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Appendix 1
Summaries of Bank of England Documents

This appendix provides supplemental documentation for the material found in chapter 3, section 3.4.2.

In a memorandum (possibly by Henry Clay, adviser to the governors), dated 20 November, Purchase of Gold for Account of Federal Reserve Bank Against Payment in Dollars, the text states that the price of gold in New York is perhaps $34.77, but this price is effective only in such cases when the gold is offered in the London market and the price is fixed on the dollar exchange, and of course only in such cases when there is no premium over and above the shipping parity. Today, for instance, the price was fixed at 2 1/2d. (pence) to 3d. (pence) premium on the shipping parity. This naturally excludes the shipment to New York as the outturn required on this basis would be something like $34.82. On the other hand, gold which has already been engaged for shipment to India could not under the suggested arrangement be diverted to London against payment in dollars unless the price were about $34.86.

In a note of a telephone call from Harrison to the deputy governor, on 20 November, Harrison said that with the market in its present position there was no chance of getting any gold; nor would any American commercial institution profitably buy gold for shipment. If conditions changed, however, he wished us (the Bank of England) to act on the lines agreed. The figure $34.77 he had fixed as a limit was based on talks with the New York banks that did this kind of business, and the American Treasury would prefer to stick to the limit. Harrison asked the bank to try it out; if the result was that we did not secure the gold but it was shipped to America by commercial institutions, then we could discuss altering the price. The deputy governor pointed out that it might not be possible to do anything at all by 23 November, and the amounts mentioned in the cable were much

larger than was likely to come into the market. Harrison said if the limits were reached, new limits could be discussed. Gold purchases in New York on behalf of the bank with the dollar equivalent deposited for them would be available immediately. He saw no reason to expect that the market would guess that we were operating on their account. The changes in the amount of gold held by us for them would not be published since they would be acting as agents for the American Treasury, which was not required to publish its foreign gold holdings. A memorandum, dated 22 November by an unnamed writer, reports that Governor Montagu Norman wishes rules or instructions to be formulated, with respect to gold for the FRB to ensure the following:

1. That the FRB will buy here only such gold as would otherwise be shipped to New York.
2. That the FRB does not acquire any more gold than under the old arrangement.
3. That the FRB under the new arrangement does not prevent the EEA from getting gold which would have come under the old arrangement.

A note, dated 22 November by an unnamed writer, lists advantages of short-circuiting the transfer of gold: We should get a better price for our gold than we should do by selling francs and releasing gold in Paris; that the effect on the dollar-sterling exchange rate would be greater for a given expenditure than it would be if we influence it only indirectly via the franc; and that it gives us an alternative to operating through Paris.

A memorandum, Gold Purchases For Account of the FRB, dated 23 November by an unnamed writer at the Bank of England, comments that the proposed arrangement with the FRB is that the bank will buy gold for them in London and earmark it in our vaults. The object of the FRB is to prevent the shipment of gold by persons who want dollars, the FRB offering through us what they estimate to be a slightly better outturn in dollars than can be obtained by actual shipment to America. In this way the FRB hopes to put themselves in a position to acquire sterling when they want it, without shipping gold from New York, and meanwhile to conceal from the public the amount of gold moving into American hands. We have agreed, and have been authorized to act within limits of time, amount, and dollar price. The memorandum continues:

> The arrangement will be effective only when the sterling price of gold is fixed upon the dollar shipping parity without any premium. If there is a premium, the dollar price which the FRB are prepared to pay will not cover the sterling price. The arrangement will not clash with bank purchases of gold for the EEA. It would clash if the bank bought gold for the FRB with sterling. The bank would buy gold for the FRB with sterling only if the bank sold dollars before or after buying gold for sterling. That would involve the bank in arbitrage risk that the arrangement does not provide for. The bank will buy gold for the EEA with sterling,

