

**THE NEW MONETARY SYSTEM
OF THE UNITED STATES**

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THE NEW MONETARY SYSTEM OF THE UNITED STATES



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FOREWORD

BY proclamation on January 31, 1934, President Roosevelt established as the monetary unit of the United States a new gold dollar consisting of 15 and 5/21 grains of gold nine-tenths fine, or approximately 41% less in gold than the old gold dollar.

This action restored to the country a monetary system using gold formally as its base after eleven months of confusing monetary conditions during which gold payments were suspended.

The monetary system established by this action is avowedly novel. Based on the Gold Reserve Act of 1934, together with other monetary and banking legislation enacted since March 4, 1933, it involves changes in domestic monetary and banking arrangements that are unique and unprecedented in American monetary development. This legislation gives extraordinary discretionary control over the nation's supply of money and bank credit to the President and the Secretary of the Treasury.

The new monetary and banking system is based on gold but designed in theory to allow the free play of domestic and international financial forces to influence the supply of money and bank credit only to the extent that such freedom contributes to, and does not interfere with, the attainment of national economic objectives. These objectives, the President has stated, are the full employment of the country's productive resources at permanently higher and more stable price levels. Executive control over the supply of money and bank credit is intended to hasten and ensure their attainment.

This form of monetary system is extremely complex, with implications for the economic development of the country beyond any man's ability to perceive. Its ultimate significance and effectiveness will be disclosed only with the passage of time and events.

The present study is intended to contribute to a clearer

understanding of the new monetary system. Its object is to explain and to bring into proper focus the basic monetary policies of the Roosevelt Administration upon which public discussion and controversy have largely centered during the past year. Chapter I is devoted to a cursory review of the development of gold-standard monetary systems. Chapter II contains a description of the new monetary system, as compared with the gold-standard system formerly maintained by the United States. Chapter III analyzes the new plan of monetary management. Chapter IV considers the implications of the new monetary program for national recovery and stability. Chapter V presents the summary and conclusions.

This publication was prepared by Dr. Ralph A. Young, of the Wharton School of Finance and Commerce of the University of Pennsylvania, who has been associated with the Research Staff of the Conference Board in connection with the studies made by the Board in the field of banking and finance in recent years.

In addition, the Board expresses its appreciation for the cooperation of Professor Benjamin H. Beckhardt, of Columbia University, Professors William J. Carson and F. Cyril James, of the University of Pennsylvania, Professor Walter E. Spahr, of New York University, and Professor Ray B. Westerfield, of Yale University, who have critically considered the manuscript in course of its preparation and offered helpful suggestions.

VIRGIL JORDAN
President

August, 1934

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THE NEW MONETARY SYSTEM OF THE UNITED STATES

CHAPTER I

THE BACKGROUND OF THE NEW MONETARY SYSTEM

IN its broadest sense, a gold standard is a system of money in which not only is gold the legal standard of value, but the entire supply of money, whether in the form of coin or currency issued by the government or central banks, or in the form of deposits subject to check issued by commercial banks, is directly related to the supply of gold.

The linking of the supply of money authorized by any government to the supply of gold is the true essence of a gold-standard monetary system. The legal definition of money as a weight of gold and the adoption of a weight of gold as the standard of value are merely an acknowledgment on the part of a government that it intends to maintain the supply of domestic coin and currency and of bank currency in a direct relationship with the supply of gold. All legal arrangements and provisions for the redemption of currencies into gold, in one form or another, for the free and unlimited coinage or monetization of gold, for the unrestricted export and import of gold, and for definite reserve ratios, against currency issues by governments and banks have only this end as their primary objective.

THE BASIS AND EVOLUTION OF THE GOLD STANDARD

In the past, mismanagement of the medium of exchange by the political authorities or by the politically delegated monetary authorities was blamed, almost without exception, for extreme monetary expansion or contraction, which produced violent inflation or deflation and economic and social

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disturbance. After each unfortunate experience, communities have striven to establish for themselves monetary systems over which their political authorities would have a minimum of discretionary control.

Accordingly, by linking their monetary systems to a commodity whose supply was independent of political influences they have sought to impose effective checks on any inclinations of governments to vary the monetary supply by arbitrary measures.

The precious metals, gold and silver, have been singularly well adapted to modern monetary needs. Both possess the qualities that communities have thought desirable for the basis of monetary systems. In modern times, however, the weight of advantage has been with gold. Throughout the ages, gold has existed in less abundant known supplies than silver and it has been universally accredited with a higher value. Moreover, it has had a higher value in proportion to bulk than silver, and this compactness has made it more readily portable and storable and caused it to be held in higher esteem by the public. Gold, therefore, has gradually been established as the ascendant commodity for monetary systems.

The preference for gold over silver as a money metal was increased by the unsatisfactory monetary experience of countries that endeavored to use simultaneously both gold and silver in their money systems at some fixed ratio. Bi-metallism introduced a sort of monetary instability, caused by the displacement for monetary purposes of the metal relatively scarce by the metal temporarily abundant. Owing to variations in the production of gold and silver, one or the other metal was in fact the basis of the monetary system, regardless of the requirements of the law and regardless of all efforts of the monetary authorities to promote the concurrent use of the two metals.

Another factor in the ascendancy of gold was the establishment of a gold-standard monetary system by England early in the last century. This action by the leading commercial, industrial, and financial power of the world set an example for monetary organization that was followed in subsequent decades by other important countries. More than

setting an example, however, this action operated seriously to disturb the prevailing monetary systems of other countries which were mainly bimetallic in character. England was the foremost industrial and creditor country of the world. London was the world's leading financial center. Thus England tended to act as a magnet for gold and rendered difficult the effective maintenance of bimetallism by other countries.

A contributing factor making gold the predominant standard for modern monetary systems was the great extension of international commerce in the nineteenth century and the increasing importance to the more advanced industrial nations of Europe of the development of foreign markets and foreign sources of foods and raw materials. Since the development of international specialization and trade was immensely aided by the maintenance of a stable exchange relationship between currencies, there was a world-wide tendency to accept gold as the standard money metal in order to provide exchange stability. Exchange stability so established made possible the distribution and employment of the world's productive resources under the guidance of commodity and service prices expressed in gold. In this way, it facilitated the attainment of balance between domestic economic activities and those of other countries to the mutual gain of all concerned.

In its early development internationally the gold standard was usually established merely by the definition of the basic monetary unit as a weight of gold, by the provision for free and unlimited coinage and smelting of gold, by the allowance of complete freedom in the shipment of gold, and by the definite legal restriction on the issuance of other coins and paper currency, together with provision for their convertibility and redemption into gold. Various modifications came to be introduced in particular countries with the passage of time, but it was not until the post-war period that the pattern of the gold standard came to be widely altered and changed.

GOLD AND THE MONEY SUPPLY

Before the World War, most nations that maintained a gold monetary standard had gone a considerable distance in

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pushing gold into the background as an actual medium of exchange. More and more, gold was replaced in active circulation by fiduciary and representative currency, by subsidiary coin, by notes of central banks, and in some countries by notes of private banks, and by deposit currency or checks. In most countries, in fact, the bulk of domestic transactions had come to be made in non-gold money, and a fairly sharp distinction was recognized between the actual money of payment and money that was standard for payment, or gold. For all practical purposes, however, the two forms of money were equally satisfactory. Free and unlimited convertibility of one into the other, provided by monetary legislation or the requirements of business practice, assured under ordinary and stable conditions that any money of payment could be turned into gold money on demand.

The typical monetary system was made up of a basic fund of gold money, an additional fund of money based on government credit, and a further fund supplied by central and commercial banks on the fractional reserve principle. Such elasticity as obtained for the monetary supply, rendering possible its expansion and contraction in accordance with the short-period fluctuations of business, was provided more or less automatically by the activities of commercial banks and by the discount and note-issuing operations of central banks. These institutions, particularly central banks which were vested with a special responsibility for the adequacy and convertibility of the monetary supply, consciously endeavored to maintain a margin of gold reserves sufficient for this purpose. In this effort they were necessarily obliged to adjust their operations to international forces tending to enlarge or contract domestic holdings of gold.

Over long periods of time, however, expansion of the national monetary supply, paralleling the growth of production and trade, was largely dependent on the available supply of gold. When the domestic gold holdings restrained the monetary supply too severely, or caused its contraction unduly, new changes in the monetary laws extending the employment of non-gold money, new schemes for effecting transactions without the direct use of money, and modifications

in the reserve practices of central and private banks were frequently employed to yield in some degree an additional measure of long-run expansibility.

The World War and the financial problems which it created for governments, both during and after the period of actual conflict, forced a wholesale delivery of the world's monetary systems from the restrictions imposed by the gold standard. The monetary excesses which accompanied the escape from gold, even though forced by the exigencies of war and the post-war finance of governments, led to a widespread demand for a renewed linking of the money supplies with gold in order to restrain further excessive variations in the quantity of money and to re-establish monetary systems that would be inter-connected so that the recovery and development of commerce and free international movement of capital might be promoted.

THE POST-WAR RETURN TO GOLD

Owing to war and post-war changes in the pattern of world political and economic organization, gold-standard systems adopted by one country after another in the first post-war decade differed radically from those obtaining before the World War. Furthermore, the general readoption of gold monetary systems, after an era of extreme monetary instability, was naturally accompanied by widespread discussion and searching criticism of the use of gold as the controlling basis for monetary organization. The post-war gold-standard forms and practices were greatly influenced and modified by this discussion and criticism. As evolved from the past, a gold-standard monetary system was merely a system for assuring that the monetary supply would not be pliable under momentary economic and social pressures and for providing an effective binding link between national economic units. Monetary and price instability, originating in changes in the world's gold supply or in shifts in the distribution of the gold supply among the various countries, was regarded as a natural accompaniment of gold monetary systems.

Post-war financial thought was preoccupied with two main

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sources of apprehension over the readaptation of gold as the basis for monetary systems. The first source of concern was the possibility that the world might be confronted within a foreseeable period by a scarcity of gold. The second was the feeling, based on experience with gold monetary standards in the past, that individual monetary systems might be subject, under new conditions, to undue contractive and expansive pressures from capricious gold movements growing out of temporary domestic and international disturbances. Both sources of apprehension were obviously rooted in fear that prevailing price structures, measurably inflated from pre-war times, might be slowly or precipitately undermined by pressure on monetary systems from long-run and short-run variations in the available supply of monetary gold. These apprehensions formed the basis of the principal modifications in gold-standard forms and practices during the post-war decade.

THE PATTERN OF THE POST-WAR GOLD STANDARD

The important post-war modifications, although generally familiar, merit specific review in connection with any objective appraisal of the new American monetary system. They are as follows:

(1) Gold was almost entirely removed from its pre-war position as an active medium of domestic exchange and was confined to monetary service in the settlement of international balances and as reserves against domestic currency issues. In some countries this was accomplished as a matter of practice and policy; in others, which baldly adopted a complete or partial gold-bullion standard and abolished or subordinated the institution of gold coin, it was made in effect a matter of law.

(2) Inconvertible currency issues of governments and central banks, necessitated by the financial exigencies of the war and post-war periods, were consolidated under the administration of central banks. In order better to accomplish this task, central banks were equipped with fairly liberal, though inflexible, fractional reserve provisions by law, and they were given the power of active and continuous manage-

ment of domestic monetary supplies independently of the political authorities.

(3) Many countries, notably those in the weaker financial class, permitted foreign assets and short-term investments in foreign markets of high gold-standard integrity to be included as currency reserves along with gold. Central banks were thus empowered in many cases to convert or redeem domestic currency for international exchange purposes in either gold or foreign currencies.

The principle underlying the development of the typical gold standard, as modified after the War, stands out clearly from the foregoing summary. It was simply to attain a maximum independence of the domestic monetary supply from the supply of gold through the centralization of monetary control and management and at the same time to secure whatever commercial advantages might accrue from international monetary co-operation under which stable exchange rates between national currencies were maintained with the help of gold. The popular demand for a return to the gold standard, as an automatic safeguard against arbitrary variations in domestic monetary supplies, was in this way reconciled in theory with the prevailing apprehension (1) over a future shortage of new gold available for monetary purposes and (2) over the possibilities of monetary instability caused by sudden shifts in the distribution of the existing gold stocks.

DIFFUSION OF THE MONETARY BASE

The evolution of gold monetary systems in the past has been toward the diffusion of the monetary base to include other assets besides gold. These assets represented loans on various commodities at different stages of production; advances or investments based ultimately on durable productive wealth accumulated from past production; and investment participation in the public debt. The trend in monetary systems, therefore, was definitely away from the use of gold as the primary active money or the predominant base for other domestic money, even though gold was retained as the legal standard of value and ultimate monetary base.

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Monetary systems were thus tending to be based on commodities and wealth in general rather than on the one commodity, gold. Even before the War monetary gold stocks of the world constituted only about 24% of the total world's supply of domestic money for gold-standard countries. In 1928, this proportion had shrunk to nearly 15%.¹ The fact that gold was retained at all was due mainly to three factors: (1) it had a traditional status in society as a peculiarly representative form of wealth owing to its long usage for ornamental purposes and as a store of value, and hence its presence inspired public confidence in money and monetary organization; (2) the popular belief endured that gold furnished a convenient and largely effective check on undue variations of the monetary supply, or that in any case it furnished a protection against arbitrary monetary manipulation by political authorities; and (3) its international acceptability and marketability made it a suitable medium for the service of international exchange and practically the only commodity generally adaptable as the common legal monetary standard for linking national monetary systems into an international system.

SOURCE OF THE DIFFUSION OF THE MONETARY BASE

Bound up with the tendency toward the diffusion of the monetary base was the progressive development of commercial banks and central banks of issue. Trading book deposits, convertible into cash on demand or on short notice, in exchange for promissory notes, commercial bills, and investments, as well as cash, commercial banks provided an ingenious mechanism for economy in the use of actual money and for the introduction of the check system by which deposits could be transferred from one person to another without the formal use of money. By virtue of their ability to operate effectively on the basis of fractional reserves against deposits, the development of commercial banks and the gradual perfection of their technique continuously injected

¹ Including demand or sight deposits of commercial banks. League of Nations, "Interim Report of the Gold Delegation of the Financial Committee," 1930, Annex XIII, Appendix V, p. 120.

an element of expansion in active, as distinguished from gold, monetary supplies.

Central banks, frequently evolved from commercial banks and functioning in part as such, contributed an even more distinctive element of chronic expansion to domestic monetary supplies, since they possessed the special privilege and usually the monopoly of note issue. By the nature of their special position, they became primarily bankers for commercial banks or were chartered as such, holding by practice or by law the larger share of the money reserves of commercial banks as deposits. Operating on a fractional reserve basis, but largely unmotivated by profit, they created currency—notes or central bank deposits—by the process of loaning or rediscounting, mainly in response to the demands of commercial banks and in exchange for their assets. Central banks thus furnished a reservoir of non-gold domestic money that could be drawn on by commercial banks and used as a basis for their operations in the event that unusual demands on the part of the business public drained away their own money assets or in the event that the public demands for a larger volume of credit money persistently exceeded their own capacities, as determined by their cash reserves, to supply such additional funds. In this manner, central banks developed into buffers for commercial banks and protectors of the domestic monetary supply for whose creation and growth the operations of commercial banks were largely responsible.

This role of central banks, which was only slowly recognized,¹ came to be of increasing importance because of the fact that non-gold money, created through the medium of banks, even though based ultimately on commodities in the process of production and accumulated durable wealth, was immediately based on credit or debt. The flexibility of the monetary system was thus greatly reduced.

Credit or debt money, pyramided on a small fraction of formal or gold money, was ordinarily expansible to a high degree, but it was not equally contractible. The liquidity of

¹ In the United States, only with the establishment of the Federal Reserve System, and in many other countries, only with the establishment of central banks after the War.

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debt was necessarily contingent on the activity of trade and the level of prices, and its liquidation in volume could only proceed slowly without the incurrence of loss. In the case of banking institutions loss had to be avoided or minimized at all costs in order to escape a collapse of the banking mechanism, because banks were not only the source of credit money but were also debtors. In fact, they were debtors whose obligations were payable on demand or short notice, whereas their assets, excluding a nominal fraction of cash, were mainly realizable only over the course of time. Although with the advance of the banking technique commercial bank deposits tended to be increasingly short-notice or demand rather than savings deposits, the average funding period for bank assets was more than compensatingly extended; that is, their portfolios included an increasing share of investment paper. Commercial banking systems throughout the world displayed the common tendency to decline in liquidity in this special sense. They depended, therefore, in a greater and greater degree on public confidence and on their ability to respond to unusual demands for the redemption of their liabilities into formal currency by access to central banks.

THE TREND TOWARD MANAGED MONETARY SYSTEMS

As a result of the diffusion of the monetary base under modern gold-standard systems, growing out of the operations of commercial and central banks, and the preponderant role assumed in such systems by credit money, the need for a continuous system of management of domestic monetary supplies became more and more urgent. The force of circumstances and the key positions that central banks held in monetary organizations compelled these banks to provide this management. They were the repositories—in the post-war period, usually the sole repositories—of domestic gold supplies and they furnished the mechanism through which domestic money, whatever its character, was convertible into gold. Furthermore, their discount, investment, and note-issue or deposit-creation operations furnished domestic monetary systems with an elasticity to adjust money supplies

to seasonal, cyclical, and even long-period variations in trade. Finally, they acted to give continuity and stability to domestic monetary supplies by counteracting or cushioning, intentionally or automatically, international gold movements arising out of trade and capital flows among countries.

Because of the acceptance of gold as the standard commodity base for money under gold-standard systems, the deeply imbedded social tradition with respect to gold, and the common fear of excessive variability of the money supply, the available supply of gold and not the will of the central bank was the final or ultimate arbiter of the quantity of domestic money. Central banks, accordingly, were definitely limited in providing temporary elasticity and long-run stability or expansibility for the supply of domestic money. They were bound by necessity to maintain ample reserves in gold and to regulate the volume of domestic money in accordance with their gold reserves. Their responsibility and the aim of their management, therefore, were to assure that domestic monetary supplies did not exceed the bounds of safety, as set by their gold reserves and by their experience with demands for actual gold growing out of domestic and international trade under varying degrees of activity and confidence. In other words, central banks were inevitably preoccupied with the problem of the convertibility of domestic currency into gold as the central task of their currency responsibility. They accepted a discretionary management over domestic monetary supplies only in so far as they possessed reserves of gold in excess of estimated or legal needs.

As gold money tended to be supplanted in domestic circulation by other forms of money, the problem of managing the national monetary supply by central banks became one of maintaining the convertibility of domestic currency into gold primarily for meeting the requirements of international exchange where gold remained the active money in the settlement of balances. To all intents and purposes the currency management of central banks appeared to be unduly devoted to the preservation of the stability of exchange rates or of the purchasing power of individual currencies over other currencies.

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Internal vs. External Stability

With the re-establishment of gold-standard conditions internationally after the War, central banks commenced to devote greater attention in their management policies to the question of the internal stability of monetary supplies and to the stability of the purchasing power of currencies over commodities and services domestically. From the primary preoccupation of maintaining the external stability of currencies they turned to the dual task of maintaining both external and internal stability. They sought to provide not only ready convertibility of domestic money into gold but also to effect a measurably better correlation between the available supply of currency and the short-run and long-run monetary needs of business, as manifested by the movement of prices and by the state of trade and productive activity. In this way they aimed to accomplish a greater stability of the purchasing power of domestic currencies over commodities and services.

In part this change of policy with respect to currency management was forced by structural and functional changes in world economic and financial activities and the insecurities to which these changes gave rise. In part it was deliberate and intentional.

This latter aspect of the change of policy in currency management is distinctly the important one and may be ascribed to a number of developments. First, there was the tendency of post-war monetary legislation to impose a greater responsibility on central banks for the control and regulation of domestic monetary supplies independently of political interference. Second, there was the persistent apprehension over the world's supply of unexploited gold resources and the predicted imminence of a shortage of new gold for monetary uses, involving perhaps a long-run contraction of monetary supplies in gold-standard countries and therefore a decline in prices. Third, there was a continuous controversy waged in scientific and popular discussion over the aims of monetary policy and the desirability of attempting stabilization of the purchasing power of currencies, which served to mould public opinion and render it receptive to monetary experiment. Finally, there was the conspicuous

trend toward more extreme nationalism in their economic policies on the part of various countries, which contributed to a popular frame of mind favorable to monetary nationalism.

All central banks, however, were not in a position to pursue a dual objective in domestic currency management under the post-war gold standard. Such a program demanded a substantial excess of gold reserves above minimum legal requirements, and post-war monetary legislation had set a fairly high percentage, on the average, of required gold reserves against central bank liabilities. In addition, a dual monetary program needed an international trade and creditor position sufficiently strong to eliminate the fear of a large and sudden loss of gold reserves from international causes.

The Example of the Federal Reserve System and the Bank of England

The lead in the pursuit of dual objectives of currency management in the post-war period was taken by the Federal Reserve System. Buttressed with a vast store of gold reserves in excess of legal requirements, accumulated mainly from the international maladjustments of the War and early post-war periods, the Federal Reserve Banks launched a program in 1923 implicitly directed at the maintenance of both internal and external currency stability.¹ Individually and as a system, they endeavored to foster a growth in the volume of commercial banking reserves, independently of the domestic supply of monetary gold, but paralleling the growth of production, trade, and consumption, so long as these appeared to keep in mutual balance. In this manner, they sought to provide a long-run expansion of deposit currency issued by commercial banks, correlated with their own currency issues and with those of the Treasury. Necessarily, allowance had to be made for changes in the activity and turnover of currency, and policy had to be sufficiently flexible to permit elasticity of the currency supply to meet the needs of seasonal and short-period variations of business activity. The manifest ultimate aim of management policy,

¹ See the Federal Reserve Board, "Tenth Annual Report, 1923," pp. 29-37.

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nevertheless, was to contribute to the long-run stability of the domestic price structure.

No less noteworthy than the example set by the Federal Reserve Banks in the pursuit of dual objectives of currency management was that of the oldest and most distinguished of central banks, the Bank of England. From the return to the gold standard in 1925 to the abandonment of gold in 1931, it was the policy of the Bank of England to prevent the full rigor of international gold movements from affecting the supply of domestic currency. Limited in the possession of excess gold reserves, its pursuit of dual objectives of currency management was of necessity less ambitious than in the case of the Federal Reserve Banks. That it was nevertheless deliberate, within the limits of its gold resources, was manifest from its actions and admitted by the MacMillan Committee on Finance and Industry, appointed by the English Government to conduct a searching inquiry into English economic conditions.¹

Other central banks endeavored to follow the example set, but they were restrained by the status of their gold reserves and the weaker positions, from the standpoint of international trade and indebtedness, of the monetary economies over which they held sway. They were limited in their freedom of management to the more pressing and immediate objective of maintaining the external convertibility of their currencies. This was essential under post-war circumstances if gold-standard conditions were to be maintained and the weight of popular support remained with the gold standard until the advent of world-wide depression.

The Technique of Dual Currency Management

The technique of dual currency management, as applied by Federal Reserve Banks after 1922, was rooted in an assumption of accurate knowledge of the quantitative behavior of the supply of currency in relation to the volume of production, trade, and consumption in the past. It, therefore, required a large array of statistical indexes of banking, currency, trade, employment, consumption, and prices, and

¹ Report of the Committee on Finance and Industry, Cmd. 3897, 1931, pp. 69-79, especially pp. 76-7.

correct judgments as to their historical and current implications. It further demanded a comprehensive understanding of the interactions of all phases of economic organization and activity, and a capacity for acting at the appropriate time to influence the supply of money.

Granted the adequacy of the guiding materials, the soundness of their interpretation, and the ability of the authorities to know when to act, the technique, at least in theory, was fairly simple.¹ It consisted, as is illustrated in Chart 1, of the adjustment of discount rates on advances to member banks according to the state of business and speculative activity, supplementing such adjustments by purchases and sales of government securities in the open market. Broadly speaking, whenever the active supply of domestic money tended to outrun the accepted normal growth of business and trade, accompanied by heightened speculative activity, discount rates were raised and government securities were sold.² On the other hand, whenever the growth of the supply of domestic money tended to be less rapid than the normal growth of business and trade, discount rates were lowered and governments were bought. If the active supply of money and the growth of business or trade tended to outrun their established normals, Federal Reserve operations were restrictive. If they lagged below their normals, central bank operations were liberal and promotive.

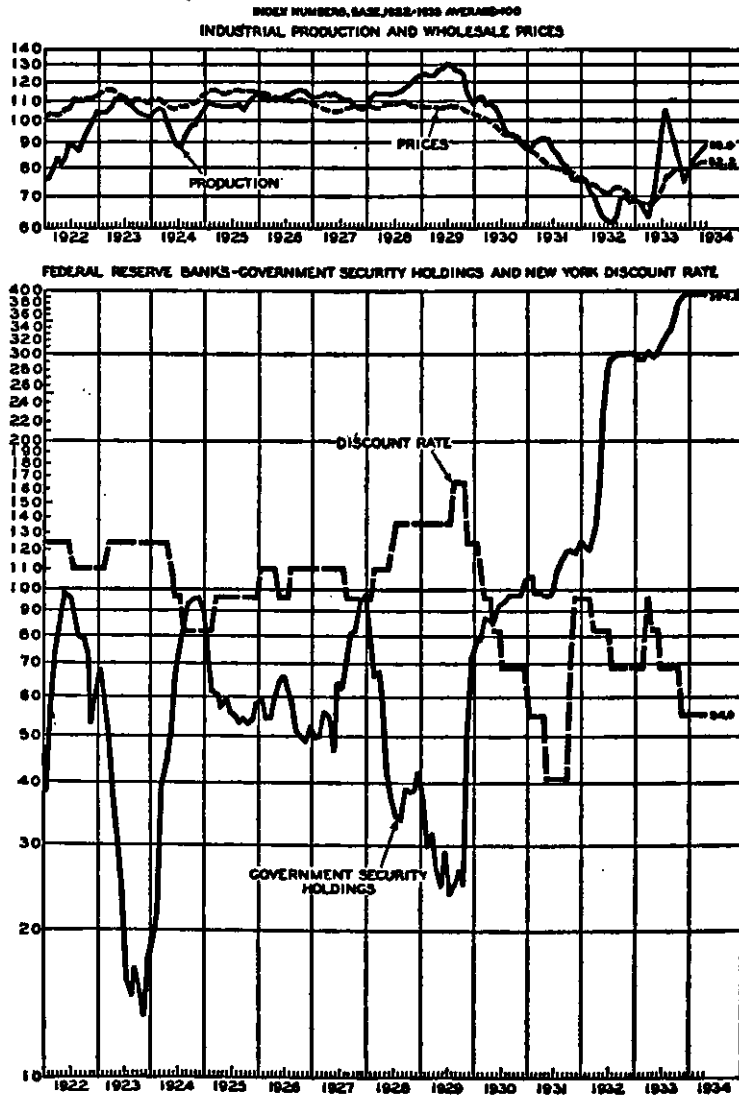
Capricious international gold movements, allowed without restriction to maintain external monetary stability, naturally prevented the ideal pursuit of policies of currency management, wholly independent of the influence of gold, but their effects, if unwanted, were at least partially counteracted in accordance with theoretical precepts. For example, in so far as it was considered undesirable to allow gold imports to affect monetary supplies, open-market sales of government

¹ For a more elaborate statement of Federal Reserve currency management technique and the reasons assigned by the various Federal Reserve Banks for their discount and open market operations from 1922 to 1931, see the Subcommittee to the Senate Committee on Banking and Currency, "Hearings on the Operation of the National and Federal Reserve Banking Systems," 71st Congress, 3rd Session, S. Res. 71, Part 6, Questionnaires 8 and 9, pp. 748-824. Particularly significant is the evidence submitted by the New York Federal Reserve Bank, pp. 760-2 and 802-8.

² Discount rate changes of the Federal Reserve Banks were necessarily conditioned by the prevailing state of market rates of interest for short-term money.

