C O P Y

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

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 rush 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,

(Signed) Allan Sproul

Allan Sproul,
President.

AS:EAV
cc to Chairman Eccles