Executive Board
Memorandum No. 70

INTERNATIONAL MONETARY FUND

May 23, 1947

TO: Members of the Executive Board

FROM: The Secretary

SUBJECT: External Sales of Gold

Attached is a memorandum on the external sales of gold which Mr. Martinez-Ostos has prepared. It will be considered at the meeting of Tuesday.

Att: (1)

Other Distribution:
Department Heads

EXTERNAL SALES OF GOLD

Prepared by Raul Martinez-Ostos

1. The wording of Article IV, Section 2 of the Fund Agreement is obviously clear and seems to indicate that a member country desiring to sell gold to another member at a price above parity plus the prescribed margin will be prevented from doing so by the regulation forbidding members to purchase gold above that limit, but it should be kept in mind that the term "member" includes only the government, fiscal agencies and central bank, as concluded in Executive Board Document No. 52 (prepared by the Legal Department on August 7, 1946). Why, then, did not the authors of the Agreement plainly prohibit members from selling gold above par plus the margin, and/or why did they not use language similar to Article IV, Section 3(i)? Those who attended the Bretton Woods Conference will clearly recall that the reasons for the rather peculiar phraseology used in that provision were the viewpoints presented by some countries interested in maintaining and developing gold mining without interfering with the purposes established by the Fund Agreement. In the minutes of Committee 1 Commission I of that Conference the following comment is found:

> "In accepting this language the Committee felt that member countries were not excluded thereby from giving special encouragement to the gold mining industries for purely domestic reasons by means other than paying a higher price for gold." (Document No. 326, July 12, 1944)

Furthermore, the Third Report of the Reporting Delegate of Committee 1 Commission I on "The Purposes, Policies and Quotas of the Fund", contains the following paragraph:

> "Article IX, Alternative A, Section 2. (Page 38 of SA/1)
>
> The Drafting Committee proposed and the Committee accepted the following wording of this Section:
>
> 'The Fund shall prescribe for transactions in gold by member countries a permissible margin above and below the agreed parity. No member country shall buy gold at a price above the prescribed range, nor sell gold at a price below that range.'
>
> The Committee felt that this wording reconciled the different views and tendencies.
>
> Under this clause, member countries are permitted to buy gold below this range and to sell above the range. On the other hand they are not prevented from following domestic policies of encouraging local gold mining industries by means other than paying a higher price for gold." (Document No. 343, July 13, 1944)

If the authors of the Articles of Agreement had in mind the possibility of member countries selling gold above parity plus margin as a means of developing the gold mining industry, they apparently foresaw the possibility that these transactions would be of an international character, since the demand in domestic markets of gold producing countries is not a sufficient incentive for producing gold. This possibility is openly recognized in Article V, Section 6(b).

There is, thus, an undeniable fact arising both from the wording of Article IV, Section 2 of the Fund Agreement and the proceedings of the Bretton Woods Conference: Article IV, Section 2 of the Fund Agreement as it stands is a compromise between on the one hand the tendencies favoring the exclusive dealings in gold by central banks, and on the other hand the old and deep-rooted fact that an international market for gold arises from the habits of hoarding the metal, which is one of the stimuli that have maintained and encouraged the gold mining industry. There is also evidence in the previous quotations of the undeniable intention of the authors of the Fund Agreement to permit members to sell gold above parity plus the margin in such a market as long as those transactions do not actually contradict the purposes of the Fund Agreement.

2. Under such conditions, members may either (a) permit gold imports by individuals at any price if the receiving nation does not fear the effects on its exchange position or reserve, or (b) prohibit gold imports not made by the central bank. Thus, at the same time that the Fund recognizes the possibility that member countries may permit the gold producers within their territories to sell gold abroad for a price above parity, the recipient country can at any time establish any kind of controls or prohibitions to restrict or stop that traffic, and in the event that these last measures should prove ineffective, can still request the selling member, directly or through the Fund, to cooperate in its efforts. In other words, the Fund Agreement recognizes the possibility that the international gold markets might provide a stimulus for the gold mining industry as long as the corresponding transactions do not, in fact, threaten the stability of a particular national currency or currencies.