paying whatever price is required to get it. FRB can get gold from two sources: (a) The big arbitrageurs who buy gold to supply a demand for dollars. They would have to be informed that the bank can give them dollars against gold at a price that would attract them. (b) The EEA when it is supporting sterling by selling gold currencies or gold. Since the United States left gold in 1933, the bank got rid of the dollars it then held and has dealt in dollars only on behalf of customers. Under the arrangement the bank would deal in dollars for the FRB. At present the bank meets the demand for dollars by selling francs or selling gold in the market. Instead the bank would sell dollars against gold for the FRB, a convenience when sterling is weak owing to a demand for dollars. Under the arrangement, it would be natural to sell gold from the EEA to the FRB, instead of the roundabout method of putting gold into the market and then buying it for the FRB. (This sentence is crossed out.) The following paragraph argues that bypassing the release of gold in Paris would get bank a better price for gold and have a bigger effect on the dollar-sterling exchange rate for a given expenditure. Ink comment on the side seems to doubt this analysis.

Cable (322/35) from Harvey to Harrison referring to Harrison's cable (283/35), dated 23 November, reports no opportunity of acquiring gold in London for the FRB.

Gold Purchases for Account of the FRB, a four-page memorandum by Henry Clay, adviser to the governors, dated 27 November. The memorandum is in four numbered sections, summarized in what follows: (1) FRB object is to provide dollars against gold in London for persons who need dollars, and gold in London for people who have payments to make in sterling (i.e., the US government for silver purchases). FRB hopes to reduce sterling-dollar rate volatility and eliminate some gold movements. FRB is offering through the bank a slightly better result in dollars than can be obtained by actual gold shipment to New York. If bank won't act on FRB behalf, it will probably employ Guaranty Trust or some other American bank in London. So far there has been no opportunity for the bank to do anything. (2) It will not be possible to make purchases under the arrangement at all times. Conditions necessary for a purchase in the bullion market include: (a) that a supply of gold is available in the market. Much gold passes through London which does not come into the market; (b) that the price of gold in London is fixed not higher than the exchange parity of the dollar; (c) that the exchange market is quiet, with no expectation of a trend that would encourage speculation; (d) that no premium on forward dollars exists In the absence of these conditions, gold could still be bought for the FRB: (i) If the EEA wishes to sell gold for dollars; (ii) If a London gold hoarder wishes to exchange gold into dollars. (3) The bank can carry out orders for the FRB by two methods: (a) One method would be for the bank to buy gold at a sterling price and sell dollars on the market. Bank could bid for gold at the fixing, up to the dollar parity, taking its share pro rata with other buyers. Simultaneously,

the bank would sell dollars; if the market would absorb them at the bank's price, earmark the gold for the FRB; otherwise, the bank should take the gold for the EEA. The procedure would involve exchange speculation, but should not deter the bank. For the defense of sterling it will be advantageous to develop this type of business with the FRB. The bank should acquire gold for the FRB when sterling was weak in the region of the level at which the bank was supporting it, and for the EEA when sterling was strong or when there was a premium over the dollar shipping parity. (b) A second method would be for the bank to buy gold at a dollar price. This would be possible from two sources: (i) The big arbitrageurs who buy gold in order to supply a demand for dollars. It would be necessary to entrust someone in the market, say Rothschilds, with a standing order to buy gold for dollars, or to let the chief arbitrageurs know that we can give them dollars against gold in London, saving them the trouble of shipment; the arrangement with Rothschilds should be tried first; and (ii) the EEA, when it is supporting sterling by selling gold currencies or gold. The bank's transactions at a dollar price would not involve a clash with EEA's requirements. Experience and the EEA operators' discretion should decide when the EEA should take the initiative (selling dollars and earmarking gold for the FRB) and when it would be better to leave the initiative to the market (taking gold in exchange for dollars as it was offered). (4) The bank got rid of dollars when the US left the gold standard, and has since abstained from dealing in dollars except for the account of customers. Under the proposal, the bank would deal in dollars on behalf of the FRB. This would be a convenience when sterling is weak and the weakness is due to a demand for dollars. At present the bank meets the demand for dollars by selling francs or selling gold in the market. Instead, we would sell dollars against gold on FRB account. In these circumstances, it would be natural to sell gold from the EEA's holding to the FRB, instead of first putting gold in the market and then buying it for the FRB. We would get a better price for our gold than we do by selling francs and releasing gold in Paris. The effect on the dollar-sterling rate for a given expenditure would be greater than if we influenced the rate indirectly via the franc. Also we would have an alternative to operating through Paris.

