Balance of Payments of the United States

	1926-29 (4 years)	1930-33 (4 years)	1934-36 (3 years)
		(Millions of dollars)	
Current Account			
Merchandise	+ 2,957	+ 1,630	+ 748
Tourist expenditures	- 2,216	- 1,654	- 910
Immigrant remittances and charitable contributions	- 1,060	- 712	- 384
Interest and Dividend	+ 2,085	+ 1,929	+ 1,117
Other Services	+ 89	- 58	- 34
Net balance on current account	+ 1,835	+ 1,135	+ 537
Capital Account			
Long term capital movements	- 2,124	+ 218	+ 1,456
Short term " "	+ 832	- 2,148	+ 1,581
Net balance on capital account	- 1,292	- 1,930	+ 3,037
Gold and Silver			
Gold	+ 234	+ 60	- 3,986
Silver (a)	-	-	- 602
Residual	- 777	+ 735	+ 1,014

(a) Prior to 1934, silver movements were included among "other services" in the current account.

In the periods, 1926-29 and 1930-33, the current account showed large surpluses which were balanced in the main by large outward movements of capital. The net gold movement was small, and outward.

In the period 1934-36, the surplus on current account was considerably reduced. A $4 billion inflow of gold took place, balanced by an unprecedented movement of capital to the United States. The reported inflow on short and long term account amounted to $3,037 million, while some portion of the Residual item of $1,014 million undoubtedly represented a capital inflow which should be added to that amount.

In the 1934-36 period, the greatest part of the reported capital movement took place in the last two years, when, according to Treasury figures, $2,607 million, divided approximately equally between short-term funds and security operations, came to the United States. Short-term banking funds were responsible for the bulk of the inflow in 1935, but these capital movements were comparatively erratic in 1936. Foreign purchases of securities in the United States rose at an accelerating pace through 1935 to the end of 1936.

Gold and the Movement of Capital
January 1, 1937 - April 14, 1937
(thousands of dollars)

Gold Movement January 1-April 14

1. Private Imports		
from England	$ 225,336 (a)	
Canada	21,451	
India	18,301	
Belgium	17,355	
Japan	15,640	
Switzerland	14,524	
Mexico	14,349	
France	10,841	
All Other	27,293	
Total		$ 365,090 (b)
2. Purchases in London by the United States Government (net)		85,380 ~~93,558~~ (c)
3. Less		
Net Earmarkings for Foreign Account		
Earmarkings under Tripartite Agreement		
England	—	
France	- 2,910	
Netherlands	22,704	
Switzerland	6,770	
Total	26,564	
Other earmarkings	21,133	
Total		47,697
Net gain of gold to the United States from abroad		402773 $ ~~410,951~~

(a) Of this amount $67,528,000 represents gold sold by Russia in the London market.
(b) In addition, a total of $44,594,000 had been engaged for shipment and was in transit to the United States as of the close of business on April 14, of which $40,963,000 represented gold from England, $1,932,000 gold from India, and $1,699,000 gold from Canada. It is not known how much of the gold engaged in the London market consists of Russian-mined gold.
(c) Note: $117,349,000 of gold was imported by the United States Government during the period January 1 to April 14. $63,369,000 of this represented gold bought prior to January 1, but imported in the succeeding period. None of this gold, of course, is included under "Private Imports."

Capital Movement - December 30, 1936 to April 7, 1937

Our data on capital movements between the Second Federal Reserve District and abroad only extend to April 7, and do not therefore reflect the movement of short-term funds in response to last week's rumors over the possibility of a change in the gold price in the United States.

224046

Net Inflow of Capital to Second Federal
Reserve District from Abroad
(in millions of dollars; + = inflow; - = outflow)

	Short Term Banking Funds	Security Transactions	Total
England	+ 35.3	+ 93.2	+ 128.5
France	- 23.2	+ 10.8	- 12.4
Germany	+ 24.5	- 5.2	+ 19.3
Italy	- 6.5	- 1.6	- 8.3
Netherlands	- 16.7	+ 56.3	+ 39.6
Switzerland	- 8.3	- 38.8	- 47.1
Other Europe	+ 19.5	+ 15.2	+ 34.7
Total Europe	+ 24.6	+ 207.5	+ 232.1
Canada	+ 4.5	- 12.9	- 8.3
Latin America	+ 46.7	+ 89.9	+ 136.6
Far East	- 19.3	+ 15.4	- 3.9
All Other	- 6.9	+ 3.3	- 3.6
Grand Total	+ 49.6	+ 303.3	+ 352.9

These data, covering 14 weeks show a net movement of capital to the United States of $352,892,000. If an adjustment be made for balances carried here with Argentine fiscal agents for the redemption of called issues, $49,500,000 of the capital movement represented an increase in this market's short-term banking liabilities to foreigners, while $303,200,000 represented the inflow of capital on security account.

A number of diverse movements of short-term funds are included in the net reported inflow of $49,600,000 mentioned above. Latin American net balances here, apart from those acquired by Argentina for bond redemption purposes, increased by $46,700,000. English net balances rose by $35,300,000 and German by $24,500,000. "Other European" net balances, which include dollars acquired by the U.S.S.R. in connection with gold sold to the Treasury prior to April 7 rose by $19,500,000. Outflows of short-term funds were reported for gold-bloc account in amounts of $23,200,000 for France, $16,700,000 for Netherlands and $8,300,000 for Switzerland. Similarly, an outflow of funds took place to Japan in the amount of $19,300,000.

In the $303,300,000 inflow of capital on security account, the Argentine redemption operations already referred to resulted in a net inflow of Latin American capital from abroad of $89,900,000. Net purchases of American securities amounted to $165,600,000, England, Netherlands, Switzerland and Japan, with amounts of $69,600,000, $46,700,000, $23,700,000 and $19,500,000 respectively, accounting for the bulk of the total. These purchases were continuously heavy in January and February, but became more erratic at the end of March. Net sales of American securities for example took place in the week ended March 24.

While no global data are as yet available for the week of April 7 to 14, yet an indication of the movement of short-term funds to the United States under the impetus of the gold price rumors is to be found in the New York City Member Bank statement for April 14, which showed an increase of $44,000,000 in "Due to

Foreign Banks." The total inflow of short-term funds, when calculated next Tuesday will undoubtedly be considerably larger in amount. It may also be mentioned that the SEC daily figures for a limited number of brokerage houses reveal that foreign sources were sellers in the New York stock market in the week of April 7-14. It is not likely, however, that much of the increase in Due to Foreign Banks came from funds received for the sale of securities here by private individuals, so it may be said that a large movement of short-term funds took place to the United States in the week ended Wednesday last, representing in small part dollars acquired by the State Bank of the U.S.S.R. but mainly a speculative movement of short-term funds to the United States in anticipation of a rumored lower gold price in the United States and a higher foreign exchange value for the dollar.

While a portion of the funds coming here in this fashion reflected purchases of dollars with existing deposits in foreign countries, some part of them represented gold dehoarded in London and offered for sale on the London gold market. Whereas ordinarily offers of gold at the time of the London fixing amount to but £200,000 to £300,000, on Friday, Saturday and Monday of last week (April 9-12), an average of more than £1,100,000 was so offered each day. Our estimate of gold hoarded privately on December 31, 1936 was $1,816,000,000 of which $1,175,000,000 was held in London. The continuance of rumors over the possible reduction in the American net gold price will doubtless result in a dishoarding of a considerable portion of this gold, and its sale to the United States Treasury. This movement would be in addition to speculative purchases of dollars by holders of balances abroad.

Gold Sterilization by the United States

1. Under the Gold Reserve Act of 1934 $2,000,000,000 of the increment in the value of the gold stock was set aside in a Stabilization Fund. These funds are prevented from affecting member bank reserves. The fund does not, however, prevent further gold imports to the United States from affecting member bank reserves, since if it imports gold in lieu of a member bank, its purchases of foreign exchange from the market require a debit to official and a credit to member bank balances with the Federal Reserve Banks.

2. Under the powers granted it by the Banking Act of 1935, the Board of Governors of the Federal Reserve System on July 14, 1936 and on January 31, 1937 raised reserve requirements for member banks, the first 50 per cent increase taking effect on August 15, 1936, the second 50 per cent (of the original requirements) being divided into equal parts, one effective March 1, 1937 and the other to take effect May 1, 1937. Excess reserves, which had been built up in the period 1934-36 entirely through the inflow of gold were affected as follows:

	Total Reserves	Required Reserves (millions of dollars)	Excess Reserves
August 4, 1936	$6,200	$2,940	$3,260
August 15, 1936	6,200	4,410	1,790
February 22, 1937	6,700	4,600	2,100
March 1, 1937	6,700	5,400	1,300

The May 1 increase in reserve requirements will presumably add another $800,000,000 to required reserves and subtract them from excess reserves. If this is the case, required reserves will have been increased from $2,940,000,000 to $6,200,000,000 between August 14, 1936 and May 1, 1937, or by $3,260,000,000. The gold represented by this increase has been largely sterilized in its effects on the banking system.

One point may be made on sterilization of gold imports by increases in required reserves. This method has the effect not only of eliminating gold already received as a base on which credit may be expanded, but in addition, of reducing the danger of credit expansion based on future gold imports by reducing the possible limits to multiple credit expansion on the basis of a given amount of gold. If, for example, $1 of member bank reserves had formerly served as the basis for an expansion in member bank credit of $10, following the doubling of reserve requirements, $1 can support only $5 in member bank credit.

3. On December 21, 1936 the Secretary of the Treasury announced that the Treasury

> "proposes whenever it is deemed advisable and in the public interest to do so, to take appropriate action with respect to net additional acquisitions or releases of gold by the Treasury Department. This will be accomplished by the sale of additional public-debt obligations, the proceeds of which will be used for the purchase of gold, and by the purchase or redemption of outstanding obligations in the case of movements in the reverse direction."

In putting this policy into operation, the Treasury, after December 21, bought gold presented to it with its cash balances, holding the gold in an "inactive gold account." This account stood at $465,326,114 on April 14. Between

December 21 and April 14, the outstanding amount of Treasury bills was increased by roughly $450,000,000 to replenish Treasury balances which had been drawn down through gold purchases. Another $50,000,000 of bills over and above maturities was issued last week dated April 21. Secretary Morgenthau announced on April 15 that he would seek $50,000,000 of new money weekly for an indeterminate number of weeks in order to continue to build up the Treasury's balances.

C. P. Kindleberger,
Foreign Information Division,
April 17, 1937.

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Contents

The Gold Standard between the World Wars

The use of gold coins as money was virtually brought to an end by the First World War. In all belligerent countries gold coins were withdrawn from circulation and gold reserves were concentrated in the central banks. In contrast to the situation in 1914 the Europe of 1920 had twenty-seven paper currencies, none with a gold parity, none with fixed exchange rates and several of them in various stages of inflation. The First World War destroyed Britain's unchallenged financial dominance. Her already noticeable lag behind newly industrialised countries in production and export growth grew worse. Wartime trade interruptions spurred industrialisation in several of Britain's traditional markets. Britain lost ground in shipping and her role as an international investor was now much diminished. The American dollar destroyed the pre-eminence of sterling without itself taking over sterling's old role. The USA became an international financier during the First World War, lending abroad to finance an export surplus during its neutrality, and later to aid its Allies.

The dollar returned with ease to the full gold standard as early as 1919 and thereafter was the guidepost for realignment of other currencies. Rebuilding the gold standard was a gradual world-wide process. Some countries sooner or later regained their prewar gold parities; besides Great Britain, these included the British Dominions, Switzerland, The Netherlands and her colonies, Argentina, the three Scandinavian countries, and Japan (which did not drop her wartime gold export embargo until January 1930). By the end of 1925 some 35 currencies in addition to the US dollar had either been stabilised on gold or had displayed exchange rate stability for a full year. Three years later the apparent reconstruction of the international gold standard was substantially complete.

From 1920 until 1924 the sterling dollar exchange rate was left free to float. The wide fluctuations which followed combined with the German Mark being stabilised against gold in 1928 led to a widespread British preference for again fixing the exchange rate. In his budget speech of April 28th 1925 the Chancellor of the Exchequer, Winston Churchill, announced that the restrictions on gold and silver exports would lapse at once and that the Bank of England would redeem legal tender in gold for export. The Gold Standard Act of 1925, passed on May 13, required the Bank of England to sell gold ingots of not less than 400 fine ounces for legal tender at the traditional price of £3 17s. 10½d. per ounce 11/12 fine. Sterling could thus be redeemed in gold in amounts worth no less than almost $8300 (£1670). Redemption in coin by the general public was not permitted. Only the Bank of England was to have the right to bring gold bullion to the mint for coinage. The Bank remained obliged, as it had been without interruption ever since 1844, to buy all the gold offered to it at £3 17s. 9d. per ounce 11/12 fine. This system was known as the 'gold bullion standard'. It enabled all the advantages of the gold standard to be enjoyed without the expense of maintaining a gold coinage. Thus the essential features of the gold standard were retained: the standard unit of the currency still represented a certain weight of gold, and its price was fixed.

By 1926 only one of the world's major countries (Sweden) provided for the redemption of bank notes in gold coins; and only one (Great Britain) for the redemption in gold bullion. The widespread usage of gold coins had disappeared. The new gold-exchange standard, during the first years of operation in the 1920s, used chiefly the US dollar as a reserve asset; and for a few years, between 1927 and 1931, the pound sterling became the major reserve asset of the Netherlands.

The United Kingdom decision to return to the gold standard at the pre-war parity of $4.86 (the actual parity was $4.8665 but for convenience $4.86 is used in the text as an approximation), announced in Churchill's budget speech, has since been interpreted as a watershed in British inter-war economic history. It was a decision which was widely criticised as having overvalued the sterling/dollar exchange rate. Most prominent among British critics was John Maynard Keynes. In 1925 Keynes published a pamphet entitled 'The Economic Consequences of Mr Churchill' warning that the old parity would hamper exports and necessitate further painful deflation in Britain. Churchill appears to have been impressed by four main arguments – the political risks involved in any decision not to return; the big, smooth rise in the exchange rate since the Tories' return (mentioned below); the widespread view that return would ensure long-term benefits on employment and trade, even if the short-term was hard; and the fact that after October 24, 1924, the gold supported exchange value of the pound had been able to rise, without apparently, any of the traditional deflationary side effects.

Although it is difficult to be precise about the extent of the overvaluation Moggridge has argued that the degree of overvaluation was 10 per cent, i.e., that British prices had fallen sufficiently only to make the pound worth some 90 per cent of this dollar rate.[1] The majority of accounts of this decision take the view that both the rate of exchange and the associated tight monetary policy imposed a burden upon the economy which, owing to structural defects, it was ill-equipped to bear and which made subsequent adjustment more difficult than it needed to be. Although they differ in the details of their reservations dissenters from this view are Alford,[2] Aldcroft,[3] Sayers[4] and Youngson,[5] with Moggridge[6] and Howson[7] being two of the most vocal critics of the exchange rate adopted. Sayers' view, that whatever the rate chosen was to a certain extent immaterial, since this would be undercut by the French and Belgians, was seen to be correct when both the French and the Belgians returned to the gold standard in 1927 at an undervalued rate. An often forgotten point about the 1920s is that, after the initial inflationary burst following the end of the First World War in 1918, British economic policy was deliberately geared for a number of years to producing conditions for the restoration of the Gold Standard. This meant that by the end of 1922 deflationary policies had already nursed the exchange rate back up from \$3.40 to \$4.63, well before the formal revaluation to \$4.86 on 3 April 1925.

The gold bullion standard lasted for six years, from 1925 until 1931. The overall inadequacy of the reserves for gold standard countries meant that countries with overvalued currencies were forced to pursue politically unacceptable deflationary policies. The rapid growth of trade unionism had made wages and prices much less flexible in the downward direction which further exacerbated unemployment. Governments generally were less willing to pursue 'laisser-faire' policies when lengthening dole queues threatened political stability. Great Britain abandoned convertibility in 1931 and the United States in 1933. In the United States during this depression period a considerable amount of gold coin and gold certificates went into hoards. After the dollar became *de facto* depreciated, Congress abrogated the gold clause in contracts and made all obligations payable in legal tender, that is, in any form of currency or coin. The Gold Reserve Act of 1934 established a new gold standard for the United States at \$35 a fine ounce with gold used only for international settlements. Gold could no longer be coined and private holding of gold coin by US residents was forbidden, a prohibition abolished in 1974. (*This was discussed on pp. 40–41.*)

During the Great Depression (1929–1933) the international gold standard collapsed, and from 1933 to 1937 countries followed a policy of extreme nationalism. Currencies were devalued competitively, tariffs were raised and other restrictions on trade, such as exchange controls and multiple currency devices, were introduced. Currency devaluations intensified the depression in the gold-bloc countries i.e. France, the Netherlands, Belgium and Switzerland.

Currency devaluations began early in the Depression. In September 1931 sterling was depreciated by about 30 per cent. On January 31, 1934, the dollar was formally devalued by 41 per cent and, between 1935 and 1936, the currencies of the gold-bloc countries were devalued. The gold standard, so laboriously restored from 1925 to 1930, was abandoned by every great trading country by 1936. The great depression swept away not only the newly established parities but also the historic gold parity of the dollar, sterling, the Netherlands guilder, and the Swiss franc. It was not until the link between gold and currencies was severed that the depression could be brought to an end and a slow recovery could begin.

The inter-war years can be seen, with hindsight, as the period when the USA achieved economic dominance over the Western world. The failure of international monetary relations during these two decades was probably

due to the USA's reluctance to assume the responsibilities that this position forced upon it. By the end of the Second World War, it had overcome these inhibitions. The formulation of a new spirit of international monetary co-operation, a necessary condition for the planning of the post-war reconstruction, depended, to a certain degree, upon the willingness of the USA to assume economic leadership.

The Gold Standard after the Second World War

Just as opinion at the end of the First World War was almost unanimously in favour of a return to the gold standard, so there was virtual unanimity at the end of the Second World War against returning to a gold standard without substantial modifications. There was also a general consensus on the need to ensure the convertibility of currencies between countries and to avoid large and frequent fluctuations in exchange rates. The Bretton Woods agreement (1944) was an attempt to modify the gold standard with the intention of removing the supposed defects of the classical gold standard while retaining some of its better features. Appendix I summarises the similarities and differences between the British and American plans which were put forward at Bretton Woods. The system adopted at Bretton Woods became known as the gold exchange standard.

According to its Articles of Agreement, the purposes of the International Monetary Fund (IMF), which was established at Bretton Woods, were to promote international monetary co-operation, facilitate the expansion of international trade for the sake of high levels of employment and real income, promote exchange-rate stability and avoid competitive depreciation, work for a unilateral system of current international payments and for elimination of exchange controls over current transactions, create confidence among member nations and give them the opportunity to correct balance of payments maladjustments while avoiding measures destructive of national and international prosperity.

Under the provisions of the Bretton Woods Agreement, all countries were to fix the value of their currencies in terms of gold but were not required to exchange their currencies for gold. Only the dollar remained convertible into gold at \$35 per ounce or 0.0285714 fine ounces of gold per dollar, which is the same thing. Therefore all countries decided what they wished their exchange rates to be *vis-à-vis* the dollar, then calculated what the gold par value of their currencies should be to give the desired dollar exchange rate. All participating countries agreed to try to maintain the value of their currencies within 1 per cent of par by buying or selling foreign exchange or gold as needed. The rules of the IMF allowed members' monetary authorities to sell gold (but not to buy) above the official price and to buy gold (but not to sell) below it. This system engendered the exchange rate stability provided by the gold standard.

Members were required to pay 25 per cent of their IMF quota in gold (with concessions for countries holding small gold stocks). It was envisaged that gold would continue to form the major part of international reserves and that gold transactions would play an important role in settling those international payments that could not be offset against one another through exchanging one convertible currency for another in the foreign exchange market.

In all these respects the new system was similar to the old gold standard. However, the IMF agreement provided formal rules allowing members to change the par values of their currencies to meet a 'fundamental disequilibrium' in their balance of payments, though these words were not defined. The Fund provided members with the opportunity of 'drawing' (i.e. borrowing) foreign currencies in amounts related to their quotas to supplement their reserves, thus allowing more time for the correction of balance-of-payments deficits; and the 'scarce currency clauses' (which never came into operation) were intended to put pressure on countries with a surplus in their balance of payments to contribute their share towards adjustment.

The most important difference between the new system and the old was not written into the Bretton Woods Agreement at all but followed from the policies of individual countries. No country, after 1945, operated any effective link between its gold reserve position and its domestic money supply; where a formal rule was maintained it was completely ineffective. The USA retained a formal link in the form of a 25 per cent reserve ratio, but in the early post-war years the US gold stock was so large that the rule imposed no great constraint; when the fall in the gold stock and the expansion of the money supply produced a situation where the rule might soon have begun to 'bite', Congress repealed it, in 1968. In the United Kingdom the Bank of England still operates within the legal form of the 'fixed fiduciary issue'; but the gold stock is now held by the Exchange Equalisation Account, not the Bank, and the amount of the note issue is in practice varied at the discretion of the Treasury. Thus fluctuations in reserves no longer have the effect on the domestic money stock that an inflow or outflow of gold had under the old system, and adjustments of the balance of payments depend on discretionary action by governments. This was the important difference between the new and the old systems.

The transitional period after the setting up of the IMF proved much longer than was envisaged at Bretton Woods and it was not until the late 1950s that the new system was fully operational. After being closed, or all but closed, since 1939, the London gold market reopened in March 1954. This was a market in which private buyers and sellers could operate. The market was calm for 6½ years and the gold price remained within a few cents of the US Treasury's buying and selling prices of $34.9125 and $35.0875 per ounce. In 1960 following the Cuban missile crisis there was a

large rise in the speculative demand for gold prompted by rumours of a devaluation of the US dollar (equivalent to a rise in the official gold price). On October 20 1960 the London price reached $40 an ounce, despite large official sales, mostly by the US Treasury. This rise in the gold price caused foreign central banks, fearing a dollar devaluation, to cash in surplus dollars at the United States gold window, and the US Treasury found itself forced to put out a press statement formally endorsing Bank of England sales of gold to stabilise the London price at the ultimate expense of the American gold stock. By the autumn of 1960 the weekly Treasury reports of American losses through the gold window were making the front page of the *New York Times*.

Charles Coombs, formerly Senior Vice President of the Federal Reserve Bank of New York who was responsible for US Treasury and Federal Reserve operations in the gold and foreign exchange markets summarised the situation as follows:[8]

> 'Thus in late 1960 the dollar had become convertible into gold on demand not only by central banks but also by private speculators all over the world. The United States Government had become thoroughly trapped by its gold commitments under Bretton Woods and a heavy responsibility for devising a safe escape route now fell on the new team of Treasury officials to be appointed by President-elect John Kennedy.

In February 1961, Kennedy made his famous pledge that the dollar-gold price would remain immutable. The price settled back to $35 but the pledge was no more than a holding operation and negotiations between the leading Central Banks immediately began which were to result in the creation of the Gold Pool. This was an agreement whereby the Bank of England would sell gold on behalf of the central banks of the USA, the United Kingdom, Switzerland, Belgium, France, Germany, Italy and the Netherlands, in sufficient quantities to keep the price at $35. The Bank of England bought or sold in the market, as required, to stabilise the price and the participants contributed gold for sale, or shared gold purchased, according to a quota. France dropped out in 1967 but the remaining countries operated the pool until March 1968.

Between 1961 and 1965 there were substantial Russian sales through the pool thereby helping the pool to operate both ways with purchases somewhat exceeding sales over the period as a whole. After the end of 1965, Russian sales ceased and the pool became a substantial net seller. The climax came with the devaluation of sterling in November 1967; this again cast doubt on the stability of the dollar, which was widely regarded as overvalued, and created an enormous speculative demand for gold. The question now was how much official gold was to be diverted to the London gold market before it was acknowledged that the game was up. Several attempts were made to dam the flood, but with gold market speculation now focussing squarely on the dollar the crisis came in March factors exerted an influence on the volume and direction of short-term capital flows that may at times have overshadowed interest-rate factors.

Conditions almost unique in history smoothed the operation of the system. Money, wages and prices were probably more flexible in both directions than they later became. Relative calm in social and political affairs and the absence of ambitious programmes of government spending and taxation all tended to tighten monetary control. Moreover, as Triffin has made clear, credit money, i.e. bank currency and deposits, played an overwhelming part in sustaining feasible rates of economic growth in the century before the First World War.[17] Triffin estimates that by 1913 credit money accounted for about 85 per cent of the world money supply.

Heller and Kreinen showed that balance of payments adjustments via domestic macro-economic policy (*à la* gold standard rules) for the 1960s time period would be costlier than adjustment via the exchange rate for most countries.[18] They conclude that the ratio of costs from income adjustment to costs from exchange rate adjustment is roughly 5:1 for Canada, 3.5:1 for Japan, and 3:1 for the United States. A similar study for the post OPEC world would undoubtedly indicate that this ratio has worsened. Michaely undertook a comprehensive study of the domestic policy responses to payments imbalances of the world's major countries during 1950–66.[19] This is in fact a test of whether countries would be willing to live by gold standard adjustment rules as the period under consideration was one of fixed exchange rates. He discovered that no country ever moved its fiscal policy consistently even in the direction called for by external considerations. Michaely also discovered that even the directional response of monetary policy to external considerations weakened from the 1950s to the 1960s.

As stated by Bergsten reasons for this antipathy to gold standard rules are obvious.[20] The level of domestic unemployment or inflation which would be needed to provide the sole cure for payments deficits and surpluses, respectively, would create huge economic costs and thus be politically unacceptable in most modern societies. Governments and monetary authorities already have great difficulty in achieving their numerous policy targets, and they could hardly afford to give up three of their policy instruments – the exchange rate, selective controls and external financing – which would be needed if the 'rules' of the gold standard were to be adhered to.

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APPENDIX I

POST SECOND WORLD WAR PLANS FOR REFORMING THE INTERNATIONAL MONETARY SYSTEM: THE ALTERNATIVE ROLES GIVEN TO GOLD

The lessons of the First World War were well remembered in the formation of international financial policy during and after the Second World War, Report to the Congress

of the Commission on the Role of Gold in the Domestic and International Monetary Systems

March 1982

Volume I

The Emergency Banking Act of March 9, 1933, granted the President emergency powers over banking transactions and over foreign exchange dealings in gold and currency movements. The next day, March 10, the President issued an executive order extending the restrictions on gold and foreign exchange dealings beyond the banking holiday proper and, in effect, prohibiting gold payments by banking and nonbanking inssitutions alike, unless permitted by the Secretary of the Treasury under license. These measures were the precursors to a far-reaching alteration in the legal structure of the monetary standard.

5. 1933-1934 -- a floating dollar[25]

Despite the effective suspension of gold payments in March 1933, the price of gold or the rate of exchange between the dollar and currencies that remained rigidly linked to gold, hovered around "par" for over a month. The suspension was regarded as part of the banking emergency and hence expected to be temporary; foreign exchange transactions were strictly controlled and limited; the Administration made no official announcement that it proposed to permit the dollar to depreciate or be devalued; and after some weeks, several licenses to export gold were granted. Moreover, the technical gold position was sufficiently strong so that there was little doubt the preceding gold parity could have been maintained if desired; the ratio of the gold stock to the total stock of money was higher than at any time since 1914.

One important step, unprecedented in the United States, was taken during this period. On April 5, an executive order forbade the "hoarding" of gold and required all holders of gold, including member banks of the Federal Reserve System, to deliver their holdings of gold coin, bullion, or certificates to Federal Reserve Banks on or before May 1 except for rare coins, reasonable amounts for use in industry and the arts, and a maximum of $100 per person in gold coin and gold certificates. The gold coin and gold certificates were exchanged for other currency or deposits at face value, and the bullion was paid for at the legal price of $20.67 per fine ounce. The "nationalization" of gold outside Federal Reserve Banks was later completed by order of the Secretary of the Treasury, dated December 28, 1933, excepting only rare coins and a few other minor items from the requirement that all gold coin, gold bullion, and gold certificates be delivered to the Treasurer of the United States at face value corresponding to the legal price of $20.67 per fine ounce. The expiration date for the surrender of gold was later set for January 17, 1934, when the market price of gold was in the neighborhood of $33 per fine ounce.

An executive order of April 20, 1933, extending and revising the gold embargo, and comments by the President at his news conference the preceding day ended the period of stability in the price of gold. The President made it clear that the Administration intended to permit the dollar to depreciate in terms of foreign currencies as a means of achieving a rise in domestic prices. The order applied the restrictions on foreign exchange transactions not only to banks licensed under the executive order of March 10, but also to all persons dealing in foreign exchange. On the same day, the Thomas amendment to the Agricultural Adjustment Act was offered in Congress. The amendment enacted into law on May 12, and explicitly directed at achieving a price rise through the expansion of the money stock, contained a provision authorizing the President to reduce the gold content of the dollar to as low as 50 percent of its former weight. The dollar price of gold immediately started rising, which is to say that so also did the dollar price of foreign currencies, including those like the French franc that remained on gold and those like the pound sterling that had gone off gold at an earlier date. In the next three months, the market price of gold rose to $30 an ounce, and thereafter fluctuated erratically between a low of about $27 and a high of nearly $35 until January 30, 1934, when the Gold Reserve Act was passed. During that period, the United States had a floating exchange rate determined in the market from day to day, as in the period from 1862 to 1879. However, there was considerably greater government intervention in the market. On September 8, 1933, an official gold price, to be fixed daily at the estimated world market figure less shipping and insurance cost, was established. The Treasury agreed to buy gold at that price to give American miners a price as high as they could have obtained by export in the absence of the export embargo.

Starting in October, the government intervened actively to raise the price of gold. The Reconstruction Finance Corporation was authorized to buy newly mined domestic gold from October 25 on, and a few days later, through the agency of the Federal Reserve Banks, to buy gold abroad. The purchase price was raised almost daily. For a time, the large-scale RFC purchases abroad made the announced price for newly mined domestic gold the effective market price. From the end of November, however, until the end of January 1934, the announced price exceeded the market price abroad.

The aim of the gold policy was to raise the prices of farm products and raw materials. Most farm products and raw materials exported by the United States had a world market, hence the decline in the foreign exchange value of the dollar meant a roughly proportional rise in the dollar price of such commodities as cotton, petroleum products, leaf tobacco, wheat, and similar items.

The decline in the foreign exchange value of the dollar was initially a product of speculative sale of dollars in the expectation of devaluation -- a short-term capital outflow. The decline was sustained by shifts in the demand schedules for imports and the supply schedules of exports produced by the cessation of internal deflation. Prices rose in the United States relative to prices in other countries. If the exchange value of the dollar had not fallen, the price rise would have discouraged exports and encouraged imports. These forces were subsequently reinforced by U.S. purchase of gold at home and abroad.

U.S. purchase of gold involved a reduction in the supply of goods for export, since gold is a potential export good, and hence a reduction in the demand for dollars by holders of other currencies (to buy the domestically produced gold). The purchase of foreign gold involved an increase in the demand for goods for import (namely, gold) and hence in the supply of dollars offered in exchange for foreign currencies (to buy foreign gold). The combined effect was to create a potential deficit in the U.S. balance of payments at the former exchange rate. Given a flexible rate, the potential deficit was closed by a depreciation of the dollar sufficient to generate, through an increase in exports or a decline in imports or a movement of speculative funds, an amount of foreign currencies exceeding the amount demanded for other purposes by enough to pay for the gold.

These effects depended very little on the fact that gold was the commodity purchased. Given a floating exchange rate, essentially the same effects on the dollar prices of internationally traded goods would have followed from the same dollar volume of government purchase of wheat or perfume, or from the economically equivalent program, adopted after World War II, of building up stockpiles of foreign-produced strategic goods. As it was, the use of gold as the vehicle necessarily meant an accumulation of gold, just as the use of wheat or perfume would have meant the accumulation of that commodity.

The choice of gold as the vehicle did have an important effect on the impact of the program on foreign countries. In the first place -- and a corresponding effect would be present for any particular commodity -- the program had a special impact on gold-producing countries. In the second place -- and this effect would be present only for a commodity serving as the basis of a monetary standard -- it had a special impact on gold-standard countries. Being committed to sell gold at a fixed price in terms of their own currency, these countries necessarily experienced pressure on their gold reserves, which in turn necessitated either abandonment of the gold standard or internal deflationary pressure. Those countries were placed in the position of having to adjust downward their whole nominal price level.

The device used to achieve a decline in the exchange value of the dollar -- borrowing funds (through the issue of RFC securities) to purchase gold -- was not unprecedented. The identical device was employed before 1879 but that time for precisely the opposite purpose: to promote a rise in the exchange value of the dollar. As noted above, the mechanical as opposed to the psychological effects of the accumulation of a gold reserve rendered resumption more rather than less difficult.

A major obstacle to using gold as a vehicle for lowering the exchange value of the dollar and thereby raising prices was the existence of the so-called gold clause in many government and private obligations and in private contracts. That clause, whose use dated back to the greenback period after the Civil War, required payment either in gold proper, or in a nominal amount of currency equal to the value of a specified weight of gold. It was designed precisely to protect lenders and others against currency depreciation. This clause, if honored, would have multiplied the nominal obligations

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of the federal government and of many private borrowers for interest and principal of debt by the ratio of the new price of gold to the old price of gold. Accordingly, a joint resolution was introduced in Congress on May 6, and passed on June 5, 1933, abrogating the gold clause in all public and private contracts, past and future. In February 1935, the Supreme Court, by a five-to-four decision, in effect upheld the constitutionality of that resolution. Not until the Act of October 28, 1977, was the prohibition against gold clauses removed, and express allowance for their use provided.

At the outset, the gold policy was one of two mutually inconsistent policies with respect to the monetary standard simultaneously pursued by President Roosevelt. The other was the organization of a World Monetary and Economic Conference which convened in London in June 1933. President Hoover had set in train the arrangements for the convocation of the Conference in May 1932, and it was originally scheduled to be held in January 1933. The aim of the Conference was to achieve cooperative action on international economic problems, and hopes were high that it would produce an agreement stabilizing foreign exchange arrangements. But the Conference was nearly a complete failure. One reason was that, while it was in process, the President apparently decided definitely to adopt the path of currency depreciation. He sent a message to the Conference on July 2, 1933, which disassociated the United States from any attempt to achieve what was described as a "temporary and probably an artificial stability in foreign exchange on the part of a few large countries" and was termed a "specious fallacy." The message was at the time given much of the public blame for the failure of the Conference. However, whatever the President might have said and however consistent U.S. policy might have been, it seems dubious that the economic preconditions existed for a viable exchange stabilization agreement. The fundamental difficulties were the probable incompatibility of the exchange rates of the sterling bloc and of the nations that still remained on gold, and the unwillingness at the time of the gold-bloc countries to change their gold parities.

The period of a variable price for gold came to an end on January 31, 1934, when the President, under the authority of the Gold Reserve Act passed the day before, reduced the gold content of the dollar to 13.71 grains and thus specified a buying and selling price of \$35 an ounce for gold (480/13.71 = \$35). He thereby devalued the gold dollar to 59 percent of its former weight. Under the terms of the Act, title to all gold coin and bullion was to be vested in the United States; all gold coins were to be withdrawn from circulation and melted into bullion and further gold coinage was to be discontinued; the Secretary of the Treasury was to control all holdings and dealings in gold; and the President was authorized to fix the weight of the gold dollar at any level between 50 and 60 percent of its prior legal weight.

