Staff Memorandum No. 152

INTERNATIONAL MONETARY FUND

December 23, 1947

TO: Members of the Executive Board

FROM: The Secretary

SUBJECT: Gold Export at a Premium from the Philippines

The attached memorandum prepared by the staff is circulated for the information of the Executive Board.

Att: (1)

Restricted

Staff Memorandum No. 152

This Memorandum Contains
Confidential Material

RD-445

INTERNATIONAL MONETARY FUND

Research Department

Gold Export at a Premium from the Philippines

Prepared by A. Harris

Under the supervision of M. Friedberg

Approved by C. C. Liang

November 13, 1947

1. Postwar Revival of Gold Export from the Philippines

The Philippine Government announced in February, 1947, that it would permit free export and uncontrolled sales of gold in the world markets as soon as recovery of the industry permitted exports. It was further reported that export licenses, which might be discontinued at any time, would be required for all gold shipments. Mining concerns had exerted pressure, arguing that export sales at the world market price would yield foreign exchange to pay for imports and aid the rehabilitation of the gold mining industry, and that gold was not needed for the Government's currency reserve because the reserve consists of U.S. dollars. At that time it was stated in the press that $40 per ounce would permit profitable operations for many producers who at present operating costs would scarcely break even at the official price of $35 per ounce. Gold mining has been an important Philippine industry; before the war it gave direct employment to more than 37,000 men, and indirectly benefited others who serviced the mines.

A June newspaper report stated that $300,000 of gold bullion produced in the Philippines was being consigned to London. The report indicated that this gold was to be sold through London on the free market against dollars at an expected price of $38.50 to $39.00 per ounce. A later report stated that $400,000 of the Atok Gold Mining Company's March-June, 1947, production was being sold in London, and $100,000 of its output to the Far East black market.

2. The Fund's Ruling on Gold Export at a Premium and Subsequent Developments in the Philippines

On June 18, the International Monetary Fund issued its recommendations regarding the prohibition of gold sales at a premium.

In an official reply to the Fund's request (dated July 21, 1947), Mr. Miguel Cuaderno, Secretary of Finance announced that

"The Philippine Government has taken the necessary steps to control the external purchases and sales of gold at prices above parity. The Philippine Government has stopped issuing licenses covering the exportation of gold received from abroad by banks or firms here on consignment for transhipment to non-member countries. For some time now, banks operating in the Philippines have been granted licenses to export gold for transhipment to Macao, a non-member country. There are strong reasons to believe that the gold sent to Macao is sold at premium prices which might adversely affect the purpose of the Fund to maintain world exchange stability.

The Philippine Government does not deal in gold, and heretofore gold produced in the country has been allowed to be exported. Since, however, it is difficult to determine whether or not domestically produced gold exported from the Philippines is sold at premium prices abroad, and in order to cooperate with the Fund in enforcing its gold policy, hereafter we will require exporters to declare the name of the buyer, the price, and the destination of the shipment, which in all cases must be a member country. If it is the desire of the Fund, we will furnish it with copies of permits issued covering the exportation of domestically produced gold. Any further recommendations to implement the declared gold policy of the Fund will be greatly appreciated."

To this letter Mr. J. L. Fisher, acting for the Director of the Fund, replied that the cooperation of the Philippine Government was appreciated and that it would not be a useful procedure in the present circumstances to forward to the Fund copies of the permits issued for the exportation of domestically produced gold. He added that he would be pleased to speak with Mr. Cuaderno when the latter is in Washington.

A July newspaper report quoted Mr. Cuaderno as saying that the government was not imposing an embargo on gold shipments, but was refusing to permit exports consigned to Macao or any port where it was known that black market prices prevailed. Further reports mentioned sales of gold in Manila at $45 per ounce and the rumored shipment of more than $5 million from Manila to China during the first week of August, despite the Government's establishment of gold export regulations. Mr. Cuaderno had alerted customs officials to be on the lookout for an unauthorized shipment by air of 377,000 ounces of gold from Manila to Macao, and stated that requests for extension of export licenses to China had been denied by the Foreign Funds Control Section of the Department of Finance. An additional press report mentioned the arrival of a third consignment of 25,000 ounces of gold to Macao from Manila, while another stated that one shipment of 25,000 ounces was held up in Manila in accordance with the Minister's ruling that the deadline for use of previously-issued export licenses was July 18.

An Associated Press bulletin of August 10, appearing in Far Eastern newspapers, reported that an unauthorized gold shipment by air to Macao had slipped by the customs agents in Manila at 3:00 P.M. on August 8. This item came to the attention of the Far Eastern Division of the Research Department early in October and was the basis of a note written by Mr. C. C. Liang to Mr. Gardner, Acting Director of the Research Department, in which attention was called to the fact that this $2 million of gold export from the Philippines was covered by export licenses issued by the Philippine Sugar Administration, and that it slipped through the customs agents without inspection. Mr. Liang pointed out that while the earlier explanation of the continued shipments had been that they were based on licenses issued before July 19--when the new regulations prohibiting the export of gold at a premium went into effect--it was evident from this item that some irregularities still existed beyond what might be explained by previously-issued gold export licenses.

