

TO Mr. Walter Gardner

FROM Chairman Eccles

REMARKS:

This is the letter and memo about which
I just talked to you over the telephone.

Sears, Roebuck and Co.

Executive Offices

Chicago

R. E. Wood
President

November 14, 1938.

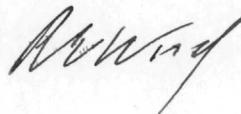
Hon. M. S. Eccles, Chairman,
Board of Governors of the
Federal Reserve System,
Washington, D. C.

My dear Governor Eccles:

I am sending you here-
with a copy of memorandum submitted by Dean
Phillips whom the Federal Reserve Bank has
been using as a consulting economist.

I really believe there
is a lot in what he says, and I am inclined to
think that the time is ripe to again have a
free circulation of gold.

Sincerely yours,



FEDERAL RESERVE BANK OF CHICAGO
Research Department

MEMORANDUM ON OUR DE FACTO GOLD STANDARD WITH SPECIAL
REFERENCE TO ITS DISCRETIONARY CHARACTER

C. A. Phillips

Mankind has long been wedded to gold, and we are not so far removed from the gold standard today as many might believe. We are, indeed, on a kind of de facto gold standard, since the price of gold has been maintained at \$35.00 per ounce, as previously it was at \$20.67 per ounce. A chief feature of the gold standard now lacking is freedom of circulation of the yellow metal and of its proxy, the gold certificate. The outpayment of gold by the treasury is now discretionary. As "the return to the gold standard" would be simple, legislatively considered, advantages and objections call at once for examination. We may consider the objections first.

One objection states that the yellow metal has become intrinsically useless under modern banking conditions, as it does not circulate but remains idle in cavernous vaults of central banks or, as in the United States, in costly sepulchres at Fort Knox. The answer to this objection is that as long as bank credit is quantitatively related to the stored metal, that metal serves as a regulator of bank loans and investments and of deposit creation and as a determining

factor with reference to interest rates and the price level. However, permitting gold to circulate actually and by certificate would accentuate the importance of the objective test and measure of value that the metal affords.

It is often contended, in the next place, that the gold standard should be condemned because its adoption and operation cause the expenditure of vast amounts of capital, labor, and management in mining gold, which is of little or no utility beyond its use in the arts and industry. This contention, it should be observed, must be founded on the assumption that society is rationally ordered; and it may be readily admitted that in an all-wise society that functions exclusively on a rational basis, the gold standard would be a redundancy. In our country this objection has comparatively little force, although our present monetary arrangements involve a heavy outlay of capital and labor in gold production. In our society, which can not be rationally ordered, gold constitutes a tangible magnitude of central and pivotal importance to our monetary managers, and it is submitted that such a norm or standard--or anchor--as gold affords is preferable,

even though costly, to a wholly intangible element or guide.

One of the most seriously stated objections to restoring gold to the channels of circulation is found in the fear that gold will be hoarded. This objection loses its force, however, when it is borne in mind that (1) we are now permitting gold to be used in international transactions and that outflow in connection therewith would scarcely be increased under conditions of gold-use freedom and (2) it would be desirable now as the upswing of business proceeds to lodge gold, on even a considerable scale, in the possession of hoarders in order to "shrink" our present superabundance of the yellow metal and (3) the de-hoarding of gold is not difficult legislatively as has been clearly demonstrated in recent years, should de-hoarding become desirable.

It is further objected that unpredictable changes in the rate of gold production, where the gold standard obtains, subject the price level to wide variations. This objection has little or no force and under our present conditions, in fact, strongly suggests the wisdom of removing circulating restrictions on the yellow metal in the United States, in order that the availability of gold for circulation might bring into

existence an additional monetary and price "control," namely, a full circulatory exchangeability between gold and gold certificates on the one hand and Federal Reserve notes on the other. This exchangeability would enable the Federal Reserve banks through a substitution of gold for Federal Reserve notes in circulation to reduce our gold reserves substantially, and, should inflation threaten, helpfully.

The above analysis of objections to the discretionary character of our present de facto gold standard has at least faintly suggested certain advantages thereof. It is an advantage of the unrestricted gold standard, in addition to those already suggested, that it provides an objective guide to currency regulation and, when internationally operative, affords tangible ties between and among currencies, preventing the greed or unskillful management of some countries from disrupting the monetary systems of others or of all. The gold standard thus, when widely employed, militates against selfish and unenlightened currency regulation and control.

Furthermore, our present de facto gold standard has considerable merit in serving as an obstacle to wild inflation,--a virtue that would be still greater

if the standard were unrestricted. Historically, the gold standard has served as a serious bar to uncontrolled inflation. Few countries, history has shown, have been able to resist the temptation to inflate their currencies and credit when they have not been held in check by some such external force as that inherent in the gold standard. The necessity of redeeming obligations in gold has served as a steady and strong deterrent to excessive currency issue. Those who in this country are fearful of inflation may logically advocate the removal of restrictions from our present de facto gold standard.

