

Treasury Department  
Division of Monetary Research

Date May 25, 1939 1938

To: Mr. Eccles

Appended is a corrected copy of  
the statement read this morning at the  
meeting of the Fiscal and Monetary  
Advisory Board.

1. It is almost the unanimous opinion among Administration officials and technicians in Washington who are on, or are cooperating with the Fiscal and Monetary Advisory Board, that there is little if any prospect for marked recovery during the next two years.

2. They also recognize the possibility of a downturn in business activity before the end of 1940.

3. With a moderate improvement in business the unemployment situation will not be substantially different from what it is now. With no improvement in business the number of unemployed will increase because of the annual accretion to the labor supply of more than half million a year, and because of continued technological change.

4. Even under favorable circumstances an improvement in business could, in the first place, be only moderate and, in the second place, could not be continued long enough to sustain an \$80 billion income. The inability of our economy to maintain even the modest objective of \$80 billion is due to the existence of certain fundamental maladjustments which have been developing. It is more and more apparent that a profound change in our economy has taken place since the 20's. We have for the first sustained period in our history a volume of savings which at a high level of national income is considerably in excess of the profitable outlets for such savings.

5. Some of the basic changes which are partly responsible for the lower level of business activity during the 30's are as follows:

(a) Certain large industries experienced the major portion of their expansion during the 20's. These have now reached a degree of maturity which eliminates them as potential outlets for large amounts of new savings. Though we expect a continued growth of most of these industries the rate of expansion and the absolute volume of new savings they will absorb will be much less than it was in the 20's.

(b) Basic difficulties in certain important industries which for special reasons do not provide nearly so important an outlet for capital as they did in prior decades.

(c) The rate of population increase has been cut in half as compared with the 20's.

(d) The virtual cessation of foreign investment which in the 20's accounted for roughly from one half billion to a billion dollars a year.

(e) State and local bodies instead of providing an outlet for savings of nearly a billion dollars a year in the 20's have actually in recent years added to the current volume of savings through a net reduction in outstanding indebtedness.

(f) Sharply curtailed expenditure on non-profit private building, i.e., churches, clubs, universities, etc. In the 20's these accounted for from a half billion to a billion dollars a year and they now are less than 200 million.

(g) The slack created by the over-production of commercial buildings which took place in the late 20's will not be taken up for several years at least.

(h) The trend of technological change over much of industry in the direction of reduced amount of capital investment required per unit of output.

(i) The tax structure now derives a greater proportion of its total revenue from taxes that curtail consumption than was true in the 20's. This has occurred in the State and local government as well as in the Federal tax structure.

(j) The serious reduction of certain foreign markets for important export crops, e.g., cotton, wheat, tobacco and hog products. The curtailment of these markets is not due to temporary factors.

6. The situation is further aggravated by the fact that those who have or control the nation's savings are definitely more timid in undertaking business risk ventures. Moreover, the increasing uncertainty, both economic, political and social, which has characterized the past decade has made people more conservative in expenditure on consumer goods and likewise in the investment of their savings.

In addition, the tax burden has increased as compared with the 20's, thus reducing the net profits left to the investor or business entrepreneur that he can expend as he wishes.

7. The experience of the United States is not unique with regard to the changed nature of the economy. The advanced European countries have experienced the same contraction of outlets for their savings. Some of them, however, have temporarily solved their problems by a new industry greater than all the new industries of the past period combined, i.e., armaments. In some of them, also, the problem has been rendered less acute by the fact that their tax program has resulted in a diversion of a larger portion of potential savings back into consumption.

8. As a consequence of these basic changes we are faced with the inevitability of a low national income unless either or both of the following happen:

(a) The development of sufficient investment outlets to absorb the savings of a high national income, and/or

(b) An increased proportion of the national income is spent on consumers goods, thereby reducing the volume of idle funds and increasing the profitable outlets for savings.

9. Turning to the immediate situation there are numerous indications that the prospects for substantially increased national income in 1939 and 1940 are not good.

There are only two elements in the picture which are bullish:

(a) Inventory reduction has been proceeding for some months and a cessation or reversal of this trend would be a stimulus to production.

(b) Expenditure on consumers goods has been maintained despite the decline in business activity.

On the other side of the picture are the following:

(a) The upturn which began in 1938 reached its peak in December and since that time the level of business activity has been downward.

(b) No significant increase in the net contribution to buying power by the Federal Government under the existing program will occur this year and a reduction is anticipated in the fourth quarter.

(c) There is little basis for the expectation that our exports in 1939 and 1940 will exceed the 1938 level despite the increased armament programs abroad.

(d) Housing activities appear to have reached a plateau and there does not seem to be any prospect of a further marked increase of home construction.

(e) No substantial increase in railroad equipment buying can be anticipated in the balance of the year.

(f) There is little prospect of an expansion in public utilities. The present capacity of the industry is adequate to meet the needs of the country even with a moderate increase in the level of business activity.

(g) Despite the increase in orders for armaments both domestic and from abroad, the heavy industries are still depressed.

(h) There is nothing in the prospects of the agricultural situation to justify the expectation that it will supply a stimulating influence on business activity.

(i) There is a further political factor, namely, there will probably develop a strong tendency on the part of certain groups to forego the prospects of immediate profits by postponing any investments or plant expansion until after the election.

10. Even if there is a moderate increase in business activity next year the unemployment situation will be substantially the same in 1940 as it is now.

In 1937, 35 million persons were employed in non-agricultural pursuits. Today less than 35 million are so employed. During 1940 we shall be doing well if we again reach the volume of employment of 1937.

