Proposed memo to the Secretary of the Treasury 12/29/37.

not sent.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

OFFICE OF THE CHAIRMAN

December 29, 1937

Memorandum for The Secretary of the Treasury

From: Chairman M. S. Eccles

In view of imminent action by the President respecting silver which makes the problem of particular interest at this time, I am transmitting herewith a memorandum setting forth briefly the monetary and other aspects of the problem which I think substantiate my conviction that the government's silver policy is ill-advised. I would appreciate it if my views could be made known to the President since I feel that in my official position as chairman of a government agency dealing with monetary problems I am under moral obligation to register my opinion respecting the silver problem, particularly its monetary aspects.

Form F. R. 131

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date December 29, 1937

To Mr. Eccles

Subject: Silver policy memorandum

From Mr. Clayton

Herewith the revised memorandum to the Secretary of the Treasury on silver policy. This revision is approved by Mr. Gardner and Dr. Goldenweiser also conferred with us.

On reconsideration I have left out of the covering memorandum any reference to the political argument. I think however, that you could explain verbally to the Secretary of the Treasury that you feel that there is little political necessity for continuing the subsidy, least of all the form in which it is now given, which has injurious monetary aspects. You are perfectly safe in stating that the mining industry, one of the chief beneficiaries of the Administration's policies, has persistently and vigorously criticized the Administration both by individual propaganda as well as by resolutions of the American Mining Congress. I have not been able as yet to get the resolutions passed during 1933 and 1934 but I have the resolutions for the years 1935, 1936 and 1937 and they uniformly condemn practically every New Deal policy except its metal policy.

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BOARD OF GOVERNORS
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OFFICE OF THE CHAIRMAN

December 29, 1937

Memorandum for The Secretary of the Treasury

From: Chairman M. S. Eccles

The Government's silver program cannot be justified as a monetary policy. Purchases of domestic silver may be advisable as a subsidy to an industry already adjusted to Government aid; but if such purchases are to be continued, I believe they should be frankly recognized as a subsidy, and not pictured as part of the Administration's monetary program. The subsidy to foreign silver interests, which is involved in the present program, should cease.

Monetary policy

This country already has excessively large reserves. The mark-up of our existing gold reserves in 1934 followed by the great acquisitions of gold that were necessary in order to hold the dollar stable on the international exchanges has left the country with $12,800,000,000 of gold against $4,000,000,000 on the eve of revaluation. Throughout the 1920's the gold reserves of this country never rose higher than $4,300,000,000 — a figure which was considered exceedingly large at the time. I am sure you are in agreement with me when I say that there is not the slightest need to add silver to these enormous gold reserves. Even if larger metal stocks were desirable, silver would not be a suitable metal for the Government to acquire. It cannot be used internationally as gold is used. Authorities of countries in the tri-partite accord do not want it. There is no country in the world today that will take silver from us at its monetary value or at any other stable rate in settlement of international balances; yet the basic use for metallic reserves today is in settlement of international balances.

Not only is silver superfluous as a monetary reserve; it has a bad effect upon the credit situation. The cumulative issues of silver certificates tend to expand member bank reserves. The great gold inflows of the period 1934-36 had the same effect. To prevent excess reserves of member banks from becoming dangerously large the Federal Reserve Board doubled reserve requirements and the Treasury in December 1936 instituted a policy of sterilizing new gold acquisitions. Even so, member banks now hold $1,000,000,000 of reserves in excess of legal requirements. For the Treasury to be adding to these reserves through purchases of silver at the same time that it is endeavoring to hold them down through sterilizing gold is on the face of it inconsistent. The silver issues are slowly but persistently tending to put the banks beyond control of the central authorities. The best that can be said for the policy is that the damage done is limited so long as the silver operations are moderate.

Industrial subsidy

The silver industry has been aided liberally by the Government for three years. Its operations have been adjusted to the Government subsidy. For these reasons perhaps it has a claim to some consideration, just as in lowering uneconomic tariff rates consideration must be given to industries that depend on protection. As the Silver Purchase Act now stands, however, the Treasury is virtually compelled to subsidize foreign silver interests in addition to American. In fact, the bulk of the Treasury's silver purchases have been made abroad. Furthermore, in view of the country's gold stock, the huge quantity of silver to be acquired under the Act makes it inevitable that a continuation of the present silver policies would subsidize world silver interests for a long time to come.

Repeal of legislation

Since our silver hoard is of little use an an international medium of exchange and actually harmful to our domestic monetary control, and since a continuation of existing policies under the Act constitute a subsidy to silver interests all over the world, I feel that, on principle, the Silver Purchase Act should be repealed. I recognize however, that a sudden cessation of the subsidy might have too drastic an effect upon our domestic producers and that there are certain existing agreements with China and Mexico which might make it embarrassing if the Act were repealed in toto. Certainly, however, the bulk of the Act including the objective, should be repealed leaving the Treasury with the power to buy or sell silver at its discretion; and the Treasury in turn, as rapidly as is consistent with its present agreements with China and Mexico, should cease its purchases of silver abroad. Foreign interests can have no valid claim to a continued subsidy from the American Government. As regards domestic producers the price at which their silver is purchased should be reduced from time to time, as the situation in the industry permits, with a view to making the industry eventually self-supporting.

Silver purchases are a real cost

Since the domestic industry is small, with an annual output of only some $50,000,000 even on the basis of the artificially inflated price of 77 cents an ounce, the continuing subsidy if progressively reduced would not be important. The argument sometimes made that a subsidy to silver costs the community nothing because the Government issues currency against the silver purchases is not a sound argument. Were that the case, the Government might issue notes to subsidize a host of industries; indeed, it would be folly to collect taxes or to borrow to meet any Government expenditures. U. S. notes are quite as good currency as silver certificates. If no costs to the community were involved, the Government could print them as necessary to meet its needs. Unfortunately the costs are real. They are twofold: (1) those to whom the currency is issued are empowered to levy upon the country's supply of goods and services just as if the tax collector had acted as their agent, and (2) in the process, the supply of banking reserves is built up, and if the operations are on an important scale, inflationary developments may ultimately be stimulated. Neither of these costs, however, would amount to much if only the domestic silver industry were subsidized.

Effect on world market of withdrawal of subsidy

Withdrawal of the subsidy from the world market might not have as catastrophic an effect on silver prices abroad as would at first sight appear. It is true that the United States has become the dominant factor in the world market since its silver program was adopted. But in part this is because it has displaced the usual sources of demand, driving China, a leading consumer of silver, from the silver standard and making it profitable for that country to sell the metal in large amounts; strengthening the forces that for a time turned India into a supplier of silver rather than a consumer; and discouraging the use of silver in industry and the arts. What has been done cannot altogether be reversed, but there are grounds for believing that as the price of silver fell upon cessation of the American purchases these other sources of demand would again become active. The resultant market would be far broader and healthier than the present market which hangs precariously upon continuing orders from our own country which injures itself in buying silver.

Summary

By way of summary, I believe that the Government consistent with its obligations under the Silver Purchase Act should (1) cease immediately the subsidy of foreign silver, (2) reduce the purchase price of silver to the limit imposed by reasonable consideration for domestic producers and certainly very considerably below the present domestic price, and (3) seek repeal of the Silver Purchase Act of 1934 or at least such amendment as would do away with the monetary objectives in the Act.