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securities were employed to absorb them. Similarly, when gold exports were not desired to contract domestic monetary supplies, they were offset by open-market purchases of government securities.

THE BREAKDOWN OF THE GOLD STANDARD

Monetary systems depending on the larger use of credit or non-gold money are always in a state of precarious balance, even though they employ gold as the standard of value and the ultimate governor of the supply of money. In the post-war period they were beset on every hand by obstinate factors of maladjustment and insecurity left by the War and reconstruction periods, and by new factors of instability growing out of the changing structure and organization of national and world economies. These factors continuously threatened and finally succeeded in upsetting domestic and international monetary balance. In the end, central banks and other monetary authorities were either unable efficiently to manage currency supplies or they were powerless by currency management to prevent the monetary collapse which actually took place.

A review of the specific monetary and non-monetary factors involved in the breakdown of gold-standard systems is beyond the scope of the present analysis. It is sufficient to observe that when production, trade, and prices receded over the world, the stability of monetary systems, nominally employing gold, but actually using credit or non-gold commodity money, was immediately imperilled, because the liquidity of assets backing this credit money was predicated on the assumption of sustained economic activity and prices. All bank assets became to a certain degree less liquid with business recession, but this was particularly true of the longer-term assets of which banks typically held an unusually high percentage. Nevertheless, banks remained fully liable for deposits on demand and short notice.

The monetary systems of countries having only a small margin of excess gold or gold exchange reserves were particularly vulnerable to business and price decline, and their position was complicated by the fact that they were almost

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uniformly substantial international debtors. As foreign exchange reserves were depleted and gold reserves drained away to creditor countries owing to unfavorable international trade conditions, the debtor countries were invariably threatened with banking crisis and collapse of credit and prices, or banking crisis was actually experienced. Whether or not experienced, the end was uniformly the same: the formal or informal severance of all connection between the supply of domestic credit money and the supply of gold.

The financial distress of debtor countries was not without its repercussion on creditor countries which were faced with banking problems of their own. Their difficulties were increased through the impairment of international investments, currency depreciation, restrictions on international trade and exchange, and pressures on international prices. The spread of distress from debtor country to debtor country gave way to international panic, carrying with it the abandonment of gold by England and of countries linked to England by central bank investments in sterling exchange and by trade. An international credit system which had been the bulwark of the post-war international gold standard and in which England played a vital role as a long-term creditor and short-term debtor broke down and spelled at least a temporary doom to the general international monetary employment of gold.

Domestic and international distrust gripped the American financial organization and exerted unremitting pressure toward the liquidation of bank credit and thereby the contraction of domestic currency supplies. Successive waves of panic followed and defied all efforts of the Federal Reserve Banks and all emergency measures of the Government to bring them under control. In fact, losses of gold internationally and the hoarding of currency domestically, tying up free gold in legal reserves, were so widely provoked by panic that freedom of action on the part of the currency authorities was greatly restricted. A banking moratorium, the temporary abandonment of gold payments, a complete recasting of American monetary organization and control were the result. The Roosevelt monetary system developed out of this broad background.

CHAPTER II

THE NATURE OF THE NEW MONETARY SYSTEM

AS gold-standard systems have evolved out of the past, they were designed to perform three major functions:

- (1) To inspire confidence in money, domestically and internationally;
- (2) To provide an objective and non-political mechanism of control over the total supply of domestic money;
- (3) To provide a medium of world-wide acceptability for use in international payments, thereby facilitating the development of international specialization in production and trade.

At different stages of the development of the gold standard these major functions were fulfilled with varying degrees of freedom. In general, however, the evolutionary drift in gold monetary systems was away from the free performance of these functions. They were gradually subjected to various forms and degrees of circumscription, as monetary systems came to be composed of a preponderant proportion of non-gold commodity or credit money and the links between domestic monetary supplies and the supply of gold grew slimmer.

Extension of limitations on the free fulfillment of the major functions of the gold standard prepared the way for emergence of "managed" currency systems which were only loosely tied to gold. Under these systems, central banks, acting more or less independently of political authorities under implied or expressed legal duties, functioned increasingly as the immediately responsible currency managers, though final sovereign authority over monetary supplies and over the agencies of monetary administration resided in the State. In the course of this development and notably in post-war times, the purpose of monetary management was

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extended from the comparatively simple problem of keeping the supply of domestic money in a definite relationship with the available stock of gold in order to preserve gold-standard conditions, to the more complex aim of maintaining the stability of the domestic monetary supply in accordance with the needs of national production, trade, and prices, irrespective, at least in part, of the available domestic stock of monetary gold and of changes in that stock. Under the pressure of multiplying sources of domestic and international instability, the chief object of monetary management thus came to be to moderate domestic business booms and to check and counteract domestic business depressions by regulating independently the supply of domestic money.

THE FEATURES OF THE NEW MANAGED GOLD STANDARD

Considered in the light of this far-reaching tendency, how radical a departure in gold monetary systems does the new managed standard of the United States actually represent?

In Appendix A and Appendix B the principal features of the managed monetary system are compared with those of the old gold standard. Appendix A shows a comparison between the technical framework of the two systems, while Appendix B compares the legal provisions pertaining to formal monetary issues of the Federal Government, national banks, and Federal Reserve Banks.

It requires only a cursory examination of the framework of the managed monetary system, in comparison with that of the gold standard formerly maintained by the United States, to disclose the extraordinary contrast between the two. The new standard is neither "fish, flesh, nor fowl" in the traditional and orthodox meaning of a gold-standard system, namely, a system under which the supply of domestic money is in a large measure governed, if not wholly determined, over the course of time by the domestic stock of monetary gold. Indeed, it is altogether nondescript in terms of the mechanical essentials commonly considered requisite for such a system and in terms of the functions that a gold standard is presumed to perform.

Gold as a Source of Confidence in Money

Under the new standard, gold is relegated to a distinctly nominal role. The dollar is legally defined as a weight of gold, and a vast reserve of gold, accumulated from the past, stands back of the primary monetary issues of the Treasury. The commodity gold, consequently, may be said to function as an inspirer of confidence in money on the part of the public. But all dollars are inconvertible into gold for domestic purposes, and under conditions of stress and uncertainty gold may no longer serve as a private store of value. In addition, the convertibility of dollars into gold for international purposes is permitted only under conditions determined by, and licenses issued by, the Secretary of the Treasury. The traditional right of private individuals, citizens and foreigners, to test at will the essential soundness of domestic banking and currency policies by redeeming currency in any form into gold on demand, a right which is considered fundamental to a gold-standard system, is definitely abrogated.

The new standard, therefore, relies in no way on the accessibility of gold to induce domestic confidence in money, but rather on the faith of the public in the Government and its ability to further the social good as against individual welfare. In no small degree, too, it relies on the power of the Government to compel the acceptance of any currency it designates in the settlement of transactions and debts.

To induce international faith in the dollar, the convertibility of dollars into gold is counted on, but such convertibility is made a matter of administrative decision on the part of the Executive, so that unqualified confidence in the dollar internationally is hindered. Complete international trust in American currency is clearly not regarded as essential for the maintenance of a satisfactory domestic money.

The Supply Function of Gold

The total domestic monetary supply is still related to the domestic stock of monetary gold, since gold occupies the key position of reserve against primary currency issues of the Treasury. Nonetheless, additions to gold stocks from do-

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mestic production, in excess of the needs for consumption, may be monetized only by their sale to the Treasury, and American acquisitions of gold from world stocks and world production may be imported and similarly monetized at the discretion of the Secretary of the Treasury. In other words, additions to gold reserves are allowed to have an effect on the whole active monetary supply only if such an effect is wanted. The Executive may exert an influence on the Federal Reserve authorities to insure that Executive gold policies are not hindered by Federal Reserve action. Reduction in the monetary gold stock is obstructed, except with the permission and under the control of the Executive. Extensive powers are vested in the Executive for counteracting the monetary effects of reductions in the gold stock. In addition the assistance of the Federal Reserve System may be obtained, if necessary, for this purpose. As a last resort, at least for a period of three years, the process of revaluation may be used, within certain legal limits, to furnish an arbitrary increase or decrease in monetary gold reserves and thereby in the issues of Treasury currency. Under present legal limitations, only an increase and not a decrease in monetary gold reserves by the process of revaluation is practically possible.

The new monetary system, therefore, does not sever abruptly all connection between the available stock of monetary gold and the total supply of domestic money, but for all practical purposes it produces this result. As the framework of the new standard is now ordered, the United States Treasury is apparently intended to be more largely a buyer of gold than a seller. An expansion or contraction of the monetary gold stock growing out of private and government dealings in gold and an accompanying expansion or contraction of the primary currency supply are permissible, subject primarily to control by Treasury regulation and policy, but also partly by Federal Reserve policy.

Gold as a Medium of International Payments

Finally, although under the new monetary system gold is retained as a medium of international exchange for settling balances of trade, service, and capital payments,

international gold movements may occur only in so far as they are deemed necessary in the judgment of, and under conditions prescribed by, the Secretary of the Treasury, even if arranged and undertaken by the Federal Reserve Banks. As a corollary of this limitation of gold movements, the value of the dollar in terms of foreign currencies is potentially subject to wider variations than obtained under conditions of complete freedom of gold movements, and these variations are subject to the control of the Secretary of the Treasury unless offset by the currency policies of foreign countries.

This limitation on the functioning of gold and the restricted role of gold in the total active supply of domestic currency will obstruct the development of international specialization and trade. In the first place, the American price structure will be less closely linked by monetary influences with the price structures of other countries than was the case formerly under the general adherence to some form of the gold standard, when gold or gold exchange holdings of individual countries acted as a limiting factor in their domestic monetary supplies. In the second place, continuous or intermittent instability of the value of the dollar in terms of foreign currencies, or the threat of such instability, will interfere with or disrupt the guidance and co-ordination in the use of available productive resources along international lines, such as would tend to result from the common expression of prices internationally in terms of gold and from the maintenance of a fixed exchange relationship between the dollar and other world currencies.

The Place of Silver in the New System

Under the former monetary arrangements of the United States, silver occupied a wholly subordinate position. It served merely as the commodity material or backing for dollar coin or currency and for subsidiary coin. National monetary policy as presented in the law, however, formally contemplated the establishment of a bimetallic monetary system in which silver along with gold at some fixed ratio would freely act as standard money and the basis for other national currency and for bank currency.

Under the Silver Purchase Act of 1934, it is declared to be

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the policy of the United States that the proportion of silver to gold in the monetary stocks of the nation should be increased with the object of having one fourth of such stocks in silver. Various continuing and permanent discretionary powers are vested in the Executive to effectuate this policy, such as the power to purchase and, under special conditions, sell silver, the power to issue silver currency secured by new silver purchases in the amount either of the actual cost or legal monetary value of such silver, and the power to subject silver and silver currency to a number of rigid controls and regulations. Although the statement of national silver policy, as contained in the law, is altogether without qualification, its actual accomplishment is left to the discretion and judgment of the Executive.¹

Under the new monetary system, therefore, silver is called into service to supplement and reinforce gold as the reserve base of domestic currency and thereby to provide an additional source of public confidence in money, domestically if not internationally. The functioning of silver in this capacity can scarcely be viewed either as essential to public confidence in money or as effective in inspiring such confidence, especially so long as a large discrepancy exists between the market value and the monetary value of silver and so long as silver currency, though freely redeemable in silver dollars, is not redeemable into an equivalent commodity value of silver or convertible into gold at all.² Furthermore, silver cannot be regarded as an additional source of public confidence in money as long as it is subject to stringent controls with respect to its private ownership, possession, and disposition, in the same manner as gold.

More important than any effects the increased use of silver in domestic monetary reserves might have in promoting confidence in money is the use of silver as a factor, along with gold, in determining the volume of currency

¹ The silver powers of the Executive under the Silver Purchase Act of 1934, together with other discretionary powers over silver granted in other legislation, and the Executive Order of August 9, 1934, nationalizing domestic stocks of silver bullion, are outlined in detail in Appendix A.

² On the date of the signing by the President of the Silver Purchase Act of 1934, June 19, 1934, the market price of silver in New York was 45½ cents. The legal monetary value of silver under the law is \$1.29. Under the nationalization order the Treasury is buying silver at \$0.50 per fine ounce.

issues of the Treasury. The use of silver for this purpose, however, is neither certain nor definite. National policy with regard to the larger use of silver remains discretionary with the Secretary of the Treasury and the President. Moreover, it is tempered by the fact that new silver currency issued on the basis of discretionary silver purchases of the Treasury may be limited to the cost of new silver acquisitions and need not equal their legal monetary value.¹

Inasmuch as action on the part of the United States in elevating the monetary status of silver is discretionary and was taken independently of any action by other countries the ability of silver to function more actively as a medium for settling international balances is in no way enhanced. Silver purchased or sold by the Treasury in effectuating this policy serves as a medium of international payments in the same sense that all readily marketable goods bought or sold internationally give rise to a supply of foreign exchange available for international payments. Direct acceptability or ready marketability of silver in unlimited quantities in various foreign countries has not been increased, and silver has not gained international financial prestige. It can be employed for balancing international transactions only in the case of a country, such as China, which maintains a silver currency system, and in the case of other countries, such as India and England, which maintain active silver markets. It may, of course, be employed indirectly between these and other countries, but with a sacrifice of efficiency and effectiveness.

"Managed" Inconvertible Currency

Whether right or wrong, the new monetary system is ostensibly in accord with modern monetary tendencies. In structure it approaches closely, if it does not actually represent, the logical extreme of these tendencies. In a jocular exchange of words between the Secretary of the Treasury and representatives of the press, following the passage of the Gold Reserve Act of 1934, it was "officially" described as "the 1934 model

¹ Thus, the Secretary of the Treasury may satisfy the requirements of national silver policy by issuing one dollar of currency for every two ounces of silver bought at the price of 50 cents per ounce. Nevertheless the silver counts towards the national reserve on the basis of its monetary value, or \$2.58.

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gold-bullion standard," "streamlined," "airflow," and "with knee-action." Stripped of its gold and silver trappings and adornments, it is a "managed" inconvertible gold currency system. Within its framework, it may be justifiably inferred, are all the requisites for the establishment of the "managed" currency system promised by President Roosevelt in his radio address of October 22, 1933, as the ultimate goal of his monetary policy.

The provisions for the management of the currency supply are of a complicated sort. On the one hand, they involve the concentration of extraordinary monetary powers for the quantitative control of the monetary supply in the hands of the political Executive, the President, and the Secretary of the Treasury. On the other hand, they involve greatly enhanced powers of qualitative monetary and banking control in the hands of the Federal Reserve authorities, particularly in the form of a greater centralization in the hands of the Federal Reserve Board of power over the actions of the Federal Reserve Banks and over the lending and investing activities of member banks.

Many of the powers over the monetary supply placed in the hands of the political authorities are of an emergency character and temporary in the sense that they are limited to a maximum period of three years. Others are continuing and permanent; for example, the powers of the Executive over gold, over extraordinary open-market operations of the Federal Reserve Banks, over the issuance of "greenbacks" to retire the public debt, over the purchase of silver and the issuance of silver currency. A system of divided monetary management is thus established. Certain emergency powers and responsibilities are concentrated only temporarily in the hands of the Executive, while all-important monetary powers and responsibilities reside permanently with the Executive. So important indeed are these Executive powers that they are sufficient to establish in the Executive, acting through the Secretary of the Treasury as an ex-officio member and chairman of the Federal Reserve Board, an unusual degree of influence over the policies of the Federal Reserve System in the future, especially as these policies may affect the quantity of the total monetary supply, and to render the

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Federal Reserve System in fact, if not in law, a mere agency for the execution of policies determined by the Executive.

The future of the American monetary supply is beyond question largely a matter of discretionary management by the Executive branch of the Federal Government and its agencies. The program of management provided for under present monetary laws and the theory on which it apparently rests are discussed in Chapter III.

CHAPTER III

THE NEW PLAN OF MONETARY MANAGEMENT: OBJECTIVES AND THEORY

THE framework of the new American "managed" gold standard may be viewed as the product of chaotic economic conditions, wrought by obstinate reaction in productive activity, employment, prices, and incomes, and consequently in the circulation of money, dating from 1929. Accompanying obdurate business reaction was a drastic liquidation of debt, which carried with it a severe contraction in the total domestic monetary supply, and notably in that share of it consisting of credit or debt money, namely, the deposit currency furnished by commercial banks. Such a development necessarily destroyed confidence in the deposit currency issues of private commercial banks and brought as a climax the complete disorganization and collapse of the monetary and banking mechanism. These events inevitably focused public attention on money and operated to put a premium on the possession of Treasury and formal bank currency as a refuge from the uncertainties of bank deposit currency.

Whatever the actual sequence of cause and effect in the processes of deepening depression may have been, one thing universally experienced as a fact was the rising value of money. To the average individual, accustomed to judge his economic status in terms of money income and outgo and money savings, money was scarce. It was not only difficult to acquire money in exchange for commodities and services in order to provide for business and family maintenance, savings, and debt payments, but competition in acquiring money was increasingly sharp. The practical conclusion, popularly drawn from this common experience, was that the supply of money had been and was being effectively dried up.

Two agencies or institutions, it was every-day knowledge,

were responsible for the supply of money: the banks and the gold standard. In the public mind they were made to bear the blame for the depressing conditions. The widespread failure of banks furnished ample and convincing evidence to the public that they were incompetently managed; the much discussed "scarcity" of gold and the widely publicized domestic and international "scramble" for gold lent color to the opinion that an unqualified gold standard was essentially an unsatisfactory standard for money.

As the business depression grew more intense it was more and more generally accepted that the primary economic problem was a dearth of money. The problem of the depression, therefore, came to be extensively viewed as purely a monetary problem. Given a larger supply of money, elementary logic proved that a larger share should be available for every one; and with a larger quantity of money available in the hands of every one for spending, price and trade recovery seemed certain. Moreover, assured a supply of money free in every way from the bondage to gold and therefore unaffected by changes in the supply of gold, it seemed equally irrefutable, in simple logic, that a recurrence of extreme depressions would be impossible.

Admittedly constructed in haste, the new monetary system naturally reflects the widespread public dissatisfaction with the deplorable state of economic affairs brought about by the business depression. It also necessarily reflects the popular diagnosis of the roots of depression, with its central emphasis on money. It is a government's response to demands made on it to grapple with the problem of regulating the supply of money in order to rectify prevailing conditions, to foster an enduring recovery, and to re-order the nation's monetary arrangements with a view to permanent economic and social reconstruction.

CURRENCY MANAGEMENT FOR WHAT?

The pressure of public opinion seemed to dictate that the supply of money be brought under definite governmental control. President Roosevelt assumed the leadership and took over the responsibilities, freely granted by the Congress,

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for effecting that control. In so doing, he found it necessary to place before the nation an expression of definite objectives for currency management in order to allay fears and win public confidence for a system of money that represented, in form at least, a radical departure from the monetary system of the past. These objectives were most elaborately set forth in his radio address of October 22, 1933, and remain essentially unmodified since that date by any subsequent statement of the Executive. They may be conveniently summed up in the following terms:

First, the restoration of commodity prices to such a level as will provide for the full employment of the nation's productive resources.

Second, the attainment and preservation of a level of prices that will enable the payment of public and private debts at more nearly the average price height at which they were contracted.

Third, the establishment of a price structure, so balanced that farm and industrial commodities may be exchanged on a continuously "fair" basis.

Fourth, the prevention of price advances beyond the level necessary to attain the foregoing ends and the maintenance of a dollar of comparatively stable commodity purchasing power.

Considered in the light of these objectives, it would seem that the thing to be "managed" is not the currency supply but the level and structure of commodity prices. Essentially this is the case. Manipulation of the currency supply is the means to be employed in the accomplishment of this larger national aim. Management of the price level and structure, in short, ostensibly gives point and purpose to the management of the currency supply under the new monetary program.

THE MEANING OF CURRENCY OBJECTIVES

It is frequently assumed that the practical meaning of the new currency objectives is the re-establishment of a level or average of commodity prices comparable to that obtaining in 1926. This assumption is apparently based on several

fairly obvious considerations. For example, it is derived from the emphasis placed in official pronouncements of monetary policy on higher commodity price levels, and in semi-official statements referring to the average level of prices in 1926. Furthermore, it is partly attributable to the fact that the most commonly employed measure of the average level of commodity prices is the index of wholesale prices, computed by the United States Bureau of Labor Statistics, representing a weighted average of 784 commodity prices, based on 1926 as 100. Finally, it finds perhaps some support in the stated objective of the President to establish a level of prices that will permit a readier liquidation of debts and effect a better balance between farm and industrial purchasing power.

In addition, this popular assumption of a 1926 price level goal has a theoretical and statistical foundation in the amount of devaluation for the gold dollar ordered by President Roosevelt on January 31, 1934. According to the widely publicized monetary theory of Professor George F. Warren, who has been one of the chief advisers to the Treasury on monetary questions, there is a close and direct relation between the commodity price levels and the price of gold in dollars over both the short and long run.¹ In fact, in his view, a country may have any price level it desires by the simple process of varying the gold weight or worth of its currency unit. Because of Professor Warren's official position and because deliberate dollar devaluation is quite without precedent in American monetary experience and hence in the public eye an altogether spectacular piece of monetary maneuvering, it is entirely natural that public opinion should identify the reduction of the gold content of the dollar as an explicit application of the Warren theory.

The statistical features of the devaluation program fully confirm this popular interpretation. In April, 1933, when President Roosevelt first launched his program of dollar depreciation and price level restoration, wholesale commodity prices according to the Bureau of Labor index number stood at 60 relative to 1926 as 100. If the wholesale price level

¹ George F. Warren and Frank A. Pearson, "Prices," Wiley, N. Y., 1933, pp. 392-393.

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were perfectly connected and correlated with the price of gold, as the Warren theory alleges, a decrease in the gold content of the dollar of 41%, amounting to an increase in the dollar price of gold of approximately 70%, should effect a roughly corresponding advance of the commodity price level. Under the Warren theory, in other words, such a decrease in the gold content should restore the average of wholesale commodity prices to somewhere near the 1926 level.

To inspire public confidence in money, a program that proposes to control the domestic currency supply largely by government fiat must have a final goal that can be generally understood by the average citizen. The present official objectives of monetary policy, formulated in response to a widespread disillusionment of the public regarding the fundamental integrity of its monetary and banking system, may be properly viewed as aiming at the attainment of acceptable simplicity for winning and sustaining public confidence.

Notwithstanding this general aim and the considerations that have led the public to assume the 1926 level of wholesale commodity prices as the ultimate objective of monetary management, it is doubtful whether the Administration has pledged itself to restore that price level. It is much more reasonable to believe that the fetish of a 1926 wholesale commodity price level, as the aim of currency management, is largely a figment of the public's interpretation of official statements and acts of monetary policy. The formula embraced by these statements and actions is altogether flexible and adaptable. That formula is entirely applicable to an eventual condition of commodity prices differing both as to average level and price relationships from those obtaining in 1926. No person alert to economic realities and to the subtleties of politics could believe that it will not be so applied.

A FLEXIBLE MANAGEMENT FORMULA

There are a number of important considerations which may be advanced in support of this viewpoint. For example, it may be recalled that experiments with currency management in the post-war period, notably by the Federal Reserve

authorities, did not work wonders in producing a stable level and structure of commodity prices, either in the eyes of the critical students of monetary developments or in the eyes of the public at large. Nor did they succeed in maintaining, within the commodity price structure, what might properly be described, from an ethical and political standpoint, as a balanced relationship between individual prices or groups of prices.

In the light of the outcome of this experiment, which was no less bold than the present monetary undertaking, it cannot be assumed that the responsible currency authorities will not be alert to the political repercussions that might grow out of failure to attain a fixed monetary goal. No politically managed currency supply, it is safe to say, could long survive the rigors of active politics, should it obstinately pursue a single arbitrary purpose and fail within the limits of public tolerance and patience to attain it.

A Full Employment Standard for Currency Policy

There are still other justifiable reasons for believing that the present formula of managed monetary policy should be regarded as a flexible and even partly tentative formula, not binding the managing authorities to a narrow interpretation of objectives. The first of these is the primary emphasis upon the attainment of a level of commodity prices that will "enable agriculture and industry once more to give work to the unemployed." "A full employment of productive resources" standard for the proper adjustment of the level and structure of prices and for the management of the currency supply to support and sustain that level and structure could easily be made to justify an average height of commodity prices either well above the 1926 average or well below it, together with a currency program appropriate in the eyes of the monetary authorities to the preservation of such an average.

What Prices to Raise and Stabilize?

Another good reason for interpreting the stated formula for currency management liberally is the simple fact that it contemplates only in a general way higher and more stable

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commodity prices. It is not known whether this means merely commodity prices at wholesale, or includes as well commodity prices at retail, or whether it means an average of both types of commodity prices.

For a number of years, monetary experts have been engaged in active controversy regarding the price level to be used as a basis for monetary policy. Should it be the production or wholesale commodity price level? The consumption or retail commodity price level? Or both of these averages?

There are, moreover, other issues at stake. For example, is it not necessary to take into account the movement of commodity prices in relationship to each other and to their average? If so, what weight should be given to a wide, as against a narrow, dispersion of prices around their average level? Is economic balance more surely manifested when the dispersion of commodity prices is narrow rather than wide?

Furthermore, there is the issue of whether or not an average of commodity prices alone is an adequate guide for the management of the currency supply. Money is spent on many other things besides commodities, and the prices of other than purely commodity items in certain circumstances may well be more important than commodity prices themselves. If the management of the currency supply is to be guided with an eye to the welfare of producers, prices of other items besides commodities, such as wages, salaries, and interest, should surely be taken into account, jointly at least with the object of maintaining a moving balance between costs and selling prices. On the other hand, if management of the currency supply is to be directed to the interests of consumers, then it would seem that the prices paid by consumers for consumption services and rents should be considered and averaged according to their importance in personal and family budgets. Finally, if management of the currency supply is to be conducted in accordance with the mechanical requirements of the conventional equation of exchange, it would appear that a truly general average level of prices should be employed as the basis of policy; that is, a price level representative of commodities at wholesale and at retail, services, wages, real estate, rents, securities, and

other items for which money is spent. In any event, it would seem that the individual price-averages for these non-commodity items should in some measure be taken into consideration.

In addition, there is the issue, whether or not average money incomes rather than an average of particular commodity prices, an average of special commodity and other prices, or an average of all prices, should be the object of currency management policy. If money incomes were raised and stabilized, say on a per capita basis, a comparative long-run stability of the price structure, it has been contended, might well be expected to result. As an alternative criterion for a monetary program, the raising and stabilizing of business profits, with the expansion of other types of incomes permanently encouraged, has recently been advanced.¹

Whatever may be the true requirements of price factors which currency management should reckon with and employ as criteria of policy, it is clear that the whole matter is subject to dispute at the present time. It is reasonable to assume, therefore, that monetary experts will be spurred on to a more intensive investigation of the relationship of the currency supply to the level and structure of prices. It is also reasonable to assume that controversy will wax sharp and possibly bitter over the many disputed issues involved, and that the public, made conscious of the relationship of the currency supply to prices, will follow such controversy, however subtle, with an active interest. The monetary authorities, one may be fairly sure, will not remain permanently blind or deaf to the trend of monetary controversy or to the weight of expert or popular opinion manifested in it.

The Fetish of a 1926 Price Level Goal

Another reason for concluding that those who formulated the managed monetary program are not to be viewed as suffering from an obstinate fixation on a specific price level

¹ This is a complex formula and would involve the use of a wide range of indices of prices, price relationships, and business activity as guides for monetary action. It is also a formula that would involve integrating monetary action with other types of social action effected by government to establish and preserve economic balance. See the Report of the Columbia University Commission, "Economic Reconstruction," Columbia University Press, New York, 1934, pp. 23-5.

pattern is the simple fact that there is nothing "normal" about the commodity price level and relationship of prices of the year 1926. The selection of that year as the base for the Bureau of Labor Statistics index number of wholesale prices was no more than a convenience to render the current comparison of average wholesale prices easier and more meaningful to the average person by having a post-war rather than a pre-war base. It was also done for the purpose of overcoming that bias which inevitably accumulates in index numbers of prices as they get farther away in time from their basing points, because of the changing form, character, and importance of commodities entering into wholesale trade. In addition, the year 1926 was doubtless chosen because, in the judgment of the Bureau's statisticians, it was neither a year of abnormal boom nor of unusual depression. It was, moreover, a year sufficiently removed from the maladjusted war and early post-war years that the assumption could be partly though not wholly sustained that the major realignment of prices necessary after a period of world-wide economic, political, and social dislocation, had taken place.