Letter to Montagu Norman, dated 28 November, from Sir Frederic Phillips, adviser to the Chancellor of the Exchequer, comments on the Clay memorandum: (1) Unnecessary shifts of gold are frequent. Bullion is sent on long journeys and then recalled before it reaches its destination. Proposal will reduce such aimless wanderings. Savings of expense will go to the US government. (2) Phillips doubts that US Treasury will use Guaranty Trust or another American bank in London if Bank of England will not act as FRB agent. Americans won't risk holding much gold in London except in agreement with British authorities. (3) Bank should ask if FRB would give it gold for sterling, but Phillips doesn't think it worth raising the question at this point. But another question should be asked. Scheme is designed to give

dollars for gold, as though FRB would always be operating to weaken the dollar and never to strengthen it. Does the FRB envisage asking the bank from time to time to sell gold for the FRB at a fixed price, say, $35.23? If not, what arrangements does the FRB envisage for selling gold if the need should arise? (4) Phillips opposes buying gold for the Fed at a sterling price. It would involve exchange risk, and why should the bank take any risk? If it buys gold for dollars, it is a mere agent. If certain countries abandon the gold standard, it would be a nuisance to be buying gold for the Americans at a sterling price. Buying gold for dollars should work smoothly. (5) Phillips believes the advantage lay with letting the big arbitrageurs into the business rather than employing Rothschilds exclusively, but says the bank knows best. (6) Phillips does not attach much importance to the question whether the arrangement will affect EEA operations. Phillips says that Sir Richard Hopkins, an adviser, reporting to the Chancellor will draw his attention to two matters: (a) Morgenthau will announce as a great triumph that he has got British authorities to cooperate in checking gold movements to the United States. That's bosh, since the plan does nothing to check acquisition of gold by the United States. (b) The plan checks physical movement of gold. There will be fewer sensational reports of enormous shipments of gold to the United States, though net movements of gold to London may appear larger. A very big new hoarder, the US government will be added to the hoarders already in London. (7) Apologizes for length of letter.

Letter from H. A. Siepmann, dated 31 March 1936 to Allan Sproul, President of FRBNY. Siepmann introduces himself as successor to Basil Catterns on the exchange department of the bank. The November 1935 order to the bank to purchase gold in London had been renewed the day of his letter, Siepmann says. He realizes that the object is not to acquire gold but to avoid its being shipped. He says, "We shall be lucky if we succeed in doing so with a bid of $34.77. Arbitrageurs who have special facilities—who can avoid, for example, the charges for interest and commission—could undercut us at the price." To be effective against all comers, Siepmann says the bid would have to be $34.78 or, when war risks are eliminated, $34.79. The prospect of a total profit of 1 percent per annum on the money during the period of shipment is enough to bring in some American banks.

We learn from a memorandum, undated (probably after 31 March 1936) from Siepmann to the deputy governor that the FRB renewed its original order (of 19 November 1935 to buy gold in London at a dollar price to prevent shipments to New York) at intervals, first of three or five working days until 11 January 1936. It resulted in two kinds of transactions: (a) a sale of 25,799 ounces by the EEA on 26 November at $34.77. This transaction, undertaken solely to open the account and so the FRB would not assume that the authorities did not care whether gold was shipped to New York or earmarked at the Bank of England, was possible only because the state of the exchanges enabled the bank to buy francs with the dollars and convert

