

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date February 14, 1938.To Chairman EcclesSubject: Recovery ProgramFrom Lauchlin Currie*LBC.*

Attached are some thoughts of mine on the recovery program. *that you might care to look over before the meeting to-morrow.*

I have some progress to report on the railway proposal. Mr. Eastman asked me to luncheon on Saturday and told me that he and Mr. Wright had taken the matter up with Colonel Young of the Pennsylvania Railroad. In general, Young's reaction was favorable, taking the position that it would be a losing proposition for the Government and favorable to the railroads. Mr. Eastman asked him for the names of railroad men in the West and South who might be sounded out, and he suggested Budd of the Burlington, and Hill, President of the Louisville and Nashville. Mr. Eastman is going to get Wright's reaction on Monday, and if favorable, he thinks you ought to see him. It occurred to me that Wright might be the man to work out the plan in detail. According to Mr. Eastman, he possesses the full confidence of both Secretary Ickes and Jesse Jones. Eastman and Wright might head the new corporation up. I know that Eastman chafes at being on an eleven-man board and I don't think he is particularly interested in the division of motor carriers to which he is assigned. I know he is out of sympathy with Chairman Splawn's full-dress conference idea.

SOME THOUGHTS ON A RECOVERY PROGRAM

I - Need of a Program

The case for the need of a program must first be established. This is difficult to do convincingly as it is in the realm of forecasting, is "theoretical", and people generally have a bias toward optimism. The case against a "natural" upturn this year that will carry through may be made on the following lines:

1. An expansion of the national income depends upon a steady increase in expenditures in the production of goods and services other than those designed to be bought out of current income by consumers. This increase must be great enough to more than offset current saving out of income.

2. This means that increased expenditures must occur in one or all of the following main categories: housing and automobiles that are not purchased out of current income; durable producers' goods; increased inventories; increased expenditures of public bodies over and above taxes. The last three represent the creation of consumers' income not counterbalanced by a corresponding or more than corresponding increase in consumers' goods. The first two represent expenditures by consumers in excess of current incomes.

3. Automobiles. In view of the high level of installment purchases of automobiles last year and the low level of output this year, it is possible that the amount spent on automobiles this year will be no greater than deductions out of current income for purchases this year and last.

In other words, it is doubtful whether consumers will increase their indebtedness on balance for motor cars at least until the latter part of the year. If, as seems likely, the contrary happens, this will be a depressing factor.

4. Houses. If costs were too high on the basis of last year's national income, they are certainly too high in relation to the current national income. There is little prospect that costs will fall sufficiently faster than rents to lead to a substantial building revival. H. O. L. C. expects to have to foreclose on 50,000 more properties by midsummer.

5. Durable producers' goods. Large excess capacity has again appeared in all lines. Considerable new equipment was installed in 1937. Some capital expansion plans were carried over into this year but will be largely completed by summer. For example, of the \$80 million program of U. S. Steel for this year, \$40 million is scheduled to be spent in the first quarter. A considerable lag of producers' plant and equipment expenditures behind an increase in productive activity is to be anticipated.

6. Inventories. Further reduction rather than a net increase is to be anticipated. This is deflationary as it represents money withdrawn from the income stream.

7. Expenditures of Public Bodies. On present plans, an excess of Federal activity-creating expenditures over activity-decreasing receipts will occur this year. It may, however, average no more than \$50 million in the first six months and \$100 million in the last six months, hardly enough to make a significant impression on total community expenditures.

No information is available on the relation of the current expenditures of other public bodies to their receipts.

8. Exports may be expected to diminish from now on in reflection of lower prices and slackening business activity abroad.

9. Conclusion. In view of (a) the unlikelihood of any significant increase in expenditures for housing, automobiles, durable producers' goods, inventories and exports; (b) further immediate declines in durable producers' goods expenditures and exports; (c) continued liquidation of inventories and consumer credit; (d) continuance of current saving out of income; and (e) the relatively small excess of Federal Government expenditures, it appears likely that business activity and prices will fall to lower levels in the second half of 1938. The only thing that appears likely to be able to prevent this is the adoption of a vigorous reflation program by the Federal Government.

II - Requirements a Program Must Meet

The program should provide for a sufficient magnitude of expenditures, should be capable of early initiation, should be flexible and provide for gradual tapering off when and as desirable, should be simple, should be popular, should have favorable longer-term implications for stability, and should call for smallest possible increase in the public debt.