Since the Treasury had formerly valued its own gold holdings at \$20.67 an ounce, and paid only that price for gold it acquired from private individuals, commercial banks, and the Federal Reserve System, it realized a large "paper" profit from the revaluation of the dollar; which is to say, the Treasury could print additional paper money entitled "gold certificates" to a nominal value of nearly $3 billion without acquiring additional gold and yet conform to the legal requirement that it hold a specified weight of gold (now less than before) for each dollar printed. Those gold certificates could not be legally held by private individuals, but they could be held by Federal Reserve Banks. Accordingly, to realize its "profits," the Treasury had to turn over gold certificates to the Federal Reserve System, receiving in return a deposit credit that it could convert into Fedeal Reserve notes or pay out by check. Stripped of its legal trappings, the economic effect was identical with a simple grant of authority to the Treasury to print and put in circulation nearly $3 billion of fiat currency in addition to the $3 billion in greenbacks already authorized by the Thomas Amendment to the Agricultural Adjustment Act.

Of the paper profit, $2 billion was appropriated to a stabilization fund set up under the control of the Secretary of the Treasury, who, with the approval of the President, was authorized to deal in gold, foreign exchange, and such other instruments of credit as he deemed necessary for the purpose of stabilizing the exchange value of the dollar. Of the balance of the paper profit, $645 million was used for the redemption of national bank notes, which simply substituted one form of fiduciary currency for another; $27 million was transferred to the Federal Reserve Banks for making industrial loans; $2 million was charged off to losses in melting gold coin; and $141 million remained in the General Fund cash balance.

Thus the interlude during which the United States was not on a gold standard was concluded. The type of gold standard on which it operated thereafter is the subject of the section that follows.

6. 1934 - 1948 -- the interwar, World War II, and postwar managed gold standard[26]

The official price of gold remained fixed at $35 an ounce from February 1, 1934, until March 31, 1972, when the official price was altered to $38. In this sense, the date in 1934 marked the return to a gold standard. But the gold standard to which the United States returned was very different, both domestically and internationally, from the one it had left less than a year earlier. The Treasury bought all gold offered to it by domestic producers at the price of $35 an ounce and sold at this price to licensed domestic industrial users. Internationally, the Treasury bought and sold gold at the fixed price in monetary transactions with foreign monetary authorities. The holding of gold coin and bullion was forbidden to private individuals in the United States, except for use in industry and the arts and for numismatic holdings, and gold no longer circulated domestically. The Federal Reserve continued to have a gold reserve requirement, but the state of the reserve was not a direct influence on policy at any time from 1933 until the threatened depletion of the gold reserve in the period from 1948 to 1968, under the Bretton Woods arrangements. In 1945, when the System was approaching the then existing requirement (40 percent for

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Federal Reserve notes and 35 percent for Federal Reserve deposits), the law was changed to require a uniform 25 percent.

Fixed buying and selling prices for gold were no longer the main reliance for maintaining rigid exchange rates with other currencies, even those of countries nominally on gold. Instead, a new finance ministry organ was created, the stabilization fund, with powers to engage in open market purchase and sale of foreign exchange and gold to influence exchange rates. During the late 1930s, most of the so-called gold-bloc countries finally left gold, and nominally floating exchange rates with government intervention through stabilization funds became the rule. During the war, many countries fixed "official" exchange rates but sought to maintain them by extensive control over foreign exchange transactions, imitating the devices developed by Hjalmar Schacht for Germany in the 1930s, rather than by free purchase or sale at fixed prices of either gold or foreign exchange. Since then, an even wider variety of multiple exchange rates came into use.

After 1934, the role of gold in the United States was not that of the base of the domestic monetary system. Rather it became a commodity whose price was officially supported in the same way as the price of wheat, for example, was under various agricultural support programs.* The major difference is that the support price for agricultural products was paid only to domestic producers, the gold-support price to foreign monetary authorities as well. In addition, the agricultural products accumulated were freely sold at the support prices to anyone, the gold only to certain foreign purchasers and to licensed domestic industrial users. In consequence, the gold program set a floor under the world price of gold in terms of dollars.

The substitution in 1934 of a fixed price for gold, rather than a variable price as under the earlier purchase program in 1933 and early 1934, meant that the number of dollars spent on gold was no longer under the direct control of U.S. authorities. Having fixed the price, they were committed to buy all that was offered by foreign monetary authorities and domestic producers. But the effects of such purchases were the same as under the earlier program. For the United States, the purchases meant an increase in the dollar value of other exports relative to the dollar value of imports, thanks to a rise in prices of internationally traded goods relative to domestic goods through the combined effect of changes in exchange

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*Herbert J. Coyne -- Many economists would generally consider gold's role more distinctive than that of an ordinary commodity in this period. Indeed, Dr. Schwartz states in the book she authored with Milton Friedman, A Monetary History of the United States, 1867-1960 (on p. 473) that: "The link between gold purchases and Treasury authorization to create high-powered money is, of course, the main remnant of the historical role of gold, and still serves to give gold some special monetary significance."

rates and in domestic price levels of the various countries. For gold-producing countries, the purchases meant a higher price for one of their products, hence an expansion in the gold industry relative to other industries and a rise in income. For gold-standard countries, the price fixed for gold in the United States determined the rate of exchange between their currencies and dollars. They either had to adjust their internal price level to that new rate -- in the process presumably disposing of some of their reserves as measured in ounces of gold -- or to change their own fixed price of gold. For all gold-standard and gold-producing countries except the United States and for nongold-standard and nongold-producing countries, the gold purchases meant a reshuffling of international trade in response to a decreased U.S. demand for products other than gold, and an increased demand for such products by gold-producing countries; the program meant an increased supply of products from the United States and a decreased supply of products other than gold from gold-producing countries. Finally, international trade had to adjust to measures adopted by gold-standard countries to meet loss of their reserves.

The price fixed for gold initially overvalued the product and therefore stimulated a rapid increase in production and a rapid accumulation of government stocks. Production in the United States including its possessions rose from less than 2.6 million ounces in 1933 to 6 millon in 1940; in the world from 25 million ounces in 1933 to 41 million in 1940. The rise in prices of other commodities and services from 1940 to 1948 lowered the relative price of gold and reduced U.S. gold output (1948) below its 1933 level, though world output still exceeded the level of that year.

There was an initial sharp jump in the U.S. gold stock from January to February 1934 that was accounted for primarily by the revaluation of gold, but part was produced by the substantial amount of gold imported, as foreigners took advantage of the higher buying price that became official on January 31. Gold was almost immediately shipped to the United States. In the six weeks from February 1 to March 14, more than $0.5 billion of gold (valued at the new price) was imported. Once the initial rush of gold imports ended, the gold stock continued to rise at a fairly steady rate to the end of 1937. Until France left gold in late 1936, roughly half of U.S. gold imports came from France. For the next year, France was a net importer of gold from the United States rather than a net exporter. During the last quarter of 1937, a large-scale withdrawal of foreign short-term balances followed rumors that further devaluation of the dollar was being considered as a possible counter-cyclical measure. Withdrawal of European short-term funds from the United States ceased in July 1938. These counter movements roughly offset the forces making for a continued flow of gold to this country, so the total gold stock remained fairly steady from autumn 1937 to autumn 1938. Munich then led to a further flight of capital from Europe and a sudden increase in the rate of gold inflow. The outbreak of war simply maintained the rate of the gold inflow. The intensification of Britain's war effort after the fall of France in early 1940 and her attempt to tap American supplies of war material, as she had in

World War I, produced a further increase. Finally, the enactment of lend-lease in early 1941, which relieved Britain and her allies of the necessity of acquiring dollars to finance war purchases, brought an end to the rapid growth of the gold stock. In sum, the gold stock in the Treasury rose from 200 million ounces when the support price was fixed in early 1934 to 630 million ounces by the end of 1940, a rise that was 1-3/4 times as much as aggregate world output during the intervening period. The gold stock declined somewhat during the war, but an inflow in 1946-48, arising from the demand for U.S. goods of war devastated and neutral countries, brought the stock to nearly an all-time high in 1948 (exceeded only in 1949).

The rise in the dollar price of currencies of gold-bloc countries was at first much greater than that of currencies not linked to gold. From January 1933 to September 1934 the rise was 70 percent for the currencies of France, Switzerland, Belgium, the Netherlands, and Italy, and less than 50 percent for the pound sterling. The gold-standard currencies therefore appreciated not only relative to the dollar but also relative to other currencies. The differential appreciation measured the special impact of our gold price-support program on the position of the gold-standard countries. The fact that they lost gold meant that they bore, as it were, a larger part of the effect of the expansion of U.S. exports and contraction of U.S. imports other than gold than other countries did, and thereby cushioned the initial impact on those other countries.

Had nothing else intervened, the gold-standard countries would have had to reduce their internal price levels relative to those of other countries in order to stay on gold, that is, in order to render something like the new structure of exchange rates consistent with no pressure on the balance of payments. In fact, something else did intervene, but it intensified rather than eased the problem of the gold-standard countries. Gold purchases under the fixed price-support program coincided with a flight of capital to the United States from Europe largely induced by political changes: first, the rise to power of Hitler in Germany which led to a large-scale attempt to transfer capital out of Germany; then the increasing fears of war which led to flight of capital from France, Britain, and other European countries.

If the United States had continued its floating exchange-rate policy of 1933 and had fixed no firm price at which it was willing to buy the world's gold, the capital flight would have produced an appreciation of the U.S. dollar relative to other currencies, which would have discouraged exports from the U.S. and encouraged imports into the U.S. That outcome would have produced the unfavorable balance of trade required as the physical side of the capital import -- and incidentally, would have worked against one of the domestic objectives of New Deal policy, namely, to raise exports relative to imports as a means of stimulating employment. If, instead, the U.S. and other countries involved had all been on a gold standard the nineteenth century variety, the attempt to transfer capital to the U.S. would have increased gold reserves in this country, even without a rise in the dollar price of gold, and decreased gold reserves abroad; it would have increased proportionately the money stock in the U.S. and thereby have promoted a rise in domestic prices and income; and it would have decreased the money stock abroad and thereby have promoted a fall in prices and income in foreign countries. These changes would have tended to produce precisely the same shift in relative prices and the same unfavorable balance of trade as the appreciation of the dollar under the hypothetical floating exchange rates would have done.

Since the flight of capital constituted an increased demand for dollars, its effect on exchange rates and on U.S. trade in commodities and services other than gold were in precisely the the opposite direction to those of the gold price-support program and tended to offset them. There was simultaneously an increased offer of dollars for gold on the part of the U.S. Government and and an increased demand on the part of foreigners for dollars to hold. By trading assets held abroad for gold and transferring the gold to the U.S. Treasury, foreigners could acquire dollars and the Treasury could acquire gold without in any way affecting the rest of the U.S. balance of payments. To the extent that such offsetting occurred, the gold program did not affect U.S. trade currents and the relative prices of internationally traded goods in ways referred to earlier. Since such changes in trade currents and relative prices tended to reduce the amount of gold offered for sale to the United States at its fixed price, the capital inflow meant that this country acquired a larger amount of gold at $35 an ounce than it otherwise would have. Hence, while the capital inflow and the gold price-support program had opposite effects on U.S. exchange rates and on U.S. trade in commodities and services other than gold, both tended to raise its gold stock. For gold-standard countries that were themselves subject to a capital outflow -- that is, for all the important gold-bloc countries that had remained on gold after 1933 -- the capital outflow reinforced rather than offset the effect of the gold price-support program. It required an additional reduction in internal price levels beyond that called for by the support program. Exports had to be still larger relative to imports if they were to finance the capital outflow without a continued outflow of gold.

The deflation that would have been required by the combined effect of the U.S. gold price-support program and the capital outflow was more than the gold-bloc countries were willing to undergo, as perhaps the effect of either alone might also have been. Accordingly, in the fall of 1936, France and Switzerland devalued their currencies in conjunction with a tripartite agreement between the United States, France, and Great Britian. The governments of Belgium and the Netherlands, which followed suit, and Switzerland also subscribed to the agreement.[27]

All these countries set up exchange stabilization funds. The Tripartite Agreement of September 25, 1936, provided that stablization fund holdings of foreign currencies would be used to avoid undesirable fluctuations in exchange rates. Arrangements for mutual currency support were undertaken, based on daily gold settlements at prearranged prices. Each day the authorities of the six countries would cable each other the prices in terms of their own currencies at which they would sell and buy gold for the next twenty-four hours. Each party would then decide, without risk of exchange losses, the buying and selling rates for the currencies of the other participants. Foreign balances at the end of each day were convertible into gold at the guaranteed price. The Agreement was a precursor of the swap arrangements that the industrialized countries perfected during the Bretton Woods period of international monetary arrangements. Under the Agreement, the U.S. Exchange Stabilization Fund purchased foreign currencies in New York at rates the foreign funds determined and that day converted these currencies into gold earmarked to its account abroad or released to it from foreign earmarked holdings in the United States. Mainly, however, gold imports into the United States were sold directly by foreign monetary authorities or private importers to the U.S. Treasury.

In purchasing gold, as in purchasing agricultural or other commodities, the U.S. Government can be said to have three sources of funds: tax receipts, borrowing, or money creation. The one difference is that the support program for other commodities (excepting silver) carried with it no authorization to create money, whereas the support program for gold did, thereby automatically providing the financial means for its continuance. Treasury deposits at Federal Reserve Banks could be increased through gold purchases by gold certificate credits equal to the amount of gold purchased times the official price of gold. Except for a minor handling charge (1/4 of 1 percent), this was also in practice the amount the Treasury spent by drawing a check on its deposits in acquiring gold. Gold purchases were usually financed in this way; hence, increases in the gold stockpile produced no automatic budgetary pressure. The link between gold purchases and the Treasury authorization to create high-powered money was the main remnant of the historical role of gold, and seemed to give gold some special monetary significance. The one important occasion when a different method of finance was used was in 1937, when the Treasury "sterilized" gold by paying for gold with funds raised through security issues.[28]

It is easier to describe the gold policy of the United States during the years 1934-1948 than it is to describe the resulting monetary standard of the United States. It was not a gold standard in the sense that the volume of gold or the maintenance of the nominal value of gold at a fixed price could be said to determine directly or even at several removes the volume of money. It was clearly a fiduciary rather than a commodity standard, but it is not possible to specify briefly who managed its quantity and on what principle. The Federal Reserve System, the Treasury, and still other agencies supervising the banking system affected the quantity of money by their actions in accordance with a wide variety of objectives. In principle, the Federal Reserve System had the power to make the quantity of money anything that it wished, within broad limits, but it seldom stated its objectives in these terms. It sometimes, as when it supported the prices of government securities from 1942 to 1951, explicitly relinquished its control. And it clearly was not unaffected in its actions by gold flows. So long as the exchange rate between the dollar and other currencies was kept fixed, the behavior of relative stocks of money in various countries was necessarily close to what would be produced by gold standards yielding the same exchange rates, even though the mechanism might be quite different.

7. 1948-1968 -- the Bretton Woods dollar/gold standard system[29]

The international monetary system that was designed at the Bretton Woods Conference in 1944 reflected professional views on the defects of the arrangements that had prevailed in the 1930s. Protectionist trade policies, exchange controls, and competitive currency depreciation of the pre-World War II period were the cautionary experiences to be avoided by the postwar world. Removal of controls on trade and payments under a system of fixed exchange rates, with adjustment of parities limited to "fundamental" disequilibrium in the balance of payments, accordingly were the goals of the system created by the delegates to the Conference. The lending facilities of the International Monetary Fund were to be available to supplement IMF members' gold and foreign exchange reserves to provide them liquidity when in temporary balance of payments deficit.

Under the Bretton Woods Agreement of 1944, the Articles of Agreement of the International Monetary Fund provided that currency par values should be expressed in terms of gold or the U.S. dollar expressed in gold. IMF members were required to pay 25 percent of their quota subscriptions in gold, with some discretion allowed to reduce the gold proportion for countries with a weak reserve position. Gold subscription payments became a permanent asset of the Fund available to supplement its lending resources; many types of transactions between the IMF and its members were required to be made in gold; and members were required to maintain the gold value of IMF holdings of their currencies. Thus gold was to play a central role in virtually all aspects of IMF operations, and of countries' international monetary obligations as defined in the IMF Articles.*

As the Bretton Woods system evolved in practice, most countries maintained the legal par values for their currencies by intervening in the exchange markets to maintain exchange rates for their currencies at specified levels in terms of the U.S. dollar. Only the United States met its par value obligations by undertaking freely to buy and sell gold in official transactions at the official price -- the dollar's par value. The entire system of exchange rates was thus linked to gold through the convertibility undertakings of the United States.

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*Congressman Henry S. Reuss -- This interpretation distorts the meaning of the Bretton Woods system and exaggerates the role of gold in it. In fact, the Bretton Woods system was designed to allow exchange rates to vary in an orderly way, not to fix them. Its authors, including Keynes, viewed it as the very antithesis of a gold standard.

The establishment of par values for currencies was an important item on the Fund's agenda. Canada, France, the Netherlands, the United Kingdom and the United States declared their par values in December 1946; Germany and Japan in 1953, shortly after they became members; and Italy, not until 1960. Some of these parities were short-lived. An abortive attempt at convertibility of sterling in 1947 ended in September 1949, when the pound was devalued. The Netherlands thereupon devalued the guilder, and France, which had had separate rates for financial and commercial transactions, unified them, depreciating the franc vis-a-vis sterling.

In private gold markets until 1953, the price of gold was at a premium, but the IMF rule required monetary authorities to refrain from selling gold at premium prices. In March 1954, several months after the premium had been eliminated, reflecting balance of supply and demand, the London gold market reopened. For the rest of the decade, the price of gold in private markets remained at $35 an ounce.

With the return of many European currencies to convertibility in 1958, the achievement of the Bretton Woods conception of international monetary normalcy seemed only a matter of time. The outflow of dollars in U.S. official aid, military spending, and private investment, and economic recovery in Europe and Japan had enabled foreigners to add to their holdings of dollars and gold. Apart from the 1950-51 Korean war upsurge, U.S. prices were generally stable until the middle of the decade of the '60s, and their rate of rise generally lower than in the rest of the world. Money supplies in the rest of the world (except in the U.K.) grew at a faster rate than in the U.S. perhaps as a result of the U.S. contribution to the buildup of other countries' monetary reserves. The dollar's status as the reserve currency of the international economy seemed impregnable. Commercial banks and private firms could make foreign payments in their convertible currencies without the approval of central banks. Tariff and quota restrictions on commodity trade among the industrialized countries were eased and foreign trade grew at a rapid rate during the period. International transfers of capital grew, with New York at the center of the flows, and the dollar assumed the role as the vehicle currency in which the borrowers obtained capital and the investors lent their savings.

The successful operation of the system depended on foreign central banks intervening with their own currencies against the dollar to maintain par values, and the United States standing ready to buy or sell gold at $35 per ounce in transactions with foreign monetary authorities. The U.S. balance of payments accordingly was determined largely by the exchange parities other countries established. In general, other countries desired surpluses that would add to their dollar reserves, and the system tended to produce a steadily weakening U.S. balance of payments and growing doubts about the sustainability of the U.S. gold convertibility commitment.

Gold Information, 1953-1956

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CONFIDENTIAL

FINAL

January 12, 1948

MEMORANDUM OF THE MEETING OF THE STAFF
GROUP ON FOREIGN INTERESTS
December 3, 1947.

A meeting of the Staff Group on Foreign Interests was held at the Board's offices in Washington on Wednesday, December 3, with the following in attendance:

Board's Staff

Mr. Dembitz
*Mr. Grove
*Mr. Hackley
Mr. Hammond, Secretary
*Mr. Knapp, Chairman
Mr. Tamagna
*Mr. Vest

Federal Reserve Bank of New York

Mr. Davis
Mr. Knoke
Mr. Kriz
Mr. Tiebout
Mr. Wallich

*Part-time attendance

The following subjects were discussed:

1. Proposed Subsidy by Canada to Gold Producers.

2. Blocked and Other Foreign Assets.

3. Policy of the United States Government toward the Bank for International Settlements.

4. Report on the Central Bank of the Dominican Republic.

5. N.A.C. Developments.

1. Proposed Subsidy by Canada to Gold Producers.

Mr. Knapp reported that the proposal for a subsidy of $7 a fine

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Late in the afternoon Mr. Knapp reported that he had during the day attended a meeting at which the Canadian problem was discussed, that the State Department was going to make representations to the Canadians at once, and that the International Fund was pressing forward its own study of the question.

2. Blocked and Other Foreign Assets.

Mr. Knapp opened the discussion with a statement to the effect that the Treasury and the N.A.C. were much concerned over the disposition to be made of foreign assets in the United States which remained blocked because of non-certification (unblocking requires certification by the government concerned that no enemy interest is involved). On the one hand, there was reluctance to betray the traditional confidence governing banker-customer relations, particularly when it might involve confiscatory and in some cases perhaps undeserved penalties. On the other hand there was reluctance to leave foreign assets unused for purposes for which American citizens were being taxed. He reported that the Treasury was inclined to submit the question to Congress with full information and with suggestions as to the possible course to be followed. The Treasury seemed prepared to recommend that countries receiving help from the United States under the E.R.P. be given full information regarding the blocked assets of their nationals, and that after they had acted, such blocked assets as remained unrequisitioned be seized and vested in the Alien Property Custodian.

In the general discussion that followed Mr. Davis expressed belief that the amount of assets affected, in the case of the French, for example, was not enough to justify the course suggested. He felt that disclosure of the ownership of the assets would be a most regrettable departure from the tradition of confidence governing banker-customer relations. In reply, Mr. Dembitz emphasized the dilemma confronting the American government: he said that no one wished to abandon the tradition of confidence but that the alternative was in effect to protect violators of foreign laws and to impose a heavier burden on United States taxpayers than there would be otherwise.

There was then discussed a plan suggested by Mr. Kriz which was in brief that foreign-owned balances and securities in the United States should be compulsorily mobilized and invested for their owners in obligations of the International Bank. This arrangement if legally feasible would preserve anonymity and yet would enable the funds to be used for the benefit of the countries whose nationals own them.

The discussion covered the need for the foreign countries concerned to agree to adopt amnesty laws so that disclosure of the ownership of the blocked funds might not be so objectionable; it also covered alternative plans for preserving anonymity of the holders and yet mobilizing their holdings for the benefit of the countries concerned against payment in their local currencies or in local government bonds.

A special problem was presented by Swiss Balances, which include an unknown though probably large amount of French money. The Swiss are not borrowing from the United States and there is therefore not the same American interest in the utilization of Swiss funds. The only result of reporting such funds to the Swiss Government would be to subject their owners to penalties for having avoided Swiss taxation. It might therefore be arranged to dispense with Swiss Government certification if the individual owners could submit to us directly convincing evidence that ownership was entirely Swiss and involved neither enemy countries nor E.R.P. recipient countries.

3. Policy of the United States Government toward the Bank for International Settlements.

Mr. Knapp reported that he was a member of an interdepartmental committee set up to prepare a special report on the B.I.S. and that his own idea -- the committee having just undertaken its task -- was to say (1) that there was no convincing evidence of bad conduct on the part of the B.I.S. during the war and that the question was no longer of governing importance anyway, (2) that there was little if any justification for the allegation that the activities of the B.I.S. would be inimical to the International Fund and Bank, and (3) that the question of whether the B.I.S. had useful functions to perform could safely be left to be decided by the interested European countries. He suggested, however, that the position of the Bank as a European central banking institution would be strengthened if it were freed of the Japanese interest and if some way could be found to liquidate, or at least clearly to segregate, the Bank's special operations in connection with German reparations the question then remaining would be the nature of American participation, if any, in the administration of the Bank.

In the general discussion that followed there was no dissent from the view that the B.I.S. might well be a useful institution, which, considering the European wish to continue it, the United States should not frustrate. Cognizance was taken of the fact that the Bretton Woods Conference had passed a resolution recommending that the B.I.S. be liquidated, but it was pointed out that this action was not binding on member governments. Mr. Knoke emphasized the fact that the present uncertain attitude of the United States authorities toward the B.I.S. was extremely vexatious and embarrassing and that he thought the decision with respect to the B.I.S. should be reached as soon as possible.

4. Report on the Central Bank of the Dominican Republic.

Mr. Wallich reported briefly on the opening of the Dominican Bank, October 1947, in the organization of which he had participated. He said that the new legislation had been facilitated by the existing political setup and that the public recognized it was technically sound. In consequence, the Bank had met a very friendly acceptance both by the public and by the commercial banks. It had been feared that the public might not readily accept the new peso bank notes which were to replace the United States currency formerly in circulation, but on the contrary the peso notes had been in immediate demand and were replacing the dollar currency much more rapidly than the new law had contemplated.

5. N.A.C. Developments.

Mr. Dembitz reported that the most important recent N.A.C. developments had dealt with aid to Europe, first the interim aid program and then the longer-term European Recovery Program. There had been set up an "Advisory Steering Committee" which included representatives of most of the government agencies concerned with the European problem (including Mr. Knapp representing the Board), to assure coordination of work in various fields -- foreign policy, financial, commodity procurement, legislative and legal, presentation to the public, etc. -- and to advise Under-Secretary

CONFIDENTIAL June 27, 1947

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MEMORANDUM OF FEDERAL RESERVE SYSTEM INFORMAL POLICY GROUP ON FOREIGN INTERESTS WITH REFERENCE TO CERTAIN ASPECTS OF UNITED STATES GOLD POLICY AND PROCEDURES

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It is the view of the Policy Group that there should be in the world today some point of reference where there is a fixed price of gold in terms of domestic currency; that in the existing world that fixed point of reference must be the United States, the United States dollar, and the fixed price of gold in terms of United States dollars; and that there should be no unnecessary obstacles to the free purchase and sale of gold in the United States, at the fixed price, for the settlement of international balances - all to the end of promoting international monetary stability.

This view has led the Policy Group to consider not only Federal Reserve transactions involving gold, but also certain aspects of the Gold Reserve Act of 1934, as amended, and certain Treasury practices and procedures thereunder as well as related matters, as follows:

(1) Licensing of Gold Transactions for Foreign Official Account;
(2) Commercial Banks' Gold Operations at Premium Prices;
(3) Loans on Gold;
(4) The Treasury's 1/4 per cent Handling Charge;
(5) Sections 8 and 9 of the Gold Reserve Act of 1934, as amended.

The recommendations of the Group with reference to these matters, with some of the considerations involved, are as follows:

(1) Licensing of Gold Transactions for Foreign Official Accounts

Recommendation for action: That the existing Treasury procedures with respect to the acquisition of gold in the United States be amended by means of the issuance of a general license or otherwise so that foreign monetary authorities may convert free dollar balances into gold (for earmark or export) without the necessity of obtaining a specific license or complying with other formalities under the Gold Reserve Act of 1934, as amended, and the Provisional Regulations issued thereunder.

Comment: Among the factors that cause foreign monetary authorities to feel uncertainty concerning our gold policy, and especially concerning their continued ability to convert dollar balances into gold, one factor is certainly the present requirement that every purchase of gold from the United States by a foreign monetary authority must be the subject of a specific authorization by the Secretary of the Treasury. In connection with this authorization, the purchaser states the purpose for which the gold is to be acquired. Furthermore, if such gold is to be exported without first being placed under earmark, a specific license under the Gold Reserve Act must be obtained. These requirements have the effect of emphasizing continuously the fact that obtaining gold for dollars is not automatic and that this country could at any time discontinue sales of gold.

The present procedure would seem to have arisen from the desire that existed in 1934, when the procedures under the Gold Reserve Act were first established, to protect the gold stock of the United States. At present, with a United States gold stock three times its size in 1934 and an unprecedentedly

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large surplus in the United States balance of payments, there appears no reason why blanket authorizations and licenses should not be issued (with the approval of the President) and publicly announced by the Secretary of the Treasury, enabling foreign monetary authorities to convert any free dollar balances into gold without any such formalities. The psychological effect of eliminating such formalities would be of some benefit, although the United States would not be committed irrevocably to selling gold, since the blanket authorization that is suggested here could be terminated at any time.

If the procedure for selling gold to foreign monetary authorities is simplified as suggested above, it would seem appropriate at the same time freely to permit transfers of gold held under earmark in the United States between the governments and central banks of other countries in addition to those which are adherents to the Tripartite Declaration, except such countries as may be excluded for particular reasons.

With respect to purchases of gold by the United States, no change in the existing system appears to be necessary at this time, with the exception of the possible elimination of certain technical requirements - for the most part involving "paper" work.

(2) Commercial Banks' Gold Operations at Premium Prices

Recommendation for action: That the Treasury Department and the Board of Governors of the Federal Reserve System join in issuing a public statement along the following lines:

"It is well known that active speculative markets in gold exist in many financial centers throughout the world, some legally and others illegally. Under present circumstances, gold is quoted in many foreign centers (often in U. S. dollars) at premiums over official prices. The premiums differ from one center to another so that private speculators, although unable to purchase gold in the United States, can make large profits by purchasing gold against dollars in one foreign market and selling the gold for dollars in another.

"The International Monetary Fund has recently issued a statement deprecating international dealings in gold at premium prices, and requesting member countries to take such action as they can take within their jurisdictions to prevent such dealings. The Fund pointed out that these transactions tend to undermine exchange stability and that they cause gold to flow into private hoards rather than into monetary reserves. Furthermore, in countries where the gold is sold, payment is often made with dollars that have been illegally acquired or held, and one effect is to use up dollars that might otherwise have been used to acquire imported goods and equipment sorely needed in those countries.

"In view of these circumstances, and on general grounds of national policy, the Treasury Department and the Board of Governors of the Federal Reserve System request American banks to refrain from encouraging and facilitating this traffic and in particular to refrain from extending the use of their facilities and funds for the carrying out of such transactions."

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Comment: Aside from the fact that gold is traded in many financial centers premium prices in terms of local currency, there also appears to be an active market for gold at a premium against dollars in a number of countries. One of the principal causes of this phenomenon, aside from the fact that gold is in many ways a more suitable hoarding medium than dollars, is the view that there may be an increase in the official dollar price of gold in the near future.

Gold is traded in some countries at prices that are only moderately above $35 an ounce, while prices in other countries on a retail basis have ranged up to $80 an ounce not only in terms of local currency equivalents but also, in some cases, directly in dollars. The opportunities for arbitrage dealings in gold against dollars between different foreign markets have therefore proved tempting to American commercial banks. There is evidence to show that United States commercial banks, although not acting as principals, have been engaged in such arbitrage dealings in the capacity of agents for foreign buyers and sellers, and as a source of credit to finance such transactions while the gold is in transit. Frequently these banks get buying orders "at best" from their customers abroad with instructions to effect the purchase to the debit of the customers' accounts on the books of the United States banks.

These operations first received public attention in articles appearing in our press last January, and were brought more clearly before the public by the Monetary Fund statement of June 1947, but they seem to have been going on for quite some time. The stories of last January dealt with purchases of gold at premium prices by American banks in Mexico at the rate of 30,000 ounces a day and the sale of such gold (at a considerable profit - 50 per cent or more) particularly in China and Hongkong but also in the Near East. Unexecuted orders in the hands of one of our banks alone at that time were reported to Federal Reserve Bank of New York at around 100,000 ounces, but several other banks are also involved in these transactions. It is difficult to estimate the volume of this kind of business so far put through but one bank has estimated that since January 1946 at least $100,000,000 of gold has been sold to the Near East and Hongkong, much of it through our banks. While India, China, Hongkong and Macao have recently taken action to restrict private gold imports, this action may not be completely effective and in any case markets continue to exist in certain other countries.

Not only Mexico but other countries (Chile, Brazil, etc.) are reported to have become participants in this trade, presumably at times at the instigation of our banks. The latter have also turned to Switzerland and to Argentina, and it has been reported that gold has been acquired in Switzerland by an American bank in lots of around 30,000 ounces at the total cost of around $42 per ounce. This gold was shipped to Hongkong or the Near East by air and sold at prices which still allowed a profit to local dealers after the payment of a 5 per cent commission to the American bank.

When important American banking institutions participate in gold transactions against dollars at premium prices, they not only contribute to monetary instability, as the Monetary Fund statement points out, but they may also give special encouragement to foreigners' belief that the dollar is at a discount and may soon suffer a reduction in gold content. Such suspicions would not be altogether eliminated by ending the participation of American banking institutions in these gold dealings, but such a step might do much to clear the air. Furthermore, in most cases these transactions use up dollars which have escaped the exchange controls of foreign countries and which are being dissipated in the purchase of gold for private hoarding rather than being used for the purchase of

-coo and equipment sorely needed abroad, or for needed strengthening of official monetary reserves.

Participation by our banks in this traffic raises the question whether American banking institutions should engage in practices inimical to the interests of foreign countries and to our own interests in promoting economic recovery abroad. We believe that they would not wish to do so if they recognized the national and international interests involved, and that if the authorities will give them a clear lead, by the issuance of a statement along the lines suggested, the banks will follow it.

(3) Loans on Gold

Recommendation for action: That the Treasury and Federal Reserve System adopt a coordinated policy along the following lines with respect to the making of loans on gold by Federal Reserve Banks and by commercial banks (or other lenders) in the United States:

(1) The Federal Reserve Banks would continue their present policy of making loans on gold for an initial period of only three months, subject to renewal, but special Treasury-Federal Reserve consultation and review would be undertaken if any renewal is proposed beyond 12 months from the date of the original loan;

(2) The Treasury would decline to license any commercial bank loan on gold for an initial period of more than 12 months, and any application for a license to renew such a loan beyond 12 months would be the subject of special Treasury-Federal Reserve consultation and review;

(3) If a loan appears to be sought for predominantly speculative purposes, the Federal Reserve Banks would (as at present) refuse the loan or, in the case of a commercial bank loan, the Treasury would decline to license the transaction.

Comment: It is considered to be an appropriate function of the Federal Reserve Banks to make short-term loans on gold to foreign monetary authorities (central banks or governments) which require dollar funds to meet temporary requirements for foreign exchange. Loans on gold are made at the regular discount rate of the Federal Reserve Bank of New York, which is at present 1 per cent per annum, and because of this low rate, foreign monetary authorities would ordinarily borrow from the Federal Reserve. In some cases special factors may cause a foreign monetary authority to seek a loan on gold from private sources in the United States, rather than from the Federal Reserve Bank - e.g., in order to cultivate closer relations with the private lender; or the borrower may not be a central bank or government, in which case it will ordinarily not be acceptable as a borrower from the Federal Reserve Bank. Notwithstanding the fact that the making of short-term gold loans to monetary authorities seems properly a central banking function, there appears no reason why private lenders should not be allowed to make them also, provided that they are not for purposes that are predominantly speculative.

Unnecessary restrictions upon loans against gold would impair the usefulness of gold (especially gold held in New York under earmark), and diminish the inclination of foreign countries to hold gold. They would thus run contrary to this country's other policies which look toward a wider distribution of world gold reserves. Loans on gold are, however, subject to certain abuse. Foreign central banks may at times engage in the improper practice of continuing to show gold in their reserve position even though it has been pledged against a loan, thereby in effect making use of the gold while giving their public the false impression that the reserves remain intact. While such practices should certainly not receive any encouragement, the fact that some central banks engage in them should not be the determining element in our decision whether to make loans against gold generally.

A second more serious possibility of abuse arises, however, from the fact that any country which borrows dollars on gold rather than selling the gold outright is thereby placing itself in a position where it would profit from any increase in the dollar price of gold. It may appear from time to time that foreign countries are motivated simply (or mainly) by this consideration, and that in effect they are indulging in bets against this country's future gold policy. In any case in which it is reasonably clear that the purpose of borrowing on gold is predominantly speculative, it would seem desirable on grounds of public policy to refuse the prospective borrower access to lending facilities in the United States.

