FEDERAL RESERVE BOARD

WASHINGTON

September 19, 1917.

Hon. Robert L. Owen,
United State Senate,
Washington, D. C.

Dear Sir:

The Board has given very careful consideration to your letter of the 7th instant and directs me to assure you that while it is desirous of doing anything in its power to relieve the situation of which you complain, it is still unable to see how, under existing conditions, the desired result can be accomplished by requiring the Federal reserve banks to establish agencies in neutral countries for the purpose of buying and selling bills of exchange.

For several months past the Board has made a close study of the subject of foreign exchange, with the view particularly of ascertaining the steps which should be taken to protect our gold reserves. Our situation is complicated by reason of the fact that the United States is now at war, so that we can no longer consider the problem from our own standpoint only, but are obliged to take into account the interests of the other nations with which we are associated in the war.

The British Government is, as you say in your letter, stabilizing sterling in New York by purchasing bills in the open market, but it is not maintaining rates for sterling in other countries. The financial aid extended by our Government has enabled it to continue these purchases, which it contends are necessary to protect it against higher commodity prices. At the same time, the allied Governments and their nationals are constantly buying goods in nearly all the neutral countries of the world, and in most of these countries the trade balance is running against them. As neither the British nor French Government is making any effort to maintain exchange rates in neutral countries, the result is that bills resulting from their purchases seek a market in New York, where they are bought at fixed rates for British Government account. Consequently, purchases made by British subjects or French citizens in Spain or Sweden, may be settled by credits in London or Paris. Bills against these credits are offered for sale in New York, although neither the Government of the United States, nor any citizen of the United States may have been concerned at all in the original transaction. In this way our own favorable trade balances have been wiped out, and our banks have been obliged to make large shipments of gold for Swedish, Dutch, or Spanish account, as the case may be, thus indirectly settling British, French, or Italian transactions in these countries.

I enclose herewith a memorandum (Exhibit A) showing that shipments of gold from the United States to Spain from January to August 1917 have amounted to $88,866,000. The Spanish Government permits the Bank of Spain to set its own price on American gold, which is taken at a figure considerably below its actual value. Several months ago the Board sought to establish relations between the Bank of Spain and the Federal Reserve Bank of New York, and by direction of the State Department the American

Ambassador at Madrid broached the subject to the Bank of Spain, but that institution declared its unwillingness to enter into the proposed arrangement. (See copy of cable sent by Department of State to American Ambassador at Madrid, and copy of the Ambassador's reply enclosed confidentially). The attitude of the Spanish banks, in which they appear to be sustained by their Government, has all along been so hostile to any reciprocal arrangement that it is evident that a Federal reserve bank agency would be permitted to do business in Spain only upon terms agreeable to the Spanish interests, if at all. The situation is further complicated by reason of the fact that there is cause to believe that some of our exports of gold may have been for German account. The order of the President of the United States dated September 7th, which became effective September 10th, a copy of which is enclosed herewith (Exhibit C), authorizes and empowers the Federal Reserve Board, subject to the approval of the Secretary of the Treasury, to pass upon all applications for exports from the United States or any of its territorial possessions, to any foreign country named in the proclamation, of any coin, bullion, or currency, and directs the Board that if, in its opinion, the exportation in question appears to be compatible with the public interest to permit it, otherwise to refuse it. Since the order has become effective the Board has received applications for the shipment of several million dollars of gold to Spain, all of which it has declined to grant, for the reason that the applications do not show that these shipments are essential for the public welfare, but appear, on the other hand, to be the result of arbitrage operations, or an attempt to transfer funds for foreign account. It will be interesting to note the effect of this policy, but it is certain that we will no longer be required to furnish the gold for the settlement of transactions with which we have no concern, and it seems probable that European nations will be obliged to settle their balances among themselves, or else that Spain may increase the list of articles upon which she has placed an embargo.

I enclose herewith copy of a press dispatch to the Journal of Commerce of New York (Exhibit D) which relates to an announcement made by the Department of Commerce, from which it appears that the Spanish Government has prohibited the exportation of olive oil. The Board is informed that the "Trading with the Enemy Bill" now pending in Congress, contains a provision giving the President of the United States the same control over imports that he now has over exports, and it seems probable that the importation of many articles for which we have substitutes or which can be produced in this country will be prohibited.

