BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date March 31, 1947

To Chairman Eccles

From Mr. Knapp

Subject: Summary of Staff Group report to Policy Group concerning "Policy Problems Relating to Gold"

This report presents a discussion of various policy problems relating to gold, most of which were raised by President Sproul in his letter of February 3 to the Secretary of the Treasury. The first three questions relate to various provisions of the Gold Reserve Act of 1934 and the provisional regulations issued thereunder which limit the extent to which this country adheres to the principles of the international gold bullion standard (calling for free purchase and sale of gold at a fixed price for the settlement of international balances).

Procedure on Gold Transactions in the United States by Foreign Monetary Authorities

It is pointed out that a complicated licensing system has been in effect since 1934 covering our international gold transactions. While no change is recommended in connection with purchases of gold by the United States (some formalities must be continued if we are to pursue our announced policy of refusing to buy Axis-tainted gold), it is suggested that Treasury regulations should be amended to enable foreign monetary authorities to convert any free (i.e. unblocked) dollar balances into gold without formalities. No great merit is claimed for this proposal, except that in a general way it would more clearly demonstrate our adherence to the gold standard; the present formalities may have been needed in 1934, when they were established, in order to protect the gold stock of the United States, but no such need exists now.

The U. S. Treasury's 1/4 Per Cent Charge on Gold Transactions

Since 1934, by Treasury regulation, a 1/4 per cent charge has been levied on purchases and sales of gold. This charge has served to deter capricious shifts back and forth between gold and dollars by foreign monetary authorities and has provided revenue for the U. S. Treasury (and the U. S. Stabilization Fund). Mr. Sproul appears to feel that this charge ought to be eliminated in order to give the international gold standard a "fixed point of reference", i.e. a flat unqualified price for gold in terms of dollars. It is also argued that the elimination of the charge would remove one of the factors causing foreign countries to seek loans on gold.

The Staff Group does not make any specific recommendation with regard to this suggestion. My own feeling is that neither of the arguments for removing this charge carries any very substantial weight and that we would not be justified in recommending to the Treasury the abolition of the charge (and the loss of revenue which this would involve).

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A more limited proposal is that the 1/4 per cent charge be waived in transactions with the International Fund, and there is something to be said for this proposal if other members of the Fund agreed to follow our lead and if the Fund itself correspondingly waived charges so that we would not simply be increasing the Fund's earnings at the expense of the U. S. Treasury. This proposal has recently been discussed at some length by the U. S. Executive Director in the Fund with the N.A.C. Staff Committee and it was agreed that consideration of the problem should be deferred until there has been further development of the Fund's position on gold charges. I do not think any purpose would be served by having the Policy Group take a position on this matter at the present time.

Sections 8 and 9 of the Gold Reserve Act

These Sections appear to delegate to the Secretary of the Treasury certain administrative freedom of action in fixing the price of gold in terms of dollars (despite the fact that the President's power to alter the gold content of the dollar has expired), and this circumstance seems to have nourished some of the speculative rumors in the market concerning the likelihood of an early mark-up in the dollar price of gold. The New York Bank people seem to feel that in order to quiet some of this speculation, Sections 8 and 9 should be repealed.

Actually it is largely a fiction that Sections 8 and 9 really do give the Secretary of the Treasury any freedom of action. In the first place, the legislative history in connection with the recent changes in the Gold Reserve Act and the Bretton Woods legislation clearly indicates the intent of Congress that no change should be made in the dollar price of gold without consultation with Congress, and the Secretary of the Treasury is unlikely to ignore this fact. But even more directly he is effectively estopped from carrying out a de facto depreciation of the dollar through gold operations because of obligations which the United States has undertaken in the Articles of Agreement of the Monetary Fund. My personal conclusion, therefore, is that it would be an unnecessary catering to the unfounded sentiment in the market to enact legislation repealing Sections 8 and 9.

Gold Operations by United States Banks in Foreign Markets

A summary is given of the fragmentary information available concerning the activities of American banks in connection with gold transactions against dollars in foreign markets (such transactions in this market are, of course, illegal). Aside from the well-known fact that gold is traded in many foreign markets at premium prices in terms of local currency, there also appears to be an active market for gold against dollars in a number of countries in which premium prices are paid because of the unique value of gold for hoarding purposes and because of speculation concerning a rise in

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the official dollar price of gold. It appears that American commercial banks, although not acting as principals, have been actively engaged in arbitrage dealings in gold between foreign markets, acting as agents for foreign buyers and sellers.

Mr. Sproul is critical of our banks for engaging in these transactions, on the ground that they are thereby encouraging speculation in gold against dollars and on the ground that they are conniving in most cases in transactions which are forbidden by the exchange controls of foreign countries. Mr. Sproul feels that the banks "will follow our lead if we can give them a clear lead applicable to all alike". If such is the case, it would seem highly desirable (mainly on the second ground cited by Mr. Sproul) for the banks to be informed that the Treasury and Federal Reserve System look with disfavor upon their participation in these gold transactions.

Engle Bill Regarding Gold Transactions

Representative Engle of California has offered a bill in Congress providing that gold mined within the United States and its territories should be freely disposable on the open market in the United States. Representative Engle apparently believes that private demand for gold in this country, if permitted to become effective, would greatly exceed the supply of domestically-mined gold, and that a market premium for such gold would develop to the advantage of domestic gold producers.

The Staff Group is agreed that this proposal has serious disadvantages and that the bill should be rejected. It sees no reason for conferring a further bounty upon domestic gold production and considers that the creation of a dual-price system such as would result from the bill would stimulate undesirable speculative activities.

The discussion of the Engle bill may be taken by Mr. Sproul as an occasion for raising also the possibility of the full restoration of free dealings in gold, including free sales from the Treasury's stock and free export. Such full restoration would, of course, have an entirely different set of consequences from those of the Engle bill; whether or not desirable on grounds of general policy, it would at least eliminate the existence of speculative premium prices for gold in terms of dollars here or abroad.

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