It seems especially difficult to justify the making of loans on gold for periods of more than 12 months. It would be much cheaper for the borrower to sell the gold and later repurchase it rather than to pay interest for any such extended period. Loans on gold running for more than one year should therefore be regarded as economically questionable; it would seem wise not to extend or facilitate such loans, except through renewals which would permit each transaction to be scrutinized periodically for evidence of its economic justification. Even if a foreign country appears genuinely to seek a loan on gold for psychological purposes, e.g., in order to utilize the proceeds while still continuing to show the gold as an asset, it would seem preferable for the loan to be made on a relatively short-term basis so that the situation could be reviewed at frequent intervals.

The coordinated policy which we recommend would not rigidly prohibit the renewal of loans on gold beyond 12 months, but it would exclude the extension of such loans for an initial period of more than one year. Commercial banks could continue to make loans up to 12 months if they wished; the Federal Reserve would continue to limit any one extension of credit to a three-month maturity, with the possibility of renewals on a relatively routine basis up to 12 months (the Federal Reserve Bank would probably indicate in advance to the borrower, as it does at present, that "we are prepared for the present to grant a loan or loans to you on the following terms and conditions, ... such loan or loans to run for 90 days but no loan or renewal thereof to mature later than ______ (up to one year) after the date of the first such loan").

A recent long-term loan on gold by an American bank against gold on deposit in Switzerland (a $7 million loan from the Chase National Bank to the Roumanian Government for a term of four years) illustrates a method by which private lenders in this country could avoid restrictions placed upon their activities through the Treasury's licensing procedure (which applies, of course, only to dealings in gold situated in the United States). Should the policy recommended above be adopted and should transactions of this sort become wide-

February 7, 1947

To: Policy Group on Foreign Interests Subject: Loans on Gold

From: Staff Group on Foreign Interests

On November 8, 1946 President Sproul of the Federal Reserve Bank of New York addressed a letter to the Secretary of the Treasury proposing a conference among representatives of the Treasury, the Board of Governors, the Federal Reserve Bank of New York, and perhaps the State Department, to discuss policy questions relating to loans on gold. President Sproul transmitted a copy of this letter to Chairman Eccles with the suggestion that the matter might be studied by the Staff Group on Foreign Interests, a suggestion with which the Chairman concurred. The Staff Group has discussed this subject and desires to submit to the Policy Group the following recommendations:

A. Recommendations:

(1) Short-term loans on gold by the Federal Reserve Banks

It is an appropriate function of the Federal Reserve Banks to make short-term loans on gold to foreign central banks (and governments) which require dollar funds to meet temporary requirements for foreign exchange. In order that all foreign correspondents of the Federal Reserve Bank of New York may be fully aware of this facility, it is suggested that the Board and the New York Bank consider including in their next Annual Reports a descriptive statement covering this and other services performed by the System for foreign correspondents.

Accepted

(2) Loans on gold by private institutions in the United States

Amended

A foreign central bank (or government) may desire to pledge its gold 224080

under earmark at the Federal Reserve Bank of New York as collateral for a loan from private sources in the United States, either because the loan is of a type that the Reserve Bank would not desire to make, or because of other reasons. At present no barrier should be raised to such a transaction by denial of facilities at the New York Bank or by refusal of the appropriate treasury gold licenses, unless the proposed loan appears to be requested primarily for speculative purposes.

B. Discussion:

Loans to foreign central banks and governments against the security of gold were not unusual before 1933; they were made by many central banks and by the large commercial banks in New York and probably in London and other large financial centers abroad. Such loans were not frequent, however. Since 1933, the Federal Reserve Banks have been asked to make, and have made, such loans with increasing frequency, but the large American commercial banks made but one such loan* until February 1945, when a syndicate headed by the Chase National Bank made a 100 million dollar loan to the Netherlands Government against gold earmarked at the Federal Reserve Bank of New York. Since then, a number of applications have been made by American commercial banks for licenses under which gold earmarked with the Federal Reserve Bank of New York would be set aside as collateral for loans to be made by them to various foreign banks. The increase since 1933 in the frequency of applications by foreign countries for dollar loans against gold appears to be due in the main to two factors: (1) the fact that since the early thirties the world has not had an international monetary standard based on an unrestricted flow of gold between

* A $300,000 loan on gold located in London, made in the early thirties.

countries, even with respect to balance-of-payments settlements by central banks and governments; and (2) the need of various foreign countries for dollars for the reconstruction of their economies and the reestablishment of their foreign trade at a time of extreme unsettlement in their financial, economic, and political affairs.

Although the Gold Reserve Act of 1934 restored convertibility of dollars into gold and of gold into dollars, it contains provisions for Treasury control (in the form of a licensing system) that give grounds for some uncertainty as to the ability of foreign countries to buy and sell gold freely in the United States. It also contains provisions, as yet unrepealed, which apparently have led to questions abroad as well as at home as to whether the price of gold in this country may be changed by administrative action.* Furthermore, under Treasury regulations, a 1/4 per cent handling charge for purchases and sales of gold was imposed, which makes it cheaper for foreign countries to meet short-term needs for dollars by borrowing from the Reserve Banks at present interest rates rather than by selling and subsequently repurchasing gold.

In view of the possible influence on the increase in applications for gold loans of these three factors, i.e., the Treasury gold licensing system, uncertainty about the United States' gold price arising from certain existing legislation, and the Treasury's 1/4 per cent handling charge for gold transactions, the Staff Group expects to give further consideration to these matters with a view to possibly formulating

* I.e. because of the power of the Secretary of the Treasury to buy and sell gold at such prices as he may deem advantageous to the public interest (Secs. 8 and 9 of the Gold Reserve Act of 1934). Section 12 of the Act, authorizing the President to alter the gold content of the dollar, was permitted to lapse by the Congress on June 30, 1943.

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recommendations, which could be communicated to the Treasury at an appropriate time, with respect to desirable changes in the Gold Reserve Act, and in the Provisional Regulations issued thereunder.

The principal consideration which has led the Staff Group to recommend that no barrier be raised at this time to foreign loans on gold for legitimate purposes is that the prohibition of such loans would impair the usefulness of gold (especially gold held in New York under earmark), and diminish the inclination of foreign countries to hold gold. A wider distribution of world gold reserves is considered to be in the interests of the United States. Undue concentration in this country of the ownership of monetary gold reserves might lead to pressure for demonetization of gold in the rest of the world and would in any case force this country to hold for an indefinite period an unproductive international asset. Loans on gold at least have the merit of leaving the unproductive asset in the hands of foreign countries. Since we want to encourage foreign countries to continue the policy of holding reserves in the form of gold, we should try not to interfere with their ability to raise funds readily by either selling or pledging their gold when any need arises. Indeed, if we deliberately restrict the usefulness of gold as collateral, foreign countries may be induced increasingly to switch their international reserves out of gold and into interest-bearing U.S. Treasury securities, which <u>would</u> be usable as collateral on dollar loans; in such case, the United States not only would acquire an unproductive international asset but also would incur an interest obligation to foreign countries.

It is recognized that loans on gold are subject to certain abuses. As suggested by President Sproul in his letter to the Secretary of the Treasury, foreign central banks may at times engage in the improper practice of continuing to show gold in their reserve position even though it has been pledged against a loan, thereby in effect making use of the gold while giving their public the impression that the reserves remain intact. Most central banks which have engaged in this practice, however, seem to have shown a corresponding foreign exchange liability in their balance sheet and where this has been done the deception is not a very flagrant one. While the practice of including pledged gold in the monetary reserve should certainly not receive any encouragement, the fact that some central banks engage in it should not be the determining element in our decision whether to make loans against gold generally, nor should a foreign central bank be refused a gold loan which has sound economic justification merely because it indulges in the aforesaid practice. It would, moreover, be inappropriate for the System to make it a condition of any gold loan that the pledged gold be deducted from the borrower's monetary reserve. It may be desirable, however, to call the attention of the U.S. Executive Director in the International Monetary Fund to any undue spread of the practice of not revealing pledges of gold for dollar loans, with a view to possible action by the Fund to discourage this practice.

A second possibility of abuse arises from the fact that any country which borrows dollars on gold rather than selling it outright is thereby placed in a position to profit from an increase in the dollar price of gold. The same is true of course of a country which borrows dollars in any other form while retaining gold reserves, or which liquidates dollar reserves instead of gold reserves to meet a balance of payments deficit. Indeed any action by which a country seeks to maintain (or increase) its gold holdings can be said to involve an element of speculation on the future price of gold. The Staff Group believes that this factor should not be ignored and that where the speculative element appears dominant access to lending facilities in the United States should so far as possible be denied. It is of the opinion, however, that loans on gold should not be refused to countries whose requests appear to be governed by their needs for foreign exchange rather than by speculative intent. A policy of refusing such loans would lead logically to restrictions upon other forms of borrowing in the United States by a country which at the same time was holding gold reserves, and it would not give adequate weight to the interest of the United States in encouraging a broader international distribution of world gold reserves. In any case, American commercial banks might escape restrictions imposed through the licensing procedure by making loans against gold located abroad.

As an example of an operation in which the speculative element would appear to have been dominant, the Staff Group would cite the recent experience with the central bank of Uruguay. This Bank had bought dollar exchange forward from exporters who could not move their goods abroad because of wartime shipping shortages. In order to convert its long dollar position into a long gold position, this Bank borrowed an equivalent amount of dollars from the Reserve Banks against the pledge of earmarked gold and invested the proceeds in further gold purchases. Indeed it sought to renew its loans for this purpose after the original occasion for the loans -- i.e. the shipping shortage -- had apparently passed. Following informal discussion of the matter in the Staff Group, the New York Bank, with the approval of the Board of Governors, declined to grant

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renewals. It had become clear that Uruguay was not borrowing to meet a demonstrated need for foreign exchange, but was motivated simply by a belief that gold was a better asset to hold than dollars -- i.e. that an increase in the price of gold was to be expected. It is possible to argue that the action of the central bank of Uruguay was more in the nature of a "hedge" than an outright speculation, since if dollars were to depreciate against gold without a corresponding depreciation in the gold value of the Uruguayan peso, the Bank might suffer a loss in terms of pesos from the maintenance of a long dollar position. Opinions differ as to whether any hedge was ever really necessary (i.e. as to whether in practice it was reasonable to believe that Uruguay would not follow the United States in any change in the gold price), but in any case with the passage of conditions requiring the central bank of Uruguay to take an abnormally large forward dollar position, any special need for a hedge disappeared.

The Staff Group desires to offer the following further comments on its recommendations, noting that in all cases of loans on gold it is assumed that "political clearance" will continue to be obtained from the State Department:

(1) Short-term loans on gold by the Federal Reserve Banks

These loans on gold have ordinarily been made to foreign central banks (and governments) in order to meet short-term (one year or less) or seasonal foreign exchange needs. In the past they have occasionally been made against gold in transit to the United States for sale to the Treasury, but in recent years they have been made only against gold held under earmark for foreign account in the vaults of the Federal Reserve Bank of New York.

FEDERAL RESERVE BANK
OF NEW YORK

RESEARCH MEMORANDUM

To Mr. Sproul

Date January 20, 1955

From Fred H. Klopstock and
Horst Mendershausen
Balance of Payments Division

Subject Capital Inflow Into the United States and the Dollar Shortage

Copies To Messrs: Treiber, Williams, Exter, Roelse, Rouse, Sanford, N. P. Davis, Roosa, Lang, Bloomfield, Coombs, Garvy, Athern, Roche, Webber, Carr, and Kriz, and Miss Bogardus.

During the past few weeks, quite a number of bankers and government officials have evidenced a great deal of interest in an article in the New York Times of January 2, filed in Geneva by Mr. Michael Hoffman. In response to your request transmitted through Mr. Roelse, this note comments on his dispatch which summarizes, under the catching headline "Flight of Capital to U. S. Continues", a recent as yet unpublished GATT study that is supposed to contain the following propositions:

1. While it is generally known that in the period 1931-37 a massive movement of European capital to the United States took place, the "disturbing influence of such capital movements" extends over the entire period since the twenties (leaving out of account the war-dominated years 1938-45) and "emerges as the chief cause of whatever dollar shortage has existed since 1926."

2. "The very countries that assert the duty of the United States to help them with capital investments have been pouring hundreds of millions of dollars a year of their own investment funds into the politically secure United States capital market."

3. If capital movements into the United States, rather than the trade imbalance, are the chief cause of the dollar shortage, the thesis that lower tariffs are required for better world balance becomes dubious.

We have written to GATT for a copy of the study. While waiting for the full story, we offer the following comments on the ideas presented in Mr. Hoffman's article.

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Prewar capital movements statistics suffered from inadequate coverage, and those of the postwar period are subject to a big margin of error because of large illicit capital transfers (especially in 1947-49) that have remained unrecorded. The statistical evidence that is available confirms the GATT proposition that there has been a continuous inflow of long-term capital into the United States in the prewar period. And except for the years of the Great Depression, this net inflow of long-term foreign capital was paralleled by a net rise of foreign short-term claims in the United States.

In the early postwar years, the statistical evidence shows, most foreign countries were able, by means of massive gold sales, to maintain, and even to add to, their short-term claims; at the same time--according to our statistics--there occurred a net disinvestment of "visible" foreign long-term capital, as foreign exchange control authorities, especially in Europe, were able to force their citizens to surrender their United States investments. It is quite likely, however, that the recorded net liquidation of securities and other capital in the 1946-51 period was more than offset by unrecorded, and unmeasurable, clandestine entries of foreign capital into the long-term capital market. That foreigners during the last few years have added to their assets here is well known. The following abstract from the balance-of-payments statistics shows--not very satisfactorily, but as far as trends are concerned, not too badly--what happened in the field of capital movements during the prewar and postwar periods.

In the course of these years, a great variety of factors induced movements of funds to the United States. By way of quick summary,[1] nonresidents bought assets from residents in order to participate in high earnings (1923-27);

1/ These flows have been analyzed in an extensive literature of private and official publications.

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United States Balance-of-Payments Statistics

Inflow of Foreign Capital into United States 1923-39, 1946-54
(In millions of dollars, excluding international institutions)

	Long-term capital (Direct investments securities, etc.)	Short-term capital	Total
1923-27	869	1,606	2,475
1928-29	821	79	900
1930-33	231	- 2,680	- 2,449
1934-39	1,151	3,037	4,188
1946-51	- 255	584	329
1952-54*	830	2,950	3,780

* 1954 partly estimated.

to make capital gains (1928-29); to repatriate foreign securities cheaply (1930-33); to make a speculative profit on the devaluation of their currencies (1934-37); to escape the threatening financial dangers, restrictions, and burdens of the approaching second world war (1938-39); to safeguard capital in a period of international tension and of fear of another world war (1946-51); and to build up interest-earning short-term dollar assets for the account of monetary authorities (1952-54).[1/] Foreign traders and bankers built up working balances throughout most of the twenties and in the early fifties, and mostly speculative and fugitive balances in the thirties and forties. Whether desirable or undesirable from the point of view of national governments and monetary authorities, normal or perverse by the standards of abstract economic analysis, related or unrelated to ordinary trade, these capital movements developed through the actions of bankers, traders, and private individuals pursuing their own

1/ The years in parenthesis suggest the times when the particular motives were relatively preponderant.

224089

interests in the foreign exchange, money, and commodity markets. Without the opportunities that the markets offered and the loopholes in postwar foreign exchange controls, these capital flows of course could not have occurred. And in market terms, there was nothing abnormal about somebody sending funds to the United States if he was willing and able to do so.

These capital flows to the United States appear paradoxical when they are regarded from a somewhat simplistic point of view. Assume that the critical problem of the United States balance of payments is to provide an "ample" supply of dollars to the outside world through imports, investment, or aid. Assume further that in the absence of such an "ample" dollar supply the outside world is "short of dollars", i.e. that it cannot obtain "enough" supplies of goods and services from this country. You may then set as a policy norm that whatever dollars the United States supplies should be used by the outside world to buy the goods and services it needs, rather than for buying capital assets here.

What if "the world" decides to apply part of its dollar earnings to the building up of deposits and investments in the United States? If it does, it seemingly manifests an excess supply of dollars. It "wastes" some of its dollar earnings on purposes that by assumption are not included in its "needs". However rational the flow of capital to the United States may be in view of existing incentives, it seems paradoxical in terms of the policy norm.

This paradox seems to have gotten under the skin of some observers who wax indignant over the inflow of "hot" money into the United States at a time when the United States taxpayer provides sizable aid to Europe and thus, in fact, replaces with his own earnings funds that are profitably invested in the United States by citizens of aid-receiving countries.

The first thing the victims of this irritation should note is the variety of reasons that have brought funds here, some of which have nothing to do with capital flight. Secondly, it should be understood that the prevention of "undesirable" or "excessive" movements of funds to the United States, whatever these discriminatory words may mean, is impossible without an elaborate system of national and internationally interlocking controls over capital movements. Thirdly, it seems very doubtful that the "undesirable" capital movements, however defined, were of an order of magnitude commensurate with what used to be called the "dollar gap" in the balance of payments of foreign countries.

Leaving aside the so-called concealed dollar shortage of the recent past, the dollar gap of the postwar years, which was defined operationally for the purposes of foreign aid, was, in the aggregate, much larger than any clandestine capital movements that are likely to have occurred during the last decade.

Of course, all estimates of such movements are pure guesswork. The residual item (errors and omissions) of the United States balance-of-payments statement, to which reference sometimes is made as an indication of the size of the concealed capital movements into United States dollar assets, does nothing more than suggest the relative magnitude of unrecorded capital movements at different periods of time.[1] It cannot be taken as a measure of the absolute amount of such movements over any period of time. In estimating the clandestine capital movements, adequate attention is not always being given to the fact that in one or two countries, notably Britain, the sense of integrity prevailing in most of the business community is an important factor inhibiting capital flight, that a certain measure of caution in order to prevent detection stands in the way of transfers of liquid funds, and that many American recipients of such capital do not always welcome them, in view of the tax, accounting,

1/ See Arthur I. Bloomfield, "Speculative and Flight Movemnets of Capital in Postwar International Finance", Princeton 1954, pp. 8-10.

and custody problems to which the holding of such funds gives rise. In short, foreigners may not have salted away as many dollars as the suspicious observers have it. It cannot be denied that unrecorded transfers of private capital were large in 1947 and also in 1949, and contributed importantly to the rapid deterioration of Europe's balance-of-payments position in those years. Yet, at its worst, the annual movement into the United States probably did not exceed one billion dollars, and may have been substantially less in 1946 and 1948. Estimates of the dollar gap during these years are, of course, very much dependent on the definition of such a "gap", but on any count the gap during these years was a multiple of any reasonable estimate of capital movements into the United States.

As to the alleged continuation of a large-scale flight capital inflow into the United States, it would appear to us that the reverse is true. The strengthening of European currencies as evidenced in the rapid improvement in the European gold and dollar position may well reflect--to an admittedly small extent--the return of private capital from its places of hiding in the United States, Switzerland, and perhaps Uruguay--to mention the more popular havens of flight capital. Of course, we lack the statistical evidence for this proposition, but from what one hears and sometimes reads, it does not appear unreasonable.

The statistics on foreign security purchases collected in the Balance of Payments Division of this Bank, and the Department of Commerce figures on direct investments, indicate that long-term investments on the part of European countries have been averaging approximately 175 million dollars during the period 1952-54. These investments reflect primarily British acquisitions of United States subsidiaries and affiliates,[1] and Swiss purchases of United States shares,

1/ The investments by the British and some other European interests are, of course, entirely legitimate; they have strengthened Europe's position in the American market, and have been approved by the exchange control authorities.

the latter having amounted to approximately 80 million dollars in 1954. Some of this money represents, of course, non-Swiss capital, but a capital inflow of this magnitude is insignificant, from the viewpoint both of the European dollar position and of the United States capital market. Our own capital movements statistics show, moreover, that the build-up of private short-term funds in the United States has been relatively small in recent years and that the existing balances do not appear to be in excess of reasonable working capital needs.

There is no indication in recent statistics of any heavy participation of foreigners in the "politically safe" United States capital market, i.e. of a flight of capital to the United States. There are many indications of a broader nature that capital is feeling quite safe in Europe today, as far East as Berlin.

Gold-Memo on the Meeting of the Staff &

Policy Group on Foreign Interests, 1947

Gold, 1950 F.F. 4431

224095

MISC. 58.2-100M-8-49

Pro Conf

FEDERAL RESERVE BANK OF NEW YORK

OFFICE CORRESPONDENCE

DATE February 17, 1950

TO Secretary's Office

SUBJECT: Effects of Gold Inflow on the United States, 1947-49.

FROM J. H. Adler, Balance of Payments Division and H. C. Carr, Domestic Research Division.

Copies to Messrs: Sproul, Knoke (Rouse), Roelse, and Moore.

The monetary effects of the gold inflow into the United States of 1947, 1948, and 1949 were twofold. First, the sale of gold increased the money supply held by the public, as the dollar proceeds were spent to buy goods in this country. Secondly, the sale of gold enlarged the credit base by expanding both the gold reserves of the Reserve Banks and the reserve funds of the nation's banks. These additions to bank reserves provided funds for a further, secondary growth of the money supply since the banks' ability to make loans or to purchase investment securities was thereby enhanced.

The influence of foreign-account expenditures upon bank reserves and deposits reached a high-water mark in 1947 when over 3 billion dollars of proceeds of gold sales and dollar balances with the Federal Reserve Banks was spent. Thereafter, as Table I shows, the amounts declined sharply.

TABLE I

FOREIGN ACCOUNT SPENDING AFFECTING MEMBER BANK RESERVES, BY SOURCES, 1947-49

(In millions of dollars)

Year	Gold purchases 1/	Change in dollar balances with Reserve Banks (- = decrease)
1947	+ 2,913	- 116
1948	+ 1,490	+ 250
1949	+ 183	+ 125

1/ Change in gold stock: 1947 adjusted for the United States subscription to the International Monetary Fund.

224096

MISC. 88.2-100M-8-48

OFFICE CORRESPONDENCE

DATE

TO

SUBJECT:

FROM

In 1947 foreign-account spending was so great that, despite large gold sales, foreign dollar balances with the Federal Reserve Banks declined. In the next two years these balances were built up. In 1949, the growth in foreign accounts with the Reserve Banks almost offset the effect of the increase in the gold stock on bank reserves and deposits.

Both in 1947 and 1948 gold sales to this country were far in excess of world gold production (outside the USSR), which in recent years has had a value of 750 million to 800 million dollars annually. Although the increment to the United States gold stock in 1949 was well below the value of the slowly-rising world gold production, gold sales to this country over the three years were greater than production by more than two billion dollars. Gold reserves of other countries therefore dropped sharply.

The primary effect of gold and foreign-account operations on the money supply held by the public in all three years was expansive. In 1947, as the Table II indicates, gold purchases and foreign balances with the Reserve Banks accounted for nearly all of the growth in the money supply. In the next year, gold operations offset a part of the decrease in the money supply that was attributable to other factors. Last year the influence of both gold and other factors was negligible.

TABLE II

ANALYSIS OF CHANGES IN THE MONEY SUPPLY, 1947-49
(In millions of dollars)

Year	Adjusted demand deposits	Currency outside banks	Total	Primary effects of gold operating on the money supply	Effect of other operations
1947	+ 3,807	- 254	+ 3,553	+ 3,029	+ 524
1948	- 1,601	- 397	- 1,998	+ 1,240	-3,238
1949	+ 1,200 1/	-1,100	+ 100	+ 58	+ 42

1/ Change from December 31, 1948 to December 28, 1949.

In 1947 and most of 1948 the Reserve System and the Treasury had to cope with inflationary developments which arose in part from the effect of gold operations on bank reserves as well as on the money supply. Bank reserves, as is indicated in Table III, rose perceptibly in 1947 and 1948, and dropped sharply in 1949.

TABLE III

DEMAND FOR AND SUPPLY OF MEMBER BANK RESERVES, 1947-49
(In millions of dollars)

	1947 1/	1948 1/	1949
Demand for reserves due to changes in:			
Reserve requirement percentages	0	+2,986	-3,587
Deposits	+783	- 46	- 140
Excess reserves	+263	+ 36	- 184
Supply of reserves attributable to changes in:			
Gold stock 2/	+3,082	+1,324	+ 58
System holdings of Government securities	-2,050	+1,650	-4,448
Other factors	+ 14	+ 2	+ 479
Changes in reserves	+1,046	+2,976	-3,911

1/1947: change from January 8, 1947 to January 7, 1948; 1948: change from January 7, 1948 to December 31, 1948.
2/ Gold stock adjusted to changes in foreign balances with the Reserve Banks. In 1947 gold stock also adjusted for United States subscription to the International Monetary Fund.

224098

MISC. 3B.2-100M-8-49

OFFICE CORRESPONDENCE

FEDERAL RESERVE BANK
OF NEW YORK

DATE

TO

SUBJECT:

FROM

In 1947, the effect of the gold increase was canceled by measures taken by the monetary and fiscal authorities. During 1948, the increases in reserve requirements by the Federal Reserve Board accounted for all of the rise in bank reserves. The fall in bank reserves in 1949 was also associated almost entirely with changes in the prescribed reserve requirements; these reductions were made in order to ease the adjustments in the economy necessitated by the halting of the inflationary boom.

From the figures in Tables II and III it is apparent that in 1947 and 1948 the gold inflow made substantially more difficult the efforts of the Reserve System and the Treasury to bring to a halt the inflationary forces prevalent in the economy. The direct contribution to the money supply made by gold purchases was not the most burdensome of the problems. It is true that gold purchases added to the funds available to domestic purchasers, but increases in deposits due to foreign demand for goods and services are not peculiar to purchases made with the proceeds of gold sales, as the same effect would have occurred if other nations had borrowed from the banks (with gold as collateral). Such borrowing, however, would not have enlarged bank reserves as did the gold inflow.

It is this feature of the gold inflow--its tendency to build up bank reserves--that was most troublesome to the Reserve System during the period. In its efforts to hold down expansion of domestic bank credit and the growth in the money supply the Reserve System was confronted at every turn with the necessity of mopping up these reserves. The problem was particularly grievous because domestic developments limited serverely the use of interest-rate changes as a method of credit control.

Despite these limitations Federal Reserve and Treasury action contributed importantly to bringing the inflationary forces under control. Some measure of their joint efforts is depicted in Table III, which shows that the change in the System's security holdings canceled out a large share of the gold inflow in 1947. In 1948, system holdings increased because of the rise in prescribed reserve requirements. The principal method pursued was to reduce the availability of bank reserves by using surplus Treasury cash income to redeem maturing securities held by the Reserve System. In this way the banks were forced almost constantly to make adjustments in their reserve positions through the sale of short-term government securities. Any increments in the excess reserves of many banks were thus of short duration. At the same time, interest rates rose modestly, and uncertainty as to their future course developed, thus affecting the lending practices of the banks.

Furthermore, the use of Treasury net receipts in the above-described fashion destroyed bank deposits and thus altered the money supply held by the public. In this way, the purchasing power of domestic buyers was reduced, and, the effect of gold purchases on both deposits and reserves was thus brought under control.

It would be inappropriate, however, to appraise the significance of the gold inflow into this country exclusively in terms of its money-creating effects. These effects were incidental to the primary purpose of the gold imports--the financing of American exports. More precisely, the purpose of the gold sales to the Treasury was the financing of those exports which could not be paid for by other means. It is the nature of gold as a medium of international reserves that it is normally used for the purchase of marginal exports, which would not, and could not, be purchased if the buying country lacked such reserves.[1/]

Thus, gold sales to the Treasury financed 13.2 per cent of total American exports of goods and services in 1947,[2/] 8.3 per cent in 1948, and 2.6 per cent in the first nine months of 1949. It is of course impossible to determine exactly what exports were financed by gold sales, as distinct from all other forms of payment for American exports. But there seems to be some justification for saying that most, if not all, of the gold sales of European countries (amounting to approximately 2,500 million dollars between January 1947 and June 1949) were used to finance "less urgent" purchases in this country, i.e., purchases over and above basic food and raw materials requirements. Without gold reserves, the buyers probably would not have made these purchases.

1/ Under certain circumstances, however, such as those prevailing in certain Latin American countries, during the postwar years under consideration, gold sales cannot be considered as a resort to "last" reserves since these gold holdings had been acquired in the course of the war years in payment for export surpluses and with the specific intention of making use of them when supplies of American goods again became available. These gold sales amounted to approximately 1 billion dollars between 1947 and 1949.

2/ The 1947 percentage figure is based on gross gold purchases, and disregards the transfer of 688 million dollars in gold to international institutions. This "outflow" obviously had no effect upon the current international transactions of the United States.

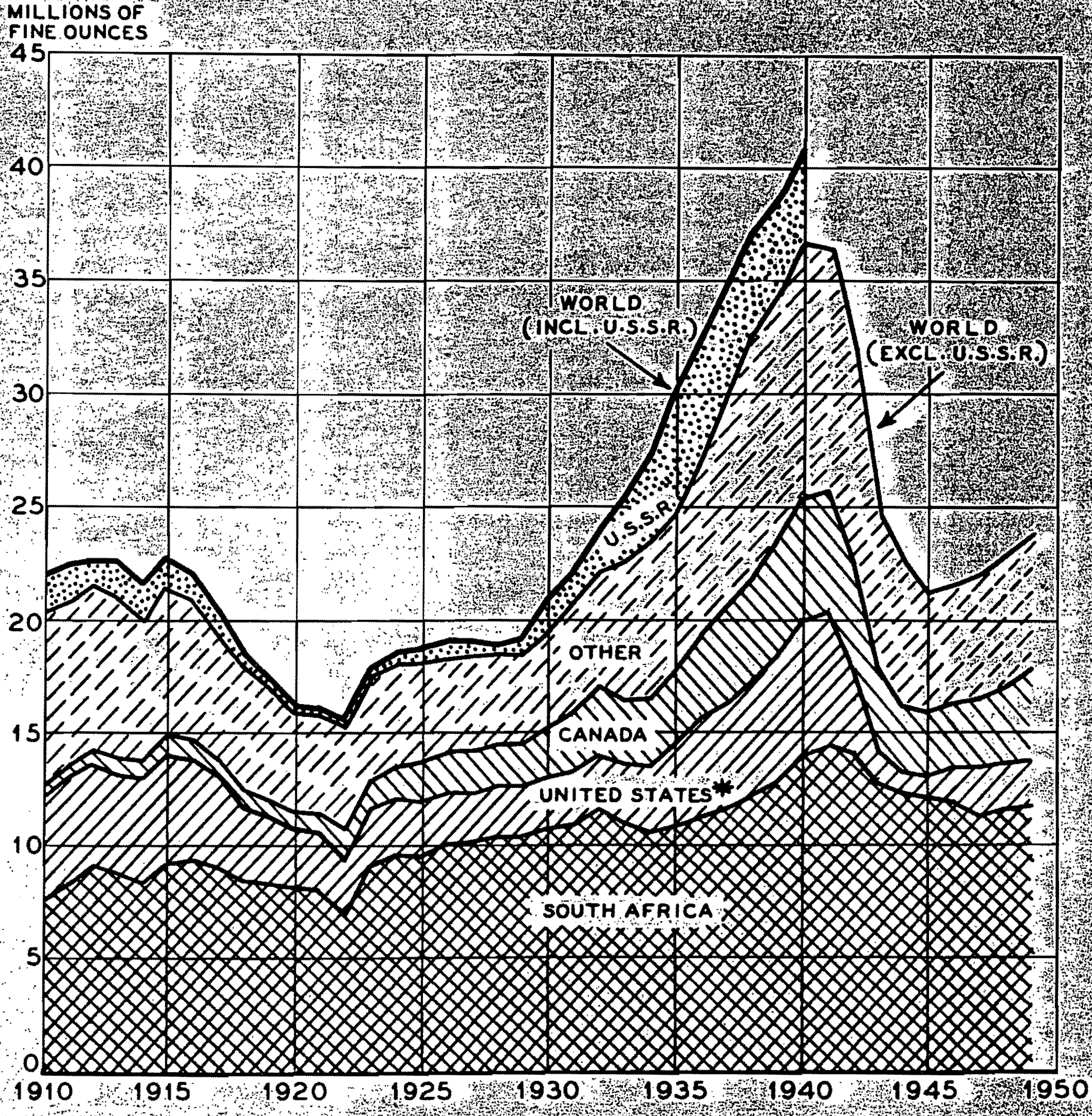
In other words, there seem to be good reasons for assuming that the export effects (as distinct from the over-all monetary effects) of gold sales were concentrated in certain definable sectors of the American economy. These sectors probably were the machinery and equipment industries (apart from top-priority items); the "less essential" sectors of agricultural production, such as tobacco and meat products; and such service industries as the movies. This view is corraborated by what can be observed of the manner in which certain countries handled their import controls, changes in which clearly indicate what goods constituted, from their point of view, marginal dollar purchases. For instance, commodities, purchases of which were eliminated or curtailed through the successive tightening of the "austerity screw" in the United Kingdom, must be considered marginal—and thus, by implication, financed by gold sales so long as they continued. In other countries, the lengthening or shortening of the list of permitted imports indicates what they considered as marginal imports, to be permitted or expanded in accordance with the availability of exchange resources.

If this view (which, it must be emphasized, follows from the concept of the use of gold for essentially marginal purposes) is accepted, it follows that the pressure on prices, too, that these gold-financed exports exerted, must be traceable in specific sectors of the economy. There can be no question that foreign orders of steel, rolling stock, and electrical equipment contributed to the price rises in the "official", and perhaps also in the "grey", markets of these commodities. Conversely, it is not surprising to find that the disappearance of the grey markets in such "non-essential" commodities as rayon yarns and certain industrial chemicals coincided with the last stage of the drawing down of gold reserves (and dollar balances) by some Latin American countries, and the imposition or reimposition of exchange controls in these countries. It probably would be inappropriate, however, to consider the gold sales to the Treasury as an important causal factor of the price rises of "essential" food stuffs, such as wheat. Foreign purchases of wheat would have taken place even if foreign countries had not been able to make use of their gold reserves.

There is one more aspect of the gold inflow of recent years which is of considerable practical significance in the long run. Gdd sales by some European countries did not take the form of a continuous flow, but came in "spurts" of a few weeks or months at a time. Thus the Netherlands, for instance, financed a large proportion of its purchases in this country in early 1948 by substantial gold sales; somewhat later it was reimbursed by the ECA for some of these purchases. The United Kingdom was faced with an intensification of its dollar imbalance in early 1949 and had to resort to large gold sales. The increase of their dollar balances toward the end of 1949 enabled both countries to replenish their gold holdings through purchases from the Treasury. In both instances the gold sales acted as a buffer against a sudden cutting off of purchases in this country. This use of gold reserves--to finance a strictly temporary stringency—is of course the proper "classical" function of gold reserves. It is interesting to note that this function is still served—in spite of ERP, the International Monetary Fund, and direct trade and exchange controls. From the point of view of the United States, the appearance of a gold inflow at a time of temporary recession such as the earlier months of 1949, is of course of considerable significance. Contrary to expectations, American exports expanded in the first six months of 1949. This expansion was partly the result of increased disbursements of foreign aid, but in part it was also financed by gold sales. This increase in exports offset to some extent the decline in business expenditures which caused the recession. Since a short-run decline in the level of American business activity leads normally to a more than proportionate decline in the volume of imports and thus of the dollar earnings of foreign countries, the sale of gold by foreign countries to the Treasury may be counted upon as a minor anticyclical buffer.