Debt Solvency and Currency Policy

A fourth reason for doubting a permanent insistence on the 1926 level of commodity prices is the fact that the debts which monetary policy aims to make more definitely solvent were accumulated at various levels of commodity prices. The outstanding volume of short-term indebtedness, estimated for the beginning of 1933 at \$104 billion, or more than three quarters of the extant long-term debt,¹ is obviously subject to an important turnover even in periods of depression and must represent much debt contracted at depression price levels.

So far as the long-term debt is concerned, estimated at about \$134 billion at the beginning of 1933, between a fourth and a third of this debt is surely a hang-over from the pre-war period when wholesale prices were much lower than in 1926, and no higher on the average than prices at the bottom

¹ According to the estimates of Dr. F. W. Ryan in "Internal Debts of the United States," Evans Clark, Ed., Twentieth Century Fund, N. Y., 1933, p. 301.

of the present depression.¹ A quarter or less of the total, moreover, was incurred during the war and early post-war years when wholesale prices were generally higher than in 1926. Less than half of the aggregate was probably the product of the era from 1921 to 1929 when wholesale commodity prices fluctuated around their 1926 average. A small fraction, less than a tenth, was incurred after 1929, when prices on the average were declining rapidly from the 1929 height.

Assuming the availability of complete records concerning the incurrence of all debts, and assuming further the existence of a statistical technique for establishing an average of commodity prices, capable of meting out average justice to all debtors, it is altogether uncertain what the outcome in terms of an index number of prices would be. Such an average would not be just to debtors who had contracted debts at the upper and lower levels of past price swings. Moreover, it would doubtless prove unsatisfactory to many individual debtors whose solvency depends on individual prices and not on average prices. It is conceivable that monetary manipulation to raise prices generally to a level compatible with equity for the average debtor might affect some debtors most unfairly because all prices, in all likelihood, would not rise equally fast. Debtors whose incomes failed to rise as rapidly as their expenses might actually be placed in a worse position than before the price advance took place.

Regardless of such debatable considerations, it must be acknowledged that the solvency of debtors, notably in the industrial and commercial spheres of our economy, is not dependent alone on prices received, but also on how much is sold at stated prices, that is on the volume of trade. Given an adequate volume of trade, many debtors are rendered solvent, even some who contracted debts at price levels materially above those of 1926. A standard for the proper level of commodity prices, such as forms the basis of the present monetary policy, which stresses the full employment of productive resources, is fundamentally a volume of trade standard. The employment of such a standard, therefore, may suffice to justify to the debtor class almost any level of

¹ Ibid., p. 13.

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commodity prices, not substantially lower than that reached at the bottom of the present depression.

The Parity of Prices and Currency Policy

A final reason for placing slight faith in the notion that a 1926 level of commodity prices is the ultimate aim of currency policy is the fact that the price relationships of that year did not permit agricultural and industrial products to exchange at a politically expedient parity. This was fully manifested by the Agricultural Adjustment Act of 1933, sponsored by the Administration and passed by the Congress with the advice of the agricultural experts of the Executive. When it came to the matter of a legal definition of a fair and just parity of exchange for farm and factory output, the ratio of exchange for the five years preceding the war period was generally selected in preference to that of 1926. If the price relationships of 1926 are politically inexpedient as the basis of practical farm relief policies, they may obviously prove inexpedient for general monetary policy. To the extent that this proves true, departure from the 1926 price average as the dominant fetish of monetary policy is bound to follow.

THE ROOSEVELT PLAN OF MONETARY MANAGEMENT

Under a modern monetary organization, it is impossible to view money and banking as separate and distinct elements of the financial system. Monetary and banking legislation deal with the same substance, money. They differ only in the fact that monetary legislation deals with formal money issued by the Government or Treasury, while banking legislation deals directly or indirectly with the monetary issues of banks, which may be formal money, such as bank notes, and informal money, such as bank deposits.

Public interest has been focused by the course of financial events on both monetary and banking legislation. Monetary legislation, however, has held the public eye more than banking legislation, because it has seemed to embody the most radical departures from past national policy. It has also dominated popular attention because the public holds gov-

ernment money in much higher esteem than bank money and believes it to be far more fundamental in essence. Finally, it has been the focal point of public interest because of the dramatic program of devaluation of the national monetary standard, the dollar as a weight of gold. Monetary legislation and policies, more than banking legislation and policies, have made copy for the press.

The new inconvertible gold standard, as a managed monetary system, draws a fairly sharp distinction in its program of management between the regulation of the supply of formal money issued by the Treasury and that of the supply of formal and informal money issued by the banks. It is primarily over the former supply that the Executive is granted discretionary control, at least for an emergency period of from two to three years. The control of the bank currency supply is left in the hands of the commercial banks and Federal Reserve Banks, subject, however, to newly imposed restrictions on banking freedom and to a greatly strengthened supervision and regulation by the Federal Reserve System. Although there are certain sources of Executive influence over Federal Reserve management policies and activities and certain links for co-ordinating the management of the two currency supplies, responsibility for the management of the two currency supplies is, nevertheless, technically separated in the new monetary system.

Historical Bases of Divided Currency Responsibility

The banking mechanism, as a currency-issuing mechanism, developed subsequent to the formal monetary mechanism. Banking institutions were for a long time, in fact, regarded purely as money-conserving and not as money-creating agencies. Historically, their first function was to provide a safe storehouse for generally acceptable formal money, authorized or issued by governments, that was held by the public in excess of immediate needs. Later they developed the function of relending funds left on deposit by the public. Finally, they became the source, first, of bank notes and, later, of check currency, based nominally on holdings of formal government money as reserves but mainly on loans and investments as other reserve assets, and seemingly

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serving merely as substitutes for formal government money in active circulation.

As a source of a part of the domestic monetary supply the banking mechanism developed independently of the mechanism of formal government money, even though it employed such money as the raw material for its operations. Banking institutions, moreover, grew up largely under private ownership and control, with increasing state regulation because of the public interest involved in their operations. On the other hand, the monetary mechanism proper was early recognized as the exclusive prerogative of the State.

An important consequence of the diverse evolution of the money mechanism and of the banking mechanism was to create differences of opinion concerning the whole problem of the supply of money; some placing emphasis on the currency supply issuing from the monetary mechanism of the State; others placing emphasis on the monetary supply issuing from the banking mechanism. This conflict and controversy tended to obscure relationships inherent between the two monetary supplies and to confuse popular thinking. In American experience, only the force of actual economic emergency seemed capable of compelling legislative enactment reflecting a recognition of an effective relationship between the two supplies of money.

The Popular View of Currency Management

When consideration is given to the historical background of the new managed money system, it is not in the least surprising that its framework should assume the shape that it does. The structure that has been reared is altogether in accord with the past development of American monetary organization and with the sort of thinking on money that is characteristic of the public at large. In the conventional view, which identifies the money supply with the formal currency issues of the Treasury, no system of currency could be regarded as a managed system which did not give the Executive large discretionary control over the issuance of Treasury currency. Manipulation of Treasury currency

issues appears to be the *sine qua non* of currency management under the interpretation commonly given to that term.

Public opinion, partly for historical reasons and partly for reasons growing out of the recent attention given by the Government to the money question, very generally views the problem of regulating the currency supply, with the aim of promoting higher price levels, as essentially a simple quantitative problem. If the doctrines expressed by the more articulate spokesmen of public opinion may be accepted as typical, the attainment of any level for domestic prices desired by the public authorities is merely a matter of issuing more and more currency under government fiat until an intended level of prices is reached. At that level, it naturally follows that stabilization is only a problem of discontinuing further Treasury issues and of maintaining their volume in such an amount as to sustain the new structure of prices.

Composition of the Currency Supply

From the standpoint of pure theory, it is quite possible to conceive of a monetary organization to which so elementary a notion of monetary management would be applicable.¹ Under the complex monetary organization of the United States, it cannot be accepted as having any direct applicability. Treasury currency, it has already been stressed, constitutes only a part of our domestic currency supply. Actually, it constitutes only a small fraction of the total effective monetary supply in the hands of the public for spending. The bulk of the effective supply is furnished by the commercial banks in the form of deposits subject to check.

This composition of the currency supply has been characteristic of the United States, as it has of many other countries, for a long period of years, and with the perfection of communication and transportation facilities, the growth of production and commerce, and the national expansion of trade, this dual nature of our actual currency has become more pronounced. This condition continues today, even after the abrupt contraction in deposit currency, caused by

¹ Such a monetary organization would be one in which government currency were the only currency in circulation and used by the public, in which complete public confidence in the value of government money obtained, and in which all business transactions were purely domestic in character.

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banking failures from 1929 to 1933. From the long-run standpoint, it is probably justifiable to view the trend towards the greater use of deposit currency as a permanent tendency in monetary organization, irrespective of temporary set-backs. Under the modern organization of industry and trade, deposit currency, except for minor day-to-day transactions, is undoubtedly more convenient and practical than other forms of currency.

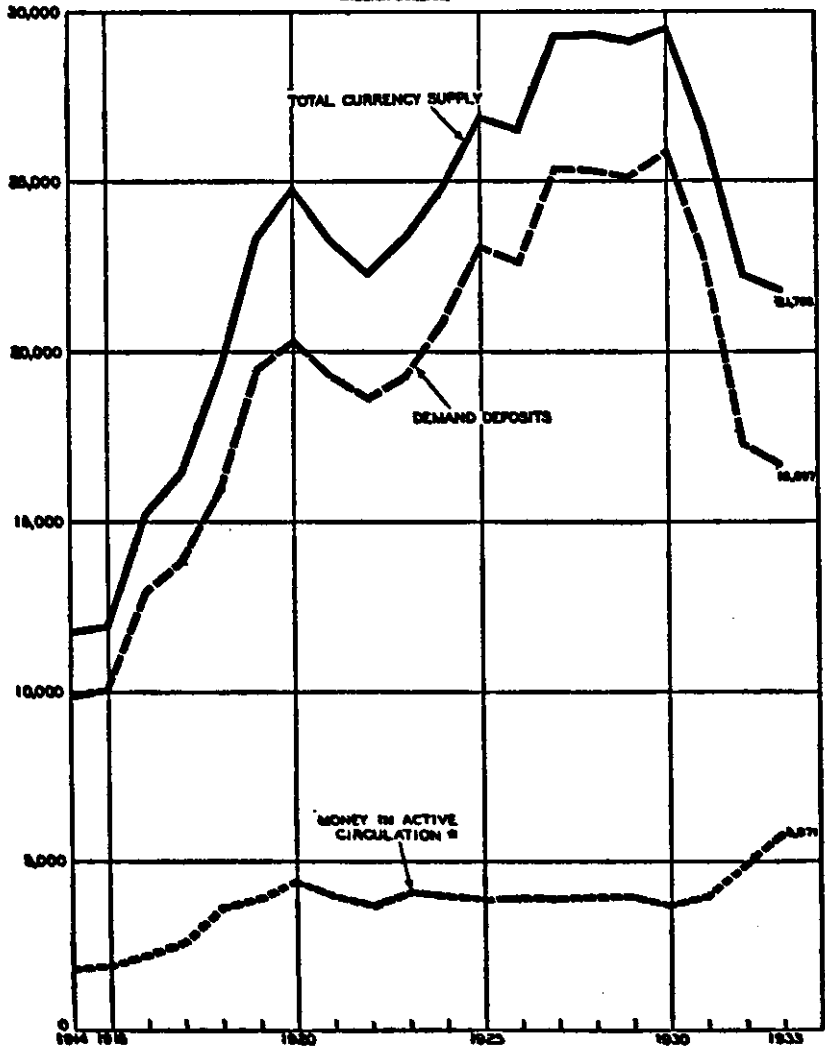
The predominant role played in current transactions by deposit currency is shown in Chart 2 in the record of the effective monetary supply available in the hands of the public for spending since 1914. In interpreting this chart, it must be recognized that all of the actual currency in circulation is not Treasury currency, since it partly consists of notes of national banks and Federal Reserve banks. It must also be recognized that back of the deposit currency stands directly and indirectly a fractional volume of Treasury currency, national bank currency, and Federal Reserve currency as banking reserves. The complicated structure of the effective currency supply is shown more clearly in Chart 3 which presents a cross-section analysis of the entire currency structure, just prior to the formal introduction of the inconvertible gold standard in its tentatively completed form. At any other date, the quantitative features of the monetary supply would be somewhat different, though the structure which the chart really aims to outline would remain essentially the same.¹

These two charts unmistakably show how erroneous it

¹ It is a curious commentary on the present program of currency management that so little statistical knowledge is available regarding the currency supply as a whole. Information regarding non-member banks, for example, is published only once a year. In constructing the tabular view of the currency supply of the United States presented in Appendix C, on which Chart 3 is based, it was necessary to combine the figures for June, 1933, for non-member banks with figures for October, 1933, for member banks in order to present a complete picture of all the elements in the effective currency supply.

While the importance of non-member bank currency is at present greatly reduced from what it was in 1929, there is no justification for assuming that it will permanently remain in its current relative position. New incorporations of non-member banks, conversions of member into non-member banks, and mergers of member with non-member banks may easily serve to raise sharply the proportion of the effective monetary supply issued by non-member banks over the course of time. It may well prove that a shift from member to non-member status on the part of many banks will be one of the long-run fruits of the federal banking legislation of 1933 and of the managed currency program.

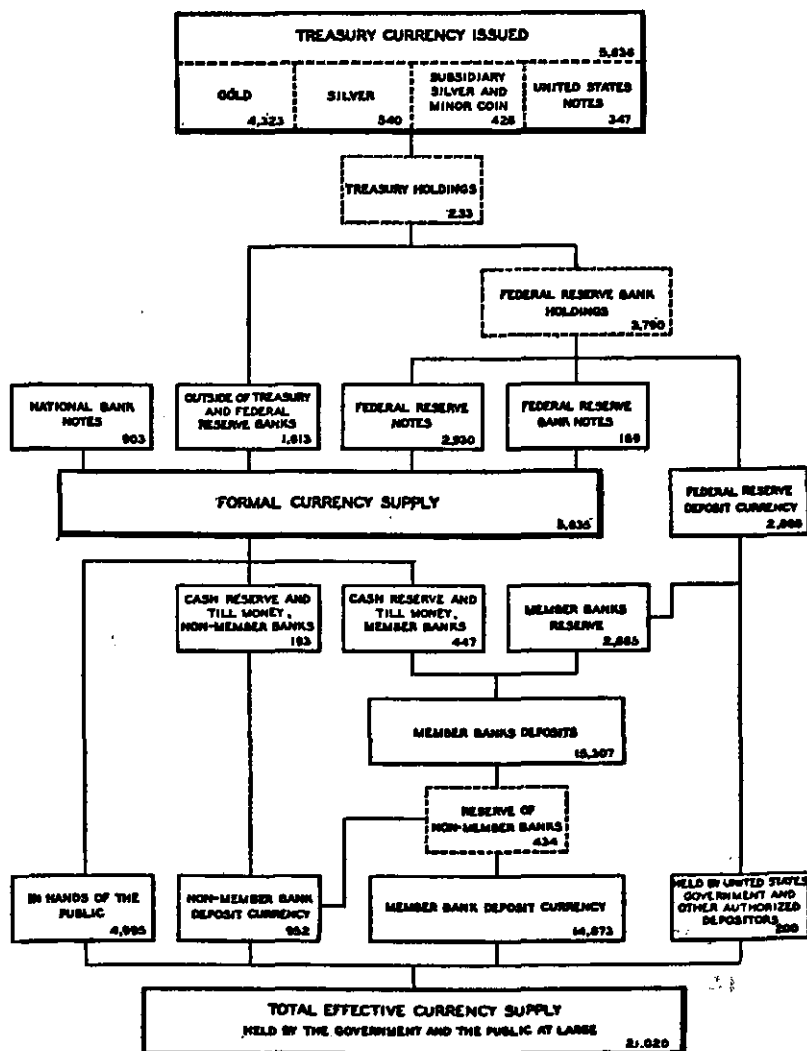
CHART 2. MONEY AND BANK DEPOSIT CURRENCY IN CIRCULATION
ON JUNE 30, 1914-1933
MILLION DOLLARS



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CHART 3. COMPONENTS OF THE CURRENCY SUPPLY OF THE UNITED STATES
OCTOBER, 1933-SEE APPENDIX C
FIGURES REPRESENT MILLION DOLLARS



would be to view the problem of managing the currency supply for purposes of price level control as a simple quantitative problem of manipulating the supply of Treasury currency. The problem is obviously very complex, involving the joint regulation of Treasury currency, Federal Reserve currency, and commercial bank currency.

Deposit Currency and the Theory of Currency Control

The nature of the composition of the aggregate currency supply is not brought forward here with the object of demolishing the notion that control of the average height of prices is merely a quantitative problem having to do with the issuance of Treasury currency. It is introduced solely with the object of clarification and of emphasizing the complexity of the problem. Many adherents of the theory of price level control through currency management, who are well informed on monetary organization, hold that the problem of control is rendered only slightly more complex because of the predominant employment of deposit currency as the principal national medium of payments. In the typical view of the more advanced monetary management school, there is an intimate connection between the total volume of Treasury currency and the total volume of deposit currency, reckoned in the logical terms that follow.

If the Treasury should issue and introduce more primary formal currency into circulation, the public would determine whether or not additional currency would remain in active use. It is reasonable to suppose, however, that the public already possesses an adequate amount in hand for its ordinary day-to-day requirements and, hence, will desire to substitute the more convenient deposit currency for additional holdings of formal currency. Bank deposits subject to check will accordingly rise, and banks will come into possession of new banking reserves equal in volume to new issues of deposit currency. Since only fractional reserves are needed as backing for the deposit currency of banks, by custom and by law, new banking reserves will normally be used by commercial banks to extend further loans and to acquire additional investments.

In this process of trading excess reserves for customers'

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notes and for investments, banks as a system will not incur a loss of reserves, though they might individually, because the public already possesses enough formal currency for day-to-day purposes. Hence, there can only result increased issues of deposit currency by commercial banks. Such increases will tend to continue until new deposit currency has served to tie up as active reserves all acquisitions of formal currency left with the banks by the public.

According to this school of thought, if issues of Treasury currency should be increased by as much as 50%, banks, in all likelihood, would increase their deposit currency correspondingly. Hence its adherents conclude that the total supply of effective currency available to the public for spending can be controlled more or less at will by regulating the supply of currency issued by the Treasury.

The critically important link in this chain of reasoning of the currency management school is the assumption that commercial banks as a group would increase their holdings of customers' notes and investments with their larger holdings of cash, gained through public deposits of formal Treasury currency. To the proponent of currency management ideas, this assumption appears to be entirely valid. If banks trade their deposit currency in exchange for formal currency, their operating expenses must tend to rise; they are put in a position where larger holdings of earnings assets are needed. But more than that, banks are actuated by a profit motive, and banking profits are reaped only from the possession of earnings assets in as high a proportion as is compatible with prudence and with law, provided, of course, that earnings yielded are sufficient to cover expenses of a larger volume of deposit currency issues.

Under the circumstances, it is alleged, commercial banks as a general rule will eagerly employ their added reserves in issuing deposit currency in accordance with the conventional and required ratio of cash reserves to deposits. Moreover, banks will behave in this way even if forced to accept a reduction of interest yields on the larger volume of assets acquired in the process of pyramiding deposit issues. The nature of the banking business, the argument is, prescribes

this type of mechanical conduct on the part of commercial banks as normal banking behavior.

The Central Thesis of the Currency Management School

The foregoing statement of the theory of the currency management school has been intentionally simplified. Merited qualifications are omitted, because the principle involved would be less readily understood if such reservations and provisos were made. Nevertheless, the exposition here given of the main contention of that school's proponents is believed to be sufficiently accurate for the present consideration of the problem of currency control. It presents fairly the central thesis that the supply of Treasury currency, filtering into the reserves of banks, is an active force operating to generate the issuance of deposit currency.¹ Granting its validity, regulation of the supply of Treasury currency is all that is needed for the purpose of managing the supply of deposit currency and thus the total monetary supply.

Federal Reserve Banks and the Currency Management School

The contention of the currency management school has purposely been set forth without taking into account the role of the Federal Reserve Banks. These banks, in the capacity of central banks, as is generally known, are repositories of reserves of member banks. Operating on the basis of fractional reserves, required by law and obtained by the redeposit of cash taken in by member banks, they issue formal currency for active circulation and for use as working and legal reserves of commercial banks, and also deposit currency which serves as reserves of member banks and indirectly as reserves of non-member banks.²

The primary reason for the existence of the Federal Reserve Banks is to provide a currency supply to which member banks may turn to rediscount commercial assets and acquire cash for temporary and emergency needs. Their powers, however, include the power to acquire assets in the open

¹ This thesis is clearly presented in the testimony of Professor James Harvey Rogers, monetary adviser of the United States Treasury, before the Senate Committee on Banking and Currency, January 22, 1934, "Hearings on the Gold Reserve Act of 1934," 73rd Congress, 2nd Session, S. 2366, pp. 312-313.

² See Chart 3.

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market, so that they too, as well as the Treasury, may be a source of currency supplies forced into the hands of the public and thence into the reserves of commercial banks. From 1922 on, it was pointed out in Chapter I, the Federal Reserve Banks employed their credit or currency issuing powers freely with the "currency management" design of maintaining the volume of commercial banking reserves and deposit currency at a level compatible with the needs of production, trade, and consumption.

To the "modern" school of currency management thought, there is a major difference between accretions to commercial banking reserves resulting from Federal Reserve currency issues and those growing out of issues of Treasury currency, at least in their effects on the behavior of commercial banks in creating their deposit currency.¹ Commercial bankers, it is said, must necessarily conduct their operations with an eye to the permanency of the reserve fund available to them as a group. When their reserves are increased as a result of Federal Reserve credit activities, experience and knowledge warn them to operate carefully, for the Federal Reserve Banks have it in their power to take away from commercial banks all reserves which they have advanced. Indeed, because of this, there is an abiding caution among commercial banks in creating deposits on the basis of Federal Reserve currency issues, though they may be willing for short intervals to employ such currency as a tide-over, while they are adjusting their own currency issue position.

On the other hand, it is affirmed that if commercial banks come into the possession of larger reserves because of an expansion of Treasury currency, they will act with no other restraints than those involved in sound banking practices. They will freely engage in lending and investing, with the result that their deposit currency issues will expand promptly and in rough proportion to the expansion in reserves. Normal banking behavior, in other words, can only be expected when commercial banks as a group are instilled with complete confidence that the available supply of banking

¹ This difference is explicitly argued in Professor Rogers' testimony before the Senate Committee on Banking and Currency on the Gold Reserve Act, previously cited. It is appropriate to observe that it is a novel point of emphasis even in academic monetary theory.

reserves is under no likelihood of variation from any arbitrary decision on the part of the central banking authorities.

The Role of the Federal Reserve Banks in Currency Management

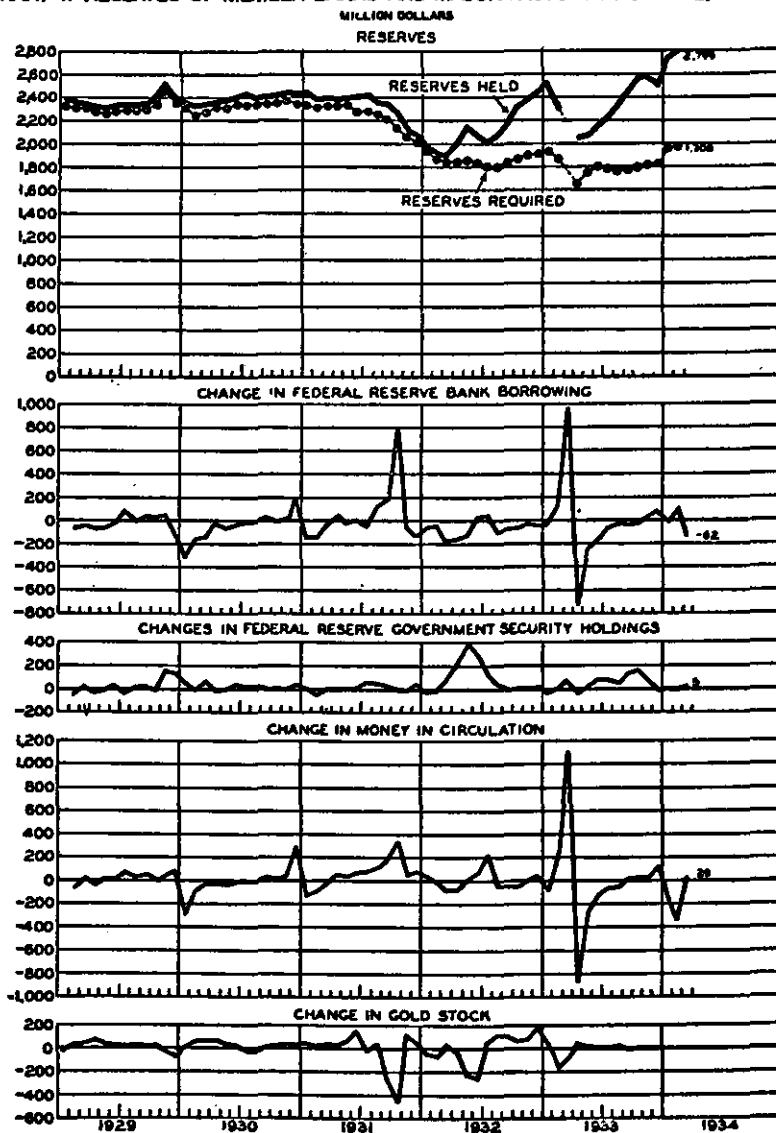
This interpretation of the position of the ascendant school of currency management thought clearly implies that all emergency efforts of the Government in the past two years to salvage the depression by having the Federal Reserve Banks engage jointly in unprecedented open-market operations¹ and low discount rate policies were misguided and mistaken, being based upon an erroneous theory of the response of commercial bankers to reserves artificially forced into their hands. The most that could be hoped from such operations, under this point of view, was precisely what is illustrated in Chart 4, namely, the accumulation of large excess reserves by commercial banks and the apparent attainment of an unusual degree of cash liquidity.

This new departure in currency management theory involves a philosophy of the role of the Federal Reserve System entirely different from that which it assumed in its currency management program adopted in the post-war period. It definitely implies that the Federal Reserve System should be reduced to a distinctly subordinate role in the general management of the currency supply. Moreover, it implicitly holds that the Federal Reserve System should have little or no determining part in the longer-run phases of monetary objectives and their attainment. Rather, its functioning should be confined, in accordance with the intentions of its founders, to the problem of providing short-run elasticity for the total currency supply as required by seasonal and other short-period fluctuations of business. In addition, its currency issuing policy should be passive, expanding and contracting the quantity in use in response to member bank

¹ For example, the open-market purchase of practically \$1.2 billion of government securities during the banking emergency of 1931-1932, mainly enabled by the passage of the Glass-Steagall Act of 1932 modifying the reserve requirements against Federal Reserve notes, and further, the additional purchase of almost \$500 million of similar securities following the banking moratorium of 1933, undertaken at the request of the Executive in accordance with his powers under the Agricultural Adjustment Act.

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CHART 4. RESERVES OF MEMBER BANKS AND MAJOR FACTORS IN CHANGE, 1929-1934



demands, as manifested by their rediscounting of commercial and other discountable assets.

