

March 14, 1942.

Mr. Henry H. Edmiston,
Assistant Vice President,
Federal Reserve Bank of St. Louis,
St. Louis, Missouri.

Dear Mr. Edmiston:

The Chairman asked me to take care of your wire of March 12, 1942, and as requested I am enclosing herewith a copy of two memos, one short and one longer, prepared by Mr. Currie in 1938.

With best wishes, I am

Sincerely yours,

Lawrence Clayton,
Assistant to the Chairman.

Enclosures 2

LC:hbw

TO Mr. Thomas

FROM Mr. Clayton

REMARKS: I am returning your memos re railroad equipment, together with an extra copy which I had made and which you might wish to keep in your files.

CHAIRMAN'S OFFICE

April 18, 1938

RAILROAD EQUIPMENT LOANSProposal

The R. F. C. has the power to purchase adequately-secured equipment trust certificates upon such terms and conditions as it may determine. Loans made for maintenance or purchase of equipment need the approval of the I. C. C. as regards maturity but do not require a certification by the I. C. C. that the railroad in question, on the basis of present and prospective earnings, may reasonably be expected to meet its fixed charges, as do loans to railroads for other purposes.

It is suggested that for a limited period the R. F. C. announce itself prepared to purchase new equipment trust certificates (a) covering 100 percent of the cost of new equipment, (b) maturing in twenty years in the case of freight cars, 10 years in the case of complete streamlined trains, (c) at a 2 percent interest rate, (d) interest beginning one year after date of loan.

Arguments in Support of Proposal

1. An offer on less favorable terms would not interest the better railroads that can now sell equipment trust certificates on a 4 percent basis or better. On an offer such as outlined above, they could hardly afford not to anticipate part of their future requirements.
2. In the present conditions of railroad finances, equipment trust certificates constitute the most secure type of loan that can be made to the roads.

3. In no other way could the Government induce as much total expenditure and employment at as little cost to itself. It has been carefully estimated that to handle the volume of traffic consequent upon full recovery in three years' time would necessitate the purchase of \$2½ billion worth of equipment.

4. Any anticipation of these requirements would both provide employment and buying power now and help mitigate the almost inevitable bottlenecks in the future.

5. It is important to limit this offer to equipment purchased in the comparatively near future, as otherwise roads will hold back. The stipulation that the equipment must be contracted for in this calendar year to be delivered before June 30, 1939, appears to be reasonable. This type of work could be begun almost immediately, as contrasted with some other elements of the recovery program.

UNITED STATES RAILROAD EQUIPMENT AUTHORITY

Proposal: Establish a railroad equipment authority, with capital stock owned by the Treasury, empowered to issue guaranteed debentures for the purpose of contracting for the purchase of new railroad rolling stock to be rented or leased to railroads.

1. The Stimulation of Recovery

Expenditures of some \$500 million on railroad equipment could be assured in the first year of operation. Apart from the stimulation this would afford the economy in general, it would provide work for the railroads' own car shops and increased traffic for the roads themselves.

2. The Removal of Future Bottlenecks

Preliminary estimates indicate that in order to handle the volume of traffic consequent upon the continuance of recovery at a desirable rate, yearly expenditures on rolling stock of about \$800 million at present prices would have to be incurred in the period 1939-41. From the standpoint of the national economy it would obviously be to our interest to utilize idle plant and labor in the immediate future in order to relieve the shortages, stoppages, and bottlenecks that will arise in freight traffic, the railroad equipment industry and in the steel industry with the continuance of recovery.

3. A Contribution to Future Stability

The railroad equipment field has traditionally a feast and famine character and is consequently an important source of economic

instability. A federal authority, not pressed by financial considerations or immediate profit considerations, could level off the peaks and valleys of railroad equipment buying.

In addition, variation in rental rates for equipment would offer a highly desirable alternative to variations in freight rates as a means of bringing about greater stability in railroad net earnings.

4. National Defense

A modernized supply of rolling stock adequate to handle the volume of traffic incident upon war appears to be an indispensable element in any comprehensive program of national defense. Moreover, experience in the handling of a national car pool will be invaluable in the event of war.