JHA:MK

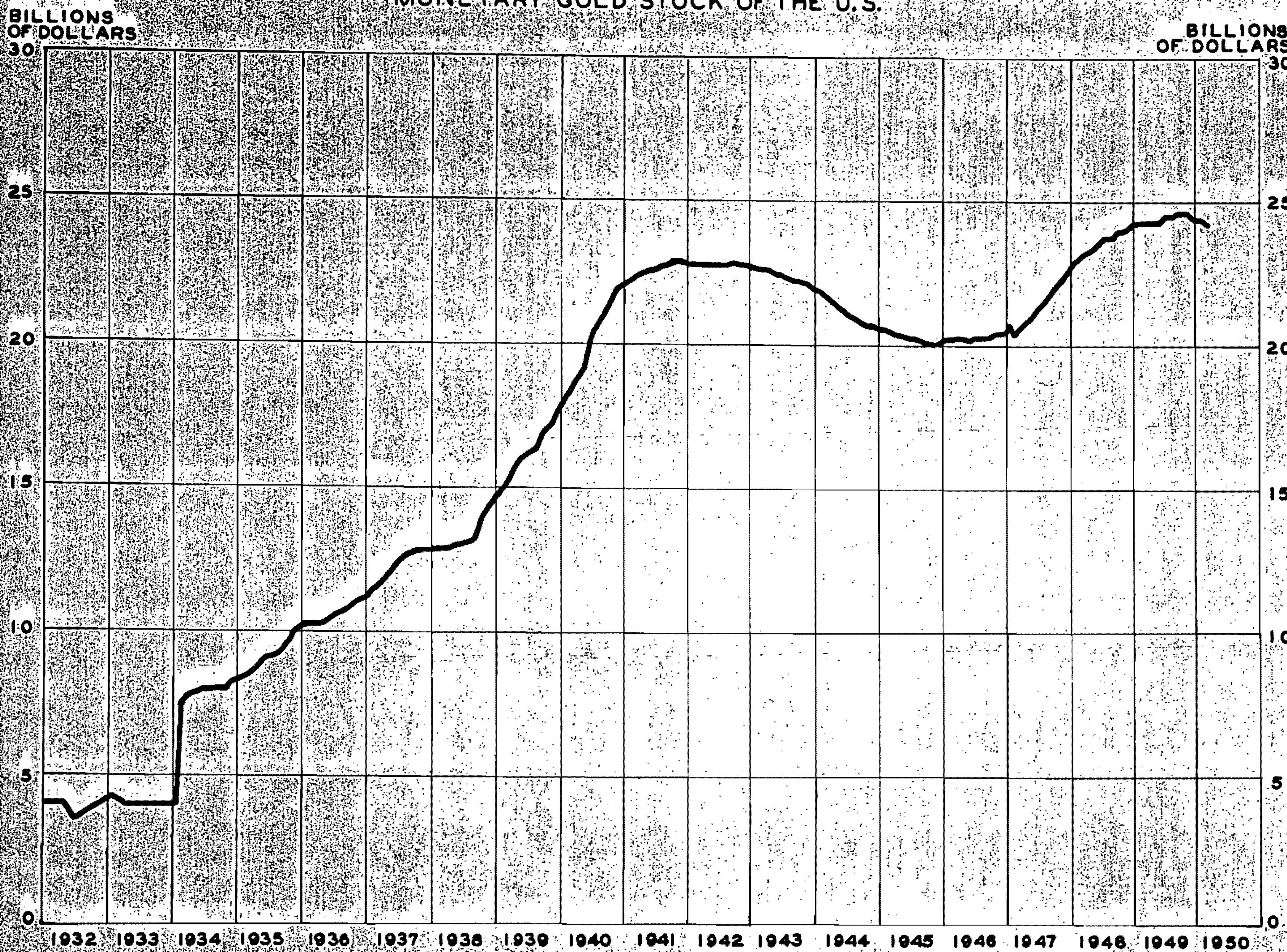
WORLD OUTPUT OF GOLD



* INCLUDING PHILIPPINES THROUGH 1941.

224105

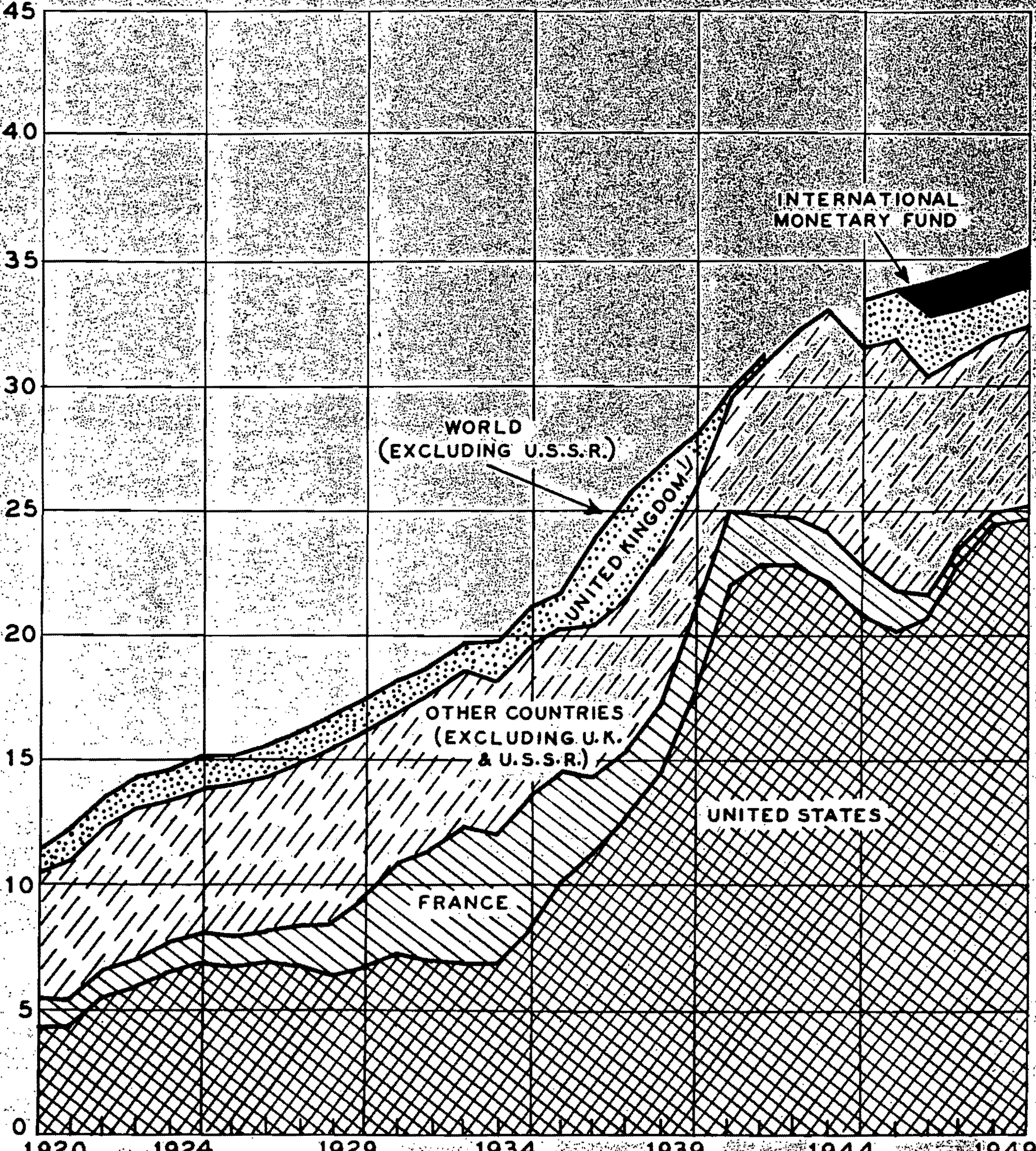
MONETARY GOLD STOCK OF THE U.S.



224106

RECORDED OFFICIAL GOLD RESERVES

(END OF YEAR; IN BILLIONS OF U.S. DOLLARS AT $35 PER FINE OUNCE)



1/ NO DATA FOR UNITED KINGDOM HAVE BEEN PUBLISHED FOR DECEMBER 31, 1942 AND 1943.

224107

Gold Holdings of the United States
(End of month figures. In millions of dollars)

1932	Federal Reserve (Gold and Gold Certificates)	Circulation	Treasury	Stabilization Fund	Total Monetary Gold Stock	Stabilization Fund-Operating Account
Jan.	2,976	970	183		4,129	
Feb.	2,938	939	188		4,067	
Mar.	3,020	896	186		4,103	
Apr.	3,004	882	194		4,080	
May	2,790	883	190		3,865	
June	2,578	882	172		3,632	
July	2,635	861	190		3,687	
Aug.	2,773	831	195		3,801	
Sept.	2,893	802	209		3,906	
Oct.	3,003	782	191		3,977	
Nov.	3,049	802	200		4,053	
Dec.	3,151	782	293		4,226	
1933						
Jan.	3,256	793	217		4,266	
Feb.	2,952	933	207		4,093	
Mar.	3,250	473	270		3,995	
Apr.	3,416	371	236		4,025	
May	3,520	317	191		4,028	
June	3,543	299	188		4,031	
July	3,548	285	200		4,033	
Aug.	3,588	274	178		4,041	
Sept.	3,591	257	188		4,037	
Oct.	3,591	250	195		4,036	
Nov.	3,573	243	219		4,036	
Dec.	3,569	237	230		4,036	
1934						
Jan.	3,557	178	297		4,033	
Feb.	3,931	167	3,340		7,438	
Mar.	4,336	161	3,197		7,694	
Apr.	4,621	157	1,177	1,800	7,757	
May	4,683	153	1,143	1,800	7,779	
June	4,808	150	1,098	1,800	7,856	21
July	4,930	146	1,053	1,800	7,931	
Aug.	5,001	143	1,034	1,800	7,978	
Sept.	4,980	139	1,058	1,800	7,978	
Oct.	4,989	136	1,077	1,800	8,002	
Nov.	5,107	133	1,092	1,800	8,132	
Dec.	5,143	130	1,165	1,800	8,238	

224108

Over

1935	Federal Reserve (Gold and Gold Certificates)	Circulation	Treasury	Stabilization Fund	Total Monetary Gold Stock	Stabilization Fund-Operating Account
Jan.	5,405	127	1,057	1,800	8,391	
Feb.	5,559	126	1,042	1,800	8,527	
Mar.	5,592	123	1,052	1,800	8,567	
Apr.	5,769	121	1,019	1,800	8,710	
May	5,901	119	1,039	1,800	8,858	
June	6,203	117	995	1,800	9,116	
July	6,246	115	982	1,800	9,144	
Aug.	6,502	114	787	1,800	9,203	
Sept.	6,633	112	822	1,800	9,368	
Oct.	7,053	111	729	1,800	9,693	
Nov.	7,347	110	663	1,800	9,920	
Dec.	7,571	109	643	1,800	10,125	
1936						
Jan.	7,667	107	608	1,800	10,182	
Feb.	7,685	106	576	1,800	10,167	
Mar.	7,680	104	598	1,800	10,184	
Apr.	7,717	103	605	1,800	10,225	
May	7,837	102	662	1,800	10,402	
June	8,119	101	588	1,800	10,608	59
July	8,210	100	537	1,800	10,648	
Aug.	8,312	99	505	1,800	10,716	
Sept.	8,397	98	550	1,800	10,845	
Oct.	8,662	97	485	1,800	11,045	
Nov.	8,811	96	478	1,800	11,184	
Dec.	8,864	95	498	1,800	11,258	
1937						
Jan.	8,862	94	602	1,800	11,358	
Feb.	8,859	92	685	1,800	11,436	
Mar.	8,856	91	827	1,800	11,574	
Apr.	8,853	90	1,056	1,800	11,799	
May	8,850	89	1,250	1,800	11,990	
June	8,846	88	1,584	1,800	12,318	169
July	8,843	87	1,714	1,800	12,446	
Aug.	8,840	86	1,840	1,800	12,567	
Sept.	9,138	86	1,717	1,800	12,741	
Oct.	9,134	85	1,784	1,800	12,803	
Nov.	9,132	84	1,758	1,800	12,774	
Dec.	9,129	83	1,748	1,800	12,760	

1938	Federal Reserve (Gold and Gold Certificates)	Circulation	Treasury	Stabilization Fund	Total Monetary Gold Stock	Stabilization Fund-Operating Account
Jan.	9,127	82	1,747	1,800	12,756	
Feb.	9,183	81	1,712	1,800	12,776	
Mar.	9,223	81	1,691	1,800	12,795	
Apr.	10,650	80	338	1,800	12,869	
May	10,648	79	390	1,800	12,919	
June	10,645	78	439	1,800	12,963	44
July	10,642	78	497	1,800	13,017	
Aug.	10,640	77	618	1,800	13,136	
Sept.	10,918	77	965	1,800	13,760	
Oct.	11,272	76	917	1,800	14,065	
Nov.	11,613	76	824	1,800	14,312	
Dec.	11,798	75	838	1,800	14,512	80
1939						
Jan.	11,948	75	859	1,800	14,682	
Feb.	12,125	74	875	1,800	14,874	
Mar.	12,553	74	831	1,800	15,258	154
Apr.	13,103	73	814	1,800	15,791	
May	13,326	72	758	1,800	15,957	
June	13,524	72	714	1,800	16,110	85
July	13,878	71	488	1,800	16,238	
Aug.	14,321	71	453	1,800	16,646	
Sept.	14,679	71	382	1,800	16,932	164
Oct.	14,838	70	383	1,800	17,091	
Nov.	14,976	70	512	1,800	17,358	
Dec.	15,209	69	565	1,800	17,644	156
1940						
Jan.	15,561	69	500	1,800	17,931	
Feb.	15,813	68	496	1,800	18,177	
Mar.	16,076	68	489	1,800	18,433	145
Apr.	16,428	68	475	1,800	18,770	
May	16,994	67	347	1,800	19,209	
June	17,754	67	342	1,800	19,963	86
July	18,202	66	394	1,800	20,463	
Aug.	18,618	66	429	1,800	20,913	
Sept.	18,940	66	438	1,800	21,244	105
Oct.	19,289	65	351	1,800	21,506	
Nov.	19,586	65	349	1,800	21,801	
Dec.	19,760	65	369	1,800	21,995	48

Over

224110

1941	Federal Reserve (Gold and Gold Certificates)	Circulation	Treasury	Stabilization Fund	Total Monetary Gold Stock	Stabilization Fund-Operating Account
Jan.	19,913	64	338	1,800	22,116	
Feb.	20,031	64	336	1,800	22,232	
Mar.	20,112	64	391	1,800	22,367	88
Apr.	20,204	63	438	1,800	22,506	
May	20,325	63	387	1,800	22,575	
June	20,322	63	440	1,800	22,624	89
July	20,317	63	495	1,800	22,675	
Aug.	20,314	62	542	1,800	22,719	
Sept.	20,461	62	438	1,800	22,761	24
Oct.	20,572	62	366	1,800	22,800	
Nov.	20,568	61	355	1,800	22,785	
Dec.	20,504	61	371	1,800	22,737	25
1942						
Jan.	20,533	61	353	1,800	22,747	
Feb.	20,515	61	329	1,800	22,705	
Mar.	20,495	60	332	1,800	22,687	12
Apr.	20,510	60	320	1,800	22,691	
May	20,522	60	332	1,800	22,714	
June	20,566	59	311	1,800	22,737	8
July	20,546	59	339	1,800	22,744	
Aug.	20,575	59	321	1,800	22,756	
Sept.	20,576	59	319	1,800	22,754	7
Oct.	20,569	59	312	1,800	22,740	
Nov.	20,573	58	312	1,800	22,743	
Dec.	20,554	58	314	1,800	22,726	12
1943						
Jan.	20,520	58	304	1,800	22,683	
Feb.	20,476	58	310	1,800	22,644	
Mar.	20,413	57	305	1,800	22,576	14
Apr.	20,303	57	312	1,800	22,473	
May	20,261	57	308	1,800	22,426	
June	20,224	57	306	1,800	22,388	11
July	20,163	57	315	1,800	22,335	
Aug.	20,071	57	315	1,800	22,243	
Sept.	20,011	56	308	1,800	22,175	7
Oct.	19,947	56	313	1,800	22,116	
Nov.	19,898	55	311	1,800	22,065	
Dec.	19,766	55	316	1,800	21,938	43

1944	Federal Reserve (Gold and Gold Certificates)	Circulation	Treasury	Stabilization Fund	Total Monetary Gold Stock	Stabilization Fund-Operating Account
Jan.	19,746	55	317	1,800	21,918	
Feb.	19,536	55	320	1,800	21,712	
Mar.	19,423	55	323	1,800	21,600	14
Apr.	19,265	55	310	1,800	21,429	
May	19,097	54	313	1,800	21,264	
June	19,010	54	310	1,800	21,173	21
July	18,823	54	319	1,800	20,996	
Aug.	18,759	53	314	1,800	20,926	
Sept.	18,647	53	324	1,800	20,825	25
Oct.	18,552	53	321	1,800	20,727	
Nov.	18,528	53	307	1,800	20,688	
Dec.	18,444	53	321	1,800	20,619	12
1945						
Jan.	18,373	53	324	1,800	20,550	
Feb.	18,346	53	308	1,800	20,506	
Mar.	18,261	53	305	1,800	20,419	32
Apr.	18,207	52	314	1,800	20,374	
May	18,112	52	306	1,800	20,270	
June	18,055	52	306	1,800	20,213	81
July	17,981	52	320	1,800	20,152	
Aug.	17,926	52	310	1,800	20,088	
Sept.	17,898	52	323	1,800	20,073	20
Oct.	17,879	51	306	1,800	20,036	
Nov.	17,870	51	309	1,800	20,030	
Dec.	17,863	51	351	1,800	20,065	18
1946						
Jan.	17,983	51	323	1,800	20,156	
Feb.	18,049	51	333	1,800	20,232	
Mar.	18,075	51	331	1,800	20,256	54
Apr.	18,097	51	304	1,800	20,251	
May	18,092	50	299	1,800	20,242	
June	18,103	50	316	1,800	20,270	71
July	18,105	50	311	1,800	20,267	
Aug.	18,098	50	333	1,800	20,280	
Sept.	18,095	50	360	1,800	20,305	113
Oct.	18,229	50	324	1,800	20,402	
Nov.	18,310	49	311	1,800	20,470	
Dec.	18,381	49	298	1,800	20,529	177

Over

1947	Federal Reserve (Gold and Gold Certificates)	Circulation	Treasury	Stabilization Fund	Total Monetary Gold Stock	Stabilization Fund-Operating Account
Jan.	18,627	49	272	1,800	20,748	
Feb.	19,113	49	1,168		20,330	
Mar.	19,222	48	1,192		20,463	163
Apr.	19,537	48	1,189		20,774	
May	19,689	48	1,196		20,933	
June	20,039	48	1,179		21,266	151
July	20,296	48	1,193		21,537	
Aug.	20,534	47	1,184		21,766	
Sept.	20,723	47	1,185		21,955	129
Oct.	21,044	47	1,203		22,294	
Nov.	21,363	47	1,205		22,614	
Dec.	21,497	47	1,210		22,754	114
1948						
Jan.	21,701	46	1,187		22,935	
Feb.	21,776	46	1,214		23,036	
Mar.	21,878	46	1,213		23,137	79
Apr.	21,910	46	1,212		23,169	
May	22,036	45	1,223		23,304	
June	22,258	45	1,229		23,532	208
July	22,407	45	1,226		23,679	
Aug.	22,465	45	1,216		23,725	
Sept.	22,603	45	1,224		23,872	188
Oct.	22,726	44	1,233		24,004	
Nov.	22,889	44	1,232		24,166	
Dec.	22,966	44	1,233		24,244	155
1949						
Jan.	23,025	44	1,202		24,271	
Feb.	23,045	43	1,201		24,290	
Mar.	23,077	43	1,194		24,314	154
Apr.	23,099	43	1,189		24,332	
May	23,116	43	1,183		24,342	
June	23,245	43	1,178		24,466	171
July	23,285	43	1,193		24,520	
Aug.	23,362	42	1,203		24,608	
Sept.	23,350	42	1,210		24,602	126
Oct.	23,320	42	1,221		24,584	
Nov.	23,232	42	1,205		24,479	
Dec.	23,176	42	1,209		24,427	
1950						
Jan.	23,168	41	1,185		24,395	
Feb.	23,120	41	1,183		24,345	
Mar.	23,020	41	1,185		24,246	

Federal Reserve Bank of New York
Research Department
Financial Statistics Division
April 28, 1950

224113

224114

Treasury Dept
Office of International Finance

March 8, 1948

RECEIVED
MAR 11 1948
W. K.

REPLY TO FEDERAL RESERVE MEMORANDUM WITH RESPECT TO
CERTAIN ASPECTS OF UNITED STATES GOLD POLICY AND PROCEDURES

The Federal Reserve memorandum recommends that changes be made in United States policies, procedures or laws relating to gold in five major respects: Gold transactions for foreign official accounts, commercial banks' gold operations at premium prices, loans on gold collateral, the 1/4 of 1% handling charge, the Secretary's power to buy and sell gold at discretionary prices under sections 8 and 9 of the Gold Reserve Act of 1934. Each of the Federal Reserve Bank's recommendations will be considered separately.

I. Federal Reserve Recommendations.

1. Licensing of Gold Transactions for Foreign Official Accounts.

Recommendation for action: That the existing Treasury procedures with respect to the acquisition of gold in the United States be amended by means of the issuance of a general license or otherwise so that foreign monetary authorities may convert free dollar balances into gold (for earmark or export) without the necessity of obtaining a specific license or complying with other formalities under the Gold Reserve Act of 1934, as amended, and the Provisional Regulations issued thereunder.

The comment on this point makes several suggestions which do not appear in the recommendation: (a) a broad general license is desirable because gold not first placed under earmark may be exported by the Federal Reserve Bank of New York only pursuant to a specific license under the Gold Reserve Act; (b) transfers of gold held under earmark in the United States should be freely permitted between the governments and central banks of other countries except as to such countries as may be excluded for particular reasons; (c) no change is necessary with respect to purchases of gold by the United States with the exception of the possible elimination of certain technical requirements, for the most part involving "paper work".

The foregoing recommendation and suggestions seem to indicate some unfamiliarity with the present status of Treasury practices and procedures. No further license beyond NY-18-1 is necessary for purchases and sales of gold by the United States, both of which are carried out through the Federal Reserve Bank of New York as fiscal agent of the United States.

The only formality required by the Treasury for sales of gold is that it be informed by telephone of the request to buy and that verbal approval be given. In most instances approval for a sale is given immediately. Only under unusual circumstances is any lengthier consideration required.

Subsequent to the sale, written corroboration of telephonic authorizations are sent to the Federal Reserve Bank of New York for purposes of record and auditing. Inasmuch as the Treasury is selling its gold, these requirements appear to constitute a practical minimum of formality.

Gold sold by the United States to a foreign government or central bank through the Federal may be exported without being placed under earmark and without a special license. The Federal Reserve Bank's license No. NY-18-1 authorizes the Federal to "export gold * * * delivered to you (the Federal) for account of any foreign government or foreign central bank, by the United States * * *."

Extensive liberalizing amendments to the NY-18-1 license were proposed by the Treasury to the Federal Reserve Bank of New York in January 1947. These amendments would, among other things, dispense with the paper work now required in connection with purchases and sales of gold between the United States and the International Monetary Fund and the International Bank for Reconstruction and Development. They also would authorize the transfer of earmarked gold held at the Federal between all foreign governments and central banks except those specially designated by the Treasury. The Treasury has made numerous requests that the Federal consider these proposals so that amendments satisfactory to the Federal and the Treasury could be agreed upon and submitted to the President for approval.

The only substantial delays which occur in connection with purchases of gold arise in connection with the Gold Declaration of February 22, 1944, and involve political as well as financial considerations which must be cleared with the Department of State. The Federal Reserve memorandum does not recommend any changes in procedure for purchases of gold except the "possible elimination of certain technical requirements". The Treasury staff, on a number of occasions has asked the Federal Reserve Bank of New York's foreign staff for advice on any ways to simplify the paper work involved and any specific recommendations would be welcomed.

On both purchases and sales the Treasury has been ready to approve transactions in advance before the final cable orders giving the exact amounts are received or decoded in the New York Bank.

The Treasury agrees that outstanding public statements on purchases and sales of gold are obsolete in many respects. Consideration is being given in connection with a more extensive study of gold policy to the desirability of issuing a new public statement and to the form which that statement might take. It does not seem, however, that much simplification or improvement of operating policies can be achieved, other than by agreement on amendments to license No. NY-18-1.

2. Commercial Banks' Gold Operations at Premium Prices.

<u>Recommendation for action</u>: That the Treasury Department and the Board of Governors of the Federal Reserve System join in issuing a public statement along the following lines:

* * * * * * *

A broadened version of this recommendation was agreed to by the Treasury and the Federal Reserve System and issued as a joint statement on July 18, 1947, substantially in the language recommended in the Federal Reserve memorandum. Mr. Knoke has reported that United States banks (to which this Federal Reserve recommendation was confined) are cooperating fully. The Treasury, since that time, has also amended its gold regulations, applicable to all persons within the United States, going as far in restricting premium gold transactions in accordance with the recommendation of the International Monetary Fund as seems feasible. The Treasury is now endeavoring to obtain full information about the measures taken by other members in compliance with the Fund's request in order to consider future United States policy on premium price gold transactions.

3. Loans on Gold.

Recommendation for action: That the Treasury and Federal Reserve System adopt a coordinated policy along the following lines with respect to the making of loans on gold by Federal Reserve Banks and by commercial banks (or other lenders) in the United States:

(1) The Federal Reserve Banks would continue their present policy of making loans on gold for an initial period of only three months, subject to renewal, but special Treasury-Federal Reserve consultation and review would be undertaken if any renewal is proposed beyond 12 months from the date of the original loan;

(2) The Treasury would decline to license any commercial bank loan on gold for an initial period of more than 12 months, and any application for a license to renew such a loan beyond 12 months would be the subject of special Treasury-Federal Reserve consultation and review;

(3) If a loan appears to be sought for predominantly speculative purposes, the Federal Reserve Banks would (as at present) refuse the loan or, in the case of a commercial bank loan, the Treasury would decline to license the transaction.

The Treasury Department does not desire to advise the Federal Reserve as to the policies and conditions upon which gold collateral loans should be made by the Federal Reserve banks. However, the Department does not wish to support the policy of restricting gold loans by the Federal Reserve banks to periods of 90 days with virtually no renewals beyond one year. Accordingly, we do not believe that renewals of such loans beyond 12 months should be subject to special Treasury-Federal Reserve consultation and review.

The Treasury Department does not agree with either of the recommendations of the Federal Reserve System regarding the licensing of gold collateral loans by commercial banks. The Department discussed this subject with the Federal Reserve and considered it at great length in connection with an application for a license to the Bank of America authorizing a gold collateral loan to the Central Bank of Nicaragua. Our conclusions were submitted to Mr. Sproul at that time and the arguments advanced by the Federal in this memorandum do not appear to invalidate them.

We believe that gold licenses should not be limited to a period of one year subject to possible renewals. In many instances the desire of a foreign central bank or foreign government to obtain a gold collateral loan from a commercial bank is based upon the need to provide for amortization over an extended period of time. Commercial banks would not be prepared to enter such long-term arrangements on the basis of a one-year license subject to possible renewals. Such a policy would, in effect, amount to a determination that most commercial bank gold collateral loans would not be licensed. (There have been five applications for gold collateral loans in the last few years. Each one ran for a period of years.)

As pointed out in the Federal Reserve memorandum, unnecessary restrictions upon loans against gold would impair the usefulness of gold and diminish the inclination of foreign countries to hold gold. This would run contrary to this country's policies which look toward a wider distribution of world gold reserves. The ability to make loans against gold tends, however slightly, to foster the importance and usefulness of gold reserves.

The fact that long-term gold collateral loans are expensive and economically unjustifiable is not a reason upon which a denial of a gold license may be predicated. The licensing power under the Gold Reserve Act of 1934 is related to the carrying out of gold policies consistent with the purposes of that Act. It would appear to be an abuse of this power to deny a license on the grounds that the foreign government was not using good judgment in negotiating the particular loan. In this connection it should be noted that some of the Treasury staff were disturbed at the terms of the Nicaraguan loan requiring a payment of 3-1/2% interest on outstanding amounts of a loan almost fully secured by gold and dollar collateral and which would run until January 31, 1955. The Treasury concluded, nevertheless, that it could not base a denial of a gold license on the belief that the terms of the loan were economically unjustifiable. The Federal Reserve, other agencies of the Government, and the International Monetary Fund did not feel that they would be justified in attempting to dissuade either the Bank of America or the Nicaraguan bank from entering the loan agreement.

The Treasury can not support the Federal Reserve recommendation that licenses be denied if the motive of the foreign government appears to be predominately speculative. The United States has little to fear from speculative loans since the Treasury has no expectation that there will be an increase in the monetary value of gold. The payment of burdensome interest rates over a period of years without any compensating benefit from an increase in the gold value would seem to be an effective way to discourage speculative gold loans. Moreover, it would be exceedingly difficult to determine whether a proposed gold collateral loan was primarily motivated by speculation against an increase in the price of gold or by other reasons. The Treasury would not wish to base its gold licensing policies on the assessment of such imponderables.

4. Treasury's 1/4% Handling Charge.

Recommendation for consideration: That consideration be given to the advisability of eliminating, or reducing to an amount approximating the actual handling costs, the Treasury's 1/4 per cent handling charge on gold transactions, especially if such action were accompanied by corresponding action by the other members of the International Monetary Fund.

The Treasury Department is not convinced by the Federal Reserve reasons for this recommendation. If there is any practical benefit to be gained from the "realization of a fixed point of reference for gold in the world", it does not appear why a buying price of $34.91 and a selling price of $35.09 are not satisfactory "points of reference". Other countries in the past have had similar spreads in their buying and selling prices for gold. Furthermore, it is difficult to understand the reasons for the Federal Reserve's conclusion that such a buying and selling price is a hindrance to the most effective working of the international gold standard.

Moreover, the reference to "the international gold standard" and the further suggestion "especially if such action were accompanied by corresponding action by the other members of the International Monetary Fund", seem to make the discussion of this point rather conjectural. So far as the Treasury knows, no important country in the world besides the United States has fixed prices for buying and selling gold which are usable for international settlements by other countries. Hence no other countries can take "corresponding action" with their gold prices. Furthermore, the substitution of controlled buying and selling prices for foreign currencies by all important countries other than the United States, the overwhelming restrictions of exchange controls, and the almost complete prevention of gold outflows and shortage of gold from having any effect on internal credit structures seem to leave no remnant of the orthodox "international gold standard" except the United States Treasury's buying and selling prices for gold.

A second reason offered by the Federal Reserve against the 1/4% charge claims that its removal would eliminate one reason for loans on gold. Since such loans are not admitted by the Treasury to be wrong or undesirable, this reason is likewise questionable.

No refutation is given in the Federal Reserve memorandum to the two reasons cited in favor of this charge, namely, that it deters capricious shifts between gold and dollars, and that it provides revenue for the United States Treasury and the Stabilization Fund.

5. Sections 8 and 9 of the Gold Reserve Act.

Recommendation for consideration: That consideration be given to introducing legislation at some appropriate time, perhaps in connection with other related legislation terminating the power of the Secretary of the Treasury contained in Sections 8 and 9 of the Gold Reserve Act to buy and sell gold "at such rates and upon such terms and conditions as he may deem most advantageous to the public interest". Pending such an amendment of the law, it is believed that some assurance to the market as to the present gold price would be given by a statement of the Secretary of the Treasury pointing out the limiting effect of Article IV, Section 2 of the Articles of Agreement of the Fund on the Secretary's authority to deal in gold, particularly if such statement were made in connection with an announcement by the Secretary respecting the proposed procedure for licensing of gold transactions for foreign official account.

The first paragraph of Federal Reserve comment on this point includes the statement, "However, the importance of this matter should not be exaggerated and, in view of the present legislative situation, it is not suggested that any bill be introduced at the present session of Congress." Although intended to apply to June 1947, this sentence would seem a good statement of policy for the 1947-48 session of Congress.

The Treasury is doubtful if it would be wise to recommend such legislation to Congress at any time unless the problem becomes a much more serious one than now, particularly in view of the danger that such a proposal would afford a favorable opportunity for efforts to make more drastic changes in the relation of gold to our monetary system.

As indicated above, the Treasury is studying the desirability of issuing a public statement on gold policy. Consideration will be given to the possibility of giving some further assurance about the price of gold in any such statement.

COPY

Mr Sproul

TREASURY DEPARTMENT
Washington 25

Office of International Finance

March 10, 1948

Dear Mr. Knoke:

There are enclosed copies of a memorandum which expresses the views of the Treasury Department on the Federal Reserve memorandum of June 27, 1947, with respect to certain aspects of United States gold policy and procedures. As indicated in our memorandum, we are considering the desirability of issuing a public statement on gold policy and, in this connection, have undertaken a more extensive study of the problems involved.

Copies of this memorandum are also being sent to Mr. Knapp. If you desire to discuss the questions raised in these memoranda, we are prepared to meet with you and representatives of the Board of Governors of the Federal Reserve System, at your convenience.

Very truly yours,

/s/ Frank A. Southard, Jr.

Frank A. Southard, Jr.
Director, Office of International Finance

Mr. L. Werner Knoke
Vice President
Federal Reserve Bank of New York
33 Liberty Street
New York, New York

224121

45

June 17, 1947.

Mr. A. N. Overby, Special Assistant
to the Secretary,
Treasury Department,
Washington 25, D. C.

Dear Mr. Overby:

In Mr. Sproul's absence from the office for a few days, permit me to acknowledge and thank you for your letter of June 12th with which you enclosed for his confidential information a copy of National Advisory Council Document No. 436. These will be brought to Mr. Sproul's attention when he returns.

Very truly yours,

Mary C. Regan,
Secretary to Mr. Sproul.

MCR:EAV

224122

MISC. 3 B.2-80M-11-46

FEDERAL RESERVE BANK
OF NEW YORK

OFFIC CORRESPONDENCE

DATE June 13, 1947

TO MR. SPROUL

FROM L. W. KNOKE

SUBJECT: PROPOSED STATEMENT BY THE INTERNATIONAL MONETARY FUND DEPRECATING INTERNATIONAL GOLD TRANSACTIONS AT PREMIUM PRICES

I assume that Mr. Overby in sending you NAC Document No. 436 (as he says he did, in a note to me this morning) has also informed you that the recommendation contained in the paper was approved by NAC yesterday.

I had a call from Mr. Dembitz at the Board this morning confirming this and adding that the only critical comment made at the meeting was that by Mr. Gaston on behalf of the Export-Import Bank who seemed to think the statement was too vague and would have liked to see more teeth put into it. However, NAC seems to have felt that this might arouse the fighting spirit of the other members, and it was decided to leave the statement in its present form.

LWK:BOC

224123

TREASURY DEPARTMENT

WASHINGTON

RECEIVED

JUN 16 1947

A. S.

ANSWERED ack. 6/17/47 - MCR

ATTENDED TO 6/23/45 A.S.

SECRET

JUN 12 1947

Dear Mr. Sproul:

In view of your interest in the subject, I am sending along to you for your confidential information a copy of the National Advisory Council document on the subject of gold transactions at premium prices. For your information, the National Advisory Council at its meeting today adopted the recommendation contained in the attached document.

I hope to get up to New York very soon and look forward to seeing you at that time.