It may fairly be inferred that, as a corollary of this theory, the functioning of the Federal Reserve System should be wholly ancillary to that of the Treasury in so far as the System is unavoidably compelled by its central banking functions to assume some share of responsibility for long-run monetary developments. It should, for example, uphold high banking standards among its members and suppress speculative banking tendencies through its supervision of member banks. Furthermore, its discount policies should be co-ordinated with the monetary program of the Treasury in order to aid the attainment of objectives determined by the Executive. Finally, its open-market operations, when employed, should be only used as a supplement or a re-enforcement of the Treasury monetary program.

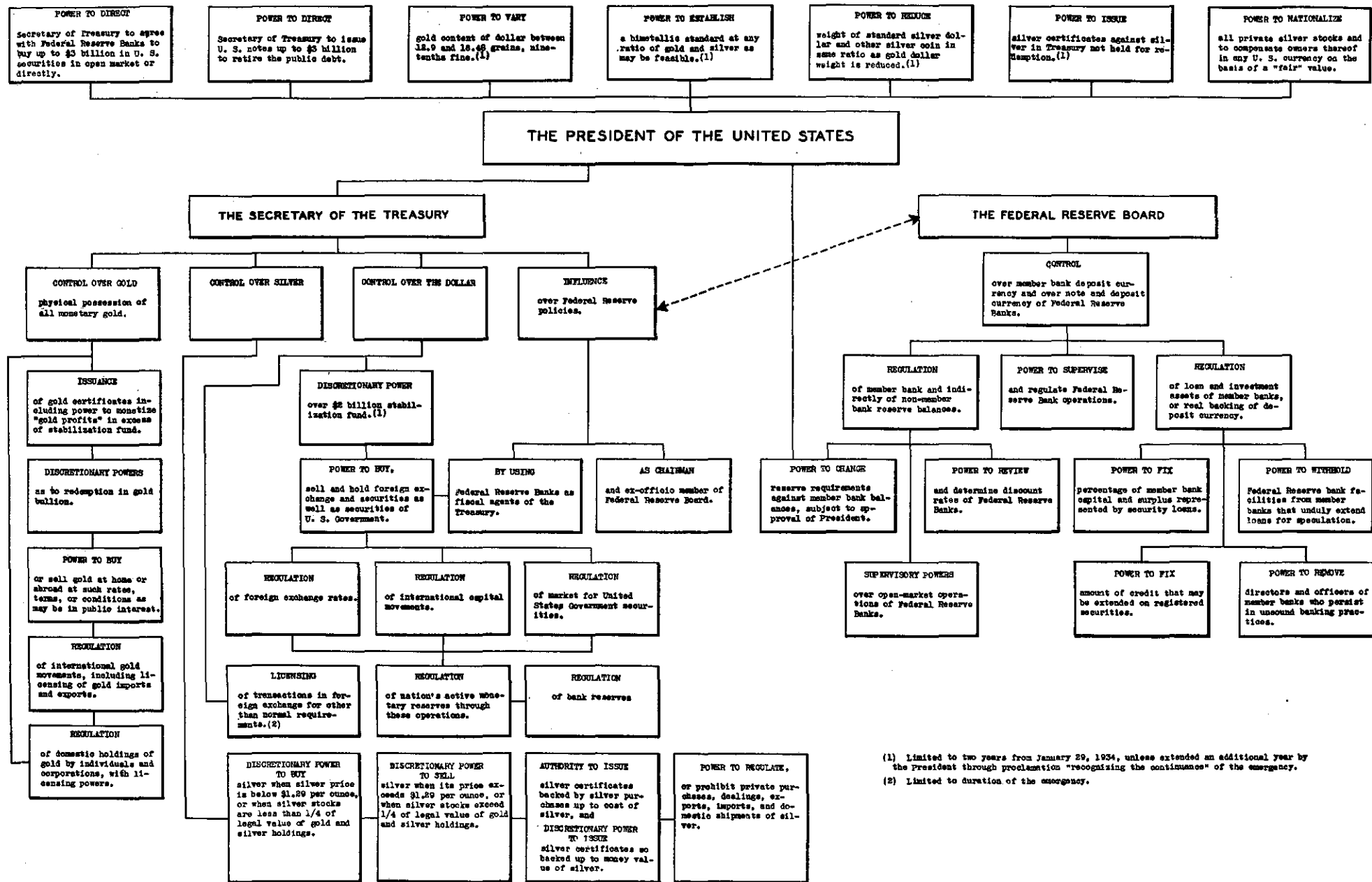
International Influences and Currency Management

For the sake of simplicity, the primary theme of the currency management school has been explained as if the whole problem were purely a domestic problem. While this is not the case, it is imperative in the viewpoint of the currency management school that all of the international causes of the variability in domestic currency supplies be brought under control. Internal monetary regulation is the immediate aim of management. Regulation of the level and structure of domestic prices is its ultimate aim. If, in the interest of national welfare, external monetary stability in the way of stable exchange rates or any other elements of international financial relationships need be sacrificed, it is quite proper that they should be. It is of first and paramount importance that domestic financial conditions be protected against international influences so that a continuous regulation of the domestic currency supply may be effective.

If domestic monetary requirements, for example, are such that gold exports should not be permitted, it is justifiable to prevent them, however adverse such action might be to the interests of foreigners. In a similar way, if gold imports are needed to expand domestic holdings and render more ample domestic monetary supplies, it is warrantable to take action

CHART 5. "MANAGED" MONETARY CONTROL

OUTLINED FROM THE GOLD RESERVE ACT OF 1934 AND OTHER MONETARY AND BANKING LEGISLATION



ternal prices of a number of very important commodities and at the same time operate to encourage exports and impede imports.¹ When the dollar depreciates internationally, for example, domestic prices of all imports tend to be immediately raised, relative to other prices, thus making imported commodities, temporarily at least, more expensive and checking their consumption.² At the same time domestic prices of many commodities made from foreign produced materials tend to rise. Likewise, the domestic prices of exports, notably of the great raw material staples of domestic production whose markets are world-wide, tend to be raised proportionately to depreciation and result in higher domestic prices of commodities manufactured from them. Prices of domestic manufactures, however, are not likely to be greatly raised in this way because of the preponderance of other than raw material expenses in their costs. To the extent that they are not enhanced in price in proportion to depreciation, foreigners may purchase them more cheaply, thus bringing greater exports of manufactured goods. Should opposite effects at some time be desired in the interests of internal price regulation, they may be easily produced, in the view of the currency management school, by dollar appreciation in place of depreciation.

Theory of the American Managed Currency System

The general framework of the new managed gold standard indicates that its underlying plan has an intimate kinship with the "modern" theory of currency management just described. Stripped to its barest essentials, it is a plan for systematically increasing the supply of Treasury currency so that the reserves of commercial banks, and necessarily also of the Federal Reserve Banks, will be materially enlarged, and commercial banks will be induced freely to expand their deposit currency issues without fear of an impending decrease in available group reserves from any

¹ During the period of actual change in the foreign exchange value of the dollar, the opposite result is generally apt to occur. See the Conference Board Information Service: Domestic Affairs, Memorandum No. 13, "National Recovery and Dollar Depreciation," p. 9.

² Such effects, of course, are not to be considered as uniform. Special conditions of supply and demand influence individual imported commodities. *Ibid.*, pp. 16-18.

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source, domestic or international. Furthermore, it is a plan that effectively reduces the Federal Reserve System for several years, if not permanently, to a state of complete passivity so far as exerting a responsible quantitative influence over domestic monetary supplies is concerned, except as Federal Reserve currency issues are required to supplement those of the Treasury. Finally, it is a plan that re-enforces the purely quantitative approach to currency management by imposing on the Federal Reserve System a greater accountability for the banking practices of its members, particularly in controlling directly undue speculative tendencies.

The general substantiation of this characterization of the Roosevelt plan of currency management is to be drawn from Chapter II. It may be further substantiated by viewing the plan as a whole in graphic outline, shown in Chart 5. The following summary gives its principal features:

(1) Large discretionary powers over the supply of Treasury currency are vested in the Executive for the purpose of ensuring a continuing stream of formal currency from the Treasury for a number of years to come.

Under the Gold Reserve Act of 1934, a fund of \$2.8 billion of profits from the revaluation of gold stocks is made immediately available as a source for this currency flow. The power of the Secretary of the Treasury to purchase silver at home and abroad until monetary silver stocks are equal to one fourth of the total monetary stocks of gold and silver reckoned on the legal monetary value basis for both metals, and his power to monetize such silver purchases according to their cost as a minimum and their monetary value as a maximum, affords a second important source of new Treasury currency. Other sources may be made available by Executive order. The size and continuity of the currency stream issuing from the Treasury, however, does not depend on these sources alone, but also on the ability of the Treasury to purchase gold from new domestic production and gold imported from abroad in response to the flow of international payments.

To the extent that silver purchases within the limits of national silver policy are employed to supply new currency issues, the gold profit fund may be preserved for future use.

Furthermore, to the extent that silver purchases are monetized on the basis of cost rather than their full monetary value, a margin of silver reserves available for subsequent currency issues may be accumulated. Finally, to the extent that new issues of currency grow out of new acquisitions of domestic and foreign gold, both the gold profit fund and the silver purchase and currency-issuing power of the Treasury may be conserved for future currency needs.

(2) An unusual degree of direct and indirect influence, in addition to that which ordinarily obtains,¹ is granted the Executive over the activities and policies of the Federal Reserve System, thus assuring that the currency-issuing functions of the central banking system will be co-ordinated, partly if not wholly, with those of the Treasury.²

Should the Treasury wish to conserve its capacity to furnish additional formal currency, the Federal Reserve System might be called on to issue its currency in place of that of the Treasury. In view of the outstanding volume of Federal Reserve currency issues, moreover, influence of the Executive might conceivably be exerted to prevent the Federal Reserve System from undertaking open-market operations calculated to offset the banking reserve effects of larger Treasury issues. On the other hand, the Executive might conceivably encourage the Federal Reserve System to engage in such operations with a view to putting itself in a better position for contributing assistance to the Treasury monetary program at a later stage of monetary developments. At the end of January, 1934, the date of the formal introduction of the new managed currency system, the Federal Reserve Banks together held \$2.4 billion of government securities. The bulk of these were potentially available for open-market operations, capable of tempering the banking effects of larger issues of Treasury currency.

(3) The total domestic currency supply, directly the

¹ By virtue of the fact that the Secretary of the Treasury is an ex-officio member and Chairman of the Federal Reserve Board and also that the Federal Reserve Banks act as fiscal agents for the Treasury in borrowing and other financial operations.

² In the event of a conflict concerning authority between the Federal Reserve Board and the Secretary of the Treasury, the former would unquestionably be compelled to give way.

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supply of formal currency issued by the Treasury and indirectly the supply of deposit currency, is protected by the force of law against sudden fluctuations induced by a widespread loss of confidence in various kinds of currency, manifesting itself in a desire on the part of the public at large to employ the precious metals as a store of value, that is, for hoarding. This is accomplished (a) by making all currency inconvertible and irredeemable into gold and (b) by giving the Executive the power to regulate, if necessary, the convertibility and redeemability of currency into silver.

(4) Special measures and controls are instituted with the object of specifically protecting the supply of deposit currency, which composes so large a percentage of the total currency supply, against sudden variations caused by the loss of public confidence in banking institutions.¹

(5) By a wide range of powers vested in the Executive over the gold value of the dollar, the foreign exchange value of the dollar, and over international gold and silver movements, the new plan aims to provide a mechanism by means of which external or internal forces will exert no unwanted or unregulated influence on domestic monetary supplies.

The New American Plan and "Modern" Currency Management Theory

The new American plan of currency management is for the most part merely a practical expression of extremist quantitative theory of the modern currency management school. As such it relies for its complete ultimate success on the correctness of ten main assumptions:

(1) That a purely mechanical relationship exists normally between the volume of deposit currency, issued by commercial banks, and the volume of formal currency issued by the Treasury, since banks ordinarily limit their issues of credit money only in accordance with their holdings of reserves.

(2) That the volume of banking reserves, assuming confidence on the part of the public in banks, may be efficiently regulated by the issuance of formal currency by the Treas-

¹ The activities of the Reconstruction Finance Corporation in providing new capital for some seven thousand banks throughout the country may properly be viewed as a supplementary governmental measure to attain this object.

ury, re-enforced by fiscal operations of the Treasury, and supplemented on occasions by the discount and open-market operations of the Federal Reserve Banks which influence the volume of their currency issues.

(3) That the average height of domestic prices is primarily and automatically determined by the impact of the total effective currency supply in the hands of the public for spending against the available supply of vendible goods and services.

(4) That the supply of deposit currency issued by commercial banks is in some measure at least independent of the state of prices and the activity of trade.

(5) That the principal international influences affecting domestic price conditions grow out of the price movements of internationally traded commodities and international shipments of gold, both of which, in so far as their effects are unfavorable to a price-raising and stabilization program, are subject to a considerable amount of governmental control.

(6) That foreign nations do not generally apply currency management programs, designed partly along similar national lines and partly as defensive measures against adverse repercussions of American managed currency policy; that comparative stability of foreign currencies is maintained; that trade policies are not employed to effect protection against currency policies; and that there is a considerable freedom in the international flow of gold.

(7) That the relationship between individual prices in the domestic price structure, the relationship between domestic and international prices, and the general organization of industry, trade, and consumption, are not apt to be critically distorted or unbalanced over the course of time as a result of currency management policy, and to produce a condition of unmanageable instability.

(8) That convertibility and redeemability of currency is not fundamentally essential in order to maintain its desirability to the public as a store of value, so long as a fairly general faith prevails in the Government's intention and ability to regulate reasonably the value of money over the long run.

(9) That the usefulness of currency as a medium of ex-

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change is in no way seriously impaired by inconvertibility and irredeemability, so long as the acceptance of formal money is legally mandatory in business transactions and so long as deposit currency is readily redeemable in lawful money.

(10) That the public at large is prepared and willing to submit to a strict monetary discipline enforced by the Government and that the Government is competent to maintain such discipline in the case of recalcitrant citizens.

Stated without qualification, these assumptions are open to dispute. The President's plan of monetary management, however, rests fundamentally on their general validity. Granting that they are valid, which involves acceptance of the view that non-monetary or organic forces in the modern social and economic regime may be influenced and moulded by those of a monetary nature to achieve a tolerably satisfactory regulation of domestic prices, the practicability of controlling the level and structure of prices through the currency-issuing program of the Treasury must also be granted. Herein lies the crux of the experiment in monetary management which the Administration has just launched.

CHAPTER IV

PROBLEMS OF CONTROLLED INFLATION

IT is relatively easy to launch a program of currency management under governmental auspices with the object of raising and ultimately stabilizing domestic prices, and attaining a reasonably full employment of productive resources. It is much more difficult to make such a program effective. For example, there are the many political pressure groups to be dealt with, representing the impatience of important political factions for the re-establishment of higher prices without much concern over the issue of how much higher the higher prices should be. Furthermore, there are the monetary phases of the Government's fiscal problems arising out of the adoption of a far-flung program of providing relief for distressed groups and of stimulating business recovery by governmental expenditures for civil and public works. There are also the problems of agricultural, industrial, and financial maladjustment, with which the Government is attempting to deal directly through the Agricultural Adjustment Administration, Farm Credit Administration, the National Recovery Administration, the Reconstruction Finance Corporation, the Home Loan Corporation, the Home Owners' Loan Corporation, and the Securities and Exchange Commission, all with their monetary implications. In addition, in its domestic monetary program the Government cannot escape the influence of the international uncertainties of a political and economic nature. Finally, there is the obstinate fact that the commercial banks are responsible for the issuance of deposit currency, which constitutes the bulk of the effective supply of currency, and that they must be relied on, in their own time and judgment, and according to the demands for bank funds, to bring about a desired expansion of deposit currency.

The question of currency management has, in reality, as many phases as the economic, political, and social organization itself. No narrow and purely technical analysis of

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monetary mechanics is sufficient to justify a plan of currency management or to indicate its possibilities. In monetary management, when other things are counted on to remain equal, they invariably prove unequal in practice. Instability, lack of balance, continuous change, whether or not desired, characterize the sphere of affairs in which monetary management has to be conducted.

It is not possible, in a limited consideration of the monetary problem, to take account of all monetary factors that exert an important influence on monetary conditions. This limitation is peculiar not only to an analysis of this sort but also to any program of monetary management. A monetary policy that did not prove flexible and adaptive to non-monetary forces of instability would by that fact be a force for instability itself.

THE ISSUE OF INFLATIONARY POLICY

The technical framework of the new monetary system may be considered from two points of view in appraising its adaptability for attaining the objective of higher and more stable domestic prices and a more complete utilization of productive resources without resulting in inflationary excesses. The first would be confined to a purely quantitative analysis of all the potentialities for monetary expansion provided for in the new monetary arrangements. The second would proceed by assuming that many of the opportunities of currency expansion provided within the general framework of the new set-up are of political importance only and that they may be largely disregarded unless political pressure on the Executive should become more critical than the Executive as a political agency may reasonably be expected to withstand. The first approach is typical of the extreme monetary alarmists and without doubt has much to commend it from the standpoint of political experience. The second, however, seems more in accord with the trend that events have recently taken.

The Viewpoint of the Monetary Alarmists

Notwithstanding the trend of events and the weight of reason, it is not warranted to ignore the first approach. The

official formula for monetary policy is highly flexible, rather than definitely rigid. It is unquestionably capable of furnishing justification for almost any state of domestic prices. Furthermore, there is always the likelihood that the effort to overcome obstinate disequilibria within the economic system will provide the incentive or the justification for new monetary issues. It is always possible to be at the point of applying regulative and stabilizing controls and yet find ample political and economic excuse for deferring their application. There is always the possibility, too, that fear of a stabilization crisis or panic may develop among the monetary authorities after a substantial price advance, and effectively deter the application of restrictions on further monetary expansion. In the face of these possibilities, there is indisputably much room for apprehension and misgiving over the new monetary program.

Obviously, if one should judge the new monetary arrangements on the assumption that most, if not all, of the discretionary powers for monetary expansion now in the hands of the Executive are likely to be applied in the course of the next few years, apprehension and misgiving could easily attain an extremely high pitch. If all of these powers were to be applied jointly or in close succession, no competent authority would deny that they would involve a total increase in the currency supply of theoretically incalculable proportions. And there could be no serious doubt of an accompanying elevation of domestic prices, wholly defiant of any formal admonitions and gestures of control. It is probably no exaggeration of the potentialities to say that if the existing powers to expand the monetary supply were employed in rapid succession, the average height of domestic prices, despite all interfering forces, would be raised before long to several times that of today. Prices, of course, would not rise uniformly, so that onerous distortions of price relationships would develop, accompanied by critical dislocations of industry and trade. No one could predict to what heights prices would finally advance, how fast would be the tempo of the rise, or how aggravated the price and production dislocations would finally become; but it can safely be stated that the monetary forces for the rise would be so

powerful and rising prices would finally acquire so great a momentum, irrespective of price and trade derangements, that no subsequent governmental action would prove politically expedient or economically effective in bringing the inflationary upswing under rational control.

The Crux of the Alarmists' Viewpoint

As the monetary alarmists properly point out, the present monetary plan is a plan of divided monetary responsibility. The Executive has discretionary responsibility over the issues of Treasury currency and an influence over Federal Reserve policies and the issues of Federal Reserve currency. The Federal Reserve authorities, nonetheless, have some degree of independent responsibility for their own operations and for issues of Federal Reserve currency.¹ Finally, the commercial banks, though by law subject to the stringent supervision of the Federal Reserve Banks, have a large measure of independent responsibility for their issues of deposit currency once they have come into the possession of larger reserves by virtue either of increased Treasury or of Federal Reserve currency issues.

If all the discretionary powers for monetary expansion now vested in the Executive were successively applied, commercial banks would acquire enormous reserves that would defy the capacity of the Federal Reserve System to counteract them by the liquidation of its combined holdings of earnings assets. Under such circumstances, discount relationships of the Federal Reserve Banks with their members would certainly diminish to a negligible importance and remain unimportant for an indefinite time in the future. In addition, with the liquidation of Federal Reserve holdings of government securities, all active contact of the Federal Reserve System with the nation's money market would be severed. Federal Reserve discount rates would cease to have any significance, except as they mirrored the movement of short-term interest rates in the central money markets. While the Federal Reserve Banks would retain some measure of control over member banks through their powers to exercise a strict supervision over the latter's lending and invest-

¹ See, however, footnote 2, p. 55.

ing activities, supervision in practice would prove difficult, and a virtual independence of member banks from the Federal Reserve Banks would exist. Furthermore, the advantages of Federal Reserve membership would be reduced, and a rather general movement of withdrawal might be provoked, frustrating Federal Reserve efforts to discipline members.¹

Long after the primary impact of the expansion of Treasury currency had been felt from the Executive's joint or successive application of discretionary monetary powers, an accelerating expansion of the deposit currency of commercial banks might easily supervene, pyramided on the basis of their greatly increased reserves by the cumulative growth of their lending and investing activities. It must, therefore, be granted that the first impact of a reckless use of the Executive's monetary powers would be merely the initiatory impact. From the unrestricted remonetization of silver, moreover, there would arise a continuing force for monetary expansion, and thence of bank currency expansion, of unpredictable strength.

It may of course be admitted, the monetary alarmists say, that the Federal Reserve System has one very powerful new instrument of control over the deposit currency issues of member banks; namely, the power to raise the fractional reserve requirements that member banks must keep against their deposit currency issues. But this power can be exercised only with the approval of the President, and political expediency may prevent such approval from being granted. In any case, it is a drastic power. If exercised after a rapid expansion of deposit currency issues takes place, its effects might be too serious. As commercial bankers know too well, deposit currency is not so contractible as it is expansible. If all commercial banks set about simultaneously contracting their deposit currency, banking panic would inevitably ensue. To believe that such a potent power might be invoked in

¹ Ability to retain membership in the Federal Deposit Insurance Corporation, by virtue of Federal Reserve membership only, could hardly be expected to constrain members from withdrawing under the circumstances here contemplated. Participation in the insurance of deposits would be likely to lose in value to banks in the face of rapidly mounting reserves, with balances continuously in excess of legal requirements.

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advance of an exceptional deposit currency expansion in order to head it off is to count on the employment of a Janus-faced policy to prevent monetary expansion at the same time that a policy of extreme expansion is otherwise being pursued.

The Alternative Viewpoint

It does not seem fair, however, to judge the new monetary program on the assumption that all the Executive's discretionary powers to provide for the enlargement of the Treasury currency supply will be used. It is more reasonable to take as a point of departure the steps of policy already taken, and particularly the action of the President in re-establishing a formal gold value for the dollar on January 31, 1934, immediately following the signing of the Gold Reserve Act of 1934. Abundant justification would seem present in this background for concluding that a course of monetary management that the Executive intends to follow has been determined, at least in a general way, and that some of the Executive's discretionary powers over the enlargement of the Treasury currency supply have been temporarily set apart as of dubious usefulness. Their application appears to be unlikely except as a last resort of management policy, if the course of action adopted fails to bring about materially higher domestic prices together with a fuller employment of available productive resources.

If this interpretation has any validity it must find support in the actual measures of monetary policy that the Administration has so far applied with the object of expanding the effective currency supply and inducing higher domestic prices. Generally speaking, six main measures of monetary policy have thus far been employed. A brief review of these policies will serve to substantiate the point of view here stressed.

MONETARY MANAGEMENT IN PRACTICE

Dollar Depreciation and Dollar Devaluation

The first and foremost measure of monetary policy in the managed currency program was dollar depreciation and

dollar devaluation. The international value of the dollar was first permitted to decline under the spontaneous impulse of market forces, and then was forced still lower by the gold-buying program of the Reconstruction Finance Corporation and the Treasury.

The objectives of this policy were apparently fourfold:¹ first, to raise directly the domestic prices of a large number of imported commodities and of the basic raw material commodities of the country's export trade; second, to set free indirect price-raising influences to bear on other domestic prices by raising costs; third, to extend the scope of domestic demands for commodities by creating uncertainty over the value of the dollar and the scope of international demands for American manufactured commodities by undervaluing the dollar in world markets; and fourth, to create "literally out of thin air" an increase in the dollar total of the nation's monetary gold reserves.

The first three objectives were necessarily of a short-run character, intended merely to give an immediate boost to domestic prices. The fourth was to satisfy the needs of the long-run monetary program. Its purpose was to put the Treasury in immediate possession of a stock of surplus gold reserves that could be monetized as needed by means of gold certificates which may be said to conform to the popular conception of a "sound" money. At the same time, it served to place the United States in such an international position that gold would be drawn into the country from world stocks and thus exert a fairly continuous pressure for the expansion of domestic monetary supplies.

Open-Market Operations

The second important measure of monetary policy employed by the Administration was the open-market purchase by the Federal Reserve Banks of approximately \$600 million of government securities. Applied after the passage of the Agricultural Adjustment Act in the summer months of 1933, granting to the President the authority to direct the Sec-

¹ See the Conference Board Information Service, Domestic Affairs, Memorandum No. 13, pp. 3-4. See also the testimony of Prof. James Harvey Rogers, "Hearings on the Gold Reserve Act of 1934," *op. cit.*, p. 312.

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retary of the Treasury to enter into agreements with the Federal Reserve Banks regarding such purchases, it represented an effort to force a new volume of Federal Reserve currency on the public and thence into the hands of commercial banks in substitution for their deposit currency. Undertaken at a time when the public was freely exchanging cash, withdrawn during the period preceding the banking moratorium, for deposit currency, its purpose was to contribute to direct expansion of this kind of currency and also to continue the growth of banking reserves on the basis of which banks might create still more deposit currency.

Release of Deposit Currency in Closed Banks

The third important measure of monetary policy was the undertaking by the Reconstruction Finance Corporation in the fall of 1933 (a) to aid in the liquification of deposit currency, frozen in closed banks and (b) to contribute to a general financial strengthening of active commercial banks. The first task involved advances of over \$750 million to approximately 2,200 banks. The second involved purchases of over \$1 billion of preferred stock and capital notes or debentures of more than 7,100 active banks, superficially to qualify them for admission to the temporary insurance plan of the Federal Deposit Insurance Corporation, but actually to restore them as effective issuers and clearance agencies of deposit currency.¹

Emergency Spending Program

The great emergency spending program of the Federal Government for direct unemployment relief, for conservation, civil and public works, and for farm mortgage and other debtor relief constitutes the fourth important measure of monetary policy, even though this program is immediately directed at meeting special phases of depression emergency. Because of its enormous proportions and because it was undertaken on top of a budgetary condition seriously unbalanced by the intractable costs of government in the face of declining revenues and the necessity for emergency outlays, over \$6 billion has been added to the federal debt of

¹ Up to the end of May, 1934.

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more than \$27 billion from March 1, 1933, to June 30, 1934. While the funds borrowed by the Treasury to finance federal spending have been furnished mainly by individual and corporate savings, more than one third of the total has been furnished by commercial banks.¹ The increase in the public debt has thus been freely employed by commercial banks as backing for deposit currency issues and to maintain and expand the deposit currency supply. From the angle of monetary policy, this was a primary object of the spending program. One of its main purposes, in other words, is to provide an interim demand for bank credit that will serve not only to support the existing volume of deposit currency but also to contribute powerfully to its expansion.

Silver Purchase Program

The fifth main step of monetary policy was the inauguration by the Treasury of a large scale silver purchase program in May and June, 1934, at first for the account of the Stabilization Fund, but after the approval of the Silver Purchase Act of 1934, declaring the accumulation and maintenance of one fourth of the national monetary reserves in silver to be national policy,² for the general silver currency and reserve account of the Treasury.³ While the accomplishment of national silver policy is a matter of discretion with the Secretary of the Treasury and the President, the Secretary of the Treasury announced on June 21, 1934, that the Treasury would "enthusiastically" carry out the policy of the Silver Purchase Act, buying silver both at home and abroad when offered at reasonable prices and issuing silver certificates on the basis of the cost value of the silver.⁴ Under the prevailing requirements for additional silver reserves to give effect to silver purchase policy, the Treasury is not only authorized to issue silver currency in the amount of several hundred

¹ As nearly as can be judged from available banking statistics.

