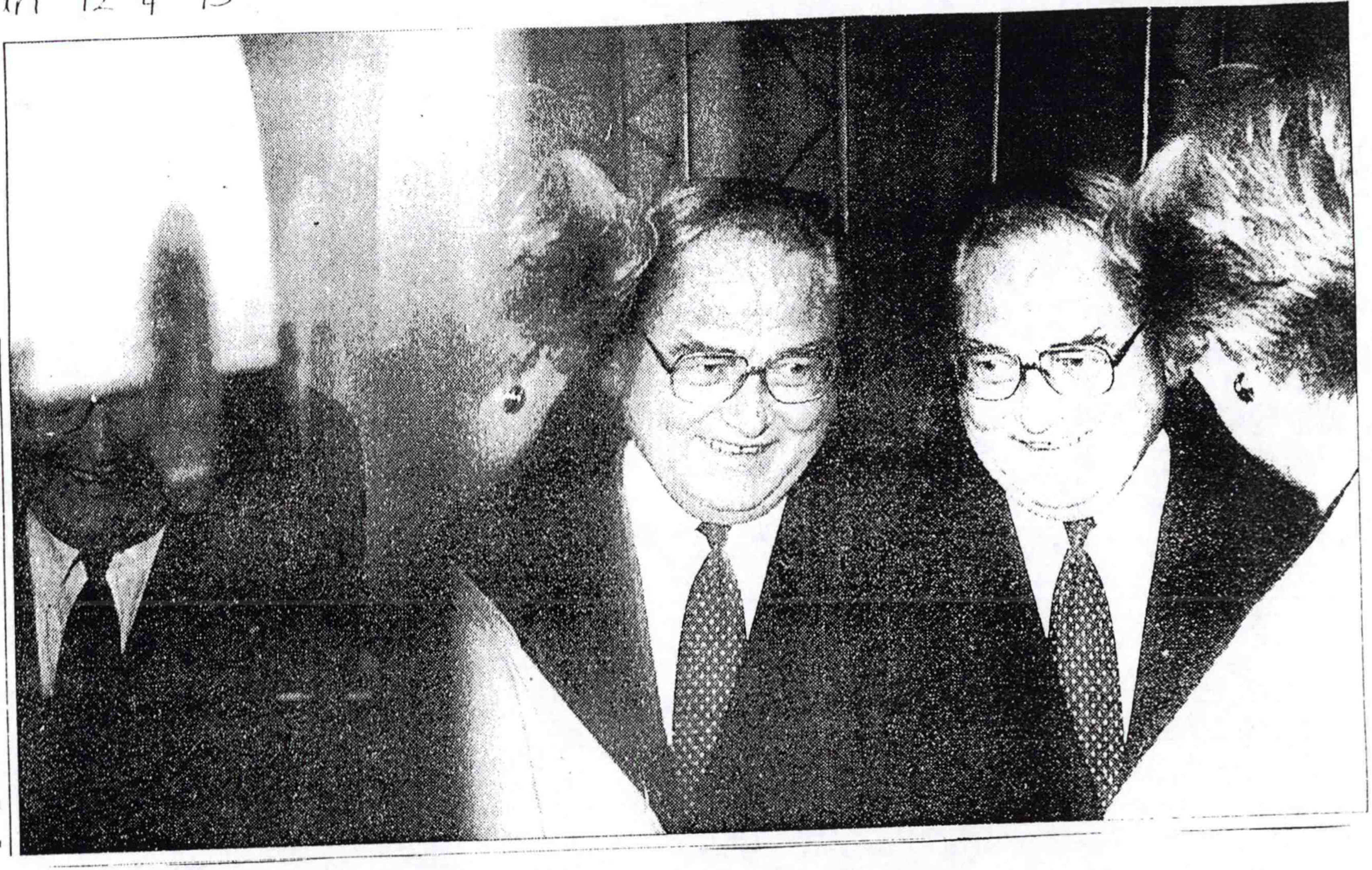
The Guardian 12·4·95

Hands across the pond

THE Governor of the Bank of England, Eddie George, and his opposite number at the Federal Reserve Bank of New York, William McDonough, yesterday opened an exhibition commemorating the relations between their predecessors Montagu Norman and Benjamin Strong, *writes Mark Milner*

Their co-operation began at the end of the first world war and is seen as the starting point for international co-operation among the world's central bankers.

Mr McDonough described the co-operation between the two banks as "very much alive and very well" while Mr George said the co-operation between the two men, who were great friends, provided the concept for central bank co-operation.



PHOTOGRAPH: GRAHAM TURNER

The Daily Telegraph 12·4·95

Norman legacy: Eddie George (left), Bank Governor, and William McDonough, president of Federal Reserve Bank of New York, with bust of Montagu Norman, at Bank Museum exhibition of Central Bank Co-operation Picture: SHARON BASELEY

It's a nice tunnel, but where were the trains? Sorry, guv, we couldn't get the parts

CHRISTOPHER FILDES

To Brunel or Stephenson, digging the hole was the hard bit. Your navvies hacked and blasted their way through the Box escarpment or the Kilsby ridge until at last they saw daylight. Then you put rails down and ran trains on them. That was the easy bit. Since those heroic days it has become more difficult, driving Sir Alastair Morton to impotent fury. His navvies hacked and blasted their way beneath the Channel and dug him a beautiful hole, all ready for the trains . . . Trains? What trains? You want them to start right away? Be reasonable, guv, they changed the specifications and we can't get the parts. The first ones will be coming along in the new year. Mark you, with this new technology, they'll need to be run in and you must expect teething troubles. Wossat? What was wrong with the old technology? You know how it is, guv, the boys must have their toys. Besides, we get so held up with Common Market regulations, you wouldn't believe. Still, I suppose that's progress, innit? Honest, if I was you, I wouldn't have told the punters they could turn up and drive on. Not in Land-Rovers, anyhow. Look at those geezers, haven't they heard of waiting their turn? Tell them the service has been delayed due to unforeseen circumstances. Tell 'em there's fish on the line. They're your bankers? Tough on them. By this time Sir Alastair's eyes are going round like pin-wheels. Bankers do not wait before they charge interest, and by the end of last year Eurotunnel owed them £8 billion. His job is to make its revenues run fast enough to catch up with its interest bill. When Eurotunnel tapped its shareholders for money, a year ago, that crossover point was pencilled in for 1998, but the forecasts in that prospectus have been missed. The bankers have been given a year's start, and their bill is compounding and accelerating. We are not going bust, says Sir Alastair.

I'm suing them

YOU CAN help his cause, as I did, by lunching in Paris — there is a good brasserie just opposite the Gare du Nord — but do not ask Sir Alastair to get you an upgrade to first class on the Eurostar train. 'Upgrade?' he snorts: 'I'm suing them.' He certainly is. His claim against the railways is going to arbitration, and an outright win would be worth, on Eurotunnel's calculations, £2.3 billion. Paid into the banks, it would make a serious dent in the overdraft. (It would make a dent, too, in the proceeds of privatisation.) Failing that, Sir Alastair has to pray for a summer when everything, finally, works. He must have the revenues if he is to stay in the race. Some of his troubles he shares with Brunel. Box Tunnel in its time brought out the health-and-safety experts — wouldn't it be dark and dangerous inside, shouldn't the Great Western be required to light it? Brunel told them that for half the year it would be just as dark outside the tunnel, owing to a natural phenomenon called night. Inside, there would be fewer things to go wrong. He had one advantage that Sir Alastair must envy and might emulate. He could rely on steam traction.

Where the money goes

I THOUGHT that the European Bank for Reconstruction and Development had gone into hibernation. I had not heard from it since the absurd Jacques Attali was exiled from its marble halls. Now it has woken up to tell us that it still knows how to get through money and in two years' time will have none left to lend, so will the shareholders (like us) please ante up some more? With 24 costly directors to keep on the road, the shareholders get a return of 0.034 per cent on their investment, which will not encourage them to reinvest. International financial bureaucracies like this can easily outlive their usefulness, if indeed they ever reach it. If its owners were to send the directors away and put the money in a building society, it would earn them £500 million a year. This could go, if they liked, to good European causes such as reconstruction and development.

More lottery winners

MY PLAN for declaring this column a national monument has run into competition from Wembley. The company that owns the ageing stadium is putting its hand out, like me, for some lottery money. It changed its name from the Greyhound Racing Association and survives by the grace of its bankers. If Wembley, why not Aintree? It needs money spent and I am sure Sir Richard Rogers would oblige. Why not Epsom, or the Forth Bridge, or Barings? How lucky we are, as I say, to have found this unlimited supply of cost-free money. Unlimited demand will follow. Limited companies are joining in. We monuments must fall apart or stick together.

Norman's conquest

THE GOVERNOR of the Bank of England writes to his opposite number at the Federal Reserve Bank of New York: 'First of all, you're a perfect old dear.' His letters are headed 'Dear Ben' or 'Dear Strongy' and signed 'Love from MN.' Not to be misconstrued: Montagu Norman and Benjamin Strong built up a friendship and alliance which first taught central bankers how to work together (all except the French, of course.) An exhibition at the Bank now tells the story. Note the cartoon of Norman striding ashore, magnetic rays streaming from his fingers, as Uncle Sam nails down his gold reserves and the torch leaps from the Statue of Liberty's hands. Governor Strong had come under the wand of the magician.

Providential

THINGS HAVE gone too far when the National Provident Institution suspends two members of its staff from duty, after allegations that they shared their bed (or a bed) with a Conservative MP. Of course people with fiduciary responsibilities must be careful of the company they keep, but there is no suggestion that NPI's security was compromised, or that anything interesting happened in its time or in its office. As Andrew Large, chairman of the Securities and Investments Board, has put it: 'There is a wide range of possible permutations, and I don't intend to speculate on which will be in demand and which won't. The point for us as regulators is to recognise that these demands can now be satisfied in a way that was previously not possible.' It just takes flexibility.

(copy 26 C. 3 ps.) [illegible]

January 11, 1925.

The visit of Mr. Montagu Norman, Governor of the Bank of England, and Sir Alan G. Anderson, who will become Deputy Governor in March, was made without any preliminary disclosure of the object of their trip, except that personal correspondence which preceded their arrival had indicated that they might be coming over to discuss the British monetary position.

When they arrived, on December 28, 1924, they explained that they were not commissioned either by the Government or by the Bank of England to conduct definite negotiations which would result in the resumption of specie payment and the establishment of a free gold market in England, because their government had not yet, in fact, made any decision on that subject. So that no arrangement looking to resumption could be more than tentative in any event.

Mr. Norman stated that the primary object of their visit was to ascertain the views of two or three people (especially J.P.M. and B.S.) as to whether the time had yet arrived for the return to the gold standard, and, if he found that opinion favored doing so, it was his purpose to secure information, first, as to what was the likely monetary and credit policy of the future in this country; and, second, what facilities could likely be arranged to insure the maintenance of gold payment once it was undertaken.

He explained that there had developed a decided improvement, especially during the last year or eighteen months, in the general stabilization of business, financial and monetary conditions abroad, this being true practically of the entire of Europe, with the exception of Russia, Turkey and the Peninsula; that political conditions were also more settled; that the adoption of the Dawes plan finally justified a more hopeful outlook as to the reparation disputes; and these, together with the definite funding of the British debt to the United States, made the time appropriate for considering what should be done about the gold standard. That the existence of lower interest rates in America than in London had made it possible to substantially close the London market to foreign borrowings except those conducted under the auspices of the finance section of the League of Nations and those required by the British dominions and colonies. But that, on the other hand, our markets have been freely opened to foreign loans, thereby greatly relieving the burden upon London and facilitating a decision as to monetary policy. He stated that others than those in the F.R.B. (J.P.M.) whom he had consulted were unhesitating in expressing the view that the time for deciding upon a resumption of gold payment by England had arrived, and, with assistance in this country, it should be possible to resume and to maintain resumption after the present Statute prohibiting the export of gold from England expired on the 31 of December next.

This was the opinion which I expressed to him, with the qualification, however, that there were three factors in the situation which might operate at times so seriously to their disadvantage that there was in fact a real hazard to be reckoned with before final resumption was attempted:

First, that the volume of foreign loans placed in this market last year (1924) was unusual, - much the largest ever known. It was due to relative conditions in their country and ours which facilitated it beyond what might be possible hereafter, and that any great reduction in the volume of foreign loans placed in this country might result in a strain on the exchange for which they should be prepared.

Second, that the gradual funding of foreign debts owing to our government, together with other payments such as those for war materials sold abroad, relief loans, costs of the army of occupation, etc., would likely require in the near future (a few years) payments of possibly $250,000,000 a year in addition to the annual service of existing foreign government loans of an unproductive nature, probably amounting to $350,000,000 additional; so that there was likelihood that hereafter there would be not less than $500,000,000 or $600,000,000 of payments of an unusual character, not growing out of current trade, to be provided for in some way, and that this amount would likely increase rather than decrease.

Third, that there must be a plain recognition of the fact that in a new country such as ours, with an enthusiastic, energetic, and optimistic population, where enterprise at times was highly stimulated and the returns upon capital much greater than in other countries, there would be times when speculative tendencies would make it necessary for the Federal Reserve Banks to exercise restraint by increased discount rates, and possibly rather high money rates in the market. Should such times arise, domestic considerations would likely ~~outweigh~~ foreign sympathies, and the protection of our own economic situation, forcing us to higher rates, might force them to maintain still higher rates, with some resulting hardship to business, etc.

All of these, and many collateral questions, were discussed at great length. But Mr. Norman's feelings, which, in fact, are shared by me, indicated that the alternative -- failure of resumption of gold payment -- being a confession by the British Government that might result in a strain on the exchange for which they should be prepared.

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All of these, and many collateral questions, were discussed at great length. But Mr. Norman's feelings, which, in fact, are shared by me, indicated that the alternative -- failure of resumption of gold payment -- being a confession by the British Government that it was impossible to resume, would be followed by a long period of unsettled conditions too serious really to contemplate. It would mean violent fluctuations in the exchanges, with probably progressive deterioration of the values of foreign currencies vis a vis the dollar; it would prove an incentive to all of those who were advancing novel ideas for nostrums and expedients other than the gold standard to sell their wares; and incentive to Governments at times to undertake various types of paper money expedients and inflation; it might, indeed, result in the United States draining the world of gold with the effect that, after some attempt at some other mechanism for the regulation of credit and prices, some kind of a monetary crisis would finally result in ultimate restoration of gold to its former position, but only after a period of hardship and suffering, and possibly some social and political disorder.

After exchanges of views on this and other matters, which continued until the fifth instant (Monday), I reported to the Executive Committee of the bank in a very general way that Governor Norman was here for the purpose of discussing these matters, and that I hoped to have something definite to submit to the Directors at their meeting on Thursday, the eighth instant.

On that date a statement of substantially the above character was made to the Directors, all of whom attended the meeting, and, in addition, the following statement was made to the Directors on the question of policy of the Federal Reserve System for the future, and as to the facilities to which Governor Norman had referred as essential before resumption of gold payment could be undertaken.

