BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date January 28, 1947

To Chairman Eccles

From Mr. Knapp

Subject: Report No. 5, Activities of the International Monetary Fund.

Harry White has submitted to the National Advisory Council a Report No. 5 dealing with the activities of the International Monetary Fund during November and the first half of December 1946. I should like to call your attention to Item 5 in this report, which reads as follows:

"5. Temporary Investment of Fund's Gold Holdings

The United States Executive Director raised with the Executive Board the question of the investment of a portion of the Fund's gold in short-term securities of the United States Government. It was generally felt that the proposed investment could be made practically riskless, but there was some feeling that the action would be misunderstood and might impair confidence in the Fund. Since some members had reservations and since it was not necessary to make an immediate decision, it was agreed to postpone the matter."

I am very surprised that Mr. White made this proposal in the Fund's Executive Board without consulting the N.A.C. I am even more surprised that he would make such a proposal at all. Since the matter has been laid on the table, there is still time to discuss it, and I should like to make the following observations:

(1) The Fund has no express power under its Articles of Agreement to invest funds in marketable U.S. Government securities. However, although the same is true of the Bank, the Bank has gone ahead to make such investments on the basis of "implied powers" and perhaps the Fund lawyers could do the same for the Fund.

(2) Even if there were no legal problem, I question whether the Fund should be encouraged to convert its gold holdings into interest-bearing U.S. Government securities; in fact, I think the U.S. Executive Director should be instructed to oppose any such move.

It seems to me that such action by the Fund would be an abuse of this country's willingness to buy unlimited quantities of gold at a fixed price. On or before March 1, 1947 the Fund will receive about 1-1/2 billion dollars of gold from member countries, and the conversion of this gold into, say, U.S. Treasury Certificates of Indebtedness would require annual interest payments from the United States to the Fund of about 12.5 million dollars. While this is not a very large sum (and the amount would be less if only part of the Fund's gold holdings were liquidated (as suggested by Mr. White)), I should think it an entirely unwarranted imposition upon the United States.

(3) Any such move by the Fund would serve to encourage foreign countries to follow the same practice with respect to their own monetary reserves. As we noted in our December Review in the Federal Reserve Bulletin:

> "Whereas in the immediate prewar years no foreign official funds were invested in short-term paper in the United States market, at the end of August of this year 1.6 billion dollars, or more than two-fifths of total official funds, was held in United States Treasury bills and certificates. The interest return on such investments, though small, may induce some foreign monetary authorities to continue holding a significant proportion of their international reserves in this form rather than in gold."

Canada and China have each had over half of their total gold and dollar reserves invested in U.S. Government securities, and other countries have made more limited investments.

It seems to me that in principle this practice is indefensible. Foreign countries should hold their international reserves in gold (or at least in idle dollar balances). If instead they unload the gold on the United States and invest the proceeds in interest-bearing U.S. Government securities, they are shirking their part in maintaining the international gold standard.

This problem may not be too important at the present time, but any rise in short-term money rates in this country might accentuate the tendency in this direction and force us to consider ways and means of restricting foreign countries' investment of their official reserves in our market.