000 on June 30, 1941. In view of the automatic increase in special issues and Savings bonds, which are subject to the regular statutory debt limitation, this would necessitate the retirement of about \$1,400,000,000 of the present outstanding open-market debt between now and the end of the fiscal year. Total Treasury maturities in this period, including Treasury bills, amount to \$3,860,000,000 which would leave about \$2,460,000,000 to be

refunded into regular Treasury obligations. As the national defense obligations can not be more than 5 years maturity, they will be attractive primarily to the large commercial banks of the country. Their issuance would, therefore, tend to expand further the already record level of bank deposits and idle funds, although there would be some offset because Treasury bills and other nearby maturities of Treasury notes and bonds that would be redeemed in cash are now largely concentrated in bank portfolios. Institutional investors, such as savings banks, insurance companies, and trust funds, which normally purchase longer-term Treasury bonds, would be severely handicapped by this program of Treasury financing. They would have to obtain suitable types of Government securities by purchases in the open market or during the secondary distribution of whatever longer-term Treasury securities are issued in the refunding operations during the remainder of the fiscal year.

#### New estimate of the deficit

The Secretary presented a revised Budget summary for fiscal year 1941 which showed a deficit of about \$5,700,000,000. His expenditure estimate for national defense was \$5,000,000,000. I am confident there is no reliable estimate on the volume of national defense expenditures during the current fiscal year but I am inclined to believe that this figure is too high. It seems to me that considerable time will elapse before we will obtain mass production of military and naval supplies. Moreover, so long as Britain continues to fight she will obtain a substantial volume of war materials from our factories. It should also be noted that from the standpoint of both the National Defense Commission and the Administration it is desirable that expenditure estimates should be high in order to indicate that rapid progress is being made on the new defense program. I am doubtful, therefore, whether it would be possible to obtain an unbiased estimate around Washington. Thus, unless we have a tremendous volume of advance payments on contracts that will not be completed until after the end of the fiscal year 1941, which does not seem to be the policy contemplated at present, I should think that actual expenditures for national defense might run \$1,000,000,000 or more below the Secretary's figure.

The Secretary's estimate of \$6,370,000,000 for total Budget receipts, on the other hand, looks a little low. The new Treasury estimates appear to have included the additional revenue derived from tax increases under the Revenue Act of 1940 and the higher income taxes during the first half of the fiscal year 1941 from 1939 incomes that the Treasury had previously underestimated. Apparently the Treasury has made no allowance for the more favorable business activity in calendar year 1940 as compared with that which was expected when estimates were originally made last December. On the basis of our estimates, total Budget receipts would be about \$6,600,000,000 exclusive of the \$700,000,000 repayment of capital by certain Government corporations.

Using our receipts estimates and placing national defense expenditures at \$4,000,000,000 would give a budget deficit of slightly less than \$4,500,000,000.

N.K.