It was explained that he had stated that the security of gold payment by England depended upon a certain degree of stability in this country; that is to say, that we did not intend to embark upon a deliberate policy of deflation, nor, on the other hand, permit the development of any considerable inflation of prices. He also explained that he felt that it was important, if it could be accomplished, that the London market remain closed to foreign loans, so far as possible, and that our market should remain open, so far as possible, which implies, of course, somewhat higher interest rates in England than in this country. He spoke, for instance, of the danger which they would encounter if we should have a price decline or a price advance of anything like 20%.

I explained to the Directors that I had pointed out to Governor Norman that no engagements could be made on this subject; that it was my belief, and I thought it was shared by all others in the Federal Reserve System, that our whole policy in the future, as in the past, would be directed towards stability of prices so far as it was possible for us to influence prices, but that it was a matter on which no engagements could be made, as we must be free at all times to reduce or increase discount rates and to establish our open market policy so as to adequately meet domestic developments. A

In reply to questions as to what he felt was reasonable to expect from us on that score, he stated to me, as he did to the Directors at lunch, that he could simply "express the hope" (and no more than the hope) that this would be the course of affairs hereafter in the United States.

As to facilities: The following plan had finally been suggested, which seemed to meet the needs of the situation and the requirements of the Federal Reserve Act. That the Federal Reserve Bank of New York, by exchange of letters with the Bank of England, would engage for a period of two years after resumption of gold payment to place at the disposal of the Bank of England a sum of gold not to exceed at any one time $200,000,000. This would be simply in the form of a gold credit to be used if needed. The gold could either be shipped to England; earmarked and held in our vault; or used to make payments in this country. To the extent that it was used, the Bank of England would give us credit on their books for the amount so used in account current. For the security of that account, they would deliver to us an obligation of the British Treasury, payable at the maturity of the credit in dollars. As credit balances arose, it would be arranged that so much as possible, - in a general way, say, one-half of the account, - would be invested by the Bank of England for account of the Federal Reserve Banks in Sterling Commercial Bills of the character eligible for discount at the Bank of England and conforming to the provisions of the Federal Reserve Act; the repayment of those bills to be guaranteed by the Bank of England. The account in this form would be flexible and capable of use; that is to say, increased or decreased as conditions required, and the effect would be to give us an obligation of the Bank of England with an obligation of the British Government to secure it; and, to the extent invested in bills, we would have the names of drawers, indorsers and acceptors of the bills purchased. The transaction would, therefore, be a gold transaction as the account would be repayable in gold, or its equivalent, at the end of two years. No discussion of terms for the account had been concluded when the report to the Directors was made.

In this connection, however, it was explained that in addition to a credit of $200,000,000 of gold, the British Government would likely find it necessary to arrange a somewhat larger credit, possibly as much as $300,000,000 through their bankers in this country and their associates. With that credit the Federal Reserve Bank would have nothing to do, except that the Federal Reserve Bank would be consulted as to the amount of the respective credits to be used from time to time, and which should be used, in order that the effectiveness of the bank's interest in the money market might not be impaired.

It was also explained that it was the intention of the Bank of England to furnish gold to all parties, as before the war, on demand, and it might result in some considerable gold shipments, although the credits now being discussed were for the purpose of moderating such shipments to the extent possible.

It was explained to the Directors that Governor Crissinger and Dr. Stewart had been present during some of the discussions, were thoroughly acquainted with the whole proposal and the conditions surrounding it, and favored the transaction in case it should be asked. Also that Mr. Mellon had been consulted and had expressed himself as in favor of it. During the course of the meeting a message was received from Washington to the effect that Governor Crissinger had consulted the members of the Board individually and found them all favorable to the proposals being discussed, and anticipated that when submitted for consideration their approval would be unanimous.

Inasmuch as the entire discussion with Governor Norman was tentative and any decision to be made would have to be made by the British Government, it was felt unnecessary to take any formal action whatever; but the Directors did, informally, indicate their approval of the proposed procedure, and expressed entire willingness to support the officers of the bank in making the necessary arrangements in case we were asked to do so. It was also informally agreed that the Chairman would appoint a committee of three members of the Board to confer with the officers of the bank in preparing forms of letters to be exchanged at some future date between the Federal Reserve Bank of New York and the Bank of England in case the matter was proceeded with.

On the afternoon of Tuesday, January 13, Messrs. McGarrah, Woolley and Young called at the bank and went over a preliminary draft of a letter which might be addressed to us by the Bank of England in the event of the decision to resume specie payment.

There were two points in connection with the exchange of letters which appeared to present the possibility of difficulty: One was the terms of the credit, and the other the arrangement by which we would have some control of which credit was used, and the extent to which each was used.

After considerable discussion, it was agreed that the general tenor of the letter was satisfactory, and that if we were able to make an effective arrangement, which, nevertheless, might be informal, by which we would exercise sufficient influence over the use made of the two credits, we should make no commission charge whatever on the total credit granted, simply charging a rate of interest somewhat in excess of the discount rate for ninety-day bills from time to time in effect, such rate to be sufficient, however, to overcome any desire on the part of the British Government to employ Federal Reserve funds in preference to bankers funds. It was explained that this understanding could probably not be made in the letter, but would need to be the subject of discussions on the other side. And it was understood that if developments indicated the imminence of a favorable decision by the British Government, I would go to London for the purpose of concluding these discussions.

Subsequent to the meeting of the Committee, Governor Norman, Mr. Harrison and I finished the drafts of letters, as per copies attached.

BS.MSB
Encs.

PRIVATE May 4, 1925.

My dear Norman:

Your note of April 22 is, of course, most satisfactory.

We have the same objects to accomplish, and the arrangement now concluded both as to your money market and our own, seems to me and to my associates to be as well designed to meet our respective situations as such arrangements ever can be, when so much that is uncertain in the future has to be anticipated.

Please be assured of our appreciation.

Very sincerely yours,

Right Honorable Montagu C. Norman,
Governor, Bank of England,
London, England.

BS.LS

Confidential
May 11, 1926. Gov't Str. Gt

THE SIGNIFICANCE OF THE STRUGGLE IN GREAT BRITAIN

Is it fundamentally an industrial or political contest, and a show of power?

A shrewd and impartial economic observer, an American with several years' residence in London and close hand contacts there, has something of this view of the struggle now on in England:

That the labor leaders' primary object is not to force a maintenance of the present wage scales or the continuance of a subsidy which will permit this maintenance, but rather to force into view the question of the nationalization of the coal mines, as the first step in the program for a general nationalization of British industry; that the strike has not been called in consequence of a referendum, but rather by the labor leaders on their own responsibility, and that at the present time the more radical party is in control; that the more conservative labor leaders are being swept along by the tide, which they have been unable to stem; that it was the belief of the more extreme party that the government would be forced to accept some kind of a compromise which would demonstrate the dominance of the labor unions, and that if this were successful it would be simply the first of a series of similar movements directed towards the same ultimate goal.

There is much to support this point of view. In the latest issue of the London "Nation," a liberal organ with what are called advanced views, there appeared a significant editorial entitled "What can labor hope to gain by the strike?" At most, on the surface it would seem to be some palliation of the proposals of the Coal Commission's report, and especially those involving a reduction of coal miners' wages. Some of the main facts in the situation that stand out are these:

(1) Much has been said about the extremely low wages prevailing in the coal mining industry in Great Britain. Little has been said of the fact

that the average wage cost, per ton mined, for the last two years has been nearly 100 per cent above the immediate pre-war average; and that a great number of other wages in Great Britain are little higher than those of the coal mining.

(2) Coal production in England has been nearly stationary since 1913, but the number of miners employed in the last year, under the subsidy, has been 10 per cent greater.

(3) Normally nearly one-third of British coal is exported, and the price of this export coal broadly controls the price of the entire product; i. e., the British coal industry is largely dominated by international conditions.

(4) Great Britain is suffering from the decline in international or world trade, and especially from the international demand for coal, so that its coal exports last year were nearly one-quarter less than in 1913.

(5) Yet, in the face of this decline, England's share in the total of world trade has increased considerably over 1913, and is now back to about the percentage of twenty years ago. The industrial depression in England is therefore not dominantly of domestic character, but rather the result of external conditions.

(6) The crisis in the coal industry has, of course, been world wide, and this includes the United States, where bituminous mining has been, in the last few years, about our least prosperous industry. Much the same conditions hold for the United States as for Great Britain.

(7) Taken as a whole, the actual loss ex-subsidy on the total of all British coal mined under the subsidy appears to have been about a shilling and a half per ton, which means that, at present prices, without the subsidy, a large number of English mines would have had to close down.

Much has been made of the steadily declining output per man, and the figures which have often been published are very striking:

		Per Worker per year
1901-5	average	281 tons
1911-15	"	255 "
1923		229 "
1924		220 "

But it is well to note that, first of all, something of the same decline of output has characterized the anthracite coal industry in this country, which approaches more nearly to English conditions of extraction than does our bituminous coal industry. Secondly, that the output per man in Great Britain has been very considerably higher than in Germany or France, and nearly twice that of Belgium.

Our bituminous coal industry works under much more advantageous natural conditions - wide seams, much nearer the surface - which permit of a much larger use of machine mining than appears to be possible in Great Britain, where the seams are narrower and the older mines very deep. The situation there has been further aggravated by the fact that in the north new coal fields have been developed, permitting much cheaper working and bringing serious competition to the older mines. This has brought to the fore the problem of relocation and transfer of large numbers of mine workers, and as many villages are little more than mining hamlets, this would involve the abandonment of a large number of habitable houses.

A further fact is that, as is clearly set forth in the Coal Commission's report, part of the present difficulty is due to the raise in miners' wages two years or more ago, at the time that German coal production was badly disorganized by the occupation of the Ruhr, the demand for British coal heavy, and mining profits high. The reopening of the Ruhr brought a coal surplus, of which the present situation is the logical result.

In the meantime, there has been a protracted fall in commodity prices in Great Britain, and some reduction in the average cost of living; so that the protest of the miners' unions against any "reduction in the standard of living" is actually an endeavor to maintain the rather artificial conditions produced by the Ruhr occupation.

But why a "general strike?" It is the first ever attempted in Great Britain of any serious character. It is as yet very far from being really "general." It does not even include the larger part of the full union strength in Great Britain.

Very roughly, about one-third of British labor is now unionized, or about 5 and a half millions of workers in all, and the present strike appears not thus far to involve much less than half the total of union workers. It is, nevertheless, serious enough, and in the minds of some observers presents one of the most momentous struggles of recent years. There is little question that the strike is largely due to the steady growth of "class feeling" in Britain, and its success will depend largely upon how much support it is to gain from the great body of British workers.

One of the main arguments of the trade unionists is that the acceptance of the Coal Commission's proposals would tend towards a lowering of the standards of living in all the chief nations of Europe, and is a concerted move in that direction. The success of the strike, on the other hand, would undoubtedly strongly influence similar movements in France, Germany, and elsewhere, and might readily lead to a general strike in Europe for the domination of the labor parties and the general nationalization of industry. The strike is therefore, in a more pronounced form than almost any other, a real "class struggle."

It will therefore be of great interest, should the strike be prolonged and become very bitter, to observe the effect outside of England, and especially in the United States. As is shown in the chart on a preceding page, there has been in England since the war generally a decline of wages more or less corresponding to the decline in general prices and the average cost of living. In the United States there has been no such wage decline. After a sharp fall in 1921, the tendency of wages in this country has been upward, rather than downward, and has now risen on the average to very near the peak reached in 1920, that is to say, to about 120 per cent above the pre-war level. In the meantime, the average urban and industrial cost of living appears not to have risen much more than about 75 per cent, so that the present "spread" between this and the average of wages in this country is unparalleled in half a century.

The effect of all this upon organized labor and workers generally has been striking. "Labor" has become conservative, "constructive," statistical, and financially ambitious. It has established labor banks and sought to encourage savings deposits; it has opened its own bureaus of statistical research, with competent and careful statisticians in charge. And, in a very broad way, its thoughts have changed from problems of division to those of addition; that is to say, from dividing up "the usufruct of capital" to join in the movement for high wages through high production and greater efficiency. There is no question of a very radical change in the sentiment and thoughts of workers within the last 15 years. And with the wide diffusion among the workers of so-called luxuries, and especially motor cars, radio, and the like, and the great increase in the ownership of their own homes, it would be astonishing if this change in feelings and in aim among the workers had not acquired a strong momentum.

It has been very different in Europe. There it has been almost continuous demoralization of trade and industry from almost every possible source, the inflation of currencies and their consequent collapse; the insane outburst of nationalistic feeling; and the raising of tariff barriers by almost all the newly created "succession states," and the patriotic endeavor to promote "home industry" at whatever economic cost; the splitting up of large estates in some of the eastern countries, with a consequent decline of production and therefore a decrease of buying power; the isolation of Russia;

the great burdens of increased taxation; and heavens knows what else.

All this has been deeply felt in Great Britain, which is essentially a trading nation, and by her workers and most other classes as well. That labor should now call a "general strike" after four or five pretty gruelling years is of deep interest as revealing what is really in the minds of labor's leaders. It seems pretty clearly not what is coming to be known as "the American idea," of wide-spread well-being through greater efficiency and increased product, but rather the division of the relatively meager product of the present day. The six pence per ton royalty enjoyed by 4,000 owners of English coal lands seems to arouse deeper emotions than the possibility of six shillings increase in the average of general wages through increased output.

But there are signs that this may not continue indefinitely. Already a committee from the labor unions has quietly visited the United States, studied conditions here, and gone home to make their report. And recently a little book has appeared in Great Britain, called "The Secret of High Wages," which is making a considerable stir. It is written by two English engineers, who likewise came to this country to find the secrets of our prosperity. It has been greeted in England as "the new industrial gospel." Everywhere the British worker is being told that the American coal miner receives something like three times the wages of a British coal miner because he mines on the average nearly three times as much coal. An American bricklayer gets three times the wages of his British brethren because he lays three times as many bricks. This is the secret.

It will be interesting to observe how rapidly the leven may spread.

England Credit

Federal Reserve Board Statement for the Press for Release in Monday Morning Papers June 1, 1925. The June 1925 Issue of the Federal Reserve Bulletin Will Carry the Following Statement Concerning the Return of Great Britain to the Gold Standard:

Restoration of gold standard.

Restoration of a free gold market in London after a period of ten years has put Great Britain once more on the gold standard. At the time of England's return to a gold basis several other countries took similar action and this, together with the fact that many other European currencies have been stabilized with reference to gold for more than a year, removes from the major part of the world's commerce and finance the uncertainties arising from wide and abrupt fluctuations of exchanges.

