

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date February 5, 1938.

To Chairman Eccles

Subject: Railroads and recovery

From Lauchlin Currie

LAC

1. Freight rate increases in building

The Association of American Railroads quotes a Mr. Palmer, Vice President of the Associated General Contractors, to the effect that "A house which would cost \$5,000 under existing freight rates will cost only \$43 more if this increase be granted". The F. H. A. analysis for a typical house costing \$5,000 with the land is as follows:

Total cost of materials	\$1,800
Total cost of heating, plumbing and electrical equipment	1,000
Labor	1,200
Land	500
Profit	500
	<u>\$5,000</u>

They estimate the total freight on materials to be \$360, on which a 15 per cent advance in freight rates would amount to \$54. On the face of it, this checks closely with Mr. Palmer's figure, especially as the F. H. A. considers its figure an outside one. However, several qualifications should be made.

(a) This freight increase is calculated on materials alone. If related to the cost of materials, it amounts to 3 per cent. A 3 per cent advance in the prices of building materials at a time when prices are already too high and rents are declining cannot be considered a negligible item.

(b) To this figure should be added something for additional freight charges on the raw materials entering into processed building materials.

(c) No allowance is made for freight rate increases on equipment or on materials entering into equipment. This may aggregate another \$10.

(d) No allowance is made for the retailer mark-up, which is customarily a flat percentage of the cost to the dealer.

(e) Assuming that all these additional elements bring the cost up to only \$75, this would be the equivalent in the F. H. A.'s typical house to an advance in labor costs of 6 per cent. Such an advance at this time will be generally deplored and condemned.

It is, of course, the old story. A sizeable percentage increase in any one of the costs becomes a small percentage of the total cost of the finished house, including land.

A mitigating factor, although not to the railroads, is the possibility that the freight increase will result in an increase in the already substantial portion of building materials that is transported by trucks. It is estimated now that railroads haul only 30 per cent of common brick, 55 per cent of building tile, etc., and 60 per cent of lumber. The catch here, however, is that the trucking companies have also applied for a rate increase.

2. General effect of the rate increases

If the rate increases are granted in full this will mean a transfer from the rest of the community to the railroads of around one-half billion dollars. It is difficult to appraise the net effect of this. A substantial proportion of the sum may go in interest, loan repayments and additions to cash, as it is unlikely that railroads will expand their maintenance and equipment expenditures at this time. Hence, the subtraction from consumer buying power may not be fully made up by increased disbursements to consumers.

3. My own feeling, which is based only on superficial study, is that the I. C. C. will feel impelled to grant a rate increase, although probably not to the full amount requested. Rail costs have increased, traffic has suffered a drastic decline and, on the basis of existing revenues together with the absence of any other plan to raise net income by some hundreds of million dollars annually, I do not see how the Commission could do otherwise. Neither of the proposals we are considering will be regarded as substitutes for freight rate increases, as the direct benefits will be mainly in the future and the indirect benefits arising from increased traffic might be offset by other adverse developments, or be insufficient unless general business activity quickly regained the 1937 level. If the proposals were announced as substitutes they would meet with violent opposition from the railroads. On the other hand, some intimation that the Administration was considering cost-reducing and traffic-stimulating measures in connection with the railroads might influence the Commission in granting lower increases than they would otherwise grant. It is a difficult point.

I am afraid that we must take a freight rate increase for granted as one of the elements in the problem, and use the argument that this makes a spending or reflation program even more imperative.