

12/27/33

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MEMORANDUM

12/27/33

At a conference on Thursday, December 14th, the following were present:

The President

The Attorney General

The Acting Secretary of the Treasury

The General Counsel to the Treasury Department

The Governor of the Federal Reserve Board.

It was stated by Mr. Morgenthau that the meeting was to discuss a plan by which the Government would obtain the profit upon the gold owned by the Federal Reserve Banks in event of devaluation.

Mr. Cummings then read a memorandum embracing a plan for this purpose.

My reaction to the plan was asked and after stating several objections to it I asked time for its full consideration. This consideration has now been given and this memorandum contains the conclusions reached.

Before discussing the plan may I present four facts:

First: Several weeks ago the President appointed a committee consisting of the Secretary of the Treasury, the Attorney General and me, to consider the very question presented at the conference and to report to him. Immediately after the appointment of this committee the questions involved were studied and I reported to the Secretary of the Treasury and to the Attorney General that I was

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prepared to discuss them. This committee is still in existence, has had no meeting and has made no report. This statement is made solely for the purpose of making it clear that the plan proposed by the Attorney General is not the product of this committee.

Second: During the present administration the Federal Reserve System has operated in complete harmony with the Recovery Program of the Administration, as illustrated in part by its purchase during this period of \$600,000,000 of governments in an effort to supply funds for every credit need in aid of the Recovery Program.

Third: There has been no manifestation on the part of any Reserve Bank of any opposition to the proper disposition under full legal authority of the profit upon the Reserve System's gold holdings, regard being had for the constitutional provision that just compensation be made for the property taken.

Fourth: The gold in question is either in the Treasury or in the twelve Federal Reserve Banks. The gold of the System has been in the same places for approximately twenty years. There has been discussion for many months of devaluation and profit upon gold in event of devaluation. This discussion has not affected the location of one dollar of this gold. No effort has been made or considered to change the possession of this gold. None will be made. The gold will remain right where it is in event of devaluation until all question of the profit upon this gold is legally settled. The Reserve Banks can be trusted to this extent, but if desired an agreement to this effect can be made.

In the light of these four statements of fact the plan suggested by the Attorney General must be discussed. This plan involves:

(1) Action by the Treasury commandeering the gold holdings of the System. This action to be without publicity, to be based upon authority of the law relating to the protection of the currency system of the United States, to be applied after usual banking hours without prior notice to the officers of the Reserve Banks.

(2) The demand at this hour and under these conditions of all gold in the vaults of the Reserve Banks, all gold held by the Federal Reserve Agents in trust for the holders of Federal Reserve notes, and all denominated "equity" in the gold of the System held by the Treasury.

(3) If the demands of the Government agents are not complied with then those agents are to post on the vaults of the banks a notice that all gold held therein is the property of the United States.

(4) Compensation for the gold so commandeered is to be made by these government agents through the medium of a writing stating that the bank is "entitled" to gold certificates for the gold taken.

Under this plan it is proposed to give the Government both possession of and title to all gold in the vaults of the Reserve Banks, all gold held in a trust capacity by the Federal Reserve Agents,

and all gold held in the trust relations by the Treasury covered in the Gold Redemption Fund, the Federal Reserve Agents' Gold Fund and the Federal Reserve System's Gold Settlement Fund.

To this whole plan I enter my very earnest and serious objection. My objections are:

(1) That the whole plan is of doubtful legality, and in my opinion would be unwarranted in law.

(2) That under the plan the result desired cannot be obtained--that is, title to the gold would not in the end rest in the Government.

(3) The plan is unworkable.

(4) The plan is unnecessary.

(5) An attempt to put the plan in operation would result disastrously to the Federal Reserve System and to the entire banking and credit situation, and would be inimical to the Administration.

May I discuss these objections?

First: The whole plan is of doubtful legality and in my opinion would be unwarranted in law.

This conclusion rests upon three bases:

(1) The problem as to the constitutionality of the Thomas amendment.

This problem exists. There is a serious question whether the Thomas Amendment is not unconstitutional in delegating legislative power to the President. This question of the validity of the

Thomas Amendment is a vital one, because unless the President's action is valid the Reserve Banks will in fact obtain no profit on their gold stocks. If the statute is unconstitutional any action by the President would be a nullity and the existing parity between the dollar and gold would not be affected by a proclamation reducing the value of the dollar. Again, if the gold content of the dollar was reduced fifty per cent resulting in a book profit to the Reserve Banks upon its gold, such profit would be lost if the present parity between the dollar and gold were subsequently reinstated. If the entire profit of the Reserve Banks on their gold were taken by the Government upon a fifty per cent devaluation of the dollar, the subsequent restoration of the 20.67 ratio would result in wiping out the capital and surplus of the Reserve Banks. Again, any action which is taken with respect to the gold profit must be considered in view of the statutory requirement regarding the maintenance of gold reserves.