Free gold movements between countries that have reestablished the gold standard will not only limit fluctuations of exchange rates but will again relate changes in the gold holdings of central banks to credit conditions at home and abroad and thus make changes in their reserve positions important factors in their credit policies. With the principal money markets of the world once more free gold markets and the exchanges between them stable, the flow of funds between these markets will respond more freely to differences in money rates and credit conditions. Credits in countries on the gold standard become interchangeable practically at par with dollar credits, which have been continuously equivalent to gold, and short-time funds will thus tend to be distributed more nearly in response to current demands as reflected in higher rates. With the removal of barriers arising from the risks of exchange, borrowing particularly for purposes of financing international trade will be drawn to the markets where money is cheapest. Thus the resumption of gold payments by the chief trading countries of the world furnishes a basis for the functioning of those forces which before the war operated to maintain a close contact between the money markets of the world.

Great Britain's gold standard act.

The decision of the British Government to remove the embargo on the exportation of gold was announced by the Chancellor of the Exchequer on April 28 when he stated that the law of 1920 prohibiting gold exports for a period of five years, except under special license, would be permitted to lapse on December 31, 1925, and that for the remainder of this year the Bank of England would be given a general license to export gold. Control of gold exports in Great Britain, which from the outbreak of the war until the legal prohibition in 1920, was by informal methods, has applied since that time to all gold except to newly mined gold produced in the British Dominions and imported into England.

In removing restrictions upon gold exports the British Government adopted certain safeguards against the dissipation of the gold reserves through the reintroduction of gold coins into circulation and against the speculative hazards to which the pound sterling might be exposed in the period immediately following resumption. These safeguards were incorporated in a bill "to facilitate the return to a gold standard and for purposes connected therewith" to be known as the Gold Standard Act, 1925, which became law on May 13. It was recognized that a return to the use of gold currency in domestic circulation was not necessary for the purpose of the operation of the international gold standard and the Chancellor of the Exchequer said that this use of gold would be an unwarrantable extravagance which the present financial stringency does not permit England to indulge in. In order to prevent the loss of gold into circulation the bill relieves the Bank of England of the obligation to redeem its own notes and currency notes in gold coin and relieves the Mint of the obligation to coin gold bullion presented to it by anyone except the Bank of England. The Bank, however, is required to sell gold in bars containing approximately 400 ounces to any person at the price of £3 17s 10 1/2d per ounce gold of standard fineness, that is, in units of about £ 1,700. Thus, while the Bank is protected against a demand for gold coin for domestic circulation, it stands ready to meet all demands for gold bullion for export purposes. The provision of the Bank Act of 1844, under which the Bank of England is obliged to purchase at a fixed price all gold offered, remains in force.

As a means of supporting sterling exchange in case of speculative pressure the gold standard bill furthermore authorizes the Treasury to "issue, either within or without the United Kingdom and either in British or in any other currency such securities bearing such rate of interest and subject to such conditions as to repayment, redemption, or otherwise as they think fit," and to "guarantee in such manner and on such terms and conditions as they think proper the payment of interest and principal of any loan which may be raised for such purpose." All loans raised under this provision must be repaid within two years and guarantees given by the Treasury will also expire in two years from the date upon which they are given. In furtherance of the objects of these provisions American credits aggregating $300,000,000 have been established, the details of which are discussed later in this review.

Report of Committee of Experts.

In reaching a decision to return to the gold standard at this time the British Government was guided by the recommendations of a committee which, in addition to considering whether the time had come to amalgamate the Treasury note issue with the Bank of England note issue, also entered into the question whether a return to the gold standard on the basis of the pre-war sovereign was desirable and if so how and when the steps required to achieve it should be taken.

In its report the committee expresses its agreement with the principles laid down in 1918 by the Cunliffe committee and after considering various alternatives reaches the conclusion that the gold standard must be reestablished in England on the basis of the pre-war gold content of the sovereign. Neither devaluation nor the substitution of the commodity price level for gold as the regulating principle of the currency appeared to the committee to be desirable. The committee's analysis of England's position in foreign trade indicated that the existing volume of exports, visible and invisible, together with the income derived from foreign investments, was undoubtedly sufficient to meet England's foreign debts, to pay for necessary imports, leaving a moderate balance for foreign investments. "In these circumstances," the committee continues, "a free gold market could readily be established and maintained at the pre-war parity, provided that by control of credit we adjusted the internal purchasing power of the pound to its exchange parity, and restricted our foreign investments to our normal export surplus." While the committee believed that the price level in England was still too high relative to the level in the United States, it was its opinion that the adjustment could be accomplished without serious disturbance, particularly in view of the fact that sterling exchange at the time of the report in February was only 1 1/2 per cent below parity.

On the subject of the amalgamation of the two kinds of note issue, the Bank of England note, issued only in exchange for gold, and the currency note, issued by the Treasury and secured largely by Government obligations, the committee recommended that no action be taken for the present, that the limit of the currency issue, by which the actual maximum for one year becomes the legal maximum for the next year, be maintained and that the Bank of England take over the currency notes at such a time in the future when experience will have demonstrated what amount can be kept in circulation without resulting in a drain on the Bank's gold reserves. As an immediate step the committee recommended that the £ 27,000,000 of gold held against currency notes be transferred to the Bank and an equal amount of Bank notes be substituted in the currency note account. This recommendation has been adopted and carried out.

Financial policy prior to resumption.

Important factors placing Great Britain in a position to reestablish the gold standard have been the balancing of the budget, reduction in the floating debt, funding of the indebtedness to the United States, rigid adherence to the limitation upon note issue, and a policy of credit control. The budget not only has been balanced, but there has been a surplus which enabled the Government to reduce the floating debt held in large part by the banks. Between the end of 1920 and the end of 1924 this debt was reduced by nearly 40 per cent, or £ 560,000,000, and the reduction was accompanied by substantial declines, especially during 1921 and the early part of 1922, in the investments, bill holdings, and deposits of the joint stock banks. With the decline in their holdings of Treasury bills, the banks were in a position to meet the increased credit demands of commerce and industry without increasing the total volume bank credit in use. The policy of maintaining relatively high money rates, especially during the past year, and of discouraging excessive foreign lending contributed to the advance of sterling exchange toward parity. As a consequence of these developments the extent of further necessary adjustment in the exchange rate and in financial conditions following the announcement of the removal of the gold embargo was greatly diminished, and the ability of Great Britain to maintain an effective gold standard greatly increased.

Course of sterling exchange.

Sterling exchange in the New York market since 1919, when the pegging of the exchanges was discontinued, has undergone wide fluctuations. The most rapid and continuous advance in sterling occurred between the middle of 1921 and the spring of 1923, when owing partly to the operation of the factors already mentioned and to trade conditions prices in Great Britain declined considerably, while prices in the United States advanced. From less than 4 per cent below par sterling exchange declined during the remainder of 1923 to a low point in January, 1924, more than 12 per cent below par. An almost uninterrupted rise during 1924 and the early part of 1925 brought sterling to within 1 per cent of parity at the time of the announcement of the resumption of gold payments. (Chart)

In order to relieve the exchange market during the remainder of this year from demands for dollar exchange by the Treasury, particularly in the autumn when Great Britain's purchases of agricultural products abroad are heaviest, the

Chancellor of the Exchequer announced that a sufficient amount of dollar exchange had been acquired to meet all payments on the American debt not only in June but also in December.

Provisions for supporting exchange.

It was recognized by the committee advising the Government on the problem connected with resumption that the advance of the pound sterling since last summer may have been partly due to speculative buying and that when parity was reached profit taking by speculators might throw a strain on the exchange. Against this danger the committee regarded as a proper safeguard the existence of adequate gold reserves and a resolute use of those reserves for the purpose for which they had been accumulated. The available reserves were in the committee's opinion amply sufficient, but if it were deemed wise to acquire also a foreign credit, the credit should be used only after a considerable amount of gold had actually been exported and the use of this credit should be considered from the point of view of the Bank of England's monetary policy as equivalent to a corresponding loss from its own reserves. "Unless these precautions are taken, borrowing abroad will, as has again and again happened, when it has been resorted to as a remedy for exchange difficulties, merely aggravate the mischief which it has been applied to cure." In announcing the establishment of the credits in America the Chancellor of the Exchequer said: "These great credits across the Atlantic Ocean have been obtained and built up as a solemn warning to speculators of every kind and of every hue and in every country, of the resistance which they will encounter and of the reserves with which they will be confronted, if they attempt to disturb the gold parity which Great Britain has now established."

American credits.

Two separate credits have been established in the United States, one by the British Government and one by the Bank of England. A credit of $100,000,000 was arranged by the British Government with J. P. Morgan and Company and a credit of $200,000,000 arranged by the Bank of England with the Federal Reserve Bank of New York in participation with other Federal reserve banks and with the approval of the Federal Reserve Board.

Under its arrangement with the Bank of England the Federal Reserve Bank of New York undertakes to sell gold on credit to the Bank of England from time to time during the next two years, but not to exceed $200,000,000 outstanding at any one time. The credit is to bear interest to the extent that it is actually used at a rate 1 per cent above the New York reserve bank's discount rate, with a minimum of 4 per cent and a maximum of 6 per cent, or, if the Federal reserve discount rate exceeds 6 per cent, than at the rediscount rate of the bank. The rate of interest to be paid by the British Government on the credit which it has established is to be determined in a similar manner. Upon the purchase of gold the Bank of England will place on its books to the credit of the Federal Reserve Bank of New York an equivalent deposit in pounds sterling. This deposit may be used from time to time by arrangement with the Bank of England in the purchase of eligible sterling commercial bills which shall be guaranteed by the Bank of England, and in that case discount earned on the bills will be applied to the payment of interest.

If occasion arises for the use of this credit, support can be given to sterling exchange either through the purchase of sterling bills in New York or abroad, or gold can be shipped to other countries on British account. Thus the Bank of England could meet a foreign demand for gold without reducing its own reserves, or it could replenish its reserves by withdrawing gold from this country or by earmarking it in New York. The form in which the credit would be used would depend upon the circumstances at the time.

In making these arrangements with the Bank of England, the Federal Reserve Bank of New York proceeded under authority of the Federal Reserve Act, which in addition to granting the reserve banks power to make contracts, authorizes them under rules and regulations prescribed by the Federal Reserve Board to deal in gold coin or bullion at home or abroad, to purchase and sell in the open market, at home or abroad, cable transfers or bankers' acceptances and bills of exchange of the kinds and maturities eligible for rediscount; and with the consent, or upon the order and direction of the Federal Reserve Board, to open and maintain accounts in foreign countries, appoint correspondents and establish agencies in such countries wheresoever it may be deemed best for the purpose of purchasing, selling, and collecting bills of exchange, and with the consent of the Federal Reserve Board to open and maintain banking accounts for such foreign correspondents or agencies.

In January of this year the Federal Reserve Bank of New York was authorized by the Federal Reserve Board to make the arrangements with the Bank of England which have been described earlier in this review. After the passage of the Gold Standard Act by the British Parliament in May, the Federal Reserve Board approved in detail the arrangements made by the New York Federal Reserve Bank. In giving approval the Board believed that the arrangement would be an effective aid toward general resumption of gold payments.

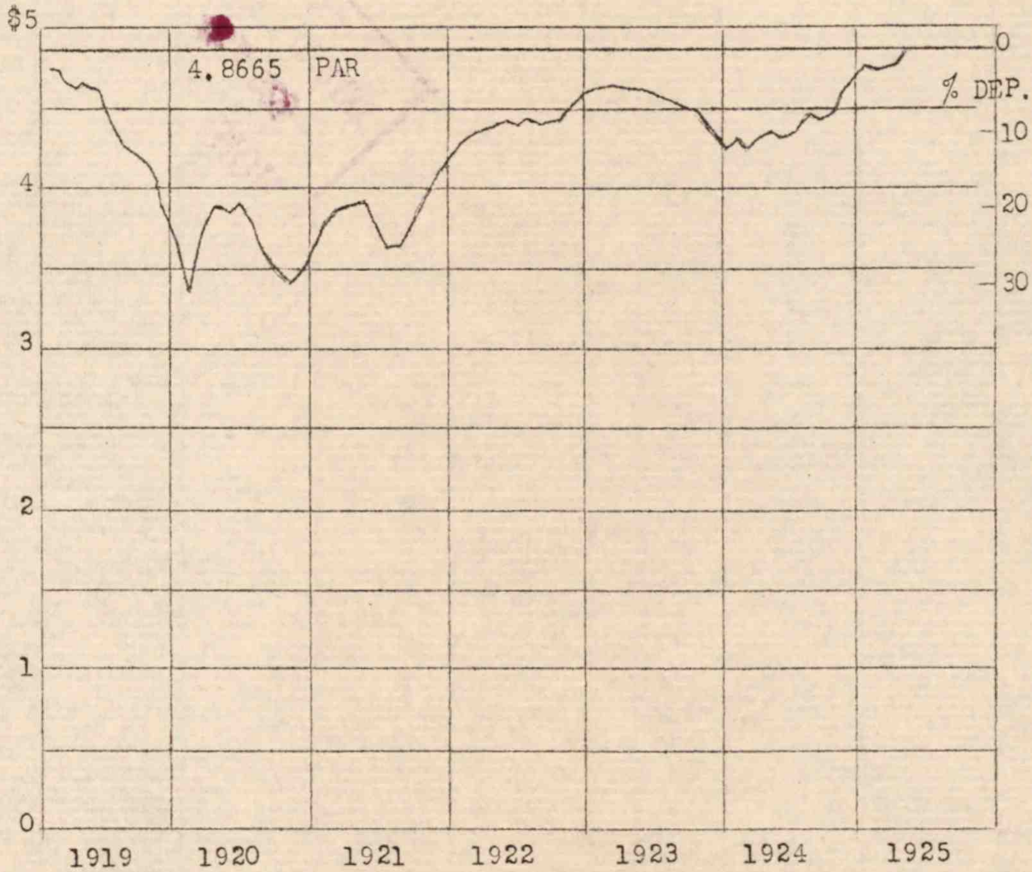
Comments of Advisory Council.

Commenting upon the participation of the Federal reserve system in the arrangements made to facilitate the return of Great Britain to the gold standard the Federal Advisory Council, which held a regular meeting in Washington on May 22, said in part: "It is with the deepest satisfaction that the Council has noted the arrangements now made, with the approval of the Federal Reserve Board, between the Bank of England, on the one hand, and the several Federal reserve banks under the auspices of the Federal Reserve Bank of New York on the other. These arrangements in the view of the Council will benefit not only the two countries directly involved, but they will enure to the advantage of the entire world. The Council feels confident that in the annals of the Federal Reserve System these arrangements will be written down as one of its proudest and most constructive achievements. It is an impressive demonstration of the efficiency of the Federal Reserve Act, as at present constituted, that we are able to render assistance on a liberal scale without fear of adverse effect upon our own financial conditions."

International trade and the gold standard.