Whatever may be the fate of the gold standard in other countries, it is apparent that stripping our de facto standard of its restrictions would be a factor of some insurance against wild inflation at home and would provide an additional lever of control over the very base upon which bank credit rests and upon which interest rates and general prices in part depend.

Nullifying the discretionary character of the standard as it now obtains in the United States would be a circumstance favorable to the reestablishment of the standard internationally, so that, as in years

gone by, it would become possible to keep the price levels and interest rates of the leading countries of the world in tune with one another.

In conclusion, it may well be stated that the conditions essential to the reestablishment of the gold standard on an international basis are now far from fulfillment,--the redistribution of the gold supply of the world, a settlement or cancellation of a major portion of international indebtedness, the breaking down of barriers to international trade, etc. Yet, the realization of the conditions mentioned may be of greater importance than the gold standard itself even when established upon an international foundation; if so, efforts thus to restore the fallen standard on an international basis might focus attention upon the forces essential in the reconstruction of world economy and prompt us to advocate the gold standard with redoubled energy.

(C. L. W.)
December 1, 1938.

General R. E. Wood, President
Sears, Roebuck and Company
Chicago, Illinois

My dear General Wood:

I was interested to get your letter of November 14 suggesting a return to free circulation of gold and enclosing a copy of Dean Phillips' memorandum on the subject. The memorandum, I am afraid, fails to convince me of the importance or the wisdom of the move. It would not contribute to the stability of the international exchanges nor would it simplify the problem of avoiding inflation in this country.

I can see nothing that would be gained in the exchange situation by permitting gold circulation, and a great deal that would be lost. The gold reserves held by the central authorities are used now exclusively for settling international balances and thus stabilizing the exchanges. The larger these reserves, the greater is the security against violent exchange fluctuations. It is true that at present this country has a volume of gold reserves that is greater than any expectations that we may have of its use on the exchanges. But we are the only country in that position. To dissipate a gold reserve that may some time assist in financial reconstruction and to do it for no apparent purpose other than a gesture toward an outmoded fetish of a past era seems to me inconceivable.

Domestically the growth of the gold reserve creates a difficult problem, but not one that could be solved by permitting gold circulation. The principal difficulty caused domestically by the inflow of gold is in the creation of an unmanageable amount of member bank reserves. These reserves result from the inflow of gold and, in the absence of hoarding, would be just as large if gold circulation were authorized as they are now. Paying out gold into circulation would not change the public's need for currency and for every ten dollar gold piece or gold certificate paid out a ten dollar Federal Reserve note or silver certificate would be deposited with a Reserve bank. And this deposit would create the same amount of excess reserves as would have been created by the gold. Nothing would be gained from the dissipation of the gold reserve.

There is just one qualification on this statement. Bank reserves would be diminished, if the gold paid out went, not into circulation, but into hoards. This would result in passing the cost of carrying the unproductive gold from the authorities to the general public. But the public

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would have to be willing to assume this cost, otherwise the gold would be redeposited. I believe that, on two grounds, there is no reason to expect that any considerable amount of hoarding would take place in this country: (1) the public has complete confidence in our currency and would not seek protection against its depreciation in acquiring gold, and (2) even if some elements would like to have their funds in gold, as the most dependable storage of value, they would remember that the holders of gold in 1933 were not permitted to benefit by the devaluation of 1934, and that all holders were ordered to turn their gold into the Treasury at the old price. In view of this experience it is difficult to believe that many people would be tempted to hoard gold in the United States.

Furthermore, gold hoards are not an ultimate protection against inflation, because the gold is likely to be tempted out of hoards at a time when prices and values are rising, that is, at the very time when credit restraint would be desirable. Gold hoarding in fact almost always acts against public policy: it depletes reserves in bad times, when confidence is low and public policy is to counteract deflation and to encourage expansion, and adds to reserves in boom times when public policy is to prevent inflation.

Whichever way you put it, I can find no possible public gain from paying out gold into circulation.

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Dean Phillips' suggestion that paying out gold into circulation would have a restraining influence on the banking authorities themselves appears to have no realistic meaning in our modern economy. With our fourteen billion dollar stock of gold it is difficult to take the suggestion seriously. It originates from recollections of disastrous currency inflations in Europe, which, of course, could not have taken place, if currency were redeemable in gold. But even that is putting the cart before the horse: these inflations were forced on the countries of Europe by war and post-war developments, and it is inconceivable that gold redemption could have been reestablished at a time when vast government expenditures were imperative and gold reserves very limited.

In our country today the only safeguard against unwise credit and monetary policies lies in the competence and sense of public responsibility of the authorities. No legal action through gold circulation or any other device, could be a substitute for that.

General R. E. Wood, - #3

These comments of mine on the memorandum are in a rather frank vein and I trust that you will keep them confidential. I have written as I have because I always find a candid exchange of views with you profitable.

Sincerely yours,

M. S. Eccles
Chairman

WRG RAG DD

WRG Eccles