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H. Hooper Mead
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BRITISH EMBASSY,

WASHINGTON, D. C.,

January 19th, 1939

No. 68 E

My Lord,

With reference to Sir Ronald Lindsay's despatch No. 15 E of the 6th January, 1938, I have the honour to enclose herewith copies of the President's budget message to the Congress, containing the estimates for the fiscal year ending June 30th, 1940.

64/2/38
2 C Summary
1 C Complete budget
U.S.C.
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pieces.

2. The table below sets out for purposes of comparison the budget figures, under general headings, for the ten fiscal years from 1931 onwards, the year in which the present series of deficits began. (The differences between these figures and those previously given, e.g. in the memorandum enclosed in Sir Ronald Lindsay's despatch No. 670 E of the 19th July last, is due to a change in the method of treatment of the financing of semi-autonomous lending bodies like the Reconstruction Finance Corporation.)

64/14/38

	Receipts	Expenditures (excluding debt retirement.)	Net deficit
	(\$ million)		
1931	3,190	3,671	481
1932	2,006	4,545 ^{3 7}	2,529
1933	2,080	3,364 ³	1,784
1934	3,116	6,011	2,895
1935	3,800	7,010	3,210
1936	4,116	8,666	4,550
1937	5,294	8,442	3,148
1938	6,242	7,626	1,384
1939 (est.)	5,520	9,492	3,972
actual	5,668	9,210	3,542
1940 (nominal est.)	5,669	8,995	3,326
Jan. 40	5,703	9,636	3,933
Jan. 40 (est.)	6,151	9,027	2,876

Notes inserted
Jan, 1940
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The Right Honourable
The Viscount Halifax, K.G.,
etc., etc., etc.

The most striking feature of the table is the rapid increase in the pace of Government expenditures, and it will be noticed that despite the economic recovery which has taken place since the summer of 1938, the expenditures contemplated for the coming fiscal year, while somewhat below the record peace-time level expected in 1938-39 are still well above any previous peace-time year, including 1936, the year in which the main part of the veterans' bonus was paid.

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3. The theory on which this continued very high level of spending is defended is set out in the President's annual message on the state of the nation (enclosed with my despatch No. 26 of the 10th January) rather than in the budget message. This theory is that the chief factor to be borne in mind is the total capital investment, private as well as public, and not the level of Government debt only; that the total of private investment has decreased since 1929 by as much as the public debt has increased; that if private capital does not go to work its place must be taken by Government funds; that a big reduction of Government investment - or spending - at the present time would bring about a new economic relapse; and that by keeping total investment, whether public or private, going, the national income will very shortly be raised to a level, eighty billion dollars, at which revenues will automatically increase sufficiently to balance the budget without higher tax rates. (Copies of a letter recently addressed by the Chairman of the Board of Governors of the Federal Reserve System to Senator Byrd are attached hereto in which the theory is more fully set out than in the President's messages to the

20. 15 Treasury

Congress. I do not think it necessary to send you the Senator's long and orthodox rejoinder.) With this theory in view the Budget expenditures have on the present occasion been classified on the basis of a new division between "ordinary" and "extraordinary" expenditures, the "extraordinary" expenditures being those which can, in theory, more readily be contracted or expanded according to the rise and fall in private investment, or in the national income. These "extraordinary" expenditures are in the main on public works, in one form or another.

4. I do not think that it is necessary for me to discuss at length the economic dangers inherent in the position. The situation is unchanged in essence since the date of Sir Ronald Lindsay's despatch of July 19th last. The policy is of course a gamble on a fuller measure of economic recovery than has yet been reached since 1929 and it is of interest to point out that Government revenues have never yet, except in the year 1920, reached to within $2\frac{1}{2}$ thousand million dollars of the present level of expenditure. The policy has naturally been severely criticised in the Conservative press, largely on the lines that a balanced budget has been made dependent on business recovery, while the unbalanced budget is itself, by the uncertainty it creates, a factor preventing business from recovering. I do not find the argument in this form very convincing, but it is certainly true that a high rate of Government spending - or to adopt the phraseology of the budget message, an increase of Government investment - is not by itself calculated to lead to the required rise in national income, unless other factors which have