Restoration of the gold standard in Great Britain was accompanied by similar action by Australia, New Zealand, the Netherlands, and the Dutch East Indies. Gold payments had been resumed in Sweden a year earlier and on June 1 South Africa removed restrictions on gold exports. The return to a gold basis over so wide an area was preceded by a continuous advance toward gold parity for about a year in most of the principal exchanges and by a narrowing of fluctuations in the value of other currencies. Furthermore, a number of European countries, though not in a position to restore freedom of gold movements, have maintained the foreign value of their currencies at a fixed relationship to gold and consequently have conducted their foreign trade on a gold value basis. This growth in the area though still not world wide in which gold has once more been restored to its role as a standard provides a broader and more stable basis for international trade than has prevailed at any time since the disorganization of the world's currencies which set in with the war. Reestablishment of the gold standard removes from commerce between nations that element of risk which arose from the uncertainties of fluctuating exchange rates and free gold movement will effect an influence towards closer adjustment between price levels in different countries. The significance of the restoration of the international gold standard should be measured not only by the benefits that will result from greater stability, but also by contrast with the declines and fluctuations in exchange that would have followed further postponement of the decisions to resume gold payments. These decisions give assurance that the exchanges of those countries which have returned to the gold basis will not be subject to sharp advances and declines and that trade with these countries, which include the largest purchasers of our agricultural products, can be conducted and financed with greater confidence and on a more secure basis.

Restoration of an effective international gold standard from the viewpoint of the banking situation in the United States is of particular importance because for the first time since the Federal reserve system was established gold movements, which for a decade have exerted an abnormal influence upon the position of the reserve banks, will be more largely controlled by the traditional influences which regulated the flow of gold under normal conditions.



Sterling Exchange in New York
Monthly Average Rates.

United Kingdom of Gt. Britain & Ireland

U. S

TREASURY DEPARTMENT

FOR RELEASE, AFTERNOON PAPERS,
Monday, July 9, 1923.

X 790

Attached hereto are copies of the formal Proposal of the British Government for the funding of the British debt to the United States, as executed on the 18th of June, 1923, by the British Ambassador, and the Acceptance thereof dated June 19, 1923, executed in behalf of the United States by the Secretary of the Treasury, as Chairman of the World War Foreign Debt Commission, with the approval of the President, together with the form of bond actually executed and delivered on July 5, 1923, by the Counsellor of the British Embassy at Washington.

C 261 GT. Brt.

SP. [illegible] 2/4/23

67TH CONGRESS, 4TH SESSION.

H. R. 14254.

IN THE HOUSE OF REPRESENTATIVES.

FEBRUARY 17, 1923.

Ordered to be printed with the amendments of the Senate numbered.

AN ACT

To amend the Act entitled "An Act to create a commission authorized under certain conditions to refund or convert obligations of foreign governments held by the United States of America, and for other purposes," approved February 9, 1922.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the first proviso of section 2 of the Act entitled "An Act to create a commission authorized under certain conditions to refund or convert obligations of foreign governments held by the United States of America, and for other purposes," approved February 9, 1922, is amended to read as follows:

"*Provided*, That the settlement of indebtedness of the United Kingdom of Great Britain and Ireland to the United

States, (1) ~~recommended by the commission and approved by the President, as set forth by him in a message presented to Congress on February 7, 1923, as contained in House Document Numbered 554, Sixty-seventh Congress, fourth session,~~ as follows:

Principal of notes to be refunded	$4,074,818,358.44
Interest accrued and unpaid up to December 15, 1922, at the rate of 4¼ per cent	629,836,106.99
	4,704,654,465.43
Deduct payments made October 16, 1922, and November 15, 1922, with interest at 4¼ per cent thereon to December 15, 1922	100,526,379.69
	4,604,128,085.74
To be paid in cash	4,128,085.74
Total principal of indebtedness as of December 15, 1922, for which British Government bonds are to be issued to the United States Government at par	4,600,000,000.00

“(2) The principal of the bonds shall be paid in annual installments on a fixed schedule, subject to the right of the British Government to make these payments in three-year periods. The amount of the first year's installment will be $23,000,000 and these annual installments will increase with due regularity during the life of the bonds until, in the sixty-second year, the amount of the installment will be $175,000,000, the aggregate installments being equal to the total principal of the debt.

“(2) The British Government shall have the right to pay off additional amounts of the principal of the bonds on any interest date upon ninety days' previous notice.

“(2)‘ Interest is to be payable upon the unpaid balances at the following rates, on December 15 and June 15 of each year: At the rate of 3 per centum per annum payable semiannually from December 15, 1922, to December 15, 1932, therafter at the rate of 3½ per centum per annum payable semiannually until final payment.

“(2)‘ For the first five years one-half the interest may be deferred and added to the principal, bonds to be issued therefor similar to those of the original issue.

“(2)‘ Any payment of interest or of principal may be made in any United States Government bonds issued since April 6, 1917, such bonds to be taken at par and accrued interest(2)’—is hereby approved and authorized, and settlements(3)~~, similar, but not more favorable in terms, with other governments indebted to the United States, as set forth in this section, are hereby authorized to be made, subject to the approval of the President~~ *with other governments indebted to the United States are hereby authorized to be made upon such terms as the commission, created by the Act approved February 9, 1922, may believe to be just, subject to the approval of the Congress by Act or joint resolution.”*

(4)*Sec. 2. That the first section of the Act entitled “An Act to create a commission authorized under certain conditions to refund or convert obligations of foreign governments held by the United States of America, and for other pur-*

poses," approved February 9, 1922, is amended to read as follows:

"That a World War Foreign Debt Commission is hereby created consisting of eight members, one of whom shall be the Secretary of the Treasury, who shall serve as chairman, and seven of whom shall be appointed by the President, by and with the advice and consent of the Senate. Not more than four members so appointed shall be from the same political party."

SEC. 3. That the provisions of section 2 of this Act shall not affect the tenure of office of any person who is a member of the World War Foreign Debt Commission at the time this Act takes effect.

Passed the House of Representatives February 9, 1923.

Attest: WM. TYLER PAGE,

Clerk.

Passed the Senate with amendments February 13 (calendar day, February 16), 1923.

Attest: GEORGE A. SANDERSON,

Secretary.

67TH CONGRESS, 4TH SESSION. } H. R. 14254.

AN ACT

To amend the Act entitled "An Act to create a commission authorized under certain conditions to refund or convert obligations of foreign governments held by the United States of America, and for other purposes," approved February 9, 1922.

IN THE HOUSE OF REPRESENTATIVES.

FEBRUARY 17, 1923.—Ordered to be printed with the amendments of the Senate numbered.

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Proposal,

Dated the eighteenth day of June, 1923, by His Britannic Majesty's Government (hereinafter called GREAT BRITAIN) to the Government of the United States of America (hereinafter called the UNITED STATES) regarding the funding of the debt of Great Britain to the United States.

Whereas Great Britain is indebted to the United States as of 15th December, 1922, upon demand obligations in the principal amount of $4,074,818,358.44, not including obligations in the principal amount of $61,000,000, representing advances deemed to have been made to cover purchases of silver under the Act of Congress approved 23rd April, 1918, of which $30,500,000 has been repaid in April and May, 1923, and the balance is to be repaid in 1924, pursuant to an agreement already made between the parties, and Great Britain is further indebted to the United States, as of 15th December, 1922, on account of interest accrued from 15th April and 15th May, 1919, on said $4,074,818,358.44, principal amount of demand obligations:

And whereas Great Britain has power under the War Loan Act, 1919 (9 and 10 Geo. 5, cap 37) to issue securities in exchange for maturing securities issued under the War Loan Acts, 1914 to 1918:

And whereas the demand obligations now held by the United States Treasury were so issued, and will become payable upon the request of the United States Treasury for their payment:

Now therefore Great Britain proposes, in the exercise of the powers above recited and in consideration and in faith of the statements, conditions, premises and mutual covenants herein contained, to issue to the United States, in exchange for the demand obligations now held by the United States Treasury, securities which shall be in their terms and conditions in accordance with the following provisions:

1. *Amount of Indebtedness.*

The total amount of indebtedness to be funded is \$4,600,000,000, which has been computed as follows:

Principal amount of demand obligations to be funded.....		\$4, 074, 818, 358. 44
Interest accrued thereon from 15th April and 15th May, 1919, respectively, to 15th December, 1922, at the rate of 4¼ per cent per annum....................	\$629, 836, 106. 99	
Less—Payments made by Great Britain on 16th October and 15th November, 1922, on account of interest, with interest thereon at 4¼ per cent per annum from said dates, respectively, to 15th December, 1922.	100, 526, 379. 69	
		529, 309, 727. 30
Total principal and interest, accrued and unpaid, as of 15th December, 1922.....................		4, 604, 128, 085. 74
Paid in cash by Great Britain, 15th March, 1923..		4, 128, 085. 74
Total indebtedness to be funded into bonds of Great Britain.		4, 600, 000, 000. 00

2. *Issue of Long-Time Obligations.*

The securities, which it is proposed to issue at par as promptly as possible, shall be obligations in the principal amount of \$4,600,000,000, in the form of bonds to be dated 15th December, 1922, maturing 15th December, 1984, with interest payable semi-annually on 15th June and 15th December in each year at the rate of 3 per cent per annum from 15th December, 1922, to 15th December, 1932, and thereafter at the rate of 3½ per cent per annum until the principal thereof shall have been repaid.

3. *Method of Payment.*

The bonds shall be payable as to both principal and interest in United States gold coin of the present standard of weight and fineness, or its equivalent in gold bullion, or, at the option of Great Britain, upon not less than thirty days' advance notice indicating the minimum amount which it is contemplated to pay at next due date in gold, cash or available funds, in any bonds of the United States issued or to be issued after 6th April, 1917, to be taken at par and accrued interest to the date of payment hereunder: *provided, however,* that Great Britain may at its option, upon not less than ninety days' advance notice, pay up to one-half of any interest accruing between 15th December, 1922, and 15th December, 1927, on any British bonds proposed to be issued hereunder, in bonds of Great Britain, maturing 15th December, 1984, dated and bearing interest from the respective dates when the interest to be paid thereby becomes due and substantially similar in other respects to the original bonds proposed to be issued hereunder.

All payments to be made by Great Britain on account of the principal or interest of any bonds proposed to be issued hereunder shall be made at the Treasury of the United States in Washington or, at the option of the Secretary of the Treasury of the United States, at the Federal Reserve Bank of New York and, if in cash, shall be made at the option of Great Britain in gold coin of the United States or in gold bullion or in immediately available funds (or, if in bonds of the United States, shall be in form acceptable to the Secretary of the Treasury of the United States). Appropriate notation of all payments on account of principal shall be made on the bonds proposed to be issued hereunder which may be held by the United States: *provided, however,* that all payments in respect of any marketable obligations issued under paragraph 9 of this proposal shall be made at the office of the fiscal agents of the British Government in the City of New York.

4. *Exemption from Taxation.*

The principal and interest of all bonds issued or to be issued hereunder shall be exempt from all British taxation, present or future, so long as they are in the beneficial ownership of the United States or of a person, firm, association, or corporation neither domiciled nor ordinarily resident in the United Kingdom.

5. *Form of Bonds.*

All bonds proposed to be issued hereunder to the United States shall be payable to the United States of America, or order, shall be issued, so far as possible, in denominations of $4,600,000 each, and shall be substantially in the form set forth in the exhibit annexed hereto, and marked "Exhibit A." The bonds shall be signed for Great Britain by the Counsellor of His Britannic Majesty's Embassy at Washington.

6. *Repayment of Principal.*

To provide for the repayment of the total principal of the debt before maturity of the $4,600,000,000 principal amount of bonds to be issued, it is proposed that the bonds shall contain provisions the effect of which shall be that Great Britain shall make to the United States payments, on account of the original principal amount of the bonds to be issued, in the amounts and on the dates named in the following table:

Date. 15th December:	Annual instalments to be paid on account of principal.	Date. 15th December—Contd.	Annual instalments to be paid on account of principal.
1923	$23,000,000	1936	$32,000,000
1924	23,000,000	1937	37,000,000
1925	24,000,000	1938	37,000,000
1926	25,000,000	1939	37,000,000
1927	25,000,000	1940	42,000,000
1928	27,000,000	1941	42,000,000
1929	27,000,000	1942	42,000,000
1930	28,000,000	1943	42,000,000
1931	28,000,000	1944	46,000,000
1932	30,000,000	1945	46,000,000
1933	32,000,000	1946	46,000,000
1934	32,000,000	1947	51,000,000
1935	32,000,000	1948	51,000,000

Date. 15th December—Contd.	Annual instalments to be paid on account of principal.	Date. 15th December—Contd.	Annual instalments to be paid on account of principal.
1949	$51,000,000	1968	$100,000,000
1950	53,000,000	1969	105,000,000
1951	55,000,000	1970	110,000,000
1952	57,000,000	1971	114,000,000
1953	60,000,000	1972	119,000,000
1954	64,000,000	1973	123,000,000
1955	64,000,000	1974	127,000,000
1956	64,000,000	1975	132,000,000
1957	67,000,000	1976	136,000,000
1958	70,000,000	1977	141,000,000
1959	72,000,000	1978	146,000,000
1960	74,000,000	1979	151,000,000
1961	78,000,000	1980	156,000,000
1962	78,000,000	1981	162,000,000
1963	83,000,000	1982	167,000,000
1964	85,000,000	1983	175,000,000
1965	89,000,000	1984	175,000,000
1966	94,000,000		
1967	96,000,000	Total	4,600,000,000

Provided, however, that Great Britain may at its option, upon not less than ninety days' advance notice, postpone any payment of principal falling due as hereinabove provided to any subsequent 15th June or 15th December, not more than two years distant from its due date, but only on condition that, if Great Britain shall at any time exercise this option as to any payment of principal, the payment falling due in the next succeeding year cannot be postponed to any date more than one year distant from the date when it becomes due, unless and until the payment previously postponed shall actually have been made, and the payment falling due in the second succeeding year cannot be postponed at all unless and until the payment of principal due two years previous thereto shall actually have been made.

In the event of Great Britain issuing bonds to the United States in payment of interest accruing between 15th December, 1922, and 15th December, 1927, as proposed in paragraph 3 above, the bonds so issued shall contain provision for the payment of their principal before maturity through annual instalments on account of principal corresponding substantially to the schedule of payments on account of principal appearing in the table hereinabove set forth.

7. *Payments before Maturity.*

Great Britain may at its option, on any interest date or dates upon not less than ninety days' advance notice, make advance payments of principal, in addition to the payments required to be made by the provisions of the bonds in accordance with paragraph 6 of this proposal. Any such additional payments shall first be applied to the principal of any bonds which shall have been issued hereunder on account of interest accruing between 15th December, 1922, and 15th December, 1927, and then to the principal of any other bonds which shall have been issued hereunder. Any payments made to the United States under this provision shall be in amounts of $1,000,000 or multiples thereof.

8. *Calculation of Interest.*

Notwithstanding anything herein contained, the interest payable from time to time on the bonds proposed to be issued shall be computed on the amount of the principal outstanding on the previous interest date, with adjustments in respect of any payment on account of principal which may have been made since the previous interest date.