The non-agricultural working population in 1940 will be about 2 million greater than in 1937 totaling somewhere between 33 and 35 million persons. We should have fully 8 million or more unemployed in 1940 (compared with less than 2 million in 1929).

In addition to this unemployment situation in non-agricultural lines, there is known to be a surplus labor supply on farms perhaps as large as 1.5 million working persons that need to shift from farming into industrial opportunities.

In view of the fact that there is no expectation for more than a moderate rise in national income for the next fifteen months, and in view of the further fact that a decline in business activity some time during the next fifteen months is a possibility, and, most important, in view of the conviction that a sustained full recovery is impossible unless action is taken to correct basic maladjustments:

There is general agreement among the persons referred to above that a comprehensive program of action should be initiated at once, such action to be designed to accomplish two things:

1. Make some important contribution toward the elimination of the basic maladjustments which stand in the way of a sustained full recovery. Though the full effects of this program will not be felt for several years, it is vitally important that such a program be initiated at once for two reasons:

- (a) It will take a long time before such a program could be worked out and put into effect.

- (b) It is important to make clear to the public that this Administration intends to push toward a further extension of New Deal principles

and will adopt measures designed to insure long-term and sustained prosperity, and that this Administration recognizes the existence of basic maladjustments and will take steps to correct them.

2. A program of immediate action designed to insure a substantially increased national income in 1940 and to protect us against a sharp downturn in business during the next fifteen months.

Some of the measures which can be undertaken to correct basic maladjustments can be initiated with sufficient rapidity to raise the national income in 1940.

If to the increase in national income that would result from measures undertaken to correct basic maladjustments there be added the further increases to the national income which would result from measures specifically designed to increase in 1940 investment and expenditures, then an increase in the national income of \$5 billion or so can be assured for next year.

There appears to be general agreement in the group mentioned above that Congress should not adjourn until an adequate program has been inaugurated. Or, if Congress is to adjourn, it should do so only with the distinct understanding that it would reconvene after a short vacation prepared to deal with these major problems, some of which have been before us for a long time.

1. It is almost the unanimous opinion among Administration officials and technicians in Washington who are thoroughly loyal to the Administration, that there is little if any prospect for marked recovery during the next two years.

2. They also recognize the possibility of a downturn in business activity before the end of 1940.

3. The result of the 1940 election is so decisive for the history of this country and possibly for the world that we believe that we cannot possibly afford to run the risk of going into the 1940 election with business little better than it is now and maybe worse.

4. The stakes are so great that we believe we should take every possible step to assure a substantially increased national income in 1940.

A program of recovery, if enacted in this session of Congress, can be successful in this objective; if it is not enacted by Congress it will provide a platform on which the 1940 election can be fought.

The Fiscal and Monetary Advisory Board has been advised by the experts of the Treasury, Federal Reserve Board and National Resources Committee that:

1. The 1938 national income is estimated at \$62 billion. For the calendar year 1939 it is estimated that the national income will be between \$65 and \$68 billion.
2. A national income of around \$80 billion:
  - a. would provide substantial reduction of unemployment.
  - b. would provide Federal revenues sufficient to balance the current level of cash expenditures on the basis of the existing tax structure.
3. An income of \$90 billion or more is attainable through full utilization of our man power, plant and equipment, technology and natural resources, assuming the elimination of some important bottlenecks.
4. Also it is important for Federal fiscal policy to take into account:
  - a. changes in the volume of the outstanding debt of State and local governments and changes in the volume and character of their expenditures and receipts.
  - b. changes in the volume of capital expenditures being undertaken by private enterprise.
  - c. the fact that available supply of credit is so great that present and prospective Federal borrowing will not create a shortage of credit available at reasonable rates for private enterprise.

In pursuit of the objective of attaining a higher national income we make the following recommendations with respect to fiscal policy for the next fiscal year:

1. If taxes are to be increased, those selected should be such as interfere least with additions to the aggregate income of the American people. These <sup>taxes</sup> among others, <sup>personal</sup> are: estate taxes, gift taxes, lowering <sup>personal</sup> tax exemptions as income rises, higher income tax on middle brackets.
2. We advise against new taxes which operate to reduce substantially consumer purchasing power. These, among others, are: processing taxes, sales taxes, taxes on payrolls, excise taxes.

3. The Board notes with approval the proposed changes in the budget presentation and recommends that the principles embodied in these changes be extended as rapidly as feasible.
4.
  - a. For the purpose of adding to the national income next year, and of preventing what promises to be a serious bottleneck within the next year or so, action should be taken to secure a large railroad equipment program.
  - b. Recovery could be further stimulated by additional government activities financed through self-financing government corporations. A special report on such activities will be later submitted.
5. That a comprehensive survey be started with the view of immediately setting up machinery to obtain all necessary detailed information with respect to the current receipts and expenditures of State, local and municipal administrative bodies and to changes in the volume and make-up of their outstanding debt.
6. Arrangements should be made at once that would make possible engineering and legal planning of various public works which would be available for immediate prosecution when required to give increased flexibility in the timing of public expenditures and increased assurance of value and utility of the expenditure itself.

*These pro*  
These arrangements are much needed not only because of the current magnitude of Federal, State and local public works and relief programs, but even more especially because of the extensive rearmament program being undertaken. To make certain that the rearmament program shall not be continued as a device to reduce unemployment or to stimulate business activity, it is essential to have such plans perfected as will permit a ready transfer of employment from armament industries into needed productive public and private works projects as soon as peak activity in the armament program is passed.