

October 12, 1936

MATTERS TO BE DISCUSSED WITH THE TREASURY ON
TUESDAY, OCTOBER 13, 1936

What we need to know

The Board of Governors, having responsibility for a large part of the country's monetary policy, needs to be informed precisely of the character of the monetary system that is now in effect. The system appears to be one that is maintained by a series of understandings among the Treasuries of the leading nations put into effect through Stabilization Funds. Unless the Board knows precisely what the policies are that are being pursued and how the machinery works in practice, it will be unable to discharge its responsibilities to the public through the formulation of rational Federal Reserve policy.

Why?

In the absence of current knowledge of the Treasury's monetary policies, the Board cannot adequately judge the effect of international movements of funds upon the volume of bank reserves and hence upon the domestic credit situation. At the moment we are vitally interested in the possibility of a flow of capital back to Europe as a result of the realignment of gold-bloc currencies. If a substantial amount of capital should return to Europe accompanied by a corresponding gold outflow, the volume of member bank excess reserves would be reduced. Such a development would be of fundamental importance in the further development of Federal Reserve policy. But whether it will occur or not depends to a considerable extent on the policies pursued by the Treasury. Will it hold exchange rates fixed and let gold and capital move? Will it do so even in the face of a major movement? Or

will it let exchange rates shift about so as to discourage capital and consequent gold movements? If no categorical answer can be given, if the whole system is experimental, then it is more than ever important that the Board should know daily just what is being done -- how in practice the thing is taking shape -- in order that it may form its own conclusions as to how it is likely to work in the future in the face of large potential movements of capital.

This daily contact with the operations of the new international monetary system is essential in order that the Board may know what movements are currently taking place. From now on the basic gold data on which the Board has relied to detect the course of capital movements throughout the world will largely disappear. Gold will move from one secret Fund to another while reported gold stocks will become as meaningless as gold in the balance sheet of the Bank of England in recent years. Unless the Board has access to the data of our own Fund and the information being exchanged on a cooperative basis among all the Funds, its knowledge of the important international movements which lie behind shifts in our banking reserves will become very defective.

The problem created by the fiscal agency

By reason of the fiscal agency relationship officials of the Federal Reserve Bank of New York already have this information. They operate the Stabilization Fund in accordance with Treasury instructions; they are consulted on the effects of new policies which are under consideration, and hence they are familiar with these policies; they carry on telephone conversations with London and Paris and thus obtain first-hand information of operations abroad. Under the law the Board has supervision over

the Reserve banks and a special responsibility for foreign transactions. The Board, not being itself in the financial market, depends upon the Federal Reserve Bank in New York to supply it with operating information. But at the present time the most vital information of this character that the New York bank has in its possession comes under the seal of secrecy imposed by fiscal agency operations. This puts the New York bank into an almost impossible position of being required by law to report everything to the Board and to obtain its permission prior to certain actions, and yet being obliged, as fiscal agent of the Treasury, to keep secret many vital transactions that it carries out. At meetings of the Open-Market Committee where Federal Reserve policy is being decided, the President of the New York bank, who is closest to New York banking interests, comes armed with inside information, while the Chairman of the Board, who represents the national interest, is not similarly informed. This situation is contrary to the public interest.

What might be done

This awkward fiscal agency situation and the whole problem of adequate information for the Board on international developments is in process of being solved by the joint meetings of the four chief officials of the Treasury and the Board. The broader policies that govern the functioning of a new international monetary system are confidentially known in connection with these meetings. This represents an important advance over the previous situation. It still remains true, however, that President Harrison and certain other officials of the New York bank must guard themselves in talking with Chairman Eccles or other members of the Board on international developments, for the Board is still being kept incompletely informed on the

movements of capital and gold that are in fact taking place under the new system, and the way in which they are being handled. The only way in which the two Federal Reserve representatives at the joint meetings can be fully informed on these developments is to have the necessary data made available to selected assistants whose business it is to follow and analyze market developments daily. A limited circle might be created at the Board somewhat similar to the limited circle which has access to these figures at the New York Federal Reserve Bank or which has access to them in the Treasury. Such groups would include one or two assistants in addition to the higher officials who already have been made familiar with the broader policies governing the operation of the new monetary system. Members of these limited groups could then talk without restraint to one another concerning all factors bearing upon the international position of the United States and their relation to the domestic credit situation. The embarrassment of the fiscal agency situation would disappear and the two chief financial organs of the Government, the Treasury and the Board of Governors of the Federal Reserve System, would be as fully informed as available data permit on the developments that fundamentally affect their respective policies.

Note on those who have access to Stabilization Fund data

The limited circles that already have access to Stabilization Fund data in one form or another are believed to be as follows:

New York

Harrison
Sproul
Williams
Knoke
Cameron
Despres
Various clerical
assistants

Treasury

Morgenthau
Taylor
Oliphant
Upham
Lochhead
Dietrich
Various clerical
assistants

It would appear that the Federal Reserve group might include at least the following: Eccles, Ransom, Goldenweiser, Gardner (together with Morse).