9. *Exchange for Marketable Obligations.*

Great Britain will issue to the United States at any time or from time to time, at the request of the Secretary of the Treasury of the United States, in exchange for any or all of the bonds proposed to be issued hereunder and held by the United States, definitive engraved bonds in form suitable for sale to the public, in such amounts and denominations as the Secretary of the Treasury of the United States may request, in bearer form, with provision for registration as to principal, and/or in fully registered form, and otherwise on the same terms and conditions, as to dates of issue and maturity, rate or rates of interest, exemption from taxation, payment in bonds of the United States issued or to be issued after 6th April, 1917, payment before maturity, and the like, as the bonds surrendered on such exchange, except that the bonds shall carry such provision for repayment of principal as shall be agreed upon; provided that, if no agreement to the contrary is arrived at, any such bonds shall contain separate provision for payments before maturity, conforming substantially to the table of repayments of principal prescribed by paragraph 6 of this proposal and in form satisfactory to the Secretary of the Treasury of the United States, such payments to be computed on a basis to accomplish the retirement of any such bonds by 15th December, 1984, and to be made through annual drawings for redemption at par and accrued interest. Any payments of principal thus made before maturity on any such bonds shall be deducted from the payments required to be made by Great Britain to the United States in the corresponding years under the terms of the table of repayments of principal prescribed in paragraph 6 of this proposal.

Great Britain will deliver definitive engraved bonds to the United States in accordance herewith within six months of receiving notice of any such request from the Secretary of the Treasury of the United States, and pending the delivery of the definitive engraved bonds will, at the request of the Secretary of the Treasury of the United States, deliver temporary bonds or interim receipts in a form to be agreed upon within three months of the receipt of such request. The United States, before offering any such bonds or interim receipts for sale in Great Britain, will first offer them to Great Britain for purchase at par and accrued interest and Great

Britain shall likewise have the option, in lieu of issuing to the United States any such bonds or interim receipts, to make advance redemption, at par and accrued interest, of a corresponding amount of bonds issued hereunder and held by the United States.

10. *Cancellation and Surrender of Demand Obligations.*

Upon the delivery to the United States of the $4,600,000,000 principal amount of bonds proposed to be issued hereunder, the United States will cancel and surrender to Great Britain, through the British Ambassador at Washington, or his representative, at the Treasury of the United States in Washington, the demand obligations of Great Britain in the principal amount of $4,074,818,358.44 described in the preamble to this proposal.

11. *Notices.*

Any notice, request or consent under the hand of the Secretary of the Treasury of the United States shall be deemed and taken as the notice, request, or consent of the United States, and shall be sufficient if delivered at the British Embassy at Washington or at the office of the Permanent Secretary of the British Treasury in London; and any notice, request, or election from or by Great Britain shall be sufficient if delivered to the American Embassy in London or to the Secretary of the Treasury of the United States at the Treasury of the United States in Washington. The United States in its discretion may waive any notice required hereunder, but any such waiver shall be in writing and shall not extend to or affect any subsequent notice or impair any right of the United States to require notice hereunder.

Signed on behalf of the Lords Commissioners of His Majesty's Treasury, this eighteenth day of June, 1923.

Washington. A. GEDDES,

His Brittanic Majesty's Ambassador
Extraordinary and Plenipotentiary.

Exhibit "A."

(Form of Bond.)

The Government of the United Kingdom.

Sixty-two year 3–3½ per cent Gold Bond

Dated 15th December, 1922. Maturing 15th December, 1984.

$ No.

The Government of the United Kingdom, hereinafter called Great Britain, for value received, promises to pay to the United States of America, hereinafter called the United States, or order, on the 15th day of December, 1984, the sum of Four Million Six Hundred Thousand Dollars ($4,600,000), less any amount which may have been paid upon the principal hereof as endorsed upon the back hereof, and to pay interest upon said principal sum semiannually on the fifteenth day of June and December in each year at the rate of three per cent per annum from 15th December, 1922, to 15th December, 1932, and at the rate of three and one-half per cent per annum thereafter until the principal hereof shall have been paid. All payments on account of principal and/or interest shall be made at the Treasury of the United States in Washington, or, at the option of the Secretary of the Treasury of the United States, at the Federal Reserve Bank of New York. This bond is payable as to both principal and interest in gold coin of the United States of America of the present standard of weight and fineness or in its equivalent in gold bullion, or, at the option of Great Britain, upon not less than thirty days' notice indicating the minimum amount which it is contemplated to pay at next due date in gold, cash or available funds, in any bonds of the United States issued or to be issued after 6th April, 1917, to be taken at par and accrued interest to the date of payment hereunder; *provided, however,* that

Great Britain may at its option, upon not less than ninety days' advance notice, pay up to one-half of any interest accruing hereon between 15th December, 1922, and 15th December, 1927, in bonds of Great Britain dated and bearing interest from the respective dates when the interest to be paid thereby becomes due, and substantially similar in maturity and other respects to this bond.

The principal and interest of this bond shall be exempt from all British taxation, present or future, so long as it is in the beneficial ownership of the United States, or of a person, firm, association or corporation neither domiciled nor ordinarily resident in the United Kingdom.

In order to provide for the repayment of the principal of this bond before maturity, Great Britain will make to the United States payments of principal in the amounts, and on the dates shown in the following table:

Date. 15th December:	Annual instalments to be paid on account of principal.	Date. 15th December—Contd.	Annual instalments to be paid on account of principal.
1923	$23,000	1946	$46,000
1924	23,000	1947	51,000
1925	24,000	1948	51,000
1926	25,000	1949	51,000
1927	25,000	1950	53,000
1928	27,000	1951	55,000
1929	27,000	1952	57,000
1930	28,000	1953	60,000
1931	28,000	1954	64,000
1932	30,000	1955	64,000
1933	32,000	1956	64,000
1934	32,000	1957	67,000
1935	32,000	1958	70,000
1936	32,000	1959	72,000
1937	37,000	1960	74,000
1938	37,000	1961	78,000
1939	37,000	1962	78,000
1940	42,000	1963	83,000
1941	42,000	1964	85,000
1942	42,000	1965	89,000
1943	42,000	1966	94,000
1944	46,000	1967	96,000
1945	46,000	1968	100,000

Date. 15th December—Contd.	Annual instalments to be paid on account of principal.	Date. 15th December—Contd.	Annual instalments to be paid on account of principal.
1969	$105,000	1978	$146,000
1970	110,000	1979	151,000
1971	114,000	1980	156,000
1972	119,000	1981	162,000
1973	123,000	1982	167,000
1974	127,000	1983	175,000
1975	132,000	1984	175,000
1976	136,000		
1977	141,000	Total	4,600,000

Provided, however, that Great Britain may, at its option, upon not less than ninety days' advance notice, postpone any payment of principal falling due, as hereinabove provided, to any subsequent 15th June or 15th December, not more than two years distant from its due date, but only on condition that if Great Britain shall at any time exercise this option as to any payment of principal, the payment falling due in the next succeeding year cannot be postponed to any date more than one year distant from the date when it becomes due unless and until the payment previously postponed shall actually have been made, and the payment falling due in the second succeeding year cannot be postponed at all unless and until the payment of principal due two years previous thereto shall actually have been made.

This bond may be paid on any interest date before maturity in whole or in part, in amounts of $1,000,000, or multiples thereof, at the option of Great Britain, on not less than ninety days' advance notice.

This bond is issued by Great Britain pursuant to the proposal, dated the 18th day of June, 1923, and to the Acceptance of proposal, dated the 19th day of June, 1923.

In Witness Whereof, Great Britain has caused this bond to be executed in its behalf by the Counsellor of His Britannic Majesty's Embassy at Washington, thereunto duly authorized.

For the United Kingdom:

Dated 15th December, 1922.

(Back.)

The following amounts have been paid upon the principal amount of this bond:

Date.	Amount paid.

Acceptance.

JUNE 19, 1923.

The Right Honorable,
Sir AUCKLAND GEDDES, G. C. M. G., K. C. B.,
Ambassador Extraordinary and Plenipotentiary,
The British Embassy,
Washington, D. C.

MY DEAR MR. AMBASSADOR: I have the honor to acknowledge the receipt of your note of June 18, 1923, transmitting the proposal dated the 18th day of June, 1923, by His Britannic Majesty's Government to the Government of the United States of America regarding the funding of the debt of Great Britain to the United States. This proposal is agreeable to the World War Foreign Debt Commission, and I am writing for the Commission and by its authority to advise you that the proposal is hereby accepted on behalf of the United States of America, pursuant to the authority conferred by the Act of Congress approved February 9, 1922, as amended by the Act of Congress approved February 28, 1923. In accordance therewith I am writing to ask that the bonds as contemplated thereby may be delivered as soon as possible to the Secretary of the Treasury of the United States in exchange for the demand obligations amounting to $4,074,818,358.44 now held by him which are otherwise now payable.

Very truly yours,

A. W. MELLON,
Secretary of the Treasury, and Chairman of the World War Foreign Debt Commission.

Approved:

WARREN G. HARDING,
President.

JUNE 19, 1923.

WASHINGTON : GOVERNMENT PRINTING OFFICE : 1923

COPY

No. 7140

UNITED STATES OF AMERICA.

DEPARTMENT OF STATE.

TO ALL TO WHOM THESE PRESENTS SHALL COME, GREETING:

I CERTIFY That SIR CECIL ARTHUR SPRING RICE,
whose name is subscribed to the paper hereto annexed, is duly accredited to this Government as Ambassador Extraordinary and Plenipotentiary from Great Britain. *

IN TESTIMONY WHEREOF I, ROBERT LANSING, Secretary of State, have hereunto caused the Seal of the Department of State to be affixed and my name subscribed by the Chief Clerk of the said Department, at the City of Washington, this 1st day of May, 1917.

(Seal)

(* For the contents of the annexed document the Department assumes no responsibility.)

ROBERT LANSING
Secretary of State.

By BEN G. DAVIS
Chief Clerk.

PE

C O P Y

KNOW ALL MEN BY THESE PRESENTS, That I, Sir Cecil Arthur Spring-Rice, Ambassador Extraordinary and Plenipotentiary of the Government of the United Kingdom of Great Britain and Ireland, having deposited in the Federal Reserve Bank of New York, the sum of Two Hundred Million Dollars ($200,000,000.00) to the credit of the Government of Great Britain and Ireland, do by these presents and under authority and by direction of my said Government, nominate, authorize and empower Sir S. Hardman Lever, K. C. B., Financial Secretary to the Treasury, whose signature is hereto attached and made a part of this instrument, to withdraw any and all deposits made by me in said Bank by check, draft or order on said Federal Reserve Bank of New York, and I do hereby authorize the said Federal Reserve Bank of New York to honor and pay any and all checks, drafts or orders drawn by the said Sir S. Hardman Lever, K. C. B., Financial Secretary to the Treasury, against any funds standing to the credit of the said Government of Great Britain and Ireland.

IN WITNESS WHEREOF I HAVE HEREUNTO affixed my signature and my seal of office on this the 24th day of April, 1917.

(Signed) Cecil Arthur Spring-Rice,
H. B. M. Ambassador

Sam. H. Lever. (Signed)

The foregoing is the true and official signature of the said Sir S. Hardman Lever, K. C. B., Financial Secretary to the Treasury, whose name appears in this instrument.

(Signed) Cecil Arthur Spring Rice,
H. B. M. Ambassador.

Witness my hand and seal of office this 24th day of April, 1917.

(S e a l)

C O P Y

KNOW ALL MEN BY THESE PRESENTS, That I, Sir Cecil Arthur Spring-Rice, Ambassador Extraordinary and Plenipotentiary of the Government of the United Kingdom of Great Britain and Ireland, having deposited in the Federal Reserve Bank of New York, the sum of Two Hundred Million Dollars ($200,000,000.00) to the credit of the Government of Great Britain and Ireland, do by these presents and under authority and by direction of my said Government, nominate, authorize and empower Sir S. Hardman Lever, K. C. B., Financial Secretary to the Treasury, whose signature is hereto attached and made a part of this instrument, to withdraw any and all deposits made by me in said Bank by check, draft or order on said Federal Reserve Bank of New York, and I do hereby authorize the said Federal Reserve Bank of New York to honor and pay any and all checks, drafts or orders drawn by the said Sir S. Hardman Lever, K. C. B., Financial Secretary to the Treasury, against any funds standing to the credit of the said Government of Great Britain and Ireland.

IN WITNESS WHEREOF I HAVE HEREUNTO affixed my signature and my seal of office on this the 24th day of April, 1917.

(Signed) Cecil Arthur Spring-Rice,
H. B. M. Ambassador

Sam. H. Lever. (Signed)

The foregoing is the true and official signature of the said Sir S. Hardman Lever, K. C. B., Financial Secretary to the Treasury, whose name appears in this instrument.

(Signed) Cecil Arthur Spring Rice,
H. B. M. Ambassador.

Witness my hand and seal of office this 24th day of April, 1917.

(S e a l)

Chapter 18

Currency and Gold Problems

Testimony before the Royal Commission on Indian Currency and Finance, London, May, 1926.

Governor Strong. At the outset, Mr. Chairman, permit me, on behalf of myself and my associates to express our appreciation of your invitation to appear before the Royal Commission for the purpose of discussing questions which are now being urged upon the attention of all nations. We are gratified by this evidence of your interest in the solution of problems to which possibly we can address ourselves with a common purpose. Nevertheless, when it was first intimated to me that an invitation would be sent, I hesitated to accept it, for two reasons. One was lest appearance before your Commission might be interpreted as an intrusion by an American banker in problems which may popularly be regarded as of concern primarily within the British Empire. The second reason was that I could not appear before the Commission without making reference to the adverse effects, indeed possibly the disastrous effects, of the proposals under discussion upon the American mining industry, and so give rise to the impression that the purpose of the appearance was to advance arguments in behalf of these interests, rather than to make a contribution to your work. In this light, my statements to you might indeed be regarded as special pleading and unduly coloured by the particular interests of our own industry.

Our examination of the suggested plan for a gold standard, which has been the subject of considerable study and deliberation, leads to the unescapable conclusion that the Indian monetary programme is a matter of vital concern to America,

Footnote. This Royal Commission on Indian Currency and Finance was appointed to consider proposals for the reorganization of the Indian currency system. Governor Strong was requested to appear before the Commission, and accompanied by Professor Oliver M. W. Sprague, Professor of Banking and Finance, Harvard University, and Professor Jacob H. Hollander, Professor of Political Economy, Johns Hopkins University. Governor Strong's testimony was in part concerned with a somewhat technical discussion of the particular proposals before the commission, and only those parts having a more general signifiaance are reproduced here.

not alone nor primarily as to domestic interests directly affected, but even more in the extent to which it involves international monetary relations of the United States, and especially as to our part in the world programme now gradually developing for monetary reconstruction. We have not therefore interpreted this invitation in a narrow sense, but rather have taken the liberty of construing it to be an expression of desire for cooperation in the solution of a great world problem. It is in fact our interest in this wider aspect of monetary reorganization which justifies our appearance before the Commission.