Sincerely yours,

A. N. Overby

A. N. Overby
Special Assistant to the Secretary

Mr. Allan Sproul,
President,
Federal Reserve Bank of New York,
New York, New York.

Enclosure.

224124

To: National Advisory Council

From: National Advisory Council Staff Committee

Subject: Gold Transactions at Premium Prices

SECRET

The Problem

1. Gold is now being sold for local currency in a number of foreign countries at prices above its monetary value, as measured by the pars certified to the International Monetary Fund or the equivalent of $35 per ounce at the official exchange rates. In many cases gold is sold even for payment in dollars at prices above $35 per ounce.

These premium prices have existed on the black markets of various European countries and on legal markets in the Philippines and some Latin American countries. The principal premium markets, however, have been China, India, and the Middle East. Several countries, e.g., Mexico, Chile and Peru, have sold some of their newly-mined gold on the premium markets. Other countries and ports, e.g., Panama, Cuba, Hong Kong and Macao, have served as intermediaries for the shipment of gold to places where higher premium prices prevail. Beirut, Lebanon, apparently is the principal market for the sale and transshipment of gold to the Middle Eastern areas.

The bulk of the premium gold transactions has been carried out on private account, but some governments or central banks have sold gold to their own nationals either at premium or parity prices (Mexico, Greece, and China) and some have exported gold to the premium markets (Mexico and Chile). From the available information it appears that gold may be imported legitimately and sold for dollars obtained on free markets in Syria, Lebanon, and the Philippines. China has, however, recently prohibited private gold transactions, and India has reinstituted an embargo on private gold imports.

2. Mining interests have been exerting pressure on the United States, as well as on several other governments which are members of the Fund, such as South Africa, Canada, and the United Kingdom, to permit private exports of gold for non-industrial or non-professional purposes to places where there are either legal or illegal markets upon which gold may be sold at a premium.

3. Section 32 of the Gold Regulations authorizes the re-exportation pursuant to license of gold derived from imported gold-bearing materials without restriction as to the intended use of the gold at the place of destination. Refined gold may be imported and transshipped through the United States in customs custody for re-exportation under Section 33 of the Regulations. Domestic refiners, banks and other enterprises have been importing foreign gold and re-exporting it under these sections for sale in the premium markets of the world. They have also participated to a large extent in the sales of gold produced in one foreign country and shipped to other foreign countries where premium prices prevail, without the gold being imported into the United States or passing through the United States under customs custody.

4. The purchase (but not the sale) of gold at prices above parity by governments (or their fiscal agents) which are members of the International Monetary Fund would appear to contravene Article IV, Section 2, of the Agreement, after the Fund has prescribed a margin on gold transactions, i.e.,

> "The Fund shall prescribe a margin above and below par value for transactions in gold by members, and no member shall buy gold at a price above par value plus the prescribed margin, or sell gold at a price below par value minus the prescribed margin."

Discussion

1. If private exports of newly-mined gold to countries where premium prices prevail were permitted by the United States, a double price of gold would result, one, a par value for gold sold to the Treasury and for industrial gold, which may be obtained from the Treasury, and the other some higher price for exportable, newly-mined gold. This differential might result in evasion of the U.S. gold regulations by the diversion of industrial gold to export purposes. Moreover, to permit exports of gold for hoarding purposes in other countries might make it more difficult to justify the prohibition of private gold holdings in the United States. The same situation would, of course, arise in other countries with substantial gold production.

2. While some of the gold sold to private persons in foreign countries is used as an actual medium of exchange, the bulk of it presumably goes into private hoards, particularly where currencies are unstable. The hoarding of gold reduces the actual or potential foreign exchange reserves of the importing countries and curtails their essential import programs since the gold could otherwise be used to purchase necessary commodities. The loss of exchange reserves may be over-emphasized since the exchange used for gold operations, where they are illegal, might never find its way into central holdings. The importation of gold at premium prices for hoarding, however, is frequently paid for directly by the exportation of goods and services (frequently through illicit channels), with a consequent loss of potential foreign exchange to the governments. The dissipation of actual or potential foreign exchange reserves will increase the demands upon the International Monetary Fund for the purchase of currency or the amount which foreign governments may seek to borrow from the International Bank or the U.S. Government. It will also make it more difficult for them to meet their exchange obligations on current account or their payments of interest and amortization of debt.

3. Since the Fund Agreement contemplates the continued use of gold as a monetary reserve and as an ordinary means of settling international balances, it is important for the operations of the Fund that existing or potential monetary gold should not be diverted from central reserves. Fund charges must also be paid in gold except when a country's monetary reserves are low (Article V, Section 8(f)). Moreover, the rate at which

members must repurchase their currencies from the Fund is determined in part by their monetary reserves which are defined as gold and convertible currencies (Article V, Section 7(b) and (c)). The Fund also will sell currencies for gold (Article V, Sections 6 and 7(a)), and insofar as members offer gold for currencies other than dollars held by the Fund, the Fund's position is strengthened.

4. Premium prices for gold are not only a sympton but also a cause of monetary instability. They create uncertainty about the value of the local currency and an unwillingness to hold it, hence a flight from the local currency may take place. In many countries where there are premium prices for gold, even U.S. dollar currency is at a discount in terms of gold, thus casting some doubt on the stability of the dollar.

5. The existence of a premium price for gold constitutes a species of multiple currency practice where the members concerned have certified par values in terms of gold, or of the U.S. dollar of a known constant gold quantity. While multiple exchange rates are not prohibited during the transitional period by the Fund Agreement, the Agreement did not contemplate the use of gold sales as a device for adopting additional multiple rates.

6. The import of gold into countries where premium prices prevail is generally illegal, and the Fund should properly be concerned with the adoption of policies by its members which would prevent the violation of the regulations of other member countries as a matter of international cooperation in furtherance of the objectives of the Fund.

7. The International Monetary Fund has taken up the problem of international transactions in gold at premium prices and has tentatively decided to issue a statement to all member countries strongly deprecating such transactions, and recommending that all of its members take effective action to prevent such transactions in gold with other countries or with the nationals of other countries. The International Monetary Fund plans to prescribe the margin above and below par for gold transactions by member countries prior to the issuance of the statement. The present draft of the Fund statement, which has been approved by the Committee on External Sales of Gold but not as yet by the Board of Executive Directors, and a copy of which is attached to this memorandum, also states that the Fund would not object to domestic transactions in gold at prices above parity, unless they have the effect of establishing new rates of exchange or undermining existing rates of other members, or unless they result in a significant weakening of the international financial position of a member which might affect its utilization of the Fund's resources. It should be noted that by this latter reservation, the Fund reserves the right to object under certain conditions to domestic gold sale policies of member countries which do not affect international gold movements and international exchange rates. The Fund also recommends that members make any representations which, in their judgment, are warranted by the circumstances to the governments of non-member countries to join with them in eliminating this source of exchange instability.

8. Implementation of the Fund's statement by the Treasury Department will undoubtedly involve continuation of the Department's present policy of licensing the exportation of domestically produced gold only for industrial, professional and artistic use, as well as a further tightening of the restrictions to insure that all gold exported from the United States is sold at prices within the margins prescribed by the Fund. It may also be deemed advisable that the Treasury Department and the Federal Reserve Board, after consultation with the Aldrich Committee, exercise moral suasion upon American banks and business enterprises to induce them to desist from engaging in international transactions in gold at premium prices.

Recommendation

The following action is submitted for the consideration of the Council:

(1) The National Advisory Council requests the United States Executive Director on the International Monetary Fund to approve the issuance of a statement substantially in the form now under consideration by the Fund, strongly deprecating international transactions in gold at premium prices and recommending that all members take effective action to prevent such transactions in gold with other countries, or with the nationals of other countries.

(2) The National Advisory Council would prefer that the International Monetary Fund make the proposed statement public after it has been received by all member governments. If this is not agreeable to the Board of Executive Directors, the U.S. Executive Director is requested to take the position that all member governments be permitted to publish the statement.

(3) The National Advisory Council recognizes that receipt of such a statement by the United States Government may require the tightening of existing United States restrictions upon the exportation of gold, and the exercise of moral suasion to induce American banks and other enterprises to desist from engaging in international gold transactions at premium prices. The Council approves in principle the desirability of appropriate action being taken to comply with the request of the International Monetary Fund, when received, including any necessary representations to nonmember governments.

DRAFT STATEMENT TO ALL MEMBERS
OF THE INTERNATIONAL MONETARY FUND

The International Monetary Fund has given consideration to the international gold transactions at prices substantially above monetary parity which have been taking place in various areas of the world. Because of the importance of this matter the Fund feels that all its members should be made aware of its views.

A primary purpose of the Fund is world exchange stability and it is the considered opinion of the Fund that exchange stability may be undermined by continued and increasing external purchases and sales of gold at prices which directly or indirectly produce exchange transactions at depreciated rates. From information at its disposal, the Fund believes that unless discouraged this practice is likely to become extensive, which would fundamentally disturb the exchange relationship between the members of the Fund. Moreover, these transactions involve a loss to monetary reserves, since much of the gold goes into private hoards rather than into central holdings. For these reasons, the Fund strongly deprecates international transactions in gold at premium prices and recommends that all of its members take effective action to prevent such transactions in gold with other countries or with the nationals of other countries.

It is realized that some of these transactions are being conducted by or through non-member countries or their nationals. The Fund recommends that members make any representations which, in their judgment, are warranted by the circumstances to the governments of non-member countries to join with them in eliminating this source of exchange instability.

The Fund has not overlooked the problems arising in connection with domestic transactions in gold at prices above parity. The conclusion was reached that the Fund would not object to such sales at this time unless they have the effect of establishing new rates of exchange or undermining existing rates of other members, or unless they result in a significant weakening of the international financial position of a member which might affect its utilization of the Fund's resources.

The Fund hopes that members will take action as promptly as possible to put into effect the recommendations contained in this statement. The Fund for its part will be glad to be of all possible assistance to its members and is prepared to discuss any gold problem which affects any individual member.

COPY

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Washington

Office of the Chairman

March 4, 1947
(Rec'd. 3/5/47)

Mr. Allan Sproul, President,
Federal Reserve Bank of New York,
New York 45, New York.

Dear Allan:

I have read the draft letter to the National Bank of Nicaragua appended to your letter of January 30 addressed to Secretary Snyder, and I understand that you have heard from him that the Treasury has no objection to its being sent. I likewise have no objection but would like to offer two comments on the letter for your consideration.

The first is that while we have no special sources of information concerning the motives which have induced the Nicaraguans to apply for this loan, the evidence strongly suggests to us that the main reason is simply their desire to show an illusory increase in their external reserves at a time when they are expanding their internal currency and credit. If this is so, i.e. if the Nicaraguans plan to carry the borrowed dollars along with the pledged gold as a reserve in the National Bank, your draft letter appears to miss the main point. The alternative form of external financing which you suggest — sale and subsequent repurchase of their gold — would not produce this sham increase in external reserves. Perhaps speculation on a rise in the dollar price of gold is not so prominent a motivation in this case as some of the comments from our Embassy have indicated — if it were, why do the Nicaraguans apparently plan to continue holding a substantial part of their external reserves in dollars rather than gold?

I realize, however, that you would find it difficult to write a letter rebuking them for using misleading bookkeeping methods in presenting their reserve accounts, and perhaps your letter as drafted will serve at least to smoke them out a little as to the nature of the transaction.

My second comment on the letter is that you might add a passage suggesting that, even if the Nicaraguans feel that they are committed to go through with the loan contract at the present time, they might consider the views expressed in your letter in the light of their right to prepay the loan at any time.

I understand that the Treasury has declined to accept your suggestion that they approach the Bank of America on this matter through the Comptroller of the Currency and that you now plan to send that bank (through the Federal Reserve Bank of San Francisco) a copy of your letter to the National Bank of Nicaragua. I agree that you can hardly do less, although in view of the terms and general background of this transaction, I would not be inclined to waste much sympathy on the Bank of America if the deal fell through.

Sincerely yours,

(Signed) M. S. Eccles

M. S. Eccles,
Chairman.

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MISC. 140A—80M—5-46

FEDERAL RESERVE BANK OF NEW YORK

February 14, 1947.

Honorable M. S. Eccles, Chairman,
Board of Governors of the
Federal Reserve System,
Washington 25, D. C.

Dear Marriner:

As an inveterate letter writer, I am not surprised by your letter of February 11th. It raises questions I might have raised myself if our positions had been reversed. Nevertheless, it probably takes up rather formally what might better have been discussed informally, since I have harbored no desire to breach our understandings with relation to the conduct of the foreign affairs of the Federal Reserve System. A semi-legal administrative staff approach to such matters sometimes snarls the traffic, as I find in dealing with my own staff from time to time.

In this case, we were directly under the gun in handling applications for licenses for various banks to engage in gold transactions, and subsequently in connection with information which came to us from the market concerning other dealings in gold by banks here. When these things came to my attention, I sensed something more important than the individual transactions and thought it necessary to bring the matter to the attention of the Secretary of the Treasury immediately. I also kept in mind, however, our System interest in the whole problem and proposed that we should proceed to study it, using the machinery set up in 1945. My general letters raised the questions as I saw them, and suggested that all aspects of the problem be considered in the light of present conditions. This, it seems to me, leaves plenty of room (although time is of the essence) for the staff group and the policy group to complete their studies of the matter, and for us to attain a meeting of minds, if possible, before we discuss the problem with the Secretary of the Treasury. I think the whole thing may appear in its proper perspective if you imagine that the Secretary of the Treasury was here talking with me, and that I brought these gold questions to his attention, orally, because they had presented themselves to me and I thought he ought to know about them. Could anyone object to that or find in it an attempt to by-pass the Board or the machinery of coordination?

As to my specific letter on the Nicaraguan loan case, if I had any views on the application for a license submitted through us by the Bank of America N. A., I had to express them at once if they were to have any chance of being effective. Sometimes we have to act on the basis of our own judgment and knowledge, without benefit of final staff studies and group reports, and this was one of those cases. A copy of the letter which we prepared to send to the National Bank of Nicaragua on this matter, and which has been cleared by the Treasury, was mailed to you with Mr. Knoke's letter of January 30th. Since you and I, so far as I know, are the available members of the Policy Group, I suggest that you look it over and let me know what you think of it.

For myself, I am strongly of the opinion that we have an obligation and responsibility, to the National Bank of Nicaragua, to bring to its attention the views expressed in the letter. If it is going to be used it should go forward coincidentally with the Treasury's statement that it has recommended to the President the issuance of the license, applied for by the Bank of America N. A., which may come through any day. At the same time, it would seem appropriate and desirable to inform the Bank of America of what we have done.

Yours sincerely,

Allan Sproul

Allan Sproul.

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Washington

February 11, 1947.
(Rec'd. 2/13/47)

Mr. Allan Sproul, President,
Federal Reserve Bank of New York,
New York 45, New York.

Dear Allan:

I have so far been an interested bystander in your stimulating correspondence with the Secretary of the Treasury concerning gold policy — your letter of November 8, 1946 concerning loans on gold by our commercial banks; your letter of January 30, 1947 concerning the Nicaraguan gold loan case; and your letter of February 3, 1947 concerning gold operations by our commercial banks in foreign markets and concerning some general problems involved in administration of the Gold Reserve Act of 1934 by the Secretary of the Treasury. I have appreciated receiving copies of this correspondence but at this point I feel obliged to ask whether most if not all of the questions raised in these letters are not matters upon which we should have a System policy, and if so, whether they should not be discussed within the System before being broached with the Secretary of the Treasury.

More specifically, are you not tending to bypass the very machinery which we set up last year to coordinate the views of the Board and of your Bank on questions of the System's international relations and policies? I refer, of course, to the Informal Policy Group and the supporting Staff Group on Foreign Interests. When your first letter of November 8 arrived, I was happy to agree with your suggestion that the subject of gold loans by commercial banks, with which it was concerned, be referred to the Staff Group for study, and their report to us with recommendations has just been distributed. I believe that we in the Policy Group should now form our conclusions on these recommendations -- and discuss them with the other Presidents, since I see that you have put the subject on the agenda for the coming Presidents' Conference -- before undertaking any joint conversations with the Treasury and State Departments and sending those Departments any letters or memoranda expressing our respective views. But my more important comment is that it would have been distinctly preferable if the Policy Group had been given an opportunity to focus on the gold loan problem -- and on the matters covered by your subsequent letters to the Secretary of the Treasury -- before your letters were ever written.

It is not my thought that you should be bound to silence if you hold views on these matters which differ from those of the Board. I feel very strongly, however, that there should be some kind of consultation and discussion within the System on matters of national policy in international finance before you commit yourself to proposing reconsideration of such policies by the Secretary of the Treasury.

So far as your letter of January 30 on the Nicaraguan matter is concerned, I understand that the Treasury is proceeding to license that transaction and that the only question which remains relates to the kind of a letter which you might write to the National Bank of Nicaragua to express your doubts as to the wisdom of their action in the matter. I would like to suggest that if you still contemplate writing such a letter, its dispatch should be delayed until the Policy Group has considered our general gold loan policy.

Your letter of February 3 touches on some matters which the Staff Group has informed us it already plans to study further (i.e. the charges and licensing procedures used by the Treasury in connection with international gold transactions), as well as some further subjects relating to participation of our commercial banks in foreign gold operations which would seem suitable for Staff Group consideration. I would suggest, therefore, that the Group be instructed to prepare a report on these subjects as a matter of first priority, and perhaps also to submit to us their observations on Representative Engle's bill (H.R. 1333) for releasing newly-mined gold for sale in the domestic market. I hope that this work can be completed in time for our projected meeting on gold loans with the State and Treasury Departments, but in any case the exchange of views among our respective staff members should result in our obtaining some useful guidance.

Sincerely yours,

(Signed) Marriner

M. S. Eccles,
Chairman.

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THE SECRETARY OF THE TREASURY

Washington

February 5, 1947
(Rec'd. 2/6/47)

Dear Mr. Sproul:

Careful consideration has been given to your letter of January 30, with respect to an application by the Bank of America National Trust and Savings Association, San Francisco, for a license to acquire a pledged interest in part of the gold earmarked in your vaults for account of the National Bank of Nicaragua.

As indicated in the staff memorandum attached to my letter of January 27, the Treasury Department is reluctant to use its licensing powers under the Gold Reserve Act as a means of controlling the purpose and terms of loans by commercial banks secured by earmarked gold. Accordingly, upon receiving assurance that all preliminary matters have been completed satisfactorily and that the Federal Reserve Bank of New York, the Banco Nacional de Nicaragua, and the Bank of America are prepared to carry out the proposed transaction, we are prepared to recommend to the President that an appropriate license be issued. A letter addressed to the attention of Mr. Sanford is being sent asking the Federal Reserve Bank of New York to communicate this decision to the Bank of America.

Although we do not believe that the Office of the Comptroller of the Currency would wish to question the making of this loan by the Bank of America, we do propose to advise the other members of the National Advisory Council and the U. S. Executive Director on the International Monetary Fund of the terms of the proposed loan for their information and any action which they may deem appropriate.

If the Federal Reserve Bank of New York, in view of its long-standing central banking relationships with the National Bank of Nicaragua, desires to write a letter along the lines of the draft enclosed with your letter of January 30, we perceive no objection to such a decision.

I am grateful to you for bringing this matter to my attention and I trust that our proposed line of action as indicated above, meets with your understanding and approval.

Sincerely yours,

(Signed) John W. Snyder

Secretary of the Treasury

Mr. Allan Sproul, President,
Federal Reserve Bank of New York,
New York, New York.

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COPY

M. Sproul

BANK OF ENGLAND
10th February 1947

Dear Werner;

Your letter of the 30th January regarding operations now taking place in the London Bullion Market gives me the opportunity I had been seeking to confess my anxieties about certain international developments affecting gold and exchange. I will first answer your specific questions:-

(1) Who, if anybody, is allowed to own gold in London?	Any person not resident in the United Kingdom or those parts of the Sterling Area which prohibit the holding of gold by residents, may own gold in the United Kingdom. Special limited exemption is of course granted to the gold manufacturing industry.
(2) Who is allowed to hold gold under earmark in London?	The same answer applies here as in (1). The Bank of England will, of course, only set gold aside for another Central Bank or a Monetary Authority.
(3) Are dealings in gold freely permitted?	Dealings between residents are forbidden and dealings with non-residents are only allowed with the express permission of the Bank of England. I go into greater detail later on the question of dealings.
(4) Is gold freely importable and exportable?	The importation of gold in the form of bullion or coin is free from formality. The exportation of gold in any form is subject to license.
(5) Are commercial banks free to make loans against gold? If so, are such loans still officially discouraged, as Einzig says in his Foreign Balances, London, 1938, etc., etc.?	Banks may not make advances against gold without the permission of the Bank of England. Such permission has been granted only most exceptionally in, as far as I can remember, one instance, and this was of a temporary character.
(6) Do you hold any strong views as to gold transactions carried on, etc.?	This is the most important question, and I propose to reply by giving you a short review of our policy and how we see things in the light of Bretton Woods.

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Dealers in gold in London are restricted by various clauses in the Defence (Finance) Regulations and will continue to be so restricted when the Exchange Control Bill has been passed.

There are six Authorized Dealers in gold other than the Bank of England, namely:-

Johnson Matthey & Co. Ltd.
Samuel Montagu & Co.
Mocatta & Goldsmid
Pixley & Abell
N. M. Rothschild & Sons
Sharps & Wilkins

These firms are allowed to buy gold on our behalf from residents of the United Kingdom who offer their gold to the Treasury under paragraph IV of the Defence (Finance) Regulations. This now represents a very small part of their day-to-day business. The Bank of England make gold available through these firms for resale to industry for industrial purposes. Except for licensed users and fabricators of gold those who come within the scope of the Defence (Finance) Regulations, i.e., persons resident in the U. K., are prohibited from holding gold coin or bullion for their own account. As indicated in my reply to your first question, there are certain Sterling Area countries who now permit their nationals to deal in gold, e.g., Palestine, Egypt, Iraq, etc., so that they are not disqualified from holding gold in London.

Gold held by non-residents is subject to other rules. While we are opposed to a market developing in London at prices other than the official price we do not object to a non-resident transferring his gold holding in London to another non-resident but if the transaction should involve sterling it could only be transferred to an account of the same residential status, i.e., Swiss to Swiss, French to French, etc. In these transactions we would not always know what consideration had been received by the transferor. Furthermore, a non-resident is at liberty to repatriate his gold - the necessary licence being a mere formality.

The importation of gold into the U. K. in the form of bullion or coin is, as I have already stated, free of license: on the other hand, during the past seven years there has been no inducement to hold gold on safe deposit in London and as yet there is no tendency for gold to come here on private account for safe custody. If such a tendency develops it may be necessary to consider imposing some licensing procedure or other means of keeping ourselves fully acquainted with the position. We have of course no objections to foreign deposits in London but are merely anxious to avoid the development of anything which might resemble a Black Market.

The exportation of gold in any form is subject to a license and such licences are only granted in the case of -

(1) non-residents repatriating their gold holdings:

(2) members of the Trade exporting semi- or wholly-manufactured gold articles.

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In this latter case steps are taken to ensure that such exports are not being made simply to satisfy a hoarding demand in the country to which the gold is consigned.

I now come to the general question of gold arbitrage. Free gold dealings are permitted by the relative authorities in the Middle East and India where the price is around £20 per ounce and these markets are naturally proving a great source of attraction to producers in the Western Hemisphere. Furthermore, the Indian Exchange Control are prepared to issue import licences for gold bought from what they describe as "soft" currency countries. In consequence, we have heard of small purchases of gold in New York and Mexico for resale in India by Dutch and Belgian firms and of regular purchases in New York by China and Syria. The price for these purchases in New York is around $43 per ounce, thus showing a handsome profit. Peru, Chile and Brazil where, as elsewhere, gold production costs have risen enormously, are also participants in the trade. Many of these transactions have the disturbing feature of representing a depreciation of sterling against gold.

Before the war London was an international centre for gold arbitrage and we are therefore under great pressure to allow London firms to participate in the business, but so far we have only allowed them to act as brokers taking a normal commission. If they chose to act as principals, they could only do so within the margins laid down in Article 4 Section 3 of the Bretton Woods Agreement, namely, within 1% either side of parity; this restriction, which I should add is ruthlessly administered, causes many protests among the bullion dealers.

We regard gold dealings at exotic prices as representing in many cases an implied depreciation of the currency concerned. The International Monetary Fund have discussed the question but have not yet taken a definite stand. Members of the Fund are apparently not prepared to apply the same restrictions in their own countries that we are applying here. Obviously, with gold selling through New York at $43, our 1% restriction effectively prevents British firms from engaging in the business as principals. This would not matter if our action were supported by a general policy of preventing the business from being done, but it is not, and actually such business is on the increase. This leaves us in the position of having to be deliberately unfair to British firms and leaving all the profits to third parties. We have refused, hitherto, to take a more self-regarding view because we believe our policy to be in the general international interest as there will be serious monetary consequences if dealings in gold at unofficial and varying prices should become widespread.

No irreparable harm results from the sale of the relatively small gold production of Latin America in the various "free markets" at a substantial premium. It feeds a hoarding demand and causes a minor wave of disturbance and many consequential reactions but, while it underlines the weakness of certain paper currencies, it does not necessarily damage the major currencies. During the past weeks, however, we have accumulated evidence that Canadian and, I believe,

U. S. gold producers, restive under rising costs and envious of lesser Latin American companies, have pressed heavily for permission to sell their production in "free markets". The French and Belgian Colonial producers are also on the point of receiving encouragement from their Governments to sell their production in India, China, etc. If anything of this nature occurs, the South African Government would not be able to maintain their present practice of buying all production at the existing parity and gold mines controlled from London would expect to share in this "good fortune". It will be argued that the weight of new gold offered would smash the premium and that the "free market" prices will revert to parity. I do not share this view as I am convinced that there is so much inherent suspicion of most paper currencies that a greater supply of gold will stimulate an even greater demand. The effect of a general availability of current gold production would be to put a great part of the world on a variable gold standard to the great damage of sterling and European currencies and with calamitous economic consequences from which the dollar would not escape.

The British Government will of course take up this matter through the usual channels and at some time the International Monetary Fund will have to be brought in. But I believe this question to be of sufficient interest and seriousness to give me a right to worry you with my personal views and to ask for your candid comment.

Yours sincerely,

/s/ G.L.F. Bolton

Mr. L. W. Knoke

Allan Sproul

FEDERAL RESERVE BANK OF NEW YORK

CONFIDENTIAL

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AIR MAIL

February 6, 1947.

The Baron Catto, Governor,
Bank of England,
London, England.

My dear Catto:

Supplementing Mr. Knoke's recent inquiries of Mr. Bolton, I am writing you informally to solicit your views on some of the general questions of gold policy now emerging as a result of transactions participated in by banks in this market and, to some extent, by factors in the London market. These transactions are principally connected with the gold traffic in the Near East and Far East at prices substantially above the official price here.

Two kinds of transactions have recently presented themselves which are, perhaps, of interest to both of us. (1) Some banks in this country are buying gold abroad, frequently from foreign central banks, at prices in excess of $35 per fine ounce, and selling the gold in foreign markets at a further advance in price. (2) Some banks in this country are financing the purchase and shipment of gold, bought in foreign countries by foreign (London) bullion dealers, through dollar loans.

It can be argued that these transactions are relatively small in amount, violate no laws or regulations of this country, are chiefly the concern of foreign countries and should be ignored by us. Or, it could even be argued that they contribute to the use of gold, and to flexibility in its use, which is to our advantage, and that any interference with them might cause uncertainty about the future of gold and prejudice the further restoration of international monetary stability.

I do not believe, however, that the argument can be left there. We still have a modified form of international gold standard and that would seem to require that dealing in gold as a commodity should not interfere seriously with its use as a monetary metal. This, in turn, has seemed to me to require that there be at least one fixed point of reference in the world, where there is only one price of gold in terms of domestic currency, and where the commodity aspect of gold is submerged in its monetary use. In recent years that fixed point of reference has been the United States dollar, and the fixed price of fine gold in terms of United States dollars. This suggests that we in the United States should not do anything, nor permit (if we can avoid it) our important banking institutions to do anything, which raises questions as to the stability of the United States dollar of present gold content. That is what may be at issue if important banks and houses in our principal financial centers facilitate or encourage or participate in the purchase and sale of gold abroad, for dollars, at prices different from those fixed by law in the United States. In the world's present state of political, social and economic unsettlement, it is too easy for people to believe that, because gold is being bought and sold abroad at a premium in terms of dollars, the dollar is at a discount and may soon suffer a reduction in gold content.

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There is also another aspect of the question — namely, the source of the dollars used to buy gold at premium prices. Obviously, in most cases, they are dollars which have escaped the exchange controls of various countries and, in terms of national interest, they are being dissipated in the purchase of gold for private hoarding rather than being used for the purchase of goods and equipment sorely needed or for strengthening official monetary reserves.

I do not want to overemphasize what is presently a problem of small dimensions, although it may well lead to important consequences. I am not particularly interested in the price at which gold sells abroad in so-called free markets for local currencies. It might be that, if more American gold were made available, these prices would be more stable; but I do not think we are called upon, in making gold available for international transactions, to supply gold for hoarding and as a hedge against distrusted paper currencies all over the world. These are things that can only be corrected when there has been some improvement in underlying political and economic conditions, and when it is possible to fix realistic and livable parities for the world's various currencies. I am interested in establishing policies and maintaining practices which will help provide the foundation for that restoration of monetary stability which was the reason for the establishment of the International Monetary Fund. Which suggests, of course, that these are matters with which the Fund eventually will be concerning itself. Meanwhile we, as central bankers, may be able to assist in keeping things moving in the right direction.

I should like the New York market to conform and contribute to a sound policy in this area, and I know that you would want the same of the London market. It would therefore be helpful if you could let me know how your mind runs on these questions.

Yours sincerely,

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Allan Sproul.

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Allan Sproul

February 3, 1947.

Honorable John W. Snyder,
Secretary of the Treasury,
Washington 25, D. C.

Dear Secretary Snyder:

Thank you for sending me a copy of the memorandum prepared by the Treasury staff on the question of loans on gold, which accompanied your letter of January 27, 1947. We are going over this memorandum, and will shortly communicate with you further with respect to the meeting of those interested, which I first suggested in my letter of November 8, 1946.

Meanwhile I should like to give expression to certain views intended to broaden the consideration of the whole question of gold at the policy-making level. Now that we are well into the transition stage of the postwar reconstruction period, and now that the International Monetary Fund and the International Bank for Reconstruction and Development are about to begin operations, it is timely to review the whole gold policy of this country and the legislation which affects it. Only in this way, it seems to me, can we help to give direction to the international use and treatment of gold, rather than allowing current development of practices in the market to give such direction, and thus largely to determine policy on relatively narrow grounds.

Since my earlier letter, which referred only to loans on gold to foreign borrowers by commercial banks in this country, two other aspects of the same general question of gold policy have presented themselves. First, it has come to our attention that some banks in this country are buying gold abroad, frequently from foreign central banks, at prices in excess of $35 per fine ounce, and selling the gold in foreign markets at a further advance in price. There are even indications that such business has been actively solicited by our banks. Second, and a variation of this practice, is the financing of the purchase and shipment of gold, bought in foreign countries by foreign bullion dealers, through dollar loans placed in this market. All of these transactions appear to us to be legal, at least in so far as the participation of banks in this country is concerned.

It can be argued that, at worst, these transactions are relatively small in amount, violate no laws or regulations of this country, are chiefly the concern of foreign countries and should be ignored by us. Or, at best, that they contribute to the use of gold, and to flexibility in its use, which is to our advantage as a principal holder of gold, and that any interference with them might cause uncertainty about the future of gold and prejudice the further restoration of international monetary stability. I do not believe that the argument can be left there, however.

Gold is still the monetary reserve metal of practically all countries, and it is still the accepted residual item in the settlement of international balances. At the same time, in some countries, and outside its limited use in

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industry and the arts, it is treated and dealt in as a commodity. To keep this international gold system in working order, and to insure that dealing in gold as a commodity does not interfere seriously with its use as a monetary metal, seems to me to require that there be in the world some fixed point of reference, where there is only one price of gold in terms of the domestic currency, and where the commodity aspect of gold is submerged in its monetary use. In the existing world that fixed point of reference must be the United States, the United States dollar, and the fixed price of fine gold in terms of United States dollars. That is a part of our responsibility as the most powerful economic force and as the leading commercial nation in the world, and a part of our contribution to the restoration of monetary stability.

To play this role we must first see to it, it seems to me, that there are no unnecessary obstacles to the free purchase and sale of gold in this country, at the fixed price, for the settlement of international balances. This suggests the need for a re-examination of the Gold Reserve Act of 1934 and the provisional regulations issued thereunder which, perhaps, contain such obstacles. I have in mind, for instance, the license required in connection with every purchase and sale of gold, the handling charge of 1/4 of 1% on all gold purchases and sales, and the power of the Secretary of the Treasury to vary the rates, terms, and conditions of our purchases and sales of gold at home and abroad. It may well be that the time has now come to remove or to modify these provisions of law and regulation.

There is another side to our responsibility as the fixed pole of the world's monetary system, and of the world's use of gold as a part of that system. We should not do anything, nor permit (if we can avoid it) our important banking institutions to do anything, which raises questions as to the stability of the United States dollar of present gold content. That is what may be at issue if important banks in the principal financial centers of this country facilitate or encourage or participate in the purchase and sale of gold abroad, for dollars, at prices different from those fixed by law in the United States. In the world's present state of political, social and economic unsettlement, it is too easy for the foreigner (or for our own people) to believe that, because gold is being bought and sold abroad at a premium in terms of dollars, the dollar is at a discount and may soon suffer a reduction in gold content. While such suspicions might not be altogether eliminated, by ending the participation of American banking institutions in these gold dealings, a clear affirmation of American gold price policy could do much to clear the air.

This suggests another aspect of the question -- namely, the source of the dollars used to buy gold at premium prices. Obviously, in most cases, they are dollars which have escaped the exchange controls of various countries and, in terms of national interest, they are being dissipated in the purchase of gold for private hoarding rather than being used for the purchase of goods and equipment sorely needed abroad, or for needed strengthening of official monetary reserves. In effect, whatever we do to facilitate or encourage this traffic, is also encouraging a capital flight from foreign countries and the breaching of their exchange controls.

I do not want to overemphasize what is presently a problem of small dimensions, although it may well lead to important consequences. I am not particularly interested in the price at which gold sells abroad in so-called free markets for local currencies, nor do I think we are called upon, in making gold freely available for international transactions, to supply gold for hoarding and as a hedge against distrusted paper currencies all over the world. These are things that can only be corrected when it is possible to fix realistic and livable parities for the world's various currencies. I am not particularly interested in claims of unfairness to the gold-mining industry of the United States, and I do not regard it as of importance that if our markets do not facilitate or participate in gold transactions they will be carried out in London or elsewhere, if dollars are not involved. I am interested in establishing policies and maintaining practices here which will provide the foundation for that restoration of monetary stability which is one of our international objectives. I am confident that the principal financial institutions in this market, and in other markets of the country, will follow our lead if we can give them a clear lead, applicable to all alike. It is because I want to be sure that the New York market conforms and contributes to national policy in this area that I am pressing these questions.

Yours sincerely,

Allan Sproul

Allan Sproul,
President.

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Allan Sproul

MISC. 140A—80M—5-46

FEDERAL RESERVE BANK OF NEW YORK

January 30, 1947.

Honorable John W. Snyder,
Secretary of the Treasury,
Washington 25, D. C.