The whole foreign exchange situation is so unsettled at present, both from economic and political viewpoints, that the Board feels it would be unwise for the Federal reserve banks to establish agencies in countries like Spain and Sweden at the present time for the purchase and sale of bills of exchange. In the Federal Reserve Bulletin for

August 1917, page 582, and for September 1917, page 683, are tables which show that since measures have been taken to stabilize exchange in New York around the present rates, New York and London rates of exchange on neutral points have run practically a parallel course, dollar exchange rates in nearly all cases showing less depreciation than the corresponding sterling rates. (Copies of these bulletins are enclosed, Exhibits E and F). This proves that American currency is more highly regarded abroad than any other, including British.

Your letter was submitted to Mr. Albert Strauss, an exchange expert of international reputation, who is here in Washington as the adviser of the Secretary of the Treasury on foreign exchange matters, and I take pleasure in enclosing a letter from him (Exhibit G) in which he comments upon the points which you have raised. Your attention is asked particularly to that part of Mr. Strauss' letter, (page 4) where he points out that it is unlikely that upon the establishment of an agency in Spain, the daily or weekly demands for the purchase and sale of Spanish exchange would about balance each other; but that, owing to seasonal demands there would be involved a large investment in pesetas at one time, or the heavy borrowing of them at another. You will notice that he states that in normal times peseta exchange was regarded as unstable and dangerous, and that it is now especially so by reason of arbitrary governmental action which is liable to be changed at any time.

The Board has seen no evidences of any widespread demand that Federal reserve banks should be required to deal in foreign exchange.

Interior banks have, as a rule, connections of long standing through which they handle their foreign exchange transactions, and I cannot recall any request made by any bank for additional facilities. The Board has indeed, received a great many communications from a certain importer of olive oil who claims to handle about twenty per cent of the olive oil that is brought into this country; but it has not heard from other importers of olive oil, although it has received occasional letters from wholesale grocers throughout the country, all in practically identical language and which bear every evidence of having been inspired, asking that it establish "a foreign exchange bureau," although no suggestion has been made as to the functions of such a bureau. Mr. Strauss is, and has been for the past ten days, in daily communication with members of the Board and sits with its executive committee as the representative of the Treasury when applications for gold exports are considered. If the functions of "a foreign exchange bureau" are those of investigation and regulation, they are now being performed by this committee.

The Board is of the opinion that the subject of paramount importance just now is the conservation of our gold reserves, to which considerations of individual profit and convenience should be subordinated.

I am, Sir,

Very respectfully,

(Signed) W. P. G. Harding.

Governor.

EXHIBIT "A"

September 15, 1917.

Memorandum for Governor Harding:

Gold exports from the United States to Spain during the present calendar year are shown by the Bureau of Foreign Commerce as follows:

January, 1917	-	$4,444,463
February	"	3,616,827
March	"	4,266,566
April	"	4,400,300
May	"	21,010,802
June	"	15,983,400
July	"	20,327,950
August	"	14,815,700
Total	- - -	$88,866,008

Respectfully submitted,

(Signed) M. L. JACOBSON.

Statistician.

MLJ-McL

EXHIBIT "B"

CONFIDENTIAL.

Copy of cablegram sent by Department of State to American Ambassador at Madrid, Spain.

January 25, 1917.

At request of Governor of Federal Reserve Board communicate to Bank of Spain through Spanish government following: quote: Federal Reserve Board has suggested, in view of difficulty of sending gold to Spain and consequent derangement of foreign exchange market, that it might be helpful if Bank of Spain would consent to establish relations with New York Federal Reserve Bank, acting as its agency in Spain and New York Federal Reserve Bank opening reciprocal account here, offering to earmark gold, keeping it under joint custody and supervision with representative designated by Bank of Spain, until normal shipments are resumed. Unquote.

Copy of cablegram received by Department of State in reply to above from the American Ambassador at Madrid:

February 21, 1917.

Bank of Spain thanks Federal Reserve Board and regrets that it cannot accept offer.

EXECUTIVE ORDER.

