

**FEDERAL RESERVE BANK  
OF NEW YORK**

November 3, 1937.

Dear Chairman Eccles:

Since the Presidents' Conference two weeks ago, we have been giving a good deal of further thought to the questions discussed at the Conference with the Board, concerning the implications of the recent decline in the securities markets and the less drastic but marked recession in business. My associates and I have discussed these problems with our directors and with others and, in the light of all the circumstances as we see them, there seem to be some steps which might now be taken to remove certain obstacles to business activity and further to encourage business recovery.

Perhaps no one can say with entire confidence whether the current economic recession may not become a serious depression. It is not necessary to recount the various opposing factors in the situation, of which you are aware, but one conclusion seems to stand out, namely, that at a time when the stimulus of government spending and credit expansion through government borrowing is coming to an end, the business spending which should take its place is at least partly blocked. The transition from public spending to private spending is evidently not being effected smoothly. I think we are all agreed that more government spending is not a feasible way out. The government and the people have set their faces against continued deficit financing. Indeed, in this

atmosphere and at this stage of recovery, it is altogether doubtful whether it would work anyway. There has recently been evidence that added amounts of government securities might find the market reluctant. Renewed deficits would likely further discourage and longer postpone private spending.

The real problem is to get private spending going again and in sufficient amounts to fill the gap left by the sharp decline in the government's net income producing expenditures. There is plenty of private spending that needs to be done and there is plenty of money available. A beginning has been made, for the amount of private spending in 1936 was larger than in 1935, and even though the last quarter may be relatively poor, the full year 1937 will show larger private spending than 1936. But just now the machinery seems to be partly stalled.

Suggestions which we have received from others and which we have ourselves examined, as to what might be done to accelerate business activity, may be classified under three general headings; (1) the general atmosphere in which business is conducted, (2) specific business problems, and (3) problems of business financing, including taxation and general credit policy.

(1) I am sure I do not need to emphasize the fact that the business community is just now extraordinarily sensitive to every wind that blows from Washington. Whatever can be said or done to indicate the awareness of the Administration concerning the problems business now faces and to clarify its objectives as they relate to business is likely to be as effective as more specific action. Business is now hesitant about making long term plans partly because it feels it does not know what the rules of the

game are going to be. If business were planning further ahead it could readily be employing more people and disbursing larger pay-rolls. To a great extent this is a problem of general atmosphere. The recent action of the Board of Governors in reducing margin requirements is proving helpful not solely or even largely because of its technical effects but more as an indication of understanding and a cooperative attitude.

(2) On the more specific business problems and more specific ways in which spending may be expedited and employment increased, the four fields which appear most promising are: (a) building, (b) public utilities, (c) railroads, and (d) general manufacturing and mining. The potential demand for new housing is generally attested, and in the other fields mentioned, there is reported to be large accumulated need for the replacement of obsolescent plant and equipment, making up deferred maintenance, and construction of plant for new or cheaper production.

(a) I hesitate to make any comments about building because you yourself know that field so thoroughly. Many had hoped that increased activity in building this year would be the chief aid in helping us over the transition period from government to private spending. But a hopeful beginning was interrupted by a rapid increase in building costs (both wages and materials) and latterly by the general uncertainty accompanying declines in the security markets. I do not have any specific suggestions to offer on this point beyond those which you have discussed from time to time, but any summary would be incomplete without the general suggestion that this field, in which actual output is still at least 50 per cent below any reasonable normal expectancy,

is one in which much progress is still to be made. Time is, of course, working with us, for the shortage of proper housing is steadily increasing, and rents are rising, though evidently they are still not high enough to offer adequate inducement for building enterprise. It may be that some recession in building at this time will have been helpful as far as costs are concerned, for past experience seems to indicate that such a rapid run-up of costs as occurred in the first half of this year does not prove very rigid in the face of falling demand.