Dear Secretary Snyder:

On December 24, 1946, this bank forwarded to you, for the attention of Mr. C. R. McNeill, an application by the Bank of America National Trust and Savings Association, San Francisco, for a license to acquire a pledged interest in part of the gold earmarked in our vaults for account of the National Bank of Nicaragua. Some six weeks prior I had written you a letter raising with you certain general questions of policy with respect to loans on gold. Consideration of these questions counselled delay in acting upon the application by the Treasury in the absence of urgent need for its disposition.

We understand that negotiations concerning this loan have now progressed to a point where action upon the application should soon be taken. While we merely serve as an avenue of transmission in connection with such applications, we cannot refrain in this case from expressing certain views. Quite apart from general considerations of policy with respect to loans on gold, it does not seem to us that either the purpose of this particular loan or its long-term character justifies the use of gold (and dollar balances already owned by the borrower) as collateral. On the basis of information available to us (much of it secondhand, to be sure) which was forwarded with the application, it appears that the borrowing is being done largely to meet an internal situation rather than to redress an international lack of balance. In such circumstances, an internal financing arrangement rather than the pledging of a large part of the borrowing country's external assets for a dollar loan, would seem to be the better answer. The term of the loan, which may be for as much as eight years, also seems inconsistent with the pledging of gold reserves and the payment of interest at a substantial rate. In this connection, we cannot overlook the dispatch of November 13, 1946, from our embassy in Managua to the Department of State, which indicated that a major consideration in arranging such a loan might be Nicaragua's desire to retain title to its gold in anticipation of a possible devaluation of the United States dollar. Whatever the reasons and motives, the loan sought is one which this bank, if asked, would not care to make; nor would we wish to be in the position of seeming to encourage our commercial banks to make such a loan.

In these circumstances we could not recommend favorable action on the application if our recommendation were requested. We can also appreciate, however, that the Treasury might not wish to use its licensing procedure as a means of controlling loans of this kind, and we know that there is a considerable body of opinion which holds that the widest possible use of gold should be encouraged, so long as such use does not violate the letter or the spirit of our gold legislation.

Nevertheless, it is impossible to avoid some responsibility, whatever the action taken by the Treasury; responsibility with respect to international transactions of large, private financial institutions in this country, such as the lender in this case, and responsibility with respect to neighboring American republics, such as the borrower in this case. We should like to suggest, therefore, that if the Treasury acts favorably on this application, it take steps at the same time to bring such views as we have expressed to the attention of the lender and borrower, and to recommend reconsideration of the loan. If this course commends itself to you, it might be appropriate to approach the Bank of America through the Comptroller of the Currency, since it is a national bank, and we should be willing to communicate with the National Bank of Nicaragua, with which we have had friendly relations for many years. There is enclosed a draft of the kind of letter we would send to the National Bank of Nicaragua if this procedure is followed, as I hope it will be.

Yours sincerely,

Allan Sproul

Allan Sproul,
President.

COPY

P.S. It has occurred to us that, if the International Monetary Fund were fully functioning, it might have an interest in a transaction of this kind, but perhaps it is too early in the life of the Fund to bring such a transaction to its attention.

A.S.

LWK:AS:EAV
Enclosure

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COPY

January 15, 1947.

MEMORANDUM TO THE FILES

Subject: Loans by Commercial Banks Secured by Earmarked Gold

Meeting in Mr. Schmidt's office, 9 January 1947, attended by Messrs. Friedman and McNeill of the Legal Division, and from the Division of Monetary Research, Mrs. Gold and Messrs. Schmidt, Kamarck, Ullmann, deBeers, Jenkins, Willis, Tomlinson, Hebbard, Kleiner, Eddy.

It was unanimously agreed:

(1) that it was not undesirable for the Treasury to issue licenses, with the required approval of the President, allowing gold under earmark for foreign central banks and governments in the New York Federal Reserve Bank to be pledged as security for loans by U. S. commercial banks, and

(2) that the Treasury should not officially review the terms of prospective loans for which licenses were asked and should not indicate whether the terms were satisfactory or unsatisfactory to the borrower's interest.

The propriety of such loans had been questioned in a letter from the President of the Federal Reserve Bank of New York to the Secretary of the Treasury. A previous discussion of the question was held in Mr. Overby's office some time ago.

Reasons in favor of the conclusion to issue gold licenses to secure loans are:

1. Would-be foreign borrowers evidently are ready to pledge gold to secure loans, and in the absence of compelling considerations to the contrary, the Treasury should not oppose such requests. Possible reasons why central banks may wish to pledge gold for loans are discussed in the appendix.

2. It is a general policy of the Administration to encourage foreign lending through private channels rather than to continue reliance solely upon official channels. The making of some loans secured by earmarked gold may not only remove the need for those particular loans by official lending agencies, but may also lead the way to further foreign lending by commercial banks.

3. It is the policy of the United States to encourage widespread holding of gold by foreign central banks and governments. Hence, we should not insist that gold be sold to the United States whenever a country needs to use its gold to obtain dollars.

4. The right to pledge gold to secure loans is one advantage in holding gold which should not be obliterated. It adds flexibility to international financial arrangements and reserves.

5. The usefulness of loans secured by gold for 90 days up to one year is fully recognized in the policies of the Federal Reserve Bank of New York. Particularly during the difficult period of postwar reconstruction, longer term loans on the same security may be entirely defensible.

Arguments against the loans, and the contrary arguments, were as follows:

1. It is cheaper for the borrower to sell the gold than to borrow against it. (Rejoinder: The borrowers should be allowed to decide what is in their best interest.)

2. If U. S. citizens are not allowed to hold gold to speculate on an increase in its price, central banks should not be allowed that privilege either. (Rejoinder: It is absolutely essential to the utility of the gold standard and of our own gold stock that foreign central banks own gold. Allowing them to retain ownership of gold while pledging it for loans is entirely consistent with this and, as stated above, tends /however slightly/ to foster the importance and usefulness of gold reserves.)

3. A second form of the argument that foreign central banks should not be allowed to speculate on an increase in the price of gold by borrowing against earmarked gold is as follows: It is against U. S. interests to allow them to borrow against the gold and buy goods with the borrowed dollars, and then later, if the price of gold is raised, sell the gold at the higher price and be able to buy more goods. (Rejoinder: At first glance, this seems to carry some weight, but looked at another way, the point seems questionable. By the same test, one might say that obtaining any loan abroad /except for very short periods/ while the borrowing central bank or government still owns gold, is a speculation on a rise in the price of gold. For example, if the Bank of France borrows in dollars without security for, say five years, while it still retains a relatively large gold reserve, would one properly charge them with reprehensible speculation on a rise in the price of gold? On the contrary, such a policy would probably be accepted as a standard and commendable practice. Is it then speculation if the Bank gives security for the loan by a pledge of some of its gold -- thereby incidentally obtaining a lower rate of interest?)

4. Use of gold as security for loans by commercial banks is an infraction of Treasury gold policies and may encourage demands for private ownership of gold. (Rejoinder: This use of gold is an insignificant infraction of Treasury gold policies. No U. S. private interest is allowed to obtain actual possession of gold under the proposed loans, and the foreign ownership is limited to a government or central bank. Private ownership of gold would not appear to be appreciably encouraged.)

5. The pledges of gold are likely to be accounted for faultily in the borrowing banks' balance sheets, and long-term borrowing against gold is a bad central bank policy. (Rejoinder: Enforcement of such objections, if they are valid /and in fact they appear open to question/ should be sought through other means than Treasury gold-licensing policy. It hardly seems up to the U. S. Treasury to tell the Netherlands Central Bank, or that of Uruguay, how to do its accounting or its central banking.)

6. Commercial banks may insist upon gold security for all their foreign loans. (Rejoinder: Resistance by borrowers and competition among lenders should work against this danger. Furthermore, there have been no loans by banks to most of the countries seeking the right to pledge gold for loans, so that such loans may be considered an unavoidable step toward more normal commercial bank lending abroad.)

7. In certain cases, compromising of a foreign country's present gold stock would violate the understanding upon which the U. S. Government has made loans to that country. (Rejoinder: Since each loan to be secured by gold will require a Treasury license, there will be ample opportunity to discuss each case and to take up with the foreign country any possible violation.)

G. A. Eddy.

APPENDIX: Possible Reasons why Foreign Central Banks should wish to Borrow Against Gold.

It does not appear necessary for the U. S. monetary authorities to know or agree with the reasons why the borrowers wish to borrow against gold. Possible reasons in favor of borrowing against gold rather than seeking to obtain an unsecured loan are:

(a) That the principal of the loan can be made almost riskless so that a lower interest rate can be obtained. (It is recognized that for periods up to 6 months it is now cheaper for a foreign central bank to borrow against gold at the New York Federal Reserve Bank than to pay the 1/4 of 1% charge twice on a sale and subsequent repurchase of gold.)

(b) Loans can be obtained in some cases which would not otherwise be granted at any reasonable interest rate if at all.

Possible reasons for borrowing against gold rather than selling the gold include the following:

(a) Some countries may have central banking laws calling for a certain gold cover of obligations, even though the gold is pledged as security for a loan.

(b) There may be psychological advantages in showing gold among the central bank's assets.

(c) The foreign government or central bank would receive the benefit of any increase in the dollar price of gold.

(d) Obtaining dollars as a loan against gold rather than by a sale of gold places a greater obligation on the borrower to adjust its finances in order to repay the loan. E.g., a government which induced its central bank to sell its gold to pay for an import definit would be under less pressure to achieve a repurchase of the gold than if it only borrowed on the security of the gold.

The Case of Uruguay

Uruguay presents a special case of a central bank desiring to borrow against gold, in order to obtain funds to buy more gold. The laws of Uruguay or a very firm policy of the central bank requires that the central bank at all times cover its peso obligations with peso assets or gold, whose peso valuation is subject to the laws of Uruguay. The dollar, being subject to the sovereignty of the United States, is not an acceptable asset to be held against peso liabilities, according to the principles followed by the Uruguayan Central Bank.

That Bank maintains the service of buying forward dollars from Uruguayan exporters. The Bank has been endeavoring to buy gold to avoid taking an open position on dollars, i.e,, it has paid out pesos and is holding a dollar asset against them. For over a year the Bank has been borrowing against its earmarked gold in the Federal Reserve Bank of New York in order to buy additional gold up to the amount of its holdings of forward dollars. Thereby it avoids taking any foreign exchange risk. At the insistence of the Federal Reserve Bank of New York, this facility has now been terminated because of the Federal Reserve Bank's unwillingness to maintain such a loan outstanding beyond one year.

It would seem desirable to permit Uruguay to contimme the practice of covering its peso liabilities by borrowing dollars and buying gold. This can be done either by inducing the Federal Reserve Bank to continue the gold-secured loan for Uruguay up to the amount of forward dollars in the hands of the Uruguayan bank, or by having the U. S. Stabilization Fund buy and sell forward dollars in the way the British Exchange Authorities do. Uruguay might also be able to work out commercial bank loans secured by gold to meet its needs, although this might be cumbersome.

Allan Sproul

FEDERAL RESERVE BANK OF NEW YORK

November 8, 1946.

Honorable M. S. Eccles, Chairman,
Board of Governors of the
Federal Reserve System,
Washington 25, D. C.

Dear Marriner:

Enclosed is a copy of a letter which I have today sent to the Secretary of the Treasury concerning the licensing of gold transactions. It is something in which I am sure you will be interested and which I think, as I suggested in the letter, we should discuss with the Treasury at an early date. Perhaps, meanwhile, the Staff Group on Foreign Interests should have a go at it.

Yours sincerely,

Allan Sproul

Allan Sproul,
President.

AS:EAV
Enclosure

COPY

MISC. 140A—80M—5-46

FEDERAL RESERVE BANK OF NEW YORK

November 8, 1946.

Honorable John W. Snyder,
Secretary of the Treasury,
Washington, D. C.

Dear Secretary Snyder:

There have recently been presented to us, in a variety of ways, proposals for foreign loans on gold which involve our processing applications to the Treasury for licenses which would permit lenders to acquire a pledge interest in gold which we hold in custody for foreign central banks or governments. The different forms which these approaches have taken are as follows:

(1) Application by Bankers Trust Company for a license to have approximately $5,250,000 of gold (now held under earmark at the Federal Reserve Bank of New York) belonging to Banco Central de Bolivia, which is the central bank of Bolivia, mortgaged, assigned, and transferred to Bankers Trust Company, such gold to be held at Federal Reserve Bank of New York for Bankers Trust Company. Gold to serve as security for a loan not exceeding in aggregate $5,000,000 to mature in five equal installments on 31st day of December in 1947, 48, 49, 50, and 51. Purpose of the loan is to finance the construction of an oil pipe line in Bolivia. Treasury is not proceeding with issuance of license pending further indication from Bankers Trust Company that it intends to proceed with the loan, consummation of which awaits certain legislative action in Bolivia.

(2) Application by Chemical Bank and Trust Company for a license to have approximately $5,000,000 of gold (held under earmark at Federal Reserve Bank of New York) belonging to Banco Central de Bolivia, the central bank of Bolivia, mortgaged, pledged, assigned, and transferred to Chemical Bank and Trust Company, such gold to be held at Federal Reserve Bank of New York for Chemical Bank and Trust Co. Gold to serve as security for a loan not exceeding an aggregate of $5,000,000 to mature not later than September 30, 1946, subject to possible short term renewal or renewals at option of Chemical Bank and Trust Co. Chemical Bank and Trust provided overdraft facilities to Banco de Bolivia in advance of the issuance of the license. Owing to the fact that the overdraft was retired a few days before the license was received by Federal Reserve Bank of New York from the Treasury, the license was never actually issued as Chemical Bank and Trust Co. informed Federal Reserve Bank of New York that it was no longer needed.

(3) Application by Manufacturers Trust Company, New York, for a license to have approximately $1,500,000 of gold (now held under earmark at Federal Reserve Bank of New York) belonging to National Bank of Czechoslovakia, the central bank of Czechoslovakia, transferred to an earmark account at

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the Federal Reserve Bank of New York in name of Manufacturers Trust Company and to acquire a pledge interest in such gold while so earmarked. Such gold to constitute collateral to revolving acceptance credit line of $1,500,000 to be extended by Manufacturers Trust Company to Legiobank Ltd., Prague, for financing imports from the United States and South America of raw materials and finished products into Czechoslovakia -- such credit to be available by drafts at 3 months' sight on Manufacturers Trust Company.

(4) Inquiry of Bank of America, San Francisco, with respect to steps to be taken to obtain a pledge interest in $2,000,000 of gold now held at Federal Reserve Bank of New York for account of Banco Nacional de Nicaragua, the central bank of Nicaragua, as partial security for a $4,000,000 loan which Bank of America is considering making to Banco Nacional de Nicaragua. Purpose of this loan is said to be to provide funds for the use of the Mortgage Bank. (The Mortgage Bank is an independent entity, wholly owned by the Nicaraguan Government, but it operates with funds advanced by the central bank.)

(5) Report concerning an inquiry about a loan on gold by Guaranty Trust Company to Banque Nationale de Roumanie in amount of about $100,000,000 to cover purchase of 1,000,000 tons of corn (cereals) to be shipped to Roumania owing to severe drought and consequent need for foodstuffs. Banque Nationale de Roumanie said to be ready to ship gold bars to guarantee advance. Guaranty Trust Company would want gold to be earmarked in vaults of Federal Reserve Bank of New York. Repayment of credit would require four to five years and would be accomplished by use of proceeds of future exports of wood, petroleum, and cereals.

This particular method of trying to obtain dollars seems to be spreading; conceivably it might grow to absurd proportions. I think we should review policy with respect to granting licenses which will permit such transactions, so that we may be consistent both in our treatment of foreign countries seeking loans and in our treatment of domestic institutions which are trying to consummate such loans. The gold licensing procedure affords a convenient method of controlling or preventing the practice, and I suggest that there be an early meeting to consider whether it should not be used in this way.

The matter obviously involves important questions of policy apart from our licensing procedure. We shall want to consider whether loans on gold, particularly under present conditions, which do not permit the ownership or holding of gold in this country except under license, are not wholly the business of central banks and governments, in so far as they have any justification at all. In the past such loans have been fairly common, as between central banks and governments, but it has been considered that ordinarily they were appropriate only to meet short-term (one year or less) or seasonal needs for dollars, generally associated with a crop failure, interference with shipping, unusual delays in marketing exports; and to meet urgent needs for dollars while gold was in transit. Their initial justification, I suppose, was that borrowing would prevent unnecessary shipments of gold, and that the cost of such short-term borrowing might be less than the cost of selling and repurchasing gold, when account was taken of handling charges and other fees. If dollars are needed for long periods or for capital purposes, however, it may be questioned whether a loan on gold is the appropriate vehicle for meeting the need. It can be held, of course, that credits which would not otherwise be granted or which would be granted only at high rates, may be obtained, and at low rates, if gold is pledged to secure the loan. But the dollars could also be obtained without interest cost by selling the gold, and the gold stock of the foreign country later replenished when it has the dollars available which would otherwise have to be used to repay the loan. The only cost to the foreign government or central bank then would be the 1/4 per cent handling charge imposed by the United States Treasury on purchases and sales of gold, a charge which, itself, may need reconsideration.

I have come to the conclusion that there are probably two principal reasons for this rash of inquiries concerning loans on gold, neither one of which, it seems to me, we should encourage. The first reason is the possibility of showing gold in reserves while at the same time having it pledged against a loan. Some foreign countries have done this in the past, I think, and it is bad bookkeeping, bad banking, and bad in principle. For countries still in a primitive stage of monetary and fiscal development, this practice might seem to be less disturbing to public confidence than wide fluctuations in gold reserves, but I doubt it and I also think it is no way to progress toward economic maturity.

The second reason is anticipation of a possible increase in the price of gold. A foreign borrower may consider it prudent to pay a premium, in terms of interest on a credit, in order to retain the chance of sharing in the windfall profits of an upward change in the gold price. This also is something which I question whether we should encourage or condone. We have an international gold standard, supported and made somewhat more flexible by the establishment of the International Monetary Fund. It is the responsibility of all countries, and certainly of those which are members of the Bretton Woods organizations, to conduct their affairs within this general framework and not to try to gain special advantage by betting against the house. If our goods are going to be given up to foreign countries for borrowed dollars now, why should the borrowing countries retain the chance of having an additional future call on our production by reason of a change in the price of gold, no matter how remote the possibility of such a change may be.

It may be argued, I suppose, that control or prevention of these private loans on gold is an interference with the return of international business to private channels, but if the business requires a pledge of gold held in our vaults under our special gold license, it has already departed from private channels. The business is then obviously not of the character which lends itself to the ordinary risks of private international lending and borrowing. Borrowers in such circumstances might better have recourse to the International Bank for Reconstruction and Development, or else might better sell their gold now to get the dollars they need.

It may be argued, also, that if foreign countries now give up, for dollars, gold which they accumulated during the war, they may be less likely later to try to attain an international balance which will permit them to recoup their gold sales. In other words, if currencies become reasonably stable during the next few years, some countries might decide they could do without gold in the future, leaving us holding the bag -- or the gold sack. This argument cuts both ways, however. They might equally well make this decision after they had used the gold as collateral for a loan, but if there had meanwhile been an advance in the price of gold theirs would be the advantage.

We want to be clear, of course, as to what we have in mind with respect to gold. I assume that it will not again be made free for domestic holding, purchase and sale, and that internationally it will be used mainly for settling residual balances. More and more, it seems to me, those final settlements will tend to take place within international organizations and between central banks. In that case loans on gold are not really on the pathway back to private international financial dealing. This aspect of the problem might also well be considered at the meeting which I have suggested, and which I think should include representatives of the Treasury, the Board of Governors of the Federal Reserve System, this bank, and perhaps the State Department.

Yours sincerely,

Allan Sproul

Allan Sproul,
President.

AS:EAV
cc to Chairman Eccles

COPY

Gold Problem Today-FRBNY, Foreign Research Division, 1947

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STRICTLY CONFIDENTIAL

THE GOLD PROBLEM TODAY

Federal Reserve Bank of New York
Foreign Research Division
M. A. Kriz

June 24, 1947.

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INTRODUCTION

The present statistical position of gold, which I have studied in a companion memorandum,[1/] raises several very difficult questions: (1) How great at this time is the world's need for gold? (2) If there is a real need for more gold, can the current supply be increased? (3) Is the present price appropriate? (4) Since the future of gold depends largely on the willingness of the United States to absorb it, what stake in the metal has this country?

To these questions I offer the following answer: We may either take the point of view that the need for gold is a myth, its use atavistic, and its supply irrelevant; or we may assign to gold - as we actually do in our day-to-day practice, and have the legal obligation to do under the International Monetary Fund agreement - the role of international currency which clearly it can only perform if the value of the existing stock and of the current output, is appropriate, which in turn depend primarily upon the price of gold. To treat gold as international currency and at the same time maintain its price at what I submit is an unrealistic level, wholly inadequate to ensure international liquidity, is a contradiction in terms. That we can effectively use gold as a means of international settlement only if its price is adjusted to the postwar structure of commodity prices is a proposition that I set forth in this memorandum and which moreover I should like to see discussed further since it impinges upon one of the basic economic problems that we are facing today.

1/ Cf. the mimeographed memorandum on "The Present Statistical Position of Gold," dated June 24, 1947.

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Chart

1. Conclusions

We are much concerned today about the impending dollar shortage, which threatens to develop at the turn of the year into a world-wide liquidity crisis. This prospect, together with the present statistical position of gold, leads in my opinion to the following conclusions:

1. There are two ways to prevent the impending international liquidity crisis or at least to reduce its impact. One is to abandon our drive towards multilateral world trading and relatively free and stable exchanges, and re-establish closed systems, barring the use of any international currency and resorting instead to international barter conducted through rigid exchange controls. The other way out is to extend further American financial aid to the outer world, more particularly to Western Europe.

2. Should we choose, as I believe we will, the second alternative as advocated by Secretary Marshall in his address at Harvard, there would be available to us three means of ensuring international liquidity: (1) extension of loans to foreign governments over and above those granted so far; (2) extension of outright grants; and (3) a readjustment in the price of gold. Should we overextend foreign loans, the structure of international indebtedness will, I fear, eventually collapse because there are definite limits to the transfer of interest and amortization payments. Should we make outright grants the vehicle of our financial aid, we would have to overcome the connotation of "charity," so detrimental both to the donor and to the recipient. The third device to increase the volume of international means of payment would be an all-round rise in the gold price, concerted and executed on an international plane under the International Monetary Fund. A readjustment in the price of gold would have immediate

economic and financial effects since the deficit countries would be able to meet a larger proportion of their import surpluses with the aid of their existing gold reserves and/or of their current gold production. It is, of course, no panacea for the economic ills of the world; but Canada and the United Kingdom and the sterling area, France, and other Continental Western European countries would experience an instantaneous improvement in their international-asset position. For purposes of illustration, I calculate that, should the price of gold be raised from 35 to 56 dollars per fine ounce, as was proposed in the United States Congress, the increment in official foreign gold stocks (excluding the U.S.S.R.) would be about 9 billion dollars. The gold price rise would also induce private dehoarding (which, in a country like France, could assume large proportions); and it would increase the value of the current output of gold by 300-500 million dollars in the first year, and by much more later on as the stimulus to gold production gradually resulted in greater output. Viewed in the perspective of the Administration program for Europe of 15-25 billion dollars for the next three to five years, the improvement in international liquidity through the readjustment of the gold price would therefore be a very substantial one. South America and the Far East would also benefit, while otherwise additional loans or grants would be necessary. After such a readjustment in the dollar value of the monetary gold stock, the volume of international currency could be supplemented by drawings on the International Monetary Fund and by loans from the International Bank. Outright grants would then be confined to necessitous countries. Another advantage of extending further financial aid through expanding the dollar value of the world's monetary stock would be the fact that this device is "commercial" in its essence, in contrast to outright grants which are "political." International trade and the economic system in America and abroad would, I take it, be freer in an environment of international liquidity brought about by an essentially commercial device than by an extension of governmental grants.

3. A rise in the price of gold would be but a recognition of the irrevocable facts that: (1) the price of gold has either remained unchanged in the face of a sharp increase in commodity prices or, in cases where there has been an increase in the official gold price in response to currency devaluation, it has been outstripped by the commodity price rise; (2) at the present price the output of gold will not expand to any appreciable extent; (3) there is no likelihood whatever of private dehoarding, in the West or in the East, unless the price is readjusted to the changed conditions; and (4) governments and central banks are reluctant, except when they have no choice whatever, to draw upon their present gold holdings since they expect an ultimate recognition of the world-wide depreciation of currencies through a rise in the price of gold.

4. A readjustment in the price of gold would be a logical step because within the present international financial set-up gold continues to be needed, not as a basis for domestic currency issue, but as an international means of payment. The need is all the greater since: (1) the present chaotic state of foreign trade requires large settlements in gold; (2) even when the International Monetary Fund is fully operating, settlements will still have to be made in gold, once the Fund's limited lines of credit have been fully utilized; (3) inasmuch as gold is primarily a British Empire product, the flow of current production serves to lessen the pressure on the British and Canadian balances of payments; (4) the rise in the value of international transactions makes it necessary to use greater amounts of gold to settle balances in international accounts; and (5) the increase in the money supply calls for more gold if capital movements are to be freed. 224162

5. So far, emphasis has been laid on the international aspects of the problem of gold today. The problem must, however, be also viewed in its American perspective. The present rate of our exports is higher than in any war year, when lend-lease accounted for about four fifths of our total shipments. With 10 per cent of the goods produced in this country going abroad, exports generate a portion of the national income, in industry and agriculture alike, that may be of critical importance to some branches since it may very well constitute the margin between profit and loss. Since exports cannot continue at the present level unless further financial aid is extended to foreign countries, the question may be raised as to the consequences for our domestic economy of a sudden drop in exports later this year. Were we, therefore, in an environment of an incipient recession generated by a decline in American exports, to increase the price of gold so as to sustain an appropriate level of employment, we would create at the same time a basis both for American prosperity and for international liquidity.

* * *

2. The World's Need for Gold

The extent of the world's need for gold has to be considered in terms of gold's present role. Its domestic role as a cover for currency issue belongs definitely to the past since in most countries the legal cover requirements have been either abolished or at least so reduced as not to hamper the expansion of money supply. This has been done even in the United States, where the legal requirements as to the reserves to be held by the Federal Reserve Banks were reduced in 1945 from their former level of 40 per cent in gold certificates against Federal Reserve notes in circulation and 35 per cent in gold or lawful money against deposits, to a uniform minimum of 25 per cent in gold certificates against combined note and deposit liabilities; and the hearings before the Committees on Banking and Currency of the Senate and of the House left little doubt that this was by far the most rational solution of the problem.

While it is unlikely that gold will be called on again to serve as an actual basis for currency issue, the metal continues to play a conspicuous role as the last-resort means of international settlements. It performs definite functions under the International Monetary Fund,[1/] and since the latter provides only limited lines of credit, settlement must be made in gold once these are exceeded. The demand for gold will be even greater if and when the current commercial-policy negotiations result in a return

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1/ The member countries paid part of their subscription in gold. Any member wishing to obtain directly or indirectly the currency of another member in exchange for gold must acquire such currency by selling gold to the Fund, provided that it can do so with equal advantage. Gold newly produced by mines in a member's territory may be sold by it in any market; but the Fund is ready to buy gold at any time for any currency of which it has a stock. Moreover, a member may be required to sell its currency to the Fund for gold.

to multilateral world trading. Pending the establishment of this envisaged economic order, gold continues to be called upon to settle the large balances that arise from the present chaotic state of foreign trade. Indeed, there are numerous instances of settlements in gold of the balances that have accrued under bilateral payment arrangements, and this widespread practice is a clear indication of gold's present use. Finally, after the outflow of gold from the United States during the war years, this country has commenced absorbing it again in payment of foreign purchases here.

Apart from these general reasons, more specific considerations can be invoked in ascertaining the world's gold need. Gold is predominantly a British Empire product, since about two thirds of the world output (including the U.S.S.R.) originates in the British Commonwealth.[1] To the extent that gold flows to the British monetary authorities, pressure on the British balance of payments position is lessened and the British need for direct financial aid from the United States is relieved.

Another significant measure of the need for a larger supply of gold is the increase in the monetary value of international transactions. To form an approximate idea of the inflation in the value of such transactions that has occurred since the beginning of the war, let us consider the rise in prices of the commodities entering into international trade. For this purpose, the best we can do is to use the indices of import and export prices of the two countries that figure most prominently in world trade:

1/ According to the Union Corporation, Ltd., the British Empire's percentage in world gold production (including the U.S.S.R.) is as follows:

1940	1941	1942	1943	1944	1945	1946
59.1	61.0	65.8	69.5	70.3	70.5	68.8

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INDICES OF IMPORT AND EXPORT PRICES
(1938 = 100)

	April 1947
Import Prices	
United States	230
United Kingdom:	
Unadjusted	234
Adjusted	199
Export Prices	
United States	194
United Kingdom:	
Unadjusted	221
Adjusted	190

Note: In the "adjusted" figures for the United Kingdom allowance is made for the 14 per cent depreciation of the pound sterling in terms of the dollar in 1939.

Whatever may be the discrepancies in the construction of the British and American indices, the American and the "adjusted" British figures tell a similar story: the prices of commodities entering into international trade are roughly double those before the war. Since the American price of gold has remained unchanged and the British was raised only by 13 per cent, it is clear that more gold is needed to settle the greatly increased balances arising in the international accounts.

3. The Supply Outlook

That foreign countries could use a larger supply of gold at this juncture, in spite of the International Monetary Fund and American foreign lending (both direct and indirect through the International Bank), can, therefore, be conceded. Are they, however, in a position to increase current production or to induce private dehoarding?

In the present section I shall investigate the outlook for supplies from current production and dehoarding; and in the next section, the release of gold from official currency reserves. The need for more gold is, in a sense, immediate; hence production has only a limited relevance to the problem of international liquidity. However, even under more normal long-run conditions, more gold might be needed.

The production problem is partly technical, partly economic. The mining engineers, while exploring gold-bearing areas, are mainly concerned with the quantity of ores, their location, and their content, and they formulate their forecasts in accordance with such findings. To take an example, "the most competent authorities on the Rand" produced in 1941 a calculation according to which the South African industry would continue until about 1952 to produce between 14 and 15 million fine ounces of gold per annum (equal to about 500 million dollars), after which there would be a gradual falling off to, say, 7.5 million ounces in 1970.

Such a forecast of future gold output to be valid, must be accompanied by the reservation that it is made on the basis of the existing relationships between the gold price and production costs.1/ Changes in production costs and the gold price appear, indeed, a more potent factor in determining output than the accidents of discovery of new deposits. Should

1/ How essential is such a reservation is illustrated in the following table, comparing forecasts of gold production for the decade 1930-1940 with actual output. The estimates are those presented in 1930 by the Gold Delegation of the League of Nations, one having been compiled by Mr. Joseph Kitchin, "a recognized authority on precious-metal statistics," and the other by the League of Nations Secretariat on the basis of official and semiofficial data furnished by representatives of principal producing countries. (The remainder of this footnote is on page 11)

As to the rest of the world, no recent estimates of future gold output comparable to those given above for South Africa are, to my knowledge, available.

What amounts of gold are likely to be released by hoarders, it is impossible to predict. In the West, hoarding is a highly rationalized practice in times when the price of gold is expected to rise, and since this very situation is likely to prevail in the near and intermediate future, it can hardly be expected that hoarders will release their gold at this time. The largest private hoardings among the Western nations are those held by the French; some estimates put the amount of gold in private hoards in France at the equivalent of 4 - 5 billion dollars. In the East, gold - a symbol of riches - is the traditional medium in which savings are held, and Eastern hoarding therefore increases in times of high prices and prosperity, and decreases when prices are low and savings small. It would accordingly take a large-scale depression to induce any Eastern dehoarding comparable to that of the thirties.

Both the future gold production and gold dehoarding thus depend on the future price of gold. This raises the question as to the appropriateness of the present price for ensuring supplies adequate to cover the world's gold needs.

4. The Appropriateness of the Present Gold Price

For the gold-producing countries, the view that mining costs are too high is tantamount to holding that the price of gold is too low. As was shown in my study of the present statistical position of gold, the spread between the price of gold and the cost of mining and refining is today so narrow that the profits of the gold-mining industry have declined throughout the entire world, and marginal producers are working at a loss. To some

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extent this state of affairs can be remedied by technical improvements to reduce costs and increase recoveries. The costs can also be reduced by decreasing or eliminating the tax burdens placed on gold mining;[1/] and, indeed, tax relief has recently been granted to gold mines in South Africa and Canada. In order to ensure a measure of profitability to domestic gold mines, a special gold price, higher than the equivalent of the American price, can be fixed either directly in the form of permission to the mines to sell newly mined gold at a higher price,[2/] or indirectly in the form of a subsidy.[3/] Motives for such price fixing can also be found in the apparent desire of the government and central bank authorities to prevent newly mined gold from disappearing on the black markets.

Help to the mining industry through tax relief subsidies and special official prices for gold is primarily a domestic affair. The wider problem of the appropriateness of the gold price clearly transcends, however, the present-day difficulties of the mining industry, and must be viewed from a much wider angle than the mere cost of producing gold.

1/ For example, by revising the highly technical provisions regarding the calculation of depletion allowances; by discriminating in favor of new mines or ultra-deep-level mining (as recently in South Africa); and by eliminating double taxation.

2/ In Chile the Mint has been selling gold since 1944 in official auctions at about 46 dollars per ounce. The gold used for such sales is that contained in the copper bars, concentrates, and minerals, exported from Chile to the United States and repurchased from the United States at 35 dollars per ounce.

3/ Australia, which established a subsidy on gold mining in the twenties, has lately had recourse to it again to keep the low-grade mines in operation. In Mexico a subsidy on the production of gold was established in 1944. In Chile the domestically mined gold is sold to the central bank at 15 per cent more than the official price of gold in the United States. Similarly, in Rumania domestic gold is sold to the national bank at substantial premia. In the French overseas territories premia on gold production were established in May 1947, retroactive as from January 1947.

The fundamental question is whether gold, at its present price, can perform its function as international currency. This, of course, is a very difficult question to answer. It has, however, such a direct and immediate bearing on the international liquidity that it seems to me imperative to explore the various avenues of approach to an answer.

1. That within our present international financial set-up the world has a need for gold, I showed above in Section 2; and from Section 3 I drew the conclusion that there is little likelihood of an increase in the supply of gold out of current production and private dehoarding. Some gold producers are moreover storing newly mined gold.[1/] As to the existing government and central-bank holdings, there is throughout the world an extreme reluctance to depart from gold. Even countries that have substantial gold reserves prefer incurring foreign debt to selling gold. England is the most conspicuous case of a country deliberately accumulating gold and at the same time borrowing in Canada and the United States the dollars, at least a part of which it could obtain by liquidating its gold holdings. Switzerland, Argentina, Canada, and other countries also are keeping the bulk of their currency reserves in the form of gold. Only the countries that have had no choice whatever have lately used up part of their gold holdings (France, Sweden, and the Netherlands - the latter after having borrowed a substantial sum against collateral of gold for over a year). In these conditions gold is more a medium for storing wealth than an international currency.

1/ The President of the McIntyre Porcupine Mines stated at the annual meeting of the shareholders that the company was accumulating and storing gold and that the Canadian Government had knowledge of it. This is the first company that has shown stored gold in its balance sheet; but reportedly this is a widespread practice.