You will understand my explaining that I am not here as a representative, official or unofficial, of the American Government, nor in fact of the Federal Reserve System as a system of banks of issue, but rather in my more personal capacity as an officer/ of that particular Federal reserve bank which is charged with the duty of maintaining relations with foreign banks of issue, an institution which has already undertaken large commitments and responsibilities in connection with this general subject. It is this programme, looking forward to further cooperative effort such as India and the other nations may give, upon which we must rely for the bettering of monetary conditions throughout the world, a matter which is just now so much the concern of mankind.

We shall all admit that the object of perfecting monetary systems is the achievement of a stable domestic and international purchasing power for the currency - a goal unattainable by any one party acting alone, and only possible through cooperative effort. Because a gold currency is that one which has had in the past the most stable buying power both at home and abroad, it is naturally the one we all now seek to secure. We must also agree that a great nation like India is entitled to any currency system which it can afford and maintain in stable relation with other currencies, and it is axiomatic that a nation which over the years has a favorable balance of payments can have any kind of a currency system it wants. But it is to be presumed that such a nation will desire a fiscal and banking organization and policy capable of enabling it to operate effectively and smoothly in both the domestic and international markets.

The essential elements of a full gold standard are complete convertibility of the note issue into gold, an absolutely free gold market, an unfettered foreign exchange market, and a banking system which effectively assimilates gold imports and regulates the consequences of gold exports. Actual circulation of gold coin or its equivalent has been a usual feature of a complete gold standard, but is in no sense essential thereto, and as a constituent of the circulating medium gold coin was becoming steadily less significant in the years preceding the world war. Any material departure from these essentials is in the direction of a gold exchange standard, which passes through various stages such as a limited convertibility of the note issue into the so-called Ricardo bars, then to convertibility of the note issue by the use of checks on gold standard countries generally, and finally to the more restricted gold exchange standard where one currency is limited to convertibility by check on but one other country having a gold or gold exchange standard. May I interject to say that there is always the danger of our attributing rather conventional or pro forma meanings to these words "gold standard" and "gold exchange standard" and "sterling exchange standard," and to express my belief that the so-called pure gold standard with a gold coin circulation in time is likely to give way, under the influence of the cooperation of banks of issue, in favor of what we now more generally describe as the gold exchange standard - a necessary consequence of the economy in the use of gold and gold coin.

The only great nation which has a complete gold standard in every particular to-day is the United States. European countries in varying degree are now practising the gold exchange standard. The object of this statement preliminary to a discussion of the questionnaire is to express the basis of my belief that the moment is inopportune for India to adopt the full gold standard system, with circulation of gold coin or its equivalent, partly because the world is not yet capable, in my opinion, of sustaining the burden which would thus be thrown upon central bank reserves, and that therefore the attempt would fail. But this does not imply that the essential objects sought by India, especially a flexible monetary system with stable purchasing power at home and abroad, are not within her reach by methods such as are now in general operation in Europe, if made to conform to Indian customs and usages. Holding this view, it might appear from the later discussion of the questionnaire that our appearance is for no other purpose than to discourage the adoption of the specific plan submitted. This view would be quite contrary to our feelings and convictions, which dispose us rather to participate in the discussion of proposals with which we and others can heartily cooperate. Indeed, it may be that before the hearings are ended the discussion will take the more agreeable turn in the direction of a programme which, instead of inviting our criticism, will enable us to consider plans of cooperation.

....

Chairman. Governor Strong, we are looking forward to-day to the benefit of your assistance on some of the wider aspects of the scheme, first of all in regard to some which relate more particularly to the gold market. Is this a convenient point at which to resume your consideration of the subject?

Governor Strong. Yes, Mr. Chairman. Reviewing the questionnaire after yesterday's session it became apparent that there was very little which I might discuss without repetition, and, if agreeable to you, what I shall say to-day will be specifically directed to the question of, and will relate entirely to, the gold position in the United States. The circulation of gold - that is, of gold coin - in the United States is really controlled to-day by considerations of habit and convenience which have not been characteristic of the gold coin circulation in countries which had such a circulation before the war. In England, for instance, the smallest denomination of note issue by the Bank of England was £5, and the intermediate circulation was sovereigns and half-sovereigns. The determination of the relative amount of circulation of these two kinds of money was really fixed automatically by the requirements of the country's trade. If smaller denomination money were required below the £5 Bank note, it took the form of a coin. In the United States we have not had a situation where what I might describe as the saturation point of those two kinds of currency has ever been reached, for the reason that with the great variety of paper money in circulation, issued in all denominations, there was no true economic demand for gold coin of, say $5, $10 and $20 denominations in order to conduct the country's trade. National Bank Notes, for instance, were issued in denominations of $5, $10 and $20, and higher. The same was true of the silver certificates which you saw yesterday, which are issued in $1, $5, $10 and $20 denominations and higher; and the same in fact was true of the so-called Greenbacks. The situation prior to the war and since the war has really been this - that in order to induce the circulation of gold coin it would be necessary to discontinue the printing of all kinds of paper money of those three denominations; and the introduction of a gold coin currency into circulation would have been a cause of great inconvenience and complaint by the public. That may be illustrated by my telling you that the chief paper money circulation in the country consists of $5 notes of the various kinds which we issue, and the next in order are $10 and $20.

At the Federal Reserve Bank of New York we receive on deposit every day from the banks something like 20 million of this paper money, and we pay out in round figures about 20 million dollars of this paper money - a very large part of it consisting of notes of $5, $10 and $20 denomination. We also receive every day, through the mail and by express from out of town banks in our district on the average about 500 shipments of paper money, ~~thexxxxxxgexxk~~ and we ship out to our Member banks about 500 shipments of paper money, largely consisting of these denominations. If those shipments and those deposits and withdrawals all had to be made in gold coin, the expense and inconvenience of handling it would be tremendous. So, as I say, the circulation of gold coin in the United States is very largely determined by habit - that is the habit of using paper money - and by convenience in handling a form of money which is very much more economical to transport and carry about than is gold coin.

I should like at this point to refer to something which I observed myself when in India in 1920, which may have some bearing. We have a large problem of internal payments to make in the United States between the different districts, just as exists in India, and I recall being told when in India, when the rupee note was gaining its popularity in 1920, that the very large denomination notes actually brought a premium becausé of the convenience that they afforded in effecting transfers. There being no demand for gold coin circulation, wonder is sometimes expressed at the very large circulation of paper money representing gold coin; that is, the gold certificates, and I should like to describe the policy which has applied to that since the outbreak of the war. When the reserves of member banks were assembled in the Federal reserve banks, a large part was paid in in gold - that is, in these gold certificates, and some small amount in gold coin. There was left in circulation, however, as hand-to-hand money a large amount of gold certificates, and there was left in the reserves of non-member banks (that is, the state banks which did not join the Federal Reserve System) a considerable further amount. The total of goldcertificates in circulation before the war was, in round figures, about $900 million, other forms of money constituting the rest of the cicuulating medium. We thought it was wise in order to lay a foundation for possibly extensive operations in financing the war, to assemble as much of this gold as possible in the reserve banks, and without describing the details of the operation, we issued Federal reserve notes in exchange for gold, and thereby further reduced the outstanding amount of gold certificates in circulation and in the hands of banks to about $200 million. That helped to build up the reserves of the Reserve banks. Then we had this great accession to our gold stock, largely represented by issues of gold certificates by the Treasury.

When the war ended and matters returned more nearly to normal, we had to decide upon a policy as to the circulation of this gold, practically all of it at that time being out of circulation and in the reserves of the Reserve banks in the form of gold certificates. So we have now restored to circulation substantially the total which was in circulation before the war; in fact, the circulation of gold certificates to-day is roughly one billion dollars. I would like to describe the reasons which led us to do so. The first was that the almost complete disappearance of gold certificates - which are readily distinguished from other forms of paper money because they are printed with yellow backs - led us to fear that there might grow up a feeling of discrimination or preference in the minds of the public between the different kinds of money in circulation - an unsatisfactory feeling to develop about the currency. The way to overcome that was to put gold certificates freely into circulation, which was done. That was the first reason. The second reason was the idea conveyed in regard to the very large gold reserves of the Reserve banks and the very high percentage of reserve at a time when there was prevalent, especially in the agricultural sections, a feeling that possibly it would be a good thing for the country to have some expansion of credit; that in some way it would life us out of the difficulties of that period. It did not seem well that the Reserve banks should show so large a bulk of gold, nor in fact so high a percentage of reserve; and the effect of paying out some 700 million or 800 million of our gold reservewas to reduce it to a less spectacular figure, if you please.

The third reason was rather more important than either of the other two. In a country which has, say, a saturation point in the circulation of gold, any movement of gold into the country or out of the country in a well-organized central banking system is instantly reflected in the reserve of the central bank. With no point of saturation in the circulation of gold (because of the existence of this large volume of other kinds of money of similar denomination) unless the amount of gold certificates in circulation was carefully fixed at a definite figure and maintained there, we would have two fluctuating funds of gold - one, the amount in circulation, and the other in the reserves of the Reserve banks. The reserve percentage of the Reserve banks would therefore be no indication of the gold movement whatever. In fact, it might be possible, by a careful adjustment of payments by the Reserve banks in meeting the demands of the circulation, to maintain the percentage of the Reserve bank at almost an absolutely fixed figure and have the fluctuation in the country's gold supply occur entirely in the gold certificates in circulation. So as a matter of policy we determined to endeavor to fix the amount in circulation at a definite non-fluctuating sum, and as gold imports or gold exports occurred, they would show at once in the reserves of the Reserve bank.

The fourth reason was of this character. A long continued period of a high reserve in the Federal reserve banks, say, at 80 or even 85 per cent, might induce a state of mind in the public which I might describe as raising the apprehension point; in other words, a sudden loss of gold by export which would reduce the reserves of the Reserve banks by, say, 20 per cent - from 85 per cent to 65 per cent. - might bring about the same reaction in the minds of the public as would a sudden reduction of reserve from 65 per cent to 45 per cent. Recognising that the percentage of reserves of the Reserve banks, as I described the other day, were necessarily large and possibly unduly large, we wished to be in a position first that we were not operating on an unduly large reserve, and second, that if any sudden decline in the reserve did occur, it could be compensated by gradually taking the gold out of circulation. It is a rather unlikely occurrence. It is hardly possible to conceive of a loss of gold which would reduce the reserves of the Reserve banks suddenly by as much as 20 per cent., but with this great mass of gold in the hands of the Reserve banks, and with a large mass in circulation, it certainly would appear to be a more conservative policy to have this compensating fund in circulation upon which we could draw in case of need to build up our reserve and soften the shock of a very large loss of gold. That, if you please, explains somewhat the policy of the Reserve banks in maintaining a large circulation of gold certificates and a somewhat lower percentage of reserve than they otherwise might have done.

Now, as to the question of the redundancy of this gold. It is a fact that, notwithstanding the very large increase in the amount of gold held in the country, there has been no considerable increase in the total percentage of monetary gold to the total deposit liabilities of all the commercial banks of the country. The expansion of credit has kept pace with the accession to our gold stock. The reason why it is possible to say that we now have an amount of free gold (not redundant, it is all functioning in our system), but which, under favorable circumstances, might be spared from our system - is due to the fact that the reserves of the banking system prior to the organization of the Federal Reserve System were scattered among some 28,000 or 30,000 different banks while now they are largely concentrated in the Reserve banks. There was no economy in the use of reserve money, and the organization of the Federal reserve banks in assembling it in one great body of course creates a very much more secure banking position than existed under the system of isolated separate reserves by each separate commercial bank, state and national. The reserve position was somewhat weakened before the war by the fact that many banks carried a portion of their reserves on deposit with other commercial banks, so that there was a pyramid of deposit liabilities on the individual reserves of the different commercial banks. In fact, when the Reserve Act was passed it was felt that the economy in the use of gold brought about by its organization in the hands of the Reserve banks justified a very considerable lowering of the amount of reserves required to be kept by the state and national banks which became members of the Federal Reserve System. That is, the national banks, all of which are members, and the state banks, some of which became members.

A question appeared in the Questionnaire relating to the probable rate of increase in the demand for monetary gold with the growth of business and bank deposit liabilities. I do not think it is possible to apply any rule by mathematical computation. One computation has been made, I believe, which indicates that the probable increased demand will be about 2.8 per cent. To show how illusive any such calculation is liable to be, one should consider the enormous changes that have taken place in the reserve position in the United States. Prior to the adoption of the Federal Reserve Act, commercial banks in the cities of New York, Chicago and St. Louis (the largest banking centers in the country) were required to keep 25 per cent reserve in cash in their own vaults. Banks in New York and Chicago are now required to keep but 13 per cent on deposit in the Federal reserve banks, and those in St. Louis but 10 per cent. That is the highest reserve requirement of any member bank. The banks located in some 75 or 100 reserve cities, so called (that is the next smaller cities) are required to keep but 10 per cent reserve on deposit in the Reserve banks as against 25 per cent. before the Reserve Act was adopted, of which 25 per cent 15 per cent might be on deposit with other banks. The banks in all other towns and cities are now required to keep but 7 per cent as against 15 per cent before the Reserve Act was adopted. Such a reduction in reserve requirements would serve to offset an annual increased demand for reserve money for our banking system for a considerable period. This is true also as to other possible developments. I might illustrate it by referring to our present practice at home in dealing with the collection of checks. A suit was recently brought by a bank, or a group of banks, to require the Federal reserve banks to give immediate credit uponchecks deposited with the Reserve bank by member banks. Had that suit been successful it would have had the effect of adding about $800,000,000 to the reserves of our member banks without any change in the quantity of gold in the country at all. That, again, would have been equivalent to a number of years additional reserve requirements for gold by the banking system. Perhaps some questions might be asked now with regard to this particular matter.

Sir Reginald Mant. Mr. Strong, you told us that the Federal reserve banks withdrew a large number of gold certificates. Will you tell us how the banks can get them in and give them out at will? Does it not depend on whether the public want gold certificates or not?

Governor Strong. You mean the Federal reserve banks?

Sir Reginald Mant. Yes. How do they increase or decrease the circulation of gold certificates?

Governor Strong. If any peculiar value, sentimental or otherwise, attached in the minds of the people to a gold certificate as distinguished from any other type of paper money, then some difficulty might be encountered. People would sort them out and keep thegold certificates and pay out other kinds of money. That was one of the reasons - to prevent any such development - which led us to put them freely into circulation. Now people do not distinguish, and there is no habit of sorting. So that as money becomes either redundant - more than is required for the circulation - or as it wears out, it is returned to the Federal reserve banks, and there we have the task of sorting out that which is unfit for further circulation and sorting it both as to kinds and as to denominations. Then if we simply discontinue paying out the gold certificates and satisfy the demand for fresh money with other forms of paper money, we very rapidly accumulate the gold in the Reserve banks again. It is an automatic operation.

....

Sir Henry Strakosch. You referred to the reduced reserve needs since the introduction of the Federal Reserve System, and you mentioned that before the Federal Reserve System was introduced the National banks had to hold 25 per cent of their liabilities in reserve.