It is difficult to satisfy all these requirements and a certain amount of compromise will be necessary. For example, W. P. A. expenditures can be made large, and are speedy and flexible and simple, However,

they do not fit the other requirements so well. The following are some comments on the individual requirements.

1. Magnitude. I do not think that it is possible to be very precise here. A definite schedule of expenditures by months is open to various objections: (a) it is not practicable and to propose it lays one open to the charge of being unrealistic; (b) it implies a knowledge of the relative quantitative magnitudes of the various depressing and stimulating forces at work we simply cannot pretend to possess; (c) in dealing with an unknown future it would be as dangerous to under-shoot as to overshoot our mark. We must, in large part, feel our way and be prepared to modify the schedule upwards or downwards as appears wise.

An immediate problem, assuming for the moment that the alternatives are open to us, is to decide whether we want a large volume of expenditures immediately and then a tapering off, or whether we want expenditures to be increased up to a point that can be sustained, say, for a year or more. In view of (a) the momentum deflationary forces have already acquired; (b) the length of time it takes for new capital plans to be matured and initiated and; (c) the very bad psychological repercussions of a renewed collapse after a sharp stimulant, I should prefer not to run the risk of shooting our bolt and exhausting our ammunition. After all, C. W. A. was cut down abruptly at the beginning of 1934 when it appeared that it was going to cost a great deal.

On the whole, my feeling is that we should work up as soon as possible to an amount we feel can be sustained for a year or more. I think it is safer to get an upward trend established and to keep it upward for a considerable period. The maintenance of the trend is more conducive to confidence than the sharpness of it. With reference to the amount of additional monthly expenditures necessary, some guidance can be derived from past experience. During 1934 and 1935 my net figure of the excess of activity-creating expenditures over activity-decreasing receipts averaged nearly \$270 million a month. This was apparently sufficient to overcome the combined deflationary forces carried over from the big depression and the aftermath of the 1933 boomlet, and to get us started upward. In the present circumstances a figure somewhere in the neighborhood of \$300 million a month should do the trick in turning the recession and getting us started upward. I estimate that my net figure will, on present plans, tend upwards during this year, averaging perhaps \$50 million a month in the first half and \$100 million a month in the second. Therefore we should plan for at least an additional \$200 million a month.

2. Speed: Much of the discussion under (1) above is applicable here. The program should be initiated before business declines still further.

3. Flexibility. Many of the elements of the program under discussion are either not subject to quick control or are somewhat

unpredictable in magnitude and timing. This applies with particular force to tax revenues. W. P. A. expenditures, however, should provide for a certain amount of flexibility, although, because of the usual lag in relief requirements behind employment, not as much as could be wished for.

4. Simplicity. The program should, as far as possible, be confined to essentials and capable of being easily grasped and understood in order both to be adopted by the Administration and accepted by Congress.

5. Popularity. The political angle must always be kept in mind. My hunch is that spending as such is not popular. The program should be directed toward broader social and economic objectives, a continuation of the New Deal program, rather than appear to be merely a return to the old spending program. One has to allow for weariness and the dulling effect of familiarity. This applies particularly and unfortunately to P. W. A. and to a lesser extent to W. P. A. I think the program should be capable of being dramatized as a "bargain year for housing", "physical rehabilitation of the railroads", the "abolition of personal insecurity from old age, sickness and disability", etc.

6. Longer-run implications. So far as possible, the program should contain elements that are capable of future development in the direction of longer-term stability. For example, steps can be taken now to remove the anticipated deflationary effect of the Social Security program in the next few years. A national health program would

pay large dividends in increased productivity and well-being in the future. Measures might be incorporated in the program which may lead the way to cheaper housing accommodation in the future. Any action that tends to transfer expenditures from the peak to the trough of business activity has enormously important longer-run implications.

7. In view of the facts that (a) most people persist in concentrating on the gross national debt and ignore offsets, and (b) many would regard a substantial increase on top of the increase in recent years as distinctly alarming, it appears desirable to contrive a program that will entail as little increase in the public debt as possible. It appears like a good time, therefore, for the Treasury to convert some of the assets the Government has acquired into cash. It also appears desirable to finance the program as far as possible through the device of having Government corporations borrow directly from the public.