2. Clearly producing countries cannot expand their output, gold producers and private investors are hoarding gold, and governments are reluctant to part with their holdings, because the present price of gold is not considered appropriate. In fact, it has either remained unchanged in the face of a sharp increase in commodity prices or in cases where there has been an increase in the official gold price in response to currency devaluation, it has been outstripped by the commodity price rise. Table I brings together the percentage changes in official prices of gold and in commodity prices, the countries being given in the order of magnitude of the former:

TABLE I

PERCENTAGE CHANGES SINCE 1937 IN THE OFFICIAL PRICE OF GOLD AND IN COMMODITY PRICES

	Price of Gold	Wholesale Prices
Sweden	- 8	+ 72 (March 1947)
United States	0	+ 71 (April 1947)
Canada	0	+ 42 (March 1947)
Argentina	0	+ 117 (March 1947)
Chile	0	+ 169 (February 1947)
Switzerland	0	+ 99 (April 1947)
United Kingdom	+ 13	+ 72 (April 1947)
Netherlands	+ 48	+ 149/ (March 1947)
Belgium	+ 49 2/	+ 232 1/ (January 1947)
France	+ 232	+ 751 2/ (March 1947)

1/ Since 1936-38.
2/ Since 1938.

In Sweden, which alone among the countries of the world has a lower official price of gold than in 1937, and in those countries where the official gold price has remained unchanged, commodity prices have increased by 50-100 per cent; elsewhere they have risen much more than the gold price. This discrepancy is not unlike that which prevailed in 1919 and 1920, when the rise in commodity prices similarly outstripped that in gold.

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3. Altogether apart from this price discrepancy, the appropriateness of the gold price can be tested by the secular movements of the price level. As is shown in the chart on the next page, commodity prices after each major war have been subject to a sharp increase, which in the late 1860's and in the early 1920's was followed by an equally sharp decline. Will the same pattern of prices repeat itself?

The chart shows commodity prices in current dollars and, for the post-devaluation years, also "in terms of gold." Although it is very difficult to interpret the significance, if any, of changes in the level of prices as reflected by a "gold" index, when the price of gold has been altered, this statistical device enables us to make two observations of interest: First, "in terms of gold" the annual average for 1946 was about at the levels of 1910 and 1931; and the estimated average for May 1947 was about at that of 1930. Secondly, if the present prices seem high to us, it is only because we make comparisons with 1939 when prices were extremely low "in terms of gold" - being indeed at about the level of the end of the nineteenth century.

Should we disregard the "gold" prices and consider only the "actual" prices as reflected by the upper line of the chart, we clearly discern that in the years 1921-28 prices remained stable at 40-60 per cent above the level prevailing before the First World War; and that between 1929 and 1932 the price level fell by fully 40 per cent. Now, as in the thirties, we have to support a heavy debt structure which can only be carried if prices are kept reasonably stable, not necessarily at the present level, but at one, say, 40 per cent above 1939. At this level prices would be high in comparison with the average of the last 75 years, and we therefore might be again confronted, in circumstances like those of the twenties, with a downward trend

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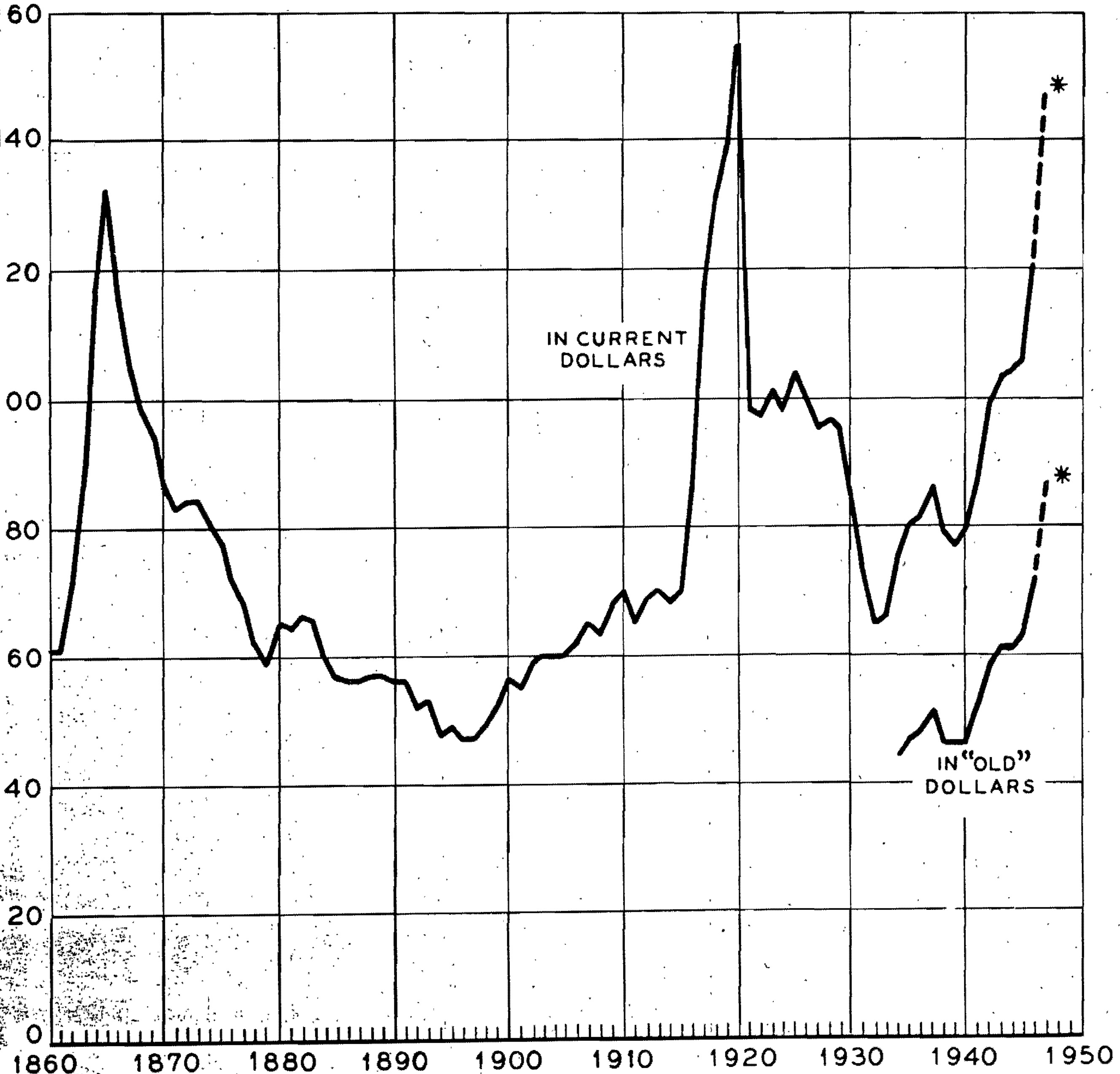
WHOLESALE PRICES IN THE UNITED STATES

(ANNUAL AVERAGES; 1926 = 100)



* AVERAGE FOR MAY 1947

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extending beyond the limits compatible with the maintenance of existing indebtedness.

4. Let me formulate in the following terms the implications of the secular price record as illustrated in the chart. The present inflationary situation is, in my opinion, a very temporary one. In the long run, deflation, not inflation, is likely to be the basic problem - with falling prices, unsold surpluses, and unemployment. The American wage and cost structure, however, is so rigid that any decline in prices, beyond one involving only the inflated profit margins, probably would be resisted by business and labor alike. The farm groups would likewise oppose any large-scale reduction in food prices. The Treasury would of course be concerned with the impact of a decline of prices on tax receipts and on the real burden of the government debt. As to those who are responsible for the over-all economic policy, they would clearly prefer policies of long-range character designed to increase the stability of the economy, rather than a downward readjustment in the price and cost structure. In such a contingency, prevailing over-all economic and monetary policies might well be reconsidered; and the question of what is the proper gold price would then be given fresh attention.

5. The American Stake in Gold

In the event that we have to face such a deflationary situation, the arguments usually invoked against an increase in the price of gold would therefore, I believe, lose their validity. Of these arguments the most important are the following.

A. The "Maldistribution" Argument

It is sometimes stated that the United States is holding a disproportionate part of the world monetary gold stock. Should the price of gold be raised, it is asserted that gold would flow in increasing quantities to the United States.

To this argument, there is a twofold answer:

First of all, the monetary gold stock of the United States seems high if attention is paid only to the recorded official reserves of the world. The picture is, however, very different if not only recorded but also centrally-held but undisclosed reserves are taken into account, as in Table II.

TABLE II

PERCENTAGE OF WORLD OFFICIAL GOLD RESERVES 1/ HELD BY THE UNITED STATES

	Percentage of Recorded Reserves 2/	Percentage of Total Reserves 3/
1920	34	
1925	44	
1930	40	
1931	37	36
1932	35	33
1933	35	31
1934	39	36
1935	47	43
1936	48	46
1937	50	49
1938	53	53
1939	70	61
1940	76	73
1941	76	72
1942	74	69
1943	70	65
1944	67	60
1945	67	57
1946	69	57

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1/ Excluding the U.S.S.R.
2/ Including disclosed holdings of the Stabilization Funds.
3/ Including, in addition to the recorded reserves, gold that has disappeared from monetary statistics.

However approximate the percentage figures given in the second column may be, they clearly indicate that in 1940 the United States possessed over 70 per cent of the world monetary gold excluding the U.S.S.R., but by 1946 only 55-60 per cent. If allowance is made for the probable Russian holdings, the United States probably is now holding only a little more than 50 per cent.

A little over half of the world gold stock held by the United States is undoubtedly a reasonable proportion. Before the depression of the early thirties, about 40 per cent of the world aggregate of national incomes was probably produced in the United States; and this country processed about 40 per cent of the world output of raw materials. At present a reasonable guess would probably weigh the United States economy as representing over one half of the entire world, including the U.S.S.R. In terms of these proportions, the American gold holdings can hardly be viewed as excessive.

There is also another angle to the argument as to the "maldistribution" of gold. Most of the gold influx to America from 1934 to 1939 was caused by the vast movements of capital from Europe to the United States. At present, similar movements of capital are precluded by the Bretton Woods Agreements and by national foreign exchange controls, with the result that such gold as the United States may be called upon to absorb in the future will primarily represent payments for goods and services sold to foreign countries in excess of goods and services that we buy from them.

The flow of gold, through which the outer world pays for its excess of expenditures here over its own sales to this country, creates domestic employment in America. It is true, of course, that in the present conditions of overfull employment, the gold influx may not be welcome. How long, however, are present conditions to last? And if we should again have inadequate employment in such industries as automobiles, machinery, etc., for which a marginal production for export ensures an over-all margin of profit, how long would we hesitate to absorb more gold?

B. The "Exchange Stability" Argument

It is further objected that a change in the price of gold would upset the existing exchange rate structure.

This assertion, however, is only valid if the change in the price of gold is unilateral, like the haphazard devaluations of the thirties. Should the price of gold be changed simultaneously throughout the world, as is possible under the Bretton Woods Agreements,[1] the prices of foreign currencies relative to each other would remain unaltered. Indeed, the exchanges would be unaffected and any hypothetical effects on the export and import trade would be reciprocally cancelled, no country obtaining an advantage over the other countries in the competition for international markets.

C. The "Subsidy to Foreigners" Argument

Raising the all-round price of gold would involve, it is finally asserted, an increase in the dollar value of the current gold output and of the existing stock of monetary gold outside the United States, with the result that so long as gold is flowing to the United States this country would have to deliver to foreign countries, for the same quantity of gold,

1/ The following is the relevant extract from Article IV, Section 7 of the Articles of Agreement:

> "...The Fund by a majority of the total voting power may make uniform proportionate changes in the par values of the currencies of all members provided each such change is approved by every member which has 10 per cent or more of the total of the quotas. The par value of a member's currency shall, however, not be changed under this provision if, within seventy-two hours of the Fund's action, the member informs the Fund that it does not wish the par value of its currency to be changed by such action."

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a substantially higher amount of dollars to finance their purchases in the United States. A higher price for gold would therefore be tantamount to a double subsidy: a grant to foreign gold producers, chiefly the British Empire, the U.S.S.R., and Latin America; and a windfall profit to governments, stabilization funds, and central banks holding the foreign stocks of monetary gold.

About ten months ago I argued in the following terms that it is in the interest of the United States to maintain the present gold price:[1/]

> "The increase in international liquidity which an increase in the price of gold would confer can equally be made good by active United States participation in the International Monetary Fund and Bank and other new agencies of international economic cooperation, and by additional direct foreign lending. It is true that the contributions to the Bretton Woods institutions and direct foreign loans are a considerable price which the United States has to pay for international economic cooperation; but, in compensation for the financial aid, the foreign countries have accepted definite commitments as regards their economic and financial policies. Should international liquidity be increased, not by providing dollars through the International Monetary Fund and through direct and indirect lending, but by the haphazard way of raising the price of gold as in the thirties, the United States would still be contributing large amounts to the outside world, but she would receive nothing in exchange. Moreover, under the Bretton Woods Agreements and under the direct loan agreements with foreign countries, the United States has established safeguards as to the use which foreign countries may make of the dollars received; on the other hand, should the remnants of the stock of monetary gold held outside the United States be expanded in terms of the U.S. dollar simply by the United States Treasury paying a higher price for gold, the United States would have no control whatever over the additional means of international payment."

The above argument still seems to me pertinent. However, it is valid only if we pursue, both domestically and internationally, such economic policies as will ensure a steady supply of dollars to the outer world. Since

1/ Cf. my memorandum on "The Price of Gold in the World Today," August 27, 1946.

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I advanced this argument, however, the situation has changed in so many respects that I wonder today whether an increase in the price of gold would not, under certain conditions, be politically more practicable and economically more efficient than an extension of American lending or of "peacetime lend-lease." In support of such a conclusion, I should like to submit the following arguments.

1. As a result of the price inflation since last summer, there has been a reduction of as much as one third in the real value of foreign monetary gold stocks, current gold production, existing dollar banking balances, the International Monetary Fund's quotas, the resources available at present to the International Bank, and the unutilized portions of the American loans granted last year. The real value of our financial aid, actual and potential, has declined accordingly.

2. The International Monetary Fund will be activated more slowly than had been expected. The size of the lines of credit that it may extend each year to member countries is limited by the Articles of Agreement; and it is further limited by the restrictive interpretation given to them in the Fund's first annual report.

3. At the present rate at which foreign countries are drawing on their available dollar credits and exhausting their dollar reserves, an acute dollar shortage impends at the turn of the year. The current deterioration of the international position of Canada, Sweden, and other countries is but a preview of a situation that will become general as soon as the recipients of American and Canadian loans have exhausted the portions thus far unspent. There are two ways to prevent the threatening international liquidity crisis, or at least reduce its impact. One is to abandon our drive towards multilateral world trading and relatively free

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and stable exchanges, and in their place re-establish closed systems, in which balances of a key currency will be used as international currency, and/or abandon the use of any international currency, resorting instead to international barter conducted through rigid exchange controls. The other way out is to continue to extend American financial aid to the outer world, more particularly to Western Europe.

4. Should we choose, as I believe we will, the second alternative, as advocated by Secretary Marshall at Harvard, there would be available to us the following three means to ensure international liquidity.

A. We could extend loans to foreign governments over and above those granted so far. Should we overextend foreign loans, the structure of international indebtedness, however, would eventually collapse because there are definite limits to the transfer of interest and amortization payments.

B. We could re-establish "lend-lease." Although Secretary Marshall has given no hints as to the form the aid to Europe would take, the Administration has presumably in mind straight grants rather than loans as the vehicle of further American financial aid. To this form of aid there are objections, from the point of view both of the donor and of the recipients, there being obvious limits to international charity.

C. Since American financial aid cannot be extended in its entirety either by straight lending or by outright gifts or even by a mere combination of the two, I wonder whether the required additional "subsidy" could not be most effectively, and with least resistance in Congress, be granted by raising the price of gold. We clearly have such a vital stake in the restoration of world economy and world peace that any "subsidy," in any form that is politically and economically expedient, should be considered.[1]

5. Let us assume, for the sake of argument, that it would prove feasible to raise the price of gold from 35 to 56 dollars per fine ounce, as was proposed in the United States Congress.[2] Since official foreign gold reserves outside the United States (excluding the U.S.S.R.) may be estimated at present at about 15 billion dollars, the U.S. dollar equivalent of the foreign gold stock would be increased to some 24 billion dollars. The windfall profit arising out of a higher price for gold would thus increase by 9 billion dollars the stock of gold eventually available as international currency. It is of course unlikely that this increment would be used in its entirety for international payments, but clearly the international economy would instantly become more liquid. Apart from the increase in official reserves, the rise in the price of gold would induce private dehoarding, which in a country like France might assume large proportions under favorable political conditions. Moreover, the value of the current output of gold would increase from 1 billion dollars a year to some 1.3-1.5 billion during the first year after the price rise and to much more in subsequent years because of the gradually expanding output.

Secretary Marshall has refrained from mentioning any figure as to the cost of his program. Various estimates emanating from the Administration, however, put the dollar outlay necessary to fill the gap in the dollar requirements of Europe at 15-25 billion dollars for the next three to five years. Viewed in this perspective, the increment in international means

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1/ A "subsidy" through a rise in the price of gold would of course be universal, instead of discriminatory as between the countries we want to help. The obvious drawback would be that the U.S.S.R., the second largest producer of gold, would automatically profit by a measure designed primarily to benefit the Western world, more particularly the United Kingdom and Continental Western Europe. The problem, however, exists in any event, although on a smaller scale, so long as the Soviet Union is in a position to obtain Western currencies by selling gold.

2/ 79th Congress, First Session, H.R. 2343 and S. 649, introduced on February 26 and 27, 1945, respectively.

of payments obtainable through the gold price rise is very substantial indeed, and although it could not do the job by itself, it would certainly reduce very substantially the necessity for outright grants. The expansion in the dollar value of the monetary gold stock could then be supplemented by the permitted drawings on the International Monetary Fund and by lending of the International Bank. It would therefore be possible to confine the outright grants to countries altogether without gold reserves or other facilities. South America and the Far East, which also have a serious dollar shortage, would likewise benefit from a readjustment in the gold price, thus avoiding further American loans and grants.

To sum up: We have the choice of extending the financial aid required for world reconstruction primarily through one of two means: outright grants, which are "political" in their essence; and a readjustment in the price of gold, which is fundamentally "commercial." Should we ensure international liquidity by raising the price of gold, we would create a propitious environment for freer world trade and a freer economic system in America and abroad by an essentially commercial device. This, it seems to me, is a decisive argument in favor of giving serious consideration to the approach to the international liquidity problem that I have developed in this paper.

MAK:DJK

RG 226 E92
B 612 F2

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33363.614

14 June 1946

TO: Mr. Walter S. Surrey, Chief
Division of Economic Security Controls
Department of State

FROM: ECONIC, SSU

SUBJECT: Tokalon case - Societe Akra

Enclosed is a copy of a report from Mr. Libich on the Tokalon case which gives additional information on the Societe Akra.

Attachment 1

Memo from JFLibich
23-5-46

Gardiner S. Platt
Chief

#1037

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SECRET FA-5820

23 May 1946

TO : Mr. Gardiner S. Platt

SUBJECT: E. Virgil Neal, Tokalon Products

1. The following is in addition to Paris cable 093 of 22 May, on which date I interviewed Mr. John F. Keane, 53 Avenue Montaigne and Mr. B. H. Gormley, 12 Avenue Emile Acollas, both of whom were administrateurs (directors) of Tokalon and both of whom are British subject of Irish nationality. Keane was a partner of Neal's for many years before the war and parted company with him in 1937, but kept his post as director of Tokalon, from which position he has never resigned. Gormley worked at Tokalon until September 1940 when he was arrested by the Germans after Neal's nephew, Mr. B. H. Reese, had unsuccessfully tried to make him resign from his post. He is convinced that Neal and Reese had him arrested by the Germans to force him out of the firm (see attached statement). He was later released by the Germans for being of Irish nationality but insists on his loyalty as a British subject. He showed some credentials from 12th Army Headquarters for work he did for them in 1944 and told me that he was just in London having his passport renewed. He and Keane seem close friends and associates. Both seem very much disgusted with the collaborationist attitude of Neal during the war and his permanent admiration of Hitler and Mussolini before the war as unbecoming an American citizen. Keane saw Neal make out checks for over three hundred thousand lire in the early 1930s for the Fascist Party. Neal was very proud of his membership in the Italian Fascist Party ~~and used to show his membership in the Italian Fascist Party~~ and used to show his membership card which was signed by Mussolini personally. He also became Commendatore of the Italian Crown and up to 1943 liked to be called by this Italian title.

2. Keane also states that Neal is eager to be removed from the British War Trade List so as to be able to sell his British holdings, evaluated at approximately three hundred and fifty thousand pounds, to an American, Mr. Charles Sweeney of the Federated Trust, London, E.C. He further states that the German, Kurt Liman, who was put in as a sort of German administrator during the war, would certainly be in a position to certify to the collaborationist activities of Neal. Liman is now residing in Baden-Baden where his French wife works as an interpreter with the French Military Government. I will try to get permission to interrogate him there.

3. Both Keane and Gormley insist that Neal was well aware and rather proud of the close association of Leandri (Mrs. Neal's friend) with the Gestapo and the SD.

4. The above is given only as background material. A third interview was held with Mr. Maurice Cola who was chief chemist of Tokalon since 1935. In 1939 he was mobilized into the French Army, taken prisoner. He returned several months later and in 1941 took up his position at Tokalon where he stayed until the liberation. He says he was disgusted with the collaborationist "goings-on" in the firm but did not

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S E C R E T

date to resign during the war as Leandri and the other chemist Frezzati would have had him arrested by the Germans if he did not behave according to their orders.

5. His story is particularly significant and interesting on the subject of the foundation of the Societe Alma. Neal, on Leandri's suggestion, founded this corporation whose only purpose was to produce shaving cream for the German Army. At Neal's order, machinery from the Tokalon firm was transported to the new factory in Boiscolomb, Seine. Frezzati was chief chemist there and trucks belonging to the SD picked up the merchandise. Cola mentioned in this connection that on May 12th 1945 he spoke with the acting manager of Tokalon in Paris, Mr. Falkner, about the Tokalon machinery still being in the Alma building and Falkner told him that he would make no claim for the return of this machinery and hopes that everybody will forget about it as soon as possible.

6. All three persons interviewed agreed that the Italian chemist Frezzati, who before the war posed as an anti-Fascist, immediately after the German occupation assumed the role of go-between for Neal and the German authorities.

7. Another close friend of Leandri's and Frezzati's is a German (possibly Alsatian) named Wirth who was one of the men employed by the German economic services in Paris. He has now opened a perfume enterprise in Nice together with Frezzati. Gormley, Keane and Cola were all very upset that the French authorities do not seem to have any intention to taking steps against Frezzati and Wirth.

Jan F. Libich /signed/
Jan F. Libich

S E C R E T

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33763.5?1

SECRET

11 May 1946

TO: Mr. Walter S. Surrey, Chief,
Economic Security Controls Division
Department of State

FROM: ECONIC, SSU

SUBJECT: Interviews with Tokalon Personnel

In accordance with our memorandum on subject dated 27 May, 1946, there are attached hereto, copies of signed statements by Keane and Gormley of Tokalon, and translations of statements prepared 19 September, 1944, by Maurice Cola, a Tokalon chemist.

The originals of these documents are on file in our office.

At this time we do not know for whom Cola's reports were originally prepared but we are informed that none of these three people have previously been approached by Allied interrogators.

Gardiner S. Platt
Chief

O. D. E.

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STRATEGIC SERVICES UNIT WAR DEPARTMENT
MISSION TO GERMANY
US Forces European Theater

APO 757

25 May 1946

TO: Mr. Gardiner S. Platt, Chief ECONIC

FROM: Jan F. Libich

SUBJECT: Virgil Neal

Ref: Cable Pari 088, and letter FA-5828; also your letter 10 May 1946

I am enclosing statements obtained from the former directors of Tokalon, Mr. John F. Keane, B. H. Gormley, and the Chemist Maurice Cola. As there are no facilities here to have the French reports translated or copied, I have no copy of them left. Irvin Mason in the Paris Embassy has been informed by me on the general lines, but has not seen the reports as he is in London.

Jan F. Libich

O. D. E.

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When B. H. Reese arrived in Paris about the 26 August 1940, he informed me that Tokalon should now profit from the presence of the Germans to manufacture as much as possible---even working all night as the Germans would be buyers and it was necessary to make contacts with them.

In October 1941 when I was in Nice Mr. Neal informed me that the German Administrator of Tokalon, Mr. Liman, whom he had seen the day before at Cannes stated: "I have seen in Gormley's dossier at the Majestic a letter against him signed by Reese." Neal said to me: "I cannot believe that of Reese, but as Leandri is here I have asked him to investigate this as Leandri is well-connected with the Majestic."

In my opinion the attitude of Neal and Reese showed a definite desire to collaborate with the Germans. Reese only acted on Neal's instructions and certainly did not act on his own initiative.

B. H. Gormley

22 May 1946

O. D. E.

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SECRET

36 Rue de Chateaudun
Paris

May 23rd,1946

My dear Libich,

The Majestic dossiers, according to the Press, are now back in France. It might be that Liman's report on Neal, etc... are in the dossier of Tokalon S.A. to which you could no doubt obtain access. No doubt this idea has occured to you already.

Faithfully yours,

John F. Keane

O. D. E.

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36 Rue de Chateaudun
Paris.

May 23rd, 1946.

Mr. Jan F. Libich
Hotel Waldorf
63 Avenue Marceau,
Paris.

My dear Mr. Libich,

(1) As requested I send you a brief note of our conversation yesterday evening in the presence of Mr. Bernard Gormley and it is understood my name will not be disclosed in connection herewith. If you desire further information I am at your disposal.

(2) Virgil Neal gave at least two sums of money totalling Lire 300.000 to Mussolini personally to put to such use as he saw fit. Neal also established a literary prize for the best article dealing with the Italian claim to dominate the Mediterranean (Mare Nostrum).

Neal became a member of the Fascist Party and his Card of Membership was signed by Mussolini personally.

(3) My last meeting with Neal was in 1941 in Monte-Carlo. I found him particularly hostile to America and England and of both countries he spoke in scathing terms. He expressed his belief in a final German Victory, advocated "Collaboration" between France and Germany as the only means of rebuilding France and extolled the idea of a United States of Europe - the then current German idea for the future of Europe.

(4) Immediately following this conversation, I met Dr. Pelckman and Mr. Kurt Limans (otherwise Karlos Limans) in the hotel lobby. Limans beckoned me to one side, said they were going up to see Neal, and added (speaking in English) "why don't you be reasonable and come in with us like Neal. You will make all the money you want." To this I made no reply. As I think you know Pelckman and Limans were at the Majestic and I knew Limans before the war.

Yours very truly,

John F. Keane O. D. E.

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25 Sept. 44

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Supplement to the report on Etienne LEANDRI (E. VIRGIL NEAL)

Leandri, since before the war, was the lover of Madame E. Virgil Neal, at present with her husband at Geneva.

E. Virgil Neal is the principal stockholder of the Tokalon company, having about 92% of the stock.

He lived in his princely residence "Le Chateau d'Azur" at Gairaut, Nice, where he lead a pompous life, well known up and down the Cote d'Azur. He had an income of 25 to 30 million francs a year. When he thought that the Germans were going to occupy the Free Zone he retired to the Hotel de Paris, Monte Carlo, where he stayed several months. His income was considerably augmented. When he no longer doubted an Allied victory, he fled to Switzerland with his wife. The Germans were supposed to have facilitated his departure and his passage across the Swiss frontier.

Leandri was received frequently at the Chateau d'Azur and at Monte Carlo. Madame Neal, who could obtain all the travel passes which she needed, visited him very often at Paris. She frequented night clubs with him in the company of Germans and of Doriot who was a very good friend of Leandri's. She stayed often with him at his residence, 53 Ave. du Marechal Foch. (See the Concierge).

It is Neal, his wife, Leandri, Prezzati and the directorate of Tokalon who engaged in the shaving soap business for the Germans. They would have liked very much to have it manufactured by Tokalon, which had the necessary installations, but they were afraid of after the war in case of an Allied victory and they decided to create a clandestine business.

The funds were advanced by Neal and his wife. Leandri was charged with starting the business and with serving as a blind for Neal who wanted to keep out of sight at any price. They naturally reaped great clandestine profits.

When everybody was in agreement, the Societe Tokalon, 183 Rue de la Pompe, Paris, began to organize the manufacture of shaving soap at 117 Rue du Marechal Joffre, at Colombes (Seine).

The directorate of Tokalon, on the order of M. and Madam Neal, organized in detail the manufacture with Prezzati. They sent the necessary machines from the Tokalon factory to Colombes: Mixing apparatus, grinders, electric motors, tube-filling machines, and various utensils as well as raw materials. As soon as the factory was ready, they put a woman

O. S. E.

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chemist of the Tokalon laboratories at Leandri's disposal in order to begin the manufacture.

As indicated previously, it is Frezzati who perfected the shaving soap and who controls its manufacture.

For the processing, filling of tubes, packaging, etc., the forewomen and the specialists of the Societe Tokalon were sent to the Colombes factory to orientate the personnel recruited by the P.P.F., Partie Populaire Francais, the chief of which was Doriot.

This business was to remain absolutely secret and the few persons of confidence who were chosen to run it had received a formal order to keep the most absolute silence under penalty of dismissal.

Leandri had his secret and official entrances at Tokalon where one could frequently see him with his great friend Frezzati. He was received very often by the directorate with which he had long conferences.

Leandri passed himself off as the confidence man of M. and Madame Neal.

Neal was supposed to have used Leandri and Frezzati for shady deals and it seems that he had an important traffic of foreign currency with the Germans.

Neal, having known that several persons were aware of his deals with Leandri and Frezzati, Wirth et Cie., and realizing that the game was up for the Germans, believed it prudent to abandon the above mentioned characters and to clear out to Switzerland.

Neal was certainly not unaware that Leandri and Frezzati were notorious collaborators.

The Leandri factory (Societe AKRA) 117 Ave. du Marechal Joffre, Colombes, was a veritable den of the P.P.F. Commandant "Antoine", the director, was a member of the P.P.F.

Neal had started a toilet soap factory in 1941 at Monte Carlo with the aid of Frezzati. A Monaco society was set up in order to evade paying taxes to the French treasury. This affair brought millions to Neal.

Neal had dumped into the coffers of the great Fascist party in Italy, several years before the war, a sum of 50,000 liras, and in gratitude, Mussolini, who had accorded him an audience, bestowed him with a decoration. He was very proud to wear it and of being called Commandatore by Frezzati. He

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was supposed to have been named Honorary Member of the Fascist party. (to be verified).

K. F. Liman (German) previously mentioned, visited him frequently at Monte Carlo as well as a German officer highly placed in the Gestapo.

In conclusion, there is no doubt that Neal knew that Leandri and Frezzati were notorious collaborators and that in any case he employed both for starting the shaving soap business.

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Prezzati, Eugenio, Italian. Age: about 37 years. Lived in France since the age of 12 or 13. Married to a French woman in 1940 or 41 with whom he lived for several years before the war. Speaks French and German perfectly.

Chemist, parfumer, employed by the Societe Tokalon, 183 rue de la Pompe 16th At. He pretends to have been captain in the Italian air corps.

He was appointed, in 1939, agent for the Fascist secret service. Later he worked as an informer for the Germans. Known in certain circles under the name of Feyrac.

Residences: 1. Main residence in Paris: 7 Rue Alexandre Cabanel (15th At.) Luxurious apartment with servents, on the top floor. It could be that he rent is not in his name (to be verified).

2. At Marseille: Small temporary lodging (address unknown).

3. At Monte Carlo, 21 Blvd. des Bas-Moulins, luxurious apartment. He made frequent self-styled trips in these last two cities for the Tokalon organization, who served as a blind, but more particularly for the account of M. Etienne Leandri (see special report attached) and for M. Wirth of the Gestapo (see below).

In 1939 he had a little job as chemist at Lesquendieu, perfumer, and lived in a modest studio 1 bis. rue du Douanier (15th At.). In July 1939 he left Lesquendieu for Tokalon as chemist at a salary of 60,000 francs a year. His salary, it seems, could have doubled since then.

At the outbreak of the war he joined the Legion Garibaldienne, as Lieutenant, knowing very well that this Legion, which was nothing official, would never leave the country. This was in order to put on the French uniform so that he could easily penetrate into military circles, making friends among the French officers, to obtain information. The movements of the French and English troops particularly interested him as well as those of the fleet.

From the very moment Prezzati joined the Legion Garibaldienne, he began to lead a pompous life and to spend without counting the cost in luxurious restaurants and the most chic night clubs, making all his trips in a beautiful car.

His wife, who was very simple, had herself decked out like a princess at the famous dressmakers, wore sumptuous dresses, precious fur coats, jewels of great value, etc. etc., His job would never certainly permit such out-of-proportion expenses with what he officially earned.

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When the Germans arrived in Paris in June 1940, he received them with open arms and didn't even take the pains to hide his game (relative to certain persons), crying out to those who wished to listen: that what had happened was good for the dirty French who had wanted to rob the poor German and the poor Italian, that we have merited a good correction and that the hour of vengeance so wished for had finally arrived. That the Germans were a splendid type, very superior to the French and that now it was we who were going to work to nourish the Germans and the Italians.

For more than three years one heard him sing the praises of the great Germany, but when the wind of the German downfall began to blow, he changed his tune, little by little, and now wished to have himself passed off as an adorer of France which he had never ceased to love, for an admirer and friend of the English and the Americans, while he had said all kinds of nasty things about them. That didn't prevent the fact that hardly a month later he was again dining with the German officers.

He tried to have himself naturalized French in 1938 and 39, but his request was rejected.

He was a notorious collaborator. Was a secret member of the great Fascist party. He is a very dangerous man, jack of all trades, a double crosser and a wheedler. Because of his great affability he knew how to hide his game with certain persons who unfortunately take him for a great friend of France while he is just the opposite.

His Contacts. A. Has not ceased to frequent German officers during all the time of the occupation and to pass whole nights with them in the cabarets. Had his small and large entrances to the Majestic, at the Villa Said, Ave. Foch, at the Chamber of Deputies, at the Cammandantur, Ave. Victor Hugo, at the Hotel Lutetia, etc. etc., and obtained all the passes he needed for him and his wife. At his home, 7 Rue Alexandre Cabanel, he received many Germans and Italians, the majority civilians. He was seen with Leandri at least two times at 93 rue Lauriston.

B. Wirth or Wirtz - intimate friend, German subject. Jack of all trades of the Gestapo, of the Hotel Majestic, of Lutetia, etc., etc. Had frequent secret interviews with him several times a week and telephoned him often. Frezzati who, by his wheedling tactics, often attracted sympathy, found means of penetrating in the French circles where Wirth could not and served him as an informer. Wirth busied himself also with purchasing for the German army and played the black market with Frezzati.

C. Nicolini, 6 Rue Picot (16th At.) Italian journalist (inflight?). This character was member of the great Fascist

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party and collaborated closely with the Germans, principally with his colleagues of the Pariser Zeitung. He was also in contact, it seems with an Italian named Morello, director of the Fiat (residence: 12 rue Piccini) who was arrested lately, then released. Frezzati was very friendly with Nicolini and visited him frequently at 6 Rue Picot. He had a long conference with him and Wirth on the 10th of August and after that one could deduce that it was Frezzati who was designated to stay at Paris and continue to serve as information agent because he was the best placed of the three.

