BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Statement for the Press

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Statement by Marriner S. Eccles, Chairman of the Board of Governors of the Federal Reserve System, and Member of the Advisory Board on Fiscal and Monetary Policy before the Banking and Currency Committee of the United States Senate.

STATEMENT OF M. S. ECCLES BEFORE THE SENATE COMMITTEE

ON BANKING AND CURRENCY S-2759

In appearing here this morning I wish to make it clear that I testify not in my capacity as Chairman of the Board of Governors of the Federal Reserve System, but as a member of the Fiscal and Monetary Advisory Board which was consulted by the President when the program underlying this bill was formulated.

I should like to state very briefly my views as to the nature of our economic difficulties that make it necessary to undertake a program along the lines proposed in this bill at this time.

I am convinced on the basis of observation and a great deal of study that has been given to the problem that the present unsatisfactory economic condition of the country, with its large volume of unemployment, is not a passing stage in the so-called business cycle but has fundamental underlying causes that need to be remedied before we can hope to achieve a sustained adequate volume of employment, a reasonably satisfactory national income, and a reasonably stable degree of prosperity. The fundamental adjustment in our economic mechanism that is required is the establishment of a better equilibrium between the capacity of the country to consume goods and services and its capacity to produce them. In the 1920's we had a fair degree of adjustment between consumption and production, but this adjustment was achieved through the existence of many outlets for investment which no longer exist at present. The automobile industry was rapidly expanding; States and municipalities were expending nearly a billion a year, in excess

of tax receipts, much of it on roads, highways, and schools. There was a billion spent a year on commercial buildings, stores, offices, and hotels. Universities, hospitals, country clubs and other non-profit institutions were spending between one-half billion and a billion a year. A similar amount was annually lent abroad. There was a rapid growth of installment selling which increased the annual spending of the people in later Twenties by nearly a billion a year. And, in addition to all this, we had a tremendous bull market in securities, which resulted in a large volume of luxury spending of profits made in the market.

Many of these factors, which helped to produce a consumer demand for goods that was sufficient to consume the products of industry, are not at present at work or in prospect. The rate of population growth is about one-half now of what it was in the Twenties. This drastic slowing up in population growth, together with declines of property values, have resulted in a decline in State and municipal expenditures so that tax revenues have, since 1932, exceeded expenditures, thus resulting in an addition to funds available for investment instead of providing an outlet for such funds. There is no disposition to make private foreign loans at this time. Commercial and office buildings are still available in excess of the demand. Churches, clubs, and universities have reduced their capital outlays to a small figure. The automobile industry is no longer in the stage of rapid expansion. There is no prospect of the kind of source of spending power as grew out of the stock market boom. And even residential construction, notwithstanding indispensable help from the Government, is below the level of the Twenties.

The magnitude of the problem facing us is clear. From 1923 to 1929, outlays of the type that absorb capital funds averaged more than $15 billions a year. Allowing for the increase in population as well as for technological advances that have taken place in the last decade, it would appear that comparable outlays today to insure reasonably full employment would have to be more than $18 billions a year, provided there is no material change in the present division of the national income between consumption and new investment.

In view of our changed conditions one of three alternatives faces the country: (1) either an unforeseen and unforeseeable very large outlet for investment must develop in new or in old industries, or (2) a very considerable increase must be brought about in the proportion of the national income that goes into consumption, or (3) the Government must provide an outlet for idle funds through deficit financing of work relief, public works, armaments, etc., or, as far as possible, through a program such as proposed in this bill for socially and economically desirable, non-profit making but largely self-liquidating investments. Unless some or all of these developments take place, we cannot escape continuous depression with its accompanying great unemployment. We can remove all the so-called deterrents to business and provide all the stimulus to business that we can contrive, and yet we shall still fall far short of the objective of full production and employment. It is only as adequate outlets are provided for our savings that the national income can rise to a satisfactory level, and it is only as the national income increases that tax revenue adequate to balance the budget can be achieved.

Of the solutions just indicated - the first is unpredictable, and we cannot wait in the hope that it will materialize sometime, somehow, although much more can and should be done to stimulate private activity in the field of housing to reach a much larger percentage of our population. The second, - a larger proportion of the national income going into consumption - should be a major part of public policy, but it appears to be a slow process, and in the meantime, as an immediate approach, increased investment operations of the Government are the only direct, immediate, and feasible plan at our disposal for the achievement of badly needed improvement.

The present bill constitutes in part an attempt to develop a program of public investment of a self-liquidating nature. It is, I think, indispensable, in view of the proposed greatly reduced employment in WPA and PWA. I am, however, forced to say that the annual expenditures that can be achieved under this program will make only a small contribution toward the solution of our basic problem. My own personal view is that the self-liquidating program, excellent as it is so far as it goes, should be supplemented by a continuing public works program.

