

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date January 31, 1938.To Chairman EcclesSubject: A recovery program and theFrom Lauchlin Currierailroad problem

It appears feasible to work out a program that would meet the needs of the railroads, would further recovery now and would be conducive to longer-run economic stability. The solution to the railroad problem that is under consideration -- freight rate advances -- would be of dubious help to the railroads, would be positively detrimental to recovery, and might eventually result in excessive returns and investment in some roads.

The program suggested for consideration is in two parts, either of which might be adopted independently, or they could be worked together. The first, and more important part, is as follows:

Let the Government, through a Federal Railroad Equipment Corporation empowered to issue its own debentures, invite bids for the construction of freight cars and/or locomotives. When built, these would be available for hire by the railroads when and as needed. It would be preferable to prohibit roads from building or buying freight cars and/or locomotives in the future.

The arguments in support of this proposal are as follows:

1. It could result in immediate increased expenditures ranging up to \$1 billion a year. Mr. Terborgh, in his memorandum on the railroads, estimates that the railroads will regain the 1929 level of traffic

when physical production is 15-20 percent higher than 1929 and that we can expect that level when we achieve a relatively normal volume of employment. If we set our objective of full employment at three years, this would call for 200,000 new freight cars a year, 1,750 freight locomotives a year, 2,600 passenger train cars a year, 450 passenger locomotives a year, and 1,000 switching locomotives a year. This would amount to an aggregate of \$928 million a year for three years.

	Increase over present Inventory needed	Re-placements needed	New units needed annually for recovery in 3 years	Cost per unit	Aggregate cost annually
Freight cars	300,000	100,000	200,000	2,700	540,000,000
Freight locomotives	2,200	1,000	1,750	125,000	218,750,000
Passenger train cars	1,000	2,250	2,600	25,000	65,000,000
Passenger locomotives	--	450	450	125,000	55,000,000
Switching locomotives	1,600	450	1,000	50,000	50,000,000
					<u>928,750,000</u>

2. Expenditures of upwards a billion dollars a year would create a large volume of employment in the railroad equipment industry, in the railroads' own car shops, in the steel and other industries, and would result in a considerable expansion of railroad traffic.

3. Reduction in railroad costs. The great bulk of the rolling stock of the roads is old and the maintenance costs are correspondingly high. Of some 44,000 locomotives, only about 3,000 have been built in the past 11 years, or less than 10 percent. According to studies of the Baldwin

Locomotive Works the maintenance cost of a freight locomotive increases from the first to the twentieth year at an annual rate of approximately 6.2 per cent. It seems highly probable that much of the rolling stock has exceeded its economic life and that the annual costs of repair and maintenance exceeds the savings effected in the amortization of the original equipment. Many roads that cannot afford high initial costs, could take advantage of reasonable rentals for the time new equipment actually is used.

Over a longer period of time large economies should be derived both from the standpoint of individual roads and nationally through a more intensive use of equipment possible through pooling. Instead of each road being compelled to have a lot of capital tied up in standby equipment, the Government corporation would hold the reserve supply. The Government corporation, in turn, would need to carry less than the aggregate now carried by individual roads. Much more accurate estimates of the national peak requirements can be made than of individual roads' peak requirements.

4. This would be one of the most economically beneficial types of expenditures the economy could engage upon at this time. While W. P. A. projects are mostly economically and nearly all socially beneficial, many of them are in the nature of luxuries. On the whole they do not contribute as much to productive resources as private capital expenditures. We know that we will need additional railroad equipment

aggregating billions of dollars to handle the volume of traffic consequent upon full recovery. While financial considerations prevent individual roads from anticipating these requirements, such considerations do not apply to the economy as a whole. From the community point of view, it would be most economical to use idle resources now to add to our productive equipment, rather than attempt to reequip ourselves all in a rush sometime in the future. This appears to be a unique case where the Government can initiate capital expenditures with a minimum of competition or of subsidizing.

5. From a national defense point of view, it appears almost as vital to have a well-equipped railroad system as to have an army. We are now in a position where we could handle very little more traffic than in 1937. The traffic congestion during the war comes to mind. Any initial loss consequent upon the failure of rents to provide fully for amortization of equipment could be charged to national defense. We are subsidizing a merchant marine for this reason.

6. The Federal Railroad Equipment Corporation, through reductions in costs of materials in connection with mass buying, and through economies in providing a national pool of rolling stock, may be able to have rolling stock manufactured so cheaply and rent it at such low rates as to make private manufacture and ownership uneconomical. If this should happen, the Corporation would have title to the bulk of the rolling stock of the railroads within 10 to 20 years. Or the

Government could prohibit railroads from acquiring new rolling equipment. We would thus gradually ease into ownership of the railroads and a large field would be available for flexible and compensatory spending of a most economic and generally approved nature. Sweden was greatly helped in the recent depression by being able to expand expenditures on the Government-owned railroads. This gradual easing into the picture by building and owning rolling stock appears the only practical mode of procedure. Outright ownership of the railroads is not politically practicable and gradual ownership through acquiring the worst and most bankrupt roads is not desirable.

7. The proposal could apply to all rolling stock or be restricted to freight cars. Personally I should like to apply it to all rolling stock. I understand that roads now carry out running repairs on rental stock. Under the present proposal this could still be required and the Corporation could have more fundamental reconditioning carried out by the railroad repair shops. Railroad labor should be in favor of the proposal. Railroad managements might not be so favorable but they could see favorable aspects as many of them could make a profit in constructing rolling stock for the corporation, they would receive increased freight traffic, and they could reduce current operating expenses.

The second part of the program contemplates the purchase, by a Government corporation, of non-cumulative preferred stock of certain railroads for certain purposes.

The roads would neither be the financially strongest nor the financially weakest, but, rather, such roads as in the judgment of the I. C. C., (1) cannot, on the basis of present traffic, cover their fixed charges without an advance in freight rates and (2) are capable of covering their fixed charges with the volume of traffic they may anticipate with relatively full employment and the reduction in costs possible with modern equipment and better plant and way.

The purpose of the loans would be (1) to rehabilitate the poorer part of our railroad network to handle the volume of traffic that will result from a restoration of full employment, at the lowest possible cost, (2) obviate the necessity of a general freight rate advance, (3) maintain railroad and other employment.

If the first proposal above is adopted, expenditures under this plan of what amounts to an interest subsidy would be restricted to the elimination of curves, grades, etc. (By straightening out curves and installing stream line trains the time between New York and Washington could be cut to two hours, ten minutes.)

If the first proposal is not adopted, expenditures could be applied, subject to the approval of the I. C. C., to both the roadbed and the equipment.

A general freight rate advance in so far as it resulted in increased revenues would benefit many strong roads which do not need help. It would, however, result in a general advance in costs, would

result in increased losses of various businesses, would be particularly disastrous in the building field, and would probably result in a diminution of freight traffic. It appears far the better course both for the railroads concerned and the economy as a whole to afford government assistance in lowering the costs and increasing the efficiency of the weaker roads.