On August 20, Andres V. Castillo, correspondent of the Research Department of the Fund, addressed a cable to Mr. Bernstein as follows: "Following from Philippine correspondent: Since receipt of statement by the Fund asking Philippines to discourage transactions in gold at premium prices, our government has cancelled all outstanding export permits to export gold received here from England, United States, and Mexico for shipment to Macao through Hongkong, especially because upon inquiry discovered all shipments to those places had been at premium prices. Parties here and Hongkong claim action of our government prejudicial to them and that they should be allowed to fulfill commitments under licenses issued before receipt of Fund's statement. They claim that our government's action cancelling licenses expiring the end of this month was not in accordance with action taken by other countries which you approved. Please advise us." In view of the unofficial character of this communication, no reply was sent.

On September 4, the New York agent of the Manila firm of Swan, Culbertson, and Fritz, gold brokers, telephoned to Mr. Gardner's office the text of a cable received from his principals, as follows:

> "Yesterday morning Secretary of Finance Cuaderno, showed me a copy of the cable dispatched August 19 addressed to Dr. Bernstein, Director of Research, International Monetary Fund; Cable signed by Dr. Castillo requesting ruling on gold shipments now awaiting re-export to Macao, but no reply was received from Washington. Our covering U.S. export licenses indicated destination Manila, not Macao, because shipping documents must conform with destination of U.S. export licenses, and as no commercial transport service to Macao, therefore it is impossible to obtain through bill lading to conform with U.S. export license to Macao. It would be extremely helpful if you could contact Mr. Bernstein, pointing out that our gold shipments purchased between June 19 and July 15 were exported under U.S. treasury licenses between July 13 and August 15. The shipment was purchased and sold in good faith on the assumption that the Philippine export licenses issued to us between the dates of July 5 and July 17 would be valid. On August 7, Philippine authorities cancelled our outstanding export licenses expiring August 15 and August 15 (sic) which action places us in a very embarrassing position as we are unable to fulfill our contracts which will prove very costly. We informed Mr. Cuaderno that other member countries had now cancelled outstanding licenses. His reply was that he is unconcerned with the action of other governments, but wishes to conform to the Fund Regulations. (signed) Swan, Culbertson, and Fritz."

During the first week of September, the press reported that President Roxas had issued an order that holders of gold export licenses issued before July 19 would be allowed to make foreign shipments. It was stated in the press that an immediate reaction to this ruling was the shipment of 43,760 ounces of gold valued at $2,188,000 ($50 per ounce) on a Trans-Asiatic Airlines plane, probably to Macao, and the sale of Philippine gold to Chinese buyers at $48.50 per ounce at a Manila auction in late September.

3. Situation Prevailing in the Buyer Countries

To understand the nature, volume, and prices of Philippine gold exports, it is necessary to describe the situation prevailing in the buyer countries. Prior to February, 1947, the Central Bank of China sold gold regularly in the open market, for purpose of checking inflation, at a price up to twice as high as the official market price paid for it to the U.S. Treasury. This deflationary gold sales policy came to an end with the promulgation of the economic emergency measures of February 17. Chinese merchants nevertheless were anxiously demanding gold as a safe hedge against inflation so that fresh gold had to be imported or smuggled into the country. The Customs returns do not show these amounts as practically all gold has been carried into China illegally.

The Hongkong Government, in order to conserve dollars and to cooperate with the Chinese Government in preventing smuggling of gold into China, refused to issue any further gold import licenses after September, 1946. In April, 1947, this policy was implemented by the cancellation of outstanding transit permits for gold which were licensed for import to Macao, unless the gold was already on its way, and by the requirement of the sale of gold holdings to the government at official prices. Gold imports into Hongkong for January-June, 1947, were valued at HK$48,927,600 (US$12,231,900) for approximately 220,000 troy ounces, or $55 per ounce. The Philippines supplied HK$1,290,000 (US$322,500) of the gold imported into Hongkong. Total gold exports from Hongkong to Macao through July, 1947, were HK$50,158,800 (US$12,539,700). On the other hand, the Macao Government continues to issue gold import permits on the routine payment of license fees, and practically all gold imported into Macao has been smuggled into China.

4. Conclusions

For various reasons, both on the supply and demand side, the illegal export of gold from the Philippines at premium prices is under existing conditions well-nigh impossible to curb. As long as the official price of $35 per troy ounce is out of line with the cost of producing gold in the Philippines, where the mines need to be rehabilitated, any gold export from that country necessarily presupposes a price above par. The economic gains from gold exports at a premium are great, despite high air freight charges. Domestic sales of gold at premium prices are tolerated; other sources of supply, e.g., Mexico, have been cut off.

So long as the Chinese inflation continues to encourage private gold hoarding, there will always be a demand for gold at far above the official market price. Moreover, the existence of the two free ports, Hongkong and Macao, makes smuggling into China possible, if not easy. A solution of this problem is not in sight, but if any substantial headway is to be made against these illegal exports, the increased cooperation of the several governments concerned will be necessary.