(2) There is no authority in law for calling in the Reserve Banks' gold under the anti-hoarding provision, first, because under the law the Reserve Banks have the right to buy and hold gold; second, because the law requires them to hold gold as reserves; third, because some of their gold was turned over to them under Government order against hoarding and the Reserve Banks were recognized as the proper agency for holding this returned gold; fourth, because the central banks of a nation holding gold for reserves and as the base for the nation's credit could hardly be termed "hoarders".

(3) There is no authority in law for calling in the reserve gold under the provision that gold may be called in by the Secretary of the Treasury when "such action is necessary to protect the currency system of the United States". There could be no logic in asserting that the currency system would be protected by depriving sixty per cent of the currency of the country of its gold base. It would appear superfluous to argue this question.

(4) The Thomas Amendment does not in terms confer any authority upon the President to deprive the Federal Reserve Banks of any gold profit resulting from devaluation. The Thomas Amendment vests no one, even by implication, with authority to deal with the subject. The debates in the Senate upon the bill show that the question whether gold profits should be taken was discussed; that the Chairman of the Committee on Banking and Currency expressed the view that the bill was not intended to cover that subject, and that it could be dealt with later. Senator Fletcher was asked whether the amendment provided any method by which any profit made by those holding gold, at the date of devaluation, could be taxed. He replied there was not, and further that he did not favor incorporating such a provision in the pending bill, although he was in sympathy with the proposal and believed that it should be considered later. The determination as to profits must be made by Congress.

Second: Under the plan the result desired cannot be obtained—that is, title to the gold would not in the end rest in the Government.

It may be possible under the plan to obtain actual or constructive possession. As a matter of fact the gold of the reserve banks now in the Treasury is as follows:

\$	in the Gold Redemption Fund.
\$	in Federal Reserve Agents' Gold Fund.
\$	in the Gold Settlement Fund.

While it is true that these funds are gold deposits placed with the Treasury in trust for certain authorized statutory trust purposes, the possession is with the Treasury. Title to these funds could not be given to or vested in the Treasury by any action of the Governor or the Federal Reserve Agent or any other officer of a Reserve Bank. The "control" of a reserve bank is vested by law in its "Board of Directors", and any disposition of its gold with any legal authority could only be had by the Board of Directors. And, under the plan suggested, any demand of the Treasury upon or compliance with such demand by an officer of a Reserve Bank would be ineffectual to vest title to the gold in the Government. For the same reason--that is, lack of authority in the bank officers to pass title--no title could be vested in the Government in the gold coin or gold bullion, by action of the officers in compliance with the plan.

A directors' meeting would have to be held and, laying aside for the present the authority of directors even in dealing with the gold reserve of a central bank, the holdings of such meetings would contravene the evidence purposes of the plan and the devaluation proposed coincident with the plan. What has been said as to the impossi-

bility of passing of title under the plan is especially applicable to the gold held by the Federal Reserve Agent, whether it is in his possession or is deposited in trust with the Treasury, since under the law this gold is held by him only as trustee for holders of Federal Reserve notes, and as such trustee he would have no right to transfer the title to such trust gold to the Government or any other party.

Again, title to the gold could not be obtained under the proposed plan by giving to the Reserve Bank a writing declaring that the Reserve Bank is "entitled" to gold certificates for its gold. That is not payment, and if payment, the giving of such an obligation is prohibited under joint resolution of Congress abrogating the gold clause, in which resolution the Government is prohibited from making any obligation containing language specifying that the "obligation shall be paid in gold or a particular kind of coin or currency."

The Reserve Banks have only \$ of gold coin and bullion that is not in the hands of the Treasury. Under the plan possession of this gold might be obtained, if it were not for the lack of authority of the bank's officer to deliver possession, but in no way under the plan could title be obtained.

It would be futile to adopt a plan that could not accomplish its purpose and which would not vest title in the Government.

Third: The plan is unworkable.

This is true, first, because of the legal difficulties

discussed, especially the lack of authority in the bank's officers to deliver title and, second, because no bank officer, in the absence of such authority, should dare to part with the bank's gold and in my opinion would not take this responsibility, but would immediately refer it to the directors upon whom the responsibility rests. This would involve the calling of a directors' meeting, the time involved in that procedure, the publication of devaluation to the bank's officers and to one hundred and eight directors, and, however proper that might be since the survival of the bank is involved, the plan would fall in this procedure and devaluation would become public property.