3. At this point it is convenient to consider the argument presented by some members of this Board to the effect that Article IV, Section 4(a) of the Fund Agreement furnishes the legal grounds for prohibiting members, in general and at any time, from selling gold above parity plus margin. My contention is that as regards gold sales, and in the face of the wording of Article IV, Section 2 and its antecedents as clearly established in the records of the Bretton Woods Conference, in order to safeguard the Fund's position against possible undesirable arguments with members or criticism from various quarters, Article IV, Section 4(a) could only be interpreted to mean that when a member complains that the sale of gold by another member is threatening the exchange stability of its currency, the Fund has the authority to request the selling member to take such steps as may be appropriate to carry out the obligation to collaborate with the Fund to promote exchange stability.

If the Fund Agreement contemplates the sale of gold by members above parity plus margin when it does not threaten the stability of another member's currency, how can the Fund, without being familiar with the particular facts in each case, rule a priori that these transactions should not be carried out? Prohibition of these transactions would be against the letter and the spirit of the Articles of Agreement because it would, in reality, mean supporting only one of the opinions presented at Bretton Woods, and would disregard the fact that Article IV, Section 2 declaredly represents a compromise between the different views debated at that Conference. Is the Board of Executive Directors warranted to make a decision based on an interpretation that seems to be clearly against what the member countries intended, and in fact agreed upon, at Bretton Woods? I think it would be ill-advised for the Fund to make at this time the general statement proposed in the report of the Committee; although there seems to be no doubt that the Fund has the authority to issue a statement of policy suggesting to member countries the advisability of stopping gold imports, it would be necessary to consider very carefully the different factors involved, as it might lead to unforseen and undesirable consequences at this moment. Anyhow, a more cautious and defendable position for the Fund in general and under present circumstances would be to study the facts of each particular case and decide it on its own merits.

4. Furthermore there are other practical problems that should be carefully studied before any action is taken by the Board. For instance, there is the possibility that forbidding member countries generally to sell gold in the market at this time might bring about a new rise in the gold premia. There are several non-member gold producing countries that could supply any amount of gold the market could absorb at an attractive price and there are also non-member non-gold producing countries with large gold reserves which have in fact been participating in that traffic. Then too there is the question of the Fund's ability to stop gold sales by individuals of member countries to private interests in non-member countries. I might suggest that all of these problems deserve very careful consideration before the Fund decides to assume a rather strong and general stand in this field.

5. It has been said that if some members did permit their gold producers to participate in the gold premium trade, great political pressure would be placed on the governments of other gold producing countries which have held the line up to the present but might have to give way, and that the resultant flood of gold into private channels would endanger the world-wide exchange rate structure. I might say that this statement seems to be rather exaggerated -- first, because member countries can take appropriate measures to stop the inflow of gold in the territories if they consider it advisable (recent experiences with the traffic of gold taking place in some ports of China and India suggest that prohibiting the imports of gold in a country would be a rather efficient means of stopping any threatening trend of gold sales above parity); second, because if a country is willing to permit gold imports to supply the hoarding demand of its nationals even at a price above parity, the Fund could discourage such a policy and, through other provisions of the Fund Agreement, could declare the member ineligible to continue the use of the Fund's resources if the policy of that member implies a large or sustained outflow of capital; third, it would seem most strange if with the present premia in the gold market, and there seems to be no prospect of a

change in that market in the near future, the pressure from the gold mining interests could not be overcome by the governments of gold producing countries that did hold the line for more than four profitable years when the premia maintained in those markets were most alluring.

6. Incidentally, it should be recalled that the Fund has not yet prescribed the margin referred to in Article IV, Section 2 of the Fund Agreement.

7. It seems to me that in the face of such a complex problem, and considering both the dubious legal basis for the proposed general prohibition of members to sell gold in the markets and the complete lack of facts to prove that the gold traffic is actually threatening the stability of a member's currency, the Fund should avoid any general statement on this subject and devote itself to studying the facts presented in each particular instance, deciding each case on its own merits.

Raul Martinez-Ostos

May 21, 1947