

## Gold emerges as a strategic issue

by Montresor

No wittier comic tableau could have come from the pen of Henry Fielding than the spectacle, in Rome Feb. 8, of central bankers cautioning against the use of gold before a public audience, whilst basing a large part of their private financial arrangements on the reserve metal in other negotiations. Yet the importance of a gathering rarely devolves upon what is said, but is to be found in who meets whom where. That the entire senior staff of the Bank for International Settlements past and present, various European central banks, and all the major gold dealers in the world convened for the "International Gold Conference" in Rome was sufficient cause for that city's newspaper *Il Tempo* to portray the event as "the most important international monetary conference since Genoa in 1922," citing the meeting which planned the establishment of the Bank for International Settlements.

The central bankers in attendance, such as Dr. Henry Wallich of the Federal Reserve Board, gave no more enlightening advice than the imprecation that nothing should be done with gold: it had better not be bought, nor sold, nor swapped, nor collateralized, until events came more clearly into focus. Yet Dr. Wallich's comments are of less interest than the quiet message he has given to friends he and I have in the Federal Republic of Germany: that both he and Paul Volcker will be looking for other employment by midyear.

Nor could the bland remarks of the chief of the Banca d'Italia, Mr. Lamberto Dini, obscure what was known to the monetary professionals in the audience: Dini's central bank, along with other European central banks, *had just*

*concluded the largest gold swaps in monetary history, and with no less a partner than the Soviet Union.* According to my acquaintances in the South African government, at least several hundred tons of gold have been assigned to different European central banks on behalf of the Soviet Union, in a "swap" (in fact a gold-collateralized short-term credit) arranged by the Bank for International Settlements, which has among its stockholders no Americans, but both East and West European central banks—as well as the Swiss private banks, who control about 20 percent of its outstanding stock.

### The Soviet gold puzzle

Some private sources in Johannesburg have put the total gold involved in this delicate matter at 1,000 tons, with a present market value of \$12 billion—which report, were it true, would show the Soviets willing to pawn about half their total reserve fund of gold in return for cash. These reports appear exaggerated, as does the report that the South Africans have bought substantial amounts of Soviet gold, aired in the London *Economist*. What appears to be the case is this: the Soviets sold between 100 and 125 tons of gold in the 10 months through October 1981 on their own account. Some market observers overcalculated Soviet sales because perhaps 90 to 100 tons of Turkish and Iranian flight capital in the form of gold reached Western Europe via the old Balkan route, much of which sold through channels that handle Soviet gold transactions, such as the Monte dei Paschi Bank of Siena.



*Gold reserves at the West German Bundesbank.*

Starting in the last two months of the year just ended, however, the Russians thought better of selling more gold into a declining market, and approached the Western European central banks. Up until 1980 the Europeans actively supported the gold price, hoping to maintain a higher value for their monetary gold, which had already been pledged in part to the European Monetary System, which supported their mutual currency-support activity. Then came the doubling of oil prices in 1979 and the end of the European current-account surplus, the collapse of European currencies against the usury-borne American dollar, and the abandonment of the gold market.

By November the Europeans had calculated that the collapse of the OPEC surplus, from \$110 billion in 1980 to a projected deficit of perhaps over \$40 billion in 1982, left them potentially swimming in liquidity, and they relegated the dollar to the vultures of the foreign exchange markets. Spirit and flesh were again strong, and Europeans welcomed the chance to absorb—if only for swap purposes—large amounts of monetary gold without driving the price up, as the Soviets desired to sell more gold without driving the price down.

In December came the Polish events and the dashing of all Anglo-American hopes that the Russians might find their empire crumbling. That the Russians emerged from the crisis stronger than ever is well understood in all the world's capitals. European commercial banks were anxious to resurrect their loans to Poland from evident bankruptcy and maintain trade flows to the

East, without which the Eastern economies were naked to the wind of depression from across the Atlantic; according to Federal Reserve sources, the commercial banks themselves began a myriad of gold swaps, gold purchases, and gold collateral agreements to ensure the continued flow of credit eastwards.

Through the mediation of the Bank for International Settlements, the European central banks and the Russians have, at one blow, ensured the Soviet payments position for the interim period of poor harvests and substantial imports, until the giant foreign-exchange earnings from their gas exports appear in 1986. They have also ensured the financial stability of Eastern Europe; pushed the United States into the dunce's corner in world financial matters; and made gold the covert center of all world monetary considerations. The Federal Reserve is behind events, rather than leading them, as it has during the two grim years past; each week its staff people scrutinize the reserve data released by foreign central banks to discover how money may have been pumped into the Soviets' purse, frustrated by the ultimate master of banking secrecy, the Bank for International Settlements itself.

At the Banca d'Italia, which did not sponsor the Rome meeting (its host was the Banca Nazionale del Lavoro, the principal financier of Socialist leader Bettino Craxi), but still overshadowed the deliberations, gold enthusiasm is muted but fierce. Gold swaps among central banks will now abound as the dollar disappears as an effective reserve asset, Italian officials say; the

central banks will never control the gold market, but will nonetheless have need of a price at which swaps may be conducted, and that price will be divergent from market. The Bank for International Settlements will become the arbiter of a gold market among central banks, as the latter act under compulsion to bring to bear their "reserve asset of last resort."

They envision a world in which an autarkical United States menaces an autarkical Soviet Union, and the world monetary system devolves onto a type of gold-based barter, at miserably shrunken levels of trade and industry. To the wizened Swiss and Italian bankers, this state of affairs is to be desired. Anyone who scoffs that they are mad, gravely underestimates them.

But, in the sense that they accommodate useful trade and shed light on underlying reality, the gold swaps are potentially of great usefulness. Jacques Rueff's conception of gold discipline, denominating currencies in gold, and settling international balances in gold transfers between central banks, would put the great benign discipline on the United States: that it must export what it imported. Such a policy is the only one that might save the dollar. No useful results may be expected from the President's Gold Commission. Its chairwoman, Dr. Anna Schwartz of Princeton University, had already sunk so low in life as to ghost-write the *opus magnus* of an economist distinguished only by his ignorance, Mil-

ton Friedman. Its principal purpose appears to be to bore the White House, the Congress, and the public on the subject of gold to the point that no serious deliberation could be possible.

Nonetheless Europe's interest in the monetization of gold provides an example for the United States that is hard to put aside. America may save the dollar and its own credit structure in two ways. At best, it would take Dr. Rueff's advice and remonetize gold at \$500 per ounce, fix the dollar to gold, and concentrate on rebuilding its industries that may export. Less to be preferred, but with good chances for success, it might adopt a formal gold standard, with specific gold cover for currency, using national monetary reserves as a limit for the issue of new money. Such a system would be workable only at a gold price of \$1,000 an ounce or more, in order to avoid the terrible contractionary effects of an absolute ceiling on the supply of money.

In all, provided that the national monetary authorities are competent to extend credit for productive investments, and not to accommodate the manic acquisitiveness of some corporate treasurers, the gold-reserve system, rather than the gold standard in the formal sense, will do all required; but should the ideological bent of the present U.S. administration require a more rigid adherence to a gold system, it must be at \$1,000 an ounce or not at all.

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