

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date October 13, 1937.

To Chairman Eccles

Subject: A Tentative Program to Meet the

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Business Recession

Attached is a tentative outline of certain things I think might be explored to combat the recession that seems to be on us.

October 13, 1937.
L. B. Currie

A TENTATIVE PROGRAM TO MEET THE BUSINESS RECESSION

The situation

The situation is daily becoming worse and the decline in business activity is gaining momentum. A further decline in production while inventories are being worked off is indicated. A decline in plant, equipment and maintenance expenditures is likely as production recedes. The downward movement should be somewhat arrested by the probable more than seasonal expansion of automobile production in October and November, but this will merely be borrowing production from next year. The federal government is making virtually no contribution towards increasing incomes now and by next March activity-decreasing receipts may be expected to exceed activity-increasing expenditures. Most forecasters are talking in terms of the Federal Reserve Board index going to 100. They all are relying upon an upswing in building to start us upward again sometime next year.

There is no need to elaborate on the bad aspects of this recession while it is occurring. There is one aspect of it, however, that may be overlooked. If inventories are permitted to be worked off to a relatively low volume anything that later changes the picture may lead to another scramble for goods at advancing prices. If building is permitted to lag, the steadily accumulating shortage will result in an even worse eventual boom. Therefore, on political, social and economic stability grounds it is highly desirable that consumer buying and residential building be sustained and that thereby the recession be tempered as far as possible.

A tentative program

I have a strong feeling that the President has not grasped the seriousness of the situation. I should like to suggest that you see him and point out the possibilities and outline a possible program designed to moderate and shorten the recession. The following points seem to me to be worth exploring:

1. Open market purchases

Total adjusted demand deposits declined one-half billion from December 1st to June 30th. Since that date there has been another half billion decline in reporting member banks alone. With a possible retirement of publicly-held government debt next year and a probable leveling off in commercial loans it is possible that adjusted demand deposits may decline further. Although the importance of this can be easily overstressed, still what influence it has is depressing. In any case the immediate danger of deposit inflation is over and there would seem to be no objection to substantial purchases of governments by the Federal Reserve banks and much to be said in favor of such a course. Insofar as these were purchased from banks it would relieve the pressure on the capital market of continued bank liquidation of governments. Insofar as governments were purchased from non-bankers a corresponding volume of deposits would be created. Finally, the psychological effect would be favorable and might help to check the expectation of lower prices and moderate the decline in inventories.

2. Margin requirements

If it is advisable to raise margin requirements as stock prices advance and brokers' loans increase, it would seem equally advisable to lower margin requirements as prices fall and brokers' loans decline. Although it might not have much effect in increasing buying directly the psychological effect should be favorable.

3. Public expenditures

Very shortly it appears that there will be an excess of cash collections over cash disbursements, thus contributing to a contraction of buying power. While we should not deviate from the goal of a technically balanced budget in the fiscal year 1939, when it is expected that restraint will be desirable, there is some question as to the expediency of economy efforts in the next nine months. Putting political difficulties aside, the proper fiscal policy from an orderly recovery point of view would be one that would provide for an increase in buying power for the next six months and for a decrease in buying power in the calendar year 1939. If, in other words, we can be reasonably sure of an upswing in business in 1939, it would be both permissible and advisable to provide for increased tax payments in that year in the coming regular session of Congress. While we are doing that, however, we should do all that we can to moderate and shorten the recession in the current fiscal year.

Certain points in line with this general policy might be explored. The W. P. A. appropriation, for example, provided only for a seasonal expansion of unemployment this winter. Now it appears that we will have in addition a cyclical expansion. In view of the changed circumstances, some thought might be given to the advisability of providing another \$100 million or so additional relief this winter. Expenditures of this type are most effective in maintaining consumer buying power and helping inventories to be moved.

The Government's accounts should be studied with a view to the possibility of increasing revenue with a minimum of unfavorable effect on consumer buying. For example, the R. F. C. has outstanding \$576 million in preferred stock and capital notes of banks. In view of the vastly improved position of banks it would appear possible to exert some pressure for repayment in the next fiscal year, thus obviating in part the need for additional taxes. As long as the interest rate on such obligations is a maximum of $3\frac{1}{2}$ percent there is not much inducement to pay them off.