² Signed by the President, June 19, 1934.

³ The Executive Order of August 9, 1934, nationalizing domestic silver stocks and authorizing the Secretary of the Treasury to pay 50 cents a fine ounce on their surrender to the Treasury, was issued after this book was in page proof. The Executive Order is discussed fully in Appendix A, particularly pp. 127 and 129. See also Appendix B, "Silver Certificates."

⁴ *New York Times*, June 22, 1934, p. 32.

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million dollars, according to the actual cost of silver purchases, but it has the legal authority to issue over one and one half billion dollars of such currency, employing the nominal monetary value of silver purchased as the base.¹ The silver purchase program thus provides the Treasury with a silver profit fund representing the difference between the purchase price of silver and the monetary value of silver amounting to \$1.29 per fine ounce, and this silver profit fund may be used to supplement the gold profit fund as the source of additional currency issues to satisfy the needs of monetary policy over the long run.

Direct Loans to Industry for Working Capital

The granting of power by the Congress to the Federal Reserve Banks and to the Reconstruction Finance Corporation to make direct working capital loans to established commercial and industrial enterprises for as long as five years, together with the power given to the Federal Reserve banks to discount such obligations for banks and other financial institutions, may be considered to be the final major action of monetary policy.² It authorizes combined loans and discounts by the Federal Reserve Banks to a total of approximately \$280 million and loans by the Reconstruction Finance Corporation to a total of \$300 million. Although direct loans by the Federal Reserve Banks may only be made under exceptional circumstances and loans by the Reconstruction Finance Corporation are limited to business firms unable to get accommodation from banks prior to

¹ The monetary gold stock of the United States amounted to \$7,850 million at the end of June, 1934, making the monetary value of silver reserves, necessary to carry out the silver purchase program, \$2,617 million. At the end of May, 1934, the monetary value of silver currency issues totalled \$813 million, and in addition several million ounces of silver bullion were held by the Treasury. It would seem, therefore, that between 1.3 billion and 1.4 billion ounces of new silver, having a monetary value of approximately \$1.8 billion, would be needed completely to carry out the silver purchase program on the basis of the present stock of gold and silver. Assuming that the Treasury could acquire this silver at a market price of \$.50, new silver currency amounting to around \$700 million would be issued under present Treasury procedure. The Treasury, however, might issue as much as \$1.8 billion, the difference between the amount actually issued and the amount potentially issuable constituting a silver "profit" fund.

² Granted under the Direct Industrial Loans Act, amending the Federal Reserve Act and the Reconstruction Finance Act, approved by the President, June 19, 1934. See Appendix A, "Federal Reserve Discount Powers."

January 31, 1935, Federal Reserve discounting of medium-term working capital loans has no time limitation. These powers, therefore, have the joint purpose of furnishing both emergency and continuing facilities for the direct and indirect support and expansion of the volume of bank currency. Their chief intent, particularly the intent of Federal Reserve powers to discount medium-term loans made by banks and other financial institutions, is to encourage a more liberal extension of bank credit and thereby to promote an expansion of bank currency on the part of the banking system at large.

IMPLICATIONS OF THE MAJOR STEPS OF MONETARY POLICY

If it is reasonable to view the steps of monetary policy, together with the official action of re-defining the dollar as a weight of gold and establishing a nominal gold standard, as casting the die for a program of monetary management, then several patent implications involved in the future course of monetary action may be considered here. It may be accepted with some degree of certainty:

(1) That the keystone of Executive currency policy is to be the monetization of Treasury profits of \$2.8 billion, obtained from gold devaluation, and the issuance of gold currency on the basis of gold acquired from new domestic production, from the recovery of old gold, and from world production and stocks through importation;

(2) That minimum silver currency issues, necessitated by silver purchases in pursuance of national silver policy, and optional silver currency issues, made possible from the accumulation of a silver profit fund in the course of silver purchases, will be freely used to supplement the issuance of gold currency;

(3) That commercial banks are to be relied on to furnish the bulk of the effective monetary supply for active circulation and that they are to be encouraged to expand freely their deposit currency issues on the basis of reserves, furnished directly by formal gold and silver currency issues of the Treasury;

(4) That the Federal Reserve Banks will not be called on

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to assume further initiative in issuing Federal Reserve currency for active circulation or for furnishing additional reserves to commercial banks although they may not be permitted to retire gradually some of their currency issues made available during the emergency, at least in the near future;

(5) That the existing federal program of emergency spending will continue to furnish a demand for bank credit funds, as well as savings funds, thus serving to preserve the existing supply of commercial bank deposit currency and to promote its expansion;

(6) That if, for any reason, a supplementary measure of a major sort is required to re-enforce the present scheme for currency management, it is more likely to take the form of further devaluation of the gold dollar, because devaluation serves to lower the international exchange value of the dollar and to exert a direct price-raising influence at the same time that it puts the Treasury in command of new resources for the issuance of gold currency.

There are, to be sure, many corollaries to these main implications, but the purpose here is merely to indicate objectively the character of the present program of currency management as it appears to be taking shape under the new monetary law. Admittedly, the interpretation must be somewhat tentative in the face of all the uncertainties, political and economic, that abound on every hand. Nonetheless, if the pattern of policy has been faithfully described, it is fairly certain that the question of any immediate application of the Executive's discretionary powers over silver,¹ other than those already exercised in connection with the International Silver Agreement of 1933, the Silver Purchase Act of 1934, and the Executive Order of August 9, 1934, may be regarded as effectively disposed of, for the time being. It also follows that the Executive's discretionary power to issue greenbacks to retire the public debt may be expected to be held in abeyance, though its application at some future date must be viewed as a practical possibility² because this power has no specific time limit.

¹ Especially the power to establish bimetallism.

² In his press conference on January 15, 1934, President Roosevelt stated that he did not regard the issue of currency to retire the public debt as "greenback" inflation, because legal provision is made for the limitation and retirement of the total issues. See the *New York Times*, January 16, 1934, p. 3.

In any event, the point to be emphasized in any calm appraisal of the Roosevelt scheme of managed monetary expansion is that the possession by the Executive of wide discretionary monetary powers does not mean their reckless exercise. There are grave responsibilities involved in any discretionary manipulation of the Treasury currency supply that may be expected to weigh heavily with the monetary authorities after the first flush of inflationary experiment is over.

THE QUESTION OF CONTROL

So far the questions of the ultimate potentialities for excessive monetary expansion and of the practicability of available measures of control under the plan of monetary management adopted by the Executive have been avoided. These questions involve so many problematical elements that no definite answers can be given to them. The answer to the first question depends partly on (a) the total issue of Treasury currency, the amount which is finally deposited with banks and enters into their active resources, and the fraction of deposits that banks are required to keep by law as reserves and (b) on the decisions of monetary authorities, the public in general, business men who borrow from banks, and the bankers themselves. The answer to the second question depends on the effectiveness of available measures of control and on the administration of those measures, especially in regard to the timing and rigor of their application. Finally, in connection with both questions it is necessary to take into account a host of non-monetary influences that are inherent in the existing social and economic organization.

A Semi-Official View of Inflation Possibilities

If it is assumed that an expansion of Treasury currency under the present monetary policy will be accompanied more or less automatically by an expansion of deposit currency of commercial banks and later by an expansion of Federal Reserve currency and a further expansion of ordinary deposit currency, it is possible to calculate a theoretical maximum of possible inflation of the effective monetary supply of truly astronomical dimensions. If the theory of the "mod-

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ern" currency management school, which is accepted by implication in the new monetary program, that Federal Reserve currency is ordinarily ineffective in causing a long-run increase in the deposit currency of commercial banks is correct, the theoretical maximum of monetary expansion under current policies is greatly reduced. Professor James Harvey Rogers, monetary adviser to the Treasury, voiced this view of the question in his testimony on the Gold Reserve Act of 1934 before the Senate Committee on Banking and Currency. The following summary of his argument illustrates this point:¹

Approximately \$2.5 billion of the total Federal Reserve currency is currency backed by "earnings assets"; that is, it is created central bank money. Theoretically, all of this currency might be withdrawn from use over a period of time by the disposal of these assets, but practically only \$2 billion would be available for such a process, since a minimum amount must be retained to meet operating expenses of the Federal Reserve System. Hence, gold profits above \$2 billion are available to produce an inflationary expansion of deposit currency that is counteractable by Federal Reserve action. Suppose, for example, that the entire gold profits of \$2.9 billion² should be rapidly paid out by the Treasury and should flow into the reserves of commercial banks. At the end of January, member banks had approximately \$850 million in excess reserves, and additional reserves of around \$1,200 million were acquired largely through gold imports and Treasury disbursements of funds previously held as cash or on deposit with Federal Reserve Banks in the six months that followed the official devaluation of the dollar, raising excess reserves of member banks to around \$1.8 billion. A total of \$4.7 billion of reserves would be made available at once for the expansion of the deposit currency of commercial banks, while further gains in reserves would doubtless arise from subsequent gold imports and domestic gold production. Accordingly, there would be a minimum

¹ "Hearings on the Gold Reserve Act of 1934," *op. cit.*, pp. 312-3. The figures are modified from Professor Rogers' testimony to allow for later developments.

² Gold profits of \$2.8 billion, plus gold taken over from the R. F. C. of around \$120 million.

reserve fund accessible of over \$2.7 billion not subject to control by Federal Reserve action. Assuming conservatively a primary expansion of deposit currency of from four to ten times this aggregate reserve fund, an "uncontrollable" bank deposit currency expansion of from \$10.8 billion to \$28 billion might be expected to ensue.

While these figures are quite impressive in themselves, they make no allowance for the effects of silver purchases under the authority of the Silver Purchase Act of 1934. As the Treasury's silver purchase policy appears to be taking shape, a minimum of approximately \$700 million of new silver currency may be expected to be issued sooner or later, and an amount up to \$1.8 billion, reckoned on the basis of the present monetary gold stock, can be issued.¹ Granted that the Treasury will vigorously strive to bring national silver policy to an early fulfillment at the same time that it is expending its gold profit fund and, further, that silver currency issues resulting from this action will flow promptly into the reserves of banks, the "uncontrollable" fund of bank reserves figured above is raised to \$3.4 billion, capable of supporting a primary bank expansion of from \$13.6 billion to \$34 billion. If the Treasury should monetize its supposed silver purchases up to the full amount permissible under the law, then the "uncontrollable" fund of bank reserves would be increased to \$4.5 billion, with the power to produce a primary expansion of bank currency of from \$18 billion to \$45 billion.

These figures are formidable. They are rendered even more formidable when weighed against the total contraction from 1929 to 1933 in the effective currency supply held by the public, amounting to about \$9 billion.² If it is assumed (1) that the Treasury will engage, as a matter of policy or of fiscal necessity, in an extreme program of monetizing the

¹ See footnote 1, p. 68.

² Depending on the manner of reckoning, particularly as regards the treatment of time deposits. Judging from middle of the year figures, the total decline in all commercial bank deposits amounted to around \$17 billion. About \$7 billion of this total, however, was possibly composed of time or savings deposits not subject to check, and hence non-currency deposits. Inasmuch as the supply of formal currency held by the public registered a net increase of roughly \$1 billion in the period, the net decline in the total currency supply held by the public, excluding time or savings deposits, diminished approximately \$9 billion.

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profits from gold revaluation; (2) that the Treasury will lose no time in bringing national silver policy to an effective consummation, with large silver currency issues accompanying it; (3) that the United States will acquire additional gold from domestic sources and from international transactions which the Treasury will permit to be freely monetized; and (4) that commercial banks will mechanically and energetically expand their deposit currency issues in response to a rapidly growing volume of reserves, a monetary inflation of huge proportions would take place.

If this were an imminent possibility, it would be truly alarming. The assumptions behind it, however, are admittedly arbitrary. They obviously fail to take into account a great many monetary and non-monetary factors that must necessarily weigh heavily in the final inflationary outcome. Furthermore, they begin with the premise of immediate and complete monetization of Treasury gold profits and the reckless pursuit of national silver policy by the Treasury. Obviously, this is a denial that any moderation will be exercised in the newly adopted program of currency management.

The Dilemma Facing Inflationary Policy

The composition of the American monetary supply being what it is, it is absolutely essential for the success of the present managed money program that a great expansion of the deposit currency of commercial banks should follow. But how fast may such an expansion take place and will its tempo be as fast as many have been led to believe? If banking expansion were purely mechanical, with bankers responding as automatons to the stimulus of larger deposits of cash and, hence, of reserves, by making loans and investments and creating additional deposit currency, the expected results would be quickly accomplished. Since, however, the banking process is not merely mechanical in its nature, deposit currency expansion will be generated slowly, and its pace will depend mainly on the recovery of prices and production, though it will partly depend on the demands made on banks by the Treasury to assist in the financing of the federal spending program.

There are, of course, many considerations entering into any tentative answer to this question, the more important of which are analyzed below:

(1) Ordinarily, a bank coming into the possession of new reserve funds will be stimulated to substitute a profitable asset for one that is barren, thereby operating to create a new deposit for itself or for some other bank, but it will not do so unless there is confidence in the stability of price and trade conditions. The reason for this is obvious. In the case of an individual bank, either a new deposit liability is created by a new loan or investment which is redeemable in cash on demand or an existing deposit so redeemable is undermargined in cash though fully margined by total collateral. There must exist a reasonable assurance that the earnings assets acquired are sound in terms of value; that is, that their value will not diminish while held by the banks. After four years of adversity, uncertainty over the value of bank assets, and actual loss on earnings assets, it could hardly be expected that banks should seek to employ excess reserves, growing out of an expansionist monetary policy, with unrestrained enthusiasm. This can hardly be expected until business recovery is much further advanced than it is. The unrestrained employment of banking reserves is characteristic of periods of speculative boom, not of depression or recovery.

(2) Because banks are service institutions, dependent in the end for the volume and stability of their deposits on the good will of the public which they serve, they naturally look first to the accommodation of customers in acquiring earnings assets. But accommodation cannot be granted indiscriminately and without security. For example, in the extension of business loans, which constitute, as they should, the bulk of the customers' loans, there must be a record of profit-earning capacity, a current financial and business condition adequate to justify a loan, security in the form of commodities or securities pledged as collateral, or endorsement by a responsible party, and assurance in the outlook for prices and trade that repayment will be made within a reasonable time. In other words, there must be conformance to a threefold standard: past record, present capacity, and

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future prospects, all of which are contingent on the general state of business and trade. Appropriate precautions must similarly be taken with real estate and personal loans, even if the Government offers partial guaranties against loss, as with home remodelling loans under the National Housing Act.

(3) Even after a year of price and trade recovery following a drastic business liquidation lasting four years, it is inevitable that every bank should be confronted with a dearth of customers who can meet sound credit tests and who are in the market for bank loans. Many industrial and commercial concerns have only a record of losses and a condition of impaired working capital with which to approach banks for loans. They are faced, in addition, with doubtful financial prospects owing to the higher costs imposed directly and indirectly by the operations of the National Recovery Administration, the Agricultural Adjustment Administration, and the monetary program, and their competitive positions are rendered uncertain by the application of code restrictions on productive activity and price policies. They can offer little inducement to banks to extend them loans, therefore, even though the rediscount facilities of the Federal Reserve Banks are available to any commercial bank under the Direct Industrial Loans Act for the rediscount of medium-term loans and obligations of established enterprises for working capital purposes. Other concerns not only suffer from these conditions but also labor under the handicap of fixed capital debt acquired in the past. Other customers, whose unfortunate experience with bank debt during the period of panic is still fresh in their memories, have a lingering reluctance to incur bank debt anew. Business corporations that followed the definite policy in the past of avoiding bank debt will likely adhere to the same policy in the future, even though the liabilities imposed by the Securities Act of 1933 in the issuance of stocks and bonds and the security markets controls and regulations imposed by the Securities Exchange Act of 1934 furnish the basis for a more favorable view of bank borrowing than formerly prevailed. There are many banking customers whose income and savings positions, after the losses of depression, are not sufficiently restored to warrant bank loans for either consumption or

speculative purposes, and there are also other customers who could afford to borrow for these objects but who are unwilling to incur the obligations involved in bank debt because of the risks and uncertainties that abound on every side.

(4) If a bank finds itself unable to acquire a fitting short-term asset in its local loan market, it may acquire an asset in the open market by the purchase of short-term commercial or acceptance paper or by placing its funds in security loans at call.¹ But the supply of commercial or acceptance paper is also limited by the state of trade and prices, while the demand for funds for security loans is dependent on the state of speculative and underwriting activity. Furthermore, member banks do not have complete freedom in making loans on securities. They are now subject to strict and continuous regulation by the Federal Reserve Board and Federal Reserve Banks in engaging in security lending. With the passage of the Securities Exchange Act of 1934, all commercial banks are subject to margin requirements fixed by the Federal Reserve Board on all loans made to acquire and carry securities, designed specifically to limit their ability to lend freely on securities and to check the demands of the securities market for bank funds. A curtailment of security market demands for bank funds is also intended by the Securities Exchange Act through the operation of its various curbs on the speculative manipulation of security prices.

(5) Because the deposit currency of commercial banks represents liabilities payable on demand, banks necessarily must invest as far as possible in short-term assets rather than in long-term securities of commercial, industrial, public utility, and transportation enterprises. Short-term maturities are easier to appraise than the long-run obligations. Nonetheless, investment in long-term securities of this character is always an avenue for the acquisition of earnings assets. The supply of private securities of the highest grade,

¹ Formerly, banks could deposit surplus funds at interest with another bank. Under the Banking Act of 1933, the payment of interest on bankers' and other demand deposits was prohibited in the case of all member banks, so that banks may now only place funds with other banks on a time basis for earnings purposes. A similar regulation was made by the Federal Deposit Insurance Corporation, applying to all its member banks, so that this restriction is now uniform for all commercial banks.

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however, is limited and high-grade borrowers have not yet entered the capital market with new bond issues on any important scale. Banks are loath to invest their funds in lower-grade bonds, semi-speculative in character, especially after the collapse of bond prices during the depression. They are also somewhat loath to acquire such assets in the face of an uncertain future for their market value that arises from recurrent inflationary scares among investors that an extreme monetary inflation, possibly in the offing, will render fixed-income securities undesirable as investment holdings. Furthermore, there is always the risk that large investment in second-grade security assets may subject a member bank to a charge of undue use of bank funds for speculative purposes, and therefore make it liable to penalties imposed by the Federal Reserve Board. Finally, under the Banking Act of 1933, all member banks may purchase investment securities of private enterprise only in accordance with limitations and restrictions prescribed by the Comptroller of Currency, and the amount that they may hold of any single investment issue is definitely limited.

(6) Government securities provide another investment avenue for the employment of excess banking reserves. Such assets may be employed as collateral for member bank advances from the Federal Reserve Banks, and under the new plan of monetary control they have an extraordinary marketability, since the Secretary of the Treasury is empowered to employ freely the Stabilization Fund in supporting the market for government securities.¹ Notwithstanding this fact, however, other considerations may deter the banks from extending indefinitely their holdings of government securities as the basis for deposit currency expansion.² More than \$8.6 billion of such assets, or over one third of the total federal debt, was held by member banks at the beginning of March, 1934, and they constituted practically 38%

¹ See Appendix A, "Open-Market Powers of the Secretary of the Treasury."

² Member and other banks that are recognized depositories of government funds have a special inducement to increase holdings of government securities by buying new issues. Under Treasury regulations, they are permitted to pay for subscriptions by crediting the Treasury with an equivalent amount of deposits. Inasmuch as no reserves are required against Treasury deposits and since they may not be actively drawn on for some time, a given bank may acquire earnings assets by subscriptions to new Treasury issues without an immediate loss of reserves.

of all earnings assets of member banks.¹ With such a large stake in federal finance, commercial banks must inevitably view with some misgiving both the present and the prospective condition of the federal budget.

(7) The expansion of bank holdings of earnings assets on a large scale, resulting in a rapid growth of deposit currency, requires that all commercial banks should act simultaneously to substitute interest-yielding assets for cash assets. It is only in this way that a primary expansion of deposit currency, amounting to four to ten times new reserves furnished to the banks by larger issues of Treasury currency, can take place. An individual bank acquiring earnings assets in exchange for cash ordinarily must count on losing an equivalent of its excess reserves through the clearings mechanism. Obviously, if for any reason whatsoever, the banks to whom its excess reserves are transferred are slow in putting them to work or find no safe opportunity for employing them at all, the process of banking expansion will be checked. On the other hand, if all banks act simultaneously to increase their earnings assets, the tempo of deposit currency expansion may be fairly rapid. No matter how hard individual banks may struggle to substitute earnings assets for surplus cash reserves, the latter can only gradually be used up as legal reserves against the mounting volume of deposit currency for the commercial banking system as a whole.

(8) Such a process of banking expansion, however, is inconceivable without an active condition of trade and a stable, if not buoyant, outlook for prices. Loans and investments by banks independent of such conditions are incompatible with the banking process, for earnings assets must have both liquidity and solvency. These are provided in the long run, so far as business borrowers from banks are concerned, only by the sale of goods in stock or process and by the productivity of durable wealth. Moreover, active trade and an outlook for firm prices are required to foster the demands for bank credit that give continuity to the banking process, furnish the support needed to maintain a given

¹ At the peak point of war-period finance, member banks held only \$4.6 billion of government securities, or slightly more than one fifth of their total earnings assets. Federal Reserve Board, "Annual Report, 1932," p. 128.

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volume of deposit currency, and provide the basis for its expansion. All earnings assets acquired by banks must be repaid in the course of time and replaced by other assets. If they cannot be replaced, contraction or liquidation of deposit currency takes place. If a banking system operates on any other basis than a turnover of banking assets with the turnover of trade, it deliberately freezes its condition in advance and openly invites ultimate disaster and collapse.

(9) The dependence of a supply of assets, available for banking operations, on trade and prices means that domestic price conditions and, hence, monetary conditions must be greatly influenced by factors growing out of international trade. Internationally, price structures are closely tied together by factors of trade, particularly trade in primary foodstuffs and raw materials, which also play an important role in domestic exchange. Since the prices of primary commodities tend to be the same in all international markets, with allowances for shipping, tariffs, and exchange costs, it is impossible to escape the effects of their variation by the mere quantitative regulation of Treasury currency. In the past, dollar devaluation of 41% was employed for this purpose, and additional legal devaluation of 9% is allowable under the discretionary powers of the President, though a greater "devaluation in fact" may be permitted, if not formally recognized, by the Executive.

Currency devaluation, however, is a policy which other nations have already applied and may apply further. It is also a policy which remaining gold-standard countries may be induced to adopt. Once used, its effects are quickly felt, but they soon come to an end, and they may be offset by the actions of other countries. There is little basis for the assumption that the principal international influences adversely affecting domestic price conditions may be counteracted in the future by varying the exchange value of the dollar.

How Much Treasury Currency Inflation Is Enough?

It is manifest that the new program of monetary management is confronted with four main sources of difficulty that render its outcome problematical:

First, there are the difficulties growing out of the objectives for monetary policy laid down by President Roosevelt himself, namely, in their combination of short-run and long-run aims. Domestic prices, the nation has been promised, are to be raised to indefinitely higher levels by monetary manipulation. Once raised, they are to be stabilized within limits of tolerance by the regulation of the currency issues of the Treasury.

Second, there are the pervasive factors of agricultural, commercial, and industrial maladjustment and unemployment, and the fact that a full utilization of available productive resources is the ultimate criterion of currency management policy. With the passage of time and with persistent individual and social effort, it is conceivable that many of the prevailing maladjustments may be corrected. But it is also conceivable that new maladjustments will develop and accumulate, and it is not impossible that forces generated by the national recovery and adjustment programs will contribute many of them. It is further conceivable that a rapid expansion of the monetary supply, produced by an overly ambitious currency management policy, may affect the agricultural, commercial, and industrial sectors of the national economy, and likewise their subsectors, so unequally as to be a major source of accumulating maladjustment.

Third, there are the perplexing problems arising out of the nature of the monetary supply to be managed, especially because so large a proportion of it is constituted of credit or debt money issued by commercial banks. To a large extent, this bank money is dependent on the state of trade and prices, and on a host of psychological and physical influences that are frequently, but inaccurately, described as "non-monetary" factors. Moreover, except during an era of speculative recovery and boom the volume of bank money is enlarged only slowly under the beneficent influence of expanding productive activity and stable or rising prices.

Fourth, there are the confusing and complex financial forces originating in the international sphere that inevitably condition domestic financial developments. Some of these forces operate directly through the prices of the great staple commodities whose markets and sources of supply are world-

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wide. Others exert only an indirect influence; as for example, the forces emanating from the monetary and commercial policies of foreign governments.

These manifold difficulties obviously render the new monetary policy hazardous to a high degree. The attainment of its objectives requires that a careful course be steered between the Scylla and Charybdis of domestic and international finance. In this, perhaps, lies its greatest danger, because the attainment of immediate objectives in the way of higher domestic prices and a more complete use of our productive facilities is of far greater importance, owing to political pressures and the plight of the federal budget engendered by emergency spending, than the successful accomplishment of price level stabilization projected for the long run. If the attainment of short-run aims fails to materialize within a comparatively brief period, as a result of external or internal influences or both, it will prove all too easy under the monetary theory on which the new currency management program rests to jump to the conclusion that the amount of Treasury currency expansion has been insufficient and that still more expansion is required to produce prompt results. If this should turn out to be the case, and it has already been indicated in the attitude of the Congress,¹ no control of, or limits to, total monetary expansion can fairly be anticipated. Once prices and trade reach the incipient stages of a boom, speculative impulses would cast aside all formal restraints and checks. Rapid bank currency expansion would follow ultimately in the train of the immoderate increase in Treasury currency, with a final outcome in total monetary inflation that no one would venture to predict. Effective control of the international value of the dollar would grow increasingly difficult and in the end might be lost altogether. A new deal in money would again be the order of the day.

INTERNATIONAL MONETARY INFLATION

It is manifestly a matter of great significance for the outcome of the American managed currency program that many

¹ As exemplified by its insistence that something should be done for silver as a means of restoring prices.

other countries have been freely employing monetary measures, notably currency depreciation and inflationary currency-issuing policies of central banks, for purposes of promoting higher domestic prices and thus endeavoring to foster economic recovery along distinctly national lines. With the exception of the so-called "gold-bloc" countries of Europe that continue to uphold their established gold-standard systems, monetary measures conforming broadly to the most liberal currency management notions may be said to have become quite generally the vogue since the widespread abandonment of the gold standard, particularly within the last year.

The course of foreign currency values in the international markets, the monetary and banking developments in countries possessing inconvertible and depreciated currencies, and the expressions of official attitudes with reference to monetary policies and the problem of raising domestic prices all support this view. It may be fairly said, therefore, that international monetary systems have quite generally come under the grip of nationalistic managed-currency programs, bent in the first instance on mitigating intolerable international financial and trade pressures on domestic business conditions, but ultimately on establishing higher internal price levels, whatever may be the behavior of external price levels.

There are several major differences between foreign monetary programs and the program of the United States. The reason for encouraging domestic price recovery in most foreign countries was provided by the involuntary abandonment of the gold standard under the stress of dwindling gold reserves, caused largely by the necessity of meeting foreign obligations in the face of receding trade values and international financial panic. Furthermore, in most foreign countries the resort to inflationary monetary measures has been less openly proclaimed as a primary means of raising domestic prices than has been the case under the program of the Roosevelt Administration. Finally, in none of the foreign countries have governments seen fit, even where reserves of gold have been adequate to permit it, to give definite legal sanction to a permanent or semi-permanent managed cur-

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rency program independently of its consequences for the co-operative re-establishment of the gold standard internationally, even though the continuance of prevailing policies might render such re-establishment impracticable.

