Form F. R. 131

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date October 29, 1938.

To Chairman Eccles

Subject: Meeting of Fiscal Advisory Committee

From Lauchlin Currie
LBC

As I have prepared quite a raft of material for your possible use in connection with the meeting of the Fiscal Advisory Committee, I thought you might like to look over it beforehand in order to decide what, if any, you would use and also to give you a chance to suggest any changes Monday morning.

Even if you do not propose to take along any material, I should like you to look over the charts as an indication of the type of work which, if carried on on a current basis, would reduce somewhat the element of guess work involved in the problem of timing. I have attached brief comments to each chart.

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Date October 29, 1938.

To Chairman Eccles

Subject: Fiscal Advisory Committee

From Lauchlin Currie

LBC

I am attaching some material for the next meeting of the Fiscal and Monetary Advisory Committee, along the lines you suggested.

1. The first is a one-page statement of the problem wherein I suggest that the title be changed from "Transition Problems" to "The Problem of Timing in Compensatory Fiscal Policy". You might want to secure this change as the present title restricts us unduly.

2. If time permits and there is sufficient interest you may want to present a slightly longer and more technical statement, which I am also attaching.

3. For illustrative purposes indicating some of the basic factors involved in compensatory fiscal policy, I am attaching some charts with brief comments.

4. In the list of investigations required I suggest that the title of (1) be changed from "Amount of national income to balance budget (a) at different price levels" to "Revenues that will be yielded by the present tax base at various national income levels, (a) currently, (b) after a year's lag".

An additional topic might be "The probable trend of main classifications of expenditures, (a) on the basis of past experiences and present plans, (b) at various employment and national income levels".

The National Resources Committee interprets the investigation entitled "Bottlenecks" to mean <u>all</u> the factors that prevent the attainment and maintenance of full employment. This entails considerable duplication with our problem of timing. I should like them to do more intensive work on probable labor and plant bottlenecks under the broad heading of "The Rate of Increase in Production and Consumption and Incomes that can be sustained without excessive price and inventory maladjustments."

An additional topic of a monetary nature might be "The Rate of Interest in Relation to Price Movements and the Attainment of Full Employment."

October 29, 1938.

THE TRANSITION PROBLEMS IN COMPENSATORY FISCAL POLICY

A more descriptive title would appear to be "The Problem of Timing in Compensatory Fiscal Policy". Any transition that may be made from deficit financing to debt retirement is merely one stage in the continuous problem of gearing fiscal operations to private business activity to the end of achieving and maintaining full employment.

The urgency of the problem need not be stressed here. The only question is how far the problem is subject to solution. This, in turn, boils down to the two-fold task of improving, on the one hand, both our analysis and the quantitative approach to the problem and, on the other hand, improving the technique necessary to carry through the policy which is indicated by our analysis.

A broad analytical and quantitative approach is very briefly summarized in the accompanying memorandum.

It is believed that with present knowledge and data more precise information than at present is available on which to base broad trends of fiscal policy can be obtained. With intensive study and the development of more and better relevant data, the basis for policy should be subject to continual improvement. It is emphasized, however, that whatever precision we can hope to obtain will still leave a wide possible margin of error, particularly in the short run, and that, therefore, efforts should be made to secure as much flexibility and appropriate automaticity in fiscal operations as possible.

October 29, 1938.

COMPENSATORY FISCAL POLICY

The Problem of Timing

A. Broad Statement of the Problem

1. A steady increase in consumption is the prime requisite of a progressive economy.

2. The desirable <u>rate</u> of increase in consumption is as rapid a rate as can be achieved without excessive price advances and inventory accumulations. This does not mean <u>no</u> advance in prices. It means no greater advance than is compatible with sustainable growth in investment, income and consumption.

3. The desirable rate of increase in consumption may be expected to vary with the degree of excess productive capacity, the number and nature of bottlenecks and shortages, the temper of the business community, etc., being higher when emerging from recessions than when approaching the limitations imposed by physical productive capacities.

4. Growth in consumption depends on growth of incomes of wage-earners, low-salaried persons, farmers and small business men, modified by the expansion and contraction of consumer saving and consumer debt. (See chart).

5. A growth in incomes is dependent upon whether the amount added to the spending stream through capital expenditures and public expenditures in excess of tax receipts is greater than the amount withdrawn from the spending stream through the failure of current income to be spent on current consumption.

6. Hence, the growth of consumption is dependent upon a growth in private capital and public expenditures in excess of current receipts, assuming no change in the relation of consumption to income, or on a rise in the proportion of the national income spent on consumption, assuming no change in private capital and public deficit expenditures.

7. Assuming the goal to be the attainment and maintenance of full employment, fiscal policy should be directed towards

(a) supplementing (or offsetting) the volume of private capital expenditures and/or

(b) modifying the relation of consumption to income.

8. The former type of action (a) is concerned with the relation of government expenditures to receipts; the latter (b) with the <u>source</u> of receipts in relation to the <u>direction</u> of expenditures.

B. Broad Quantitative Approach to the Problem

1. Calculate national income necessary for full employment.

2. Estimate maximum <u>sustainable</u> rate of increase in national income to achieve (1).

3. Ascertain ratio of capital investment plus government contribution to income in the past.

4. Consider how far developments of recent years may be expected to call for a different ratio.

5. From (1), (3) and (4) calculate amount of private capital formation plus contribution by non-federal public authorities necessary for full employment.

6. Determine desirable rate of increase in capital expenditures to arrive at full employment.

7. Estimate the probable expenditures in each important field of capital expenditures.

8. If a deficiency appears likely, consider how far this could be made up (a) by a continuing federal contribution and/or (b) through a modification of the ratio of consumption to income; if an excess appears likely, consider how far this could be offset (a) by a negative federal contribution and/or (b) through slowing up the rate of increase in consumption relative to the growth in income.

C. The Handling of the Short-term Compensatory Problem

1. The type of approach outlined in B, while valid within broad limits, necessarily entails a possible margin of error large in relation to the magnitude of the federal contribution. Inventory movements, changes in consumer debt, housing and foreign developments are particularly difficult to forecast over the short term.

2. Therefore, the practical approach should be along two lines:

(a) Securing such longer-term modifications in the fiscal policy of the Government as appear called for as a result of the broad, over-all type of statistical investigation outlined in B.

(b) Securing as large a measure of flexibility and appropriate automaticity in Government receipts and expenditures as possible, both within and outside the budget, so as to be in a position to secure the appropriate reaction to unforeseeen short-term business developments.

LIST OF CHARTS

1. Gross National Product and Private Capital Formation plus Net Government Contribution, 1925-1937.

2. Gross Capital Formation plus Net Government Contribution, 1925-1937.

3. Expenditures on Producers' Durable Goods, 1925-1937.

4. Gross and Net Federal Contribution to Buying Power, 1932-1938.

5. Income Payments and Consumers' Expenditures, 1929-1938.

6. Compensation of Employees of Public Service and of Manufacturing, 1929-1938.

7. Production and the Quantity of Retail Sales, 1929-1938.

8. Producers' Durable Goods and Their Utilization, 1929-1937.