REGULATIONS RELATING TO THE EXPORTATION OF COIN, BULLION & CURRENCY.

By virtue of the authority vested in me, I direct that the regulations orders, limitations, and exceptions prescribed in relation to the exportation of coin, bullion, and currency shall be administered by and under the authority of the Secretary of the Treasury; and upon the recommendation of the Secretary of the Treasury I hereby prescribe the following regulations in relation thereto:

1. Any individual, firm or corporation desiring to export from the United States or any of its territorial possessions to any foreign country named in the proclamation dated September 7, 1917, any coin, bullion, or currency, shall first file an application in triplicate with the Federal Reserve Bank of the district in which such individual, firm or corporation is located, such application to state under oath and in detal the nature of the transaction, the amount involved, the parties directly and indirectly interested and such other information as may be of assistance to the proper authorities in determining whether the exportation for which a license is desired will be compatible with the public interest.

2. Each Federal Reserve Bank shall keep a record copy of each application filed with it under the provisions of this regulation and shall forward the original application and a duplicate to the Federal Reserve Board at Washington together with such information or suggestions as it may believe proper in the circumstances and shall in addition make a formal recommendation as to whether or not in its opinion the exportation should be permitted.

3. The Federal Reserve Board, subject to the approval of the Secretary of the Treasury, is hereby authorized and empowered upon receipt of such application and the recommendation of the Federal Reserve Bank to make such ruling as it may deem proper in the circumstances and if in its opinion the exportation in question be compatible with the public interest, to permit said exportation to be made; otherwise to refuse it.

The White House,

September 7, 1917.

(Certain exports in Time of War Unlawful)

BY THE PRESIDENT OF THE UNITED STATES OF AMERICA

A PROCLAMATION

WHEREAS Congress has enacted, and the President has on the fifteenth day of June, 1917, approved alaw which contains the following provisions:

"Whenever during the present war the President shall find that the public safety shall so require, and shall make proclamation thereof, it shall be unlawful to export from or ship from or take out of the United States to any country named in such proclamation any article or articles mentioned in such proclamation, except atsuch time or times, and under such regulations and orders, and subject to such limitations and exceptions as the President shall prescribe, until otherwise ordered by the President or by Congress: Provided, however, that no preference shall be given to the ports of one State over those of another.

"Any person who shall export, ship, or take out, or deliver or attempt to deliver for export, shipment, or taking out, any article in violation of this title, or of any regulation or order made hereunder, shall be fined not more than $10,000, or, if a natural person, imprisoned for not more than two years, or both; and any article so delivered or exported, shipped, or taken out, or so attempted to be so delivered or exported, shipped, or taken out, shall be seized and forfeited to the United States; and any officer, director, or agent of a corporation who participates in any such violation shall be liable to like fine or imprisonment, or both.

"Whenever there is reasonable cause to believe that any vessel, domestic or foreign, is about to carry out of the United States any article or articles in violation of the provisions of this title, the collector of customs for the distrist in which such vessel is located is hereby authorized and empowered, subject to review by the Secretary of Commerce, to refuse clearance to any such vessel, domestic or foreign, for which clearance is required by law, and by formal notice served upon the owners, master, or person or persons in command or charge of any domestic vessel for which clearance is not required by law, to forbid the departure of such vessel from the port, and it shall thereupon be unlawful for such vessel to depart. Whoever, in violation of any of the provisions of this section shall take, or attempt to take, or authorize the taking of any such vessel out of port or from the jurisdiction of the United States, shall be fined not more than $10,000 or imprisoned not more than two years, or both; and, in addition, such vessel, her tackle, apparel, furniture, equipment, and her forbidden cargo shall be forfeited to the United States."

