Form F. R. 131

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date March 18, 1940

To Chairman Eccles

Subject:

From Emile Despres

I have received a letter from Charles P. Kindleberger, a former assistant of mine now with the Bank for International Settlements, in which he sets forth a private proposal of his own regarding American gold policy. Although there may not be much chance of implementing his proposal at the moment, the suggestion seems to me better conceived and more practical than any others which I have seen for doing something about gold. The key paragraph describing his proposal is quoted below:

> "It is simply this: under his powers of licensing foreign exchange transactions, which are not lapsed, the Secretary of the Treasury can require that the dollars paid by him on purchases of foreign gold be paid into special accounts for foreign central banks at the Federal Reserve banks, to be released only against the export from the American market of certain export commodities of which the U.S. is in ample or even redundant supply. The list of the commodities would of course be fixed in advance, and would presumably include wheat, cotton, tobacco, but it might be feasible to change the list from time to time by amendments, or even to negotiate the addition of various commodities, in instances where the scheme limited to agricultural commodities would work a hardship on a country (Canada, Australia), under the State Department's trade agreement program. Since the purpose of the plan is to limit gold purchases from abroad, the list of the commodities might be limited to those whose average exports since 1936 totalled, say, $500-600 millions annually. Any addition to gold purchases above this level, after the scheme was introduced, therefore, would result either in an increase in exports of these commodities, or an increase in dollar balances, not affecting excess reserves, which were available only for the purpose of purchases of these commodities."

I should be inclined to broaden the list of commodities which we are willing to export in exchange for gold, raising his 500-600 million dollar figure to, say, 800-1,000 million dollars. The advantages of the plan are, it seems to me, as follows:

1. It would retard the rate of gold inflow to the United States.

2. It would serve to counteract the adverse effects of recent British and French economic measures upon our exports of agricultural products and consumers' goods generally.

3. It would make it necessary for the belligerent governments to pay for their purchases of war goods through the sale to us of assets other than gold.

4. It would require no elaborate exchange control machinery, since control provisions would apply only to the Reserve banks and would not extend to the commercial banks.

The British are now operating a two-rate system. Sterling exchange for the purchase of essential raw materials, such as rubber, tin, and jute, a large part of whose supply is under British control, can be acquired only at the official rate, while sterling for the purchase of British textiles and other goods whose exportation Great Britain desires to encourage may be acquired at the lower, free rate. Under the system which Kindleberger proposes dollar exchange for the purchase of goods whose exports we want to encourage would be more readily available to foreigners, and therefore cheaper, than exchange for the purchase of war goods. Since the demand for war goods is insistent and inelastic, our exports of such goods probably would not be significantly curtailed but we would receive in exchange assets other than gold; our exports of foreign products now feeling the adverse effects of discriminatory measures abroad would be stimulated. In my judgment, the plan would reduce the gold inflow without depriving us of the stimulus which foreign spending in our markets provides. Moreover, it would induce a more balanced and diversified export pattern.

ED

COPY

BANK FOR INTERNATIONAL SETTLEMENTS

BASLE, February 28, 1940

Emile Despres, Esq.,
Board of Governors of the
Federal Reserve System,
Washington, D.C.

Dear Emile,

Graham and Whittlesey's "Golden Avalanche", bad as it is, deserves credit for having stimulated me last night into producing an idea, which, if I say so myself as shouldn't, contains sufficient ingenuity to make it worthy of the master, yourself.

It is simply this: under his powers of licensing foreign exchange transactions, which are not lapsed, the Secretary of the Treasury can require that the dollars paid by him on purchases of foreign gold be paid into special accounts for foreign central banks at the Federal Reserve banks, to be released only against the export from the American market of certain export commodities of which the U.S. is in ample or even redundant supply. The list of the commodities would of course be fixed in advance, and would presumably include wheat, cotton, tobacco, but it might be feasible to change the list from time to time by amendments, or even to negotiate the addition of various commodities, in instances where the scheme limited to agricultural commodities would work a hardship on a country (Canada, Australia), under the State Department's trade agreement program. Since the purpose of the plan is to limit gold purchases from abroad, the list of the commodities might be limited to those whose average exports since 1936 totalled, say, $500-600 millions annually. Any addition to gold purchases above this level, after the scheme was introduced, therefore, would result either in an increase in exports of these commodities, or an increase in dollar balances, not affecting excess reserves, which were available only for the purpose of purchases of these commodities.

The difficulties attendant upon the introduction of the plan are minimized by the fact that the gold business has been taken by the war entirely out of private hands, by the fact that the exchange control provisions would apply only to the Federal Reserve banks and would not require elaborate machinery extending to the commercial banks, and by its nice adjustment to the political temper of the country. In the latter connection, it may be said to satisfy the necessity to do something about gold, render distinct and tangible aid to the farmer (through speculative price rises which would attend its introduction, and which would require that introduction to be as unsuspected as possible to avoid sales of earmarked gold on the one hand, and a scandal from having the Division of Research and Statistics long a million bushels of wheat), provide a blow to Russian and Japanese purchases of war materials against gold, at the same time without the appearance of being discriminatory against the Allies.

As to the effects on the exchange market, they are hard to analyze. The flow of capital to the United States is uncontrolled only from Belgium, Holland and Switzerland at the present time, and it is problematical whether these countries could withstand a real loss of capital at the present time, or the steady drain of the balance of payments (excepting Belgium) over a long period even without a flight. Would the announcement of this scheme change the world's private demand for dollars for hoarding? I doubt it. The scheme would mean that these countries could not sustain a capital outflow by selling gold to the United States, but it can be argued that it would be better for them to save their foreign assets for purchases of foodstuffs. In the countries subject to foreign exchange control, it would presumably have no effects on rates. The Bank of England might lower the price at which it is prepared to buy gold, but the 168s figure is a nominal one anyway. The same would be true of other countries. Have I overlooked an angle here?

As I understand it from my "once-over-lightly" perusal of the newspapers, the Treasury is importuning the British to sell American securities before it sells us gold, while British public opinion rather favors hanging on to the earning assets and letting the sterile ones go. The scheme, of course, fits this bill neatly. Proceeds of British exports, sales of securities, and requisitioning of dollar balances will be more than sufficient to cover airplane contracts, purchases of trucks, etc., etc. (If you care to elaborate the scheme, you might supply me with details). And the British could even sell us a lot of their $700 millions of new gold production annually if they were willing to buy wheat from us rather than from Argentina, our cotton rather than Indian (that Crown Colony is getting fat), or smoke more Gold Flakes.

Canada is a more difficult case, and out of traditional friendship it might - I only say might - be advisable to treat their gold production on a par with our own, or to extend the list of export commodities to include some manufactures they buy from us to a value of a third, say, of their $150 millions of production. Australia's production being smaller could be lumped with South Africa's as a British problem. I haven't any thoughts on Colombia, Venezuela, or the other gold producers of Latin America, but is there any reason why, if they import any of these agricultural commodities, why they shouldn't buy them from us?

I wish I could talk over this with you now, and even thought of contributing some hard cash to the solution of the gold problem in the U.S. by calling you up about it, or less satisfactory, cabling you a digest of it. The excitement of attending one of the miracles of modern science, I fear, however, would have made me tongue-tied. If you think the proposal has merit, will you take the necessary steps to communicate it to White, so that George can receive the unction of occupational therapy by devoting 2000 words to it? I should also be interested to hear what Walter and Chan think, and what type of alternative suggestions are currently under consideration. One thing further, has anyone else thought of this sort of thing?

With warm regards to you and the Madam,

(s) Charlie