Consideration, too, should be given to the question as to whether these bank officials should be required to choose between a course which would subject them to the criticism of their directors, if they arrogated to themselves the power vested by law in their directors, or a course which might subject them to the penalty of the law against hoarders. I am of opinion that these officers have not merited the necessity of such a choice, and I am also of opinion that the record of these banks in support of the Administration's recovery program should preclude the possibility of the imposition of such a plan upon them.

Fourth: The plan is unnecessary.

It is not necessary to resort to this or any other plan when the law can provide very speedily a full plan. This full plan can be provided by Congressional legislation which could be had

immediately after devaluation. This Congressional action could ratify the devaluation and remove the constitutional questions surrounding the Thomas Amendment. It could provide for compensating advantages to the Reserve Banks for taking their gold and remove the constitutional doubt as to such taking without compensation. It could give necessary protection to the Reserve Banks in event of a later revaluation. No private plan of devaluation could provide such necessary protection, and the proposed plan is devoid of such protection.

It would remove the uncertain legal problems involved in applying the anti-hoarding law or laws for improving the currency system in taking possession of this gold. It could make effective the title to the gold and could provide, through giving certain compensating advantages to the reserve banks, for the application of the profits made.

All of this is so simple, so straight, and so effective that it should be followed. It would remove a large element of criticism which would follow devaluation under any other plan. Congressional action is going to be absolutely necessary in connection with devaluation. It can be of no practical effect without determination of many monetary problems involved in its application. Congressional action could well embrace this problem of profits.

Fifth: An attempt to put the plan into operation would result disastrously to the Federal Reserve System and to the entire banking and credit situation and would be inimical to the Administration.

This is equally true whether the plan succeeds or fails. It would be unwise to subject the System, the banking situation, and the Administration to the harsh criticism that will follow the attempt. It would be more unwise to accept the criticism and then fail in the plan, and this outcome would seem certain.

We must realize what is being suggested. It is to take the gold reserves from the System and to replace them with gold certificates that may not be redeemed in gold; to deprive the System of what the law says it must have; to leave sixty per cent of the currency off the gold base that the law requires; to do this without notice even to the Central Banks themselves; to raise large questions of the goodness of reserve currency; to jeopardize in certain contingencies even the solvency of the Reserve System; to have the reaction of this situation upon the banking structure of the country, probably to cause large withdrawals from the Reserve Banks themselves: all followed by a distrust of the whole banking structure.

The method of approach of this plan will bring its own criticism. All this without necessity when the straight path is the simple path to the end desired. The Administration should not be subjected to this criticism.

I respectfully suggest that the success of the proposed plan resulting in putting title in the Treasury to the gold should be the last thing the Administration should want. In the Treasury the gold could (1) remain in the treasury and not be used, or (2) could be sold by the Treasury and this it would not want to do, or (3) could serve as the base for an issue of gold certificates,

and then under the law could be used for no other purpose. Neither the Administration nor the Treasury would want such an issue of gold certificates nor such a limitation upon the gold. At present gold certificates are not allowed to circulate. If circulated by the Treasury they must be redeemed in gold by the Treasury, or the Treasury would be in the anomalous position of issuing gold certificates not redeemable in gold. If redeemable in gold, then three or more billions of gold would be payable to the public on these gold certificates and could be hoarded or exported by the public. And this in the face of the present policy of the Administration in respect to gold.

As against this defenseless situation, in view of our present policy with respect to gold, exactly the reverse would occur if the gold was left in the Federal Reserve Banks. There all the gold would be for reserve purposes, and as the base for an issue of currency redeemable in gold or lawful money. Federal reserve notes would be issued and the present policy in regard to gold would be preserved. The profit on the gold as allocated by Congress to the Government would be credited by the Reserve Banks to the Government and would be available in lawful currency or in deposit credit for meeting Government obligations. The gold would remain in the Reserve Banks for other purposes in accord with Governmental policy.

I trust it may not be necessary but in conclusion I must ask, if my objections are overridden and this plan is adopted, that the confidence reposed in me in this matter be broadened to embrace

the Governor and Chairman of each reserve bank so that they may be fully informed and be guided by their own view of their responsibility in the matter.

I regret the length of this memorandum. To have said less would have been to fail the Administration and to fail the Reserve System. This I would not do.

Respectfully submitted,

E R Black

Governor, Federal Reserve Board.