OUTLINE OF A PROGRAM TO MEET ABOVE REQUIREMENTS

I - General Remarks

I think that a five-point program made up of W. P. A. (and Rural Rehabilitation), housing (both public and private), railroads, Federal Toll Authority, and health and old-age security best meets the requirements I have just discussed. It is, in the first place, simple and easily grasped. W. P. A. and assistance to private housing provide

the elements of speed, flexibility, and magnitude. Public housing, railroad betterments, Toll Authority operations and increased health and old-age expenditures will come along later to permit a diminution of W. P. A. expenditures. The last three elements will have wide appeal and their development will be a contribution to future stability. They can be dramatized as furthering basic New Deal objectives. Public assistance to private housing and, to a lesser degree, Federal grants-in-aid for health and hospitals, provide leverage. The public housing, railroad and Toll Authority proposals will involve a negligible cost to the Federal budget in comparison with the total expenditures they will bring about.

II - Timing

All the above elements of a program require new legislation. It is imperative that it be secured before Congress adjourns. Some of the obstacles in the way are: (a) the fact that a housing bill has just been passed. There will be some disposition to wait for results before making any further moves to assist private housing. (b) An increased relief appropriation for the remainder of this fiscal year is pending. It will be difficult to reopen this matter again for this fiscal year. (c) There is still a widespread expectation that business is at its low point and will improve by itself in the second half of the year.

In view of these factors and the ordinary inevitable delays in securing legislation it is going to be difficult to secure any additional spending above what is now scheduled for the remainder of this

fiscal year.

In these circumstances I am wondering whether it might not be good strategy to rush the amendments to the Social Security Act, revive P. W. A. under cover of a health and hospitals program, amend the U. S. H. A., and provide for the setting up of the Federal Railroad Equipment Corporation and Federal Toll Authority. None of these would be generally thought of as Federal spending for pump priming purposes, although they will begin to take effect in the second half of the year and will be in full swing in 1939. Then, later in the spring, when and if business and residential construction fails to pick up, present to Congress the enlarged W. P. A. - private building subsidy plan as more frankly spending recovery measures.

III - Individual Points

1. W. P. A. and Rural Rehabilitation. Corrigan Gill is assembling material on the W. P. A. part of the program; Ezekiel, on rural rehabilitation.

2. Old Age and Invalidity Insurance. I have received assurances that the following proposals will receive a large measure of support in the Social Security organization and from many outside experts.

(a) Advance the date of payment of benefits to January 1, 1939, in lieu of 1942. It is estimated that this would bring in over 800,000 persons 65 years or older who will have made contribution on incomes aggregating \$2,000 or over for a two-year period.

(b) Change the formula on which benefits are based in such

a way as to increase average benefits to \$17.50, which is approximately the average for old-age pensions on a means test basis in the states. The details of this proposal have been fully worked out in the Social Security Board.

(c) Provide benefits for surviving widows and provide a 50 per cent supplement to the existing benefit when the wife is dependent.

(d) Assume for the purpose of the Act that any covered worker who becomes permanently incapacitated has attained the age of 65. This would call for about \$150 million a year.

The combined effect of these four proposals would be to increase out-payments under the old age sections of the Act by \$400 million a year. This will in very large measure offset the present deflationary effect of the excess of contributions over benefits. It would aid a far more needy and deserving class than would the remission or reduction of old-age taxes. Practically every dollar paid out in this way would be respent. It would be enormously popular as it would provide security for hundreds of thousands of older men and their wives and for hundreds of thousands of others who have recently become incapacitated. It would, of course, remove the dread of economic dependence from millions of others.

3. A National Health Program. America has lagged behind in the provision of adequate medical care for a large portion of the people. There has recently been an upsurge of interest and concern in this

problem. This is evidenced not only by an outpouring of speeches, books and articles but also by the remarkable growth in the number of persons participating in purely voluntary group hospital insurance. The number of such persons increased from 300,000 in April 1937 to 1,000,000 in December. A survey just concluded has brought to light the wide prevalence of chronic sickness. Conditions in the South are particularly shocking. There must be hundreds of thousands of cases where a simple operation, say, for hernia, would make people self-sustaining who are now dependent. There is a deficiency of 400,000 hospital beds, (\$1.2 billion) in relation to 1929, when the number was admittedly inadequate. The rehabilitation and conservation of our human resources should certainly come before the rehabilitation and conservation of our physical resources.

