

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

## Office Correspondence

Date March 6, 1940To Chairman Eccles

Subject: \_\_\_\_\_

From Emile Despres

Attached is Ezekiel's latest version of the memorandum prepared for Secretary Wallace outlining a new spending program. Ezekiel tells me that the Secretary would like to have your views regarding both the specific recommendations and the general wisdom of urging something of this sort upon the President at this time. I told Ezekiel that I would pass along to him any reactions which you might wish to express.

Attachment,

*E.D.*

## Economy, Debts, and Business

At the time your budget message was prepared, business activity in the country was setting a new high record. Industrial production for December was 128 (F.R.B. index). Since then it has dropped sharply, as is shown in Figure 1. The preliminary estimate for February is 110, and now (at the end of the month) business is only running at the level of about 105.

You clearly indicated that a good many of the budget estimates were based on an expectation of continued high business activity. Thus, in introducing your budget you stated:

"In approaching the Budget for the fiscal year 1941 I have sought, as in the past, to relate fiscal policy to probable economic necessities. As the Budget is being prepared we are achieving the highest levels of production and consumption in our history. The extent to which recovery has progressed, and the degree to which speculation and price increases have, on the whole, been kept in check, have made it possible for us to consider a substantial lessening of Government expenditures on activities not immediately essential for national defense."

You also stated that if business did not continue favorable, the estimates would have to be reconsidered. Thus, with reference to the recommended estimates for relief agencies, you said:

"In submitting estimates for these agencies I have taken into consideration the current improvement in business conditions....

"While the estimates are appreciably less than those for the current year, I am hopeful that they will prove adequate..... Relief expenditures should be closely geared to actual needs. If conditions fail to meet our hopes additional funds may be necessary. I may, therefore, submit revised estimates later in the session."

Further, in discussing the agricultural programs, you concluded with the statement:

"I have not, however, included estimates for new appropriations for parity payments in 1941. I am influenced by the hope that next year's crops can be sold by their producers for at least 75 per cent of parity. I do not suggest in any way abandonment of the policy of parity payments heretofore adopted, and future events may call for some appropriation to this end. I note, however, in passing, that the Congress has failed to make any provision for the financing of these payments already made or obligated for 1938 and 1939 crops."

The sharp break in business activity has already carried it down to near the level that prevailed before the outbreak of the war. Business analysts both within and without the Government expect the decline to go further, although there is a difference of opinion as to just how severe the decline will prove to be. The more optimistic forecasters expect the decline to stop with a bottom level perhaps not below 100 on the Federal Reserve Board's index, and with the recovery getting under way fairly promptly. Other well-informed observers, however, including some in both Government and private business, fear that the decline may continue downward until a low is reached somewhere between 80 and 85 on the F.R.B. index, with recovery not getting under way until next summer or early fall and remaining at moderately low levels throughout the year. The attached appraisal of business prospects (Appendix 1) prepared by the Industrial Economics Division of the Department of Commerce, indicates that this very unfavorable development is not at all unlikely, even after allowing for increased exports due to war demands.

Business prospects have thus changed drastically from those of three months ago. Business activity for the year will average only slightly higher than for last year, and if the reaction continues it may average far below last year and even approach the bad conditions of 1938.

National fiscal policy must therefore be reconsidered in the light of this altered business prospect. As you stated in your budget message:

"The experience of 1938-39 should remove any doubt as to the effectiveness of a fiscal policy related to economic need. The wise exercise of such a fiscal policy imposes grave responsibility on the Government. Government must have the wisdom to use its credit to sustain economic activity in periods of economic recession and the courage to withhold it and retire debt in periods of economic prosperity."

Apparently the rapid upsurge in business activity following the start of the war, and the accumulation of business inventories at that time, has produced another period in which Government action is necessary to modify or check business reaction.

