

Excerpt from a letter received by  
the Federal Reserve Board.

"The enormous demand for raw materials owing to the war and the resulting high price of them has made the Neutrals creditors of the Allies and as the export of gold, the usual medium of settling adverse balances, on has been largely prohibited rates of exchange on the United States and our Allies are ruling at a considerable discount in the neutral countries. This discount has increased to us the cost of the very necessary raw materials at least the amount of the discount. All the Allies including ourselves have endeavored by arranging special credits, that is by borrowing money in those countries, to keep the exchange from being too much against us, just as England before our entry into the war, ~~after~~ having sold us all the securities that she could, borrowed heavily in this country to buy our necessary products.

My suggestion is that we change our recent policy and settle balances in gold. I well understand the fear that if the war lasts a long time we shall find our gold being depleted and our reserves endangered. This fear is, I think, based on the fallacy which I had hoped had passed with the enactment of the Federal Reserve Act that a fixed proportion of gold or legal tender must be held absolutely intact against outstanding bank notes or deposits. The strength of a bank is not in its proportion of cash reserve but in the character of its loans and discounts and in its reputation. It makes no difference if its cash is 60% or 10% of its liabilities provided this proportion is large enough for the public to feel confident that they can obtain the kind of money that they wish when drawing their deposits or when presenting notes for payment. Fortunately in this country our people are not accustomed to the use of gold, so that a removal of what are practically restrictions on gold payments would not result in any withdrawals of gold except for export.

How much would be withdrawn for export to settle our exchanges? Our Allies would not withdraw gold as the exchanges with the Allies are still very much in our favor. With Holland, Switzerland, and the Scandinavian countries our imports have nearly ceased and if necessary we can prevent gold going to these countries as contraband. With Spain now that withdrawals of German deposits to that country are being prevented and the army purchases have been covered by a special loan no large withdrawal of gold need to be expected. The European neutrals want our products not gold which is at a discount with them owing to its superabundance. The South American countries alone will take our gold, and this is especially true of Argentina.

Suppose fifty, or even one hundred million dollars in gold were shipped during the next year to Argentina, this amount would not materially effect our enormous stock of gold or reduce materially the sixty per cent of gold which is held against the Federal notes. Only forty per cent was contemplated by the Federal Reserve Act so that the amount is now one and one-half as much as was planned. A reserve is of no use except as it gives credit and as it is used. Forty per cent gold, or even less will amply protect our credit.

Besides the obvious savings in the purchasing power, by having our dollar worth its gold equivalent in foreign countries, which would result from free export of gold, the general credit of this country would be wonderfully strengthened in foreign countries both during the wartime and afterwards. There is nothing that hurts the credit of a country and its merchants so much as a depreciated currency and a refusal to pay in the international standard of value, namely gold. We have been endeavoring to build up our commerce with South America, but unsatisfactory delivery of merchandise and the refusal to ship gold has given its people a bad opinion of our country and its merchants.

Moreover, if the neutral countries were certain that they could obtain gold from this country, they would not want it. They all have more gold than ever before and they have no use for more. If our credit was good, they would have large deposits with our banks or instead of rediscounting at once in this country all time bills of exchange on the United States, their bankers would have such bills held for their account so as to earn the interest, just as our bankers before our entry into the war held large amounts of long Sterling bills. England, besides paying for a portion of the necessary supplies from the United States in gold, also thereby reduced rates of interest in this country so that we held her bills and loaned the government money. It seems to me that this would work in exactly the same way in the neutral countries. Not only would we pay for products which we need with gold, which we do not need, but re-establish our credit and by lowering interest rates in the neutral countries, induce their people to place their funds in this country and thereby stop their demand for our gold. In fact, I doubt very much if it would take nearly fifty millions of gold to rectify the exchanges with Argentina or even with the whole world. If this is so, it seems extremely foolish for the United States to pay interest on loans from Spain or Argentina and still have to pay a premium of from 10 to 25% on its purchases, owing to our depreciated exchange, and also to ruin our credit as a nation, not only for now, but for all time.

(August 29, 1918)