TREASURY DEPARTMENT

WASHINGTON

October 25, 1939.

The Honorable Marriner S. Eccles,
Chairman, Board of Governors,
Federal Reserve System,
Washington, D. C.

Dear Mr. Eccles:

Secretary Morgenthau asked me to send to you this copy of the exchange of correspondence between himself and Senator Vandenberg.

Yours very truly,

Eugene S. Duffield

Eugene S. Duffield,
Assistant to the Secretary.

Enclosures.

UNITED STATES SENATE

Committee on Finance

October 17, 1939.

Honorable Henry Morgenthau, Jr.,
Secretary of the Treasury,
Washington, D. C.

My dear Mr. Secretary:

I should like to inquire - if I am entitled to the information - whether the stabilization fund is now being used in connection with the stabilization of the British pound and the French franc; and whether there is any stabilization agreement under which we continue to operate in conjunction with England and France or any other foreign countries.

I should also appreciate your viewpoint on another phase of this problem. I assume that you are continuing to purchase at $35 an ounce, all foreign gold that is offered. In view of depreciated foreign currencies, is not this equivalent to paying considerably more than $35 an ounce so far as the foreign seller is concerned? If we put our foreign trade with belligerents and a strict "cash and carry" basis, will it not be likely to substantially increase this inflow of foreign gold - perhaps to so dangerous an extent that we finally shall practically monopolize the world's gold supply? Would this not seriously threaten the world's subsequent return to the use of monetary gold - and thus relatively threaten the ultimate value of our own enormous gold hoard? Should not the purchase of foreign gold be curtailed and re-priced at least for the period of the war?

I am not asserting any pre-conceived judgments of my own in submitting these questions to you. I am simply seeking information from authentic sources and I shall greatly appreciate a reply within the next few days.

With warm personal regards and best wishes,

Cordially and faithfully,

(Signed) A. H. VANDENBERG

October 24, 1939.

My dear Senator:

I should like to answer in some detail the questions in your letter of October 17, so as to clarify certain aspects of problems relating to gold.

You write:

> "I assume that you are continuing to purchase at $35 an ounce, all foreign gold that is offered. In view of depreciated foreign currencies, is not this equivalent to paying considerably more than $35 an ounce so far as the foreign seller is concerned?"

I am uncertain what you mean by this question. It is subject to several different interpretations and to make certain that you obtain the information you ask I will endeavor to answer each of them separately.

1. Does the question ask whether the foreign seller of gold receives more purchasing power over goods and services here than he did prior to depreciation? If that is the sense of your question then the answer is "No". The $35 per ounce (less 1/4 of 1 percent) which the foreign seller of gold receives probably represents less and certainly not more purchasing power in terms of goods and services in this country than it did before the depreciation of currencies in recent months. Such purchasing power of $35 in the United States varies, of course, with changes in prices of goods and services in the United States. Since most goods and services that can be purchased here by a resident of a foreign country have risen in price during the past two months, it follows that the foreign seller of gold probably gets less goods and services for his $35 now than he did a few months ago.

2. Does the question ask whether the foreigner can get more units of his own currency for gold by selling it in the United States than by selling it in his own country? If this is the sense of your question, again the answer is "No". We pay no higher price for gold (allowing for commissions, handling charges, etc.) than other countries do. After a foreign seller of gold converts the dollars he obtains for his gold into sterling, for example, he finds that he has approximately

the same amount of money as he would have had if he had sold that gold in London. (For a further explanation of this I refer you to pages 7, 8 and 9 of my letter to Senator Wagner, dated March 22, 1939, a copy of which is enclosed for your convenience.)

3. Does the question ask whether the foreign seller of gold gets more units of his local currency for his gold now than he did before the depreciation of his currency? If this is the sense of the question, the answer is clearly "Yes". That is exactly what depreciation of a currency in terms of gold means, namely, that each unit of a depreciated currency is exchangeable for less gold.

4. Does the question ask whether the greater number of units of the depreciated currency which the foreign seller obtains for his gold can purchase more goods and services at home than could the smaller number of units he obtained for his gold before depreciation? The answer to this question is "Probably yes". Prices in the country of a depreciated currency do not usually rise as much as the currency depreciates for a considerable period of time, if at all. During that period the holder or producer of gold will get more local goods and services for an ounce of gold than he did before. But he gets more goods only if he buys goods at home; furthermore, he gets more goods for an ounce of gold not because we continue to pay $35 an ounce for gold, but because his own country gives more units of its currency for an ounce of gold.

When taken in the context of your whole letter one further possible interpretation of your question suggests itself. You may be asking whether the recent depreciation of foreign currencies will of itself lead to an increased inflow of gold. If this is the sense of your question, the answer is "Probably no". It is, of course, impossible to foretell at this time the total effect of a Europe at war upon our balance of payments. The specific effect of the recent depreciations of foreign currencies, however, would clearly seem to operate in the direction of a reduction in gold offerings. Depreciation of foreign currencies vis-a-vis the dollar means that American goods and services are less attractive to the foreigner because he must give more of his own currency in exchange for a dollar's worth of merchandise than formerly. In other words, the depreciation of foreign currencies is a factor which operates in the direction of reducing our exports to and increasing our imports from the countries involved. Thus the effect of the change will tend to reduce our favorable balance of trade and consequently such inflow of gold as may be attributable to our export surplus. It is true that price changes may in time offset the effect on the relative attractiveness of foreign and American goods initiated by the depreciation of foreign currencies. But even in normal times this adjustment usually does not take place for some time.