Even more basic, however, is the necessity of increasing the proportion of the national income that goes into consumption. The line of progress in this field is clear. It has been traveled ahead of us by many of the older countries. Old-age security provisions in European countries have been so designed as to increase consumption relative to income. In England only sixty per cent of the cost of a national old-age pension scheme

is met by payroll taxes; in Sweden only twenty-two per cent. In our country, however, we will have, in the three years ending next December, taken out of consumption in the form of payroll taxes $1.7 billion more than has been returned in old-age benefit payments. Payments under the old-age assistance part of the program have constituted only a minor offset to this withdrawal. In addition, we have increased national saving and decreased consumption through the operation of our unemployment insurance program. The changes in our old-age security program now pending will alleviate this situation slightly. Even if pending amendments are passed, however, we will collect some three to four hundred million dollars more than we pay out in benefits next year. These provisions will have to be further revised. We shall also have to reconsider our entire tax structure, with a view to decreasing taxes on consumption and increasing taxes on income that would otherwise add to unused investment funds.

It is idle money, hoarded money in cash or in deposits, that obstructs the flow of the national income. Money that is saved and invested continues to function, and we must find means both of increasing the proportion of the national income that is consumed and of providing investment outlets for the money that is saved. There is no other way to keep the economy going in a satisfactory manner.

This, then, is the situation in which the present bill must be viewed. If the various items in the bill are approved, and if the resulting programs are prosecuted with vigor, investment outlets for an additional portion of the mounting savings of the community will have been provided in

useful self-liquidating projects which will not entail any charge on the budget nor any increase in the public debt. There is little financial risk involved as compared with the social and economic gain. The present extremely low level of interest rates makes it possible to utilize a part of our vast volume of idle funds, to make some of them available to borrowers who could not afford to use them if the rates were higher, and thus to diminish the number of idle men.

The provision of certain transportation facilities on a toll basis will permit the construction of certain by-passes, tunnels, bridges, etc., whose cost should properly be borne by the user. The rural security loans will enable hundreds of thousands of farmers who now cannot support themselves and are a continuing charge on relief funds to become self-supporting. Such an investment is one of the most desirable our country could possibly undertake. The rural electrification loans will bring the benefits of electricity to thousands of farmers and will provide markets for the private power companies and for the makers of appliances.

It is, however, of the section relating to railway equipment that I wish to speak particularly. I think the Committee will be interested in the considerations that led to its inclusion in this program. We have, on the one hand, in the railroad equipment industry, one of the most depressed of all our capital goods industries. On the other hand, we have the railroads, with the supply of rolling stock rapidly declining in quantity and deteriorating in quality. Our supply of freight cars is back to the level of 1905. Well over 40 per cent of the freight cars are twenty years of age or

older. Over 70 per cent of the locomotives are 20 years of age or older and only 3 per cent are under ten years of age. Some 13,000 steam locomotives of American railroads were built before 1910. Most of the machine shop equipment of American railroads is universally acknowledged to be obsolete and in poor condition. Consequently, repair costs are high, both because of the age of the rolling stock and because of the character of the equipment of the machine shops. In no field, I believe, from the point of view of economy, recovery or national defense, could the Government's credit be better used than in enabling the roads to modernize their equipment.

The success of this program depends upon low interest rates, long maturities and no down payments so that railroads can acquire new equipment at annual costs no greater and in some cases less than those arising out of the operation and maintenance of some of the present aged and obsolete equipment. The bill contemplates that the interest charged will be no higher than the cost of the money to the RFC on like maturities and in no case more than the highest rate on long term Government obligations.

The present bill proposes that to the existing loaning powers of the RFC which have been used to a relatively small extent by the railroads for new equipment, the railroads should be permitted to acquire equipment on a leasing basis. The Government will then be in a position to meet the needs of every type of railroad for every type of equipment. Many railroads will doubtless prefer to acquire equipment through the customary form of equipment trust certificates. Others, however, who are reluctant to increase their debt, will prefer to acquire equipment on the very favorable

terms that will be possible through a leasing arrangement.

In fact, in certain cases, the leasing arrangement will make expenditures possible that would otherwise not be undertaken. Thus it will now become possible for the Government to finance a major rebuilding program, should this prove the economical thing for any railroad to undertake. The RFC will be in a position to contract to purchase older equipment, to have it rebuilt in the shops of the railroad in question, and lease this equipment back to the railroad. Again, the purchase of machine shop equipment can be facilitated through a leasing arrangement, and the cash resources of railroads can be saved for urgently needed improvements on way and structures. Finally, the scrappage of obsolete equipment and the sale of used rolling stock to certain foreign countries that are badly in need of cheap equipment can be facilitated.

I have found in discussing this proposal with various men in the industry in recent days that a good deal of confusion and misunderstanding exists as to the nature of the leasing arrangement. Since it is proposed that the leasing arrangement should be used merely as a means of enabling railroads to acquire equipment, and that the RFC should not purchase any equipment except upon the agreement to lease and upon the specifications of individual roads, I suggest that this be made perfectly clear through a re-phrasing of paragraphs (b) and (c), under Section 8.

I should also favor making this additional $500 million available for loans as well as leases, as the existing loaning power of the RFC for railroad equipment is limited. Paragraph (a) could well be deleted, pro-

viding the specifications submitted by individual roads for rolling stock to be constructed and leased to them should be subject to the approval of the RFC. If these changes were made, they would meet the only objections that I, personally, have heard raised to this part of the Self-Liquidating Bill.