The Present Relationship of International Currencies

At the present time, the various countries of the world are in conflicting monetary camps. There is, for example, one group of countries that agreed at the London Economic Conference to co-operate with each other in upholding their existing gold-standard systems. Another group, namely those countries composing the British Empire, are bound by agreement reached after the close of the London Economic Conference to co-operate with England in maintaining inter-country exchange stability and in monetary policy directed to increasing commodity prices. A third group is represented by the Scandinavian countries which were compelled for reasons of trade and finance to relate their currencies more or less closely to the pound sterling and each of which is endeavoring to promote higher internal prices independently of the others. Still other countries, mainly those burdened with large international debts, more or less individually and often with the aid of stringent exchange and trade controls, as well as partial or complete moratoria on the payment of external debts, are following national monetary programs according to the dictates of necessity and self-interest.

A summary view of the prevailing state of international currency values brought on by the world-wide abandonment of the gold standard and the pursuit of national monetary programs is given in Table 1, which shows the percentages of currency depreciation from pre-depression gold parities as of June, 1934. Owing to the exchange controls and "blocked" currency systems that are maintained by a number of countries, whose international indebtedness is high and whose internal confidence in their ability to avoid extreme currency instability without exchange controls is low, the figures are in some cases only nominal and do not reflect the true amount of existing depreciation in terms of gold. The general impression which this table is intended to convey is little affected by this lack of complete accuracy, however,

since its purpose is merely to illustrate the extent of de facto, if not de jure, devaluation of the 41 currencies of the world.

The Problem of International Monetary Stabilization

Although the United States has set an example for the rest of the world by its formal stabilization of the dollar and re-establishment of a nominal gold-bullion standard, at least from an international viewpoint, the legal framework of the new American system, with its various discretionary powers and provisions for future variation of the gold and foreign exchange value of the dollar, is admittedly not designed to inspire international confidence in the dollar. It cannot be expected to induce other countries to bind themselves by law to a definite monetary program, calculated to provide for an enduring stability of the value of currencies in terms of each other and the re-establishment of an international monetary system based on the free use of gold in international payments. On the contrary, it can probably be expected only to foster the continuation of international monetary instability, to encourage further deliberate depreciation of currencies, to discourage efforts to restore international currency values to higher levels, and to extend the application of distinctly national monetary programs by foreign countries.

Many reasons for this view may be given, but the more important considerations in support of it are as follows:

(1) The employment of deliberate dollar depreciation and devaluation by the United States, with the dual aim of gaining an advantage in export trade at the expense of import trade and of raising generally domestic prices, has tended to engender retaliatory and defensive currency depreciation and tariff barriers by other countries, because trade gains for the United States, accomplished in this way, can only be had at the expense of other countries. The temporary termination of dollar depreciation by formal revaluation, contrary to popular impression, has not removed the incentive to foreign retaliation. Since dollar depreciation was both rapid and substantial, the resulting advantages to many American exports and disadvantages to many imports have

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TABLE 1: THE EXCHANGE VALUE OF PRINCIPAL FOREIGN CURRENCIES AS PERCENTAGES OF THEIR PRE-DEPRESSION PARITIES, JUNE, 1934

1. "Gold Bloc" Currencies	Percentage
Belgium.....	99.8
France.....	100.0
Italy.....	97.1
Netherlands.....	100.2
Poland.....	100.0
Switzerland.....	100.0
2. "Sterling Bloc" Currencies	
British Empire currencies	
England.....	61.6
Australia ¹	49.1
Canada.....	59.9
Egypt.....	62.2 ²
India.....	61.7
Newfoundland.....	59.7
New Zealand ¹	49.2
South Africa ¹	60.9
Scandinavian Currencies	
Denmark.....	50.0
Finland.....	52.6
Norway.....	56.2
Sweden.....	57.7
3. Other European Currencies	
Austria ¹	79.8
Bulgaria ³	96.2 ²
Estonia.....	62.5 ³
Germany ¹	95.5
Greece.....	43.0
Latvia.....	98.1 ⁴
Lithuania.....	99.8 ²
Hungary ³	98.7 ²
Portugal.....	62.2
Rumania.....	99.3
Spain.....	42.1
Jugoslavia ¹	76.6
4. Latin American Currencies	
Argentina ⁵	32.9 ²
Bolivia.....	40.3 ⁴
Brazil ¹	42.6 ²
Chile ¹	49.9 ²
Colombia ¹	37.4 ²
Cuba.....	59.4
Mexico.....	33.1
Peru.....	49.3 ⁴
Uruguay ¹	46.1 ²
5. Japan.....	35.6
6. United States.....	59.1

¹ Nominal only due to the existence of exchange controls. ⁴ April, 1934.

² May, 1934.

³ Partly nominal.

⁵ Free rate.

tended to linger on, because internal prices of many commodities, notably manufactured articles, as well as domestic

incomes, have not risen proportionately to the reduced value of the dollar, and they may not rise proportionately for some time to come. Furthermore, the possibility of further depreciation and devaluation of the dollar makes foreign countries determined to meet unfavorable effects on them by reserving their own freedom of action.

(2) To the extent that deliberate dollar devaluation has been effective in giving the United States a more advantageous trade position internationally, it is likely, because of America's large creditor account, to make the country a magnet for gold drawn from the world's free gold stocks and new gold production. Many of the debtor countries originally abandoned the gold standard because their available gold reserves had been drained away internationally. While depreciation of their currencies, even though involuntary, would ordinarily have served to correct this condition over a period of time by making possible the re-accumulation of gold reserves and the re-establishment of currency stability at a new and lower level of gold value, these debtor countries have not yet been able to build up gold reserves adequate to establish a gold basis for monetary policy. Their ability to accomplish this task is rendered more difficult by trade advantages accruing to the United States from its monetary program. To the extent that such debtor countries disposed of their exports to the United States, but mainly bought their imports elsewhere, they probably suffered some measure of real loss of international purchasing power in the past year by the monetary policy of the United States. In a similar way, the currency depreciation policy of England has operated and continues to operate against their international interests.

(3) The maintenance of international monetary stability of debtor countries that are in the stage of developing resources or of paying off accumulated debts has always been aided in the past by a continuous flow of international loans. The drying up of international lending during the 1928-1929 boom and in the depression period weighed heavily on the international financial position of the debtor countries. The failure of international investing to revive, furthermore, has delayed the accumulation of gold reserves by debtor coun-

tries which is essential to a re-establishment of more stable currency conditions. The monetary policy of the United States presents definite obstacles to a permanent revival of international lending for the reason that long-term investment commitments are unlikely on a large scale in the face of arbitrary changes in international currency values, with the risks that such changes entail for the status of international debts.

(4) Uncertainty over the international value of any currency tends to stimulate the flight of capital from that currency to other stronger currencies. The presence of large amounts of foreign capital in any financial market purely for safekeeping frequently leads to doubts for the currency stability of that market at a later date. The recent withdrawal, following dollar revaluation, of American capital accumulated for safety in European gold-standard countries during the period of depreciation of the dollar, for example, proved a source of considerable international strain. The existence of a large fund of mobile capital of this character in the international markets is not only encouraged by international currency instability or uncertainty, which purely nationalistic monetary policies promote, but it acts as an aggravating force for perpetuating instability.

(5) The ability of the countries still adhering to the gold standard to carry out their expressed intentions of upholding their established monetary arrangements regardless of the policies of other countries depends in considerable part on apparent intentions of other governments. As long as the United States, as a matter of choice, and other countries, by choice or necessity, hold to the policy of manipulating the international value of their currencies for purposes of trade advantage, or for purposes of defense against currency manipulation of others, or for the purpose of raising domestic prices, the position of the "gold bloc" countries must remain precarious, thus providing a potential source of still further international monetary instability.

(6) So long as national price structures are interrelated by trade in primary raw materials and other commodities, it is unlikely that any important country now possessing an inconvertible currency will be willing permanently to stabi-

lize its currency in terms of gold without it being clear that nations generally have the intention of acting likewise. The legal provision for further depreciation of the dollar at the discretion of the Executive is sufficient notice to foreign countries that the United States is unwilling to co-operate in permanent stabilization measures for the time being. That it has been so interpreted is exemplified by the critical reception given in the conservative English financial press to the recent proposals of the Monetary Committee of the International Chamber of Commerce for the adoption of an international program looking towards the restoration of world currency stability.¹

World Currency Instability and Domestic Price Recovery

Despite the attractive features that arbitrary manipulation of the gold and international value of the dollar present in the abstract, it should be remembered that these features are contingent upon a policy of inaction on the part of foreign countries. It is abundantly manifest from the world's monetary and trade experience of the past three years, and especially in the last year, that a passive policy cannot be relied on. Reciprocal currency depreciation, rigid exchange controls, blocked currency schemes, international debt defaults, tariff and quota trade policies are contrived in turn by other nations to defeat the aims of countries that overtly employed currency depreciation to promote higher domestic prices. The effect of these measures has necessarily been cumulative. Furthermore, they have borne down heavily on world trade and investment, and by restricting trade and investment they have served to depress prices or retard world price recovery.

World price recovery, however, is indisputably requisite to domestic price recovery, both from the standpoint of the role which raw material production plays in domestic productive activity and from the standpoint of the important position which prices of raw materials, closely connected by international trade with similar prices abroad, occupy in the

¹ See the London Statist, "Stabilization and the Pound," March 31, 1934, pp. 480-1; also the London Economist, "Back to Gold," March 31, 1934, pp. 685-6. The proposals of the International Chamber of Commerce are printed in full in World Trade, April, 1934.

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domestic price structure. As long as nationalistic monetary programs, such as those currently applied by the United States and other countries, have as by-products cumulative trade restrictions and depressive price influences in international markets, world price recovery is bound to lag. Without world price recovery, important domestic prices, notably of the international staples, are destined to an uncertain course despite internal production curtailment programs. Without a more certain course for these prices, inflationary policy must to some extent be frustrated because a rapid expansion of credit money, issued by commercial banks on which inflationary policy must necessarily depend, cannot take place freely when price uncertainty for the important internationally traded commodities is retarding their response to the internal inflationary program.

The International Issue of Gold

Notwithstanding the considerations favoring the continuation of world monetary instability as a necessary by-product of the widespread application of decidedly national monetary programs and their interaction, it is nevertheless true that gold retains great prestige for both domestic and international monetary employment. Its prestige has probably never been higher. World-wide financial disturbances have made the world "gold conscious."

If the prestige of gold renders it the only commodity adaptable for general international use in maintaining the external stability of currencies, active monetization of gold in national currency systems must again be freely permitted and domestic currency supplies must be held in a satisfactory relationship with gold holdings to insure the preservation of external stability under ordinary conditions. Under modern credit currency organization, this requires the maintenance of a monetary gold stock adequate not only for usual purposes but also sufficient to inspire domestic confidence in currency stability.

In order to have such a stock, to be sure of retaining it, and to enjoy its expansion over a period of time along with the gold stocks of other countries, international currencies must stand in such relationship with each other that fluctuations

in national gold holdings will be moderate, and that each country may be able to share in the distribution of new gold production.

In the case of countries whose depleted gold reserves have not been restored, currencies must be related to other currencies in such a way that future trade and investment may serve to restore their gold holdings as well as to provide for their maintenance and growth.

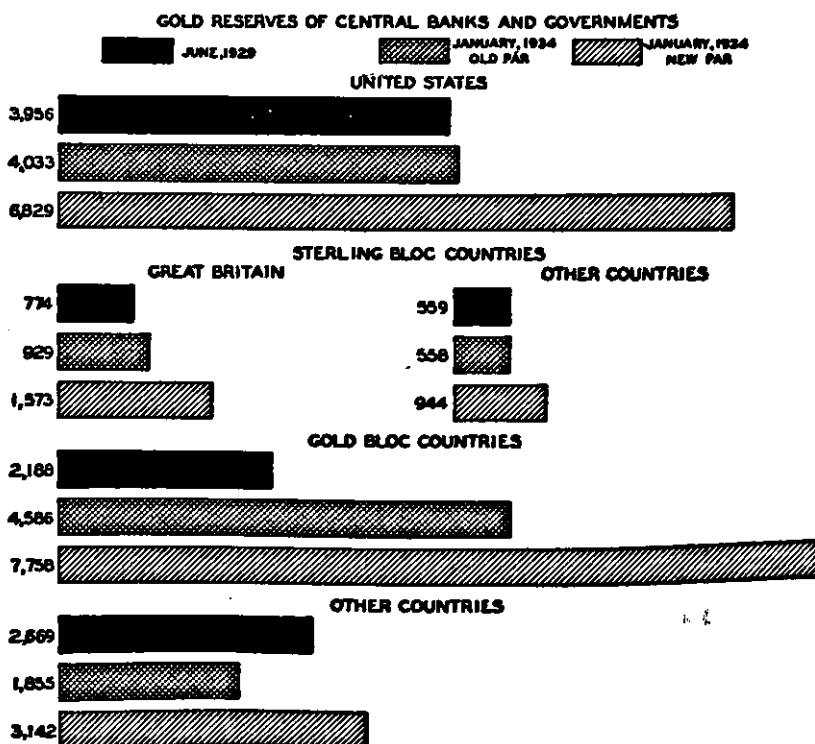
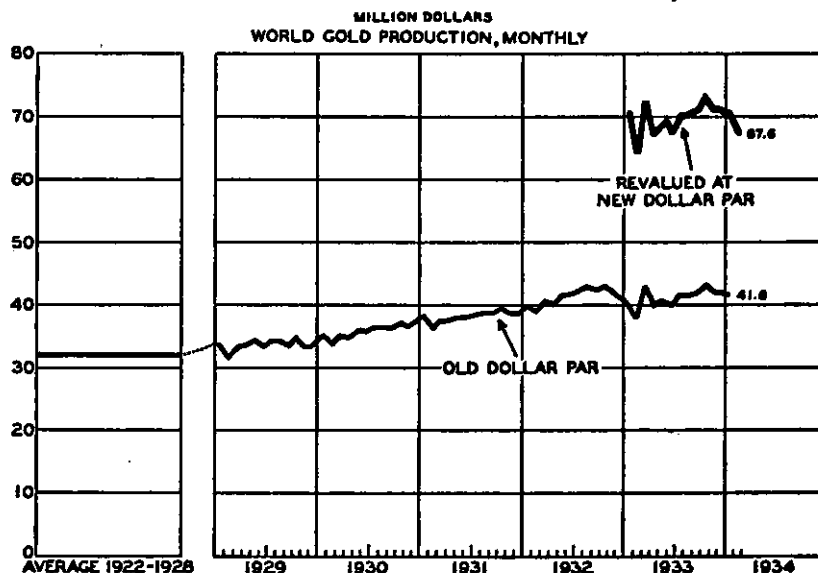
The Effects of Universal Currency Devaluation

Practically speaking, there are two divergent sets of forces that influence the outcome of prevailing international currency instability. On the one hand, there are the forces arising out of uncertainty as to the length to which public opinion and domestic economic pressure will drive the United States and other countries in the application of expansionist monetary measures under existing policies. On the other hand, there are the forces of monetary self-interest, that prevent the governments with unstable currencies from undertaking definite monetary devaluation, independently of unequivocal action of the United States and England, and that urge the "gold bloc" countries, maintaining stable gold currencies, to abandon stability.

The effects of competitive policies, inherent in national monetary programs, lead to universal currency devaluation. If this should occur, relentless inflationary pressure would be exerted by gold itself. In the first place, treasuries of countries possessing large gold stocks would come into the possession of substantial gold profits which they would be under immediate pressure to use for the improvement of budgetary positions. In the second place, world production of gold, already materially increased since 1929 by the higher commodity and currency values for gold, as is shown in Chart 6, would be widely stimulated. Finally, there would be a release for monetary use of some part of the world's \$2.1 billion of hoarded gold, of which more than \$1.5 billion has been accumulated since 1930,¹ and gold would be recovered

¹ Estimates of non-monetary gold stocks, according to Sir Henry Strakosch, Chairman of the Union Corporation of London, quoted in the Federal Reserve Board, *Weekly Review of Periodicals*, April 17, 1934.

CHART 6. DOLLAR VALUATION OF WORLD GOLD PRODUCTION AND MONETARY STOCKS, OLD AND NEW PAR VALUE, 1922-1934



from other sources. All countries would not fare equally well in the world-wide inflationary impetus from gold that would result from universal currency devaluation, because many debtor countries are largely denuded of gold, but there can be no doubt that all would share it in some measure. A re-established gold standard would stand in grave danger of "misbehaving by overexuberance immediately on its reappearance after banishment for inefficiency and malingering."¹

AN ERA OF MONETARY INSTABILITY AND CONTROVERSY

The international financial impasse brought about by the manipulation of currency systems for purely national aims cannot be removed without international monetary co-operation. International monetary co-operation, however, requires an abandonment of the more decidedly domestic phases of contemporary currency programs. It also requires a fair unanimity of opinion regarding the underlying principles on which currency organization should be based and regarding the objectives of national monetary policies. It obviously requires, furthermore, a higher degree of mutual trust and confidence among nations than exists at the present time and a solution for the vexing international political problems that underlie much of the distrust. Finally, it necessitates a greater freedom in the flow of world trade and investment than currently obtains, abandonment of many of the controls and barriers impeding trade and capital movements, and co-operative measures of reconstruction to aid the weaker economic areas.

The plight of world-wide currency instability, with its unavoidable repercussions on domestic recovery policies, is manifestly more than a monetary phenomenon. As long as world sentiment is incapable of supporting measures for international action, active minds will continue to explore various paths to Utopia. Of these, the nationally managed monetary path is especially alluring, because it can be made to appear simple and understandable, other things remaining

¹ "Gold Hoarding and Dis-Hoarding," *Midland Bank, Monthly Review*, London, December, 1933-January, 1934, p. 3.

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equal or not entering into consideration at all. Domestic inflationary experimentation, independently of world monetary developments, may easily win public support for its continuation, though not without an accompanying barrage of controversy. With the direction that world monetary policies have recently taken, it is indeed safe to expect a great era of monetary controversy, domestically and internationally, the outcome of which is not even dimly perceptible at present.

CHAPTER V

SUMMARY AND CONCLUSIONS

THE new monetary system of the United States is a "managed" inconvertible gold currency system. Its immediate objective is to promote a rise in domestic prices and a revival of business activity by expanding currency and credit. Its ultimate intention is to assure stability in the general purchasing value of the dollar and to bring about full employment of the productive resources of the nation. To accomplish these objectives the President asked and obtained from Congress broad discretionary powers of monetary management and control. The most important of these powers are as follows:

1. The President may vary the standard weight of the gold dollar between 12.9 grains and 15.48 grains of gold nine-tenths fine and thus increase or decrease the monetary supply of gold. This power is limited to a maximum period of three years from January 29, 1934. The weight of the old gold dollar was 25.8 grains of gold nine-tenths fine. Under the old law the Executive had no discretionary power over the weight of the dollar.

2. The President may provide for the unlimited coinage (or purchase) of silver at any fixed ratio with gold that he may determine. He may also reduce the weight of the standard silver dollar and subsidiary silver, and issue silver certificates against silver bullion or coin in the Treasury. These powers are also limited to a maximum period of three years. No discretionary powers of any kind over the issue of silver currency were vested in the President under the old law.

3. The President is directed under the Silver Purchase Act to increase the proportion of silver to gold in the monetary stocks of the United States until one fourth of the value of the monetary stocks is in silver, and, if necessary, to nationalize all private holdings of silver. Silver certificates

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must be issued in an amount equal to the cost value and may be issued in an amount equal to the monetary value of such silver. No provision of this kind was included in the old law.

4. The President may direct the Secretary of the Treasury to issue up to \$3 billion of United States notes—greenbacks—to retire the public debt. Such notes, if issued, must be retired at 4% per year. This power is continuing until repealed by Congress. The old law contained no provision of this kind.

5. The President may direct the Secretary of the Treasury to enter into an agreement with the Federal Reserve Banks to buy up to \$3 billion of United States securities in the open market. The President had no such power under the old law.

Under the control of the President, the Secretary of the Treasury has been given the following powers:

(1) Physical possession of all monetary gold and control of all dealings in gold and, if necessary, silver. Under the old law banks, corporations, and individuals were permitted to hold gold and silver and deal in them freely.

(2) Discretionary powers over redemption of currency into gold bullion. Convertibility of currency into gold bullion may be permitted, at the discretion of the Secretary, by the purchase of gold from the Treasury under license. Under the old law currency was convertible into gold on demand.

(3) Discretionary power over the monetization of (1) the \$2.8 billion of gold profits obtained from the revaluation of gold stocks in accordance with the new weight of the gold dollar and (2) all gold purchased by the Treasury. Of the total gold profits, an amount of \$2 billion is set aside as a Stabilization Fund. The Secretary is authorized to monetize this Fund only for purposes of stabilizing the exchange value of the dollar and for supporting the market for United States Government securities. This power is limited to a maximum period of three years from January 29, 1934. Under the old law the Secretary had no discretionary power over gold monetization.

(4) During the existence of the Stabilization Fund the Secretary may deal actively at home and abroad in foreign

exchange and in gold for the account of the Fund with the object of stabilizing the exchange value of the dollar. In addition, he may buy or sell gold, at home or abroad, for the general account of the Treasury at any price or terms as he may deem to be in the public interest. Under the old law the Secretary had no such powers.

(5) The Secretary may buy silver at home and abroad at such rates and times and on such terms as he deems reasonable. No purchase, however, may be made at a price in excess of the monetary value of silver of \$1.29 per ounce nor at a price in excess of \$0.50 per ounce for silver situated in the United States on May 1, 1934. No purchases may be made when silver stocks are equal or greater in amount than one fourth of the monetary value of total gold and silver stocks. Under the old law the Secretary had no discretionary power to deal in silver at home or abroad.

In addition to these extraordinary powers the President and the Secretary of the Treasury have obtained under the new monetary legislation a marked degree of influence over the policies of the Federal Reserve Banks. Under the old law the President had no power to influence in any way the open-market operations of the Federal Reserve Banks. Under the new law, the Banks may be "persuaded" by the Secretary of the Treasury, if ordered by the President, to purchase up to \$3 billion of government securities or securities of government-controlled corporations either in the open market or directly from the Treasury or both. The Federal Reserve Banks are no longer allowed to deal freely in gold and foreign exchange. The Federal Reserve Banks will necessarily play only a passive rôle under the new monetary system. Their task will be to meet seasonal and other short-period credit demands of business and to issue currency in response to member bank demands. The Reserve Banks will not be called upon to exert an influence on the total supply of currency and credit except in so far as they may be requested by the political authorities to supplement or reinforce the monetary program of the Treasury.

On the other hand, the Federal Reserve Board has been given increased powers of control over the policies and practices of member banks. The Board may (a) fix the percent-

age of member bank loans and investments that may be represented by stock and bond loans; (b) remove officers and directors of member banks who persist in unsound banking and credit practices; and (c) suspend a member bank from the use of Federal Reserve credit facilities because of undue use of bank credit. Furthermore, under the Securities Exchange Act of 1934 the Board has the power to impose the same margin requirements for member and non-member loans extended for the purchase or carrying of listed equity securities as are imposed for loans made by brokers, dealers, and others to whom Federal Reserve margin requirements may apply.

Under the old monetary system centralized control of the total supply of currency was provided mainly by the operations of the Federal Reserve Banks under the general supervision of the Federal Reserve Board. The control was exercised primarily by changes in rates of discount, by open-market operations in government securities, and by expansion or contraction of Federal Reserve note and deposit currency. Through the exercise of these powers the Reserve Banks endeavored, individually and as a system, to prevent excessive contraction or expansion of the total supply of domestic money. In their management policies the Reserve Banks were strictly limited by the available supply of gold and by the need of maintaining the external stability of the dollar.

Under the new monetary system centralized management of the total supply of currency is concentrated in the hands of the political authorities and may be exercised (a) by open-market operations of the Stabilization Fund under the control of the Secretary of the Treasury; (b) by purchases and sales of gold and silver at home and abroad for the general account of the Treasury; (c) by the use of the President's discretionary powers to issue United States notes, to influence Federal Reserve open-market operations, to change the gold content of the dollar, to establish bimetallism, and to revalue the standard silver dollar and other silver money. The monetary program so established is highly experimental. The concentration of discretionary monetary powers in the hands of the Executive affords a marked degree of flexibility

to the whole plan. Because of this flexibility present monetary policies may be changed, leading to a new revision in the legal framework and in the functional and structural features of domestic monetary and banking organization at a later time. The official formula of monetary policy, aimed primarily at a full employment of internal productive resources rather than a specific dose of price elevation, even though ostensibly directed at higher prices, is a thoroughly elastic formula, capable of permitting a partial, if not complete, departure from a marked inflationary course.

A number of developments might easily change the course of monetary action. For example, it may be brought about as a result of the more or less spontaneous recovery of business activity without the reattainment by domestic commodity prices of former levels, but with dangerous speculative developments in many directions. It might also be caused by a rise in domestic prices, unaccompanied by a recovery of business activity sufficient to create fairly full employment of productive resources, that would make the public apprehensive over the effect of the monetary experiment on the standard of value, on the distribution of the national income, and on the maintenance of living standards. Finally, the necessity of co-operating with other nations in the restoration of international monetary stability in order to promote international trade and international price recovery might compel a shift of monetary course.

Although the present monetary program is now in a state of flux and transition and may be altered and modified under the stress of future developments, for the time being its main object is to generate an expansion of domestic currency supplies that can be maintained over a long period of time. The means for such an expansion are provided in a number of ways. For instance:

- (1) Devaluation of the dollar has furnished the Treasury with \$2.8 billion of gold profits, the monetization of which will serve to expand the currency issues of the Treasury for several years to come. It has also affected the international financial position of the country, causing a large influx of gold from foreign sources and an increase in the monetary gold stock as a result of imports and new domestic produc-

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tion, totalling over \$900 million from the end of January to the end of June, 1934. Additional gold acquisitions may be expected, but they need not give rise immediately to additional issues of gold currency unless such currency issues accord with Treasury policy.

(2) The silver purchase policy adopted by the Congress authorizes the Treasury to purchase approximately 1.3 billion ounces of silver on the world's markets and to issue silver currency up to \$700 million or more on the basis of the cost of silver purchased, or up to almost \$1.8 billion on the basis of its monetary value.¹ Further purchases of silver and issues of silver currency may be required or permissible in order to give practical expression to silver purchase policy in the event of growth in the monetary gold stock.

(3) The various discretionary powers affecting the Treasury's leeway in issuing currency and vested with the Executive may be employed to insure the maintenance of Treasury currency expansion. While some of these powers are temporary, limited in application to a maximum period of three years from the enactment of the Gold Reserve Act of 1934, they may be exercised within this interval with a view to conserving or enhancing the Treasury's capacity for issuing currency in the future.

(4) These discretionary powers, together with the power of the Executive to request the Federal Reserve System to undertake operations leading to the issue of possibly \$3 billion of Federal Reserve bank currency, and also the Executive's powers to control the ownership, use, and transportation of both gold and silver and to regulate the international value of the dollar may be used by the Executive to induce expansionist credit policies by the Federal Reserve System.

(5) A strengthening of the commercial banking organization, variously fostered by the Federal Government by means of new legislation, financial aid to banks by the R.F.C., and credit operations of the Federal Reserve Banks, assures that additional Treasury issues will flow promptly into banks in exchange for deposit currency, add to banking reserves, and stimulate the activity of banks in making loans and investments, thereby creating bank deposit currency. As a

¹ Estimated as of the end of June, 1934.

result of restored confidence in banks and of the various measures of national monetary policy, the reserves of member banks have already been raised to over \$4 billion, or about \$1.7 billion over their height in pre-depression years. In addition, reserves in excess of legal requirements as backing for deposit currency issues of member banks have been raised to the unprecedented figure of \$1.9 billion,¹ or to an amount capable of supporting a primary expansion of deposit currency of member banks of from \$7.6 billion to \$19 billion without any additional expansion of Treasury currency.

