FEDERAL RESERVE BOARD

STATEMENT FOR THE PRESS

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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 the 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 reëstablished 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 those 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 10½d per ounce gold of standard fineness, that is, in units of about £1700. 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 it is 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 reached 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 $1\frac{1}{2}$ 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 of 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 one per cent of parity at the time of the announcement of the resumption of gold payments.

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 problems 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 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 of one 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, then 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. 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 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 movements will exert an influence toward 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.