You ask the further question:

> "If we put our foreign trade with belligerents on a strict 'cash and carry' basis, will it not be likely to substantially increase this inflow of foreign gold - perhaps to so dangerous an extent that we finally shall practically monopolize the world's gold supply?"

The prohibition of credits to belligerent governments may possibly have the effect of reducing our exports to belligerent countries. This might in turn reduce the value of our total exports compared with what our exports would be were the prohibition not included in the Neutrality Act. Were the belligerent governments to purchase some of their imports from the United States on credit, a portion of the payments due us might be postponed. However, whether this postponement would result even in a temporary reduction in the inflow of gold cannot be forecast because:

(1) It is not known what proportion of the dollars used for payments would be acquired from the sale to us of gold, and what proportion would be acquired from other sources.

(2) It is not known whether an extension of credits to belligerents would result in greater purchases from the United States or whether there would simply be a substitution of some credit purchases for cash purchases. Only in the latter instance would it be possible for part of the inflow of gold to the United States to be postponed. In the former case it would mean that the gold inflow would be the same over the short period of time and would be greater at some subsequent time when credits were liquidated.

You ask this further question with respect to gold:

> "Would this (increased inflow of gold) not seriously threaten the world's subsequent return to the use of monetary gold - and thus relatively threaten the ultimate value of our own enormous gold hoard?"

This war demonstrates, if any demonstration were needed, that gold constitutes the best form in which foreign exchange resources can be held. Even under the most difficult conditions of war, belligerent governments which possess gold can buy with it anything that is for sale.

The new situation in world trade brought about by the war in Europe will, of course, introduce some changes in the distribution of gold among the nations of the world. Belligerent countries will probably lose gold, but numerous neutral countries, which now have little gold, may be put in a position to increase their holdings as a result of improvements in their trade balances. As a consequence, the war may well have the effect of causing a wider distribution of gold among the countries of the world. Such an increase in gold holdings by many countries would give more countries a stake in the continuation of gold as a medium of international payments. The gold producing countries, of course — including the British Empire, which now produces half the world's gold — will continue to have a vital interest in the use of gold as a monetary metal.

These considerations, as well as others, indicate that gold will emerge from this disturbed period with added prestige as the international medium of exchange. For further discussion of the future usefulness of gold as a monetary metal, you may wish to refer to pages 16, 17, 18 and 19 of my letter to Senator Wagner referred to above.

Your last question on gold relates to a suggested change in our monetary policy. You ask:

> "Should not the purchase of foreign gold be curtailed and re-priced at least for the period of the war?"

I am not clear whether by re-pricing gold you have in mind an increase or a decrease in the price of gold. I judge from the context of your letter, however, that you are inquiring about the effects of a reduction in the dollar price of gold.

My views with respect to the consequences of reductions in the price of gold are fully set forth in my letter to Senator Wagner referred to above. The discussion appears on pages 13 to 16 of that letter, and I think it may be appropriately re-read in connection with your inquiry.

You raise the question of the advisability of reducing the price of gold "for the period of the war". Any substantial change in the price of gold which is known to be temporary would have seriously disrupting influences on trade and international capital flows. It would introduce a still greater risk element in business relations with foreign countries and would, moreover, increase world speculation in dollar exchange.

I now turn to the question in your letter referring to the Stabilization Fund.

You write:

> "I should like to inquire - if I am entitled to the information - whether the stabilization fund is now being used in connection with the stabilization of the British pound and the French franc; and whether there is any stabilization agreement under which we continue to operate in conjunction with England and France or any other foreign countries."

When I appeared before the Senate Committee on Banking and Currency last March, Senator Taft raised the following question:

> "Suppose there is a foreign war and suppose you go out and do what you can to buy $2,000,000,000 worth of pounds: Isn't the effect of that to give England the power to buy $2,000,000,000 worth of goods in this country under the cash and carry provisions?"

I would like to reaffirm the position which I took at that time. My reply was, and still is, as follows:

> "Senators, if there is a war in any foreign country, before we would use the stabilization fund or any money in the Treasury to assist any country in prosecuting that war, I would come up before the proper committee and ask for guidance."

The stabilization fund is not acquiring any currencies of belligerent countries and is holding only a trifling amount of foreign currencies of belligerent countries acquired long before the outbreak of the war.

I trust that this furnishes you with the information you requested.

Sincerely,

Enclosures.

(Signed) HENRY MORGENTHAU, JR.,

Secretary of the Treasury.

Honorable Arthur H. Vandenberg,

United States Senate.

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