Gold by Alice Roth

Lifeboat economics?

An increase in gold-collateralized loans, sanctioned by the U.S., serves as a debt prop.

The use of gold by governments as collateral in obtaining loans is becoming an increasingly frequent and widely accepted practice, my sources report. According to Thomas Wolfe, a Washington consultant, leading financial institutions, including the New York money center banks, are pressuring Third World governments to turn their gold reserves into "useable money," either through gold-collateralized borrowing or by swapping gold for foreign currency.

The growth of gold-collateralized lending constitutes a de facto remonetization of gold, which has occurred under the watchful, and apparently complaisant, eye of the U.S. Federal Reserve. The Fed's tolerance is not so surprising when one considers that gold represents one of the last remaining "hard-commodity" props beneath the international debt structure.

British bankers, in particular, increasingly advocate the use of gold as means of settling payments imbalances. In a Sept. 30 editorial, the London *Financial Times* warned the International Monetary Fund that the rollover of Third World debts through overly "liberal" lending would be a "potentially highly inflationary . . . solution." The *Times* recommended that the IMF consider "the mobilisation of gold in settlements as an alternative to pyramiding banking claims."

It should be understood that the new system presently emerging has little to do with the gold-based system envisioned by Charles de Gaulle or present French monetary strategists. French officials, in their better moments, think of gold as a means of mobilizing liquidity to expand world trade and put capital to work in industrializing the Third World sector. New York and London think of gold merely as an asset to get one's hands on before the Eurodollar market sinks.

The method by which gold-collateralized loans or gold swaps are conducted is as follows: most banks will insist that the gold be kept on deposit in one of the major international money centers, such as New York, London, Zurich, or Frankfurt. Most of the world's central banks hold their gold at the Federal Reserve Bank of New York, so it is a relatively easy matter to transfer the gold from the borrowing country's account at the Fed to that of Chase Manhattan or Citibank. Out of official world reserves totaling 930 million ounces, the Fed holds 370 million ounces.

If a swap arrangement is used, the country can arrange to reverse the swap by buying back the gold within a prearranged time period. In this way, there is never any change in the level of the country's reserves, but the bank has the gold in the event of default.

Until recently, the Fed reported all transfers from accounts held by foreign customers to those of New York banks as an "import" of gold into the United States. Two months ago, the Fed ceased all such reporting, ostensibly on the grounds that the countries involved had requested greater confidentiality. This indicates that the practice may have become much more widespread.

The U.S. government itself may have begun to take a fresh look at gold as a possible safety net should a severe dollar crisis erupt. Apart from the Soviet Union, the United States is still the largest government holder of gold. In an interview with *Euromoney* this month, Dresdner Bank managing director Hans-Joachim Schreiber reports that the U.S. Treasury discovered earlier this year that, when valued at $850 an ounce, its gold reserves are sufficient to cover all dollar balances held by foreign central banks. The Treasury may also be considering the seizure of foreign-owned gold and other assets held in the United States in the event of a breakup of the Eurodollar market. West Germany still holds the bulk of its reserves with the New York Fed, but the French shipped theirs back to Paris during the 1960s as a national security precaution.

One New York precious metals trading firm suggested that the reason for gold's recent weakness may have been sales by Iraq or Iran to finance their war. As Mr. Wolfe pointed out, this is highly unlikely since either country could have obtained a gold-collateralized loan easily enough on European markets. The actual reason for gold's weakness was the Fed's hiking of dollar interest rates, which may have been anticipated by some market participants. This period of weakness should soon pass as gold's de facto remonetization gains further ground.