E. Souchon, Marie-Therese, 86 Rue Lepic, Paris (18e.At.) Woman of very bad morals. Had numerous German lovers during all the time of the occupation. Worked for the Gestapo as informer. Made numerous investigations and searches with Gestapo agents. Had a permanent circulation permit for day and night. Was intimate friend of Frezzati since long before the war. He had her taken on at Tokalon as a worker, this to serve him as a blind and render her less suspicious. She was an informer for Frezzati and made a report to him every morning.

F. K. F.Liman, German, lived in France for a long time before the war. Married to a French woman. Residence: 17-21 Rue Duret (16e At.). German administrator of Societe Tokalon. Had his official office at the Chamber of Deputies and private office at rue Duret where he received many German civilians and officers,very influential persons. Was named an Honorary Nazi last January for services rendered. Agent of the Gestapo. In flight. Could be hiding in France with his wife's family.? Was to have bought in 1943 beautiful property of more than 2 million francs, but not in his name. In July and to the end of August he moved from his apartment an enormous quantity of silver, cases of fine winds, cognac and liquers as well as very beautiful furniture, in order to put them in safekeeping under the pretext that he feared the bombings. He had other furniture returned and his apartment is at present under the guard of a woman friend and her mother-in-law Madame Bompel who also occupies a small apartment at 17-21 Rue Duret that Liman used to live in himself about two years ago. It is probable that the furniture which is in this apartment belongs to him. Frezzati knew Liman very well and visited him from time to time. Liman used Frezzati for dirty work but we know from a reliable source that Liman despised him profoundly.

Frezzati could circulate freely throughout France in his very luxurious automobile (which is at Monte-Carlo now) thanks to the special permits that Wirth and Liman procured for him. It goes without saying that he was authorized to circulate with his wife at any hour of the day or night. He was bearer of a card of official buyer for the German army. It was Wirth who got this card for him.

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Frezzati is strongly suspected of having had M. Bernard H. Gormley, Manager-Director of Societe Tokalon, Irish nationality, arrested in September 1940. It was after several visits at Tokalon by Wirth, who questioned Gormley himself, that the latter was arrested and sent to St. Denis for 9 months. After a search in his office and at his private residence, 4 Rue Deleau a Neuilly, all his personal records were stolen. When he was released from St. Denis, he had nothing left. It was after steps were taken by the Minister of Ireland in France in front of Liman that Gormley was released as an Irish subject. Liman was manager of the Societe Tokalon. M. Gormley was almost shot because a trap had been set to make him seem to be a spy. It is a very long story that Mr. Gormley could tell himself if he were questioned. When Frezzati knew that Mr. Gormley had been released, he was furious about it and did everything possible to have him arrested again by affirming that he was not Irish but English. Liman feared complications with the Minister of Ireland, whom he handled with care, not wishing to tread on his toes, but during all the time of the occupation, Gormley was closely watched.

<u>Important Details</u>. A. Frezzati bought himself a very luxurious car in 1940 while a year before that he didn't have a sou.

B. He also bought in 1940 and 41 hundreds of thousand francs worth of jewels.

C. He always looked for apartments on the top floor so that he could get out onto the roof easily and quickly.

D. He was always armed.

E. Since the Allied landings he was in a great stew and it was perfectly obvious that he was far from calm.

F. Several days before the Allies got to Paris he destroyed a large amount of papers which he burned or threw down the drain.

G. He had frequent interviews with officers of the Italian armistice commission at Aix en Provence and at Marseille. He pretended to be the intimate friend of an Italian general (whose name we don't know) who was president of the armistice commission.

H. He went several times, on special invitation, to Rue des Saussaies.

<u>In Conclusion</u>. 1. There is not the shadow of a doubt that Frezzati played a double game.

2. That he was a collaborator devoted body and soul

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to the Germans.

3. That his associations, more than suspect, point him out as an active agent for the Germans and the Italians.

4. That in order to operate very smoothly he got jobs in French firms which easily served as a blind for him.

5. That it was impossible for him to lead the gay life and to spend the money he did on the official salary that he made.

6. That he played the black market with the Germans.

Other information which we have omitted.

1. According to our latest information, Frezzati was reported to have found a way to hide the greater part of his fortune.

2. He frequented clandestine gambling houses regularly.

3. He had many other extremely suspect associates but unfortunately we haven't been able to learn the names of all of the persons he visited.

4. He had friends in the French police and was supposed to have dined with Bussiere about two months ago.

5. He went regularly to the Cote d'Azur and to Marseille at least once a month.

6. He stopped going to the Cote d'Azur when Italy capitulated because he was afraid of being arrested or of being caught by the anti-Fascist Italians which he knew. He returned to Marseille, to Nice and to Monte Carlo for the last time last June. He has been gone for about a month.

7. He had a night club at Montparnasse which he sold about two years ago. We shall be able to find out the name shortly.

Paris 19 September 1944

Frezzati spoke a little English and understood it well enough. Since the arrival of the Americans he looked for all the ways he could to inform himself on all that concerned the army and to learn the troop movements. He continued to frequent the bars and night clubs and he had been seen and heard several times in the act of adroitly questioning the Americans and the French military.

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Leandri, Etienne. Age ? Claims to be 34 years. Born in Corsica. Residence: 53 Ave. du Marechal Foch (Very luxurious apartment). Procurer. Former world dancer known at Nice and at Juan-les-Pins. In flight. Was supposed to have succeeded in crossing the Swiss frontier and is supposed to be at Geneva.

Notorious collaborator. Intimate friend of Doriot. Gestapo Agent. Belonged to the gang, Spirito, Carbone, Bony, Laffont & Co. Carbone was his intimate friend. When Carbone was killed in the derailment of the Paris-Marseille train, it was Leandri who identified his body, who had it transported to Paris and who personally handled the burial. He bought over 50,000 frs. worth of flowers for him.

Leandri never went out without being armed with two automatic revolvers, and in his luxurious automobile, driven by a chauffeur, he always had two machine guns. The Germans gave him all the gas he needed and he had all the passes necessary to travel anywhere in France day or night. He made frequent trips in the Midi and on the Cote d'Azur. One often saw his car parked in front of 93 Rue Lauriston.

He was the official supply man for the German army for shaving soap in tubes.

In 1940-41 he founded a self-styled Society for the sale of a shaving cream sold under the name "Creme a Raser Olympic", then later under the trade mark "Akra". He installed a laboratory and a factory, 117 Rue du Marechal Joffre at Colombes. He had as director a Monsieur Antoine who was, it appeared, ex-commandant of the French army. Almost all the personnel belonged to the P.P.F. with rare exceptions.

He manufactured millions of tubes of shaving cream for the Germans and every month trucks full of tubes went to Germany. These tubes were sold at 30-45 francs each.

He realized enormous profits which were estimated at 30 or 40 millions. It is well known that the treasury knew nothing about it because all that was made in this affair was on the Q.T.

In order to manufacture this shaving cream, he needed, monthly, tons of stearine, oleine and glycerine. These raw materials were very rare. He organized in every detail with his associates of rue Lauriston an association for fleecing the small-town markets of enormous quantities of tallow which were sent to Ousinberche, 200 Quai de Clichy, at Clichy; to Crucq, a tallow melter at Villejust; and to a third melter whose name we unfortunately do not know, to be transformed into stearine, oleine, glycerine, and thus the trick was played.

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While the Parisians were dying of hunger and lacked fats, hundreds of tons of beautiful tallow were being used in the manufacture of shaving soap for the Germans.

What is curious in this affair is that the committee for the organization of fat procurement were aware of nothing.

For putting into practical operation the formula of his shaving soap, Leandri needed a technician. He had recourse to his great friend Eugenio Frezzati.

Frezzati was his technical consultant all the while he worked at Tokalon. He put the shaving soap in operation for him and conducted numerous researches for him, for he had the intention of manufacturing other products for the Germans and to launch a large business after the war. He continued to work for him up until the liberation of Paris. Naturally Frezzati was royally paid. (Frezzati, Eugenio, Italian, pseudonyme, Feyro, chemist of the Tokalon company. Residence: 7 Rue Alexandre Cabanel - See special report attached).

Leandri was very well known in night clubs and the smart restaurants where one met him frequently with German officers, with Frezzati and his wife, with Italians, Doriotists and friends of the Rue Lauriston.

He bragged of spending more than 25,000 francs a day and of having suits made costing 40,000 francs. He bragged also of financing Doriot.

It is Frezzati who organized in every detail the manufacture of shaving soap at Colombes. After the Allied landing, many of the machines of the factory were supposed to have been removed. M. Antoine is reported to be still there and says now that he never liked the Germans and that he is a great friend of the English and the Americans.

Leandri was also very friendly with a M. Wirth, a German, notorious Gestapo agent and purchasing agent for the German army. This Wirth was a great friend of Frezzati and it is he who introduced him to Leandri. (See special report attached on Frezzati).

Paris, 19 September 1944.

Jo-La-Terreur was also a friend of Leandri.

The ton of coal which was used to heat the church of Batignolles during the funeral of Carbone was given by Leandri and came from his factory,117 rue du Marechal Joffre at Colombes.

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WAR DEPARTMENT
OFFICE OF THE ASSISTANT SECRETARY OF WAR
STRATEGIC SERVICES UNIT
25th & E STREETS, N.W.
WASHINGTON 25, D.C.

INTEROFFICE MEMORANDUM

10 May 1946

TO: Mr. Homer Hall

FROM: ECONIC

SUBJECT: E. Virgil Neal

Confirming my telephone conversation of yesterday, will you please dispatch this letter by pouch for Libich?

G.P.

Attachment Gardiner S. Platt

SECRET

224201

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B 612 F2

33563-510

COPY

VIA POUCH

INTEROFFICE MEMORANDUM

10 May 1946

TO: Mr. Jan F. Libich

FROM: Gardiner S. Platt

SUBJECT: E. VIRGIL NEAL

An additional activity of your particular friend has just come to light in an X-2 report from London dated 14/2/46, which reads as follows:

"NEAL is reported to have offered to place his newspapers in the United States at the disposal of the Germans for propaganda purposes."

Inasmuch as we have had no indication of Neal's owning or controlling any newspapers, I went over to the State Department and discussed the matter with Mr. Hapke from Bern, who has the Neal case in hand.

Mr. Hapke informed me that Virgil Neal is the cousin of Ben Reese, Sr., owner of the St. Louis Post Dispatch, but other than that he is not sure that Neal has newspaper connections. However, he does not preclude this as a possibility in view of Neal's extreme talent in hiding his commercial activities under various cloaks, holding companies, etc. He believes that this phase of Neal's activities should be investigated because this report had come to the attention of the State Department in early 1944. In his investigation of it, Hapke ascertained that Neal wrote many letters to his cousin in St. Louis following the Nazi propaganda line as to the invincibility of the German Wehrmacht; that the Wehrmacht was the only stabilizing influence in a chaotic Europe, and the only bulwark against Communism, etc. These letters might have influenced the editorial policy of the St. Louis Post Dispatch at this crucial time, but such activity would not have represented treachery, as the letters were written prior to our entrance into the war and similar letters were, unfortunately, written by many U.S. businessmen abroad who were exposed to Nazi propaganda.

Mr. Hapke is not certain as to when he will return to Berne, so he suggests that you get in touch with Mr. Paul Blum as soon as you reach Bern and ask to see the Neal file prior to investigating this particular phase of his activity. I sincerely hope that Mr. Hapke will be there at the time of your visit, because he has the whole case at his fingertips and can point out quickly any gaps in the information which could be filled in through your efforts. He is particularly glad to know that you are trained in propaganda procedures because he thinks this skill will help you dig out the pertinent facts.

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33363-S10
X

SECRET

INTEROFFICE MEMORANDUM

10 May 1946

TO: Mr. Honor Hall

FROM: ECONIC

SUBJECT: E. Virgil Neal

Confirming my telephone conversation of yesterday, will you please dispatch this letter by pouch for Libich?

Attachment

Gardiner S. Platt

SECRET

224203

RG 226 E92
B 612 F2

SECRET

VIA POUCH **INTEROFFICE MEMORANDUM**

10 May 1946

TO: Mr. Jan F. Libich

FROM: Gardiner S. Platt - ECONIC

SUBJECT: E. VIRGIL NEAL

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224204

WAR DEPARTMENT

OFFICE OF THE ASSISTANT SECRETARY OF WAR

STRATEGIC SERVICES UNIT

25th & E STREETS, N.W.
WASHINGTON 25, D.C.

5 January 1946

TO: Major Hans V. Tofte

FROM: Commander Frank G. Wisner

SUBJECT: Safe Haven Investigations

REFERENCE: Memorandum dated 20 December from ECONIC to Chief, SI.

1. I have read reference memorandum which I return to you herewith.

2. I am favorably impressed with the program and recommendations outlined in this memorandum. They appear feasible and very sensible. However, the question arises in my mind as to just what all this has to do with SSU. The suggested program could not be implemented by SSU in Germany or elsewhere abroad.

3. The Safe Haven situation in Germany has at all times been very badly confused, with many agencies involving themselves and with much conflict and jealousy evident. The Treasury Department is probably the one most likely to make use of the recommendations contained in this memorandum, and it is therefore my suggestion that it be brought to the attention of the appropriate authorities of Treasury Department here in Washington for them to make such use of it as they see fit.

FGWisner
F.G.W.

RG 226 E92
B 612 F1

WAR DEPARTMENT
OFFICE OF THE ASSISTANT SECRETARY OF WAR
STRATEGIC SERVICES UNIT
25th & E STREETS, N.W.
WASHINGTON 25, D.C.

5 January 1946

TO: Major Hans V. Tofte

FROM: Sgt. Leo J. Falek

SUBJECT: Safe Haven Investigations

REFERENCE: Memorandum dated 20 December from ECONIC to Chief, SI

1. I fully agree with the suggestion made in the memorandum, i.e. to recruit the help of the German people in order to find Safe Haven funds. However, I have to raise some objections to the technicalities suggested out of the knowledge of the German people acquired during a 25 year residence in that country.

2. The majority of the Germans will not respond to an appeal promising financial reward for submitting Safe Haven information, from a psychological point of view.

3. Money will ~~net~~ be a sufficient incentive under the existing conditions in Germany, where people cannot buy anything.

4. While the appeal should be given full publicity, the informants should be promised that their anonymity will be guarded if desired, I feel that more information will be forthcoming that way.

5. Instead of being offered remunerations the informants should be assured of forgiveness for their Nazi-affiliations, if they were "small Nazis". This would mean assurance of livelihood and other advantages for the individual concerned. Nazis who are being held and facing trial for their activities should be promised leniency for submitting information. Since the informants involved probably are secretaries, bookkeepers, bank tellers etc., it is assumed that no major criminals are among them and this suggestion should by no means be interpreted as giving War Criminals a "carte blanche".

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33563.201

1 February 1946

TO: Mr. Herbert J. Cummings, Assistant Chief, Division of Foreign Activity Correlation, Department of State.

FROM: ECONIC, SSU

SUBJECT: Foreign representatives and employees of American Firms.

Now that American manufacturers and merchants have started to rebuild their foreign business, they will appoint many local agents, representatives, salesman, secretaries, bookkeepers, etc. They also will retain local talent, such as lawyers, technicians, etc.

As they do not have the facilities to investigate the political past of these persons, the danger is that in many cases they will employ persons whose activities and sympathies are against the security of the United States. As only firms and prominent personalities were placed on Proclaimed Lists, there is no documentary information.

Particularly in Latin America, Spain and Portugal, very often persons of German descent with language facilities possess a zeal and energy not found in the native population. Local inquiries reveal only commercial abilities and connections. Local gossip cannot be trusted.

Enemy agents will seek to penetrate United States firms by offering more attractive inducements.

As such infiltration of U.S. industry and trade by agents or sympathisers of hostile powers is very dangerous, the following measures are recommended:

(1) American firms or persons intending to employ aliens outside the United States should be invited by the Department of State to have such persons checked by the Department.

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(2) A working agreement should be arranged between SSU and the Department of State whereby SSU files should be consulted for any trace of hostile activity connected with these names. U.S. firms should not know that any agency other than the Department is advising them.

Gardiner S. Platt

Cc to Mr. Walter S. Surrey, Acting Chief,
Division of Economic Security Controls,
Department of State,
1869 Commerce Building.

Col. William P. Maddox

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CONFIDENTIAL

WAR DEPARTMENT
OFFICE OF THE ASSISTANT SECRETARY OF WAR
STRATEGIC SERVICES UNIT
25th & E STREETS, N.W.
WASHINGTON 25, D.C.

INTEROFFICE MEMORANDUM

27 February 1946

To: Chief, SI
Attention: Colonel William P. Maddox

From: ECONIC

Subject: Foreign representatives and employees of American firms

In a memorandum from this office to Mr. Herbert J. Cummings, Department of State, dated 1 February 1946, the facilities of the Econic Section were offered as a means of checking the political and war-time commercial activities of persons and firms about to be employed abroad as representatives of American firms.

Reports continue to reach us that Germans and other undesirable aliens have been successful in obtaining American representations, particularly in former neutral countries. In some cases they have used their new credentials as evidence of a clean bill of health from the Americans and have prevailed upon the foreign government in question to unblock their funds. Their new "respectability", unknowingly conferred upon them by American firms, also interferes with the carrying out of the repatriation program, as it provides the foreign government with a legitimate reason for doubting their undesirability.

In order to drive home the point to the State Department, we suggest that the field offices in former neutral countries be requested to report on instances where American representations have been granted to undesirable persons, placing special emphasis on the activities of the individual during the war and, if possible, stating the extent of the change made in his prestige and financial position as a result of his new status.

GSP

Gardiner S. Platt
Chief

CONFIDENTIAL

224209

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33563.1113

MEMORANDUM 13 November 1945

TO : Chief, SI, through Mr. Gardiner S. Platt
Chief, X-2, through Major L. M. Sharrar
Chief, Special Funds, through Mr. Emerson Bigelow
Chief, R&A, through Mr. E. K. Kirkpatrick
Chief, RR, through Lt. George B. Young

FROM : ECONIC

SUBJECT: Preliminary Intelligence Study No. 28

It is requested that you have your branch prepare a brief report, in duplicate, from material in your files on the firms and individuals named on the attached list. Request for this information has been made by the Alien Property Custodian.

Should there be material in your files which could not be removed from your office, please contact Mr. Jan Libich, ext. 2922.

For ready reference and filing purposes, kindly number your reports in accordance with the original requests from us, in this case "Intelligence Study No. 28, Subject No.______."

GP

Gardiner S. Platt

Attachment

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American Company	Possible Intermediate Owner	Suspected Beneficial Owner
1. Advance Solvents & Chemical Corp., New York, New York.	U.S. Residents.	I.G. Farbenindustrie.
2. American Bemberg Corp., American Enka Corp., North American Rayon Corp., New York, New York.	Algemeene Kunstzijde Unie, N.V., Arnhem, Netherlands.	Vereinigte Glanzstoff Fabriken, A.G., Elberfeld, Germany.
3. American Bosch Corp., Springfield, Mass.	Stockholms Enskilda Bank, Stockholm, Sweden.	Robert Bosch, G.m.b.H., Stuttgart, Germany.
4. American Potash & Chemical Corp., New York, New York.	Hope & Co., Consortium voor Internationale Financieringen (Consifi), Amsterdam, Netherlands.	Kaliwerke Salzdetfurth, A.G., Berlin, Germany. Wintershall, A.G., Kassel, Germany.
5. Herman Basch & Co., Inc., Thorer & Hollender, Inc., New York, New York.		Thorer & Co., Theodor Thorer (partnership), Leipzig, Germany.
6. E. Bilhuber, Inc., Bilhuber-Knoll Corp., Orange, New Jersey.	Knoll & Co., A.G., Liestal, Switzerland.	Knoll, A.G. Chemische Fabriken, Ludwigshafen, Germany.
7. Harvard Brewing Co., Lowell, Mass. Spur Distributing Co., Inc., Nashville, Tenn.	Uebersee Finanz-Korp., A.G., Liestal, Switzerland. Fritz von Opel (interned in U.S.A.).	Wilhelm von Opel, Marta von Opel, Ruesselsheim, Germany.
8. The Pilot Reinsurance Co. of New York, New York, New York.	Union Bank of Switzerland, Zurich, Switzerland. Union Ruckversicherungs Gesellschaft, Zurich, Switzerland. Assicurazioni Generali, Trieste, Italy. (also several Dutch and Swedish enterprises)	Munich Reinsurance Co. (Munchener Ruckversicherungs Gesellschaft), Munich, Germany.
9. William Prym, Inc., Dayville, Conn.	Hans A. Prym, Walter Conta (both United States citizens)	William Prym, G.m.b.H., Stolberg, Rhineland, Germany.
10. Rohm & Haas Co., Inc. Philadelphia, Pa.		Otto Rohm, Jr., Countess Marianne Rohm Thun-Hohenstein, Darmstadt, Germany.
11. Schering Corp., Bloomfield, New Jersey.	Chemical & Pharmaceutical Enterprises, Ltd. (Chepha), Lausanne, Switzerland.	Schering, A.G., Berlin, Germany.
12. Schloeman Engineering Corp., Pittsburgh, Pa.	Karl Feller (United States resident).	Schloeman Aktiengesellschaft, Dusseldorf, Germany.

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30 July 1945

TO : ECONIC

FROM : Chief, Division of Economic Intelligence, SI-ETO

SUBJECT: A short outline of six months' work in the Paris office of the Division of Economic Intelligence

The original concept of the Division of Economic Intelligence in Paris was based on an inquiry suggested by Dr. Robert McLeod, as to the possibilities of operating economic SI work in former Allied, as well as neutral, countries. Dr. Acheson canvassed the situation and made a report in February. On the basis of this report, the Division of Economic Intelligence was set up in March under an ETO directive. This antedated the Director's memorandum of 16 April, setting up the work on an OSS basis.

The work developed slowly, due to a paucity of personnel, but almost from the beginning certain necessary functions began to emerge. The work of the Paris office divided itself into two parts: the liaison with and briefing of other missions, e.g. Brussels and Aquitaine, on the economic aspects of SI work; and, secondly, the work of the Paris mission itself as a primary collector of economic information.

The work of the Paris office as an intelligence collection unit again sub-divided itself into a number of easily discernible functions:

1. Liaison with other Government agencies, e.g. the Embassy, U.S. GCC/Political, U.S. GCC/Financial (as well as intra-OSS liaison with R&A and X-2), and liaison with the British Embassy and SOE.

2. The direction of field men and the management of the office, including preparation of disseminations, etc.; maintenance of agents, paid and unpaid, within France; and maintenance of rear and forward echelons in London and Wiesbaden.

3. Contact with financial and business houses, both

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French and American, e.g. Rothschild, Guarantee Trust, Siemens-France, and GE.

4. Contact with French governmental agencies, especially DGER.

The liaison function within ETO demanded that the Paris office concern itself with briefing and encouraging the work along economic lines of the other missions in Western Europe. Close contact was maintained between the Paris office and the missions in MEDTO, Bern, Nice, the Aquitaine and Basque missions, Brussels and the Hague. All these missions were quite willing toward and capable of collecting economic intelligence, as long as targets were clearly delineated. Reports from these missions (with the exception of Bern) cleared through the Paris office.

The Division of Economic Intelligence received requests for information from three sources: Washington, Wiesbaden, and the American Embassy in Paris. By far the greatest amount of the work (between 75% and 80%) was done at the suggestion of the American Embassy or in following leads developed within the organization.

It became clear as the work progressed that there was a distinction between the SI job in Germany and SI's functioning within the economic field in that crescent of countries on the western periphery of Germany. Within Germany records and personnel are available for inspection and interrogation. Clandestine methods are not essential. The wealth of material now under analysis may take years to examine, and the interrogation of prominent business men, unless directed by leads found on the outside, are fruitless from the standpoint of tracing the escape of war potential. Paris was chosen as the ETO base because it formed a natural center of the crescent running from Brussels and Antwerp on the north to Turin and Milan on the south. Also, since Paris had pioneered in the work and contained more trained personnel, it was natural that the other missions should look to that center for briefing and other types of organizational suggestions. The importance of lateral communications emerged early in the experiment, and they were developed to a considerable extent. The Scandinavian countries and the Balkans were not included in this regional setup, since their normal lines of communication did not run through Paris.

The theory upon which this western crescent operated was based on covering the primary dispersal points for war potential escaping from Germany. It was planned that at least one highly trained man would be placed in each of these centers to watch, as a Washington correspondent watches, the daily flow of business and personnel through his station. Thus, capital destined for industry in northern Spain would of necessity emerge through Zurich and Barcelona, or both. A well-placed expert in the money markets of either one of those cities could easily spot both the presence of such capital and its destination.

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It was felt that such information should be correlated in one center within the crescent, which center could then brief the others on detecting the final resting place, or safehaven, of such war potential.

These men at the primary dispersal points would necessarily work under cover and would be removed if their cover were blown. By the same token, it has been most seriously urged that the organization in Paris be put under cover immediately. Such an organization could be small since, as a long-term project, the work would have to be done by contacts in the French financial circles and in the American colony, as well as by paid agents. Already some spadework has been done to discover the possibilities of placing certain men in French governmental agencies as observers of the uses made of Lend Lease materials. French Minister Raoul Dautry is interested in this suggestion. The small group of paid economic intelligence men should operate as the foreign branch of some American governmental organization. It has been suggested that the Office of the Alien Property Custodian would constitute an almost ideal cover, since the questions which would interest Alien Property Custodian are almost exactly those to which Economic Intelligence, OSS, would want the answers.

E C Acheson

Edward Campion Acheson
Chief, Division of Economic Intelligence
SI-ETO

cc: Western Europe Section, SI

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SECRET X

INTEROFFICE MEMORANDUM

26 March 1946

TO: Mr. William P. Maddox
Chief, P Branch, Office of SI

FROM: ECONIC

REF: IN Cable 34896

SUBJECT: Economic Intelligence Directive - China

We are interested in obtaining information on the following subjects:

1. Describe in detail the official Chinese organization charged with taking over and liquidating Japanese property. Who are its principal officials? How, in general, does it proceed with its functions?

2. What organization handles repatriation of the Japanese? How is it progressing with its work? If slow progress is being made what are the apparent reasons for such slowness?

3. What is the present status of large Japanese companies, such as Mitsui, and what are the plans for their liquidation or nationalization?

4. What are the rules and practices with regard to the disposition of German property as opposed to Japanese property?

5. What action has been taken or controls imposed with respect to the following German retail firms in Shanghai?

(1) Kiessling and Bader

(2) Cafe Federal

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(3) China Coffee Roasters

(4) Bayer

(5) E. Merck

(6) C. Illies & Co.

6. To what extent is Deutschen Farben-Handelsgesellschaft, Waibel and Co., now active and what sort of controls are exercised over its activities? What is the present status of the firm's directors - Gadow and Hildebrandt?

7. Tientsin Baugesellschaft is reported to have converted its name shares to bearer shares in October, 1945. Arrangements were handled by the company lawyer, Kleinschmidt. The Tah Chung Bank, which at one time was 80% German-owned, was reported to be interested in the purchase of these shares. Determine the ownership of this bank as well as the ownership of the Baugesellschaft.

8. Friedrich Fuchs, manager of Elarco Engineers and Constructors, and Victor Pereira, proprietor of the Central Agency, are reported to have collaborated in shipping German Embassy gold from Shanghai to Tientsin. Who has possession of the gold now?

9. During August, September and October, 1945, The Yokohama Specie Bank, Tientsin, is reported to have transferred 4,323,107 grams of gold to the Federal Reserve Bank next door. A Mr. Chiang, Chungking representative who has taken over the Yokohama Specie Bank, is reported to have the receipts for this gold. What disposition has been made of the gold or what is planned to be done with it?

10. It is reported that Portuguese or Chinese citizenship can be purchased in Tientsin or Shanghai. How extensive is this racket? What personalities are involved? Endeavor to provide us with specific examples of cases in point.

11. The Russians are reported to have signed a secret trade agreement with the Chinese which gives them far greater trade opportunities than American business. What are the provisions of this treaty? When and by whom was it made?

12. Is there any indication of an extensive in-flow of British capital into China?

Gardiner S. Platt
Chief

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224216

BRITISH EMBASSY,
WASHINGTON 8, D.C.

8th March, 1947.

Ref: 527/84/47

~~SECRET~~

My dear Red:

May I please refer to the meeting which you and I had with Mr. Warren, Mr. Connelly, and Denis Allen of this Embassy on Monday last, 3rd March, when we discussed the question of refugees, displaced persons and surrendered enemy personnel in Italy. After our meeting I telegraphed your views to the Foreign Office and have now received their reply.

The Foreign Office agree with your suggestion that an approach should be made now to I.G.C. asking that organisation to take over administrative responsibility for ALCOM camps with effect from 1st April, and responsibility of supply with effect from 1st May or even sooner if this should be practicable. They have informed Sir Herbert Emerson accordingly.

IGC (D)

As regards the screening to be undertaken in ALCOM camps, the Foreign Office welcome your offer that United States personnel should participate in the screening teams and hope that they can be made available very shortly. The Foreign Office are of the opinion that there will be a considerable amount of screening to be done in ALCOM camps. It appears, according to the Foreign Office's information, that I.G.C. are not in a position to get together the necessary teams of experts to carry out screening and therefore the responsibility will have to be undertaken by the two governments. The Foreign Office also hope very much that you will agree to make available any personnel you can to help in the screening of camps which are a British responsibility.

Mr. W. C. Dowling,
Assistant Chief, Division of
Southern European Affairs,
Department of State,
WASHINGTON, D. C.

/Personnel

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Personnel on the British side for this task are very short and any assistance you can provide in this respect will be most warmly welcomed, particularly if persons can be made available with the least possible delay.

The Foreign Office will agree to your paper CCAC 214/1 of 28th February on the subject of Chetniks, but His Majesty's Government would not, of course, continue to assist in maintaining those transferred to ALCOM camps after 1st May when it is suggested that I.G.C. take over supply responsibility, provided that the latter organisation find them eligible. Those who are found ineligible for I.G.C. or I.R.O. assistance will have to become again a British responsibility.

The Foreign Office promise to let us have their definitive views very shortly on United States paper CCS 657/16 which deals with the repatriation of Soviet citizens.

So far as screening definitions go, the Foreign Office suggest the following:

(A) Blacks

Persons against whom a prima facie case can be made to show that they willingly and actively collaborated with the enemy against the Allies, or committed atrocities or crimes against the Allies, and whose conduct can be shown to have been such as to justify the British or United States Governments in considering their forcible surrender to the governments of their countries of origin for trial and eventual punishment. (Separate proposals will be made for the Ukrainians).

/(B) Whites

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(B) Whites

Persons who prima facie appear likely to become the concern of I.R.O. in accordance with the terms of its constitution, when the I.R.O. is established. This may include persons who are regarded as innocent by the British or United States Governments, but who are not so regarded by the governments of their countries of origin.

(C) Greys

Persons (I) whom it has not yet been possible to screen sufficiently thoroughly to establish prima facie whether they fall under categories (A) or (B)

(II) who, after preliminary screening, appear prima facie neither eligible for international assistance under the constitution of the I.R.O. nor likely to deserve forcible repatriation.

The Foreign Office are very anxious that Brigadier Maclean should have a precise Anglo-American directive for the day-to-day operations of his mission. They only fear that issue of this by C.C.S. is likely to take considerable time and hope once agreement has been reached that it can be sent to him with all possible speed. In the meantime the Foreign Office suggest that he should continue to act on the instructions which I sent you under cover of my letter 527/14/47 of 11th February. The Foreign Office will be glad to consider any modifications to these instructions which you wish to suggest.

The I.G.C. are considering what surplus British military stocks in Italy they wish to take

/over

over and the Foreign Office promise to let us have a statement on this matter as soon as possible.

The Foreign Office have some doubts about your contention that I.G.C. should be able to resist undue pressure from governments of origin once the organisation have taken over in Italy. In any case, in view of the very short time available for screening before Treaty ratification, they remain strongly in favour of removing from danger as many as possible at any rate of those who are now a British responsibility. potential Greys They would not expect the I.G.C. to participate in such a move but screening would continue in North Africa or elsewhere, and the Foreign Office would request that any persons found to be 'White' according to our definitions would in due course receive I.G.C. or I.R.O. assistance. The Foreign Office have unfortunately no concrete progress report to make as yet about plans for the transfer to North Africa of those 'Greys' who are a British responsibility.

I should like to have a very early discussion with you and Mr. Warren about this matter so that we may decide what further steps we should now take to get the machinery for a solution working.

Yours very sincerely,

PETER

P. Solly-Flood.

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SECRET

WS-156
June 10, 1944.

EMBASSY OF THE

UNITED STATES OF AMERICA

London, May 26, 1944.

No. 15924

SUBJECT: EUROPEAN ADVISORY COMMISSION: Transmitting draft of a directive on Displaced Persons in Germany of other than German nationality

The Honorable
The Secretary of State,
Washington, D.C.

Sir:

1/ I have the honor to enclose a copy of a draft directive on Misplaced Persons in Germany of other than German nationality received informally from Sir William Strang, who intends to circulate this paper in due course to the European Advisory Commission. The draft directive has been shown to Dr. E. F. Penrose who has been concerned with some of the questions treated therein in the course of his work in London, but it would also be appreciated if the American Delegation could be furnished with such comments on the paper as the interested authorities in Washington may have to offer.

Respectfully yours,
For the Chargé d'Affaires a.i.

JACOB D. BEAM
Second Secretary of Embassy

Enclosure:
1. Draft directive as stated.

JDB/MW

224221

Secret

WS-156, Annex I
June 10, 1944.

/Enclosure No. 1 in Despatch No. 15924, of May 26, 1944, from the American Embassy at London, England/

COPY

DRAFT DIRECTIVE ON DISPLACED PERSONS

1. Your principal tasks in connection with displaced persons of other than German nationality (and in particular persons of non-German nationality brought into Germany from outside for forced labour and other purposes) will be the following:-

(a) to prevent them from attempting any premature or unregulated movements. All means of propaganda should be employed to this end;

(b) to establish camps and feeding centres in Germany for them;

(c) to establish a strict health control;

(d) to arrange for their welfare pending their departure from Germany;

(e) to ensure that remittances by displaced persons to their families out of wages or unemployment benefits are continued. For this purpose you should communicate through the appropriate channels with the authorities of the countries concerned, as payment to the beneficiaries will be made by them and ultimately dealt with in the financial settlement between Germany and each country concerned (N.B. this sub-paragraph does not apply to displaced persons of neutral or satellite nationality);

(f) to

(f) to collect necessary data regarding numbers, identity, location, nationality, original domiciles, etc., of displaced persons. Full particulars of the displaced persons and of the homes to which they wish to return should be collected as soon as possible in order to enable the authorities concerned to be consulted as to those wishes and a preliminary system of priorities to be established. Such facilities as may be practicable should be given them for communication with their families;

(g) to work out an order of priorities for the removal of these persons from Germany, having due regard to the importance of the work on which they may be engaged in Germany. For this, consultation will be necessary with the authorities of the countries concerned and with U.N.R.R.A.;

(h) to establish contact with the authorities of the receiving countries and with U.N.R.R.A. with a view to preparation for the reception of displaced persons in the areas to which they are returning. They should not be despatched from Germany until their home authorities are prepared to receive them. This may entail prior arrangements for the reception in Germany of Germans at present occupying their homes;

(j) as soon as the priorities have been established and the necessary arrangements have been made for the reception of these persons in their countries of destination, to arrange for their orderly transfer;

(k) you should approach the authorities of the countries concerned, through the appropriate channel, with a view to making arrangements for the collection by their representative of any German currency in the possession of their nationals, for its exchange, within such limits as they see fit, into other currency, and for the grant in appropriate

currencies