Form F. R. 131

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date May 24, 1937.

To Chairman Eccles

Subject: Statement for the President.

From Lauchlin Currie
LMC.

Attached is my tentative draft of a statement to be left with the President. I am not sure that it is the kind of thing you had in mind but it can serve as a basis for the final statement.

Not used

May 24, 1937.

FRC.

PROSPECTS FOR INDUSTRIAL ACTIVITY

Although both production and national income for the year 1937 as a whole will average substantially higher than in 1936, this will be attributable mainly to the relatively high level of activity with which the year started. There appears to be little reason to expect more than a very modest increase in production, employment and incomes for the remainder of this year. There is a distinct possibility of a greater than seasonal let-down this summer while production adjusts itself to the recent slackening of forward buying. In the meantime, progress is being made in adding to the productive capacity of the steel and other industries so that production will be able to expand further next year without being stopped by the emergence of bottle-necks.

MONETARY POLICY

After the last increase in reserve requirements on May 1st banks were left with over $900 million of excess reserves. Even with the higher reserve requirements this volume of excess reserves would permit an expansion of $4.5 billion in demand deposits. In addition to this large volume of unused lending power, insurance companies and other institutional investors have a large volume of funds available for investment. It would appear, therefore, that the current relatively higher level of interest rates is not attributable to a shortage of loanable funds. It appears desirable, however, in view of the immediate business situation, to continue an easy money policy, taking no steps to absorb excess reserves further for the time being but, on the contrary, increasing them, if necessary, over the June financing and income tax period.

BUDGET POLICY

Owing, on the one hand, to the payment of the bonus in the fiscal year 1937 (including that paid in June 1936) and, on the other hand, to the collection of substantial social security taxes in the fiscal year 1938, a very drastic reduction in the contribution to the increase in the national income attributable to the fiscal operations of the federal government is in prospect. We estimate this reduction as being somewhere in the neighborhood of $3 billion. It will be greater, of course, if the anticipated deficit of $400 million is wiped out by a reduction in expenditures. In fact, because of old-age and unemployment insurance taxes, there will be an excess of more than $700 in cash collections. This excess, however, will not permit the retirement of publicly-held debt so long as it has to be used to sterilize gold imports.

In these circumstances it is urged that a balanced budget should be achieved not by a curtailment of expenditures, but by additional taxes of a character that will not decrease spending. The following considerations may be urged in support of this recommendation:

1. If recourse is to be had to the use of government credit in future depressions, it is essential to secure a substantial retirement of the public debt before the next recession.

2. It is very possible that social security taxes will not be raised to the levels at present provided for in the Social Security Act, and that benefits will be larger. Hence, we should not place too much reliance on social security taxes as a source of funds for the retirement of the publicly held debt.

3. The problem of relief will be with us for some years to come. It is unlikely that private industry will absorb this year the 600,000 that will have to be dropped from the rolls under the $1.5 billion appropriation, and considerable pressure for the continuance of relief work on the present scale must be expected.

4. A continuation of the New Deal program will cost more money.

5. The absence of new taxation throws the emphasis on a contraction of expenditures, and the economy issue gives opponents of the New Deal program their most effective means of blocking that program.

6. The failure of revenues to measure up to earlier estimates constitutes a valid reason for departing from the previously announced intention to impose no new taxes this session.

7. The present is the best time to impose new taxes if it is to be done at all. Next year is an election year. A small surplus will be in prospect for the fiscal year 1939, and a drive to reduce taxes at that time is to be expected.

8. Taxes imposed now will not be payable until 1938; if delayed until next spring and not made retroactive they will not be payable until 1939.

9. Various desirable tax reforms, such as providing for a gradual elimination of the personal, dependent and earned income exemptions in the higher income brackets, and the gradual elimination of the exemption of $40,000 in the higher estate tax brackets, the

removal of exemptions of estates from the capital gains tax, increased taxes on foreign capital, and others of like nature, could be effected. Such taxes would neither decrease consumer spending nor, with the present superabundance of loanable funds, decrease appreciably expenditures on capital account.

GOLD AND FOREIGN CAPITAL

The gold problem, so far as the United States is concerned, is the problem of foreign capital inflows. Without such inflows we would not be in the position of having to increase our interest-bearing debt in order to supply large profits for the gold mines of the world, as, in the absence of capital inflows, we would receive no gold. England, who derives large benefits from the ownership of gold mines, would then have to bear her proper share of the cost. Only if this cost is borne by England will it be possible to come to terms with her in handling the problem raised by an annual world gold production of over $1.25 billion. Foreign commentators admit that the United States will continue to attract foreign capital and, hence, gold, unless such capital is subjected to heavier taxation. In addition to the other arguments urged previously for measures to deter the inflow of foreign capital, is the present argument that such measures constitute a necessary prelude to the satisfactory handling of the gold problem.