Governor Strong. In the three central reserve cities of Chicago, New York and St. Louis.

Sir Henry Strakosch. With this smaller ratio of reserves do you regard the situation as satisfactory as it was before the introduction of the Federal Reserve System?

Governor Strong. Yes, I regard it quite as satisfactory, and even more so, for the reason, first, that the reserve is mobilized with the reserve banks, and, second, because the reserve banks are now capable of meeting a sudden increased demand for currency by issues of Federal Reserve notes against discounts of member banks. The difficulty prior to the establishment of the Federal Reserve System was that without any capacity for expansion of the note issue the only way a member bank could meet a demand was by paying out its reserve and, when anything like panicky conditions arose, such as occurred in 1893 and 1907, the banks hoarded their reserves;, they would not pay them out. On both of those occasions we had a premium on currency. Now that we have a central reserve fund and a capacity to meet any demand for currency, that situation does not arise. It certainly would have arisen during the war if there had been no Federal Reserve System with capacity to meet almost unlimited demand.

Sir Henry Strakosch. That, you would say, is one of the great benefits of a central banking system in a country?

Governor Strong. I should say it is essential to any modern banking system.

Sir Henry Strakosch. To have the banking and currency reserve centralized within one institution?

Governor Strong. Yes.

Sir Maneckji Dadabhoy. I want to ask you one or two questions by way of information. I understand the United States started on a gold standard in 1897?

Governor Strong. I am not sure of the year, but I think the Act to which reference was made the other day, requiring the Secretary of the Treasury to maintain all forms of money in circulation at par, was passed in 1898 and I think it may be generally stated, overlooking the peculiarities of our system as to details, that the gold standard became firmly established with the adoption of that Act.

Sir Maneckji Dadabhoy. When you started a gold standard did you have some form of gold currency at the initial stage?

Governor Strong. We had a circulation of gold on the Pacific Coast only, of any consequence. All the other gold circulation in the country was in the form of gold certificates.

Sir Maneckji Dadabhoy. How do you distinguish the term "saturation point" from "redundancy"?

Governor Strong. I would like to adopt Dr. Sprague's definition which he made to my entire satisfaction the other day. I should say that free gold is, as I have described, expressed by an unduly large reserve percentage in the central bank, and that a redundancy is an excess over the requirements of the nation for conducting a given amount of business at a given price level.

....

Governor Strong. I have been asked to elaborate a little one part of my statement in regard to gold coin circulation. I referred to the fact that gold coin had circulated on the Pacific Coast as distinguished from gold certificates. This was the outgrowth of the gold discoveries on the Pacific Coast in about 1849. The immense unoccupied territory between the Eastern sources of supply of gold coin and paper money made it, of course, difficult to introduce a circulating medium in a part of the country which was growing very rapidly under the impulse of the gold discoveries, and in the early days of the mining camp period of the Far West the currency was in the form of small nuggets of gold taken from placer mines. Every store had scales where the gold was weighed, and people actually made their payments with the gold as it was taken from the placers. The next development was a rather irregular coinage of this gold by private persons on the Pacific Coast. Some of the coins, although rather crude, had quite a wide circulation. Some of them were of good workmanship, and are still treasured as souvenirs of the early days of the development of the West. This habit of gold coin circulation grew, and later a Mint was established in Denver, and gold coin came tobe put quite largely into circulation. The habit of the use of gold coin onthe Pacific Coast did not finally disappear until the Federal Reserve Bank in San Francisco furnished adequate supplies of gold certificates and other forms of money.

Then gold coin was largely withdrawn from circulation and paper money substituted, although it was a task of some difficulty, because that coin had been in circulation for so many years that almost all of it was abraded below the limit of tolerance. The holders of the coins did not like to turn them in and assume their abrasion loss, so the Federal Reserve Bank of San Francisco assumed that loss. The gold coin came in, and is now practically out of circulation even in California.

....

Sir Henry Strakosch. I asked a question yesterday regarding the legal obligation to compel the member banks to hold a certain percentage of their liabilities with the Federal reserve banks, and I asked you why it was that the percentage to be deposited with the Federal reserve bank was different in the different localities. You suggested that you would later on mention what the reason was, but you did not.

Governor Strong. I cannot say that I can defend that particular system, because logically it might appear under a banking system which had developed along different lines from ours, that country banks, being more remote from the Central Bank, should have a higher reserve. The reason for the difference of reserve requirements between the central reserve cities, the reserve cities and the country banks, was due to certain characteristics of our old system, where the country banks carried their reserves in the reserve cities and the central reserve city banks, and all of the banks of the country, including the reserve city banks, might carry their reserve in the central reserve city banks, so that the development of the different size of reserves grew out of the feeling that a greater responsibility rested upon the banks in reserve centers which were carrying a proportion of reserves for banks located in country sections.

Sir Henry Strakosch. If a new system were set up, you would, I take it, not advocate any such distinction being made as has been made under the Federal Reserve Act?

Governor Strong.. I think the proportion of reserve would have to be based upon very different considerations than those which existed in America, when this particular practice was incorporated in law. You understand that before the establishment of the Federal Reserve Act country banks were required to carry a certain percentage of reserve, of which a portion had to be in cash, in their vaults, and a portion might be carried with a correspondent bank in a money center. That is what led to requiring a higher percentage of reserve to be carried by the commercial banks located in the money centers.

Sir Henry Strakosch. Yesterday you told us there are two ways of dealing with the relationship of the commercial banks and the central bank. One would be the one in practice in America, to let the commercial banks hold a certain given percentage of their liabilities with reserve banks, and the other would be the system adopted in this country, where no such provision exists, but where the central bank carefully discriminates for whom it opens accounts and rediscounts. In a country with an undeveloped banking system, and with what may be called a lack of banking discipline, would you not regard the system under which the commercial banks are compelled to deposit some of their reserves with the central bank a preferable one to the one that has grown up in this country? What I have in mind is this. If you were to enact that any bank trading as bankers, that is to say, taking money on deposit which can be withdrawn by check, were held to deposit some of their reserves with the central bank, and at the same time to disclose its own status, as is the case in some of the central banking countries, that would conduce to educating the public to the duties of bankers better than if there were no such well-defined system?

Governor Strong. The development should be considered rather historically. In the United States we had long periods of wild and reckless banking practices, which imposed great hardships upon the people of the country, and very severe losses at times. Not only have we the habit in the United States of doing a great deal by legislative enactment, expressed with great particularity, but in the case of banking our experience had been so unfortunate in former years that Congress and the legislatures were ready to impose very careful and precise restrictions upon banking, and not only that, but to introduce a very extensively organized system of reports and examinations. We do banking now too much by law in America, I think, and not enough by good judgment; but that is the way a system in liable to develop in a new country which is growing. Whether it would be wise in India to impose the same type of particular legal restrictions and requirements upon banking that we have in the United States, would depend upon a pretty thorough understanding of banking methods in India, how secure they are, and how certainly and carefully the business is conducted. In England it has been the development of centuries, but the growth in the United States had sprung up relatively almost overnight. The need for this type of regulation and supervision seemed to be apparent to everybody, at any rate that is the way we have grown. There are those who say that it makes very bad bankers. They try and do everything by law instead of by good judgment. The probability is that under such a system as we have had, banking has not developed quite as successfully as it might have done with some greater sense of responsibility. On the other hand, we may have been protected from banking disasters which would be very serious, and constant failures of banks that otherwise would have occurred. If you introduce such a system of careful scrutiny and examination, such as we have, it is quite natural that Boards of Directors come to rely upon the examination by the Controller, or the State Superintendent, as partly relieving them of some of their responsibility to see that the bank is always in a good condition. When you are dealing with a private banker, subject to no supervision whatever, you have wholly different conditions. My remarks yesterday were intended to suggest, as they probably have to your mind, the need for special study of that kind, and the desirability of not attempting to do what we did inthe case of our Federal Reserve System. Considering that the Federal Reserve System has worked pretty well in

America, it might be thought it would also work pretty well inIndia, but I am not willing to say that it would work well in India.

Sir Henry Strakosch. What has been suggested is this, that in a country unaccustomed to the central banking system the functions of the central bank are usually not well understood. In particular, it is not well understood that the central bank is there to hold the cash reserves of the commercial banks. I have heard of instances where, owing to the absence of such statutory provisions, somecommercial banks have refrained deliberately from depositing their cash reserves with the Central bank. Such action largely impedes the proper functioning of the central bank.

Mr. Strong. We have had considerable experience in that very matter, when you consider that out of possibly 18,000 or 20,000 banks which can qualify to be members of the Federal Reserve System in America we have only about half that number, principally, the national banks, of which there are a little under 10,000, who were required to be members. The state banks are permitted to become members, on conforming tocertain standards. The membership of the state banks has been largely confined to the banks in the large money centers, which not only became better acquainted with the menning of the system and the security afforded by membership, but really had greater need of membership - at least they thought they had, especially during the war - when the same conditions prevailed that youreferred to. There are many good banks in the United States which might be members of the system, and probably would profit by being members, but they still do not understand well enough what the central bank means to feel the urge to join the system.

Sir Henry Strakosch. It has been suggested that it would be proper for a central bank to undertake the savings bank business, that is, to allow interest on savings deposits. Would you favor that, or do you see any objection to it?

Governor Strong. It certainly would not be a desirable thing in the United States. It might apply in India; but one of the outstanding objections

lies in this fact: that the accumulation of a large volume of savings in the central bank, upon which liabilities for interest arise, makes it necessary for the central bank to lend money and earn money. Certainly we have learned in recent years that to inject into the operation of the central bank the regular practice of lending money for profit can sometimes do great damage. If the obligation to earn money was imposed upon the bank, by taking a type of deposit which required payment of interest, it might interfere with a normal credit policy. May I illustrate it by this very simple analogy fromthe United States? We hold about 2 1/4 billion dollars of reserve deposits of our members. That is the reserve account of the nation. There has been a very strong desire at times expressed by the member banks that they should get interest on their balances just as they formerly did when they carried a part of their reserves with commercial banks, - say, 2 per cent interest. In order to pay 2 per cent interest on those
In order to earn 45 million dollars a year
balances we would have to be able to earn 45 million dollars a year; to pay that interest,it would be necessary for us to expand our credit, at present discount rates, by 1,100 to 1,200 million dollars. In other words, it would force an inflation upon the country. Conditions in India may be different, and you may be able effectively to separate savings accounts and their investments from the credit operations of the bank of issue; but if it did have the effect of requiring the bank to earn money by investments at a time when it was not desirable, I should think it would be a very undesirable thing for the central bank to do.

Sir Henry Strakosch. You referred yesterday to the necessity that to have a properly functioning central bank there must be a money market. Would you agree that the establishment of a central bank is the best means of establishing such a money market, and that without a central bank a money market cannot be properly developed?

Governor Strong. Yes; and it results in developments that are distortions of the money market. Prior to the establishment of the Federal reserve bank practically the entire readjustment of the money position of the banks of New York, and largely of the whole country, was effected through the Stock Exchange loan account - a most undesirable situation. When reserve became impaired the banks called loans on the Stock Exchange for payments and we had a crash in stock prices, money rates climbed, and there were all the difficulties of an unorganized money market. That is all avoided now. We do not have these occurrences because we have got a better organized money market, with the Reserve bank to take care of these peaks and troughs of demand. They are very cossiderable in the United States. The Christmas demand alone for currency to do the shopping for Christmas presents imposes upon us an expansion of our loans of about 400 million dollars.

Chairman. Before we close the evidence, is there any other matter to which you wish to refer by way of correction or explanation.

Governor Strong. I have nothing further to suggest as to our evidence. But I do not think that my colleagues and I would be satisfied to conclude this hearing without expressing our very great appreciation of the opportunity to appear before the Commission, and for the privilege of being able to make possibly some small contribution to its work. I think personally I should say from my own experience at home that no greater service can be perfomed to India than what has been undertaken by this Commission. The first 20 years of my banking life in New York stand out to-day as the experience of passing through recurrent years of strain, of anxiety and of disaster which the accomplishment of our reforms seems finally to have enabled us to escape, notwithstanding the occurrence of the worst war in history. So may I conclude by saying that we all feel great admiration and respect for the eminent men who are willing to lay aside important business and other obligations and devote themselves, as you gentlemen are doing, to a great service to the 300 million people of India.

Chairman. We are very much obliged to you and your colleagues for your assistance, and for taking so long a journey to put that assistance at our disposal, and for the very generous measure with which you have put your time at our disposal in the course of the last four days. I am sure I speak on behalf of all my colleagues when I say that I feel most profoundly that you have been of the greatest possible assistance to our deliberations.

PRIVATE.

ACKNOWLEDGED
JUN 22 1922

Bank of England

ACKNOWLEDGED
JUN 12 1922
B. S.

31st May, 1922.

My dear Strong,

I send you a copy of the Report of the Financial Commission of the Genoa Conference and I have sent another to Governor Harding.

I must call your attention to Resolution 15 of which I was not aware when we were discussing these questions and as to which I should be glad to hear your views. But I do not think the suggestion in the Resolution need embarrass you as you already enjoy an adequate Exchange market.

With kindest regards,

Yours most sincerely,

M Norman

Benjamin Strong, Esq.

N/S 4/13/22

before my departure. I am looking forward to our meeting and to the opportunities that we shall have to discuss many subjects of mutual interest.

Until then with warmest regards,

Believe me,

Yours most sincerely,

M. Norman.

Benjamin Strong, Esq.

I hope to land in N.Y. on May 3rd or 4th & as you will then be in Washington perhaps you could arrange for someone to engage hotel-accomodation (not forgetting my Dick) & to let me know about it on arrival at the dock. M.N.

Allied Governments. One is the threat of occupation of the Ruhr. All others are subordinate to this threat. Do you seriously believe that the Reichsbank, except backed by all of the authority that may be exerted by the Allied Governments, can accomplish what is desired simply by the appointment of a technical advisor, whether neutral or otherwise, whose duty it will be to see that the printing press is limited in its operations? I frankly can't see it, and the proposal impresses me as being subsidiary to the main issue, which is whether the influence of the Allied Governments will be sufficient to induce the German Government to impose sufficient taxes and to float sufficient permanent loans to meet reasonable reparation obligations, or whether, failing to do so, France is to be allowed to send an army into Germany. Sympathizing without reservation with the principle which you suggest in regard to the Reichsbank, I cannot help feeling that practically the arrangement will not be effective however it may be attempted. In a later letter I shall make some reference to this in so far as it affected my reply to your cable regarding the gold credit.

It has undoubtedly occurred to you that the ultimate limitation upon reparation payments by Germany is the ability not of Germany to pay in an economic sense, but the willingness of the German people to maintain a reasonably sound Government in office which is willing to carry out a reparation program that is sound, and that pressure for the imposition of a program of reparations beyond that point of willingness will result in a government which will be incapable of making any payment of consequence. It has struck me recently in reading press despatches from Germany that the factor of safety in this respect is being dangerously reduced.