Specific Proposals

(a) Increase expenditure for maternal, child and general public health work provided for in Titles 5 and 6 of the Social Security Act. (\$40 million).

(b) Make Federal grants-in-aid to assist states to provide general medical care to needy poor and to others, otherwise self-sustaining, unable to obtain medical care. Such grants would be conditioned on an equal sum being appropriated by states and local bodies. The Federal grant-in-aid could amount to between \$50 and \$100 in the next fiscal year and amount ultimately to between \$100 million and \$150 million.

Proposals (a) and (b) would ensure an additional combined Federal, state and local expenditure of \$150 million- \$250 million in the next fiscal year.

(c) Hospitals. In addition to the deficiency of \$1.2 billion just mentioned, I am informed that \$600 million should be spent for special hospitals for the chronic sick, plus another \$250 million for modernization and needed outpatient clinics of existing hospitals. A program to make up at least a part of this deficiency (which is currently still growing) should be inaugurated immediately. Both W. P. A. and P. W. A. have acquired experience in this special type of work. A formula can be devised of varying the Federal contribution according to need so that, on the average, states and local bodies will contribute about as much as the Federal Government. The Public Health Service could be brought in to provide standards of specification. It is estimated that local bodies could be induced to match \$100 million of Federal money during 1939.

The combined health program would result in an expenditure of Federal funds of between \$200 million and \$250 million next year, which, with local contributions, would result in a total expenditure of between \$350 million and \$400 million.

4. Federal Toll Authority. There appear to me to be many dangers in having Congress hastily authorize important projects without adequate, disinterested and exhaustive study. Since, in any case, it is doubtful

whether a significant amount could be spent in materials and labor this year on any project authorized, I should favor action at this time being confined to the establishment of a Federal Toll Authority. This Authority would have its capital purchased, say, by the R. F. C., or the Treasury, and be empowered to issue its own debentures. It should be authorized after thorough investigation, to initiate projects (subject to the approval of the President? or proposed Federal Stabilization Committee, if established?). Some provision should be made so that in the future its operations would have a compensatory effect. If, for instance, it decides that a subway for Washington, a certain elevated highway, vehicular tunnel or toll road is economically justified, it should go ahead with all the preparatory work, but delay the actual initiation of the project unless business activity is low or tending downward.

5. Housing. As I understand it, your present ideas are as follows:

(a) For a limited period, provide that W. P. A. shall furnish free labor on private and public residential construction up to 10 per cent of the F. H. A. appraised cost of a new dwelling unit (exclusive of land.) This would be conditional on the W. P. A.'s ability to supply the type of labor specified by the contractor. If the contractor finds the labor too unsatisfactory he may make a new requisition. (Should W. P. A. be empowered to hire more workers to meet contractors' requirements if it is able to attract such workers at its security wage?).

In order to obtain a rough idea of the size of the subsidy, it may be pointed out that on 300,000 new dwelling units, appraised at \$1.2

billion it would amount to \$120 million.

(b) Eliminate (for a limited period?) local authorities' 10 per cent contribution of capital for U. S. H. A. housing. Should the requirement that slums must be diminished concomitantly with the erection of new properties be eliminated? Off hand, this requirement appears objectionable. I should also favor the elimination of the requirement that the \$500,000,000 fund shall be apportioned among the states, and put it on a first come, first served basis.

(c) Utilize the experience, personnel and land of the Farm Security Administration by securing an appropriation for a limited amount of low-cost public housing. You proposed giving the completed properties to local housing authorities. I should think there would be some political objection to this which might be met by turning properties over to local housing authorities at half the cost.

(d) I am not sure of the present status of the proposals to set up or assist corporations to engage in large-scale low-cost housing for demonstration purposes.

Conclusion

The broad character of the program herein suggested, and its timing, is as follows:

1938

1. Increase W. P. A. and Rural Rehabilitation.
2. Provide subsidy to private housing and extend public housing.
3. Establish Federal Railroad Equipment Corporation and secure authority to purchase non-cumulative preferred stock of railroads.
Begin operations.
4. Establish Federal Toll Authority.
5. Increase health and hospital expenditures.
6. Amend Social Security Act.

1939

1. Diminish W. P. A.
2. Diminish subsidy to private housing.
3. Increase Equipment Corporation's operations.
4. Begin Federal Toll Authority operations.
5. Increase old-age and invalidity payments.
6. Increase health and hospital expenditures.