hitherto/

hitherto held back recovery are eliminated. A discussion of these broader aspects of the problem would carry me far outside the scope of this despatch. But even assuming that the desired increase in the national income can be brought about - and I personally find it not unreasonable to suppose that this might be successfully accomplished before very long - the position would be by no means free from danger. With the vast amount of unused credit facilities now lying idle in this country, if once the inflationary movement does begin to take hold, it is likely to be very difficult to control it without precipitating a new depression in which event a new burst of spending would presumably, according to the theory, be embarked upon, only starting from an even higher initial level of expenditure. And in any case the difficulty of expanding or contracting the "extraordinary" expenses according to the rise or fall in private investment or in the national income, is bound in practice to be very great. Many of these public works, e.g. the flood control schemes, plans to deal with river pollution, road building, etc. would be very difficult to cut down at any time in the face of local demand for their continuance. Moreover the lapse of time necessarily involved in either setting up or discontinuing any large scale public works must at the best make the weapon an exceedingly clumsy one, owing to the impossibility of timing its employment. Apart altogether from theory the simplest summary of the situation is that deficits are likely to continue for the remaining period of Mr. Roosevelt's term as President, and that it is, for obvious reasons, impossible to look farther ahead than that.

5. It must of course, as always, be borne in mind that the President's figures of expenditure represent his preliminary recommendations only, made six months before the fiscal year opens, and that the final appropriations, which lie with the Congress, may differ considerably from the President's figures. It is not yet clear how the division of groups will work out in the present session of the Congress, but while it appears likely that the Congress will adopt a more independent attitude than in recent years, and while the influence both of the Republican and of the right wing Democrats has no doubt been increased, I should not anticipate that this will lead to any large reduction in the appropriations below the President's figures. There are of course violent general attacks on the Administration's spendthrift policy, and an effort is at present being made to cut the relief deficiency appropriation for the current year, but the proposed cut, even if carried through, is of quite moderate dimensions, and a general desire for economy is a very different thing from a determination to drastically reduce specific items of expenditure which are popular in themselves. Pressure from the constituencies in fact seems calculated to prevent any really substantial cut in the big items of expenditure proposed.

6. As a result of these deficits the gross Federal debt has risen from \$16,185 millions on the 30th June, 1930 to \$39,500 millions at the date of writing. The increase is however really less than the gross figures taken by themselves would indicate. The budget message lists \$16,431 millions as durable improvements and recoverable loans and investments; but it is clear that

the bulk of this expenditure (e.g. on roads, Civilian Conservation Corps work, etc.) is not recoverable in the ordinary sense, although it may of course increase the real wealth of the country, and hence lead indirectly to increased Government revenues. However some \$5,500 millions of Government obligations are held by Government agencies and trust funds, and there is a balance of some \$2,500 millions in the Treasury General Fund, as well as \$2,000 millions in the Stabilisation Fund. On the other hand Government guaranteed bonds outstanding amount to some \$5,000 millions. The Government's profligate budgetary policy has not injured its credit, as is shown by the fact that United States Government bonds are standing at an all time high level, and the computed average rate of interest on the total outstanding interest bearing debt is about 2.58% against 2.59% in June last, and 3.8% in 1930.

7. I am not including in this despatch any detailed comparison of individual sub-heads in the budget for 1939-40 with the expenditure in previous years, for the reason that the appropriations, as stated above, rest with the Congress, and individual figures may be materially altered in the course of Congressional debate. But it will of course be noticed that the cost of national defence, which never exceeded \$700 millions a year for 1931 to 1935 has since then risen as follows:-

1935/

	\$ millions
1935-36	880
1936-37	895
1937-38	980
1938-39 (est.)	1,017
1939-40 (est.)	1,336

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8. Finally I enclose herewith a supplementary request by the President for an appropriation of \$875 millions to enable the administration of relief through the Works Progress Administration to be carried on through the remainder of the current fiscal year. This request is at present under discussion in the Congress, and the amount requested may be somewhat reduced. From the broad budgetary point of view however neither this request nor the possibility of its reduction is of very great importance, since a supplementary appropriation for this purpose was anticipated when the estimate of the outturn of the 1938-39 budget was prepared in June last. That estimate was for a deficit of a little under \$4000 millions, and this estimate still stands. The net deficit for the 6 months to the 31st December has been \$1,650 millions.

10. Copies of this despatch and of the enclosures are being sent to the High Commissioner for the United Kingdom in Canada, the Prime Minister of Australia, care of the Dominions Office, His Majesty's Treasury and the Department of Overseas Trade.

I have the honour to be,
 with the highest respect,
 My Lord,
 Your Lordship's most obedient,
 humble servant,

(SGD) V. A. L. MALLETT

H.M. Chargé d'Affaires.