My dissatisfaction with this, and other letters that I am dictating to you today, arises from the fact that they cover essential matters which we should quietly discuss and for which letters are a very inadequate vehicle in which to express ones views in detail.

Yours very sincerely,

Mr. Montagu C. Norman.

upon the banks and cannot be resold. In other words, they must be sufficiently unprofitable to restrain the banks from holding them but sufficiently profitable to induce the public to buy them; and, that is exactly what happened with this issue. It will give you a line upon our market sentiment and conditions, because commercial paper is selling at 7 1/2%, the rate for stock exchange call loans is from 6 to 7%, and the rate for prime bankers bills about 6%. The general feeling of uncertainty about the goodness of commercial loans and credits induces many individuals and corporations to buy Treasury Certificates, which is also indicated by the fact that the year certificates sold in larger volume than did the six months certificates.

I want to give you a little view of general business conditions. With but few exceptions, prices are still falling. The steel business is literally going to pieces, the United States Steel Corporation now operating considerably under 50% of capacity, and the independent steel mills somewhere from 20 to 25%. Such business as is being taken I believe represents considerable cuts from quoted prices, but steel prices cannot go very much lower so long as labor rates are maintained, and that wage policy seems to be the policy of the Steel Corporation to the "last ditch." Common labor in New York has now been much reduced. We are undertaking to get figures on wage reductions and until they are assembled I shall only say generally that the cost of labor is coming down, but the real crisis in the wage adjustment will probably not arrive until the railroad labor problem has been dealt with. Railroad traffic has literally melted away. The earnings of a very large percentage of the mileage represent little, if any, margin over operating costs, and the railroad companies, in despair, are making an earnest drive not only to reduce labor costs, but to make it more efficient, and also to get rid of the useless working men who were forced upon them during the period of Government operation, who do little more than stand around and draw a day's wage for a very few hours work.

The great price reductions of which we have kept you advised are now being reflected in the annual statements of condition of the large borrowing firms and corporations. They show losses on inventories of such extent as to make it difficult for the commercial paper houses to sell the usual volume of commercial paper which these concerns generally float in the market; and, of course, the pressure on the larger banks where these borrowers keep their bank accounts is by so much the greater. All of that we feel in New York more than in any other part of the country. The decline in cotton, wool, meat, copper, etc., has been extremely severe, and, probably, in these and some other important commodities quoted prices are below cost of production. There are bright spots here and there. One of them is in the retail trade which keeps going astonishingly well, considering that prices have not yet been very much reduced. But, it is a fact that new goods are coming along at very much lower prices, due to the reduced cost of raw material, and these goods, in competition with old stocks, are having a competitive effect upon retail prices, which are, and will continue, declining.

If there had been no Federal Reserve System in this country, bankers would now be insisting that borrowers pay their loans, and, were this to force sacrifice sales of inventories at present quoted prices, we would have a long list of insolvencies, closing mills, unemployment, etc. The assurance given to bankers generally by reason of the existence of the reserve system has resulted in a much more temperate and courageous treatment of this whole credit situation than in past times of crises, and makes one hopeful that we may escape the worst effects of this period of price reduction.

Temporarily, our reserves show improvement due to the last certificate sale, collection of income taxes, etc. I shall not explain the technical reasons which cause this, but it is usually the case on our quarter days, and we are taking advantage of this occasion, when our reserve percentage is artificially enlarged, to change the method of calculating reserves, to one much sounder in principle than the method formerly employed, which has the effect of reducing the reserve percentage about 1 1/2%. This will show when the effect of the Government's borrowing and tax collection wears off.

There are certain special matters mentioned in your letter that I must refer to.

As to Soviet Russia; we get intimations that gold from Russia is creeping into us through various roundabout channels. They say some is coming through Mexico, that some is coming from Sweden, and even France. It is a difficult matter for us to deal with and we have put the responsibility squarely up to our Government. If the gold is melted, say, in Sweden or in France, or in Mexico, or even if they receive Soviet gold, but keep it and ship us their own gold in place of it, how can we very well check the movement? They might even ship us their own coin for an amount equivalent to the amount of Russian gold received. This whole gold matter is giving us a good deal of concern. We have received from the present movement over the past twelve months, or so, $135 millions in excess of what we have exported, and it still continues to come. Hence my cable to you, the reply to which has just reached me. I shall write separately on this subject, as we shall likely ask you to help us deal with the matter.

It does not look as though the trade agreement which you have entered into with Soviet Russia will be very popular over here. Certainly, from a distance, it has more of the appearance of a political move than a sound business venture, as our people seem skeptical of the possibility of any desirable business resulting, with the possible exception of such limited sales of goods as may be paid for with "tainted" gold.

The flood of security issues here seems, temporarily, to have been arrested. I guess our markets were getting a little congested. We had quite a number of foreign loans, and some domestic loans, all of which were going pretty well until a few weeks ago, when one or two failures, or at least only partial successes, slowed up the offerings.

I am interested in what you write about the Imperial Bank. Possibly you have talked with the Secretary of State for India, and he may have told you what I said to him after you left London. I have gone over the memorandum entitled "Central Banks," numbering the paragraphs from one to twelve, and enclose a memorandum in reply, to which I have added paragraphs 13, 14, and 15, which I hope will be of some aid. Your own memorandum covered the ground pretty thoroughly. While I was in India, although not attempting to make any special study of the subject, I was struck by the absence of a well organized method of dealing with the domestic exchanges, collections, etc. The Imperial Bank with its system of branches, and with its expert knowledge of native credits, and of the inland bill, should be in a position to deal with domestic collections and exchanges better than any other. Such a scheme could be made to synchronize with currency and redemption operations, and, I should think, would very much stabilize banking operations. I was told that large denomination Rupee notes are sometimes sold at a premium in various sections of India, because of their convenience in effecting interior settlements. Possibly the Imperial Bank might take a leaf out of our book in this matter, but the important thing is to persuade them, or require them, to conduct their operations in London with you, in harmony with your policy, and so as to avoid such a situation as has developed in Australia.

As to the latter, we were having such difficulty in getting settlement of collections and accounts, that permission was granted to our banks to accept finance bills, that is, bills drawn in settlement of collections, and our banks, generally, offered these facilities to their Australian correspondents, but so far as I can learn the offer has not been generally availed of. It might be in the interest of the Commonwealth if the Commonwealth Bank used some sterling balances for the purpose of making settlements in this country. Exchange on New York has been quoted in Sydney and Melbourne at a considerable premium.

Cuba, as you know, has been struggling with a bad banking situation, largely brought on, I fear, by improvident management of the local banks, but to a great extent by the sharp decline in sugar. Their election having been successfully concluded, with General Crowder there representing this Government in a general advisory capacity, I look for improvement. A commission has been appointed, consisting of a few experienced men, to advise the President of Cuba, in regard to banking and financial matters, and the general economic situation, one member of the commission being an old associate of mine, Mr. Oscar Wells, formerly Governor of the Federal Reserve Bank of Dallas, and now President of the First National Bank of Birmingham. He happens to be in New York just now and tells me that conditions are really looking up, although slowly. A new sugar crop will be needed to help them out of their difficulties, and I have no doubt that it will be successfully financed. You know they have no currency of their own, American currency circulating very freely, particularly notes of our Federal reserve banks. Their favorable trade balance has given them command to our paper money, and now they have put an embargo upon its export so that they probably have a redundance in circulation. There can, of course, be no depreciation in this currency, although during the moratorium period checks drawn by depositors upon their local banks have sold at tremendous discounts, some below 50% of their face value, and the effect of this has been to liquidate deposits and loans to such an extent that the condition of some of the banks has been much improved.

Unfortunately, we have a situation in the Philippines which requires drastic treatment. I fear it is due to mismanagement, rather than to inherent unsound conditions. You probably have heard stories of the difficulties of the Philippine National Bank. We are urging our Government to step in and take authoritative control and give necessary assurance to the bank's creditors that their interests will be taken care of. Their difficulties largely grew out of speculation in exchange by the manager of their Shanghai branch, as well as making some slow loans in Manila. If our Government takes vigorous steps to clean up the situation, I have no doubt it will be handled without loss to anyone, except possibly the Philippine Government; that is, the stockholders, of which the Government is the largest.

What you say of Mr. Kiddy's correspondence I really understood without hearing from you. It would, as you say, be a thousand pities if our two institutions were accused of getting up a "money trust." I have always taken the position that both you and we had three possible courses in our relations with each other: One was to deal wholly independently with our respective problems, without any relations, and in complete ignorance of what the other was doing, in other words, to ignore each other; another might be to pursue a wholly selfish policy, each disregarding completely the interests of the other, and possibly pursuing a policy antagonistic to the other; and the third might be to adopt a policy of complete understanding, and exchange of information and views, and to cooperate where our respective interests made it possible. How can there be any choice between these three, nor any ground of complaint, so long as we are right and not afraid of our critics?

As I explained to you in London, we keep no register by numbers of our note issues. The only exception being gold certificates of large denomination, where records, I believe, are kept by the Treasury Department, but these of course are now very little used, the great bulk of the certificates being in the hands of the Federal reserve banks. We have always felt that the advantage gained in keeping such a register was trifling in return for the enormous cost involved in a country where the volume of currency in circulation is so great as with us.

I am so glad that you had a nice visit with Ben. A letter recently received from him gave a glowing account of your hospitality and his reception at the bank. I consider it a great compliment to him, and to me, that you should have given him the opportunity to lunch with the directors, and appreciate it as thoroughly as he did, which is a great deal. Ben and his brother returned from Europe Saturday, both of them looking exceedingly well and very glad to be back home. Also, many thanks for the little parcel which I will greatly value, more even that you realize, although I had circumvented your modesty about your picture during a recent visit with Moreau Delano, when I found that he had an extra one, which he was good enough to give me.

I expect shortly to write Sir Ernest Harvey in regard to the attemps at forgery. He was good enough to send me a report, and the people in our Bureau of Engraving and Printing, I hope, will have some suggestions to make about ink, with a view to protection.

The Winslow bill authorizing a more prompt method of repaying the Government's debt to the railroads has been passed and became law. We expect the present payment to be about $200 millions, and ultimate total payments of about $340 millions, on this score. But, after all, this ends railroad payments, whereas during the last twelve months, or so, the railroads, one way or another, have taken a total of one billion dollars out of the Treasury, so you see there is an encouraging outlook as to Government expenditures on that account.

Just now there seems to be a gradual influx of foreign visitors which has a significant, but I should not say ominous, appearance. British, French and Japanese are here or coming. Very privately and confidentially, all that I have been able to learn of the policy of the new administration in matters in which you and we are both interested, is rather encouraging in the belief that it will be neither Bourbonistic nor reactionary. I am sure that they want to do the right thing, but they will suffer through having so few of the old responsible heads of the Government at hand, who know the history of the past. We have, on the whole, a very good Cabinet, and the juniors for the various departments, I learn, are being chosen with great care. I sincerely hope that we may shortly start upon a period of constructive work of reconstruction, and that this country will do its share.

I am not at all hopeful about the Ter Meulen scheme and have become discouraged of the success of the proposed large export credit corporation which is being organized under the provisions of the Edge law by the American bankers. This scheme has encountered rough weather, the banks are hesitating about subscribing to the stock, and, I fear, that it will make but a halting start, if it starts at all. They were a bit too ambitious, apparently, and they, in common with Ter Meulen, overlooked the fact that the volume of business to be done is limited, not by the amount of capital which can be raised by stock issues or borrowings, so much as by the quality of the business which is available to be done abroad, and people are now learning that the political risks inherent in Central Europe are still so grave as to require insurance before capital can be invited into such enterprises.

Replying, now specifically, to yours of March 1st, the Prime Minister seems to have encountered the same difficulty which we have all encountered. He seems unwilling to deal with things as they are in this matter of export credits, and prefers to emphasize a hypothetical condition which he would like to create but cannot well create so long as the risks of exchange and political uncertainty are as grave as at present. I cannot for the life of me see what object is gained by asking the bankers to make bad loans and then blaming them and abusing them if they do not make them. I was particularly pleased to get your explanation of the incident, which makes the situation clear enough.

It would be a pleasure to see Lord Chalmers when he arrives if I have the opportunity of doing so. The President has appointed, and the Senate confirmed Mr. Eliot Wadsworth as Assistant Secretary of the Treasury, to succeed Nicholas Kelley, who in turn succeeded Mr. Rathbone, in charge of Foreign Loans. Wadsworth is a very old and intimate friend of mine; a splendid fellow and with considerable knowledge of European conditions, as he was the operating head of the American Red Cross under Davison during almost the entire war period. He was formerly a partner of the firm of Stone & Webster; you will recall meeting Mr. Stone recently in London. He is still one of our directors.

What you say about Ben Guinness was not surprising as most Americans who visit Europe, I fear, assume to know a good deal more about our policy, and about such matters as credit conditions here than is always justified. What I have written you on this subject is absolutely the fundamental and controlling factor, that is, the debt of member banks to the reserve bank. Until that is much reduced, or until we reduce our rates, I hardly see how money conditions can ease. It has been estimated that to reduce the loan and investment account of the reserve banks from three billions to one billion would in turn involve a loan contraction by all the banks of the country, running all the way from four and a half billions to nine billion dollars, according to the varying views of different estimators. My own view is about half way between these two extremes, that is, from six to seven and a half billions, although it is little more than a guess. As a matter of fact, the loans of all of the banks of the country, according to our present estimates, have actually been reduced only something like 4%, while a contraction, such as I have indicated, means about 20%.

In conclusion, and for your own eye, I want to write that my best opinion, just now, is that we should maintain our rates on this side unless we see, as still may be possible, that the pressure is so great that it may force insolvencies that are, what I might call "legitimate." In other words, that are not the result of improvident, reckless speculation, and adventures, but are simply the misfortunes resulting from price declines. If our situation should become serious on that score, it might be that we would be forced to modify our policy. Meantime, a conference of the Governors of the reserve banks has been called at Washington for April 12, when we are going to get down to "hard pan" and discuss a policy for the whole system, exchange views, and, I hope, develop something constructive. It is still too soon to form any estimate of what the policy of our Government, and the country generally, will be as to foreign finance. So many questions are pressing upon us, such as our new tax and revenue legislation, possible tariff legislation, relief to the farmers, a great plan of departmental reorganization, which the President has in mind, (all, you will observe, are domestic questions) that I fear, that the development of a national policy in this particular matter will be of very slow growth. I have dictated the above just as I would talk to you were I at Thorpe Lodge, and apologize for the length of the letter.

With warmest regards,

Sincerely yours,

Montagu C. Norman, Esq.,
Governor, Bank of England,
London, England.

BS:MM

Enc.

If there had been no Federal Reserve System in this country, bankers would now be insisting that borrowers pay their loans, and, were this to force sacrifice sales of inventories at present quoted prices, we would have a long list of insolvencies, closing mills, unemployment, etc. The assurance given to bankers generally by reason of the existence of the reserve system has resulted in a much more temperate and courageous treatment of this whole credit situation than in past times of crises, and makes one hopeful that we may escape the worst effects of this period of price reduction.