In the case of the utilities and the railroads, though the maximum potential demand is probably less than in building, spending could be more promptly released. In both cases we are informed, as we assume you are, that there are programs for maintenance and construction all prepared, which could provide a prompt basis for added employment.

(b) It is my own view, as I stated at the joint conference with the Board on October 19, that perhaps the best opportunity for an effective immediate release of productive forces is in the public utility field. From the best information we are able to obtain about the utilities, power consumption appears to have about caught up with present producing capacity. Maintenance and new equipment expenditures appear to be behind. The utilities estimate that they could spend, promptly, at least as much as \$1 billion and continuing amounts of about the same magnitude, over a period, if their immediate future were clarified on the one point of government competition. The utilities, and present and potential investors in their securities, are afraid that the

government may set up competing subsidized distributive systems, and thus destroy all or part of the value of their properties. If they were affirmatively reassured on this one point, they could go ahead with plans now formulated and could tap the market for needed funds. Such a decision as to government policy, which it seems to us need not be in conflict with previous policy, would give business a quick impetus in an important capital goods industry and thus would readily open the way for a considerable amount of reemployment.

(c) The railroads are another possible field in which increased employment might be effected, though there is difference of opinion as to the speed with which this can be accomplished. Increased traffic, due to increased business activity in general, would of course be directly helpful. The railroads, however, have been caught between the pressure of advancing costs, due to wage increases, higher taxes, etc., on the one hand, and depressed and regulated income on the other. How much this difficulty can be remedied by rate revisions or what other steps might be necessary is a question to which prompt attention should be given. Anything that can be done to improve the position of the railroads would not only be importantly helpful to business in general, but would also help one large area of the securities market which is now most depressed and on which savings banks, commercial banks and insurance companies are greatly dependent.

(d) General manufacturing and mining concerns are now large spenders for maintenance and for new plant and equipment. For a number of months, for example, machine tool manufacturers have

been working practically at capacity. Mr. Terborgh of your staff has estimated that all such expenditures in manufacturing and mining will total over three billions of dollars this year. Clearly, this is a large enough sum so that even minor fluctuations have an important effect on employment. There may not be any single move in government policy which would influence this spending, but those more general moves which were mentioned earlier, and the more specific sorts of action just discussed, would be the kind of evidence as to the future of business which is calculated to replace the present hesitancy with renewed activity.


(3) Concerning the problems of business financing, perhaps the main point to be emphasized is the widespread belief, apparently leading to decisions by business men and investors, that certain of our present taxes inhibit the financing of business and promote disorder in security markets. A program to review and revise the tax system, particularly the undistributed profits tax and the capital gains tax, would be a constructive step, not only by the removal of possible defects in the tax system, but also by encouraging business initiative generally.

As I understand it, the System's philosophy with respect to these problems has been to bring about increased production and increased employment. Our assumption has been that our success eventually would depend largely upon a revival in the capital goods industries, which in turn demands that these industries have easy access to the capital market. We believe that anything which unnecessarily interferes with the further development of this process is contrary to all that has been done to try to improve

the standard of living of the whole population.

I realize that this letter does not do much more than indicate what we deem to be the most likely points of attack on the problem of preventing the current recession from becoming, perhaps, a real depression. I am enclosing a memorandum which Mr. Williams has prepared in the course of our discussions and which undertakes a review of the current situation from the historical and theoretical standpoints. We are also preparing other memoranda relating to business financing and the capital markets which I shall send along to you as they are finished. In the meantime, however, it has seemed to me to be worth while to give you this summary of our views. It will, at least, prepare the ground for further specific suggestions which we may develop, or for a common effort to answer some of the questions which have been raised, or for discussions at the next meeting of the Federal Open Market Committee, when many of these questions will likely form a part of our discussion of open market policy.

Faithfully yours,

  
George D. Harrison,  
President.

Hon. Marriner S. Eccles,  
Chairman, Board of Governors  
of the Federal Reserve System,  
Washington, D. C.

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