BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

SECRET

Office Correspondence

Date December 1, 1947

To Chairman Eccles

Subject: Canadian Gold Subsidy

From Mr. Knapp JBK

Mr. Southard called me this morning to say that a special meeting of the National Advisory Council will be held Wednesday afternoon to consider the subject covered by the attached memorandum. There is to be a meeting in his office on the matter tomorrow afternoon, and I would greatly appreciate receiving any guidance from you before that time.

Attachment

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Date December 1, 1947

To Chairman Eccles

Subject: Canadian gold subsidy

From Mr. Knapp

I should like to give you a further report concerning discussions on the Canadian gold subsidy, since this matter may soon be brought to a head (the Canadian Parliament is convening on December 5).

The Executive Directors of the International Monetary Fund held a series of meetings on this subject last week but apparently made very little progress. As I mentioned in my memorandum of November 20, although the Fund Articles of Agreement commit member countries not to pay more than the parity price for gold, whether of domestic or foreign origin, the relevant committee report of the Bretton Woods Conference states that this clause was not intended to prohibit subsidies on gold production. Some of the Fund Directors, led by Andy Overby, have been trying to insist that a subsidy stated in terms of dollars per ounce of gold really amounts to a higher price for gold and therefore is contrary to the Fund's Articles of Agreement. While they may succeed in forcing the Canadians to accept this interpretation, the Canadians could still devise other types of subsidy which would not be open to this criticism. Action by the Fund cannot, therefore, deal with this country's objection in principle to any subsidy which stimulates Canadian gold production and the sale of Canadian gold to the United States.

On Friday, November 21, Mr. Clark, Canadian Deputy Minister of Finance, met with Mr. Southard, Mr. Overby, Mr. Ness, and myself to discuss the proposed subsidy. We told Mr. Clark in the most direct terms of the grave concern in the United States Government over the proposed Canadian action. However, Mr. Clark, who had been called down from New York on short notice, was not prepared for any negotiations on this subject, and at the end of the meeting simply stated that he would report the conversation to his Government. No reaction has yet been received from Ottawa, but we expect one very shortly.

In presenting the Canadian point of view on this matter, Mr. Clark made the following points:

(1) In making the subsidy proposal in a public statement, the Canadian Minister of Finance had had no idea that there would be any serious objection from the United States. (I interpret this to mean that there may be some hope that the proposal will be withdrawn or substantially amended in view of the U.S. reaction. There would be much less prospect for such a reversal if the Minister had anticipated U.S. opposition but had nonetheless proceeded with the announcement of his proposal.)

(2) The subsidy proposal had been made primarily for domestic reasons--the fact that its adoption would contribute to the solution of Canada's dollar problem was, according to Mr. Clark, only a "happy coincidence".

(3) The domestic problems which the subsidy would alleviate are:

(a) Unemployment in certain distressed communities dependent wholly on gold mining, which was now languishing because of the squeeze between the fixed price of gold and the rising cost of operation. Mr. Clark argued that the labor in these mines could not be transferred to other industries because of the isolation of the mining communities--his rough estimate was that some 17 to 18 thousand men were employed in gold mining.

(b) The lack of incentives under present conditions for exploration and development of the northern territories in Canada. Mr. Clark argued that Canada needed "depth as well as breadth" and was anxious to expand the country northward. He stated that in the past it had been the lure of gold which had led to the opening up of the northern wilderness and that discoveries of iron and base metal mines, uranium, etc., had all resulted from the pioneering work of gold prospectors. Under present conditions this incentive was disappearing. This is a very interesting argument, but Mr. Clark had to admit under questioning that the subsidy might not make a great deal of difference. We pointed out that gold prospectors would not be going out to search for mines which would be made profitable only by the subsidy arrangement; they would always be searching for the rich "El Dorado" which would make their fortune even without the subsidy.

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Pending receipt of some word from the Canadian Government, and pending the outcome of the discussions in the International Monetary Fund, we and the Treasury people have been giving some thought to the course of action which we might take if the Canadians refuse to back down. As a minimum, we are agreed that there should be a public statement deploring the Canadian action and expressing this Government's disapproval of any form of subsidies to gold production. But should we go further and take some kind of countermeasures? The countermeasures which we have considered are:

(1) Refusal to purchase Canadian new gold production. This would be a very drastic action and very awkward to enforce; it

also might have very serious repercussions if it were interpreted around the world as a first step by the United States toward abandoning our present free gold purchase policy. In view of all of the complications and troubles which a measure of this kind might create, I am extremely doubtful whether such action is practicable or desirable.

(2) Restricting credit or other forms of aid to Canada (e.g. aid in the form of off-shore purchases under the Marshall Program). While it may be useful to threaten the use of such measures, in fact if the Canadians go ahead in spite of us, we cannot very well employ measures of this kind. Stability in Canada is very important to us not only from a political point of view but also because we want Canadian assistance in carrying out the European Recovery Program. Hence our bargaining power in this sector is not very great.

(3) Withholding gold mining machinery and supplies from Canada. It is by no means clear how much this would hamper Canadian gold production, but it would certainly do something to prevent the increase in production which might otherwise result from the institution of a subsidy. Such a measure would, of course, be much resented in Canada, but it could be justified from our point of view on the ground that equipment and materials of this kind are in very short supply and that we are anxious to see available supplies devoted to more productive purposes than the mining of gold. This countermeasure also has the advantage of dealing directly with the problem created by the gold subsidy. It should be noted, however, that Canada has hitherto been exempt from all of our export controls so that this measure would represent a sharp departure from previous practice.

(4) Appeal to the International Monetary Fund to give consideration to the whole problem of artificial stimuli to gold production whether by subsidies, tax concessions, preferential exchange rates, etc. Under this proposal the United States would announce in its public statement that we were requesting the International Monetary Fund to study these problems with a view to finding ways, by amendment of the Fund's Articles of Agreement or otherwise, to put a stop to such undesirable practices. We would also reserve our right to take such action as might seem necessary after completion of the Fund's report on the subject, thus threatening--without saying so explicitly--reconsideration of our gold purchase policy if these undesirable practices continued to be employed.

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The foregoing presentation is based on the assumption that foreign countries may be stimulating their domestic gold production for sale to the United States. It is worth considering, however, how we might feel if their purpose were rather to stimulate gold production for the purpose of reconstituting depleted monetary reserves. Suppose, for example, that the Canadians told us that, barring any unforeseen developments, they would simply add to their gold stock any increase in their gold output resulting from the subsidy. Of course they could not promise they would never use this gold, but since their gold stock is now down to only 250 million dollars, and since they are known to be anxious to rebuild it, they might well be willing to state that their intention would be not to use for external payments the increased gold output resulting from the subsidy.

It seems to me that such a statement, combined with a change in the form of the proposed subsidy so as to remove its direct implication of an increase in the price of gold, might satisfy our requirements. Treatment of the Canadian case on this basis would not prejudice our taking issue with the introduction of subsidies in other countries where the purpose (or effect) was to produce additional sales of gold to the United States. It would also leave us free to oppose demands for subsidies from our own gold miners, since we could point out to them that the gold stock of this country was already more than ample.

I do not feel very enthusiastic about this proposal mainly because of the uncertainty which would always exist as to whether additional new gold production would actually serve merely to build up foreign gold holdings. However, if an agreement could be reached with the Canadians along these lines, it might provide an answer to the present very awkward situation.