In view of the sharp reaction already under way and of the danger of an even more serious reaction ahead, we suggest that a new program be promptly initiated to check the present reaction and provide for sustained recovery thereafter. There are three possible elements of such a program:

1. Immediate action for increased expenditures during the last quarter of the current fiscal year. If the business decline continues there is great danger that businessmen may start drawing on their heavy inventories, and hold back on future production until they have disposed of much of those inventories. This would produce a further sharp contraction of production and employment. Action directed to check the decline promptly would help prevent this further intensification of the decline. In order to offset

the present contraction in business and private investments, increased expenditures of \_\_\_\_\_ million dollars a month during the final quarter of this fiscal year would be needed.

2. Enlarged expenditures for relief programs during the 1940-41 fiscal year. This would provide increased expenditures through WPA, CCC, NYA, Food Stamp Plan, and similar activities to maintain the public buying power until longer-time programs could get going. To provide continued increase in activity, expenditures of at least \_\_\_\_\_ million dollars a month during the first half of this fiscal year would be needed, in addition to the amount already provided in the appropriation bills now in Congress.
3. Expanded investment activities of the sort provided by USHA, REA, Farm Security Administration tenant and rehabilitation loans, to provide an expanding investment with little or no budgetary expenditure. This would make it possible to reduce the amount of relief expenditures as the capital investment from these programs broadened. These activities should provide for capital investment of at least \_\_\_\_\_ million dollars a month to insure continuation of the business recovery and to make it possible to reduce direct relief expenditures.

#### The problem of timing

There is a question of policy as to whether the first element mentioned above needs to be included in the program, or whether the mere announcement of the program consisting of the second and third elements would be sufficient. You will recall that in April 1938 the mere recommendation of expanded Government action, in your message to Congress on April 14, 1938, was sufficient to cause an immediate advance in security markets. Business activity did not begin to pick up, however, until July, and did not really boom until late November. In the spring of 1938, business activity had already been declining for more than half a year, and the stock market had already broken wide open. At the present time, although industrial production has declined nearly 25 points, the stock market has not yet broken badly, and neither the business community nor Congress is as yet as deeply concerned about the depression as it was in the spring of 1938. If the reaction is to be checked in time, and turned without penetrating to exceedingly serious depths, prompt and more powerful action than that taken in 1938 is needed. Accordingly it is recommended that new programs including elements along the first line indicated above, as well as along the second and third, be initiated.

April 30, 1940

Chairman Eccles

Emile Despres

Mr. Alan Johnstone, general counsel of the Federal Works Agency, called on me yesterday afternoon at the suggestion of Dr. Ezekiel, in order to discuss the proposal that the PWA subsidize the construction of non-Federal public works through a series of annual contributions instead of a single capital grant. PWA is more popular with Congress than WPA, and a PWA appropriation for fiscal 1941 would pass easily, Mr. Johnstone believed, if the President's endorsement could be obtained. Mr. Johnstone said that Mr. Carmody would like to get a number of high officials who favor continuation of the PWA program to put their views before the President, either personally or in writing, as was done so effectively in the case of WPA.

They have been thinking about trying to get an appropriation of \$300 million for a PWA non-Federal construction program, but if they decide to seek legislation for a system of annual contributions, they will ask for \$25 million, equivalent, on a capital grant basis, to something like \$500 million. PWA, by obtaining authorization to discount State and local securities with the RFC, could obtain \$100 million in cash, so that annual contributions would not require any new money from the Treasury in the coming fiscal year. Mr. Johnstone indicated that he plans to get in touch with you on your return to discuss this matter. He believes that the President and the Secretary of the Treasury would find the annual contribution method more acceptable than that of capital grants, because, when combined with the discounting operation mentioned above, it would not require any increase in the direct Treasury debt.

Secretary Wallace has indicated to Dr. Ezekiel that he thinks the time may soon be ripe for another meeting like that on WPA, this time to discuss PWA and, perhaps, old-age pensions. Secretary Wallace raised the question whether Messrs. Hopkins, Jackson, and Carmody should not be asked to such a meeting. I gathered from Dr. Ezekiel that Secretary Wallace prefers to have you call such a meeting instead of calling one himself.