

No. 1. An immediate spending program of such funds as are presently available.

This should embrace not only direct relief but more desirably projects which would add to our national wealth and to a considerable extent be self-liquidating.

One mechanism for getting direct relief and work on such projects coordinated would be to transfer the functions of P. W. A. to W. P. A. By such consolidation, Hopkins would be in a position of not only affording direct relief but also building houses, building dams, reservoirs, etc.

The announcement of this program should have deep reassuring influences. It should, in my opinion, be accompanied by a statement to the effect, along the lines of your previous utterances, that this is merely an intermediate and temporary program pending the reopening of the capital markets for which you have plans to be announced later. Consumer purchasing power must first be increased before increased production can be confidently expected.

Point No. 4 listed below is a suggestion of possible treatment of that problem.

No. 2. I have sent you, under separate cover, my comments on the railroad program submitted by the I. C. C. committee.

I cannot over-emphasize the importance of the emergency aspect of the program which I have outlined. As I indicated at one of the conferences, at the present rate we will have only a hand-full of solvent railroad systems at the end of this year. I do not think

we can afford to take the risk of that shock to our whole financial and credit structure. The impact on life insurance companies, mutual savings banks, commercial banks, and other institutions would be very severe. It would produce a depression or fear psychology which we can ill afford.

Accordingly, I recommend a statement to the effect that you intend to recommend immediately to Congress that steps be taken to insure that railroad credit will be protected and not further impaired. As I have indicated in my railroad memorandum, the specific measure is to vest you with adequate authority to guaranty the still solvent roads a return of not more than 3% for the next 18 months. I think it should likewise be stated that recommendation will be made to Congress that the federal government be authorized to invest not less than \$800,000,000 in the next twelve months in the primary railroad systems of the country for the purpose of rehabilitation, e.g., the making of some of the huge deferred capital expenditures which sorely need to be made.

This statement on the emergency aspects of the railroad problem would have an enormous settling influence. Furthermore, action along the lines suggested in my railroad memorandum would actually start the flow of capital into productive railroad enterprise. This should have its effect all the way down through steel mills, paint factories, etc.

I think that the railroad program outlined above will immediately improve the bond market. Just as a declining bond market drags the stock market and business down, so a rising bond market should pull both up and break the spiral of deflation.

No. 3. As we have discussed before, the commercial banks of the country and other credit agencies have not been adequately serving the needs of business. Adequate service would, in my opinion, entail rather basic changes in bank policy, particularly the standards under which bank examiners are operating and the rules governing bank investment.

Chester C. Davis of the Federal Reserve said this morning that it would be advisable for you to ask the authorities in the government to get together for an examination of rules which would enable banks to grant loans on a reasonable basis without having the loans criticized as slow or doubtful. He also indicated that if any advance statement was made in this connection, it would be desirable to assure business that if freeing the banks in this respect does not accomplish the purpose, machinery will be developed by the government without delay that will assure such concerns that they can obtain credit for their legitimate needs at reasonable costs and for adequate terms.

My view is that the examining authorities should be asked to get together at once on a revision of rules for examinations and for changes in rules governing investments. But I hate to see any delay whatsoever in opening the reservoirs of credit for the legitimate

needs of legitimate business. Accordingly while the banks are revising their policies in these respects temporary utilization of the R. F. C. would be possible and desirable. Rather than for the R. F. C. itself to make the loans (which would involve time and delay), I think it would be desirable to utilize the facilities of local banks and announce an arrangement whereby R. F. C. under its present powers would stand behind the banks on such loans made during a limited period of time. Accordingly I suggest the following:

During the next thirty days R. F. C. will guaranty 90 per cent of loans by banks (without prior approval by or for R. F. C. but subject to an aggregate of \$100,000,000) of the following character: Loans made to small enterprises for the purposes of continuing production and employment. Any such loan may mature up to three years. The maximum of any such credit to any one borrower at any given time shall be not more than the lowest of any one of the following:

- (a) \$100,000.; or
- (b) 20 per cent of the total resources of the borrower; or
- (c) 25 per cent of the total cost of sale (exclusive of the salaries of the officers of the borrowers, or of the borrower, if he is an individual,) for the last fiscal year.

R. F. C. will not require, as a condition of its guaranty, prior approval by or for it of such loans.

The foregoing plan would be possible under Section 5d of the R. F. C. Act.

No. 4. The foregoing are three immediate dynamic steps which I think can be taken and in a very constructive manner. There remains the problem of opening up the capital markets. This will take a longer period of time. As you know, the way in which I think it should be done is through the device of regional industrial banks whose original capital would be supplied in part by the government. If such a mechanism were established, we could then proceed to re-open the capital markets in the very near future and take advantage of the increased consumer purchasing power which the spending program would create. Without some such method of opening up the capital markets, I am fearful that the normal investment banking machinery will not function adequately.

I attach hereto a memorandum which I have had prepared but which, in view of the limited time, I have not had an opportunity to polish and rework. But it has in it my basic reasons for urging the setting up of industrial banks. To do so would, of course, require additional legislation.

As the country came to the support of your leadership in 1933, it will do so in 1938 on this broad program of reconstruction. Basically, the country is at the point where it can move forward with great speed in industrial activity. In view of the huge amount of deferred expenditures which have been piling up, we are, in my opinion, on the verge of one of the greatest periods of prosperity that the

country has ever seen. That should have broad appeal to the profit motive which makes the capitalistic system click.

To summarize, the realization of these objectives means two basic steps: first, increasing consumer purchasing power, and second, opening up the capital markets. The second cannot precede the first due to the fact that with decreasing purchasing power there is no incentive to take on new plant capacity, etc. But with a spending program, and increasing consumer purchasing power, the program for the capital markets can follow immediately and when processes of investment are reestablished and take up the slack of labor, government spending can be proportionately decreased.

To summarize, I suggest an immediate announcement of the following:

(1) Announcement of government spending program.

(2) Emergency railroad program (see my separate letter).

(3) R.F.C. guaranty of loans by banks to small industries until there can be established a liberalization of bank examiners' scrutiny of such loans.

(4) Capital market program as a second step.