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AND WHEREAS the President has heretofore by proclamation, under date of the twenty-seventh day of A ugust in the year One Thousand Nine Hundred and Seventeen, declared certain exports in time of war unlawful, and the President finds that the public safety requires that such proclamation be amended and supplemented in respect to the articles hereinafter mentioned:

NOW,THEREFORE, I, WOODROW WILSON, PRESIDENT OF THE UNITED STATES OF AMERICA, DO HEREBY PROCLAIM to all whom it may concern that the public safety requires that, except at such time or times, and under such regulations and orders, and subject to such limitations and exceptions as the President shall prescribe, until otherwise ordered by the President or by Congress, the following articles, namely: coin bullion and currency: shall not, on and after the tenth day of September in the year One Thousand Nine Hundred and Seventeen, be exported from or shipped from or taken out of the United States or its territorial possessions to A lbania, Austria-Hungary, Belgium, Bulgaria, Denmark, her colonies, possessions or protectorates, Germany, her colonies, possessions or protectorates, Greece, Leichtenstein, Luxembourg, The Kingdom of the Netherlands, Norway, Spain, her colonies, possessions or protectorates, Sweden, Switzerland or Turkey, Abyssinia, Afghanistan, Argentina, Bolivia, Brazil, China, Chile, Columbia, Costa Rica, Cuba, Dominican Republic, Ecuador, Egypt, France, her colonies, possessions or protectorates, Guatamala, Haiti, Honduras, Italy, her colonies, possessions or protectorates, Great Britain, her colonies, possessions or protectorates, Japan, Liberia, Mexico, Monaco, Montenegro, Morocco, Nepal, Nicaragua, the colonies, possessions or protectorates of The Netherlands, Oman, Panama, Paraguay. Persia, Peru, Portugal, her colonies, possessions or protectorates, Roumania, Russia, Salvador, San Marino, Serbia, Siam, Uraguay, or Venezuela.

The regulations, orders, limitations and exceptions prescribed will be administered by and under the authority of the Secretary of the Treasury, from whom licenses in conformity with said regulations, orders, limitations and exceptions will issue.

Except as hereby amended and supplemented, the above mentioned proclamation under date of August 27, 1917, shall continue in full force and effect.

IN WITNESS WHEREOF, I have hereunto set my hand and caused the seal of the United States of America to be affixed.

Done at the City of Washington, this seventh day of September in the year of our Lord One Thousand Nine Hundred and Seventeen and of the Independence of the United States of America the One hundred and Forty-second.

By the President,

Secretary of State.

EXHIBIT "D"

NO SPANISH OLIVE OIL EXPORTS

Royal Order Prohibits Shipments of All Classes

Washington, Sept. 12 (Special) -- Spain has imposed further restrictions on olive oil, according to an announcement made by the Department of Commerce today. The Department published the following cable from the American Consulate at Barcelona:

> "Spanish Government by royal order published September 7 prohibits exportation of all classes of olive oil, excepting that already billed at point of origin for railway transportation and that invoiced for maritime shipment, both exceptions conforming to export requirements of royal order reported in this consulate's cablegram of August 13".

(Journal of Commerce, Sept. 14, 1917, p. 2.)

EXHIBIT "G".

September 15, 1917.

Honorable W. P. G. Harding,
Governor, Federal Reserve Board.

Dear Governor Harding:

I have read with great care your letter of September 5, to Senator Owen and his answer to you under date of the 7th, in regard to which you have asked me to express my views.

I think Senator Owen is entirely right in his contention that if we took steps to confine exchange operations between Spain and the United States to the settlement of commercial transactions between those two countries that the Spanish exchange in the United States, and as a consequence dollar exchange in Spain, would rule around normal; which is to say that so long as both countries interposed no obstacles to the free shipment of gold out of each, the exchange rate would fluctuate around the gold value of the peseta by a margin not exceeding in either direction more than the cost of the shipment of the gold. In fact, with the balance of trade between Spain and the United States running heavily in favor of the United States, it is altogether likely that the peseta would sell in the United States at less than the normal gold value of

Exhibit "G".

the peseta. Had these conditions obtained between Spain and the United States, it is altogether unlikely that Spain would have declined to receive American gold except at a discount, because no gold would have moved to Spain from the United States and there would have been no point in any such regulation.