them into gold in Paris without loss. (b) two small purchases in the market of 4,000 ounces on 5 December, and 8,000 ounces on 6 December at a sterling price, and sold to the FRB at $34.77 plus 1/8 per mille brokers' commission. The resultant dollars were sold to the market. Thus, despite the British doubts that the price the FRB proposed would elicit sales of gold, sales at that price had been made. Siepmann writes, "Assuming that the FRB again renew their order from time to time, I propose that we should not repeat the first operation, that is, manufacture gold deposits in London for the FRB at the cost of a transfer of EEA gold from London to Paris, where we now have, if anything, too much. But I should like to take seriously the responsibility which, in effect or by implication, the FRB place upon us, of participating in their control operations. Their intention seems to be not merely—and not so much—to prevent arbitrage and gold shipments as such (though there may be special reasons for avoiding them at the present moment), but rather to substitute 'control' operations for 'automatic' adjustment through gold movements. If the US Exchange Fund holds gold in London, it is in a position, pro tanto, to prevent depreciation of the dollar on European currencies, but such control requires the presence of a watchful agent in London, and we are being tacitly invited to act as such."

"A dollar price of $34.77 is probably inoperative for either purpose, and I have written to [Allan] Sproul [George Harrison's successor at the FRBNY] to point this out. But it may be that even with an operative limit, our present arrangements would be ineffective. We have to carry them out through Rothschilds, to whom we simply pass the FRB limit, with instructions to report to us if occasion arises. But Rothschilds and the most active bullion brokers are themselves concerned with arbitrage, and a purely passive attitude on our part might easily lead to our missing opportunities because, instead of looking for them, we wait to have them brought to our attention. It would be a poor response to the FRB's instructions if we then had to explain that our failure to prevent shipment was due to the gold not having been offered to us."

"If the FRB order is renewed, and especially if their limit is raised, I propose that we keep actively on the lookout for any chance of doing business on their terms; that we should be ready to suggest variants to the FRB. If we can do so within their intentions, and that we should even be prepared at a later date, to extend the system, as we did, in practice, when we sold them EEA gold—to purchases based not merely upon a dollar limit but upon a price, in whatever currency, which has the effect of determining the value of the dollar."

George F. Bolton, assistant to Cameron F. Cobbold, adviser to the governors of the bank, commented that if Siepmann's idea were effectively adopted, we should encounter trouble with our European friends. The French and Dutch might complain legitimately that we, by arrangement with the FRB, were facilitating a flow of gold from Paris and Amsterdam.

Letter from Siepmann to Sproul, 2 May 1936. "You may have been surprised—I confess I was—to find that we were able to deal in gold three times this week on your terms; and you may think that I ought now to take back what I said about your price being scarcely adequate for your purposes. But I don't. On the contrary, I want to tell you once again what a tricky business it is; and I want to discourage you from believing that our present arrangements provide an effective barrage, in all circumstances, against gold movements from London to New York. I am not thinking merely of the Indian shipments with alternative destinations, of which one found its way past us—as any of them may—a week or two ago. I am thinking of the general conditions which prevail in our market here, and which require us to be uncommonly vigilant and ingenious if we are to carry out your intentions successfully. It is, of course, quite a good thing that you should keep us on our toes; and I am not pleading for a price which would make it all easy going, especially as I realize that your objective is not to accumulate gold here but to take as little as possible, or at any rate no more than you would otherwise get across the water. But let me tell you that on Thursday (30 April), when we made our second purchase for you, we had three American banks competing with us and ready to bid your price. We got there first, that time, but if you really want to achieve your object, I think you have to be prepared to outbid the market; only by a shade, maybe; but still, outbid. Shades make all the difference in a market which has become as wide and as highly competitive as the bullion market is to-day in London. The six bullion brokers have been accustomed for years to act as principals, and the hoarding demand gives them every opportunity of doing so on a fairly big scale and to their certain advantage. At times, when the market is active, they will make a two-way price, and in addition, there are about a dozen banks, English and foreign (not counting the American banks here) who have set up bullion departments, mostly in recent years, and are willing from time to time to deal in gold. This pack of hounds is pretty hot on the trail, and I don't profess to be the huntsman—because, to tell you the truth, I am quite glad to see people discover new fields of initiative and enterprise, though I am sorry that the hoarding demand should give them such regular opportunities for unloading. The immense hoards in London are not quite sedimentary; they heave and turn a little at a time, and cloud the waters of supply as well as of demand. The result is that figures and statistics have little or no relation to what is really going on at the time when they appear.