5. Betterment of the Financial Structure of Railroads

The gradual substitution of rented and leased rolling stock for owned equipment would permit a reduction in the debt of railroads and a substitution of variable for fixed charges. Moreover, the proposal offers a means whereby the Government could stimulate private expenditures without getting deeper involved in the complicated financial structure of the railroads.

6. Improved Efficiency

The proposal, through making possible continuous buying, greater standardization, and more liberal provisions for research, should permit very substantial reductions in costs to be achieved. It should also permit more efficient utilization of rolling stock in the handling of empties, etc.

7. Relation to the "Railroad Problem"

The proposal could be adopted independently and without prejudice to any comprehensive program of reorganization and consolidation of the railroads, which may take a long time to accomplish.

Objections to the Proposal:

1. Government Ownership.

The proposal does, of course, involve a degree of Government ownership, so far as rolling stock is concerned. It may be pointed out here, however, that

(a) it is only a degree removed from the present practice of making loans to financially shaky roads,

(b) it is far removed from the actual Government operation of railroads as is practiced in certain other democratic countries such as Canada and Sweden,

(c) it is proposed that the Government operations be confined to research and ordering, renting or leasing equipment and that no construction or repair be undertaken in Government shops.

2. Loss to the Government

It may be objected that the Authority's equipment will be used only during peak periods and years of exceptionally high traffic volume and that for the rest "the Government will be left holding the bag."

This objection can easily be disposed of by pointing out that this all depends on the terms of leasing or daily rentals. If they are set sufficiently low, it will pay the railroads to use the Authority's equipment, and rely on old high - repair - cost equipment for peak requirements. Low rental rates will also

constitute an inducement to retire old equipment.

This way out, however, raises another objection. If rentals are set too low, the revenues of the Authority will be inadequate to service its obligations and keep its equipment in good repair. It should, however, for the following reasons, prove possible for the authority to set sufficiently low rentals to induce the railroads to use its equipment and yet not suffer a loss:

(a) it will have the advantage of borrowing at lower interest rates than the railroads can secure;

(b) being a very large and continuous buyer of standardized equipment it should be able to secure greater price concessions than any individual road could obtain;

(c) there should be economies consequent upon the growth of a national car pool;

(d) it will be in a position to charge higher rentals in good years to recoup any losses sustained in bad years.

Finally, it must be kept in mind that even though the Authority should actually show a loss, this would not be incompatible with a large net national gain in more stable and higher national income, production and employment.

3. Technical Difficulties

The proposal has been examined by a number of operating railroad men and although problems have been pointed out in connection with repairs, zoning, storage, etc., it appeared to be the general

consensus that the problems would be similar to those now encountered in connection with "foreign" cars and the private leasing companies, such as Pacific Fruit Express, and various ways of meeting these problems were at hand.

In connection with the determination of the volume of new equipment of various types, it would appear feasible to make far better national estimates of the number of different types of freight cars and locomotives that a certain volume of traffic will require than could possibly be arrived at as the sum of individual estimates made independently by the various roads.

4. Inequities as Between Roads

Some companies have normally an excess of cars and others a deficiency. Some companies, therefore, would be in a better position to take advantage of low rentals on new equipment while others might suffer a loss of revenue now derived from the use of their cars by other lines.

Again, many roads now build a substantial amount of equipment in their own shops and individual hardships might result from the inevitable changes in the location of work consequent upon national bidding for a single buyer. These changes might be tempered by policies of the Authority in distributing new equipment, repair and reconditioning work.

Alternatives:

The alternatives appear to be either to do nothing or to stimulate railroad equipment purchases through loans to railroads from the R. F. C., on favorable terms.

It is said that if the R. F. C. should announce that it was prepared to purchase equipment trust certificates

(a) up to 100 percent of the cost of new equipment,

(b) at a $2\frac{1}{2}$ percent rate,

(c) for comparatively long maturities,

(d) the offer to be available for a limited period only,

a very large amount of anticipatory railroad equipment buying would be induced.