We must not lose sight, however, of the important consequences that would follow from the steps necessary to bring about the above condition of affairs. These steps would involve the absolute prohibition of arbitrage in exchange. Such arbitrage is in effect the sale in New York of cash balances held in France and England, and the remittance to Spain of the proceeds of the sale of such foreign balances. While it is true that such transactions are undertaken by banks and bankers for the profit involved in the transaction, the transactions would not be possible except for the fact that the underlying transactions respond to a real need of the situation. These underlying facts are that we are at the present time paying to Spain in gold, debts due to that country by England and France. These payments are made by us out of the advances made by us to our Allies, and they are made in gold because of the fact that neither France nor England are permitting the export of gold at the present time. France, I believe, has an absolute prohibition on the export of gold; and England, without a formal prohibition, is preventing the export by the concerted action of its bankers and the influence of the Bank of England. I believe both France and England feel that they

Exhibit "G".

can not at present, with due regard to the safety of their own financial structures, part with gold, and yet they must pay for essential purchases made in Spain. I understand, though I have no direct knowledge of the subject, that their purchases are for materials absolutely needed for the support of their populations or for the presecution of the war. The Spanish Government is unwilling to receive American gold and mint it into pesetas except at a discount of some six or seven per cent. This is a suspension of the free coinage of gold and amounts in effect to a change by the Spanish Government in the mint value of the peseta. This is, of course a hardship on persons owing money in Spain, where it appreciates the value of the coin in which they are obliged to make payment. Apart from the question of fairness in thus changing their standard of value, the position of the Spanish Government is probably wise, as the effect of this prohibition is to prevent, to a certain extent at least, an inflation and a consequent rise in domestic prices. I am told that the price of olive oil in Spain is now only twenty-five per cent higher than it was before the outbreak of the war. Such a rise, of course, is very moderate compared with the rise in commodity prices that has taken place during the last four years with us and in other countries that have suffered price inflation.

I see no remedy for this situation except such control of all operations in foreign exchange as will reduce our exchange relations with every country to the settlement of our direct trade balances with that country. It may be that the increasing complexities of inter-

Exhibit "G"

national intercourse may gradually force us to take such drastic action. In the meantime, however, there are certain other steps which might help this situation, such as an effort to make it profitable for the Spanish banks or Spanish Government to invest or to leave in the banks of this country the large credit balances that are arising here in their favor. I know that this whole subject is engaging the constant attention of your office and of yourself.

I do not think that Senator Owen's suggestion that the Federal reserve banks establish an agency in Spain would remedy the situation unless at the same time steps were taken to prevent arbitrage transactions through sterling and francs; and if such steps are taken I think that the effect which the Senator has in mind would be brought about without the establishment of an agency in Spain. Senator Owen assumes that with the establishment of an agency in Spain the daily or weekly demands for the purchase and sale of Spanish exchange would about balance each other. Without having myself any detailed knowledge of the subject, I believe it is more likely that there would in certain seasons of the year be a large demand to pay for certain imports and at other periods of the year a large supply for the purpose of collecting the proceeds of the sale of exports, and that there would be involved a large investment in pesetas at one time or heavy borrowing of them at another. Even with an agency in Spain, I doubt whether the Federal reserve bank would find it wise to carry heavy balances or to borrow large amounts. In normal

Exhibit "G".

times, before the war, peseta exchange was most unstable and dangerous, and it is so now where commercial conditions may be complicated by arbitrary Governmental action.

My understanding has always been that the provision in the Federal Reserve Act empowering the Federal Reserve Banks to deal in foreign exchange and establish foreign agencies, was for the purpose of permitting the Federal Reserve Banks to employ their funds in foreign markets with a view to their control of the discount rate and to put them in a position where through their holdings in foreign bills they might be able to minimize the movements of gold between New York and foreign markets. I do not understand that this provision is intended to put the Federal Reserve Banks into the exchange business in competition with private banks and bankers. As a matter of fact, there is ample competition in the exchange field. There is no business that operates normally on a smaller margin of profit. The margin of profit is so small that over ten years ago my firm stopped dealing in foreign exchange, as they did not think it worth while to continue. Of course, at the present time, the margin of profit is often very considerable, but this margin arises out of the unusual risks connected with the business, such as fluctuating insurance rates, interference with cables,(so that it is impossible

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to close transactions on both ends with any degree of certainty) and the arbitrary actions of Governments in restricting gold movements as well as changing mint regulations, so that the margin where large, represents in effect a speculation.

Yours very sincerely,

ALBERT STRAUSS.