"During the past three weeks, the price of gold in London has been fixed on the dollar and, as you have seen, occasionally at par with dollar-sterling rate. What happens? Classical theory requires that arbitrageurs should get out their calculating machines, work out the profits per mille which they can make on a shipment to New York, buy their gold in London and cover their exchange, or hope to. Nothing of the kind. They just buy the gold and remain short of dollars, either spot or forward according to their individual

positions. They then sit on this protected position and have a practically safe bet. Sooner or later, the London price of gold will be fixed at a substantial premium over the dollar-sterling rate, either because the dollar has weakened (and they buy their gold when it is the strongest currency in the world) or because the hoarding demand has become temporarily intensified as the result of one or the other of the scares which, nowadays, we can safely expect every week or fortnight. But if, in the meantime, finance has become a shade more costly, or patience has worn a little thin, we may suddenly see shipments of gold to your side when there is no business of the kind in the London market at all. You may then conclude that we have been less watchful than we should be!

"I have no figures at all, but it would not surprise me a bit if at the moment there were £3 or £4 million of gold now held in London but representing potential shipments to New York."

Sproul responded to Siepmann in a letter, dated 5 June 1936. "I must admit that I cannot get steamed up about our buying price for gold in London. Perhaps that is because I don't have to try to beat the market, as you do in the execution of an order, but it does deem to me to be something which can safely be the subject of experimental handling. Even if some gold does slip by, there is no great harm done.

"I am not yet convinced, of course, that our price is altogether too low to do the business under straight arbitrage conditions. One of our banks, which last month tried bringing in some gold from London, for which it paid $34.77 1/8, showed a loss of a few dollars on the transaction, and now figures that it could not hope to do better than break even at $34.77. (It had a melting loss of 1/4 per mille on the shipment it brought in.)

"The other kind of business you mentioned does not seem to me the kind of business with which we would want to compete in any case. Those fellows are just taking a flier in gold, and I shouldn't want to try to interfere with them. If, as a result of such goings on, some gold is shipped over here at times, we certainly wouldn't hold it against you.

"Our French friends seem to have put the gun to their heads again and maybe this time it will go off. Over here the market is principally interested in what will happen to the sterling dollar rate in case there is a gold embargo in France or the French try to adopt exchange control. I suppose the majority opinion in this market is that sterling will advance because of the continued pressure of French and, perhaps, other continental funds seeking to get into sterling. I personally should think, however, that sterling is quite as likely to decline in terms of dollars. If our balance of payments can't be paid off in gold, except to the extent that new or dishoarded gold comes forward, there is liable to be a pressing demand for dollars, particularly if 'investors' on your side and elsewhere, continue to think well of our securities. I gather that if this is the trend, however, you are pretty well fixed for gold which could be sold to 'moderate' the movement.

"What all this business is leading to, I am afraid, is a demonstration of the difficulties of a world of all managed currencies, or of half managed currencies and half gold currencies. I don't think we are going to get very far so long as half of us are in the boat and the other half swimming in the water, or with all of us in the water. How to get your people and our people into the same boat, on a mutually satisfactory basis, is the difficult and important problem, but the one we ought to solve, as I see it. Then we could pick up the swimmers as fast as they wanted to be taken in (without rocking the boat), and some of them could just hang on to the boat indefinitely.

"Things have come to a pretty pass when we must all spend our weekends waiting to see or hear what a Mr.Blum may do."