The prospect that an accelerating expansion in the total supply of domestic currency will occur in the future is undeniably great. Under the monetary system, however, in which the deposit currency of banks plays such a preponderant rôle, any rapid increase in the aggregate currency supply must be largely engendered by lending and investing activities of banks. Loans and investments by banks are only accumulated as the result of a series of specific banking operations which are necessarily conditioned by the past record of, as well as by the outlook for, trade and prices in particular business lines and also by broader economic, political, and social factors that jointly combine to create an atmosphere of certainty and financial confidence. They are also conditioned by inescapable international influences affecting in varying degrees commodity and security prices as well as the temper of internal primary markets.

To expect the banks to blind themselves to the existence of numerous maladjustments, partly inherited from the past and partly arising from national and world recovery efforts, is to take an unreal view of the banking process. It is equally unreal to attribute to the banks the capacity for actively promoting a rapid expansion of their deposit currency issues, except during periods of speculative boom when all the rules of prudent banking are ignored. Commercial banks are mainly passive agents in creating deposit money, responding to the demands of business for temporary capital needs according to demonstrated earning capacity and to the demands of government for financing interim fiscal needs.

¹ As of the beginning of August, 1934.

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Although they may be active in making security investments, their holdings of security assets are necessarily limited by the requirements of conservative banking, by experience, and by legal restrictions.

Banks cannot escape from their inherent responsibilities for the soundness of their assets, in terms of short-run liquidity and ultimate solvency, which stand back of their deposit currency issues. Escape is not provided even if they are relieved by law of all obligations to redeem their deposit currency issues in gold; even if they are provided with unlimited access, by borrowing, to formal currency issues of the Treasury and to the currency issues of the Federal Reserve Banks; and even if their deposits liabilities are guaranteed.

Nevertheless, a huge capacity for bank currency expansion has resulted from the monetary program and policies of the Federal Government and this capacity may be enormously increased in the future. Nor can it be ignored that the deficit in the federal budget, due to the emergency spending program, constitutes a forced draft making for bank currency inflation to the extent that it must be financed through commercial banks.

Government finance, prices of commodities and securities, trade, money incomes, and bank deposit currency may easily enter an ascending spiral, every advance in one inciting an advance in the others, but with physical production and trade, fixed prices and incomes, including wages, lagging behind in the rise. Whatever controls are possessed by the Executive and the Federal Reserve authorities and whatever institutional and other obstacles are present to impede its progress, monetary experience clearly shows that the forces for the rise, once under way, are powerful and impelling and that monetary authorities are seldom willing to cope vigorously with them, while institutional obstacles give way under the ingenuity of business enterprise. Such possibilities belong largely to the future. The resistance offered by domestic and world economic conditions to an overpowering inflationary movement is great. Nonetheless, there are real and dangerous possibilities and they should be recognized and dealt with in advance.

Under the old gold-standard system maintained by the

United States, the ultimate limiting factor in the aggregate currency supply was the domestic stock of monetary gold. The gold stock, however, was merely a limiting factor because of the predominant employment of credit money issued by commercial banks on the basis of fractional cash reserves of either Federal Reserve or Treasury currency which were finally related to gold. The ultimate connection between the total currency supply and national gold holdings gave support to domestic and international confidence in the dollar; it afforded an objective check on any sudden and arbitrary expansion in the primary currency supply at the hands of the Treasury or the Federal Reserve authorities; and it furnished a link between American monetary and financial developments and those of other countries.

Under the new monetary arrangements the place and importance of gold has been drastically changed. On every side, barriers and restrictions have been placed on the regulative influence of gold on the monetary supply. No longer is the monetary gold stock an ultimate limiting factor in the total currency supply; no longer does it function as a main-spring of confidence in the dollar; no longer does it provide any final check on a sudden and arbitrary expansion in the primary currency supply at the hands of the monetary authorities; and no longer does it furnish any practical link binding domestic and world monetary and financial developments. While gold is retained in the monetary system, its position is largely nominal, and the dollar, except temporarily, has no certain domestic or international gold value. Gold, in fact, may only function freely to increase the supply of primary Treasury currency and not to diminish it. Other sources of increase in the primary currency supply, subject to Executive discretion, are, potentially at least, of far greater importance than gold.

The future of the American monetary supply rests very largely with the Executive. Currency management, therefore, is a political matter and is subject to all the political forces, international as well as national, though predominantly the latter, to which Executive policy must give heed. For the time being, this can mean only one thing; that is extreme monetary nationalism. Definite commitment to

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such a course by so important a country internationally as the United States must necessarily result in reciprocal monetary nationalism by other countries, re-enforced by higher tariff barriers and more rigid trade quotas. It must also result in extended international currency instability and the disruption of international capital flows and of debtor-creditor relationships. Over the long run, it means a drying up of international trade and an impetus to international political friction.

APPENDICES

APPENDIX A
TECHNICAL FRAMEWORK OF THE OLD GOLD
UNDER THE OLD GOLD STANDARD¹

Definition of

The dollar of the United States was defined as a weight of 25.8 grains of gold nine-tenths fine.

Free and Unlimited

Standard or fine gold bullion or foreign gold coin offered by any person was freely convertible into gold coin or currency in unlimited quantities at any mint of the United States Treasury. Charges were made only for assaying the gold and for mint costs other than actual coinage.

Limitations on Gold Coin

The issuance of gold coin or currency was definitely limited to the quantity of standard gold offered to the mints for conversion into coin or currency at the standard weight for the gold dollar fixed by the Gold Standard Act of 1900.

¹ Based on the monetary and banking statutes of the United States in force prior to March 4, 1933.

APPENDIX A
STANDARD AND THE NEW MONETARY SYSTEM
UNDER THE NEW MONETARY SYSTEM^a

the Dollar

The dollar of the United States is defined as a weight of 15 5/21 grains of gold nine-tenths fine.

Coinage of Gold

All gold coin is withdrawn from circulation and melted into gold bars. No gold may be coined, but gold certificates may be freely issued against gold held in the Treasury.

Standard or fine gold bullion or foreign gold coin may be presented in unlimited quantities to the mints only for sale and not for coinage. Such gold may be presented, however, only by persons licensed by the Secretary of the Treasury, and may include only newly mined domestic gold, unmelted scrap gold, or foreign gold imported after January 30, 1934. The purchase of other gold by the mints must be specially authorized by the Secretary of the Treasury.

All mint charges are deductible from the price of any gold purchased by the mints, as well as a Treasury discount at 3/4%. Payment by the Treasury may be made with any direct obligations, coin or currency of the United States, authorized by law, or with any unappropriated funds in the Treasury.

and Currency Issues

The Secretary of the Treasury is authorized, *but not required*, to issue gold certificates against gold acquired and held by the Treasury under the terms of the Gold Reserve Act of 1934, up to the legal value of such gold. Thus, he is granted discretionary power over the monetization by the issue of gold certificates of: (1) the \$2.8 billion of gold profits obtained from the revaluation of gold stocks in accordance with the new weight for the gold dollar and

^a Based on the Gold Reserve and Silver Purchase Acts of 1934, accompanying orders and regulations, and the monetary and banking statutes of the United States as modified by legislation passed subsequent to March 4, 1933.

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Discretionary Powers of

No discretionary power over the standard weight for the gold dollar was vested in the Executive.

National Policy with

Under an Act of 1893, it was declared to be the policy of the United States to effect the joint monetary use of both gold and silver under a bimetallic system established through international agreement. Again, under an Act of 1897, the President was given authority to call an international conference with a view to securing international agreement on the use of silver. The Gold Standard Act of 1900, finally, declared that the provisions of the Act were not intended to preclude the accomplishment of international bimetallism whenever conditions might make it possible to secure concurrent action of leading foreign nations.

Discretionary Powers of the

No discretionary powers of any kind over the issue of silver currency were vested in the Executive, and silver currency issues were definitely limited by law.

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(2) all gold purchased by the Treasury under authority of the Gold Reserve Act.

Notwithstanding this general discretionary power of the Secretary of the Treasury over the monetization of unpledged gold holdings, the Secretary of the Treasury is granted special authority over the monetization of \$2 billion of the total gold profits set aside as a Stabilization Fund. He is authorized to monetize this Fund only for purposes of stabilizing the exchange value of the dollar and for supporting the market for United States Government securities. The life of the Fund is limited to two years from the passage of the Gold Reserve Act, unless extended for an additional year or terminated sooner by the President.

Executive over Gold Dollar

The President, at his discretion, may vary the standard weight for the gold dollar between 12.9 and 15.48 grains of gold nine-tenths fine, and thus increase or decrease the monetary gold supply of the Treasury. This power may be exercised if warranted by international conditions, by the necessity of maintaining the parity of domestic currency issues, or by emergency needs for an expansion of domestic credit. It expires within two years from the passage of the Gold Reserve Act of 1934, unless continued for an additional year or terminated sooner by the President.

Regard to Silver

Under the Silver Purchase Act, it is declared to be the policy of the United States "that the proportion of silver to gold in the monetary stocks of the United States should be increased, with the ultimate objective of having and maintaining one fourth of the monetary value of such stocks in silver." This policy, according to the President's message to the Congress on the subject of silver legislation, May 22, 1934, is intended to be pursued independently of any action on the part of other countries in providing for a larger monetary use of silver.

Executive over Silver and Other Currency

If warranted by international conditions, by the need for maintaining a parity of the currencies, or by emergency needs for credit expansion, the President may: (1) provide for the unlimited coin-

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Discretionary Powers of

The Executive had no discretionary powers over the issuance of other types of United States currency.

Legal Tender and

Gold coin and certificates representing gold were the principal legal tender or lawful money of the United States. Silver dollars and United States notes were also full legal tender or lawful money but were limited as to issue. Other coin and currency of the United States had limited legal tender powers and were not lawful money. Silver certificates, however, were not legal tender, but they were regarded as lawful money for banking purposes because

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age (or purchase) of silver at any fixed ratio with gold that he may determine; (2) reduce the weight of the standard silver dollar and subsidiary silver; or (3) authorize the issuance of silver certificates against silver bullion or coin in the Treasury, in excess of outstanding silver certificates. These powers expire two years after the passage of the Gold Reserve Act of 1934 unless extended for an additional year or terminated sooner by the President.

The Secretary of the Treasury is empowered and directed to issue silver certificates in any denomination secured by silver purchased in pursuit of national silver policy as laid down in the Silver Purchase Act of 1934. The face amount of such securities may not be less than the cost of all silver bought under the terms of the Silver Purchase Act, but may, at the discretion of the Secretary of the Treasury, aggregate the full lawful monetary value of silver purchases, or \$1.29 per fine ounce. The Secretary of the Treasury may use his own judgment in purchasing silver to carry out the national silver policy until silver stocks are equal to one fourth total stocks of gold and silver, but the price paid may not exceed \$1.29 per ounce, nor more than \$.50 for silver situated in the United States on May 1, 1934. The issuance and placing in circulation of at least the minimum amount of silver certificates on the basis of silver purchases are mandatory.

Executive over Other Currency

If warranted by international conditions, by the need for maintaining a parity of the currencies, or by emergency needs for credit expansion, the President may authorize the Secretary of the Treasury to issue up to \$3 billion of United States notes, "greenbacks," to retire the public debt. Such notes, if issued, must be retired at the rate of 4% per annum. No time limit is set in the law for the lapse of this Executive power, so that it may be adjudged continuing and permanent until repealed by the Congress.

Lawful Money

All coins and currencies issued by the United States, including bank notes of national and Federal Reserve Banks and Federal Reserve notes, have unlimited legal tender powers and hence are lawful money.

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of their ready redeemability into silver dollars. Bank notes issued by national and Federal Reserve Banks and Federal Reserve notes were not legal tender but had limited circulation powers.

Parity of the

The Secretary of the Treasury was required to keep all currencies of the United States at a parity with one another and with the gold dollar. In practice, this requirement was literally adhered to. All United States currencies were freely exchangeable with one another at the Treasury, and they were freely redeemable in gold coin or bullion at parity.

Redemption Funds for

Special redemption funds against different currency issues, including bank notes, were maintained by law with the Treasury in gold or lawful money in order to facilitate the maintenance of parity between domestic currencies. For example, a fixed redemption fund of \$150 million in gold was maintained against United States notes; a 5% redemption fund in lawful money was maintained against national and Federal Reserve Bank notes; and a 5% redemption fund in gold was held against Federal Reserve notes.

Federal Reserve

The Federal Reserve Banks were empowered to hold standard or fine gold bullion as well as gold coin or currency and Treasury deposits payable in gold in their 35% reserves required against deposits and 40% reserves required against Federal Reserve note issues. Other lawful money as well as gold coin or bullion and Treasury gold deposits could be held as required reserves against deposits.

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Currencies

The Secretary of the Treasury is required to keep all currencies of the United States at a parity with one another and with the gold dollar. A literal adherence to this requirement is necessitated only in respect to various currencies circulating domestically and gold certificates. What constitutes an effective parity between domestic currencies and the gold dollar, regardless of the legal definition of the gold dollar, is a matter of discretion with the Secretary of the Treasury. He is only under obligation to redeem gold certificates when offered by Federal Reserve banks *if, in his judgment*, redemption is necessary to maintain the equal purchasing power of every kind of currency.

Treasury and Bank Currency Issues

Special redemption funds against different currency issues continue to be required by law with the Treasury in order to facilitate the maintenance of the parity between the currencies. The fixed redemption fund against United States notes and Treasury notes of 1890,¹ however, has been made merely a reserve fund. Gold certificates in place of gold are stipulated for the redemption fund against Federal Reserve notes.

Banks and Gold

The Federal Reserve Banks are empowered to hold only gold certificates and Treasury deposits payable in gold certificates in their 35% reserves required against deposits and 40% reserves required against Federal Reserve note issues. Other lawful money as well as gold certificates and Treasury gold deposits may be held as required against deposits.

¹ Treasury notes of 1890 may be considered as obsolete since only \$1 million approximately remain in circulation.

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Suspension of Gold

The Federal Reserve Board was permitted to suspend reserve requirements of Federal Reserve Banks for short periods and to renew such suspension, but was required to impose a graduated tax on the deficiency in reserves. Federal Reserve Banks in turn were required to pass this tax on to member banks in the form of higher discount charges.

Redemption of Federal Reserve

Federal Reserve Banks were obliged, by practical necessity, to redeem their deposits and, by law, their Federal Reserve notes in gold or lawful money. Since they were obliged to accept all forms of money offered by member banks in exchange for their own liabilities, they constituted agencies outside the Treasury where domestic money could be converted into gold in any form.

Federal Reserve

The Federal Reserve Banks were empowered to deal freely, at home or abroad, in gold coin or bullion. Such dealings contributed to the free convertibility of United States currency, bank notes, and bank deposits into gold coin and bullion.

Powers of Secretary of

The Secretary of the Treasury had no general discretionary powers to deal in gold at home or abroad, although the performance of its coinage redemption and conversion functions by the Treasury involved operations tantamount to obligatory dealings in gold. Notwithstanding, the Secretary of the Treasury was empowered to

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Reserve Requirements

The Federal Reserve Board has the power to suspend reserve requirements of the Federal Reserve Banks for short periods, and to renew such suspensions. If, however, reserves have become deficient as a result of an emergency credit program, entered into under agreement with the Secretary of the Treasury acting at the direction of the President, no graduated tax on the deficiency in reserves is required, and hence, no automatic increase in discount rates.

Deposits and Note Issues

Federal Reserve Banks are obliged to redeem their deposits and Federal Reserve notes only in lawful money. They may apparently redeem them in gold for purposes of maintaining the parity of the currencies and, under present Treasury regulations, for settling international transactions, with the approval of the Secretary of the Treasury. But each "redemption" may be made only to persons licensed by the Secretary of the Treasury to acquire, hold, and ship such gold.

Dealing in Gold

All gold dealings of the Federal Reserve Banks are subject to regulation by the Secretary of the Treasury. Under existing Treasury regulations, issued January 31, 1934, the Federal Reserve Banks may acquire gold abroad by purchase, lawfully held gold domestically by purchase, and Treasury gold by redemption of gold certificates for purposes of maintaining the parity of the currencies and settling international balances. All gold acquisitions not used for these purposes within a period of six months must be paid into the Treasury in exchange for an equivalent amount of dollar credits payable in gold certificates.

Treasury to Deal in Gold

With the approval of the President, the Secretary of the Treasury is empowered to purchase gold in any amounts at home or abroad with any direct obligations, coin or currency authorized by law, or with any unappropriated funds of the Treasury. Such purchases may be made at such rates and on such terms or conditions

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borrow gold on the security of the United States bonds or notes bearing interest up to 3%, or to sell such bonds for the purpose of buying gold, if additional gold holdings were needed by the Treasury to maintain the parity of the currencies or to strengthen national gold reserves. In addition, he was required to acquire gold in this way to restore the fixed gold redemption fund against United States notes and Treasury notes of 1890 to \$150 million in the event that it should fall below \$100 million.

Powers of the Secretary of

The Secretary of the Treasury had no discretionary power to deal in silver at home or abroad.

Federal Reserve Dealings

The Federal Reserve Banks had the power to deal at home or abroad in foreign exchange (cable transfers and time bills of ex-

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deemed most advantageous to the public interest. Moreover, they may be made regardless of any provision of the law requiring the maintenance of the parity of the currencies or limiting the purposes for which direct obligations or currency may be issued, or requiring any direct obligations to be issued as a popular loan or on a competitive basis.

The Secretary of the Treasury, in addition, has independent discretionary powers to sell gold in any amounts at home or abroad at such rates and on such terms or conditions as may be most advantageous to the public interest. Gold specifically held as currency reserves, however, may only be sold to the extent necessary to maintain the parity of the currency with the gold dollar.

During the life of the Stabilization Fund, finally, the Secretary of the Treasury has unrestricted power to deal in gold at home or abroad for the account of the Fund.

the Treasury to Deal in Silver

To give effect to national silver policy, the Secretary of the Treasury is authorized to buy silver at home or abroad at such rates and times and on such terms or conditions as he deems reasonable and most advantageous to the public interest. No purchases, however, may be made at a price in excess of the monetary value of silver of \$1.29 per ounce, nor at a price in excess of \$.50 per ounce in the case of silver situated in the United States on May 1, 1934. Moreover, silver may not be purchased when monetary silver stocks are equal to or greater than one fourth of the monetary value of total gold and silver stocks.

Whenever the market price of silver exceeds its monetary value or whenever silver stocks are in excess of one fourth of the monetary value of total gold and silver stocks, the Secretary of the Treasury, with the approval of the President, may sell silver at home or abroad at such rates and times and on such terms or conditions as he deems reasonable and most advantageous to the public interest.

in Foreign Exchange

The Federal Reserve Banks may continue to deal freely at home or abroad in foreign exchange, but so long as an emergency is held

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change) subject to regulations of the Federal Reserve Board. Such dealings, though never large in practice, contributed to the maintenance of the parity between the dollar and foreign gold currencies.

Powers of Secretary of Treasury

The Secretary of the Treasury had no power to deal actively at home or abroad in foreign exchange with the object of stabilizing the exchange value of the dollar.

Executive Control over Foreign

Except under emergency conditions no less serious than those accompanying war, the Executive had no clear legal powers to subject transactions in foreign exchange to any regulation or control.

Ordinary Discount Powers of

Subject to limitations, restrictions, and regulations of the Federal Reserve Board, the Federal Reserve Banks had the power to rediscount for member banks on their own endorsement: (1) bona fide commercial paper of not more than 90 days maturity; (2) agricultural and livestock paper of an original maturity of nine months but due in 90 days; and (3) sight or demand bills of exchange to finance shipments of non-perishable agricultural commodities, but not for longer than 90 days. In addition, the Federal Reserve

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to obtain by the President, only under license of the Secretary of the Treasury. In addition, such operations are subject to regulation by the Federal Reserve Board, and the Board has special supervision over all relationships and transactions between a Federal Reserve Bank and any foreign bank.

to Deal in Foreign Exchange

During the existence of the Stabilization Fund, the Secretary of the Treasury is empowered to deal actively at home or abroad in foreign exchange as well as gold for the account of the Fund with the object of stabilizing the exchange value of the dollar. The permanent and continuing powers of the Secretary of the Treasury to buy or sell gold abroad and to buy or, under special conditions, sell silver abroad, necessarily involve accompanying powers to deal in foreign exchange in order to effect such buying or selling transactions.

Exchange Transactions

During any national emergency as the President may declare, foreign exchange transactions and all international transfers of credit by banking institutions may be subject to Executive regulation and control. Under the regulations laid down for the present emergency, all foreign exchange transactions must be licensed by the Secretary of the Treasury unless they are for normal commercial or business requirements, reasonable travelling and personal purposes, or the fulfillment of obligations entered into before March 9, 1933.

the Federal Reserve Banks

Ordinary discount powers of the Federal Reserve Banks are broadened to permit advances to members on their promissory notes secured by eligible paper up to 90 days instead of only up to 15 days.

Such powers are also enlarged to permit Federal Reserve Banks to make direct advances, not exceeding 90 days, to individuals, partnerships and corporations on promissory notes secured by direct United States obligations.

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Banks had the power to make up to 15-day advances to member banks on their notes collateralized with eligible paper, with United States Government securities, or with obligations of the Federal Intermediate Credit Banks. As a matter of practice, uniform discount rates were maintained by the Federal Reserve Banks for all rediscounts and advances, though differences in rates obtained as between the different Federal Reserve Banks.

Emergency Discount Powers of

The Glass-Steagall and Emergency Relief Acts of 1932 granted Federal Reserve Banks three emergency powers applicable with special permission of the Federal Reserve Board: (1) to make advances on promissory notes secured by non-eligible assets to groups of not less than five member banks at discount rates at least 1% above prevailing rates; (2) to make similar advances to individual member banks having \$5 million capital or less; and (3) to discount eligible commercial paper directly for individuals, partnerships and corporations unable to secure banking accommodation through ordinary channels. The first and third powers are continuing; the second was temporary, up to March 3, 1933.

Federal Reserve Deal-

The Federal Reserve Banks had the power to deal freely, at home or abroad, in United States Government securities, municipal

UNDER THE NEW MONETARY SYSTEM

The Federal Reserve Banks are also authorized to discount or purchase from any bank, trust company, mortgage company, credit corporation for industry, or other financial institution industrial and commercial obligations maturing within five years and entered upon for the purpose of obtaining working capital. Any such financing institution must obligate itself for at least 20% of any loss sustained, or advance 20% of the working capital for the borrowing firm without obligating itself on the amount advanced by the Federal Reserve Banks.

The aggregate amount of such Federal Reserve discounts or purchases, including emergency discounts or purchases as may be made directly, is limited to the combined surplus of the Federal Reserve Banks as of July 1, 1934, plus all amounts paid by the Secretary of the Treasury to the Federal Reserve Banks up to the par value of the Federal Deposit Insurance Corporation stock which they hold, or up to \$139 million. All amounts so paid by the Secretary are to be made out of the gold profit fund.

Finally, the Reserve Banks are authorized to discount six-month notes to finance residential and farm building construction if such notes are accompanied by agreement with a responsible party to advance the amount of the loan on completion of the building.

the Federal Reserve Banks

The temporary power to make emergency advances to member banks of \$5 million capital or less is extended to any member bank until March 5, 1935. Special approval of the Federal Reserve Board is not required.

Furthermore, the Federal Reserve Banks, under authority granted by the Federal Reserve Board, may make direct loans to, or purchase obligations of, established industrial or commercial businesses. Such loans or purchases of obligations may be made only if accommodation on a reasonable basis is otherwise unavailable, if they are for working capital purposes, and if they have a maturity not exceeding five years. Moreover, they can be made only out of resources of the Federal Reserve Banks allocated for discounts of medium-term industrial and commercial loans.

ings in Open Market

The open-market dealings of the Federal Reserve Banks are put under the guidance of a Federal Open Market Committee

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and state warrants, and banker's acceptances under the general regulation of the Federal Reserve Board. In dealing in acceptances, the Reserve Banks were passive, merely setting a rate at which they would buy. In dealing in government securities, they were active and co-operated as a system in accordance with policies decided formerly by an Open-Market Investment Committee consisting of representatives of the more important Federal Reserve Banks, and since 1930, by an Open-Market Investment Conference including representation from all Federal Reserve Banks.

Executive Influence in

The Executive had no power to influence in any way the open-market operations of the Federal Reserve Banks.

Open-Market Powers of the

The Secretary of the Treasury had no discretionary powers to deal with public funds, at home or abroad, in bills of exchange and securities.

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with a member elected by each Reserve Bank and under *specific* regulation of the Federal Reserve Board. All open-market operations are to be definitely governed "with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country." If a Federal Reserve Bank shall decide not to participate in open-market operations recommended and approved, it must notify the Committee and the Board.

Open-Market Operations

If justified by international conditions, the necessity of regulating and maintaining the parity of the currencies, or emergency needs for an expansion of domestic credit, the President may direct the Secretary of the Treasury to enter into agreement with the Federal Reserve Banks and the Federal Reserve Board whereby the Federal Reserve System will undertake either open-market purchases of government and government-controlled corporation securities, or direct purchases of government securities from the Treasury, or both, to a total of \$3 billion. If reserves should fall below the legal limits as a result of such operations, no graduated tax is required on the deficiency in reserves. Nor are higher discount rates automatically involved on this account. In case an undue expansion of credit should ensue from these operations, the Federal Reserve Board may take whatever steps seem necessary to control credit conditions, but only with the approval of the Secretary of the Treasury.

Secretary of the Treasury

The Secretary of the Treasury is empowered, during the life of the Stabilization Fund, to deal in any credit instruments or securities expedient for the account of the Fund, as well as in gold and foreign exchange. Moreover, the Secretary of the Treasury at his discretion, but with the approval of the President, may invest any portions of the Stabilization Fund, not needed for stabilizing the exchange value of the dollar, in any United States Government securities.

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Export and Im-

Gold coin or bullion could be exported and imported from the United States in unlimited quantity and without restriction or license by any person, association, or corporation.

Export and Im-

No restrictions of any kind were imposed on the export and import of silver.

Private Owner-

Any person, association, or corporation had the right to deal in, hold, or transport gold in any form for any purpose without restriction.

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As a permanent and continuing power to regulate the market value of United States Government securities, the Secretary of the Treasury may anticipate, from time to time, the payment of interest on the public debt by a period not exceeding one year, either with or without a rebate of interest upon the coupons.

port of Gold

Gold bullion and foreign coin can be exported and imported for private domestic and foreign account only under license and regulation of the Secretary of the Treasury.

The Secretary of the Treasury, however, may import and export gold freely, either with the approval of the President in connection with the general gold account of the Treasury or under his discretionary authority in connection with the operations of the Stabilization Fund.

Under Treasury regulations now in force, issued January 31, 1934, the Federal Reserve Banks may only import and export gold, as necessary in the judgment of the Secretary of the Treasury, for purposes of maintaining the parity of the currencies and settling international balances.

Other gold exports and imports are licensed for domestic account only when applied for by persons engaged in a gold-using industry, profession or art, or when undertaken for sale to the United States. This allows a considerable freedom in the import of gold, but disallows free exportation of gold on private account for financial and banking purposes.

port of Silver

Power is vested in the Secretary of the Treasury, with the approval of the President, to investigate, regulate, and prohibit, by license or otherwise, the exportation, importation, and transportation of silver and to require reports on the facts involved. Under existing regulations, issued June 28, 1934, silver may be freely imported, but it may be exported only under license for legitimate business purposes.

ship of Gold

Title to the entire monetary gold stock of the United States is vested in the United States Government. Only persons, associations, or corporations licensed by the Secretary of the Treasury,

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Private Owner-

Any person, association, or corporation had the right to deal in, hold, or transport silver in any form without restriction.

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and abiding by regulations issued by him may hold, transport or deal in gold in unfabricated form. Such licenses are issued under Treasury regulations of January 31, 1934, only to persons engaged in industry, professions or the arts, requiring gold for customary use. Unsmelted and unrefined gold, newly mined, may be acquired and held without license, however. So also may gold for industrial, professional or art use in amounts of twenty-five ounces of fine gold or less. Unsmelted scrap gold in amounts of five ounces of fine gold or less, in addition, may be held, but not acquired, without license.