There might also be a study in order to ascertain the possibilities of speeding up expenditure of appropriations already made. There should be some opportunity to do this in connection with P. W. A., public highways and navy appropriations.

4. Building

The importance of securing a building revival next year cannot be overstressed. The continuation of recovery depends on it. Certain types of increasing expenditures are primary and certain types are secondary or derivative. For example, plant and equipment expenditures are derivative in the sense of depending on a growth in demand and production -- we cannot expect them to initiate an upward movement. This is the basic weakness in the position of those who are merely content to make a large volume of capital funds available. Occasionally inventory expenditures can be the primary source of an upturn in incomes, as in 1933. This, however, depends on some bullish development that leads to expectations of rapid price advances.

More generally the impetus to increasing expenditures must come from building, as in 1922 and 1924, or from an excess of government expenditures over receipts, as in 1934-1936. Since there will be an excess of tax collections in the near future, we are by a process of elimination forced back to building as being the primary source on which we must depend for a reversal of the downward trend in incomes, demands and production.

The prospects in this field are not encouraging. We have had to revise steadily downward our expectations for this year from 450,000 units to 300,000 units. Hence, with a national income in 1937

some seven or eight billion dollars higher than in 1936 we will only get 20,000 more housing units built this year. Since rents have continued to move up the explanation for this disappointing showing must be sought in higher building costs. Although there appears to be some prospect of a softening in building material prices, this may be offset by a leveling off in the index of new rents if incomes decline and unemployment increases. It appears dangerous, therefore, to wait until a natural readjustment of the rent-cost relationship leads to increased building.

What positive action might be taken by government to stimulate building?

It appears to me that several things might be done:

A. The President must be made to see how much is at stake and be induced to take the lead in getting the unions, equipment and material producers and lenders together in a concerted effort to reduce costs. Full publicity might be used and the feasibility of annual wage contracts be aired. The possibility of a national conference and the setting up of local committees might be explored. Out of the resulting publicity and discussions would come pressure toward reduced costs and against higher costs. Additional pressure would be brought on Congress to amend the Federal Housing Act and the Wagner-Steagall Act.

B. The Federal Housing Act should be amended along the lines you suggest. I do not think, however, that this will be sufficient. Even with the modifications you propose, facilitating the formation of national mortgage associations, there is some question whether the volume of large-scale mortgages available and the spread in the interest rates will make the formation of such associations attractive. In any case the urgency of the problem is such that we should leave no approaches unexplored. Therefore I renew my suggestion that

C. The financing costs of insured mortgages should be reduced. This could be done without legislation. I would reduce not only the maximum but also adopt a sliding scale whereby it would become profitable to insure 50 or 60 percent mortgages. At the present time very few such mortgages are insured. A 4 percent maximum rate for a 50 percent insured mortgage, with a one-half percent service charge and a one-fifth of one percent insurance charge would put pressure on the whole mortgage lending field. I would couple this with:

D. An amendment that F. H. A. mortgages after 1939 would continue to be guaranteed by the Government.

E. The possibility of amending the Wagner-Steagall Act in order to secure some immediate expenditures might be explored. According to the Chairman of the New York City Housing Authority, New York City is prepared to spend immediately all that it is eligible to receive in the next three years, \$40 million. If the Act is interpreted to mean that a State can only have a maximum of ten percent

of the yearly appropriation, this would reduce New York City's yearly share to the negligible figure of \$13 million. If possible it appears highly desirable to amend the Act on a first come, first serve basis. Generally, the possibility of putting some steam behind the Act might be explored. An administrator is not even yet appointed and if nothing is done it is doubtful if we will get any expenditures from this source at the time we most need them.

5. The President has made such definite commitments on the Wage-Hour Bill that it appears useless to oppose it. What could be done, however, is to represent to him the advisability of avoiding any abrupt change and, so far as possible, to time the application of the Act to any industry to increasing profits and activity in that industry.

6. As an aid in putting any program over it would be highly desirable for the President or for you to make a speech frankly stating the position, how we got into it, and what we propose to do to get out of it, giving the country the sense of a grasp of the problem and of a well-rounded and concerted program designed to meet it. In your absence there have been too many of the old discredited type of statement to the effect that everything is fine and conditions are fundamentally sound. Such statements do a lot of harm.