While this alternative is far better than doing nothing at all, it appears inferior on various counts to the proposal under discussion.

1. It Lacks Flexibility.

The chief objection, from the compensatory fiscal policy viewpoint, is that an emergency loan operation does not provide a mechanism through which the Government could operate continuously, and outside the budget, to smooth out fluctuations in expenditures in an important field.

With reference to the immediate situation, it is almost impossible to forecast the extent to which a favorable loan offer would be taken up. Once announced, it would be difficult to change the terms. If a big rush of orders ensued, deliveries would have to be spread over a future period, or else a temporary bottleneck would occur. If few

orders came in, the terms could not be lowered further or the offer extended without arousing a sense of grievance on the part of those who had already availed themselves of the offer.

2. There are definite obstacles in the way of offering terms that will really be effective.

The R. F. C. must consider the soundness of each individual loan and cannot explicitly rely upon averaging and upon higher interest returns in good years offsetting low returns in bad, as could the proposed Authority. The most favorable terms offered to date by the R. F. C. were in connection with the purchase of equipment trust certificates of the Southern Railroad for 100 percent of the cost of freight cars, at 4 per cent, and for fifteen years.

In bad years, when on national economic grounds, expenditures on railroad equipment are most desirable, the credit of the railroads is weakest and, confronted with surplus equipment on the one hand and financial difficulties on the other, they would be most reluctant to borrow and purchase new equipment even on the most favorable terms.

3. A loan operation does not offer a good possibility for securing cost reductions and efficiencies.

Each loan being an individual loan, there does not exist the same opportunity to derive the economies arising from large, continuous orders of standardized equipment, or from research, or from car pooling.

4. Other implications

Further large loans to the railroads would involve the Government still more in the complex financial structure of railroads, and would

result in a further increase in railroad debt and fixed charges. Moreover, it would be difficult to refuse to other borrowers the particularly favorable terms that would have to be offered to the railroads.

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March 13, 1942.

Mr. Clayton:

These memoranda are the only ones we can find in our files on the subject. I suppose the longer one is what is wanted. It seems to be the only copy we have in the division.

W.T.

Attachments

Form F. R. 511

TO

Woodlief Thomas

FROM _____

REMARKS:

Can you find

a copy of this for

me. Please rush

it

LC

W
7/24/38
by P.C. Curran

CHAIRMAN'S OFFICE



TELEGRAM
Board of Governors
of the
Federal Reserve System
Leased Wire Service
Received at Washington, D. C.

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1942 MAR 12 PM 4 12

ECCLES

OSCAR JOHNSTON EXPRESSED DESIRE AT BOARD MEETING TODAY TO SEE
DETAILS OF PROPOSED RAILROAD EQUIPMENT POOL DEVELOPED IN
CONNECTION WITH SPEND-LEND PROGRAM IN 1938 MR DAVIS SUGGESTED
THAT YOU MIGHT SEND US AIRMAIL A COPY OF THE PLAN FROM YOUR
FILES. MR JOHNSTON WANTS TO EXPLORE POSSIBILITIES OF A
GOVERNMENT-OWNED EQUIPMENT POOL TO MEET URGENT NEED FOR
SUFFICIENT CARS TO MOVE WAR TRAFFIC

EDMISTON.

FEDERAL RESERVE BANK
OF
ST. LOUIS

March 17, 1942

Mr. Lawrence Clayton,
Assistant to the Chairman,
Board of Governors of the
Federal Reserve System,
Washington, D. C.

Dear Larry:

Thanks so much for sending me the memos with regard to a proposed plan for a railroad equipment pool. After reading them over I am sure that Mr. Johnston will find them exceedingly helpful.

We certainly enjoyed the Chairman's visit to St. Louis last fall. For myself I miss my friends in Washington, but have been having very interesting work at the St. Louis bank. I hope I can plan a trip to Washington sometime this spring. With kindest personal regards, I am

Very truly yours,



Henry H. Edmiston,
Assistant Vice President.