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PROPOSED REVERSAL OF THE GOLD STERILIZATION PROGRAM

With a view to checking the business decline, the Treasury is considering a reversal of its gold sterilization program. The measures being considered are two: (1) an announcement that no more gold will be sterilized; (2) desterilization of about $1,000,000,000 of gold already held in the inactive account.

Not a good time for announcement that sterilization policy is to be abandoned.- This is not an appropriate time for such an announcement since gold at present is flowing out of the country and there is no occasion for sterilization. It would be better to leave this decision to be considered at a time when gold imports are resumed. At this time the only effect would be to assure bankers that future gold imports -- if and when they occur -- will be added to their reserves. Since the banks have ample reserves now -- $1,000,000,000 above requirements -- and give little thought to the future, an announcement of the proposed policy now would not encourage banks to lend or invest any more freely than they are doing and would be a commitment which might embarrass the Treasury later when conditions may have changed.

Desterilization of $1,000,000,000 of gold already in the inactive account.- This measure would have an immediate effect. As the desterilized gold was used, member bank deposits would increase and excess reserves would rise from about $1,000,000,000 to about $2,000,000,000. Use of the gold would also enable the Treasury to pay off $1,000,000,000 of outstanding debt, or to spend $1,000,000,000 without increasing the debt.

The increase in member bank reserves, however, would do little to check the present business decline. With excess reserves already large, short term money rates a fraction of 1 percent, and the government bond market well sustained, little more can be done to aid business on the side of cheap money. The recession is not due to monetary stringency. On the contrary, it has come about in the face of continuous monetary ease. If even more extreme ease is desired, it can readily be provided by further purchases of government securities by the Federal Reserve banks. The advantage of open-market operations over desterilization is that purchases of securities by the Federal Reserve banks would give them assets which could later be sold if the business upswing is resumed and dangerous credit expansion on the basis of excess reserves is threatened. Gold desterilization, on the other hand, cannot be reversed easily, and might lead to an uncounteractable inflationary situation when another upswing of business gets under way.

The chief merit of desterilization is that it would give the Treasury additional funds without taxation or borrowing. If the Treasury employed this cash to retire debt, there would be little stimulus to business. The fact that the debt was reduced would be interpreted favorable by those who watch the gross debt figure, but it would be recognized that it is not the result of reduced expenditures or increased taxes, but of the sale of an existing asset. It would not, therefore, greatly consold those who worry about the government's credit. The proceeds of debt redemption would go largely to investors or to banks which already have ample funds available for use whenever inviting opportunities for placing their funds present themselves.

If desterilization is undertaken, the proceeds should be used for relief and public works. This would enable the Government to meet, without borrowing or additional taxes, the increased needs that this recession is sure to produce. It would furthermore place the funds in the hands of consumers, and thus directly stimulate the demand for goods. It would help to check the decline in business.

This policy, however, should be adopted only if it is definitely believed that borrowing another $1,000,000,000 by interrupting the progress now being made towards a balanced budget would prove to be a serious disappointment to the business world.

Desterilization can be rendered safe, moreover, only by obtaining for the Board of Governors of the Federal Reserve System adequate powers to deal with the swollen bank reserves which desterilization creates. Power to apply the same reserve requirements to nonmember banks as now apply to member banks and authority to require special reserves against foreign deposits in this country might be sufficient for a time, but ultimately broad controls over a unified banking system would be necessary for the Board.

Finally, this policy should be adopted only as a part of a well-rounded program dealing with the fundamental causes of the recession. These causes, as has been pointed out, are not monetary, but are in the maladjustment between costs, prices, and rents, particularly in the building industry.