Whenever the Secretary of the Treasury deems action necessary to protect the currency system of the United States, he is empowered to require all private individuals, associations, or corporations to deliver all gold coin, bullion, or certificates to the Treasury and to provide compensation for such delivery in an equivalent of other forms of coin or currency, together with payment for all costs of transportation.

ship of Silver

All profits arising from transfers of any interest in silver bullion, if a party to the transfer is a resident American citizen or if the silver bullion is situated in the United States, are subject to a 50% tax.

In addition, the Secretary of the Treasury has the power, with the approval of the President, to regulate or prohibit the acquisition, importation, exportation, or transportation of silver, by licenses or otherwise, and to require reports as to the facts involved.

Finally, whenever action is required to regulate the value of the money of the United States, the President may require delivery to the United States mints of any or all domestic silver, regardless of its situation or ownership. Payment for such deliveries may be made in standard silver dollars or any other coin or currency on the basis of the monetary value of silver less deductions for brassage or seigniorage, and costs. In no case, however, may the compensation payment be less than the fair value of the silver delivered as determined by the market price for a reasonable period of time just prior to the Executive order requiring the delivery of silver. All reasonable costs of delivery must be paid by the Treasury.

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Free Gold

Monetary and banking law, Treasury practices, and the operations of the Federal Reserve together provided the United States with a free gold market. The Treasury and the Federal Reserve Banks constituted the heart of the gold market.

Free Silver

A free silver market, based on private transactions of both domestic and international origin, and intimately connected with world silver markets, prevailed in the United States.

Domestic Price

A fixed and invariable domestic market price for gold of \$20.67 per fine ounce and \$18.60 per standard ounce obtained in the United States. This was due to the following conditions: (a) the legal definition of the dollar as a weight of fine gold of 23.22 grains, giving an ounce of fine gold the monetary value of \$20.67; (b) the legal obligation of Treasury mints to convert fine or standard gold bullion or foreign gold coin into United States gold coin freely and without coinage charge, or to issue an equivalent amount of gold certificates for gold bullion or coin deposited with the mints; (c) the free and unlimited convertibility of all non-gold coin and currency into gold coin, bullion, or currency; and (d) the legal obligations and operations of the Federal Reserve Banks with reference to gold.

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The Executive Order of August 9, 1934, requires all domestic silver bullion, privately held *on the date of the order*, of more than 0.8 fineness, to be delivered to the Treasury within 90 days. Individual silver holdings for industrial, professional and art uses in excess of 500 fine ounces are excepted. The order authorizes the Secretary of the Treasury to pay 50 cents a fine ounce for all silver surrendered under its terms, plus reimbursement for costs of delivery to the nearest Treasury mint. Subsequent to the final date of surrender, only private persons, associations, and corporations licensed by the Secretary of the Treasury may withhold silver bullion covered by the Order.

Market

A rigidly controlled gold market, dominated and regulated by the Executive, notably the Secretary of the Treasury, now obtains in the United States.

Market

A governmentally controlled silver market, under Executive regulation, notably by the Secretary of the Treasury, and dominated by the silver purchase policy of the Treasury, now obtains in the United States.

for Gold

A fixed monetary value for gold of \$35 per fine ounce is temporarily fixed by the Executive, subject to change for a period of two years within the limits of \$34.52 and \$41.34. Under existing Treasury regulations, issued January 31, 1934, the Treasury will only buy gold at \$35 per fine ounce less $\frac{1}{4}\%$ and only sell gold for \$35 per fine ounce plus $\frac{1}{4}\%$. These buying and selling prices, in addition, are subject to change by the Secretary of the Treasury without notice. So long as the buying and selling prices cited above are not changed, the market price for gold bullion for private industrial, professional and art use may vary within the limits of \$34.91 and \$35.08 per fine ounce.

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The Domestic

A variable domestic price for silver formerly obtained, determined by the free competitive play of domestic and international supply and demand forces. The domestic price maintained a close parallel with the price of silver on foreign markets by virtue of continuous international transactions and arbitrage in silver and of the unrestricted import and export of silver.

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Price for Silver

Three prices for silver temporarily prevail domestically: (1) the open-market price which applies to silver bullion not covered by the silver nationalization action; that is, to silver bullion not situated in the United States on August 9, 1934; (2) the Treasury price for silver nationalized by the Executive Order of August 9, 1934, amounting to 50 cents per fine ounce; and (3) the Treasury price for newly mined domestic silver purchased from producers under the Executive Order of December 22, 1933, amounting to \$0.645 per fine ounce.

The open-market price no longer parallels closely the world price because of a transfer tax, effective May 15, 1934, on all profits gained from silver transfers. The tax restricts transactions on the domestic silver market and renders the connection between domestic and foreign silver prices less intimate. This connection may also be disturbed by the Executive Order of August 9, 1934, which has temporarily terminated all trading in silver contracts on the New York Commodity Exchange.

At any time, the Secretary of the Treasury, subject to the approval of the President, may convert the domestic market silver price into a rigidly controlled price by the exercise of his powers to regulate or prohibit the private acquisition, exportation, importation and transportation of silver. Such action might or might not be accompanied by further nationalization of silver.

Strictly speaking, the Treasury has no formal price for silver. The Executive Order of December 22, 1933, nevertheless, authorizing the Secretary of the Treasury to *receive* newly mined domestic silver *for coinage* at a price of \$1.29 per fine ounce, less 50% for seigniorage and services, established such a price in effect. This Order gave effect to the International Silver Agreement of 1933, under which the United States committed itself for four years from January 1, 1934, to absorb 24.4 million ounces of newly produced domestic silver for coinage or currency reserves, while governments of other producing areas agreed to absorb 10.6 million ounces, and other governments with large monetary stocks, i.e., the governments of India and Spain, agreed to restrict their sales of silver to 40 million ounces annually. The Executive Order of August 9, 1934, does not establish a formal price for silver.

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The Export and Im-

Unrestricted international gold shipments operated to limit narrowly and automatically the fluctuations of the dollar from its parity with foreign gold currencies in the exchange markets. Such shipments took place largely whenever the exchange rates for foreign currencies exceeded the costs of acquiring and shipping gold or the so-called export and import points for gold. Because of the maintenance of a free gold market and an unvarying market and mint price domestically, only handling, insurance, interest, and freight charges entered into the costs of exporting and importing gold so far as American markets were concerned.

Convertibility of

Deposit currency (deposits subject to check) issued by commercial banks was in practice convertible into any other coin or currency on demand and was legally convertible into lawful money. The free exchangeability of other coins and currencies into gold meant that, for all practical purposes, bank deposit currency was directly or indirectly convertible without restriction into gold coin or bullion on demand.

Fractional Reserves

Commercial banks were required to maintain fractional reserves against deposits, and these percentage reserves were definitely

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port Points for Gold

International gold shipments continue to limit the fluctuations of the dollar from its parity with foreign gold currencies. Such gold shipments, however, do not take place automatically when exchange rates render them profitable, but only if permitted by license and regulation of the Secretary of the Treasury. When permitted on private account, domestic or foreign, the export and import points for gold shipments are affected by the Treasury's buying and selling price for gold, as well as by actual transport, interest and insurance costs. On the other hand, when permitted for the account of, or under the direction of, the Federal Reserve Banks, the export points at least may be lower, since, under prevailing Treasury regulations, the Federal Reserve Banks may redeem gold certificates for settling international balances. The fact that the Secretary of the Treasury maintains strict control over exports and imports for gold and the fact that the Treasury's buying and selling prices for gold may be changed without notice, make the gold export and import points of exchange rates uncertain.

The limits to the dollar's fluctuations against foreign gold currencies in the international exchange markets, therefore, are not so precise as formerly except for short periods of time when Treasury gold policies are considered certain. In so many words, indeed, the effective parity between the dollar and foreign gold currencies is a matter of judgment of the Secretary of the Treasury.

Deposit Currency

Deposit currency issued by commercial banks is convertible without restriction into lawful coin or currency on demand, but no mandatory, direct or indirect, convertibility into gold in any form on demand obtains. Convertibility of deposit currency into gold bullion may be permitted indirectly at the discretion of the Secretary of the Treasury by the purchase of gold from the Treasury under regulation and license.

for Deposit Currency

The fractional reserves of member banks, whose deposit currency issues now constitute more than four fifths of the total for

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fixed by federal or state banking law. In the case of member banks, whose deposit currency issues were three fourths of the total for the country, reserves of from 7% to 13%, against demand deposits, depending on the location of the bank, had to be maintained in the form of balances with Federal Reserve Banks. In the case of non-member banks, reserves could be maintained as cash or balances with other banks.

Control over the Issue

By lending and investing reserves in excess of those required, commercial banks freely created deposit currency. Loans and investments, however, were subject to some limitation and regulation by law. In addition, banks were subject to periodical examination by public supervisory authorities for purposes of appraising their assets and adjudging their solvency.

Total Reserves for

The total amount of deposit currency that commercial banks could issue depended on the volume of reserves. In turn, the volume of reserves depended generally on the following main factors:

- (a) The monetary gold stock of the country as affected by do-

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the country, are subject to change under emergency conditions by order of the Federal Reserve Board, with the approval of the President.

of Deposit Currency

Commercial banks may freely create deposits on the basis of excess reserves, but their loans and investments are subject to a more strict regulation and supervisory control.

Member banks, for example, may only purchase investment securities under limitations and restrictions prescribed in regulations of the Comptroller of the Currency, excepting United States securities and those of the Federal Home Loan banks, the Home Owner's Loan Corporation, and securities issued under the Farm Loan Act. Moreover, their investments in any investment issue, except small issues, may not exceed 10% of the amount outstanding or 15% of their capital and 25% of their surplus.

The Federal Reserve Board, in addition, has the power: (a) to fix the percentage of member bank loans and investments that may be represented by collateral (stock and bond) loans; (b) to remove officers of member banks who persist in unsound banking and credit practices; (c) to suspend a member bank from the use of Federal Reserve credit facilities for undue use of bank credit.

Under the Securities Exchange Act of 1934, the Federal Reserve Board has the power to impose the same margin requirements for member and non-member loans, extended for the purchase or carrying of listed equity securities, as are imposed for loans made by brokers dealers and others to whom Federal Reserve margin requirements may apply.

Deposit Currency

New factors are introduced affecting the total volume of commercial bank reserves available as the basis of bank currency issues. They include:

- (a) The issue of gold currency resulting from the Treasury's

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mestic gold production and consumption, and unrestricted international shipments of gold;

(b) The limited coin and currency issues of the Treasury and the bank note issues of national and Federal Reserve Banks, including Federal Reserve notes;

(c) The supply of credit furnished by the Federal Reserve Banks in the form of deposit balances and Federal Reserve notes as determined by the volume of rediscounts or advances to member banks and by open-market purchases in excess of sales of Government securities;

(d) The proportion of the total coin and currency supply required by the public for circulating media, for a store of current value, and for hoarding;

(e) The proportion of the total cash resources of banks required by law to be earmarked as reserves against time and savings deposits.

Insurance of

Ownership of deposit currency and savings deposits was wholly at the risk of the depositor.

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expenditure of unappropriated profits obtained from the revaluation of gold reserves;

(b) The issue of gold currency resulting from the Treasury's employment of the \$2 billion Stabilization Fund to stabilize the exchange value of the dollar and to support the Government security market;

(c) The issue of gold currency resulting from the Treasury's expenditure of stabilization balances after the expiration of the Stabilization Fund in two or three years after the passage of the Gold Reserve Act;

(d) The issue of gold currency as affected by Treasury purchases and sales of gold, at home and abroad, from the general funds or gold reserves of the Treasury;

(e) The issue of gold currency as affected by Treasury restrictions and controls over the domestic consumption of gold and over the export and import of gold;

(f) The issue of gold currency as affected by the Treasury's expenditure of profits, or recovery of losses, incurred in connection with any subsequent revaluation of gold reserves permissible under the law as a result of dollar revaluation;

(g) The issue of silver currency in consequence of Treasury purchases of silver under national silver policy, at least up to the cost value of new silver bought and possibly up to its full monetary value;

(h) Federal Reserve credit made available by extraordinary and emergency open-market operations undertaken at the request of the Executive;

(i) Additional coin and currency issued by the Treasury by authorization of the President under his discretionary monetary powers.

Deposit Currency

In order to reduce the risks of ownership of deposit currency and savings deposits, the Federal Deposit Insurance Corporation, owned partly by the Federal Government, partly by the Federal Reserve Banks, and partly by insured banks, is established. A Temporary Insurance Fund introduced by the Corporation January 1, 1934, covers deposits of all insured banks up to \$2,500 until

Management of the

Centralized management of the total supply of currency was provided mainly by the operations of the Federal Reserve Banks, under general supervision of the Federal Reserve Board. It was effected primarily by the exercise of discount powers, by open-market operations in bankers' acceptances and government securities, and by the issue of Federal Reserve note and deposit currency. Operating on a fractional reserve basis, Federal Reserve Banks could employ excess reserves to protect the reserves of member banks, and indirectly of non-member banks, from undue contraction by public withdrawals of cash and gold exports. They could also operate to temper or prevent undue expansion of commercial bank reserves due to larger public deposits of cash and gold imports. Thus, centralized management by the Federal Reserve System tended to make for a more regular growth of bank reserves and to maintain the entire currency supply in line with the expanding currency needs of production and trade. While Federal Reserve policy was not infrequently conditioned by the requirements of Treasury finance and hence was subject to Treasury influence, the Federal Reserve System had a large measure of independence in pursuing its currency management policies.

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July 1, 1934, and until July 1, 1935, deposits of insured mutual savings banks up to \$2,500 and of other insured banks up to \$5,000. Under the Permanent Insurance Fund, effective July 1, 1935, deposits of insured banks up to \$10,000 are fully covered; deposits from \$10,000 to \$50,000 are 75% covered; and deposits in excess of \$50,000 are 50% covered. Non-member state banks are eligible for participation in the Deposit Insurance Corporation only until July 1, 1936.

Total Supply of Currency

Centralized management of the total supply of currency is primarily attained: (a) by open-market operations of the Stabilization Fund under control of the Secretary of the Treasury; (b) by the Secretary of the Treasury's regulation of gold domestically and purchases and sales of gold at home or abroad for the general account of the Treasury; (c) by the Secretary of the Treasury's regulation of silver domestically and purchases of silver at home or abroad; (d) by the exercise of the President's discretionary powers to issue United States notes, influence Federal Reserve open-market operations, revalue the gold dollar, establish bi-metallism, and revalue the standard silver dollar and other silver coin; (e) by ordinary and emergency discount operations of the Federal Reserve Banks; and (f) by direct supervision of the Federal Reserve Banks over the loan and investment activities of member banks. The liberally endowed currency-issuing capacity of the Treasury, supplemented by Federal Reserve credit and currency issuing operations, may be employed to provide whatever volume of banking reserves is deemed desirable and to sustain the expansion of such reserves in the future in order to influence the supply of bank deposits. Centralized currency management is thus placed in the hands of the Treasury, with the Federal Reserve System functioning in a subsidiary management rôle in accordance with Treasury policies.

APPENDIX B

KINDS OF MONEY OF THE UNITED STATES UNDER THE OLD

I. Under the Old Gold Stand-

Kind of Money	Denominations Authorized	Backing	Redemption Provisions
<i>Treasury Currency:</i>			
Gold coin.	\$2.50-\$20.00 (Issuance of \$2.50 gold coin discontinued).	Value of metal.	
Gold certificates.	\$10.00-\$10,000	Value of metal held as reserve.	In gold at Treasury.
Silver dollars. . . .	\$1.00	Value of metal and credit of the Government.	Not redeemable by law.
Silver certificates	\$1.00-\$100.00 (10% of issue may be higher than \$10.00).	Value of silver dollars backed by metal. Hence, silver dollars held as reserve and credit of the Government.	In silver dollars at Treasury.
United States notes.	\$1.00-\$10,000	\$150 million gold reserve fund and credit of the Government.	In gold at Treasury.
Subsidiary silver	\$.10, \$.25 and \$.50.	Value of metal and credit of the Government.	In lawful money at Treasury in sums of \$20.00.
Minor coins.	\$.01, \$.05.	Credit of the Government.	In lawful money at Treasury in sums of \$20.00.
<i>Bank Currency:</i>			
National bank notes.	\$1.00-\$1,000.00 (Issued mainly in denominations of from \$5.00-\$100.00).	Government bonds with note issue privilege and 5% redemption fund in lawful money.	In lawful money at Treasury and national bank of issue.
Federal Reserve Bank notes. . .	\$1.00-\$1,000.00 (Issued only in denominations of from \$1.00 to \$50.00).	Government bonds with note issue privilege and 5% redemption fund in lawful money.	In lawful money at Treasury and Federal Reserve bank of issue.

APPENDIX B

GOLD STANDARD AND UNDER THE NEW MONETARY SYSTEM

ard (Prior to March 4, 1933)

Legal Tender Power	Limitations as to Issue
Unlimited.	Unlimited.
Unlimited.	Unlimited against deposits of gold coin or bullion with the Treasury.
Unlimited.	Limited in accordance with special silver coinage authorizations made from time to time by Congress.
Not legal tender, but receivable for public dues.	Limited to deposits of silver dollars with the Treasury. Also issued on retirement of Treasury Notes of 1880 secured by silver dollars coined from Treasury bullion stocks. Treasury Notes of 1890 are now practically retired.
Unlimited, except for interest on public debt and import duties.	Limited to \$346 million.
Up to \$10.00. A few special \$.50 issues are full legal tender.	Limited in accordance with subsidiary silver authorization by Congress.
Up to \$.25.	Limited in accordance with minor coinage authorization by Congress.
Not legal tender, but receivable for public dues other than import duties. Receivable at par by national banks.	Limited to paid-in capital of issuing bank and to amount of bonds outstanding bearing circulation privilege. Prior to July, 1932, only \$675 million of 2% bonds had this privilege. From July 22, 1932, for a period of 3 years, \$3,085 million of bonds bearing interest up to 3½% were granted circulation privilege under the Federal Home Loan Bank Act. The paid-in capital of all national banks at end of 1932 was \$1,631 million.
Not legal tender, but receivable for public dues other than import duties. Receivable at par by national banks.	Issued at request of Federal Reserve Board to replace national bank notes when national banks desire to retire their note issues.

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KINDS OF MONEY OF THE UNITED STATES UNDER THE OLD

I. Under the Old Gold Standard

Kind of Money	Denominations Authorized	Backing	Redemption Provisions
Federal Reserve notes.....	\$5.00-\$10,000.00.	At least 40% in gold and balance in commercial paper or Government bonds to March 3, 1934, under the Glass-Steagall Act.	In gold at Treasury; in gold or lawful money at any Federal Reserve bank.

II. Under the New

Treasury Currency:

Gold certificates	(Any denomination may be authorized by Secretary of the Treasury).	Value of metal held as reserve.	Redeemable only by Federal Reserve banks at discretion of Secretary of Treasury.
Silver dollars....	\$1.00.	Value of metal and credit of the Government.	Not redeemable by law.
Silver certificates	\$1.00-\$100.00 (10% of issue may be higher than \$10.00 on outstanding issues. Any denomination may be prescribed by Secretary of Treasury for new issues under authority of the Silver Purchase Act of 1934.)	Silver dollars or bullion of a monetary value equal to face of certificates. Hence backed by value of metal held as reserve and credit of the Government.	In silver dollars at Treasury. (Silver certificates issued under the Agricultural Adjustment Act as amended by the Gold Reserve Act of 1934, may be redeemed in subsidiary currency.)

GOLD STANDARD AND UNDER THE NEW MONETARY SYSTEM

(Prior to March 4, 1933) (Continued)

Legal Tender Power	Limitations as to Issue
Not legal tender, but receivable for public dues. Receivable at par by all member banks and Federal Reserve banks.	Limited only by gold and collateral available as reserves and security.

Monetary System

Unlimited.	Unlimited against gold held by Treasury.
Unlimited.	Under the Agricultural Adjustment Act as amended by the Gold Standard Act of 1934, the President has the power to: (1) provide for unlimited coinage of silver at any ratio with gold; (2) devalue the silver dollar in the same ratio as the gold dollar; (3) authorize the employment of silver in Treasury not needed for redemption as backing for new silver certificate issues. These powers expire in from 2 to 3 years. Under the first power, the President has authorized the Secretary of the Treasury, in accordance with the International Silver Agreement of June 20, 1933, to receive for coinage <i>at least</i> 24.4 million ounces of domestic silver annually for 4 years at the statutory price of \$1.29 per fine ounce. One half amount so received is charged as seigniorage, the other half is coined. Under the Silver Purchase Act of 1934, the Secretary of the Treasury is authorized to coin silver dollars in such amounts as are needed for the redemption of silver certificates issued under the Act.
Unlimited.	Under the Agricultural Adjustment Act as amended by the Gold Standard Act of 1934, the President has the power to: (1) authorize the issue of silver certificates against the deposit of silver bullion; and (2) authorize the issue of silver certificates against uncoined silver bullion in the Treasury. These powers expire in from 2 to 3 years. Under the Silver Purchase Act of 1934, the Secretary of the Treasury is authorized and directed to issue silver certificates secured by silver purchased in accordance with national silver policy, in a face amount not less than cost of the silver bought. He may issue certificates up to the full lawful monetary value of silver purchases, or up to \$1.29 per fine ounce. Silver certificates issued are collateralized only by an equal number of standard silver dollars or an equivalent in lawful value of bullion.

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KINDS OF MONEY OF THE UNITED STATES UNDER THE OLD II. Under the New

Kind of Money	Denominations Authorized	Backing	Redemption Provisions
United States notes.....	\$1.00-\$10,000.	\$150 million gold reserve fund and credit of the Government.	In gold certificates or lawful money (?) at Treasury.
Subsidiary silver	\$.10, \$.25 and \$.50.	Value of metal and credit of the Government.	In lawful money at Treasury in sums of \$20.00.
Minor coins....	\$.01, \$.05.	Credit of the Government.	In lawful money at Treasury in sums of \$20.00.
Bank Currency:			
National bank notes.....	\$1.00-\$1,000.00 (Issued mainly in denominations of from \$5.00 to \$100.00).	Government bonds with note issue privilege and 5% redemption fund in lawful money.	In lawful money at Treasury and national bank of issue.
Federal Reserve Bank notes...	\$1.00-\$1,000.00 (Issued only in denominations of from \$1.00 to \$50.00).	Government bonds with note issue privilege and 5% redemption fund in lawful money. During period of emergency, declared by President, March 6, 1933, backing may include any direct obligations of United States or any eligible commercial paper up to 90% of its value.	In lawful money at Treasury and Federal Reserve Bank of issue.
Federal Reserve notes.....	\$5.00-\$10,000.	At least 40% in gold certificates and balance in commercial paper or government securities to March 3, 1935, under Glass-Steagall Act as amended March 5, 1934. The President may extend this privilege 2 additional years.	In lawful money at Treasury or at any Federal Reserve Bank.

GOLD STANDARD AND UNDER THE NEW MONETARY SYSTEM
Monetary System (Continued)

Legal Tender Power	Limitations as to Issue
Unlimited.	Limited to \$346 million. Under the Agricultural Adjustment Act, the President has the power to authorize the issue of \$3 billion United States notes to retire the public debt. If issued, the Secretary of Treasury is required to retire and cancel 4% of amount outstanding annually. These are non-redeemable notes.
Unlimited.	Under the Agricultural Adjustment Act as amended by the Gold Reserve Act of 1934, the President has the power to (1) authorize subsidiary coinage of silver in Treasury not needed for redemption as backing for new silver certificate issues; and (2) reduce the weight of subsidiary silver in case the weight of the silver dollar is reduced. These powers expire in from 2 to 3 years.
Unlimited.	Limited to minor coinage authorizations by Congress.
Unlimited.	Limited to paid-in capital of issuing national banks and to amount of bonds outstanding bearing circulation privilege. The paid-in capital of all national banks at the end of October, 1933, was \$1,564 million. Under the Federal Home Loan Bank Act, bonds bearing interest up to 3½%, as well as 2% bonds, carry the circulation privilege. The amount of 2% bonds outstanding on January 31, 1934, was \$674 million and of other eligible bonds, \$3,918 million. No provision is made for the compulsory retirement of emergency issues.
Unlimited.	Unlimited except as to collateral available for backing until banking emergency, declared on March 6, 1933, is terminated by President. Issues thereafter limited to bonds bearing circulation privilege. The Secretary of the Treasury is authorized to provide for retirement of emergency issues.
Unlimited.	Limited only by gold certificates and collateral available as reserves and security.

APPENDIX C

TABULAR VIEW OF THE CURRENCY SUPPLY OF THE UNITED STATES APPROXIMATELY AS OF THE END OF OCTOBER, 1933¹

All amounts in million dollars

ELEMENTS OF TREASURY CURRENCY SUPPLY

TREASURY CURRENCY ISSUED

Gold.....	\$4,323	
Silver.....	540	
Subsidiary silver and minor coin.....	426	
United States notes.....	347	\$5,636
(Federal Reserve notes, Federal Reserve Bank notes and national bank notes are treated separately at a later point)		

Stated in Form of Treasury Circulation Statement

In Treasury.....		\$2,069
Property of Federal Reserve Banks.....	1,836	
Held for Federal Reserve Banks and Agents....	1,787	
Redemption Fund Federal Reserve notes.....	37	
Redemption Fund Federal Reserve Bank notes..	12	
Property of U. S. Treasury.....	233	
Money outside Treasury.....		3,567
In Federal Reserve Banks.....	1,954	
Money in circulation.....	1,613	5,636

Otherwise Stated

In Treasury and Federal Reserve Banks.....		4,023
Property of U. S. Treasury.....	233	
Property of Federal Reserve Banks in Treasury..	1,836	
Property of Federal Reserve Banks not in Treasury	1,954	
Money in circulation, i.e. outside of Treasury and Federal Reserve Banks, forming part of formal currency supply.....		1,613 5,636

FEDERAL RESERVE BANK RESERVES AND CASH

From Federal Reserve Bulletin		
Total gold reserves and cash ²	3,816	
Redemption Fund—F. R. Bank notes ³	12	3,829
From Circulation Statement		
Gold reserves and Treasury currency ³	3,790	
National bank note holdings ³	38	3,828

¹ The figures here given are copied from or computed from official sources which do not, however, have identical dates. The Circulation Statement is of October 31, 1933, the data regarding member banks of October 25, 1933, while data computed by non-member banks is of June 30, 1933. While it is believed that individual figures are correct totals are necessarily only approximations.

² October 25, 1933.

³ October 31, 1933.

ELEMENTS OF FORMAL CURRENCY SUPPLY

Total Formal Currency Supply

Treasury currency as above calculated.....	\$1,613	
Federal Reserve notes, net ¹	2,930	
Federal Reserve bank notes, net ²	189	
National bank notes, net ³	903	\$5,635

Use of Formal Currency Supply

Cash reserve and till money of member banks ⁴	447	
Cash reserve and till money of non-member banks ⁵ ...	193	
In hands of public ⁶	4,995	5,635

ELEMENTS OF EFFECTIVE CURRENCY SUPPLY

*Total Effective Currency Supply Held by Public and United States Government**Federal Reserve Bank deposit currency*

Held by U. S. Government and authorized depositors ⁴	200	
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Member bank deposit currency

Total ⁵	15,307	
Less non-member reserve balances.....	434	14,873
Non-member bank deposit currency ⁶		952
Formal currency in hands of public.....		4,995 \$21,020

¹ Less Treasury and Reserve Bank holdings.

² October 25, 1933.

³ June 30, 1933.

⁴ Includes deposits of foreign central banks, special deposits of member and non-member banks operating on a restricted basis, clearings balances of non-member banks, and miscellaneous items. Strictly, only U. S. Government and foreign central bank deposits, totalling \$43 million, should be included in this item. The difficulty of showing the other deposits in Chart 3 furnishes excuse for lumping them here.

⁵ Net demand deposits subject to check plus U. S. Government deposits.

⁶ Reckoned as nearly as possible from available data on the same basis as member bank deposit currency.

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